

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)
Public Utilities Act.)

PUBLIC
REPLY BRIEF OF STAFF OF THE
ILLINOIS COMMERCE COMMISSION

(Confidential Marked By Gray Highlight)

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NOW COMES Staff (“Staff”) of the Illinois Commerce Commission (“Commission”), by and through its undersigned counsel, pursuant to Section 200.800 of the Commission’s Rules of Practice (83 Ill. Adm. Code 200.800), and respectfully submits its Reply Brief in the instant proceeding.

I. INTRODUCTION

In addition to Staff and AGL Resources Inc. (“AGL”), Nicor Inc. (“Nicor”), and Northern Illinois Gas Company d/b/a Nicor Gas Company (“Nicor Gas”) (collectively, “Joint Applicants”), the following parties submitted Initial Briefs in this matter: the People of the State of Illinois, through Lisa Madigan, Attorney General of the State of Illinois, (“AG”) and the Citizens Utility Board (“CUB”) (collectively, “AG/CUB”), and Local Unions 19, 117, 134, 150, 176, 364, 461, 701, International Brotherhood of Electrical Workers (“Unions”).

Many issues have been resolved between the Joint Applicants and Staff as indicated by the Status Report which was filed by the Joint Applicants on July 13, 2011. Staff’s Initial Brief gave a summary of these resolved issues and they will not be

repeated here. Aside from issues addressed in this Reply Brief and the Agreed Stipulation Between Joint Applicants and Staff filed on August 24, 2011, Staff stands by its positions articulated in its Initial Brief. Failure to address a specific issue in this Reply Brief does not constitute a change of position from Staff's Initial Brief. For the reasons stated below, Staff's recommendations should be adopted by the Commission.

II. Sections 7-204(c)(i) and (c)(ii)

A. Staff Position

In its Initial Brief, Staff argued in favor of its recommendations regarding Section 7-204(c) of the Act. Staff's recommendations are that (a) all savings resulting from the proposed reorganization shall be flowed through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission (Section 7-204(c)(i) of the Act); and (b) any costs incurred in accomplishing the proposed reorganization in this or any future proceeding shall not be recoverable through Illinois jurisdictional regulated rates (Section 7-204(c)(ii) of the Act). (Staff IB, p. 33) Without restating its arguments set forth in its Initial Brief, Staff affirms its recommendations here.

On August 24, 2011, Staff and the Joint Applicants entered into an Agreed Stipulation ("Stipulation")¹ regarding Section 7-204(c) issues only, wherein the Joint Applicants accept Staff's recommendations on the allocation of savings resulting from the proposed reorganization (Section 7-204(c)(i)), and the recoverability of costs incurred in accomplishing the proposed reorganization (Section 7-204(c)(ii)). (Staff RB, Attachment A, Item 2.) Also part of the stipulation is a requirement that Nicor Gas shall

¹ Please see Staff RB, Attachment A, for a copy of the executed Stipulation

not be allowed to increase distribution rates for a period of three years from the completion of the proposed merger. (Staff RB, Attachment A, Item 4.)

If adopted by the Commission, the agreements reached in the Stipulation provide a period of rate certainty for customers for three years following the completion of the reorganization. The agreements also allow time for savings related to the proposed reorganization to materialize and be reflected in the costs associated with the regulated intrastate operations used by the Commission for setting rates in future rate proceedings. Staff recommends that the Commission adopt the Stipulation in its entirety.

B. Response to Joint Applicants

Staff will not respond to the portion of the Joint Applicants' initial brief regarding Section 7-204(c). As noted above, the Joint Applicants and Staff have reached an agreement regarding the resolution of Section 7-204(c) requirements. As such, there are no remaining contested issues between Staff and the Joint Applicants regarding Section 7-204(c) of the Act.

C. Response to AG/CUB

In their initial brief, AG/CUB argued that the Joint Applicants failed to provide sufficient evidence to allow the Commission to make the statutorily-required rulings regarding the allocation of any savings resulting from the proposed reorganization. AG/CUB observed that the Joint Applicants have been inconsistent in their testimony regarding savings. (AG/CUB IB, pp. 20-21) Further, AG/CUB claimed that the Commission should not "be satisfied with vague promises to reflect unnamed savings of any sort in the regulated cost of service in future rate proceedings," stating that the

Commission has only once in the 13 years (since Section 7-204(c) of the Act became law) accepted “generic, non-quantified statements about potential savings.” (AG/CUB IB, pp. 33-34) In conclusion, AG/CUB claimed the Joint Applicants “failure to quantify any merger savings whatsoever leaves the Commission without the statutorily-required basis upon which to approve the transaction.” (AG/CUB IB, p. 35)

Staff shares the AG/CUB concern that the Joint Applicants have not presented any evidence of completed analyses or studies which identify or quantify actual synergies and cost savings resulting from the proposed reorganization. If the Joint Applicants had presented such evidence, as several previous petitioners have, the Commission’s required ruling on the allocation of any savings would be more palpable. While the plain language of Section 7-204(c)(i) of the Act may not require the quantification of savings, this does not mean that the Commission cannot or should not call for quantification of savings if it determines such quantification is necessary (e.g., in determination of the appropriate allocation of those savings.) However, in the immediate proceeding, no quantification is necessary. In Staff’s view, an order which finds that all savings shall flow through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission will fully address these concerns.

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

The Joint Applicants have failed to demonstrate that the proposed reorganization will not diminish [Nicor Gas]’ ability to provide adequate, reliable, efficient, safe and least cost public utility service...” (220 ILCS 5/7-204(b)(1)) All that the Joint Applicants offered in this regard was the conclusory statements about AGL Resources’ “track

record” and intentions in their Petition and testimony.² Despite repeated requests from Staff, the Joint Applicants never provided substantive evidence demonstrating that AGL was familiar with Nicor Gas operations or how AGL would conduct operations. (See Staff IB, p. 7) The Joint Applicants’ argument that Mr. Maple’s testimony was “based on an unfounded and unreasonable set of assumptions regarding how he believes AGL should have conducted its examination of Nicor Gas’ operations” (JA IB, p. 16), ignores the principled position taken by Mr. Maple in favor of creating a side issue about the due diligence report. It was very clear both from discovery and starting at page 2 of Mr. Maple’s testimony that he was conducting an analysis to determine whether the reorganization would affect Nicor Gas’ ability to provide adequate, reliable, efficient, safe and least cost public service. (See Staff Ex. 11.0R, p. 2 *et seq.*) Mr. Maple, a gas engineer, reviewed “the information AGL provided about its review of Nicor’s assets and operations and its attempts to familiarize itself with them.” (*Id.*, p. 3) He clearly stated that the Joint Applicants had provided insufficient information for him to form an opinion as to whether the reorganization would affect Nicor Gas’ provision of utility service. (*Id.*)

A. Nicor Gas Operations

Contrary to the Joint Applicants’ arguments (JA IB, pp. 16, 17), there never was any shift in focus by Mr. Maple. This argument blatantly ignores large portions of Mr. Maple’s direct and rebuttal testimony. Throughout this proceeding the Joint Applicants

² See for example, “AGL Resources has a track record ... of its regulated subsidiaries and operating themn reliably, efficiently, and safely. Under AGL Resources’ ownership, Nicor Gas will continue to provide adequate, reliable, efficient, safe, and least-cost public utility service” (JA Petition, ¶ 13, p. 7); “... we expect our Nicor Gas customers to receive the same service they are currently enjoying.” JA Ex. 1.0, p. 7, ll. 149-150); “The reorganization will be seamless for Nicor Gas customers.” JA Ex. 2.0, p. 8, l. 134)

have refused to provide substantive evidence in response to Staff's concerns. Rather than providing substantive evidence about the future operations of Nicor Gas, the Joint Applicants responded to Staff's concern in their rebuttal testimony by advocating that the Commission should make this determine based upon (1) an assessment of the acquirer, AGL, touting its operating history and previous integrations; (2) their commitments related to staffing of Nicor Gas operations subsequent to the reorganization; and (3) only one reference to actual operations; their reliance on the fact that Nicor Gas is the low cost provider of gas distribution service in Illinois today. (See JA Ex. 8.0, pp. 5-6)

Staff responded by again emphasizing that its "analysis is focused on the Nicor Gas operations, in particular whether AGL will be able to operate the system without any diminution in service quality." (Staff Ex. 17.0, p. 4) Staff acknowledged the Joint Applicants' staffing commitments, but stated "I do not understand this to be a commitment to maintain the identical employees or practices and it does not address concerns about the plant and operations." (*Id.*) Mr. Maple also found no solace in Nicor Gas' history of being the low-cost gas provider, stating that he did not disagree, but that does "nothing to satisfy the inquiry as to whether the reorganization will diminish service.... It begs the question, 'what do they plan,' but I have not seen an answer to that question." (*Id.*, pp. 5-6)

From the very beginning, Mr. Maple's position has been that the Joint Applicants must prove to the Commission that they meet the requirements of Section 7-204(b)(1) of the Act, which says the merger must not diminish the utility's ability to provide adequate, reliable, efficient, safe, and least-cost service. Joint Applicants have been

equally consistent. They continue to insist on relying on the history of the AGL or Nicor Gas operations; “AGL has successfully operated a natural gas distribution utility for more than a century...” (JA IB, p. 18); “Nicor Gas customers have had the lowest gas distribution rates of any major gas utility in Illinois for many years.” (*Id.*, p. 14) While Joint Applicants argue that the Section 7-204(b)(1) analysis is forward-looking (*Id.*, p. 17), they have failed to provide any forward looking facts upon which Staff could base its analysis.

Rather than responding to Staff’s concerns about Nicor Gas operations post-merger, the Joint Applicants mischaracterize Mr. Maple’s testimony about the due diligence report. They claim he “asserted that AGL did not provide sufficient proof that it conducted adequate due diligence *before* entering into a \$3 billion transaction with Nicor Inc.” (JA IB, p. 19, emphasis in original) The Brief goes on to claim, “...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.” (*Id.*) Again, the Joint Applicants’ due diligence arguments are simply an attempt to draw attention away from the fact that the Joint Applicants have not satisfied the requirements of the Act. It is clear from Mr. Maple’s testimony that his focus was not on the due diligence reports for their own sake. Mr. Maple actually stated that he “examined the due diligence reviews to determine the level of familiarity AGL has with how Nicor Gas operates... The absence of a detailed due diligence report reflects a failure by AGL to conduct a complete analysis of Nicor Gas.” (Staff Ex. 11.0R, pp. 5-6)

The Joint Applicants use the due diligence argument to portray Mr. Maple as someone who has no experience with the issues to which he is testifying. On the contrary, Mr. Maple is well qualified to offer an expert opinion on whether the Joint Applicants have demonstrated that the operation requirements of Section 7-204(b)(1) have been met. Mr. Maple has a bachelor's degree in mechanical engineering and a master's degree in business administration (Staff Ex. 11.0R, p. 1) – both of which are very relevant to the issues at hand. In addition, Mr. Maple also has over 13 years of experience at the Commission, where he has testified in dozens of cases involving complex business arrangements, project planning, evaluation of utility operations, rate cases, and even mergers, among other topics. (*Id.*, pp. 1-2) In this proceeding, Mr. Maple attempted to review very specific areas of operation, such as the way the Joint Applicants would operate the utility, the way they would purchase gas, and the way they would operate the storage fields. These are the same issues that Mr. Maple has repeatedly testified about during his 13 year career at the ICC. (Tr., July 20, 2001, p. 834) Clearly, Mr. Maple has the knowledge and experience necessary to determine whether the merger will diminish the utility's ability to provide adequate, reliable, efficient, safe, and least-cost service.

B. Integration Planning

Mr. Maple's attempt to review the operations of the merged utility *going forward* is reported in his "Integration Planning" testimony. (Staff Ex. 11.0R, pp. 10-14) The testimony indicates that the Joint Applicants failed to provide any meaningful evidence about how they intend to buy gas, operate the storage fields, perform maintenance, procure supplies, or any other critical operational details post-reorganization. The Joint

Applicants' response to this testimony is dismissive: "...Mr. Maple's claims about our integration planning process miss the point I am confident the integration process will yield an organization and processes that will serve our customers well following the Reorganization." (JA Ex. 8.0, pp. 6-7)

The Joint Applicants again mischaracterize the record when they state "...Mr. Maple also claims that AGL failed to present sufficient information regarding integration planning activities." (JA IB, p. 19) The Joint Applicants cite to Mr. Maple's direct testimony, where he references their responses to data requests. At that time they had provided no documentation, but simply indicated that they "are engaged in an integration planning process..." (Staff Ex. 11.0R, p. 10) The Joint Applicants continue by making reference to "Joint Applicants Exhibits 20.0 and 21.0 [which] together contain over 3,500 pages of documentation" relating to integration planning, (JA IB, p. 20), These documents were provided to Staff on July 13, 2011, nearly 3 months after Mr. Maple prepared his direct testimony.

Although the Joint Applicants tout the "voluminous documentation" of "over 3500 pages" of information that they provided on the integration process (JA IB, p. 20), it is notable that they do not point to any evidence within the documents upon which the Commission could rely in making a finding that the reorganization will not diminish Nicor Gas' provision of utility service. Indeed, the Joint Applicants flooded Staff with "voluminous documentation", but none of it answered the questions about how the new utility would purchase gas, how it would operate its storage fields, how it would maintain its system, or any other pertinent information about whether the service would be adequate, reliable, efficient, safe, or least cost. The material was a hodgepodge

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.” (JA IB, p. 14) However, as fully explained during cross-examination, the Joint Applicants are not committing to retain the same employees in the same jobs. In fact, the Joint Applicants are committing only to retain “equivalent” employee hours for a three year period and explained that Nicor Gas employees could be let go, assigned to other duties, or even work for other AGL Resources affiliates while AGL Resources employees in another state work for the Nicor Gas utility. (Tr., July 19, 2011, 573)

D. Summary

The Joint Applicants cannot list the standards and practices by which they will operate, they cannot explain how they will maintain the transmission, distribution, and storage systems in a safe and useable manner, and they cannot explain how they will purchase, transport, and sell gas in the most efficient manner. (Staff IB, p. 9) Despite their reliance on the FTE commitment, the Joint Applicants cannot identify which employees they will retain and which they will terminate, they. (*Id.*) For all the reasons discussed above, the Joint Applicants have failed to demonstrate that the proposed reorganization will not diminish [Nicor Gas’] ability to provide adequate, reliable, efficient, safe and least cost public utility service...” Therefore, Staff continues to recommend that the Commission deny the Joints Applicants’ petition.

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

The Joint Applicants have not demonstrated that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers. The proposed reorganization is likely to result in a downgrade of Nicor Gas' credit ratings, which would lead to higher debt and equity costs as a direct result of Nicor Gas' affiliation with non-utility company AGL Resources. (See 220 ILCS 5/9-230) Therefore, the effect of the decline in Nicor Gas' credit ratings following the reorganization constitutes an adverse rate impact under Section 7-204(b)(7) of the Act.

Staff's position has three components. First, there is a strong likelihood that at least Standard & Poor's ("S&P"), if not Moody's Investors Service ("Moody's"), will downgrade Nicor Gas' credit ratings as a direct consequence of the reorganization. Second, without an offsetting increase in the percentage of debt in Nicor Gas' capital structure, those higher costs of debt and common equity would lead to higher rates. Finally, the Commission has a statutory obligation under Section 9-230 of the Act to remove any incremental risk or increased cost of capital which is the direct or indirect result of the public utility's affiliation with unregulated companies. (Staff IB, pp. 12-15) Staff has proposed a condition which would provide a specific, effective means for eliminating the adverse impact of the expected decline in Nicor Gas' credit ratings in future rate cases. (Staff IB, pp. 20-22) Although the Joint Applicants offered a proposal to address Staff's concerns, their proposal is deficient for those reasons described in the Staff IB (pp. 16-20), Specifically, Staff recommends the following condition to ensure the reorganization will satisfy the requirements set forth in Section 7-204(b)(7) of the Act:

The Commission should require that, in future ratemaking proceedings, Nicor Gas' post-merger capital structure contain no more common equity than the post-merger capital structure of its parent company, AGL Resources, provided AGL Resources maintains issuer credit ratings of BBB-/Baa3/BBB-, or better from S&P/Moody's/Fitch. Staff recommends that this condition represent a ceiling on Nicor Gas' post-merger equity ratio for ratemaking purposes, rather than a floor, in order to provide interested parties the opportunity to propose capital structures, capital structure adjustments, or a hypothetical capital structure in future rate cases for Nicor Gas. (Staff IB, p. 21)

This reply to the Joint Applicants initial brief ("JA IB"), and the arguments previously provided in the Staff IB (pp. 12-22), fully explain why Staff's proposed condition is supported by the evidentiary record and is the only condition offered that fully addresses the requirements of Section 7-204(b)(7) of the Act.

Section 7-204(b)(7) requires a finding that the reorganization "is not likely to result in any adverse rate impacts on retail customers." (220 ILCS 5/7-204(b)(7)) The Joint Applicants characterize this requirement as one that "bars approvals of reorganizations that will likely adversely increase rates." (JA IB, p. 21, emphasis added) This characterization inserts the word "increase" into Section 7-204(b)(7), where it is not otherwise found. Joint Applicants also assert that "[n]ot all rate increases are necessarily adverse rate impacts". (*Id.*, footnote 9) This implies that the determination of whether a rate increase is adverse is left completely to the Commission's discretion. To the contrary, the General Assembly has placed some constraints on the Commission's determination regarding which rate impacts are adverse and which ones are not. Section 9-230 of the Act is a prime example; the General Assembly has barred from rates any incremental risk or increased cost of capital due to a utility's affiliation with unregulated or nonutility companies. (220 ILCS 5/9-230) It is not relevant whether

said incremental risk or increased cost of capital is reasonable or offset with savings elsewhere. (*Illinois Bell Telephone v. Illinois Commerce Commission*, 283 Ill.App.3d 188, 669 N.E.2d919, 207, 933 (Second Distr., 1996)) Clearly, the General Assembly has determined that any such impact on rates would constitute an adverse rate impact on retail customers.

Thus, it follows that the Joint Applicants' argument that the Commission must view the reorganization's effect on Nicor Gas rates in totality (JA IB, p. 22) is flawed. The Joint Applicants' interpretation of Section 7-204(b)(7) would require the Commission to ignore the effect of non-utility affiliates on Nicor Gas' cost of capital to the extent those costs do not cause an overall rate increase. That result would be contrary to the clear language of Section 9-230. Moreover, even if the Joint Applicants' interpretation of Section 7-204(b)(7) is correct, Section 9-230 notwithstanding, Joint Applicants have not identified a single dollar of savings to offset the increase to Nicor Gas's cost of capital should its merger be approved without Staff's proposed condition.

The Joint Applicants argue that they are not seeking to change rates, and have "taken significant steps to insulate Nicor Gas from the perceived risks associated with the non-utility businesses." (JA IB, p.22) This argument is only valid to the extent that Nicor Gas' rates will never change subsequent to the reorganization. Any new rates the Commission puts into place subsequent to the reorganization will be adversely impacted by an increase in Nicor Gas' cost of capital resulting from Nicor Gas' affiliation with unregulated or nonutility companies; that is, unless Staff's proposed condition is imposed to avoid the adverse impact due to Nicor Gas' affiliation with AGL.

With regard to the “significant steps” to insulate Nicor Gas from its affiliates, Joint Applicants have agreed to only two: Nicor will not lend to affiliates and will maintain a separate credit agreement. Joint Applicants have stated that they will not take actions, such as but not limited to, restrictions on common dividends or having an independent board of directors, to insulate (or ring-fence) Nicor Gas from the risk of its affiliates. (Staff IB, p. 14)

The Joint Applicants allege that they have offered strong protections in their proposed means to evaluate any adverse rate impact. (JA IB, p. 26) The Joint Applicants have neither explained the mechanics of the proposal nor described the means by which the Commission could evaluate any adverse rate impact on rates, as demonstrated by the following excerpt from the Joint Applicants testimony:

Q And do you know if the joint applicants have a proposal as to how the Commission would determine what effect non-utility and unregulated affiliates have on Nicor Gas’s cost of capital?

A Well, I believe that the Commission would look at all the factors, as the Commission usually does in this type of process, to make that determination. I don’t think that necessarily needs to be a part of anything that we’ve [Joint Applicants] proposed. (Tr., July 19, 2011, pp. 510-511, and more generally, pp. 493-514)

The Joint Applicants’ proposal assumes that adverse rate impacts on Nicor Gas’ customers could be avoided in future rate cases by applying estimated cost rates for debt and equity that assume Nicor Gas’ credit rating remains AA to Nicor Gas’ post-merger capital structure for the first three years following the reorganization. (Tr., July 19, 2011, p. 495) However, the Joint Applicants’ proposal fails to account for whether the resulting financial strength is commensurate with the assumed pre-merger credit rating or whether another rating is more cost-effective. (JA IB, p. 27) This is a serious

deficiency in the proposal. In contrast, Staff's proposed condition would avoid any mismatch between capital structure and corresponding cost rates that could be excessively costly for Nicor Gas' customers. (Staff IB, p. 21)

The inquiry that must be addressed here is whether the acquisition of Nicor Gas by AGL Resources is likely to cause a decline in Nicor Gas' credit ratings, which will cause the cost of capital to increase unless there is an offsetting increase in the amount debt comprising Nicor Gas' post-merger capital structure for ratemaking purposes. The Joint Applicants argue that "[t]here is no evidence that a downgrade of Nicor Gas is likely absent its participation in a common money pool with AGL affiliates." (JA IB, p. 23) This argument ignores a plethora of evidence in the record to the contrary.

Currently Nicor Gas has AA/A2/A issuer ratings from S&P/Moody's/Fitch. In contrast, AGL Resources is currently rated A-/Baa1/A- by S&P/Moody's/Fitch. (Staff Ex. 9.0, pp. 4-7) Following the merger announcement in December 2010, S&P placed the 'AA' corporate credit rating and 'A-1+' commercial paper rating of Nicor Gas on CreditWatch with negative implications. Specifically, S&P states:

The Dec. 7, 2010, CreditWatch placement of Nicor Inc. and Nicor Gas Co. followed AGL Resources Inc.'s announcement that it plans to acquire Nicor...Based on our calculated pro forma credit metrics, we would expect that the new company's corporate credit rating would be no lower than 'BBB+' when the acquisition closes....We expect to use a consolidated ratings approach on the new company and will equalize the corporate credit ratings of all entities in the corporate structure. (*Id.*, pp. 4-5 *emphasis added*)

Similarly, Moody's changed the outlook on Nicor Gas' A2 rating to negative from stable, stating, "[t]he negative outlook is based on the expectation that the merger will combine Nicor with AGL resulting in a more leveraged entity which will look to utilize the strong

cash flow of Nicor Gas to help service the additional debt to be taken on to consummate this acquisition.” (Staff Ex. 9.0, pp. 5-6) Specifically, Moody’s states:

Nicor is smaller than AGL (about 70% in terms of assets) but has a much stronger credit profile due to Nicor Gas. This disparity will help AGL absorb Nicor while maintaining its credit metrics. Nicor’s leverage in terms of debt-to-capitalization is in the mid 40% range compared to AGL’s in the low-50% range. While Nicor has lower debt, it has the capacity to generate at least as much cash flow as AGL. As of the last twelve months ended September 30, 2010, Nicor’s reported total debt was about a third of AGL’s while its cash flow from operations before working capital (CF pre-w/c) was slightly more than AGL’s. (Staff Group Cross Ex. 2, pp. 16-17)

Based on these statements from S&P and Moody’s, Ms. Phipps concluded that, following the proposed reorganization, Nicor Gas would likely have lower long-term credit ratings than today. (Staff Ex. 9.0, pp. 10-11) Although the Joint Applicants imply that the views of the rating agencies may have changed, there is no evidence in the record that they have. Significantly, if either S&P or Moody’s has changed its evaluation of the likely credit impact of the proposed merger on Nicor Gas as a consequence of Joint Applicants agreeing to remove Nicor Gas from the AGL Resources money pool, Joint Applicants did not come forward with the new credit reports announcing the credit rating agencies change in position.

Currently, Nicor Gas’ commercial paper ratings are A-1+/P-1/F-1 from S&P/Moody’s/Fitch. (Staff Ex. 9.0, pp. 4-5) Ms. Phipps explained that there is no assurance that Nicor Gas would maintain those tier one commercial paper ratings following the reorganization given the expected downgrade to Nicor Gas’ long-term ratings following the reorganization. (Staff Ex. 9.0, p. 11) Specifically, Moody’s notes that P-1 short-term ratings typically correspond to A credit ratings and higher while P-2 short-term ratings typically correspond to credit ratings between A and Baa2, which

means Nicor Gas is unlikely to maintain tier one commercial paper ratings following the proposed reorganization. Currently, S&P, Moody's and Fitch rate AGL Capital Corporation's commercial paper program A-2/P-2/F-2, which ratings more closely correspond to the long-term credit ratings S&P and Moody's expect to assign to Nicor Gas following the proposed reorganization. (Staff Ex. 9.0, p. 12) That is, following the proposed reorganization, Nicor Gas would likely have lower short-term credit ratings than today.

The Joint Applicants fail to grasp the significance of the S&P and Moody's statements and contend that "unproven fear of a ratings downgrade is just the beginning of a long and winding road ..." (JA IB, p. 23) The Joint Applicants then build an argument to the effect that Staff 's position is based upon multiple, unfounded assumptions. (See *Id.*, pp. 23-24) To the contrary, there is overwhelming evidence that a decline in Nicor Gas' credit ratings is likely following the reorganization; thus, meeting the standard of Section 7-204(b)(7). Following a decline in Nicor Gas' credit ratings, the cost of short- and long-term debt will increase for Nicor Gas because lower credit ratings denote higher risk and investors require higher returns for riskier investments. (Tr., July 19, 2011, pp. 492-493) Those higher debt costs increase financial risk, which will cause Nicor Gas' cost of equity to increase. (Staff IB, p. 13) These are not assumptions. These are facts. Moreover, the Joint Applicants clearly state that Nicor Gas' target equity ratio will remain 56%. (JA Ex. 3.2) Hence, Nicor Gas customers will pay higher costs of debt and equity without any offset from a lower common equity ratio because of this reorganization. Section 9-230 makes clear that the Commission must remove those incremental costs from Nicor gas' cost of capital, which means the

Commission must remove the incremental cost of capital associated with the decline in Nicor Gas' credit ratings in future rate cases (contrary to the Joint Applicants IB, Section 9-230 says nothing about billing determinants).

Joint Applicants' argument that "it is legally impossible for the proposed reorganization to result in an increase in the cost of capital for ratemaking purposes," (JA IB, p. 25) is nonsensical. It appears to be premised on the notion that the dictates of the General Assembly are infallible; if the General Assembly so declares that a utility's rates cannot include an increase in its cost of capital due to its affiliation with unregulated or nonutility companies then it becomes a fact that such increases to a utility's cost of capital are removable to the last iota. Staff's proposed condition, on the other hand, is premised on the notion that if the General Assembly dictates every increase in the cost of capital – to the last iota – that is due to a utility's affiliation with non-utility and unregulated entities cannot be included in rates, then either the Commission must determine whether said increase to the cost of capital is removable or in the alternative use its authority to prevent that increase in the cost of capital from occurring in the first place. Joint Applicants commit yet another logical fallacy by implicitly assuming that any unregulated or non-utility affiliate of a utility must necessarily increase the utility's cost of capital. Joint Applicants contradict this errant logic when they deny that an affiliation with AGL Resources will increase Nicor Gas' cost of capital. (JA IB, p. 23)

The Joint Applicants' argument that there is nothing atypical or complex about AGL's non-utility business and that the Commission has adjusted for Nicor Inc.'s own unregulated businesses for years is also deceptive. While the record in this proceeding

does indicate that Nicor Gas has unregulated or nonutility affiliates, no evidence exists that those affiliates ever increased Nicor Gas' cost of capital. To the contrary, the Commission's Order and Order on Rehearing in Nicor Gas' last rate case, Docket No. 08-0363, do not even mention Section 9-230.

Even if one were to accept for the sake of argument that Nicor Gas' affiliation with Nicor Inc., or its unregulated or nonutility subsidiaries did increase Nicor Gas' cost of capital, circumstances in the gas industry have changed such that it is far more challenging to remove the incremental costs and risk due to non-utility affiliates today than it was a decade ago. That is, today, the gas industry comprises approximately ten companies (one less if this merger is approved) that can be used to estimate the cost of equity for a gas utility, which means the results derived from what is essentially a universal gas sample must be adjusted to reflect the standalone risk of the utility. In contrast, more than a decade ago, when a larger universe of gas companies existed, the cost of equity estimate for a gas utility was derived using a gas sample comprising companies similar in risk to the standalone utility operations of the target gas utility, rendering further adjustment unnecessary. (Tr., July 20, 2011, pp. 779-780)

Given the foregoing, the complexity inherent in Section 9-230 adjustments will only increase in future rate cases. Therefore, Staff proposes a condition that will provide a specific, effective means for eliminating the adverse impact of the expected decline in Nicor Gas' credit ratings in future rate cases. (Staff IB, pp. 20-22)

The Joints Applicants raise the of issue of single-issue ratemaking. (JA IB, pp. 25-26) There are no rates being set in this proceeding. In fact, the Joints Applicants recognize this themselves: "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 changes in rates for customers as a result of the proposed reorganization.” (JA IB at 21) Staff’s condition is directed at assuring that rates set in future proceedings can be in compliance with Section 9-230. Staff’s proposed condition is to be implemented in a future rate case, in which all revenues and costs will be examined and rates will be authorized based on the typical, thorough Commission review process. Single-issue *ratemaking* is not an issue in this proceeding.

Joint Applicants’ argument that Staff is proposing an “unprecedented adjustment” (JA IB, p. 22) is incorrect. To the contrary, Staff’s proposed condition would employ a commonly used and widely accepted financial analysis that requires making pro forma adjustments that replace equity with debt on Nicor Gas’ balance sheet and income statement until the resulting pro forma financial metrics correspond to Nicor Gas’ post-merger credit rating. (Tr., July 20, 2011, pp. 792-793) Ms. Phipps used the same iterative process to assess the effect of Nicor Gas issuing debt to fund Performance Based Rates (“PBR”) refunds up to \$286.5 million on Nicor Gas’ financial metrics. (See ICC Staff Ex. 9.0, pp. 9-10) Towards that end, JA Ex. 3.3 presents the same pro forma financial metrics that Staff evaluated (*i.e.*, fund from operations to debt; debt to earnings before interest, taxes, depreciation and amortization; and debt to capital) for the post-merger AGL Resources. Therefore, Staff’s proposed adjustment, which is based on a widely accepted financial analysis, should be adopted.

Without Staff’s proposed condition, the likely declines in Nicor Gas’ credit ratings will increase its cost of capital. Illinois law prohibits the Commission from including *any*

incremental risk or increased cost of capital which is the direct or indirect result of the public utility's affiliation with unregulated or non-utility companies. (220 ILCS 9-230, emphasis added) Illinois law also requires that before approving a reorganization, the Commission must find that the reorganization is not likely to result in any adverse rate impacts. (220 ILCS 7-204(b)(7)) The proposed reorganization is likely to result in a downgrade of Nicor Gas' credit ratings. Lower credit ratings would lead to higher debt costs, which in turn, would lead to higher equity costs since higher debt costs increase financial risk. Since the cost of capital is a component of a utility's rates, then an increase in financial risk would result in an adverse rate impact on Nicor Gas' customers. The increase in Nicor Gas' cost of capital would be the result of Nicor Gas' affiliation with non-utility company AGL Resources (See 220 ILCS 5/9-230), and therefore constitutes an adverse rate impact under Section 7-204(b)(7) of the Act. For all the foregoing reasons, in addition to the reasons set forth in the Staff IB, pp. 12-22, Staff's proposed condition for ensuring the proposed reorganization satisfies the requirements of Section 7-204(b)(7) of the Act and should be adopted.

V. CONCLUSION

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations.

September 1, 2011

Respectfully submitted,

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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.)

**AGREED STIPULATION BETWEEN
JOINT APPLICANTS AND STAFF**

AGL Resources Inc. (“AGL”), Nicor Inc. (“Nicor”), Northern Illinois Gas Company, d/b/a Nicor Gas Company (“Nicor Gas”) (collectively “Joint Applicants”), and the Staff of the Illinois Commerce Commission (“Commission”) hereby submit this Stipulation to the Commission related to the findings required under Section 7-204(c) of the Public Utilities Act (“Act”), 220 ILCS 5/7-204(c).

1. To resolve the issues associated with Sections 7-204(c)(i) and 7-204(c)(ii) of the Act, the Joint Applicants and Commission Staff agree to the following terms and recommend that the Commission approve these terms in order to meet the requirements of those sections.

2. The Joint Applicants agree with Staff witness Bridal’s stated position, *see* ICC Staff Exhibits 7.0 and 13.0, with the clarifications and conditions reflected in Paragraphs 3, 4, 5 and 6 hereof.

A. Section 7-204(c)(i)

3. The Joint Applicants and Staff agree that achieved savings at Nicor Gas resulting from the proposed Reorganization, if any, shall be flowed through to Nicor Gas customers as part of costs associated with the regulated intrastate operations for consideration in a future rate case filed by Nicor Gas.

4. In order to provide rate certainty for customers for a period following the Reorganization, and to allow the effect of savings, if any, to materialize, the Joint Applicants and Staff agree that the base rates of Nicor Gas shall be fixed at their current rates for a period of three years following the closing of the proposed Reorganization. Nicor Gas may file at its option a base rate case, in a time consistent with the provisions of the Act and the Commission's Rules, which would implement new distribution rates no earlier than three years following the date the proposed Reorganization closes. (To illustrate this proposal, if the Reorganization closes on November 1, 2011, Nicor Gas' base rates shall be fixed until November 1, 2014. Nicor Gas would be allowed to file a general rate case at a time that would allow new rates to go into effect on or after November 1, 2014.) The Joint Applicants retain the right to request that the Commission waive the timing provision set forth above if the financial integrity of Nicor Gas is jeopardized to the extent of negatively affecting customers. Under the terms of this provision, customers will receive all of the achieved savings, if any, associated with the test year in that case as an embedded reduction to the cost of service from that period forward.

5. Sections 9-220(h) and (h-1) of the Act, as set forth in Public Act ("PA") 097-0096 and PA 097-0239, require Nicor Gas, among other utilities, to enter into a sourcing agreement with a clean coal substitute natural gas ("SNG") brownfield facility and a clean coal SNG facility, or elect to file biennial rate cases in 2012, 2014, and 2016. As of the date of this Stipulation, Nicor Gas has not yet made such an election. Although it is unlikely at this time that Nicor Gas would not enter into the referenced SNG sourcing agreements, if Nicor Gas should elect not to enter into such a sourcing agreement, the Act then requires that Nicor Gas file biennial rate cases in 2012, 2014, and 2016. Notwithstanding the forgoing paragraph, rate case filings under such statutes are permitted by this Stipulation.

B. Section 7-204(c)(ii)

6. The Joint Applicants and Staff agree, subject to the terms set forth in Section 7-204(c)(i) above, that the costs incurred in accomplishing the proposed Reorganization shall not be recovered through Illinois jurisdictional regulated rates in this or any future proceeding. For clarification, the costs at issue (*i.e.*, Transaction Costs, Change in Control Costs, Financing Costs, Separation Costs, and Legal and Other Professional Costs) included in the Joint Applications' Supplemental Response to Staff Data Request RWB 3.01, Exhibit 5 (Staff Group Cross Exhibit 2 (Public) at 7-8 (NRE 004555-4556)), are the costs incurred in accomplishing the proposed Reorganization, which will not be recovered through Illinois jurisdictional rates.

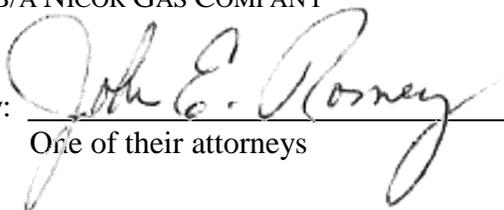
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Respectfully submitted,

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