

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

AGL RESOURCES INC., NICOR INC., and)
NORTHERN ILLINOIS GAS COMPANY)
d/b/a NICOR GAS COMPANY)
) Docket No. 11-0046
Application for Approval of a Reorganization)
pursuant to Section 7-204 of the Illinois Public)
Utilities Act.)

**JOINT APPLICANTS’
INITIAL POST-TRIAL BRIEF**

Dated: August 18, 2011

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AGL Resources Inc. (“AGL”), Nicor Inc. and Northern Illinois Gas Company d/b/a Nicor Gas Company (“Nicor Gas”) (collectively “Joint Applicants” or “JA”) hereby file with the Illinois Commerce Commission (“Commission”) this Initial Post-Trial Brief addressing issues subject to the July 19-20, 2011 evidentiary hearings in this proceeding.¹

I. EXECUTIVE SUMMARY

On December 6, 2010, AGL and Nicor Inc. entered into a merger agreement which will result, in part, in AGL becoming the parent company of Nicor Gas (the “Reorganization”). Linginfelter Dir., JA Ex. 1.0, 6:123-27; JA Ex. 1.1. While new to Illinois, AGL is a well-known and respected operator of six natural gas distribution utilities, with a successful history of providing safe, reliable and cost-effective service to approximately 2.3 million end-use customers.² Linginfelter Dir., JA Ex. 1.0, 1:6-8, 3:58-59, 4:68-5:93; D’Alessandro Dir., JA Ex. 2.0, 7:108-099, 7:117-8:122. The un rebutted evidence demonstrates that AGL brings to the proposed Reorganization a team of highly qualified leaders, managers and employees, which has many years of experience running utilities effectively and efficiently, and providing safe, reliable and cost-effective energy delivery and responsive customer service. Application at 4; Linginfelter Dir., JA Ex. 1.0, 1:11-18, 2:24-36, 3:58-59, 4:68-5:93, 7:132-33; D’Alessandro Dir., JA Ex. 2.0, 7:117-8:122. Together, AGL and Nicor Gas personnel will continue to provide Nicor Gas customers with the same low-cost, safe and reliable service that these customers have received for years. Linginfelter Dir., JA Ex. 1.0, 6:130-7:153, 9:196-10:205.

¹ The Joint Applicants previously submitted their Initial and Reply Briefs on issues surrounding the approval of the proposed Operating Agreement, which will govern certain transactions between Nicor Gas and its current affiliates, as well as between Nicor Gas and AGL and AGL Services Company.

² These six operating companies are located in Florida, Georgia, Maryland, New Jersey, Tennessee and Virginia: Atlanta Gas Light in Georgia; Chattanooga Gas in Tennessee; Elizabethtown Gas in New Jersey; Elkton Gas in Maryland; Florida City Gas in Florida; and Virginia Natural Gas in Virginia. Application at 2; Linginfelter Dir., JA Ex. 1.0, 1:6-8, 4:69-82.

In combining the second and third largest pure natural gas distribution companies in the United States, the Reorganization will create one of the lowest-cost, most diversified families of natural gas utilities in the country, guided by a seasoned and well-respected management team. Linginfelter Dir., JA Ex. 1.0, 5:96-6:121. The Reorganization will be seamless for Nicor Gas customers, as they will continue to receive service from Nicor Gas in the same fashion and pursuant to the same rates, terms and conditions upon which they now receive service. Linginfelter Dir., JA Ex. 1.0, 6:115-16, 7:139-50, 9:176-79; D'Alessandro Dir., JA Ex. 2.0, 6:93-7:107, 8:134-40. Nicor Gas will retain its current name, corporate form and headquarters in Naperville, Illinois, and will continue to operate as an Illinois public utility, subject to the Commission's jurisdiction and all applicable Illinois law and regulations. Linginfelter Dir., JA Ex. 1.0, 12:250-52; D'Alessandro Dir., JA Ex. 2.0, 6:94-7:99; O'Connor Dir., JA Ex. 6.0, 4:81-5:86. Over time, the Joint Applicants expect that Nicor Gas customers will benefit further through the sharing of best practices with its affiliated utilities and realize the positive impacts of greater scale. Linginfelter Dir., JA Ex. 1.0, 5:103-6:117, 7:132-39, 7:150-53, 9:183-85; D'Alessandro Dir., JA Ex. 2.0, 7:117-8:131.

Key to the proposed Reorganization is a series of commitments related to Nicor Gas' customers, its employees and the communities it serves, which include:

- A dual commitment to (1) maintain for a period of three years 2,070 full-time equivalent employees ("FTEs") working in support of Nicor Gas' business—a figure based on the number of FTEs at Nicor Gas as of December 31, 2010—and (2) maintain for the same three-year period that level of FTEs working in the state of Illinois (Tr. 407 (O'Connor); 572-73 (Reese));
- Honoring existing union contracts (Linginfelter Dir., JA Ex. 1.0, 7:144-45; McCain Dir., JA Ex. 4.0, 5:94-97; Tr. 665 (Linginfelter));
- Continuing the level of community and charitable contributions that Nicor Gas has been providing to Illinois communities in its service territory (Linginfelter Dir., JA Ex. 1.0, 7:145-46); and

- Establishing, post-closing, a newly expanded Distribution Operations headquarters in Illinois to coordinate activities for the seven AGL operating companies (*Id.* at 7:147-49).

In addition, the Joint Applicants do not seek a general increase in Nicor Gas’ rates as a condition of the Reorganization. O’Connor Dir., JA Ex. 6.0, 7:133-34; Linginfelter Reb., JA Ex. 8.0, 18:417-19; Cave Sur., JA Ex. 14.0, 5:101-03. Taken together, these commitments reflect the Joint Applicants’ acknowledgment of their responsibility to Nicor Gas’ customers, its employees and the communities in the service territory.

The Joint Applicants respectfully request Commission approval of the proposed Reorganization pursuant to Section 7-204 of the Public Utilities Act (“Act”) (220 ILCS 5/7-204), as well as other related approvals. The Joint Applicants have worked diligently to resolve issues relating to the proposed Reorganization. To that end, the Joint Applicants entered into a Stipulation with the Retail Energy Supply Association (“RESA”) and Interstate Gas Supply of Illinois (“IGS”) resolving issues concerning customer choice and competition. Nicor Gas Ex. 8.0. In addition, the Joint Applicants have agreed to a variety of conditions proposed by the Commission Staff (“Staff”), which are detailed later in this brief.³ Among these conditions are the unprecedented commitments, for a period of *five years* following the closing of the Reorganization, to:

1. Maintain in Illinois the current number of FTEs—51 full and 24 partial—in the following areas: Corrosion Control, the Technical Compliance Department, the Locating Services Department, the Transmission Integrity Management Program, and the Distribution Integrity Management Program (Burk Dir., Staff Ex. 12.0, 20:447-23:537; Burk Reb., Staff Ex. 18.0, 7:141-43; JA Ex. 12.2; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58);
2. Maintain in Illinois management personnel directly responsible for the day-to-day supervision of the positions identified in paragraph 1 (Burk Reb., Staff Ex. 18.0, 7:144-45; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58);

³ A list of the conditions agreed-upon as between the Joint Applicants and Staff is also submitted with this brief as Attachment A.

3. Maintain in Illinois the current level of training and quality assurance programs for compliance monitoring activities (Burk Reb., Staff Ex. 18.0, 7:146-47; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58); and
4. Meet with the Commission Staff's Pipeline Safety Program Manager, or his designee(s), to discuss any proposed material change(s) to the job duties for any of the positions identified in paragraph 1 (Burk Reb., Staff Ex. 18.0, 8:148-50; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58).

Acceptance of these additional conditions underscores the Joint Applicants' focus on continuing to operate in a safe and reliable manner, and to work cooperatively with Staff on such issues.

The parties' efforts to narrow the issues have been successful in reducing the open issues to only four items:

- Section 7-204(b)(1) – Staff erroneously claims that the Joint Applicants have not demonstrated that “the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service.” This claim is without merit. The overwhelming evidence demonstrates that Nicor Gas will continue to operate in the same safe and efficient manner that it does today. While Nicor Gas will have a new parent company, AGL, that company, in its current and prior corporate capacities has successfully and safely operated a gas utility for over 150 years.
- Section 7-204(b)(7) – Staff erroneously claims that the proposed Reorganization “might” have an adverse impact on rates by speculating about one component of Nicor Gas’ cost structure. Staff, however, applies the wrong legal standard and misapprehends the facts to arrive at its flawed conclusion. Nonetheless, the Joint Applicants have made a proposal that reasonably addresses Staff’s concern.
- Section 7-204(c)(1) – The Illinois Attorney General’s Office and the Citizens Utility Board (collectively “AG/CUB”) erroneously claim that savings will somehow immediately inure to Nicor Gas as a result of the proposed Reorganization. The evidence refutes this claim, demonstrating that the Joint Applicants expect savings from the combination of non-regulated activities. Further, the commitments to maintain general FTE levels for three years (and FTE levels in specific operating areas for a minimum of five years) and to honor union contracts show that Nicor Gas will continue to incur escalating expenses in these areas. In addition, Nicor Gas already is by far the low-cost provider of distribution services in Illinois. Thus, AG/CUB’s reliance on savings from another merger involving a high-cost utility is unreasonable and without merit. Notably, Staff does not agree with the recommendations presented by AG/CUB regarding the finding required by Section 7-204(c).

- Section 7-204(c)(2) – Staff and the Joint Applicants share similar positions concerning the manner in which the proposed Reorganization costs should be addressed. In short, the Joint Applicants do not seek to recover transaction costs, subject to one caveat: should a party other than Nicor Gas seek to adjust rates within five years of completing the Reorganization, Nicor Gas can assert that it is entitled to offset savings resulting from the Reorganization with Nicor Gas-related transaction costs.

The Joint Applicants address each of these issues below.

In conclusion, the evidentiary record fully supports Commission approval of the proposed Reorganization. Post-Reorganization, Nicor Gas will remain the low-cost provider of gas distribution services in Illinois, while continuing to provide safe, reliable and efficient service that customers have come to expect. Accordingly, the Joint Applicants respectfully request that the Commission approved the proposed Reorganization.

II. RELIEF REQUESTED

The Joint Applicants have requested that the Commission make the following findings and approvals:

1. the Commission’s approval, under Sections 7-204 and 7-204A of the Act, to engage in the Reorganization, through which Nicor Gas will become a subsidiary of AGL;
2. the Commission’s approval under Section 7-102 of the Act (to the extent required) to engage in the Reorganization;
3. the Commission’s authorization, pursuant to Sections 7-101 and 7-204A(b) of the Act, for entry by Nicor Gas into: (1) an Operating Agreement (“OA”) governing transactions between Nicor Gas and its current affiliates, as well as with AGL and its subsidiary AGL Services Company (“AGSC”); (2) a Services Agreement (“SA”) governing services to be provided to Nicor Gas by AGSC, the shared services subsidiary of AGL; (3) four agreements with Sequent Energy Management, LP (“Sequent”), AGL’s wholesale gas marketing subsidiary—a Gas Exchange agreement, an Interstate Hub Service Agreement, an Intrastate Hub Service Agreement and a Base Contract for Sale and Purchase of Natural Gas (“NAESB”)—as well as capacity release arrangements between Nicor Gas and Sequent in accordance with the Federal Energy Regulatory Commission’s (“FERC”) capacity release rules; and (4) the Tax Allocation Agreement Among Members of the AGL Resources Inc. Affiliated Group (“TAA”), as amended to include the surviving Nicor Inc. companies as parties to that agreement;

4. the Commission's approval of any required proposed accounting entries associated with the Reorganization; and
5. the Commission's authorization for taking such other measures in connection with the Reorganization as may be reasonably necessary for effecting the Reorganization.

Application at 6, 8, 12-13 and Att. A, *Information Required Pursuant to 220 ILCS 5/7-204A(a)(5)*; O'Connor Dir., JA Ex. 6.0, 12:254-13:268; Hathhorn Dir., Staff Ex. 8.0, 18:442-48 and Att. B.

III. RESOLVED ISSUES BETWEEN THE JOINT APPLICANTS AND STAFF ON THE REQUIRED 7-204 FINDINGS

The Joint Applicants and Staff were the only two parties in this proceeding to address all of the required findings set forth in Section 7-204 of the Act. The following discussion identifies and addresses those provisions of Section 7-204(b) that have been resolved pursuant to agreement, as detailed in the evidentiary record.

A. Sections 7-204(b)(2) and (b)(3)

Section 7-204(b)(2) provides that the Commission, in approving a reorganization, must find that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers. 220 ILCS 5/7-204(b)(2). Under Section 7-204(b)(3), the costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes. 220 ILCS 5/7-204(b)(3).

The Joint Applicants have demonstrated that the proposed Reorganization meets the requirements of Sections 7-204(b)(2) and (b)(3). Staff agrees. The Joint Applicants plan to continue the service arrangements already in place for Nicor Gas and to augment them with the shared services arrangement with AGSC that already governs the costs being charged to the existing AGL Resources utilities. Linginfelter Dir., JA Ex. 1.0, 10:208-11:223. The Joint

Applicants also propose to leave in place the existing Commission-approved OA, subject to certain amendments, which governs the transactions between Nicor Gas and its current affiliates as more fully discussed in the Joint Applicants' briefs on OA issues. *See also* Linginfelter Dir., JA Ex. 1.0, 11:228-30.

Joint Applicants witnesses Reese and O'Connor testified that the Reorganization includes appropriate contractual requirements, allocation standards and compliance processes to ensure that AGL's nonutility activities, including the activities of its non-regulated subsidiaries, will not be subsidized by either Nicor Gas or its customers. Reese Dir., JA Ex. 5.0, 4:74-7:147, 9:195-11:253; O'Connor Dir., JA Ex. 6.0, 11:226-12:243. Further, the operations of one regulated subsidiary will not be subsidized by another. *Id.* In addition, AGL and Nicor Gas have systems in place for ensuring fair and accurate allocation of costs and facilities between utility and non-utility activities. *Id.* All these measures keep corporate costs and inter-company transfers properly allocated. *Id.* Finally, Nicor Gas will continue to adhere to the Commission's Uniform System of Accounts for Gas Utilities. Application at 9.

Pursuant to the Reorganization, the Joint Applicants seek approval of the following agreements to address Nicor Gas' transactions with affiliates: (1) an OA, which will govern transactions between Nicor Gas and its current affiliates, as well as with AGL and AGSC⁴; (2) a SA between Nicor Gas and AGSC; (3) four existing agreements between Nicor Gas and Sequent—a Gas Exchange agreement, an Interstate Hub Service Agreement, an Intrastate Hub Service Agreement and a NAESB—as well as capacity release arrangements between Nicor Gas and Sequent from time to time in accordance with FERC's capacity release rules; and (4) the TAA, as amended to include the surviving Nicor Inc. companies as parties to that agreement.

⁴ Further discussion of the evidence regarding the proposed OA is found in the Joint Applicants' previously submitted Initial and Reply Briefs on issues surrounding the approval of the Joint Applicants' proposed OA.

Application at 6, 8, 12-13 and Att. A, *Information Required Pursuant to 220 ILCS 5/7-204A(a)(5)*; Reese Dir., JA Ex. 5.0, 2:22-42; O'Connor Dir., JA Ex. 6.0, 4:64-70, 12:254-13:268; Hathorn Dir., Staff Ex. 8.0, 18:442-48 and Att. B.

Staff witness Hathorn recommended that the Commission approve the transaction as to Sections 7-204(b)(2) and (b)(3), subject to nine conditions:

1. require AGSC to pay Nicor Gas the fully distributed cost for services provided to AGSC under Nicor Gas' OA;
2. add an access to records paragraph under the SA;
3. require changes in allocation method to be filed with the Commission under the SA;
4. require an annual Internal Audit on the SA;
5. require a triennial cost study of the services provided under the SA;
6. require an annual filing of a Billing Report for the SA;
7. directly charge or assign human resources-related costs;
8. require the Joint Applicants to file an executed copy of the TAA on e-Docket; and
9. require the Joint Applicants to file the final disposition of journal entries on e-Docket.

Hathorn Dir., Staff Ex. 8.0, 20:509-21:539. The Joint Applicants have accepted each of these conditions, as further clarified through rebuttal and surrebuttal testimony. Reese Reb., JA Ex. 10.0, 3:67-5:114; Reese Sur., JA Ex. 15.0, 1:15-3:57.

Staff witness Rearden also recommended several conditions with respect to approval of the proposed transaction under Sections 7-204(b)(2) and (b)(3):

1. Sequent will not be a party to Nicor Gas' OA;
2. There will be no right of last refusal for Sequent on spot purchases; and
3. The Joint Applicants should consult with Staff and receive Commission approval before the Joint Applicants sign an asset management agreement.

Rearden Dir., Staff Ex. 10.0, 13:174 -14:194. The Joint Applicants have accepted these conditions. Linginfelter Reb., JA Ex. 8.0, 11:243-13:297; O'Connor Reb., JA Ex. 11.0, 8:173-9:182; Linginfelter Sur., JA Ex. 13.0, 6:125-7:144.

In addition to the SA, the OA and the TAA, the Joint Applicants' request for approval under Sections 7-204(b)(2) and (b)(3) included four existing agreements between Nicor Gas and Sequent that will become affiliate interest agreements post-Reorganization. Application, Att. A, *Information Required Pursuant to 220 ILCS 5/7-204A(a)(5)*. Staff witness Rearden recommended approval of these agreements. Rearden Dir., Staff Ex. 10.0, 13:281-83.

Finally, no party objected to the Joint Applicants' request for approval for entry by Nicor Gas into capacity release arrangements with Sequent from time to time in accordance with FERC's capacity release rules.

The evidentiary record supports findings that the proposed Reorganization complies with Section 7-204(b)(2) and(b)(3) of the Act.

B. Section 7-204(b)(4)

Section 7-204(b)(4) provides that the Commission must find that the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure. 220 ILCS 5/7-204(b)(4).

The evidence demonstrates that the Joint Applicants have met this requirement. In testimony, Joint Applicants witness Cave and Staff witness Phipps agreed that since Nicor Gas and AGL currently have access to the capital markets on reasonable terms, the proposed Reorganization will not significantly impair Nicor Gas' ability to raise capital on reasonable terms, subject to two agreed-upon conditions. Cave Reb., JA Ex. 9.0, 3:53-4:81; Phipps Dir., Staff Ex. 9.0, 4:69-5:81, 6:127-7:139, 10:211-11:214. The two conditions proposed by Staff witness Phipps regarding Section 7-204(b)(4) are: (1) there will be a separate credit facility for

Nicor Gas; and (2) a compliance report will be filed following the Reorganization, providing copies of post-merger Nicor Gas credit facilities. Phipps Dir., Staff Ex. 9.0, 5:47-51. The Joint Applicants accepted these two conditions. Cave Reb., JA Ex. 9.0, 3:53-4:81.

The evidentiary record supports a finding that the proposed Reorganization meets the requirements of Section 7-204(b)(4) of the Act.

C. Section 7-204(b)(5)

Section 7-204(b)(5) provides that the Commission must find that the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. 220 ILCS 5/7-204(b)(5).

Joint Applicants witnesses Linginfelter, D'Alessandro and O'Connor testified that, under the proposed Reorganization, Nicor Gas will remain an Illinois public utility subject to all of the same utility laws, rules, regulations, decisions and policies that currently govern its operations. Linginfelter Dir., JA Ex. 1.0, 12:248-54; D'Alessandro Dir., JA Ex. 2.0, 6:93-7:99; O'Connor Dir., JA Ex. 6.0, 4:81-5:86.

Staff witness Burk recommended certain conditions, as modified in rebuttal testimony, relating to pipeline safety to ensure that the proposed Reorganization will comply with the requirements of Section 7-204(b)(5). Burk Dir., Staff Ex. 12.0, 20:447-23:537; Burk Reb., Staff Ex. 18.0, 7:139-8:166. Joint Applicants witness Linginfelter agreed to Mr. Burk's modified conditions. Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58. Specifically, the Joint Applicants agreed to these conditions and committed for a period of five years following the closing of the Reorganization to:

1. Maintain in Illinois the current number of FTEs—51 full and 24 partial—in the following areas: Corrosion Control, the Technical Compliance Department, the Locating Services Department, the Transmission Integrity Management Program, and the Distribution Integrity Management Program (Burk Dir., Staff Ex. 12.0,

20:447-23:537; Burk Reb., Staff Ex. 18.0, 7:141-43; JA Ex. 12.2; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58);

2. Maintain in Illinois management personnel directly responsible for the day-to-day supervision of the positions identified in paragraph 1 (Burk Reb., Staff Ex. 18.0, 7:144-45; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58);
3. Maintain in Illinois the current level of training and quality assurance programs for compliance monitoring activities (Burk Reb., Staff Ex. 18.0, 7:146-47; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58); and
4. Meet with the Commission Staff's Pipeline Safety Program Manager, or his designee(s), to discuss any proposed material change(s) to the job duties for any of the positions identified in paragraph 1 (Burk Reb., Staff Ex. 18.0, 8:148-50; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58).

In accordance with Mr. Burk's recommendations, the Joint Applicants also agreed that Nicor Gas will petition the Commission 90 days prior to the end of the five year period to determine whether Nicor Gas' performance concerning pipeline safety issues is reasonably comparable to pre-Reorganization levels at Nicor Gas, or requires an extension of the commitment period for the items identified in Paragraphs 1 and 2 beyond five years. Burk Reb., Staff Ex. 18.0, 8:152-62; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58. Further, the Joint Applicants agreed that Nicor Gas will review the petition and performance with Staff 60 days before filing such petition. Burk Reb., Staff Ex. 18.0, 8:164-66; Linginfelter Sur., JA Ex. 13.0, 4:82-86, 8:154-58. With these agreements from the Joint Applicants, Mr. Burk concluded that the Reorganization can be found to comply with Section 7-204(b)(5). *See* Burk Reb., Staff Ex. 18.0, 7:139-8:166.

Because the Joint Applicants agreed to resolve the issues presented in Mr. Burk's testimony as discussed above, it is Staff witness Stoller's position that the proposed transaction meets the requirements of Section 7-204(b)(5). JA Ex. 13.2.

The evidence demonstrates that the proposed Reorganization meets the requirements of Section 7-204(b)(5) of the Act.

D. Section 7-204(b)(6)

Section 7-204(b)(6) provides that the Commission must find that the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction. 220 ILCS 5/7-204(b)(6).

Joint Applicants witnesses Linginfelter and O'Connor testified that the Reorganization should have no significant adverse impact on the competitive retail gas markets in Illinois. Linginfelter Dir., JA Ex. 1.0, 12:260-13:266; O'Connor Dir., JA Ex. 6.0, 3:51-53, 5:87-7:130. In particular, pursuant to the Act and Nicor Gas' tariffs, its customers may purchase their gas supply from suppliers other than Nicor Gas and have the third-party gas supplies delivered to them over Nicor Gas' gas distribution systems, and these competitive activities will not be adversely affected as a result of the Reorganization. O'Connor Dir., JA Ex. 6.0, 5:87-7:130.

Pursuant to a Stipulation, the Joint Applicants, RESA and IGS resolved all competitive issues between the parties. Nicor Gas Ex. 8.0.

Meanwhile, Staff witness Rearden recommended that the Commission find, as required under Section 7-204(b)(6), that the proposed Reorganization is not likely to have a significant adverse effect on competition for both the small customer transportation market and the large customer transportation market. Rearden Reb., Staff Ex. 16.0, 1:11-2:34.

The evidentiary record is thus wholly un-contradicted that the proposed Reorganization meets the requirements of Section 7-204(b)(6) of the Act.

IV. CONTESTED ISSUES BETWEEN THE JOINT APPLICANTS AND STAFF AND/OR AG/CUB ON THE REQUIRED 7-204 FINDINGS

A. Section 7-204(b)(1)

1. The Joint Applicants Have Demonstrated that the Proposed Reorganization Meets the Requirements of Section 7-204(b)(1)

Section 7-204(b)(1) requires that the Commission find that “the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service.” 220 ILCS 5/7-204(b)(1). The evidentiary record fully supports the required finding under Section 7-204(b)(1).

The evidence demonstrates that the proposed Reorganization will combine two companies that are industry leaders in safety and operational efficiency, and both AGL and Nicor Gas are committed to providing “high quality, safe and reliable service” to their respective customers. Linginfelter Dir., JA Ex. 1.0, 7:132-34, 9:196-10:201; D’Alessandro Dir., JA Ex. 2.0, 7:117-8:124; McCain Dir., JA Ex. 4.0, 5:88-89. No party has attempted to refute this evidence. Further, Mr. Linginfelter testified at evidentiary hearings that the Reorganization can be characterized as “two really fine companies coming together that bring a lot of talent to the table.” Tr. 663.⁵

AGL currently owns and operates six natural gas distribution companies, serving 2.3 million end use natural gas customers in six states. Linginfelter Dir., JA Ex. 1.0, 4:68-5:90. Joint Applicants witness Linginfelter emphasized that the utilities that have been previously acquired by AGL are “almost exclusively managed by legacy employees in those utilities.” Tr.

⁵ Mr. Linginfelter is the Executive Vice President in charge of Utility Operations for AGL. Linginfelter Dir., JA Ex. 1.0, 1:5-6. His experience in operating gas utilities was not, and cannot be, questioned. He has primary responsibility for supervising and operating AGL’s six current natural gas distribution companies. *Id.* at 1:11-14. He also was directly involved in AGL’s acquisition and integration of Virginia Natural Gas and NUI Corporation, which included the operating companies of Elizabethtown Gas and Elkton Gas, into the AGL family of companies. *Id.* at 2:25-34. Thus, Mr. Linginfelter has a great deal of experience involving the acquisition and integration of gas distribution utilities into the AGL family of operating companies.

661. And, Mr. Linginfelter expects the same to be true for Nicor Gas should the proposed Reorganization be approved. Linginfelter Sur., JA Ex. 13.0, 9:187-94, 10:205-07. Meanwhile, Nicor Gas serves 2.2 million customers in urban, suburban and rural areas of Illinois, and has a history of providing safe and reliable service in an efficient manner. D'Alessandro Dir., JA Ex. 2.0, 3:55-58. Nicor Gas also has a history of commitment to cost control that is reflected in distribution rates, "where Nicor Gas customers have had the lowest gas distribution rates of any major gas utility in Illinois for many years." *Id.* at 5:73-76. AGL recognizes the strong assets of Nicor Gas, including that it is "a very well-run company, very efficient, very solid management team." Tr. 661 (Linginfelter). There is simply no reason to conclude that the combination of these two well-managed entities would somehow lead to either operator becoming incapable of running the new combination of seven gas distribution systems in a reliable, efficient, safe and cost-effective manner.

Further, Messrs. Linginfelter, D'Alessandro and McCain all testified that, under AGL's ownership, Nicor Gas will continue to provide adequate, reliable, efficient, safe and least-cost public utility service. Linginfelter Dir., JA Ex. 1.0, 9:194-10:201; D'Alessandro Dir., JA Ex. 2.0, 6:93-7:113; McCain Dir., JA Ex. 4.0, 5:88-105. More particularly, the Joint Applicants have made numerous commitments described throughout this brief that are designed to ensure that Nicor Gas' customers continue to enjoy the quality of service they have come to expect.

Importantly, AGL's commitment to retaining the same over-all number of FTEs "assures that Nicor Gas will continue to have personnel who are familiar with the day-to-day obligations for operating its distribution, transmission and storage assets, as well as retain the expertise in procuring and managing its gas supply requirements." D'Alessandro Dir., JA Ex. 2.0, 7:105-07. Joint Applicants witness Linginfelter testified at the evidentiary hearing about AGL's

recognition of “the caliber of talent and quality of organizational process from Nicor.” Tr. 664. Nicor Gas will retain its corporate headquarters in Naperville, Illinois and will maintain a strong local management team to ensure the continued provision of safe, reliable, efficient and cost-effective utility service. D’Alessandro Dir., JA Ex. 2.0, 6:95-97. Finally, the Joint Applicants have committed to maintaining certain pipeline safety FTEs for a period of five years following the closing of the Reorganization, a pledge that satisfied Staff witnesses Burk and Stoller concerning the Joint Applicants’ continued focus on operational safety. Burk Reb., Staff Ex. 18.0, 7:139-8:166; JA Ex. 13.2.

The Joint Applicants also intend to share and combine their respective best practices to the benefit of all their customers from cost and service perspectives. Linginfelter Dir., Ex. 1.0, 7:138-39; D’Alessandro Dir., JA Ex. 2.0, 8:125-31. For example, over time, further enhancement in service should result from the sharing of best practices and the combined company’s operational efficiencies and economies of scale, which will position Nicor Gas to effectively manage cost escalations that are being experienced throughout the industry, including labor wage increases, cost increases for other benefits and vehicle fuel costs. Linginfelter Dir., JA Ex. 1.0, 5:103-6:117; D’Alessandro Dir., JA Ex. 2.0, 8:125-31; Tr. 671 (Linginfelter); Tr. 850 (D’Alessandro).

The evidentiary record also demonstrates that the Joint Applicants have been engaged in an extensive integration planning process since the proposed Reorganization was first announced. *See, e.g.*, Tr. 369, 383 (O’Connor); JA Ex. 20 (JA Supp. Response to Staff Data Request RWB 3.08); JA Ex. 21.0 (JA Response to Staff Data Request 1.01). Nearly 400 AGL, Nicor Inc. and Nicor Gas employees have been involved in examining the operations of the companies in preparation for integration should the Commission approve the proposed

Reorganization. JA Ex. 21.0 at NRE005571, NRE005573 and NRE005576-5584 (JA Response to Staff Data Request 1.01 and Exhibit 1 thereto); Tr. 697-98 (Linginfelter). At the end of June, the Integration Team, led by Joint Applicants witness Reese, presented a comprehensive report to the Chief Executive Officers of AGL and Nicor Inc., which detailed the current state of operations for the AGL and Nicor Inc. companies, including Nicor Gas. JA Ex. 20 at NRE 005112-5147 (JA Supp. Response to Staff Data Request RWB 3.08 and Att. 1). No party did, or could, refute the extensive integration planning processes underway.

Given AGL's lengthy and successful operation of gas utilities, the Joint Applicants' commitments made in this proceeding (including the acceptance of numerous Staff conditions), and the clear demonstration that the Joint Applicants are fully engaged in integration planning, the evidence overwhelming shows that the Joint Applicants have met the requirements of Section 7-204(b)(1). Accordingly, the Commission should find that the proposed Reorganization complies with Section 7-204(b)(1) of the Act.

2. Staff's Claims Concerning the Joint Applicants' Compliance with Section 7-204(b)(1) are Legally and Factually Flawed

a. Staff's Claims are Legally Flawed

Staff witness Maple testified—based on an unfounded and unreasonable set of assumptions regarding how *he believes* AGL *should have* conducted its examination of Nicor Gas' operations—that the Joint Applicants somehow have not supported the required finding under Section 7-204(b)(1). Maple Dir., Staff Ex. 11.0R, 3:49-4:60; Maple Reb., Staff Ex. 17.0, 7:120-25; *see also* Tr. 832. Mr. Maple's claims, while shifting during the course of this proceeding, are legally infirm and factually flawed.

From a legal perspective, Mr. Maple's novel interpretation of Section 7-204(b)(1) finds no support within the Act, or in prior Commission Orders involving the application of Section 7-

204(b)(1). In direct testimony, Mr. Maple primarily focused his assessment on the due diligence AGL performed when determining whether to enter into a merger agreement with Nicor Inc. Maple Dir., Staff Ex. 11.0R, 3:42-10:189.⁶ Section 7-204(b)(1), however, does not address what transpires during a pre-merger due diligence process. Rather, its focus is forward-looking, seeking to ensure that a reorganization will not negatively impact *future* utility operations. Accordingly, Mr. Maple's initial claims concerning due diligence activities undertaken before the merger agreement was executed are baseless and inconsistent with the Act.

During evidentiary hearings, however, Mr. Maple shifted his focus, stating that what he meant by "due diligence" was that AGL "may not understand all the aspects of Nicor [Gas] and the way that it's operated," "so that [AGL] wouldn't necessarily understand how to continue operating [Nicor Gas] in an efficient, safe, least-cost manner going forward and maybe wouldn't know -- understand all of their practices and, you know, other ways that they operate." Tr. 832. Mr. Maple also testified during the evidentiary hearings that he believes that, in order to satisfy Section 7-204(b)(1), AGL needed to demonstrate "an understanding of the *smallest details* of the inner workings of the acquired company's operations." Tr. 828 (emphasis added).⁷ Mr. Maple did not provide a practical definition of what he meant by "the smallest details." More importantly, nothing in the Act or prior Commission Orders supports Mr. Maple's clarified "standard" and Mr. Maple did not, and cannot, cite to any such support.

⁶ For example, Mr. Maple testified that his review of whether the Reorganization meets Section 7-204(b)(1) "focused on the preparations AGL made for merging with Nicor" and that he "examined what AGL provided in response to Staff data requests that asked for documentation of its due diligence review of Nicor," because, according to Mr. Maple, "[w]ithout a thorough due diligence review and report, AGL's decision makers could not know how much Nicor Gas is worth and whether or not the two companies are a good fit for each other operationally." Maple Dir., Staff Ex. 11.0R, 3:43-44, 3:46-48, 5:85-88.

⁷ Notwithstanding his claimed concerns, Mr. Maple has admitted that he is unaware of "any material deficiencies with respect to Nicor Gas' current gas storage operations, gas supply portfolio, or distribution infrastructure." Tr. 843; JA Cross Ex. 1.0, Staff's Response to JA-Staff Data Request 4.14.

The focus of the Commission’s analysis under Section 7-204(b)(1) is, in the plain language of the statute, to look at whether the applicants have the “ability to provide adequate, reliable, efficient, safe and least-cost public utility service” going forward. There can be no doubt that the Joint Applicants have this ability. As discussed throughout this brief, and amply demonstrated by the evidentiary record, the Joint Applicants have the experience, financial resources and commitments to maintain Nicor Gas’ operations management and staffing at the same level of service as Nicor Gas’ customers currently experience. In short, the Joint Applicants have demonstrated that the Reorganization will be seamless for Nicor Gas’ customers in that they will continue receiving the same service they currently enjoy at the present, Commission-approved rates. Linginfelter Dir., JA Ex. 1.0, 7:149-50; D’Alessandro Dir., JA Ex. 2.0, 8:134-40.

The Joint Applicants have presented evidence that fully satisfies any plain and reasonable reading of Section 7-204(b)(1): “the proposed reorganization will not diminish the utility’s *ability to provide* adequate, reliable, efficient, safe and least-cost public utility service.” 220 ILCS 5/7-204(b)(1) (emphasis added). AGL has successfully operated a natural gas distribution utility for more than a century, and has successfully operated six such utilities for more than a decade. Linginfelter Dir., JA Ex. 1.0, 4:68-5:93. As described in detail throughout this brief, the evidence demonstrates that AGL is fully aware of Nicor Gas and its operations through its due diligence and ongoing integration planning process. *See, e.g.*, Linginfelter Reb., JA Ex. 8.0, 4:95-10:216; JA Ex. 20.0 (JA Supp. Response to Staff Data Request RWB 3.08); JA Ex. 21.0 (JA Response to Staff Data Request 1.01). The Joint Applicants also have agreed to a variety of Staff proposed conditions, including conditions to protect the provision of reliable, efficient and safe service (*i.e.*, the Joint Applicants’ acceptance of Staff witness Burk’s conditions described in

Section III.C above). In sum, nothing within the Act, or in any prior Commission Order supports Mr. Maple's *ad hoc* standards for complying with Section 7-204(b)(1) of the Act.⁸

b. Staff's Claims are Factually Flawed

Not only are Staff's claims concerning Section 7-204(b)(1) legally infirm, they are factually flawed. Staff witness Maple initially asserted that AGL did not provide sufficient proof that it conducted adequate due diligence *before* entering into a \$3 billion transaction with Nicor Inc. Maple Dir., Staff Ex. 11.0R, 6:116-18 ("The absence of a detailed due diligence report reflects a failure by AGL to conduct a complete analysis of Nicor Gas."); Tr. 805 (Maple). The evidentiary record more than refutes Mr. Maple's argument that AGL failed to conduct a complete analysis before executing the merger agreement. Moreover, Mr. Maple made this statement despite admitting that he has absolutely no experience performing due diligence or integration planning on behalf of an acquiring entity or an entity being acquired. JA Cross Ex. 1.0, Staff Response to JA-Staff Data Requests 4.01-4.02, 4.17-4.18.

In supporting his conclusion that the Joint Applicants have not met the requirements of Section 7-204(b)(1), Mr. Maple also claims that AGL failed to present sufficient information regarding integration planning activities. Maple Dir., Staff Ex. 11.0R, 10:190-13:258. The evidence demonstrating the extent to which the Joint Applicants have been engaged in integration planning refutes Mr. Maple's claim. Joint Applicants witness Linginfelter testified that the integration process is not "a simple study prepared by AGL" waiting to be implemented; instead, the integration process here was carefully organized, includes appropriate representatives from both companies, and began with the first step of understanding each company's processes, structures, and practices. Linginfelter Reb., JA Ex. 8.0, 6:137-43.

⁸ Interestingly, Mr. Maple admitted during cross-examination that he did not make any recommendations at any time in his direct or rebuttal testimony as to what he needed to see, or conditions he wanted to impose, for AGL to be able to meet his interpretation of 7-204(b)(1). Tr. 842-43.

Moreover, the Joint Applicants have provided information about their integration planning process during the course of discovery in this proceeding. *See, e.g.*, JA Ex. 8.1; JA Ex. 20.0; JA Ex. 21.0. Joint Applicants Exhibits 20.0 and 21.0 together contain over 3,500 pages of documentation relating to the Joint Applicants' integration planning. And yet, even after receiving and reviewing this voluminous documentation, Mr. Maple still insisted that he lacked sufficient information to support the Reorganization. Tr. 830.

As to AGL's pre-merger investigation of Nicor Inc. and Nicor Gas and the integration planning for the post-merger combination of utilities and shared services functions, should it occur, the evidence demonstrates that AGL:

1. examined and analyzed the plethora of public information available from Nicor Gas' reporting to the Commission and Nicor Inc.'s reporting to the Securities and Exchange Commission, including information regarding (a) Nicor Gas' operations as described in its last two rate cases before the Commission, (b) the issue pending before the Commission regarding Nicor Gas' Performance Based Rates program, and (c) Nicor Inc.'s required disclosures about conditions, events or requirements of its businesses that would be material to investors;
2. examined or confirmed Nicor Gas' operations, including field operations and compliance;
3. relied upon the excellent reputation of Nicor Gas for safety in the natural gas industry as reflected in industry analyses prepared by entities such as the American Gas Association;
4. relied upon Nicor Gas' status as the low cost provider of gas distribution service in Illinois;
5. reviewed status of Nicor Gas' employees, such as the existence of change of control provisions in employment contracts; and
6. reviewed voluminous records made available in this proceeding documenting the integration process that is already underway at AGL and Nicor Gas, including a detailed map of the integration process, the findings of the Integration Team as presented to the Chief Executive Officers of AGL and Nicor, Inc., and a listing of all individuals involved in the integration planning process and documents prepared by those individuals in connection with the integration.

Linginfelter Reb., JA Ex. 8.0, 4:95-10:216; Linginfelter Sur., JA Ex. 13.0, 8:161-16:338; JA Ex. 20.0 at NRE 005129-5130 and NRE 005145; JA Ex. 21.0; Tr. 653-56 and 694-98 (Linginfelter). Substantial and compelling evidence completely refutes Mr. Maple’s factual claims. Accordingly, the Commission should reject Staff’s assertions concerning the Joint Applicants’ compliance with Section 7-204(b)(1) of the Act.

B. Section 7-204(b)(7)

Section 7-204(b)(7) imposes a single, direct requirement: “the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.” 220 ILCS 5/7-204(b)(7). It bars approvals of reorganizations that will “likely” adversely increase rates.⁹ “That standard refers broadly to ‘adverse rate impacts’ as a whole. It does not refer to any individual cost, category of costs, or for that matter, costs as a whole.” Cave Sur., JA Ex. 14.0, 1:17-19.

1. No Rate Increase is Caused by the Reorganization

The proposed Reorganization meets Section 7-204(b)(7). It is uncontested that the proposed Reorganization includes no rate increase. “The reorganization is not a rate proceeding, nor have the Joint Applicants asked the Commission to consider any change in rates for customers as a result of the proposed reorganization.” Cave Sur., JA Ex. 14.0, 5:101-03. Moreover, the Joint Applicants have made clear that they have no intention of filing a rate case resulting from the transaction. *See, e.g.*, Linginfelter Dir., JA Ex. 1.0, 6:115-17; O’Connor Dir., JA Ex. 6.0, 7:133-34. Those representations have never been called into question. The Joint Applicants further agreed that *none* of the merger’s net costs will be passed through to retail customers as qualified by the Joint Applicant’s proposal in response to Staff witness Bridal. Cave Reb., JA Ex. 9.0, 5:106-08. Merger costs simply cannot, therefore, result in a rate increase.

⁹ Not all rate increases are necessarily “adverse rate impacts.” For example, it would be hard to characterize rate increases that are less than inflation or that are accompanied by greater service improvements as “adverse.” The question of whether all rate increases are adverse rate impacts has not been at issue in this case.

“The fact is that there will be no adverse rate impact as a result of the proposed Reorganization.” Cave Reb., JA Ex. 9.0, 2:34-35. The Joint Applicants’ submissions and other evidence more than satisfies Section 7-204(b)(7), which only authorizes rejection of transactions that are “likely” to raise rates adversely.

2. Staff’s Speculative Concerns about a Single Cost, the Utility Capital Cost Component, are Both Unfounded and Legally Unrelated to Section 7-204(b)(7)

Staff witness Phipps argues that Section 7-204(b)(7) would not be met, at least absent an unprecedented adjustment she proposes to now impose in future rate cases. *See* Tr. 792-93. She bases her concern solely on unsubstantiated fears about a single factor—credit ratings—related to a single utility cost—the cost of capital. By contrast, “[u]nder Section 7-204(b)(7), the Commission must find that the proposed reorganization, *in its totality*, is not likely to result in an adverse rate impact on customers. The standard does not single out one particular cost or aspect of the utility’s costs, but rather requires the Commission to consider the ultimate impact of the entire reorganization on customer rates.” Cave Reb., JA Ex. 9.0, 6:116-20 (emphasis in original). By looking at only one cost component, Ms. Phipps’ “view ignores the fact that the Joint Applicants are not seeking changes to rates, and that the Joint Applicants have, in fact, taken significant steps to insulate Nicor Gas from the perceived ‘risks’ associated with the non-utility businesses.” Cave Sur., JA Ex. 14.0, 2:24-27. Moreover, the “remedy” she proposes—an automatic adjustment to future capital structures used for ratemaking purposes—ties the hands of future Commissions, lacks factual support, and is squarely contrary to the terms of the law.

The cornerstone of Ms. Phipps’ argument is her concern that because AGL has generally lower—but still amply strong—credit ratings than Nicor Gas currently enjoys, Nicor Gas may be downgraded as a result of the merger. While acknowledging that “[n]othing concerning the ultimate effect of the proposed reorganization on Nicor Gas’ credit ratings is known with

complete certainty,”¹⁰ she nonetheless relies on reports that *predate* the Joint Applicants’ agreement that AGL affiliates will not be able to borrow from a common money pool including Nicor Gas funds. Staff Ex. 15.01 (Standard & Poor’s report, Mar. 22, 2011); Staff Ex. 15.02 (Moody’s Investors Service report, Dec. 7, 2010); Cave Reb., JA Ex. 9.0, 11:228-37; Tr. 785-87 (Phipps). There is no evidence that a downgrade of Nicor Gas is “likely” absent its participation in a common money pool with AGL affiliates. Cave Reb., JA Ex. 9.0, 7:141-52; Phipps Reb., Staff Ex. 15.0, 2:30-31. In fact, the very rating agency reports that Ms. Phipps cites and attaches to her rebuttal testimony suggest otherwise. *See* Staff Ex. 15.01 (Standard & Poor’s report); Staff Ex. 15.02 (Moody’s Investors Service report); Cave Sur., JA Ex. 14.0, 3:51-4:79. For example, the Moody’s report states as follows:

NI-Gas’s A2 issuer rating is likely to be downgraded by one notch to conform with those of AGL’s rated operating subsidiaries Atlanta Gas Light Company and Pivotal Utility Holdings, which are rated one notch lower at A3 senior unsecured given NI-Gas’s expected inclusion in AGL’s money pool.

Staff Ex. 15.02 at 1. The report later states in no uncertain terms that “[a]ligning NI-Gas’s post-merger ratings with those of its prospective sister companies assumes that NI-Gas will become part of AGL’s money pool arrangement in which subsidiary funds are managed centrally.” *Id.* Staff simply cannot demonstrate that a downgrade is “likely.” Indeed, there is “no basis for stating that Nicor Gas’ credit ratings will decline” as the transaction is presently proposed. Cave Sur., JA Ex. 14.0, 4:80-81.

Nonetheless, that unproven fear of a ratings downgrade is just the beginning of a long and winding road for Staff’s argument. To be relevant to rates, this putative downgrade must persist until some future date when a rate case occurs. Staff also must assume that Nicor Gas, absent the

¹⁰ Phipps Reb., Staff Ex. 15.0, 2:20-21 .

merger, also would continue to maintain a higher credit rating. The next step is that this assumed credit rating “spread” must actually manifest itself in higher overall credit costs. This involves a host of assumptions about the proposed and accepted capital component costs, as well as the capital structure. After factoring this in, these higher credit costs must result. Then, those higher credit costs must be part of a higher overall revenue requirement, taking into account all of the effects and long-term efficiencies. In addition to being a huge and unfounded factual assumption, this leap poses grave legal problems for Ms. Phipps’ construct, as noted below.

Yet, still more steps are required. That higher hypothetical revenue requirement also must justify higher rates under the then-applicable billing determinants. Section 7-204(b)(7) speaks clearly and only to rates, not costs or revenue requirements. “Rates change in rate cases in response to changes in those total costs and/or billing determinants” (Cave Sur., JA Ex. 14.0, 7:138-40), not in response to changes in credit ratings. “Nicor Gas’ delivery rates do not change as a result of a change in its credit ratings or its credit costs, and it is simply not possible to predict how (or if) rates will be impacted by a predicted movement in one factor that itself only affects a portion of one utility cost.” *Id.* at 7:140-43.

Next, for there to be any possibility of an adverse rate effect, the Commission—in the face of Staff’s avowed concern—would have to find that the hypothetical higher capital cost contribution to the higher revenue requirement is legally, justly and reasonably reflected in the increased rates. Staff does not explain how this could happen if the cause of the increased overall capital cost was simply the affiliation with AGL and not, instead, a just and reasonable cost of the capital supporting service to Nicor Gas’ customers going forward. This concern is especially fanciful given the specific requirements of Section 9-230 of the Act, which—ironically—Staff witness Phipps emphasizes. Section 9-230 directs the Commission in any rate

case to remove the effect on the cost of capital of a utility's affiliation with unregulated entities.¹¹ 220 ILCS 5/9-230. Section 9-230 assures that in any future rate case, if the cost of capital of Nicor Gas were to increase as a result of its affiliation with AGL, the Commission will remove any such effect, eliminating any potential "rate impact." There is no reason to doubt that the Commission can apply Section 9-230. There is nothing atypical or complex about AGL's non-utility businesses, and the Commission has adjusted for Nicor Inc.'s own substantial unregulated affiliated businesses for years. *Cave Sur.*, JA Ex. 14.0, 4:86-92. Given that any capital cost increase arising from any such affiliation must be removed in any rate case, merger or no, it is legally impossible for the proposed Reorganization to result in an increase in the cost of capital for ratemaking purposes. "The direction [Section 9-230] gives to the Commission is to protect consumers from the effect, if any, of unregulated activities by ensuring that the approved return excludes their effect. Nothing in the reorganization affects, impairs, or even implicates that function." *Id.* at 5:97-100.

Finally, Staff's theory also runs afoul of bedrock legal principles of ratemaking. It has been established for decades that one cannot presume that overall utility costs increase because of an increase in any one component of those total costs. The Second District Appellate Court recently described the principle clearly and explained why, as a matter of law, total costs cannot be presumed to increase just because one cost component increases:

The rule against single-issue ratemaking makes it improper to consider in isolation changes in particular portions of a utility's revenue requirement. The rule ensures that the utility's revenue requirement is based on the utility's *aggregate* costs and the demand on the utility, rather than on certain specific costs related

¹¹ Staff's argument that Section 9-230 applies in this case fails on a plain reading of the law, which applies when the Commission is "determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges." 220 ILCS 5/9-230. There is no doubt that this proceeding is not one to determine a reasonable rate of return upon investment, nor is it one to "establish rates or charges." *Id.* A rate case, by contrast, is just such a proceeding and the Commission has always applied Section 9-230 in that context.

to a component of its operation. Often a change in one item of the revenue-requirement formula is offset by a corresponding change in another component of the formula. For instance, certain expenses for one aspect of a utility's business may be offset by savings in another area, thus removing the need for greater revenue. If rates are increased based solely on one factor, the ratemaking structure becomes distorted because there is no consideration of the changes to the other elements of the revenue formula, such as the operational savings from the improvements.

Commonwealth Edison Co. v. Illinois Commerce Comm'n, 405 Ill. App. 3d 389, 410 (2nd Dist. 2010) (citations omitted; emphasis in original). This principle underscores why is it incorrect and legally improper to presume that a revenue requirement increases because of an increase in one cost or component. Staff witness Phipps not only recognizes the general legal principle barring single-issue ratemaking, but agrees that this principle makes it “improper to consider in isolation changes in particular portions of a utility’s revenue requirement.” Tr. 782-83 (Phipps).

There is, in short, no basis in Staff’s speculation for any conclusion that an increase in rates is “likely” if the proposed Reorganization is approved.

3. The Joint Applicants Have Voluntarily Offered Strong Additional Protections

The Joint Applicants, however, have gone far beyond proving that the Reorganization is not likely to raise rates. In a good faith effort to resolve Staff’s concerns about potential future credit ratings changes and how any such potential rating changes, if they occur, might affect equity costs, the Joint Applicants have voluntarily proposed a means to “evaluate any adverse rate impact” and explained “how such a proposal might work to eliminate any adverse rate impact.” Cave Sur., JA Ex. 14.0, 6:131-32. In particular, the Joint Applicants’ voluntarily propose that:

For the three-year period following the closing of the proposed reorganization, in any proceeding involving rates where an underlying determinant factor is the cost of capital, the Joint Applicants agree that the appropriate debt and equity costs should

be based on a study that assumes Nicor Gas' credit rating to be the same as its rating immediately prior to the closing of the reorganization. Further, in any future proceeding involving rates, beyond that three-year period, where cost of capital is an underlying determinant factor, the Joint Applicants agree to file a study addressing applicable requirements of Section 9-230 of the Act, including (to the extent required by that provision of law as it then exists) analyzing the impact, if any, of Nicor Gas' affiliation with AGL Resources and its other subsidiaries on the cost of capital for Nicor Gas.

Id. at 7:152-8:161.

By pegging for three years¹² the credit rating of the post-merger utility, for ratemaking purposes, to Nicor Gas' existing credit rating, there is no mechanism by which a credit rating downgrade—the only concrete potential risk factor Staff has identified—could result in increased costs or rates. Phipps Dir., Staff Ex. 9.0, 16:329-33. Indeed, by freezing the existing AA credit rating for three years, the Joint Applicants are voluntarily offering to forgo any argument that Nicor Gas' own credit rating might change for reasons unrelated to the merger or that another rating is more cost-effective.

Finally, the Joint Applicants understand that Staff has questions about the mechanics of such a study (*e.g.*, who would conduct it, who would pay for it, etc.), as indicated at evidentiary hearings. Tr. 493-94 (Cave). These issues should not, from the Joint Applicants' perspective, be serious bars to resolution, provided the mechanisms are fundamentally fair. However, the Joint Applicants and Staff were not able to reach agreement on such issues.

¹² Three years is a reasonable period for this additional protection. As years go on, predicting what Nicor Gas' credit ratings, capital structure, and total capital costs would have been absent the transaction becomes more and more simply an exercise in speculation and, after a full three years, it would be unreasonable to simply assume its ratings and capital structure goals would remain perpetually unchanged. Of course, the Joint Applicants proposal does not foreclose any argument that the affiliation with AGL has increased Nicor Gas' costs. It simply defines the period during which Nicor Gas will produce a study on this subject.

C. Section 7-204(c)

1. The Joint Applicants Have Demonstrated that the Proposed Reorganization Meets the Requirements of Section 7-204(c)

Section 7-204(c) requires the Commission to rule on (a) the allocation of any savings resulting from the proposed reorganization; and (b) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization, and, if so, the amount of costs eligible for recovery and how the costs will be allocated. 220 ILCS 5/7-204(c). The Joint Applicants' evidence fully supports the required findings.

The evidence demonstrates that the Joint Applicants: (i) have not identified any immediate net savings to Nicor Gas from the Reorganization, particularly given the undeniable fact that expenses related to AGL's commitments to maintaining workforce levels and honoring the existing union contract will continue and escalate; and (ii) are not seeking recovery of transaction costs related to the Reorganization even though the Joint Applicants expect to incur a significant amount of costs in order to capture long-term benefits. Linginfelter Dir., JA Ex. 1.0, 9:181-83, 13:282-14:289; Reese Dir., JA Ex. 5.0, 12:261-73. Accordingly, the Joint Applicants stated in the Application that the Reorganization will not raise savings allocation or cost recovery issues for the Commission to address under Section 7-204(c). Application at 11; Linginfelter Dir., JA Ex. 1.0, 14:289-90; Reese Dir., JA Ex. 5.0, 12:261-73.

The evidentiary record supports the Joint Applicants' position that there will be no short-term savings at the utility, while there may be long-term benefits, including possible savings, as a result of the Reorganization. It will be extremely difficult, if not impossible, to obtain any short-term savings at the utility given that the undisputed evidence shows: (1) Nicor Gas already is by far the low-cost provider of natural gas distribution service in Illinois; and (2) the expense resulting from the Joint Applicants' commitment to maintaining the same number of FTEs and

honoring the current union contract. Linginfelter Dir., JA Ex. 1.0, 7:141-45; D'Alessandro Dir., JA Ex. 2.0, 5:73-76; O'Connor Sur., JA Ex. 16.0R, 4:71-76. Indeed, the undisputed evidence also shows that employee costs are likely to increase over time as the costs for wages and other employee benefits increase. Tr. 671 (Linginfelter). Further, there may be operational benefits that will not necessarily be tied to lower operational costs, such as better service for the same cost. Tr. 637 (Linginfelter). Finally, there will be benefits that the Joint Applicants may only achieve through incurring costs. For example, Mr. O'Connor testified about the Joint Applicants' decision, as part of the integration planning process, to standardize a common computer platform for three areas of the combined company—financial accounting, procurement and human resources/payroll. Tr. 464-65. Mr. Linginfelter testified at length about Joint Applicants' position at the evidentiary hearing and summarized it as follows: “[w]e don't know all the costs that we are going to bear and we don't know all the savings..., but we do think our ability to manage well in a combined company is good for customers ultimately around rates.” Tr. 674; *see also* Tr. 672-80.

Given these facts, it is not surprising that the proposed Reorganization is focused on “long term evaluations of best practices and economies of scale and scope that will be developed over time, as well as savings from unregulated activities.” O'Connor Sur., JA Ex. 16.0R, 3:55-59. Joint Applicants witness O'Connor testified that the expected benefits or savings to accrue from the Reorganization in the short-term will occur at the *unregulated* businesses and not at the utility, including, for example:

1. Benefits to come from the unregulated side of the businesses—“namely, from the combination of the retail businesses of Nicor, Inc., and AGLR, the unregulated side of those businesses” where “the back office will combine the accounting, the computer systems, et cetera, of those two companies to achieve substantial savings.”

2. In the unregulated side of their businesses, the Joint Applicants anticipate growth in terms of achieving “greater access to customer bases on behalf of the combined company.”
3. “Also at the trading companies, Nicor Enerchange and Sequent, part of AGLR, again, we anticipate combining the back offices, the accounting and all those functions at both companies to achieve savings.”

Tr. 462-63. In part, AGL and Nicor Inc. came together in the merger because they saw the possibility for such benefits to be obtained for their respective *unregulated* retail platforms. As Mr. Linginfelter testified, “a major driver for AGL Resources was the ability to combine non-regulated operations. We believe that the opportunity to integrate those businesses can provide substantial commercial and operational improvements early and that integration of operations will provide the opportunity to manage our costs better long term.” Linginfelter Dir., JA Ex. 1.0, 6:118-21.

Because Section 7-204(c) refers only to savings *at the utility*, the Commission’s analysis under 7-204(c) should be limited to the evidence demonstrating no immediate savings at the utility, as opposed to a long-term assessment of possible savings that may be achieved with likely substantial costs incurred. In light of the evidentiary record described above, the Commission should find that the proposed Reorganization meets the requirements of Section 7-204(c)(i) and (c)(ii) of the Act.

2. The Joint Applicants Have Accepted Staff’s Proposal Concerning Section 7-204(c) Subject to One Caveat that Provides Certainty to all Parties

Staff witness Bridal made two recommendations with respect to approval of the Reorganization under Section 7-204(c): (a) all future savings resulting from the reorganization be incorporated into the test year for purposes of setting rates so all savings will flow through to the benefit of customers in a future rate case; and (b) any costs associated with accomplishing the reorganization not be recoverable from ratepayers. Bridal Dir., Staff Ex. 6.0, 2:37-43.

In response, Joint Applicants witness Linginfelter pointed out that AGL must incur the costs of the Reorganization as a precondition to any ability to achieve any savings in the future; therefore, the Joint Applicants stated they would accept Mr. Bridal's proposal "if it is amended to reflect the fact that any savings should be measured net of the costs to achieve them."

Linginfelter Reb., JA Ex. 8.0, 19:431-34. In particular, the Joint Applicants proposed that the condition include the following language:

In the event that any party, other than Nicor Gas, causes or requests a review of Nicor Gas' earnings during the five year period following the completion of the Reorganization, Nicor Gas shall be afforded the opportunity to request the Commission consider inclusion of a test year amortization (1/5 of the total cost of the Reorganization as stated in response to Staff Data Request RWB 1.03 (Mr. Effron refers to these costs as "merger costs")) in determining revenue requirement in that proceeding.

Id. at 19:434-20:443. Under this proposal, for a period of five years after closing the Reorganization, if any proceeding is initiated to examine or downwardly revise Nicor Gas' current rates (*i.e.*, a proceeding initiated by the Commission or a party other than Nicor Gas), Nicor Gas would have the opportunity to present facts to allow the Commission *to consider* whether the cost to achieve the Reorganization should offset any savings achieved as a result of the Reorganization. Linginfelter Sur., JA Ex. 13.0, 16:349-53; Tr. 638 (Linginfelter). The Joint Applicants' proposed language would not commit the Commission to allowing recovery, but only would provide Nicor Gas with the opportunity to argue for recoverability of the costs to achieve savings realized in the context of that case. Linginfelter Reb., JA Ex. 8.0, 20:444-46. It is difficult to imagine any scenario in which this proposal in practice would result in prejudice to any party. The Joint Applicants' proposal is exactly equivalent to Mr. Bridal's recommendation except in the unlikely case that the Commission were to initiate a rate proceeding, not requested

by Nicor Gas, during the five year period following the Reorganization. Linginfelter Sur., JA Ex. 13.0, 6:121-24.

Mr. Bridal did not agree to the Joint Applicants' reasonable proposal to address the requirements of Section 7-204(c) in a balanced and equitable manner. Bridal Reb., Staff Ex. 13.0, 7:175-78. For support, Mr. Bridal pointed to previous Commission rulings in which costs incurred in accomplishing a reorganization were excluded from recovery in future rate proceedings. *Id.* at 8:193-10:256. Yet, the Joint Applicants are not seeking to recover transaction costs related to the Reorganization. Linginfelter Sur., JA Ex. 13.0, 17:372-73. Moreover, in none of the dockets cited by Mr. Bridal did the applicants propose the balancing the Joint Applicants propose in this proceeding.

For the foregoing reasons, the Commission should adopt the Joint Applicants' proposed condition to meet the requirements of Section 7-204(c) of the Act. This proposal reasonably balances the interests of customers, the Commission and Nicor Gas.

3. AG/CUB's Recommendations Concerning the Required Findings under Section 7-204(c) are Wholly Without Merit

In order to make the required findings under Section 7-204(c), AG/CUB witness Effron made several overreaching recommendations, none of which have merit. *See* Effron Dir., AG/CUB Ex. 3.0, 8:21-9:5. As an initial matter, Staff does not agree with the recommendations presented by AG/CUB regarding the finding required by Section 7-204(c). Bridal Reb., Staff Ex. 13.0, 2:36-38. Moreover, as discussed above, the record demonstrates that there are no immediate cost savings to the utility to be quantified, and Mr. Effron has failed to provide a single reasonable basis to demonstrate otherwise. Instead, Mr. Effron relies on irrelevant data points to try to extrapolate purported "savings" to be assumed by the Commission in this proceeding, including the projections of savings identified in the merger application of WPS

Resources Corporation and Peoples Energy Corporation, as approved by the Commission in Docket No. 06-0540 (“WPS/PEC”), and the “separation costs” estimated as part of the Joint Applicants’ initial filing. Effron Dir., AG/CUB Ex. 3.0, 5:1-6:12.

The Joint Applicants demonstrated that the WPS/PEC merger is not a reasonable comparison as there is no evidentiary similarity—and Mr. Effron offered none—between that merger and this proceeding. O’Connor Reb., JA Ex. 11.0, 5:95-6:122. For example, the gas utilities at issue in the WPS/PEC merger were, and remain, the highest cost providers of gas distribution service in Illinois, which is a far cry from Nicor Gas’ historical position as the lowest cost provider in Illinois. O’Connor Reb., JA Ex. 11.0, 7:147-49; D’Alessandro Dir., JA Ex. 2.0, 6:84-86. Put another way, Nicor Gas current operations are far more economically efficient than the utilities Mr. Effron uses in his attempted comparison. No party, including AG/CUB, even attempts to refute this key point. Thus, the opportunity to drive costs down at Nicor Gas, compared to the opportunities motivating the WPS/PEC merger, is not remotely comparable. Here, AGL was largely motivated by the potential benefits from combining non-regulated operations, not reducing what is already the lowest cost structure for any gas utility in Illinois. Linginfelter Dir., JA Ex. 1.0, 6:118-21. In other words, the Joint Applicants’ proposed Reorganization has been driven from the beginning by a very different motivation than what was at issue in the WPS/PEC merger. *See* O’Connor Sur., JA Ex. 16.0R, 3:47-59.

The record also contains other clear contrasts between the WPS/PEC merger and the proposed Reorganization here. For example, the WPS/PEC merger did not include any commitment to maintain FTE levels at the utility for any period of time, whereas the Joint Applicants have committed to maintaining the FTE levels for three years at Nicor Gas—and for certain safety compliance personnel, that period is five years. O’Connor Reb., JA Ex. 11.0,

6:109-13. Furthermore, the WPS/PEC merger occurred more than five years ago, and in an entirely different business and economic environment from that currently experienced by the Joint Applicants. *Id.* at 5:105-6:107.

Mr. Effron's reliance on separation costs is similarly flawed. His argument that the estimated separation costs identified by the Joint Applicants should be used as a measure for the savings to be achieved at the utility is without merit because those savings will occur, if at all, at the holding company level, not at the utility. O'Connor Sur., JA Ex. 16.0R, 3:65-4:70.

Similarly, should a Nicor Inc. executive be able to exercise his or her change of control agreement, it will have no impact on Nicor Gas' rates because it is a "once-off cost" that "would not be recoverable in a future rate case, were that cost to be allocated to Nicor Gas in the first place." Tr. 464 (O'Connor).

Finally, Mr. Effron's position that Nicor Gas is allegedly "overearning" (Effron Dir., AG/CUB Ex. 3.0, 9:5-6) has no bearing whatsoever on the Commission's required findings under Section 7-204(c), which focus on savings resulting from a reorganization, not past utility economic performance. Moreover, Mr. Effron's position that Nicor Gas is currently overearning is unsubstantiated. Using Mr. Effron's own "metric of net income as a percentage of average equity, Nicor Gas has *under-earned* in five of the last seven years." O'Connor Reb., JA Ex. 11.0, 8:158-59 (emphasis in original). Thus, the facts simply do not support Mr. Effron's claims.

Even assuming that Nicor Gas' earnings are somehow relevant to the Commission's approval of the Reorganization, which they are not, Mr. Effron's analysis of projected earnings is flawed. Inexplicably, Mr. Effron considers only two variables, both unrelated to the Reorganization—the impact on rate base of the recently enacted extension of bonus depreciation

and the recently approved Illinois state income tax increase. *Effron Reb.*, AG/CUB Ex. 3.0, 3:10-4:9. Use of only two variables is clearly erroneous, as the Commission’s mandate is to conduct a comprehensive review of the costs impacting Nicor Gas’ revenue requirement. *O’Connor Sur.*, JA Ex. 16.0R, 5:98-109. The Commission does not look only to a single issue, or two issues, when evaluating rates. *See, e.g., Bus. & Prof’l People for Pub. Interest v. Illinois Commerce Comm’n*, 146 Ill. 2d 175, 244 (1991) (“The rule against single-issue ratemaking recognizes that the revenue formula is designed to determine the revenue requirement based on the *aggregate* costs and demand of the utility. Therefore, it would be improper to consider changes to components of the revenue requirement in isolation.”) (emphasis in original). Consequently, Mr. Effron’s focus on only two of the many variable components of earnings is an invitation to the Commission to commit legal and factual error.

V. OTHER APPROVALS/AGREEMENTS

A. Approval under Section 7-102

The Joint Applicants referenced Section 7-102 in its Application (at 11-12), which requires Commission approval whenever a “public utility may by any means, direct or indirect, merge or consolidate its franchises, licenses, permits, plants, equipment, business or other property with that of any other public utility.” 220 ILCS 5/7-102(A)(d). Section 7-102 also requires Commission approval for a public utility to “assign, transfer, lease, mortgage, sell (by option or otherwise), or otherwise dispose of or encumber the whole or any part of its franchises, licenses, permits, plant, equipment, business, or other property....” 220 ILCS 5/7-102(A)(c).

It is the Joint Applicants’ position that neither Section 7-102(A)(c) or (d) apply to the Reorganization, because the Reorganization does not involve a direct or indirect merger or consolidation of two utilities’ businesses or property and is not a sale or disposition of a utility’s business or property, but rather is a change in control transaction subject to Sections 7-204 and

7-204A. Application at 11-12. Indeed, Section 7-204(e) expressly provides that “[n]o other Commission approvals shall be required for mergers that are subject to this Section.” 220 ILCS 5/7-204(e). However, if the Commission were to determine that the Reorganization is also subject to Section 7-102, the information submitted by the Joint Applicants in this proceeding is sufficient to meet the requirements of Section 7-102. Application at 12. No party other than the Joint Applicants presented evidence regarding Section 7-102. Because the evidence supports the Commission’s findings under Section 7-204, it also supports approval of the Reorganization pursuant to Section 7-102 of the Act, should such approval be necessary.

B. Section 7-204A(a)

The Joint Applicants satisfied all the minimum filing requirements under Section 7-204A(a), including by submitting copies of proposed affiliated interest agreements in accordance with Section 7-204A(a)(5). Accordingly, as discussed above in Sections II and III.A, the Joint Applicants seek approval of the following agreements to address Nicor Gas’ transactions with affiliates: (1) an OA, which will govern transactions between Nicor Gas and its current affiliates, as well as with AGL and AGSC; (2) a SA between Nicor Gas and AGSC; (3) four existing agreements between Nicor Gas and Sequent—a Gas Exchange agreement, an Interstate Hub Service Agreement, an Intrastate Hub Service Agreement and a NAESB—as well as capacity release arrangements between Nicor Gas and Sequent from time to time in accordance with FERC’s capacity release rules; and (4) the TAA, as amended to include the surviving Nicor Inc. companies as parties to that agreement. Application at 6, 8, 12-13 and Att. A, *Information Required Pursuant to 220 ILCS 5/7-204A(a)(5)*; Reese Dir., JA Ex. 5.0, 2:22-42; O’Connor Dir., JA Ex. 6.0, 4:64-70, 12:254-13:268; Hathhorn Dir., Staff Ex. 8.0, 18:442-48 and Att. B. Staff witnesses Hathhorn and Rearden recommended approval of these agreements, subject to the conditions described in Section III.A above. Hathhorn Dir., Staff Ex. 8.0, 20:509-21:547;

Rearden Dir., Staff Ex. 10.0, 13:281-83. Accordingly, the Commission should approve each of these agreements.

C. Other

In addition to the matters described above, Staff witness Phipps made two recommendations with respect to approval of the Reorganization: (1) Nicor Gas should file a post-merger report that describes Nicor Gas' post-merger capital structure and identifies capital structure adjustments that result from the Reorganization to address Section 6-103 of the Act and, if there are push down accounting adjustments to Nicor Gas' balance sheet, then Nicor Gas should also file a petition seeking Commission approval of a fair value study and resulting capital structure; and (2) the Joint Applicants should revise Nicor Gas' short-term borrowing addendum to the OA to comply with the Commission's money pool rules (83 Ill. Adm. Code 340), by permitting Nicor Gas to borrow from non-utility affiliates but not permitting Nicor Gas to make any cash advances to non-utility affiliates. Phipps Dir., Staff Ex. 9.0, 19:384-94, 22:447-54. The Joint Applicants agreed to comply with these recommendations as part of the approval of the Reorganization. Cave Reb., JA Ex. 9.0, 3:43-50; 10:210-11:237.

Staff witness Hathhorn also recommended that the Joint Applicants be required to file a semi-annual compliance report on the Commission's e-Docket system in Docket No. 11-0046, reporting on the status of progress of all conditions imposed by the Commission in this case. Hathhorn Reb., Staff Ex. 14.0, 6:161-7:164. Ms. Hathhorn recommended that this reporting requirement should remain in effect until all conditions have been satisfied or the Joint Applicants petition the Commission and receive approval to cease such reporting requirement, whichever comes first. *Id.* at 7:164-67. Joint Applicants witness Reese accepted this recommendation on behalf of all the conditions accepted by all Joint Applicants witnesses. Reese Sur., JA Ex. 15.0, 2:45-3:57.

VI. CONCLUSION

The Joint Applicants respectfully request that the Commission make the findings required by Section 7-204 of the Act and approve the Reorganization because the evidence fully supports each requisite finding. Additionally, the Commission should make the other findings reflected herein, and grant any other relief the Commission deems appropriate.

Dated: August 18, 2011

Respectfully submitted,

AGL RESOURCES INC., NICOR INC.,
AND NORTHERN ILLINOIS GAS COMPANY
D/B/A NICOR GAS COMPANY

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CERTIFICATE OF SERVICE

I, John E. Rooney, certify that I caused a copy of the Joint Applicants' Initial Post-Trial Brief to be served upon the service list in Docket No. 11-0046 on August 18, 2011.

/s/ John E. Rooney

John E. Rooney