STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

AGL Resources 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	**)**	

CORRECTED INITIAL BRIEF OF THE PEOPLE OF THE STATE OF ILLINOIS AND THE CITIZENS UTILITY BOARD REGARDING NON-OPERATING-AGREEMENT ISSUES

AUGUST 19, 2011

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Pursuant to Section 200.800 of the Rules of Practice of the Illinois Commerce Commission ("Commission" or "ICC"), 83 Ill. Admin. Code 200.830, and the briefing schedule established by the Administrative Law Judge ("ALJ"), the People of the State of Illinois, through Lisa Madigan, Attorney General of the State of Illinois, ("AG") and the Citizens Utility Board ("CUB"), through its attorney, hereby submit their Initial Brief in the above-captioned docket. This proceeding was initiated by Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" of "NG")) and AGL Resources Inc. ("AGL"), (collectively, "Joint Applicants" or "JAs"), to attain the necessary Illinois Commerce Commission approval under Article VII of the Public Utilities Act ("PUA"), (220 ILCS 5/7-204), for the proposed merger between Nicor Inc., Nicor Gas' parent company, and AGL. This Initial Brief will address all issues related to the proposed merger, other than those previously addressed in AG/CUB's Initial and Reply Briefs Regarding Operating Agreement Issues, previously filed on June 20, 2011 and July 12, 2011, respectively.

I. INTRODUCTION AND STATEMENT OF THE CASE

On January 18, 2011, AGL Resources Inc. ("AGL"), Nicor Inc. ("Nicor"), and Northern Illinois Gas Company ("Nicor Gas"), (collectively "Joint Applicants") filed their application for Commission approval of a corporate reorganization under Section 7-204 of the Public Utilities Act ("the Act"), thereby initiating this docket. 220 ILCS 5/7-204. Under the terms of the proposed reorganization, AGL would become the new corporate parent of Nicor Gas. Included within the reorganization petition is a request for approval of the Joint Applicants' proposed Operating Agreement ("OA"), which would replace the agreement that is the subject of Docket No. 09-0301.[1] This Agreement and the Operating Agreement that is at issue in Docket No. 09-0301 include the same terms and conditions for the "central management of certain services, the provision to each other of certain services and facilities, and the transfer of certain property" and other transactions between Nicor Gas, AGL and the listed affiliate companies."[2] Issues related to the proposed OA have been previously briefed, as noted above.

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[1] The Commission has the authority under Section 7-101 of the Public Utilities Act to condition approval of an affiliate services contract, such as the Operating Agreement, in such a manner as it may deem necessary to safeguard the public interest. 220 ILCS 5/7-101. Under Section 7-101(3) of the Public Utilities Act ("the Act"), the Commission shall review all contractual arrangements between a regulated utility and its affiliates. 220 ILCS 5/7-101(3). The Commission may condition approval of an affiliate agreement "in such manner as it may deem necessary to safeguard the public interest." *Id.* Likewise, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove an affiliate contract or arrangement if it concludes that any such contract is not in the public interest. *Id.*

[2] On March 24, 2011, the Joint Applicants filed their Request for Administrative Notice in this docket, which requested that the Commission take administrative notice of all data request responses and testimony from ICC Docket No. 09-0301 in this proceeding, as contemplated in a Stipulation signed by the Joint Applicants, Staff, the AG, CUB and the Retail Energy Supply Association ("RESA"). The Joint Applicants argued that Commission adoption of the request would "promote administrative efficiency by limiting the Commission's consideration of all prospective affiliate and operating agreement issues involving Nicor Gas to one proceeding" and noting that "the operating agreement issues raised in ICC Docket No. 09-0301 comprise a subset of the issues to be addressed in this proceeding pursuant to Section 7-204(b)(2)-(3) of the Act." Request at 2.

On that same date, Nicor Gas filed a Motion in Docket No. 09-0301 notifying the Commission that Nicor Gas, Staff, the AG, CUB, and RESA had reached agreement that all data request responses served and all testimony filed in the 09-0301 proceeding could be used in ICC Docket No. 11-0046 without objection (as memorialized in a separate stipulation), and that it was anticipated that parties would incorporate the operating agreement issues into their 11-0046 testimonies. Motion at 2-3.

Section 7-204(b) provides that no reorganization shall take place without prior Commission approval. 220 ILCS 5/7-204(b). In reviewing any proposed reorganization, the Commission must find that:

> (1) the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;
> (2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;
> (3) 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;
> (4) 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;
> (5) the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;
> (6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;
> (7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

220 ILCS 5/7-204(b). In addition, Section 7-204(c) provides that the Commission "shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting form the proposed reorganization; and (ii) 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 People and CUB urge the Commission to reject the proposed merger and reorganization. From the initiation of this docket through cross-examination of the JA witnesses, the petitioners have demonstrated an unwillingness to divulge the specific information needed for the Commission to make the specific findings required in Section 7-204(b)(1) of the Act – that the proposed merger will not diminish Nicor Gas' ability to provide least cost service -- and under Section 7-204(c) of the Act – requiring a ruling on how to allocate merger savings and costs. The evidence shows that, on the one hand, the JAs have asserted to rating agencies, shareholders and this Commission that the merger will create efficiencies. For example, JA witness Henry Lingenfelter, Executive Vice President of Utility Operations for AGL Resources, testified, "It is our view and experience that consolidation in our industry can provide benefits to utility customers." JA Ex. 1.0 at 5. He noted that "(s)cale can provide many of the efficiencies and resources needed in the changing (natural gas utility) landscape." *Id.* at 6.

On the other hand, the JAs' have insisted throughout this case that the merger will only produce savings for the two corporate parent companies, AGL Resources Inc. ("AGL") and Nicor, Inc. ("NI"), and that there are no identifiable savings or even estimates to be quantified for the regulated utility, Nicor Gas, as a result of the merger. JA Ex. 11.0 at 6. Notwithstanding this assertion, the JAs also state that "To date, no analyses have been performed to determine any areas where synergies or savings may be potentially achieved as a result of the reorganization."[3] This intransigence on the issue of identifying savings and costs comes despite the fact that the JAs testified that an integration planning process has been ongoing since January of 2011. Tr. at 383. The claim simply is not credible in light of the following facts:

- In nearly every merger/reorganization petition presented to the Commission since Section 7-204(c) became law, the merger petitioners specifically identified anticipated savings at both the corporate parent level and the regulated utility level in their petitions and/or pre-filed testimony. For example, the WPS Resources Corporation/Peoples Energy Corporation/The Peoples Gas Light & Coke Company/North Shore Gas Company petition, provided *at the start of the docket* that the petitioners estimated that annual savings in personnel costs of $33.8 million could be expected, with 79% of that savings coming from reductions to corporate staffing.[4]

- Assuming savings are achieved at the corporate level only, the parent company costs that are allocated to the regulated utility, Nicor Gas, in every rate case, stand to be reduced if the JAs claims about corporate efficiencies are to be believed.[5]

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[3] AG Cross Ex. 7 (JA Response to AG 1.19).
[4] AG Ex. 3.0 at 5.
[5] *See* AG Cross Ex. 5, Tr. at 383-398.

- Despite their alleged inability to identify synergies or savings, the JAs *have* identified expected separation costs of $21 million, plus additional separation costs associated with the highest ranking Nicor Inc executives. Such separation costs would be incurred in conjunction with a reduction to the number of administrative, management, and executive employees enabled by the merger. As noted by AG/CUB witness David Effron, "there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs."[6]

- While the JAs claim that the merger "is really based on long term best practices and scale and scope that can keep costs, over the long term low for our customers,"[7] the JA witnesses were unable to come up with a consistent definition of "long term," thereby creating doubt about their claims that near term synergies or savings are not identifiable in the short run, long run or otherwise.

- The JAs stand to gain additional efficiencies through their commitment to maintain the number of gas distribution "full time equivalent employees" at a level comparable to the current level.[8] Moreover, this commitment does not apply to Nicor Gas administrative employees and Nicor, Inc. employees, a portion of whose salaries are allocated to Nicor Gas.

- Savings can be achieved as a result of the merger in areas other than staffing, such as facilities integration, professional services, purchasing and information technology.[9]

- The Commission Staff believes the JAs failed to provide sufficient information to determine what effect the proposed reorganization would have on Nicor Gas's ability to provide adequate, reliable, efficient, safe and least-cost public utility service.[10]

- Staff also testified that the applicants failed to conduct a thorough due diligence review, and as such the merger should be denied.

The JAs assertion that they have not identified any savings for the regulated utility and that savings will only occur at the corporate level over the long run rings hollow when the JAs also admit that they performed no analyses to determine any areas where synergies or savings may be potentially achieved as a result of the reorganization. This does not constitute sufficient evidence for the Commission to render a ruling on "(i) the allocation of any savings resulting form the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs

[6] AG/CUB Ex. 3.0 at 5.
[7] JA Ex. 11.0 at 7.
[8] Tr. at 461, *Id.* at 576.
[9] *Id.* at 4.
[10] Staff Ex. 11.0 at 3.

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).

Moreover, the Commission will not have satisfied its duty under Section 7-204 of the Act to approve the merger, with a generic condition that the petitioners track future savings for some future allocation to ratepayers in future rate cases. The JAs have asserted in this docket no such savings exist. The substantial evidence in the record points to the opposite conclusion, i.e. that synergies and savings are real and identifiable. The JAs, the evidence suggests, simply will not do it, despite having been engaged in the integration planning process for more than six months. The Commission must not gamble, with ratepayers assuming the risk, that Nicor Gas will see fit to identify such savings in the future, if at all.

The JAs hesitancy to reveal the details of the integration plans that might produce merger-related savings likewise affects the Commission's ability to conclude that the reorganization will not diminish Nicor Gas' ability to provide adequate, reliable, efficient, safe and least-cost utility service, under Section 7-204(b)(1) of the Act, as well as Section 7-204(b)(7) of the Act, which requires a finding that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers. These deficiencies in the evidentiary record thwart the Commission making the findings required under Section 7-204(b) and (c). The proposed merger, as such, should be denied.

II. ARGUMENT

A. Joint Applicants Have Failed to Show that the Proposed Reorganization Will Not Diminish Nicor Gas' Ability to Provide Adequate, Reliable, Efficient and Least Cost Public Utility Service, Pursuant to Section 7-204(b)(1) of the Act.

Staff witness Mark Maple testified that there is insufficient information provided by the JAs for the Commission to determine what effect the proposed reorganization would have on

Nicor Gas' ability to provide adequate, reliable, efficient, safe and least-cost public utility service, pursuant to Section 7-204(b)(1) of the Act. In light of that conclusion, he also recommended that the Commission decline to approve the requested reorganization. ICC Staff Ex. 11.0 at 3-4.

The record supports Mr. Maple's conclusion. As he noted, in Direct testimony, Mr. Maples testified that a thorough due diligence review by a company contemplating merging with or acquiring another company would involve an examination of all aspects of a company, from financial records, personnel, legal and regulatory issues, physical assets, and operational procedures and costs, to name a few. Staff Ex. 11.0 at 4. Reports of such assessments are missing from the record, according to Mr. Maple. As noted by Staff, AGL is assuming financial, regulatory and legal obligations by merging with Nicor Gas, and the purpose of due diligence is to assess the extent of those obligations. Without 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. *Id.* at 5. While the JAs claim in their Application for Reorganization that "the Reorganization will be seamless" (JAs' Application for Reorganization, par. 4), and that customers will continue to receive service "in the same fashion and pursuant to the same rates, terms and conditions…," these assertions are unreliable in light of other evidence in the record.

For example, in AG 1.20, the JAs were asked: "…do the Joint Applicants have any quantification of benefits (in terms of rates, eventual cost savings, quality of service, or other) to Nicor Gas ratepayers that will result from the Reorganization? If so, please provide such quantification, with supporting documentation." In response, the Companies stated, "No. Currently, AGLR and Nicor are engaged in an integration planning process with the objective to identify best practices and determine the most efficient and cost effective manner to perform a variety of functions following the completion of the proposed merger. To date, no analyses have been performed to quantify any potential benefits to Nicor Gas ratepayers upon completion of the Reorganization." AG Cross Ex. 8. When asked if that response meant there could be costs associated with the merger to Nicor Gas ratepayers, JA witness Reese stated that that was possible. Tr. at 549.

In response to Mr. Maple's concerns, JA witness Lingenfelter stated that the JAs have demonstrated that they have satisfied Section 7-204(b)(1) of the Act "by showing how the Reorganization will affect Nicor gas *going forward*." JA Ex. 8.0 at 5 (emphasis in original). But Staff witness Maple testified that he has "seen no substantive evidence that AGL has a fundamental knowledge of the Nicor Gas operational system. The evidence suggests that while the two merging corporations may feel comfortable with their plans for corporate merger and reorganization, the record lacks evidence as to what the Commission and Nicor Gas ratepayers can expect related to the AGL/Nicor Inc./Nicor Gas reorganization, particularly as relates to the statutory standard that requires a finding that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service."

Mr. Maple's rebuttal testimony specifically highlights the holes in the record on this point. While the JAs point to publicly available information and a reliance on the Commission's "active program of reviewing and monitoring its utilities" as support for their confidence that it is acquiring "a utility with an excellent reputation,"[11] that information "cannot possibly replace AGL's need to conduct its own due diligence review." Staff Ex. 17.0 at 11. While the JAs insist they are immersed in an integration review to uncover "best practices" between and among the

[11] JA Ex. 8.0 at 7.

merging entities[12], that admission is not substantial evidence that the reorganization will not diminish Nicor Gas's service quality or increase prices.

Mr. Maple noted that when asked in discovery whether the JAs have performed any studies on how to best integrate, with AGL's current practice, 1) the operation and maintenance of Nicor Gas's distribution system; 2) the operation and maintenance of Nicor Gas's transmission system; 3) the operation and maintenance of Nicor Gas's storage system; and 4) the gas supply and materials procurement methods of Nicor Gas, the JAs stated that they are "engaged in the integration planning process." Staff Ex. 11.0 at 11-12. When asked whether they had performed any studies to investigate the potential to achieve additional operational efficiency through using the combined utilities' pipeline transportation capacity, leased storage assets, owned storage assets, purchase of gas supply, hedging activities and other gas supply related functions in conjunction with each other; the JAs again stated they are "engaged in the integration planning process." *Id.* at 12. When asked whether the JAs had performed any studies to investigate integrating Nicor Gas' Gas Control functions into AGL's existing operations, again, the JAs responded that they are "engaged in the integration planning process." *Id.* Mr. Maple ultimately concluded:

> …the Joint Applicants must show that they have carefully studied the many different aspects of operating the utility as a combined company. They should be able to demonstrate that AGL understands the smallest details of the inner workings of Nicor's operations. They should be able to demonstrate that (sic) they have chosen to maintain or improve all of Nicor's current operational standards after the integration. Only then should the Commission be satisfied that the proposed reorganization would not diminish service. Instead, to support their position, the Joint Applicants are relying on a hollow promise of maintaining Illinois staffing levels for a short, three-year period after the proposed merger. The Joint Applicants have provided (sic) Commission and its Staff no analysis to consider, no integration studies no revised

[12] Staff Ex. 11.0, Attachment 2

> standards, no due diligence reports – absolutely nothing of substance to demonstrate they have any specific knowledge about how Nicor operates.

Staff Ex. 17.0 at 13-14.

Other uncertainties in the record thwart the Commission's ability to find with certainty that the proposed reorganization will not diminish Nicor Gas's ability to provide least-cost service, as discussed further in part B below.

B. Joint Applicants Have Failed to Show That the Proposed Reorganization Will Not Increase Nicor Gas Customer Rates, Pursuant to Section 7-204(b)(7) of the Act.

Section 7-204(b)(7) requires the Commission to find the proposed reorganization is not likely to result in any adverse rate impacts on retail customers. 220 ILCS 5/7-204(b)(7). JA witness Gerald O'Connor, Senior Vice President of Finance and Strategic Planning for Nicor Inc. and Nicor Gas, testified that AGLR and Nicor Inc. and its affiliates, including Nicor Gas, have been and are engaged in an integration planning process with the objective to identify best practices and determine the most efficient and cost-effective manner to perform a variety of functions following the completion of the proposed merger. Tr. at 369 (O'Connor). This integration process has been going on since January of 2011. Tr. at 383. Yet, the JAs maintain that, at this point, there are no estimates of the costs that will be saved by Nicor Gas as a result of the merger, as discussed later in this Brief. If that is the case, how can the applicants claim that the reorganization will not lead to increased costs?

The JAs failure to conduct due diligence, as highlighted above, supports a conclusion that the Commission lacks evidence in this docket to make a finding that Section 7-204(b)(7) has been satisfied. In addition, other uncertainties about the future operations under AGL control raises uncertainties on this statutory issue. Currently, Nicor Gas does not use an affiliate "services company" to provide certain services to the utility. Tr. at 366-368. Services companies are typically used by multi-jurisdictional entities to provide services to multiple utilities at cost. ICC Staff Ex. 8.0 at 4. Post-merger, however, the JAs will have AGSC, the AGL Services Company, provide these services. AG Cross Ex. 1 (JA Response to AG 1.23). To date, however, no estimate of the allocation of such costs, and whether it would be higher or lower than the costs that Nicor Gas would incur without using the AGSC, has been made. *Id.*

JA witness O'Connor further testified that he could not testify that the costs that would be allocated to Nicor Gas by the AGSC would not result in increased costs to Nicor Gas. Tr. at 372. In addition, when asked in discovery to explain the extent to which costs allocated from the AGSC will supplant costs currently incurred directly by Nicor Gas over the next five years, and to describe those costs, the JAs stated that no such analysis has been prepared by the JAs. AG Cross Ex. 2 (JA Response to AG 1.24). Mr. O'Connor testified that he cannot state whether the new corporate parent allocation will not, in fact, add to costs being incurred by Nicor Gas directly rather than simply supplanting the corporate parent allocated costs. Tr. at 373. JA witness Lingenfelter likewise testified that no analyses have been performed to date related to escalated costs that may or may not be incurred by Nicor Gas as a result of the reorganization. Tr. at 602-603; AG Cross Ex. 19. Moreover, as noted above, AGLR and Nicor are engaged in an integration planning process with the objective to identify best practices and determine the most efficient and cost effective manner to perform a variety of functions following the completion of the proposed merger. Because that review is pending, JA witness Reese admitted that there could be costs associated with the merger to Nicor Gas ratepayers, JA witness Reese stated that that was possible. Tr. at 549.

Other evidence supports a finding that Section 7-204(b)(7) has not been satisfied. Staff witness Phipps testified that ratepayers are likely to experience adverse rate impacts in connection with the proposed merger due to an expected decline in Nicor Gas' credit ratings should the Commission approve the JA's merger. ICC Ex. 15.0 at 2. Both Standard & Poor's and Moody's rating agencies have indicated that they expect to downgrade Nicor Gas' credit ratings following the proposed merger. ICC Ex. 15.01 and Ex. 15.02. Because credit agency ratings reflect the creditworthiness of corporate entities as a whole, including all affiliates, Nicor Gas' credit rating necessarily will be impacted by its consolidation with the AGL companies, which carry more financial risk than does Nicor, Inc. ICC Ex. 15.0 at 5; ICC Ex. 9.0 at 5-6. Consequently, Phipps concludes, without the JAs taking appropriate steps to protect Nicor Gas from the increased financial risk associated with the AGL companies, the JA's proposed reorganization is likely to increase the cost of capital for Nicor Gas and adversely impact its retail customers through increased rates. Thus, the merger does not satisfy Section 7-204(b)(7). ICC Ex. 15.0 at 4.

Section 9-230 of the Act provides that no incremental risk or increased cost of capital "…which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies" can be included in regulated utility rates or charges. 220 ILCS 5/9-230. Because Section 7-204(b)(7) requires the Commission to take into account all likely adverse rate impact on retail customers, the increased financing costs associated with non-utility affiliates -- which are the target of the 9-230 prohibition -- call for special scrutiny, especially in view of the greater financial risks posed by the affiliation of Nicor Gas with AGL, to which Staff testified.

Phipps does not consider the JAs' offer to produce a study "detailing the effects of the Reorganization on the utility's overall costs of service," in its next rate case sufficient to ensure that ratepayers are protected from the higher costs of capital associated with the unregulated affiliates that would become part of the Nicor-AGL merger. ICC Ex. 15.0 at 3-4. First, Staff witness Phipps explained, the JA's offer to use unspecified merger benefits to offset these increased finance costs post-merger disregards the absolute nature of the prohibition contained in Section 9-230. The People and CUB agree with this view of Section 9-230, which does not contemplate the application of any offsetting accounting mechanisms in calculating a rate of return on utility investment.

Second, Phipps notes, the JA's proposal to study the effects of the reorganization on the overall cost of service post-merger does not explain how the Commission would meet the requirement that it remove "every iota of incremental cost" due to non-utility affiliates, as required by Section 9-230 of the Act, and as interpreted by a 1996 Illinois Appellate Court decision. ICC Ex. 15.0 at 4; *Illinois Bell Telephone Co. vs. Illinois Commerce Comm'n.*, 283 Ill.App.3d 188, 669 N.E.2d 919 (2d Dist. 1996) ("*Illinois Bell*"). As Phipps testified under cross-examination, "…if every iota of that risk is not removed, then customers will pay rates that reflect something that is riskier than the utility's stand-alone utility operation." Tr. 789. The failure of the JA proposal, Phipps concludes, "…would result in an adverse rate impact on retail customers," contrary to the specific requirements of Section 7-204(b)(7).

The AG and CUB endorse the disciplined way that Staff is taking on this issue. The JAs are proposing a "balancing" approach, something not even suggested in the language of Section 9-230. The General Assembly obviously believed that monopoly ratepayers should not be saddled with *any* of the capital costs of non-utility ventures, and deemed this issue important enough to explicitly bar the practice in a specific statutory prohibition. In fact, the Court pointed out that the Commission was not permitted any discretion in this regard:

> In section 9-230, the legislature used the word "any" to modify its prohibition of considering incremental risk or increased cost of capital in determining a reasonable ROR. This usage removes all discretion from the Commission. Section 9-230 does not allow the

> Commission to consider what portion of a utility's increased risk or cost of capital caused by affiliation is “reasonable” and therefore should be born [sic] by the utility's ratepayers; the legislature has determined that any increase whatsoever must be excluded from the ROR determination. It is impermissible for the Commission to substitute its reasonableness standard for the legislature's absolute standard. It is impermissible for the Commission to substitute its reasonableness standard for the legislature's absolute standard. The Commission may not define a portion of the Act in a way that conflicts with a specific directive contained in the Act. The Commission may not define a portion of the Act in a way that conflicts with a specific directive contained in the Act. *Illinois Bell Telephone Co. v. Illinois Commerce Comm'n*, 203 Ill.App.3d at 442, 149 Ill.Dec. 148, 561 N.E.2d 426. We hold that if a utility's exposure to risk is one iota greater, or it pays one dollar more for capital because of its affiliation with an unregulated or nonutility company, the Commission must take steps to ensure that such increases do not enter in its ROR calculation.

Illinois Bell, 283 Ill.App.3d at 207.

That the Appellate Court went so far as to ban the inclusion of a single “iota” of risk reflects the well-established principle that utility rates should reflect *only* the costs of the risks associated with the regulated company providing utility service, and not the costs of non-utility corporate undertakings. Not only did the Court construe the statute in the strictest way possible, it directed the Commission to take affirmative steps to prevent the inclusion of non-utility generated capital costs in utility rates. Given its unmistakable statutory duty to ensure that no unwarranted capital risk is reflected in utility rates, the Commission must adopt a specific plan to protect ratepayers from absorbing a single dollar of these costs. Moreover, it cannot find that the merger meets the requirements of Section 7-204(b)(7) unless it directly addresses this issue.

Staff witness Phipps' proposal, offered during cross-examination, to add leverage to Nicor Gas' capital structure post merger to bring it in line with its post-merger credit rating in the utility's next rate case has merit, as it would properly treat Nicor Gas as a stand-alone company for purposes of calculating the rate of return component of rates. It would comply with the requirements of Section 9-230 and eliminate the threat to retail rates that Section 7-204(b)(7) prohibits. Unless this or a comparable methodology to implement 9-230 is adopted, the Commission cannot conclude that the proposed reorganization meets the requirements of Section 7-204(b)(7).

The record, for the reasons stated above, is devoid of evidence that will assure the Commission that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers." 220 ILCS 5/7-204(b)(7).

C. The Evidence in the Record Does Not Permit the Commission to Rule on the Allocation of any Savings the May Result from the Proposed Reorganization, As Required Under Section 7-204(c).

As noted in the Introduction of this Brief, Section 7-204(c) provides that the Commission "shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting form the proposed reorganization; and (ii) 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).

Ratepayers have an equitable right to share in the benefits of the merger because they protect Nicor Gas from business risks as a regulated monopoly, rate-of-return utility. It is an accepted principle of utility ratemaking law that capital gains inure to the party who bears the risk of capital loss. *Democratic Central Committee of D.C. v. Washington Metropolitan Area Transit Comm'n*, 485 F.2d 786, 806-807 (D.C. Cir. 1973).

In the instant case, the JAs have been consistent in their inconsistencies related to merger savings. On the one hand, they claim that the proposed reorganization will create efficiencies, noting that "(s)cale can provide many of the efficiencies and resources needed in the changing (natural gas utility) landscape." JA Ex. 1.0 at 6. On the other hand, the JAs insist that any merger savings that are likely to occur as a result of the reorganization will happen at the corporate parent level, i.e. the unregulated side of the business. Tr. at 462-463. In other words, synergies might inure between AGLR and Nicor, Inc., but Nicor Gas and its ratepayers will not specifically experience cost savings. Tr. at 461. This claim, they argue, is reliable principally because 1) of their commitment to maintain the number of gas distribution "full-time equivalent employees" at a level comparable to current numbers, and 2) because Nicor Gas "is far and away the lowest-cost provider (of natural gas delivery service) in the state of Illinois. Tr. at 461.

But here again, the record is cloudy, given the responses of witnesses during cross-examination. For example, when asked whether the JAs "expect there to be savings on the unregulated side of the business post merger," JA witness O'Connor stated, "Again, no analysis has been done to compute whether or not savings will occur on the unregulated side." Tr. at 434.

AG/CUB witness David Effron, whose professional career includes more than 25 years as a regulatory consultant and who has testified in more than 200 cases before regulatory commissions in 25 states, disputed the JAs claims that merger synergies and savings allocable to Nicor Gas are unlikely. He noted that the JAs' employee retention commitment does *not* apply to Nicor Gas administrative employees and Nicor, Inc. employees, a portion of whose salaries are allocated to Nicor Gas. *See* also, AG Cross Ex. 5, Nicor Gas' Schedule C-13 from ICC Docket 08-0363, detailing the test year allocation of affiliate company costs to the regulated utility, Nicor Gas. Should savings occur at the affiliate/corporate parent level, those savings would be allocated to Nicor Gas. He testified, too, that there can be savings in areas other than staffing, such as facilities integration, professional service, purchasing, and information technology. AG/CUB Ex. 3.0 at 4.

Mr. Effron testified that he believed the merger would result in immediate savings that can and should be quantified. For example, the JAs provided an estimate of merger related costs in their information responsive to the requirements of 220 ILCS 5/7-204(a)(3). One of the items is "Separation Costs" of $21.0 million (Update as of April 22, 2011). Such separation costs would be incurred in conjunction with a reduction to the number of administrative, management, and executive employees enabled by the merger. In response to AG Data Request 2.03, the Applicants had stated that they had not quantified the annual reduction to personnel cost that could be achieved as a result of such employee separations. However, there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs. AG/CUB Ex. 4.0 at 6.

While the burden of quantifying savings rests squarely on the JAs shoulders, Mr. Effron referenced savings quantifications produced by the joint applicants in Docket No. 06-0540 (WPS Resources Corporation, Peoples Energy Corporation, The Peoples Gas Light and Coke Company, and North Shore Gas Company) as an example of the savings that can result from transactions such as the reorganization at issue in this docket. He noted that in that case, the applicants estimated that total separation costs of approximately $22.4 million incurred in conjunction with the proposed merger in that docket would lead to annual savings of $33.8 million in personnel costs. Assuming the same ratio of annual savings to separation costs in this docket, the estimated separation costs of $21.0 million imply annual savings in personnel costs of about $31.7 million. It is also worth noting that in Docket No. 06-0540 only about 12% of the annual $33.8 million the savings in personnel costs was estimated to come from utility staffing, with the remaining 88% of savings to come from reductions to corporate staffing. (With regard to Peoples and North Shore, approximately 21% of the savings in personnel costs was estimated to come from utility staffing, with the remaining 79% from reductions to corporate staffing.) *Id.*

The JAs refuted this analogy, arguing that the proposed Reorganization is not focused on immediate synergies and savings at the utilities, but 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. JA Ex. 16.0 at 3. Mr. O'Connor specifically claimed that that merger is not relevant because it took place five years ago in a different economic climate, it did not include any commitment to maintain full time equivalent employee levels at the utility for any period of time (as the JAs have) and that JAs "have evaluated and determined that there are no quantifiable savings related to Nicor Gas from the proposed merger." JA Ex. 11.0 at 5-6.

This rationale rings hollow, however. Less than half of the forecasted savings in Docket No. 06-0540 were estimated to come from staffing reductions ($170.5 million out of total savings of $373.0 million in the first five years following the merger). Therefore, Mr. Effron rejected the notion that the commitment to maintain the number of Nicor Gas distribution full time equivalent employees at the current level means that there will be no synergies or cost savings opportunities in the period immediately following the merger. In fact, he stated that given the anticipated separation of administrative and management employees and the Applicants statements in their presentation materials regarding "achievable financial and operational benefits driven by increased scale and scope" and "savings through the elimination of duplicate public company costs," he believes that it is highly likely that completion of the merger will produce immediate savings from synergies and economies of scale. AG/CUB Ex. 3.0 at 6.

In addition, AG Cross Ex. 3. (the Memorandum of Agreement from the WPS/Peoples Energy merger) rebuts, to a large extent, Mr. O'Connor's claims that the WPS/Peoples merger lacks the critical distinction that this merger application has – a commitment to retain the regulated utility's workforce (or employee-equivalents). That cross exhibit shows (as does the Commission Order and appendix) that the applicants committed that there would be no reorganization-related layoffs or reorganization related position reductions among the UWUA Local 18007 employees, and that, in fact, the applicants would add a number of unionized positions as conditions of the merger. Tr. 374-376, AG Cross Ex. 3. Moreover, Mr. O'Connor admitted during cross-examination that he did not review any WPS/Peoples Energy merger document directly, but rather spoke to a number of attorneys and people in his department who researched the case. Tr. at 374, 376.

Employee complement guarantees aside, other opportunities for savings allocable to Nicor Gas customers abound, the record evidence shows. JA witness O'Connor, one of seven principal members of the merger JAs' Transition Committee[13], confirmed that the Joint Applicants' are looking at "how to reorganize corporate and administrative programs," a common information technology ("IT") platform. Tr. at 399-400. On the other hand, with respect to IT, the JAs claim that they "have not looked at any cost benefits arising from that consolidation." Tr. at 401. The Companies have looked at "the best way to organize (the) procurement functions." *Id.* Yet, the members of the Transition Team "have not looked at any cost benefits or costs to be incurred to organize that." *Id.* The notion of maximizing efficiencies is "a long-term goal," according to Mr. O'Connor. Yet, Mr. O'Connor hesitated to define "long-term." Tr. at 402. When asked whether the JAs are asserting that savings are not identifiable or quantifiable or whether they simply have not been identified or quantified yet, Mr. O'Connor stated that "none have been quantified to date." Tr. at 457. When pressed to indicate when the reorganized company would be able to identify and quantify those savings, Mr. O'Connor testified that "it's going to be over the long term… ." *Id.* at 458.

[13] Tr. at 402.

So, if the Company is focused on the long term what period does this represent? As it turns out, it depends on who you ask. For example, when asked to define the term, Mr. O'Connor said, "At a minimum, several years." Tr. at 445. He added that it might be appropriate to ask JA witness Lingenfelter how he defines the term. *Id.* JA witness Reese, when referencing a timetable for quantification of synergies and savings, defined "long term" as "a period greater than one year." Tr. at 548. She indicated, too, that if synergies and savings analyses were performed "immediately after the merger closed", it may be possible to identify net, short term savings. *Id.* JA witness Lingenfelter similarly defined the "long term" as "generally speaking, long term is more than a year." Tr. at 594. He added, "It could be several years."

The JAs also try to distinguish this reorganization from the WPS/PEC merger analogy provided by Mr. Effron by focusing on the long term vs. the short term. JA witness O'Connor, for example, testified that the proposed reorganization is not focused on immediate synergies and savings at the utilities, but 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. JA Ex. 16.0 at 3. But given the prior definition of long term as "more than a year" (a relatively short time), the effort to distinguish this merger from others falls flat. This ambiguous application of the definition of short term and long term in the context of the merger savings discussion also raises serious doubts about the JAs efforts to evaluate and quantify merger savings.

When the evidence is viewed as a whole, it is clear that there is a certain, troubling nonchalance in the Companies' attitude toward calculating savings that is inconsistent with the Commission's duty under Section 7-204(c) of the Act. The Commission is charged with allocating any savings resulting from the proposed reorganization, and cannot approve a reorganization without ruling on the savings issue. 220 ILCS 5/7-204(c). The JAs claim that any merger savings to be realized by Nicor Gas would occur over the long term is troubling because 1) "the long term" has multiple, vague definitions; 2) if "the long term" is simply a period greater than a year – not a long period in the regulatory world, given rate cases are sometimes filed using future test years -- the Companies should be able to come up with some sort of quantification/estimate of savings.

Moreover, when asked to provide an estimate of the long-term operational benefits that will inure to the benefit of Nicor Gas customers, *the JAs position is that review has not been performed.* Tr. at 595; AG Cross Ex. 19 (JA Response to AG 1.07). Mr. O'Connor, however, testified that "the Joint Applicants have evaluated and determined that there are not quantifiable savings related to Nicor Gas resulting from the proposed reorganization." JA Ex. 11.0 at 6. The Commission can only be left scratching its rhetorical head over that kind of contradictory double-speak. As Mr. Effron rightly notes, "It appears to be the Joint Applicants' position that because they have not presented any estimate of the savings from the reorganization, there will be no savings. This is a non-sequitur, and any claim of zero savings is not plausible." AG/CUB Ex. 4.0 at 7.

Yet, as noted above, Mr. Lingenfelter and the JAs believe "It is our view and experience that consolidation in our industry can provide benefits to utility customers." JA Ex. 1.0 at 5. This assumption, according to Mr. Lingenfelter, is because "That has been our experience in each of the transactions that we've been a part of the last decade or more." Tr. at 596. Those "transactions" were defined as AGL's acquisition of Virginia Natural Gas Company in 2000, and a New Jersey-based holding company known as NUI that owned gas utilities in three states. *Id.* When asked whether he has done any analysis (as a member of the Integration Team) to determine whether the reorganization will put Nicor Gas in a better position to manage any escalated costs that all gas utilities will be facing, he stated, "All I have is my experience in other acquisitions at AGL Resources, which confirm that that's the experience we have at AGL in an acquisition or merger." Tr. at 605. These prior mergers/acquisitions, according to Mr. Lingenfelter, are similar to the merger that is the subject of this docket "(o)nly to the extent that they are gas utility companies in the United States regulated by states." *Id.*

This conclusion, however, conflicts with the JAs position that Mr. Effron's reference to the recent WPS/Peoples Gas merger is not relevant. More importantly, that qualifier is hardly sufficient evidence for the Commission to evaluate the proposed merger under the criteria of Section 7-204(c) of the Act. Staff witness Bridal, too, agreed with Mr. Effron's point, noting that the fact that the JAs claim that they have not done any analysis to determine any areas where synergies or savings may be potentially achieved "does not appear to be consistent with what has happened in past mergers that have come before the Commission." Tr. at 745. Mr. Bridle agreed that such an analysis should be performed. Tr. at 747-748. The JAs' claim should not constitute acceptance of the position that there are no savings.

In sum, the merger should not be approved because the Commission lacks the evidence needed to rule on the allocation of any savings under Section 7-204(c) of the Act.

D. The Joint Applicants' Commitment to Maintain Nicor Gas's Full-Time Equivalent Employees Is Not Sufficient Evidence that No Merger Savings Can Be Expected in the Near Term.

As noted above, the JAs point to their commitment to maintaining the level of full-time equivalent ("FTE") employees across Nicor Gas's service territory for a period of three years as support for their claim that there will be no immediate savings experienced by Nicor Gas.[14]

[14] The number of FTEs is based on the number of FTEs at the utility as of December 31, 2010. Application at 5; JA Ex. 1.0 at 7, JA Ex. 1.1 at 75; JA Ex. 4.0 at 5.

More particularly, JAs claim this commitment is a "dual" one where they will maintain 2,070 FTEs in support of NG's business and in the state of Illinois. Tr. at 542:18-21 (Reese). The JA carefully point out that the 2,070 FTEs may not be the same for each commitment because there may be ten employees located in another state providing services to NG, while at the same time ten employees in Illinois may be providing services to AGL entities other than NG. *Id*. at 573:5-13 (Reese). As shown below, this commitment does not in itself demonstrate that no savings could be achieved immediately post-reorganization, because it allows for staffing reductions and other efficiencies to be gained, which could result in savings attributable to the utility.

The commitment regarding workforce must be examined carefully, considering it is the main source of support for the JA's claim that savings cannot be calculated and that no savings will be achieved. The JAs are very careful to distinguish, however, between the FTE employee commitment and maintaining head counts in their discussion of staffing commitments. The JAs continually claim that the integration planning process is ongoing and no specific decisions regarding resources have yet been made. AG Cross Ex. 6. Mr. O'Connor, however, acknowledged that the FTE commitment would allow the JAs to use existing resources at AGL to subsume utility-related tasks:

> Q Okay. So am I correct that -- to give an example, tasks that are currently being performed by a single Nicor Gas employee could potentially be performed -- tasks equating a 40-hour full-time equivalent employee currently being performed by a single individual could be potentially performed by two different employees, each contributing, say, 20 hours per week to those tasks?
> A That is correct.
> Q And that would add up to a 40 full-time equivalent employee under the Joint Applicants' definition; right?
> A That is correct.
> Q So hypothetically, a Nicor Gas employee position, let's say it's a manager, could be eliminated and instead, two either former AGL managers or two other Nicor Gas employees could expand their

> duties to include the tasks formally performed by that one Nicor Gas manager?
> A That's true as it relates to the AGL employee. Because the Nicor Gas employees are fully employed, it's unlikely they would be able to take on the additional responsibility you described.
> Q Okay. But it's true that a Nicor Gas manager, an individual manager, that positions could be eliminated and those tasks, those duties could be consumed by existing employees at AGL?
> A That's possible.
> Q And then those full-time equivalent hours would be charged to Nicor Gas?
> A That is correct.
> Q Or allocated to Nicor Gas?
> A Correct.

Tr. at 419-20. Simply because the JAs have not yet quantified how their strategy to more efficiently use existing resources could reduce operating costs does not mean there are no cost savings to be had.

JA witness Reese agreed that the FTE commitment cannot be construed as committing to a particular employee count: that is, it does not mean that no Nicor Gas employees will be terminated or that headcount will not decrease:

> Q And do you agree that those services may supplant some of the work that is currently being performed internally at Nicor Gas?
> A It is possible.
>
> Tr. at 541-42:21-2. Ms. Reese also testified:
>
> Q In fact, it doesn't have to be as simplistic as the example I gave where two individuals would be performing tasks of what was formerly one full-time equivalent employee. It could be ten AGLR -- or I'm sorry, AGSC -- for example, AGSC employees could be performing partially -- partial services that were once related to that single employee's functions; is that right?
> A That's true.
>
> Tr. at 543-44:16-3.
>
> She continued:

> Q -- which is just another way of saying that the commitment isn't to particular employees. It is to the equivalent work of a full-time employee?
> A That's true. And the joint applicants are committed to the level of staffing in Illinois.
> Q But that level of staffing may include reduced head count post merger at Nicor Gas, don't you agree?
> A Which may then be employed by AGS Services Company.

Tr. at 545:2-6. Thus, AGS resources could replace existing utility staff while maintaining the FTE commitment. Staff's cross-examination of Ms. Reese further demonstrates the likelihood that AGL resources subsuming utility positions would mean reduced headcount at the utility:

> Q Would you agree that if AGL folks did come in to take over Nicor Gas employees' departments, that those Nicor Gas employees would either have to be terminated or reassigned to other departments?
> A I would assume that they would have to be reassigned to other departments if their positions were taken over by somebody else, otherwise they'd have nothing to do.
> Q And if they were not to be assigned to other departments, they would be terminated; correct?
> A Subject to a review and approval by the Transition Committee, that's possible.

Tr. at 461. It is clear that the FTE commitment will allow the post-Reorganization utility to reduce its operating costs by reallocating resources and utilizing AGL Services to perform work.

The FTE commitment in effect amounts to a sophisticated shell game whereby the JAs make it appear staffing will remain stagnant when it is quite possible that staffing reductions will occur. The clear distinction between FTEs and headcount is deliberate and will allow the JAs to reduce operating costs – at the very least with regard to elimination of certain personnel and the associated overhead costs. Ms. Reese testified that, under the JAs' staffing commitment of 2,070 FTEs being maintained for Nicor Gas operations, the FTE commitment could be provided by employees of either Nicor Gas or AGL Services Company. Tr. at 576:7-12. Ms. Reese further agreed that it is possible that there may be reduced overhead personnel costs associated with a reduced number of Nicor Gas employees contributing to the FTE commitment. *Id*. at 576:13-19.

In fact, the JAs are actively evaluating staffing decisions. One of the reasons cited by JA in support of its position that savings have not, yet, been quantified was because the integration plan has not been completed. See AG Cross Ex. 6 (JA DRR to AG 1.04). Mr. O'Connor testified that integration activity "is looking at the best way to organize the company by function. To date, the integration activities have not looked at specific individuals, numbers of individuals, or positions of those individuals within the new company." Tr. at 398-99:18-2. Although the JA steadfastly insist that no staffing decisions have been made, the process to determine how personnel will be utilized post-reorganization – with the obvious goal of running the various operations most efficiently – continues to progress. This process will ultimately lead to staffing decisions, including possible staffing reductions.

JA produced in discovery many presentations that were made to the Integration Team and the Executive team during the course of the last 8 months or so. One of those documents, titled "Executive Session April 7" discusses the "People Impact Strategy," which addresses post-reorganization staffing decisions. JA Ex. 21.0 (Staff 1.01 Ex. 4, Attach. F). The JA hired an outside consulting firm – Javelin HR – which will work "with the Transition Committee to facilitate an objective process to select the talent for the AGL Resources post Reorganization." CUB Cross Ex. 3 (JA DRR to Staff 1.04). The following statements suggest this process will include more efficient use of personnel resources, including elimination of certain personnel:

- BEGIN CONFIDENTIAL XXXXXXX XXXXXXXX XXXXXX XXXXXXX XXXX XXXXXXXX END CONFIDENTIAL
- BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL *Id.*
- BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL *Id.*

- BEGIN CONFIDENTIAL XXXXXXXXXXXXXXXXXX END CONFIDENTIAL

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- BEGIN CONFIDENTIAL XXXXXXXXXXX
  - XXXXXXXXXX
  - XXXXXXXXXX
  - XXXXXXXXXX END CONFIDENTIAL

JA Ex. 21.0 (Staff 1.01 Ex. 5, Attach. L, NRE 006120).

Mr. Lingenfelter testified that the post-Reorganization company may potentially move certain services currently provided by Nicor Gas personnel to the AGL Services Company, which is the arrangement currently used by AGL for its call service centers. Tr. at 569. The rationale for the post-Reorganization company to move services from utility personnel to the services company is because of operational efficiencies ("the reason it would be done is because you would be more efficient to be able to provide that service across a larger base of utilities. So you'd move those employees and the services up to the Services Company rather than have it as a direct cost of Nicor Gas." Tr. at 570.). Yet, the JA continue to maintain that the operational efficiencies that will result from combining operations, utilizing best practices and achieving economies of scale and scope will not lead to cost savings attributable to the utility.

As noted above, Mr. O'Connor claims that the JA have done no analysis to determine whether savings could be achieved by the reorganization, and do not expect savings to materialize in the short-term. He provided two reasons in support of savings being unlikely: 1) "The FTE commitment to maintain the equivalent amount of time at the company;" and 2) "Nicor Gas is far and away the lowest-cost provider in the state of Illinois. There just isn't space in the cost structure of Nicor Gas to -- to achieve any savings, any meaningful savings." Tr. at

461. If the JA could use existing AGL resources to perform utility functions and eliminate utility personnel, however, not only would this achieve direct payroll savings, but also all the associated overhead personnel costs, as Ms. Reese agreed. Tr. at 576.

The Joint Applicants' commitment to maintain Nicor Gas's Full-Time Equivalent employees simply is not credible evidence that no merger savings will occur at the regulated utility level.

E. The Evidence in Prior Merger Dockets Before the ICC Supports the AG/CUB Position That the Joint Applicants' Failure to Estimate Merger Savings is Inconsistent with Prior Merger Applications.

The notion that savings are either not probably for the regulated utility nor identifiable at this point, should they arise, is not credible. As noted above, this intransigence is not consistent with other merger applicants' testimony before the Commission based upon a survey of merger cases that have come before the Commission since Section 7-204(c) became law.

In the 1999 merger between SBC Communications, Inc, Ameritech Corporation and Illinois Bell Telephone Company, the petitioners specifically quantified a savings amount that they estimated would be achieved as a result of the reorganization. In that instance, the petitioners, who opposed passing savings on to its customers, nevertheless provided specific savings numbers to the Commission, as noted in the Commission's Order:

> Were the Commission to order a savings flow through based upon this estimate via a one time rate credit, the $31 million would have to be grossed up for taxes by a factor of 1.7. The resultant figure ($52.7 million) represents 100% of the present value of the pretax merger net savings.

1999 WL 1331303, Order of September 23, 1999. In evaluating the allocation of savings under Section 7-204(c), the Commission held:

> To be specific, Ameritech Illinois is required to track its share of all actual merger-related savings and all merger-related costs, as herein defined, separately for the period beginning on the date that

> the merger is consummated and ending on March 15, 2000. AI shall submit that information as part of its annual Alt. Reg. filing on April 1, 2000. Furthermore, this information will continue to be provided in Ameritech's annual price cap filings until such time as an updated price cap formula has been developed in Docket 98-0252. In the annual price cap filings, AI is required to flow-through merger savings net of reasonable costs in the manner here described until such time as an updated price cap formula has been developed.

Order of September 23, 1999 at 91-92.

In the 1999 merger involving GTE and Verizon Communications, Inc., the petitioners claimed that the merged company as a whole will realize $2 billion in expense savings three years after the merger. Applicants also estimated that the merger transaction costs and merger implementation costs will total $1.8 billion. Re GTE Corporation, Bell Atlantic Corporation, 198 P.U.R.4th 193 (Order of October 24, 1999). In that docket, the Commission approved the merger subject to a number of conditions, including:

> • GTE will reduce rates by $10.3 million upon merger consummation to account for earnings and merger savings, with the reduction achieved by reducing residential and local usage rates by $6.6 million, non-cost based access charges by $1.74 million, and intraLATA toll rates by $1.68 million;
>
> • GTE will file for a general rate case some three years after merger closure, allowing the commission the opportunity to fully allocate actual, realized merger costs and savings;
>
> • prior to that general rate case filing, GTE will not apply for an increase in local residential and business service rates or local usage rates for non-competitive residential and business accounts (except as required for commission-ordered Universal Service Fund modifications);
>
> • the merged entity will aggressively compete to provide local service to Chicago's residential and small and medium business customers, thus offering substantial head-to-head competition with Ameritech, the dominant LEC in the Chicago market;
>
> • the merged entity will spend a minimum of $270 million in infrastructure capital investment in Illinois over the next three years, exclusive of additional investment the post-merger entity will be making to support entry in the Chicago market;
>
> • the merged entity will maintain offices in Illinois with a level of staff to ensure

compliance with all commission rules; and

• the merged entity will not interfere with commission-approved interconnection agreements with competing local exchange carriers.

Id. at 1.

In ICC Docket No. 00-0476, a proposed reorganization among Illinois-American Water Company, Citizens Utilities Company of Illinois and Citizens Lake Water Company, the petitioners were likewise able to provide specific, quantifiable estimates of savings to be achieved at both the corporate and regulated utility level:

> Illinois-American estimates that savings resulting from the Acquisition will be approximately $447.7 million over the 40-year period, with a present value of approximately $80 million. The estimated savings consist of operations and maintenance (O&M) labor ($101,978,506), chemicals ($207,093), management fees ($140,527,382), group insurance ($23,052,721), pensions ($8,004,818), regulatory expense ($10,850,579), other insurance ($2,777,004), customer accounting ($1,003,158), miscellaneous expense ($8,251,156), maintenance expense (-$5,872,447), depreciation ($45,276,778), general tax ($14,095,145), and capital investment ($97,567,000). (IAWC Ex. 3.1R)

<u>Illinois-American Water Company, Citizens Utilities Company of Illinois and Citizens Lake Water Company – Petition for Approval of Proposed Reorganization,</u> ICC Docket No. 00-00476, Order of May 15, 2011. In this instance, the Commission concluded:

> The Commission believes that a fair treatment in this case of the savings attributable solely to the Acquisition is a 50/50 sharing between shareholders and ratepayers. The Commission shares the concerns expressed by Staff and IIWC regarding the difficulty in measuring Acquisition savings. Illinois-American has not presented a specific methodology for quantifying Acquisition savings. The Commission believes that it would be unworkable to litigate the appropriate quantification methodology in the next rate proceeding. Therefore, Illinois-American is required to file, within 90 days of the date of the Order in this proceeding, a petition seeking approval of a specific methodology for quantifying Acquisition savings. The Commission also believes that the level of precision in quantifying savings declines as time progresses.

> Therefore, the Commission concludes that to the extent a methodology for quantifying Acquisition savings is approved in the proceeding discussed immediately above, the revenue requirement will be allowed to be increased to account for 50% of the demonstrated Acquisition savings only in rate cases filed within three years of the date of this Order.

Id. at 39. Here, the Commission took action to ensure that the savings and costs were properly quantified, for the benefit of ratepayers as well as shareholders, rather than waiting for the next rate proceeding.

In ICC Docket No. 04-0294, merger petitioners Illinois Power Company and Ameren Corporation likewise specifically identified savings that the companies anticipated would occur. For example, Ameren assessed the effect of the transaction on rates by comparing IP's 2007 revenue requirements under two scenarios: Dynegy ownership and Ameren ownership. There were four key differences between the two scenarios: under Ameren ownership, (i) rate base was greater due to the effect of the transaction on accumulated deferred income taxes ("ADIT"), (ii) non-fuel O&M was lower due to Ameren's forecast of synergies that the Reorganization will produce, (iii) the Ameren ownership scenario reflected amortization of the regulatory asset, and (iv) purchased power and gas costs were lower due to Ameren's forecast of savings of 1.5% that would be realized through greater combined purchasing power (“bulk purchases”) and savings of 4.7% due to Ameren's calculation of lower costs arising from IP's improved credit rating under Ameren ownership. The analysis showed that, overall, IP's 2007 revenue requirements would be lower under Ameren ownership than under Dynegy ownership.

> The Commission finds that Ameren, AG, and CUB have agreed that, with the conditions agreed to by Ameren, including Conditions 19 through 25 on Appendix A to this Order, the record supports a conclusion that the Reorganization is not likely to result in any adverse rate impacts for retail customers. No other party has disputed this conclusion. While there was some disagreement in the record as to the specific amounts of savings that IP will achieve

> after closing, Ameren has agreed to measures to assure that IP is taking adequate steps to produce savings and to impose quantifiable measures to insure that rates are not increased if savings fail to materialize. Further, Ameren has agreed to cost mitigation in the form of a residential RTP program, which, the record indicates, should reduce costs not only for program participants, but for non-participants as well. Accordingly, based on the terms of the MoA, Applicants' Exhibit 47.0, and Attachment B thereto, including the commitments made by and the conditions agreed to by Applicants therein, and taking into account other information in the record as necessary, the Commission finds that the proposed Reorganization is not likely to result in any adverse rate impacts on retail customers.

Order of September 22, 2004 at 22. Here, a Memorandum of Agreement was reached among the parties to ensure rates would not increase, along with other agreed upon conditions.

In the WPS/Peoples reorganization case (Docket No. 06-0540) cited by Mr. Effron, the Applicants go into great detail regarding "savings resulting from the reorganization," as documented in the Commission's Final Order in that docket:

> In their Application, Applicants state that the Reorganization was estimated to produce synergy cost savings of approximately $177 million across the combined companies' regulated businesses through 2011, and that by using standard allocation methods, approximately $77 million of these savings would be allocated to the Gas Companies over the five years after closing. Applicants stated that these allocated savings would have the effect of reducing the Gas Companies' costs, revenue requirements and rates. Applicants also stated that in addition to the stock exchange premium that would be paid by WPS Resources to PEC shareholders, the estimated total cost to the combined company of accomplishing the Reorganization and achieving the synergies and costs savings would be approximately $186 million, of which about $178 million would be allocable between regulated and non-regulated subsidiaries….
>
> Applicants' witness Thomas J. Flaherty, Senior Vice President with Booz Allen Hamilton Inc., presented testimony and exhibits to show the development of the estimated Merger-related synergy savings and costs to achieve and the allocation of savings and costs to the Gas Companies. Applicants' Exs. TJF-1.0 - 1.6. He identified and provided estimates of savings over the first five

> years after closing in the following categories: Staffing (Corporate and Utility); Corporate and Administrative Programs (Administrative & General Overhead, Benefits, Credit Facilities, Directors' Fees, Facilities, Insurance, Inventory, Professional Services, Regulatory Affairs, Shareholder Services and Transportation); Information Technology (Capital and O&M); Supply Chain (Contract Services and Materials & Supplies Purchases); and Fuel (Gas Supply). He explained the sources of savings projected to be achieved in each of these categories and described the methodologies used by the Applicants to estimate the projected…06-0540; WPS Resources Corporation, PE Reorganization…

Order of February 7, 2007 at 44-45. In the end, a Memorandum of Agreement ("MOA") was entered among the parties to the docket. Among the provisions included in the settlement was a condition that Peoples Gas and North Shore would recognize in a planned 2007 rate case, using a historical test year ending September 30, 2006, known and measureable changes for merger-related synergy savings of $11,445,000 for PGL and $1,633,000. *See* Appendix to Order. As noted earlier, too, a specific commitment to retain and increase union personnel was also a part of the MOA.

In only one instance over the past 13 years has the Commission deemed satisfactory generic, non-quantified statements about potential savings from the merger applicants, when approving a merger. In ICC Docket No. 09-0268, merger applicants, Frontier Communications, Corporation, Verizon Communications Inc., Verizon North, Verizon South and New Communications of the Carolinas, Inc. claimed that the acquiring company, Frontier, "intends to expand broadband availability over time, and any direction by the Commission requiring Frontier to redirect savings elsewhere would detract from broadband investment in Illinois." Order of April 21, 2010. Frontier testified that while they believed there may be future synergies and resulting savings in the future, estimating savings on an Illinois-specific basis have not been determined, would be speculative and that "any such savings will likely be offset by expenses incurred to achieve them and associated with upgrading the network facilities to be acquired." *Id.*

While the Commission declined to reject the merger based on these vague savings assessments, the Commission conditioned the approval of the merger on several requirements including specific investment levels in the Illinois local exchange networks at issue, a specific, closely monitored requirement that broadband investment be stepped up such that by December 31, 2013, 85% of the households within the service territory of the New Frontier Illinois ILECs are able to access broadband service provided by Frontier at speeds of up to 3.0Mbps download speed, a waiver of certain change fees and a three-year rate cap on non-competitive service rates, among other provisions. *See* ICC Docket No. 09-0268, Appendix at 1-11.

Arguably, the Commission's interest in increasing the level of broadband investment and improving service quality deemed insufficient by Staff in these central Illinois exchanges guided the Commission's hand in its approval of the merger. Those circumstances do not apply in the instant case. No promises, for example, to accelerate main replacement, improve leak repair rates are a part of this record. The notion that ratepayers (and the Commission) should be satisfied with vague promises to reflect unnamed savings of any sort in the regulated cost of service in future rate proceedings conflicts with the requirement in 7-204(c).

In sum, the JAs position that there are no quantifiable merger savings – at either the corporate parent level or the regulated utility level -- or that they have yet to be quantified because of the integration planning process, is inconsistent with the majority of previously filed applications for merger that have been presented to the Commission over the last decade or more.

F. Evidence that Nicor Gas (CONFIDENTIAL) Should Give the Commission Pause About Accepting the Joint Applicants' Assertion that Any Savings Achieved Will Be Flowed Through to Ratepayers.

As noted above, AG/CUB witness Effron testified that the proposed reorganization would most likely result in savings. Effron further demonstrated in his rebuttal testimony, that when those savings are added to Nicor's current earnings and to its expected earnings in the near future, BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL. AG/CUB Ex. 4.0 (Confidential) at 3-4. The JAs have responded by suggesting that its commitment to maintain the number of gas distribution full-time equivalent employees at a level comparable to the current level preclude the possibility of any immediate savings and therefore also preclude any savings in Nicor Gas's distribution operations that can be passed on to ratepayers. Additionally, the JAs have represented, both in testimony and through responses to discovery, that they have not specifically identified any other potential savings from this merger. AG/CUB Ex. 3.0 at 4.

Needless to say, the JAs failure to quantify any merger savings whatsoever leaves the Commission without the statutorily-required basis upon which to approve the transaction. In addition to the representations that ratepayers are not due to receive any immediate financial benefits from this merger, Nicor Gas's own data shows that the utility is presently earning more than its authorized return. As Effron testified, the company is projecting net income of BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL in 2011, and BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL in 2012. AG/Cub Ex. 4.0 (Confidential) at 2. Given a forecasted common equity balance of approximately BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL for those years, the resulting returns on equity – which Nicor witness O'Connor does not dispute[15] -- is approximately BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFI DENTIAL in 2011 and BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL in 2012, compared to the Company's authorized return on equity of BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL . AG/CUB Ex. 4.0 (Confidential) at 2-4. Specifically, as can be seen on Schedule DJE-2, when Nicor's forecasts are updated to incorporate the effect of known tax law changes, BEGIN CONFIDENTIAL XXXXXXXXXXX END CONFIDENTIAL. AG/CUB Ex. 4.0 (Confidential) at 4; AG/CUB Ex. 4.0, Schedule DJE-2 (Confidential).

Mr. O'Connor claims that the utility's prospects for growth in revenue opportunities are limited because of the "substantial amount of conservation and energy efficiency underway in Illinois" and an uncertain customer growth rate. Tr. at 465: 10-22. However, at least with respect to energy efficiency efforts of its customers, Mr. O'Connor acknowledged on cross-examination that Nicor Gas's current rate design allows it to recover 80% of its fixed charges through the fixed customer charge. Tr. at 477:7-12. He further admitted that this rate design lowers the utility's exposure to throughput variation resulting from reduced usage due to conservation/energy efficiency. *Id*. at 477:4-6. Mr. O'Connor claimed that customer growth "eroded" in the economic environment of 2008-2009 from the average 30,000 customer per year in the mid-1990's through 2007, but did not quantify the extent of the alleged erosion and acknowledged that it was "starting to come back." Tr. at 465:17-22. He did not claim to know what customer growth would likely be in the near future ("So we're not sure whether that'll be 5,000 a year or 10,000 a year or zero going forward.") Thus, the purported support for reduced revenues resulting from increased conservation and decreased customer counts are unsubstantiated on this record.

[15] Tr. 449.

Mr. O'Connor testified that those "net savings, net of costs to achieve those savings, could be used to delay the filing of a subsequent rate case on behalf of the gas company, or should there be a rate case, those net savings would reduce the request for any rate increase that would be filed by Nicor Gas." Tr. at 461-2. This testimony stands in contrast to the JA commitment to flow through all savings resulting from the reorganization to the benefit of customers in a future rate case, with any costs associated with accomplishing the reorganization for a period of 5 years, if the JA initiate the rate proceeding. JA Ex. 13.0 at 16:342-354.[16]

The JAs claims that that no merger savings are anticipated for the regulated utility, and that if any savings occur, they will be flowed through to ratepayers in the next rate case should the JAs initiate a proceeding, leaves Nicor Gas ratepayers in a "heads-I-win/tails-you-lose" quandary. On the one hand, evidence (CONFIDENTIAL) supports the assumption that Nicor Gas will not be filing a rate case any time soon. And if the JAS are wrong, and savings *are* achieved post-reorganization, ratepayers will be denied the benefit of the savings for the foreseeable future.

These facts point to the unfairness and inequity of trusting the JAs when they say merger savings for the regulated utility are either non-quantifiable or are "long term" in nature, and approving a merger without the evidence needed to fairly and truly rule on the allocation of any merger-related savings.

These arguments, and the merger, should be rejected, pursuant to Section 7-204(c) of the Act.

[16] If, however, a rate proceeding was initiated by any other entity, JA want the opportunity to recover the costs to achieve ("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.") *Id.*

G. F. Merger-related Costs Should Not Be Recovered From Ratepayers.

In addition to requiring a Commission finding regarding the allocation of merger-related savings, Section 7-204(b)(7) of the Act provides that the Commission shall not approve a reorganization without ruling on "...(ii) 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).

Two of the categories of merger-related costs are "transaction costs" (fees to financial advisors) and "change in control costs" (payments to executives terminated in conjunction with a change in control). Both of these categories of costs are associated with the change in ownership of Nicor, Inc. and do not relate to the operations of Nicor Gas. These costs should not be recoverable from Nicor Gas ratepayers in any circumstances. AG/CUB Exhibit 3.0 at 10.
At present $125 million of such reorganization costs have been identified and should not be recoverable. AG/CUB Exhibit 3.0 at 10; Staff Exhibit 13.0 at 3-12. Mr. Bridle also concluded that none of the approximately $125 million in reorganization costs identified to date[17] by the JAs, as well as any additional merger-related costs that might occur post reorganization, should be recovered through Illinois regulated jurisdictional rates. Tr. at 752.

Concurring with Mr. Effron Mr. Bridal states:

> I do agree with Mr. Effron that 'transaction costs' and 'change in control costs' should not be recoverable from ratepayers because they are associated with the change in ownership of Nicor, Inc. and do not relate to the operations of the utility.

ICC Staff Exhibit 13.0 at 3.

Additionally, Mr. Bridal testified that the types of costs not recoverable would include additional transaction costs or any additional change in control costs, any additional separation costs related to accomplishing the reorganization [that] occur after the

[17] *See* Staff Group Ex. 2, JA Supplemental Response to RWB 3.01

reorganization. Tr. at 758. He further testified that, should the Commission approve the merger, language should be included that would disallow any additional transaction costs or merger-related costs identified after the merger is completed. *Id.*

Mr. Effron further noted that in ICC Docket 06-0540, the applicants did not seek to recover transaction costs and change in control costs from ratepayers. AG/CUB Ex. 3.0 at 10. Mr. Bridal provides a succinct chronology of cases (in addition to the WPS/Peoples Gas merger citation) of Commission decisions that support Mr. Effron's rational that "transactional costs" and "change in control costs," along with any other reorganization costs not related to the operation of a utility, is consistent with the Commission's treatment of similar costs. *See* ICC Staff Exhibit 13.0 at 4-6.

Among the Orders provided was the Commission's ruling in <u>SBC Communications, Inc., SBC Delaware Inc., Ameritech Corporation, Illinois Bell Telephone Company</u>, ICC Docket No. 98-0555, the Commission specifically clarified its September 23, 1999 ruling on the merger of SBC and Ameritech that no merger-related transactional costs should be recovered in utility customer rates:

> As for the meaning of 'costs,' the Commission agrees with Staff that none of the merger 'transactional costs' shall constitute legitimate costs for present purposes. 'Transactional costs' shall be defined as those costs and expenses incurred in connection with the merger transaction and shall include but not be limited to fees and expenses of financial advisors and consultants and lawyers; filing fees; proxy costs; the costs of securing regulatory approval of the transaction; employee retention payments; employee change in control payments; employee severance costs; employee relocation costs; the costs of third party auditing or technical assistance necessary to comply with the conditions imposed by the Commission in this Order; the administrative costs associated with the Consumer Education and Community Education funds; and the costs of penalties should conditions and benchmarks imposed by the Commission in this Order not be met. It is only these costs directly associated with AI's provision of service which qualify under Section 7-204(c).

1999 WL 1334698, Amendatory Order on Rehearing at 7 (November 15, 1999).

In addition, should a merger be approved and non-transactional and non-change of control costs be eventually recovered along with identified savings, Mr. Effron testified that the amortization period of the recoverable transition costs should be longer than five years, as requested by the JAs. A proper matching of costs and benefits would mean that the costs should be amortized over the same period that the expected benefits will be realized. The merger benefits will be realized in perpetuity (or "long term"), and spreading the amortization over eternity is the same as no amortization at all. Given the extended period over which merger benefits are expected to be realized, Mr. Effron recommends an amortization period of at least ten years. In addition, as the transition costs are incurred, the Applicants will begin to realize any savings made possible by those costs. Therefore, the amortization of the recoverable transition costs should begin as they are incurred.

III. CONCLUSION

Wherefore, the People of the State of Illinois and the Citizens Utility Board respectfully request that the Commission enter an Order consistent with the recommendations made in this Brief.

Respectfully submitted,

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