

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

AGL Resources Inc., Nicor Inc., and :
Northern Illinois Gas Company d/b/a :
Nicor Gas Company :
: **11-0046**
Application for Approval of a Reorganization:
Pursuant to Section 7-204 of the Illinois :
Public Utilities Act. :

PROPOSED ORDER

September 29, 2011

TABLE OF CONTENTS

I.	PROCEDURAL HISTORY	1
II.	THE PROPOSED REORGANIZATION	4
A.	IDENTIFICATION OF THE PARTIES TO THE REORGANIZATION AND THEIR AFFILIATES	4
1.	<i>AGL and Its Affiliates</i>	4
2.	<i>NI and Its Affiliates</i>	4
B.	THE REORGANIZATION	5
C.	ASSERTED RESULTS OF THE REORGANIZATION	5
D.	RELIEF REQUESTED	6
III.	APPLICABLE STATUTORY AUTHORITY	7
A.	SECTION 7-204 OF THE ACT	7
B.	SECTION 7-204A OF THE ACT	9
C.	SECTION 7-101 OF THE ACT	9
D.	SECTION 6-103 OF THE ACT	9
E.	SECTION 7-102 OF THE ACT	10
IV.	FINDINGS AND CONCLUSIONS	10
A.	SECTION 7-204(B): REORGANIZATION APPROVALS	10
1.	<i>Finding 1: “the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service”</i>	10
a)	Issues Presented & Analysis	10
b)	Commission Conclusion	15
2.	<i>Finding 2: “the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers,” and</i>	16
	<i>Finding 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”</i>	16
a)	Issues Presented and Analysis	16
b)	Commission Conclusion	18
3.	<i>Finding 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”</i>	18
a)	Issues Presented & Analysis	18
b)	Commission Conclusion	19
4.	<i>Finding 5: “the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities”</i>	20
a)	Issues Presented & Analysis	20
b)	Commission Conclusion	21
5.	<i>Finding 6: “the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction”</i>	21
a)	Issues Presented & Analysis	21
b)	Commission Analysis and Conclusion	22
6.	<i>Finding 7: “the proposed reorganization is not likely to result in any adverse rate impacts on retail customers”</i>	22
a)	Issues Presented & Analysis	22
b)	Commission Conclusion	30
B.	SECTION 7-204(C): TREATMENT OF COSTS AND SAVINGS	31

1.	<i>Issues Presented & Analysis</i>	31
2.	<i>Commission Conclusion</i>	35
C.	SECTION 7-204A OF THE ACT	35
1.	<i>Issues Presented & Analysis</i>	35
2.	<i>Commission Conclusion</i>	36
D.	APPROVAL UNDER SECTION 7-102 OF THE ACT	36
1.	<i>Issues Presented & Analysis</i>	36
2.	<i>Commission Conclusion</i>	37
E.	THE NICOR INTER-AFFILIATE OPERATING AGREEMENT	37
1.	<i>Settled and Withdrawn Disputes</i>	38
2.	<i>The Remaining OA Dispute</i>	39
a.	Applicable Law.....	42
b.	Unjustified Subsidization	45
c.	Cost Allocation.....	54
d.	Public Interest.....	54
1.)	Pricing and Necessity	56
2.)	Misleading Solicitation	58
3.)	Other Public Interest Indicators	63
3.	<i>Remedies</i>	68
a.	End of NG Involvement in NS Product Solicitation	68
b.	Current GLCG Enrollment & Information Disclosure	72
c.	GLCG as a Utility Service.....	73
4.	<i>Commission Conclusion</i>	75
F.	SECTION 6-103 AND OTHER APPROVALS	76
1.	<i>Issues Presented & Analysis</i>	76
2.	<i>Commission Conclusion</i>	77
V.	FINDINGS AND ORDERING PARAGRAPHS	77

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By the Commission:

I. PROCEDURAL HISTORY

In an application filed January 18, 2011, AGL Resources Inc. (“AGL”), Nicor Inc. (“NI”), and Northern Illinois Gas Company d/b/a Nicor Gas Company (“NG”) (collectively, “Joint Applicants” or “JA”) asked the Illinois Commerce Commission (“Commission”), for approval, pursuant to Sections 7-204 and 7-204A of the Public Utilities Act (“Act”)¹, of a reorganization (the “Reorganization”) by which NI will merge with and into a subsidiary of AGL and NG will become a wholly-owned subsidiary of AGL. JA also seeks approval pursuant to Sections 7-102² and 7-204A(b) of the Act for entry by NG into an affiliated interest agreement by which it would receive shared corporate and other services from AGL’s subsidiary AGL Services Company (“AGSC”). JA requests additional approvals and findings in connection with the Reorganization, as more fully discussed in this Order.

Petitions to intervene were filed by: the Citizens Utility Board (“CUB”); the People of the State of Illinois by the Office of the Attorney General (“AG”); the Retail Energy Supply Association (“RESA”); Interstate Gas Supply of Illinois, Inc. (“IGS”); The Manchester Group, LLC (“Manchester”); the Environmental Law and Policy Center (“ELPC”); and Local Unions 19, 117, 134, 150, 176, 364, 461 and 701, International Brotherhood of Electrical Workers, AFL-CIO (collectively, “IBEW”). All of these petitions to intervene were granted by a duly authorized Administrative Law Judge (“ALJ”) of the Commission.

Pursuant to due notice as required by law and by the rules and regulations of the Commission, prehearing conferences were held in this matter before the ALJ at the

¹ Respectively, 220 ILCS 5/7-204 and 7-204A.

² 220 ILCS 5/7-102.

Commission's offices in Chicago on February 8, April 4 and 6, June 29 and July 14, 2011.

On March 24, 2011, the JA requested that the ALJ take administrative notice of NG's request for leave to file a Stipulation in Docket 09-0301, in order to support their motion to suspend that proceeding. Docket 09-0301, which sought approval of the Operating Agreement ("OA") governing NG's transactions with affiliates, was initiated pursuant to the following provision in the Commission's Order in NG's most recent rate case:

IT IS FURTHER ORDERED that Nicor shall file a petition within 120 days of the date of a final Order in this proceeding seeking either re-approval of its current Operating Agreement, or, approval of a new affiliated interest transaction agreement; this petition shall address the criteria expressed by Staff, as is set forth in Section XIV(C) herein; and, it shall be supported by verified testimony.³

The Stipulation in Docket 09-0301 sets forth an agreement reached among NG, Staff, the AG, CUB, and RESA regarding the use in this docket of data request responses served and testimony filed in 09-0301. On April 6, 2011, the ALJ granted JA's request and established a schedule in this docket for filing testimony, conducting an evidentiary hearing and receiving briefings addressing OA issues. On April 15, 2011, NG, Staff, AG/CUB, IGS/RESA and Manchester filed in this docket testimony previously filed in Docket 09-0301 as direct and rebuttal testimony. On April 22, 2011, NG filed in this docket surrebuttal testimony relating to OA issues, which responded to the Staff and intervenor rebuttal testimony originally filed in Docket 09-0301 (and subsequently re-filed in this docket).

On May 19, 2011, JA filed a Stipulation they entered into with RESA and IGS⁴. Attached to the Stipulation was a Settlement Agreement that resolved "all issues between the Joint Applicants, RESA and IGS presently pending in this proceeding, Docket 11-0046, as well as the issues brought into this proceeding from Docket 09-0301."⁵ As a result of that Stipulation, RESA, IGS and Manchester withdrew all their testimony from this docket.

On May 20, 2011, JA and Staff filed a Stipulation reflecting the resolution between JA and Staff of all but one contested issue relating to the terms and provisions of the proposed OA⁶. Attached to the Stipulation was a draft OA that identified the language that remained at issue between JA and Staff in Section 2.2(e)⁷.

³ In re Nicor Gas (proposed general increase in rates), Dckt. 08-0363, Order, Mar. 25, 2009, at 185.

⁴ NG Ex. 8.0.

⁵ *Id.* at 1.

⁶ JA Ex. 7.0 at 1.

⁷ JA Ex. 7.1.

On May 23, 2011, an evidentiary hearing concerning OA issues was held before the ALJ at the Commission's offices in Chicago. JA, Staff, AG and CUB entered appearances. JA presented testimony and exhibits from Gerald P. O'Connor, Senior Vice President for Finance and Strategic Planning for NG, Agustin J. Ros, Vice President, NERA Economic Consulting, and John Erickson, Vice President, American Public Gas Association. Staff presented testimony and exhibits from Dianna Hathhorn, Accountant, Accounting Department, Financial Analysis Division, and David A. Sackett, Economic Analyst, Policy Program, Energy Division. AG/CUB presented testimony and exhibits from David J. Effron, a utility regulation consultant. The Stipulations between JA and Staff, and JA and RESA and IGS, were also admitted into evidence, along with certain cross-examination exhibits.

On July 19 and 20, 2011, additional evidentiary hearings were held on all other issues relating to the JA reorganization request and inter-affiliate agreements, before the ALJ at the Commission's offices in Chicago. JA, Staff, AG, CUB, RESA and IGS entered appearances.

During the July evidentiary hearings, NG presented testimony and exhibits from the following witnesses: Mr. O'Connor, Henry Linginfelter, Executive Vice President-Utility Operations for AGL; Rocco D'Alessandro, Executive Vice President-Operations for NG; Stephen Cave, Vice President-Finance and Treasurer for AGL; Anthony McCain, NG's Vice President-Field Operations; Elizabeth Reese, AGL Vice President-Operational Planning and Analysis; and Richard Lonn, Director of Regulatory Compliance for AGL.

Staff presented testimony and exhibits from the following witnesses: Harold Stoller, Director, Energy Division; Richard W. Bridal II, Accountant, Accounting Department, Financial Analysis Division; Dianna Hathhorn, Accountant, Accounting Department, Financial Analysis Division; Rochelle Phipps, Senior Financial Analyst, Finance Department, Financial Analysis Division; David Rearden, Senior Economist, Policy Program, Energy Division; Mark Maple, Senior Gas Engineer, Engineering Department, Energy Division; and Darin Burk, Manager, Pipeline Safety Program, Energy Division. AG/CUB presented testimony and exhibits from Mr. Effron.

All of the foregoing testimony and exhibits were admitted to the record during the July hearings (with minor exceptions based on parties' objections), along with certain cross-examination exhibits.

On June 20, 2011, JA, Staff and AG/CUB each filed their respective Initial Brief regarding OA issues ("IB-OA"). On July 12, 2011, JA, Staff and AG/CUB each filed their respective Reply Briefs regarding OA issues ("RB-OA").

Pursuant to the request of the ALJ, on August 18, 2011, JA submitted a Draft Order addressing all uncontested matters. The Draft Order was circulated and agreed to by Staff, AG, CUB, RESA and IGS.

On August 24, 2011, JA and Staff filed a Stipulation memorializing a resolution between those parties of issues related to findings required under Section 7-204(c) of the Act. The Stipulation also includes an agreement by the JA that, unless specified circumstances occurred, NG's base rates would be fixed at their pre-Reorganization level during the first three years following closing of the Reorganization. The JA filed a Revised Draft Order on September 1 to reflect that Stipulation⁸.

On August 18, 2011, JA, Staff, AG/CUB and IBEW each filed their respective Initial Briefs ("IB") on all issues other than the OA issues previously briefed. On September 1, 2011, JA, Staff, AG/CUB and IBEW each filed their respective Reply Briefs ("RB").

On September 27, 2011, the record was marked "Heard and Taken" by the ALJ.

II. THE PROPOSED REORGANIZATION

A. Identification of the Parties to the Reorganization and Their Affiliates

1. AGL and Its Affiliates

AGL is a Georgia corporation headquartered in Atlanta, Georgia⁹. AGL's principal business is the distribution of natural gas through public utility operating companies in six states: Florida, Georgia, Maryland, New Jersey, Tennessee, and Virginia (Atlanta Gas Light in Georgia; Chattanooga Gas in Tennessee; Elizabethtown Gas in New Jersey; Elkton Gas in Maryland; Florida City Gas in Florida; and Virginia Natural Gas in Virginia). These utility companies currently serve approximately 2.3 million end-use customers. They each construct, operate, and maintain intrastate natural gas pipelines and distribution facilities. AGL is also involved in several related and complementary businesses: retail natural gas marketing to end-use customers, primarily in Georgia; natural gas asset management and related logistics activities for each of its utilities and non-affiliated companies; natural gas storage arbitrage and related activities; and the development and operation of high-deliverability natural gas storage assets. AGL manages these businesses through four operating segments and a non-operating corporate segment.

2. NI and Its Affiliates

NI owns NG and other subsidiaries, including several energy-related businesses¹⁰. NG is an Illinois public utility within the meaning of Section 3-105 of the Act¹¹. NG provides regulated natural gas service in 643 communities in northern and

⁸ Much of the text of the Stipulation appears in section IV.B.1 of this Order.

⁹ All facts in the paragraph are derived from the Application at 2-3 and JA Ex. 1.0 at 1 & 4-5.

¹⁰ Application at 3.

¹¹ 220 ILCS 5/3-105.

central Illinois, serving approximately 2.2 million customers in urban, suburban, and rural areas of the state¹².

B. The Reorganization

NI, AGL, Apollo Acquisition Corporation (“Apollo”), an Illinois corporation and a wholly-owned subsidiary of AGL, and Ottawa Acquisition LLC (“Ottawa”), an Illinois limited liability company and a wholly-owned subsidiary of AGL, have entered into an Agreement and Plan of Merger, dated December 6, 2010 (the “Merger Agreement”)¹³. Pursuant to the Merger Agreement: 1) AGL will acquire the stock of NI in exchange for a combination of cash and AGL stock; 2) Apollo will merge with and into NI; and 3) Apollo/NI will merge with and into Ottawa with the surviving company remaining a wholly-owned subsidiary of AGL (the “Merger”)¹⁴. Upon consummation of the Reorganization (the “Closing”), NG will become a wholly-owned subsidiary of AGL¹⁵. NG will retain its current name, corporate form, and headquarters in Naperville, Illinois, and will continue to operate as an Illinois public utility, subject to the Commission’s jurisdiction and applicable Illinois law and regulations¹⁶.

C. Asserted Results of the Reorganization

In combining the second and third largest “pure” natural gas distribution companies in the United States, JA declare that the Reorganization will create one of the lowest-cost, most diversified families of natural gas utilities in the country, guided by a seasoned and well-respected management team¹⁷. JA also assert that the Reorganization will be seamless for NG customers, as they will continue to receive service from NG in the same fashion and pursuant to the same rates, terms and conditions under which they now receive service¹⁸. JA further predict that, over time, NG customers will benefit as NG will share best practices with its affiliated utilities and realize the positive impacts of greater scale¹⁹. JA witness Lingenfelter testified that an example of one such benefit would be NG’s utilization of the GIS system used by AGL utilities. It marks where gas mains are located and is used in conjunction with Google Earth technology to map the distance of gas mains to customers’ residences²⁰.

AGL avers that it is capable and ready to undertake the Reorganization with a proven track record of acquiring and integrating natural gas distribution utilities and utility holding companies²¹. AGL believes that it brings to the Reorganization a team of highly qualified leaders, managers and employees with many years of experience

¹² Application at 3; JA Ex. 2.0 at 3.

¹³ Application at 3; JA Ex. 1.1.

¹⁴ Application at 3; JA Ex. 1.0 at 6.

¹⁵ Application at 3; JA Ex. 1.0 at 6.

¹⁶ Application at 3-4; JA Ex. 2.0 at 6-7.

¹⁷ Application at 4; JA Ex. 1.0 at 5-6.

¹⁸ Application at 4; JA Ex. 1.0 at 7; JA Ex. 2.0 at 6-8.

¹⁹ Application at 4; JA Ex. 1.0 at 7, 9.

²⁰ Tr. 669 (Lingenfelter).

²¹ Application at 4; JA Ex. 1.0 at 4-5.

running utilities effectively and efficiently, and providing safe, reliable, and cost-effective energy delivery and responsive customer service²².

JA state that AGL has strong investment-grade credit ratings and substantial financial resources²³. JA further aver that AGL will give NG a larger financial platform for making investments to maintain safety and improve reliability and customer service²⁴. JA assert that NG's customers will continue to enjoy excellence in customer service under AGL ownership²⁵. JA do not seek a general increase in NG's rates as a condition of the Reorganization²⁶ and, as a result of the August 24, 2011 Stipulation between JA and Staff, pledge (with certain exceptions) not to seek authorization that would alter NG's base rates during the three years immediately following closure of the proposed Merger.

The JA also emphasize that they have committed to maintaining the level of full-time equivalent employees ("FTEs") across NG's service territory for a period of at least three years²⁷. More particularly, they describe this as a "dual commitment" to maintain 2,070 FTEs, based on the number of NG FTEs as of December 31, 2010 in support of NG's business *and* in the state of Illinois²⁸. The 2,070 FTEs may not be the same for each commitment because there may be, for example, 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 NG²⁹. The JA also say they will fully honor NG's existing collective bargaining agreements³⁰.

JA maintain that both AGL and NG have a strong tradition of service and commitment to the communities they serve, and that their support for a variety of civic, community, and philanthropic efforts will continue after the Closing³¹. JA also assert that it is in the best interests of JA and the communities served by NG that the economic prospects of those communities be enhanced³².

D. Relief Requested

JA request the following findings and approvals by the Commission:

1. approval under Sections 7-204 and 7-204A of the Act to engage in the Reorganization, through which NG will become a subsidiary of AGL³³;

²² Application at 4.

²³ Application at 5; JA Ex. 3.0 at 4, 7.

²⁴ Application at 5; JA Ex. 3.0 at 5-6.

²⁵ Application at 5; JA Ex. 1.0 at 3, 7; JA Ex. 2.0 at 6-8.

²⁶ Application at 5; JA Ex. 1.0 at 6; JA Ex. 6.0 at 7.

²⁷ Application at 5; JA Ex. 1.0 at 7, JA Ex. 1.1 at 75; JA Ex. 4.0 at 5; Tr. 665 (Linginfelter).

²⁸ Tr. 572-73 (Reese).

²⁹ *Id.* 573.

³⁰ Application at 5.

³¹ Application at 5; JA Ex. 1.0 at 5, 7; JA Ex. 1.1 at 75.

³² Application at 5.

³³ *Id.* at 6.

2. approval under Section 7-102 of the Act (to the extent required) to engage in the Reorganization³⁴;
3. authorization pursuant to Sections 7-101 and 7-204A(b) of the Act for entry by NG into: 1) an OA governing transactions between NG and its current affiliates, as well as with AGL and AGSC; 2) a Services Agreement ("SA") governing allocations to NG from AGSC, the shared services subsidiary of AGL; 3) four agreements with Sequent Energy Management, LP ("Sequent"), AGL's wholesale gas marketing subsidiary - a Gas Exchange agreement, an Interstate Hub Service Agreement, an Intrastate Hub Service Agreement, and a Base Contract for Sale and Purchase of Natural Gas ("NAESB") - as well as capacity release arrangements between NG and Sequent entered into in accordance with the Federal Energy Regulatory Commission's ("FERC") capacity release rules; and 4) the Tax Allocation Agreement Among Members of the AGL Resources Inc. Affiliated Group ("TAA"), as amended to include the surviving NI companies as parties to that agreement³⁵;
4. approval of any required proposed accounting entries associated with the Reorganization³⁶; and
5. authorization for taking such other measures in connection with the Reorganization as may be reasonably necessary for effecting the Reorganization³⁷.

III. APPLICABLE STATUTORY AUTHORITY

A. Section 7-204 of the Act

Subsection 7-204(a) of the Act provides that:

(a) For purposes of this Section, "reorganization" means any transaction which, regardless of the means by which it is accomplished, results in a change in the ownership of a majority of the voting capital stock of an Illinois public utility; or the ownership or control of any entity which owns or controls a majority of the voting capital stock of a public utility; or by which 2 public utilities merge, or by which a public utility acquires substantially all of the assets of another public utility; provided, however, that "reorganization" as used in this Section shall not include a mortgage or pledge transaction entered into to secure a

³⁴ *Id.*

³⁵ Application at 6, 8, 12-13 and Att. A, *Information Required Pursuant to 220 ILCS 5/7-204A(a)(5)*; JA Ex. 6.0 at 12-13; Staff Ex. 8.0 at 18 and Att. B.

³⁶ Application at 6.

³⁷ *Id.*

bona fide borrowing by the party granting the mortgage or making the pledge.

In addition to the foregoing, "reorganization" shall include for purposes of this Section any transaction which, regardless of the means by which it is accomplished, will have the effect of terminating the affiliated interest status of any entity as defined in paragraphs (a), (b), (c) or (d) of subsection (2) of Section 7-101 of this Act where such entity had transactions with the public utility, in the 12 calendar months immediately preceding the date of termination of such affiliated interest status subject to subsection (3) of Section 7-101 of this Act with a value greater than 15% of the public utility's revenues for that same 12-month period. If the proposed transaction would have the effect of terminating the affiliated interest status of more than one Illinois public utility, the utility with the greatest revenues for the 12-month period shall be used to determine whether such proposed transaction is a reorganization for the purposes of this Section. The Commission shall have jurisdiction over any reorganization as defined herein.

(b) No reorganization shall take place without prior Commission approval. The Commission shall not approve any proposed reorganization if the Commission finds, after notice and hearing, that the reorganization will adversely affect the utility's ability to perform its duties under this Act. 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.³⁸

Subsection 7-204(c) of the Act states that the Commission “shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from 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.”³⁹

B. Section 7-204A of the Act

Section 7-204A(a) of the Act sets forth the minimum information that must be included in an application for approval of reorganization pursuant to Section 7-204⁴⁰. Section 7-204A(b) of the Act provides that an agreement involving the use of any public utility employee’s services by an affiliated interest, or the transfer of assets between a public utility and an affiliate, is subject to the Commission’s review “in the same manner as it may review any other public utility and its affiliated interest.”⁴¹

C. Section 7-101 of the Act

The essential standard of approval under Section 7-101 of the Act, which governs certain transactions between affiliated interests, including the inter-affiliate OA here, is that the agreement must be in the public interest. To uphold that standard, the Commission may disapprove the agreement or “condition [its] approval in such manner as it may deem necessary to safeguard the public interest.”⁴²

D. Section 6-103 of the Act

Under Section 6-103 of the Act⁴³, “[t]he capitalization of a public utility formed by a merger of two or more corporations shall be subject to the approval of the Commission.” Additionally, “[i]n any reorganization of a public utility, resulting from a

³⁸ 220 ILCS 5/7-204(a) and (b).

³⁹ 220 ILCS 5/7-204(c).

⁴⁰ 220 ILCS 5/7-204A(a).

⁴¹ 220 ILCS 5/7-204A(b).

⁴² 220 ILCS 5/7-101(3).

⁴³ 220 ILCS 5/6-103.

forced sale, or in any other manner, the amount of capitalization...shall be such as is authorized by the Commission.”⁴⁴

E. Section 7-102 of the Act

With respect to approval of the proposed Reorganization, the JA maintain that Section 7-102 of the Act⁴⁵ is inapplicable. However, if the Commission determines that it is applicable, they assert that they have satisfied its requirements. Because the section is lengthy, we will not set forth its contents here. Rather, pertinent subsections will be set out as needed for analysis below. Insofar as this proceeding examines the Nicor OA as a stand-alone agreement (that is, apart from its legal significance as a component of the proposed merger), there is no dispute that Section of 7-102 applies.

IV. FINDINGS AND CONCLUSIONS

A. Section 7-204(b): Reorganization Approvals

Section 7-204(b) requires that the Commission make a series of findings to ensure that the proposed reorganization will not “adversely affect the utility’s ability to perform its duties under the Act.”⁴⁶ With respect to several of those findings, the JA accepted certain conditions recommended by Staff, in order to secure Commission approval.⁴⁷ Each finding required by 7-204(b) is addressed below.

1. Finding 1: “the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service”

a) Issues Presented & Analysis

Two disputed issues have been framed under subsection 7-204(b)(1) - first, whether there is enough evidence to find that NG’s pre-merger ability to supply statutorily sufficient service will not be diminished by the proposed Reorganization and, second, whether the JA have, in fact, committed to maintain union contracts and Illinois employment levels. The two issues are related, insofar as the latter issue bears upon NG’s ability to sustain pre-merger service quality⁴⁸. The Commission will nonetheless analyze them separately, so that the parties’ arguments are more clearly delineated.

1.) Sufficiency of JA’s Evidence

⁴⁴ *Id.*

⁴⁵ 220 ILCS 5/7-102.

⁴⁶ 220 ILCS 5/7-204(b).

⁴⁷ A list of agreed-upon conditions is attached to the JA RB.

⁴⁸ For brevity, we will generally use service “quality” as a surrogate for the multiple attributes of service (“adequate, reliable, efficient, safe and least-cost”) addressed by the statute

Concerning NG's post-merger ability to deliver quality service, Staff and AG/CUB have not offered their own evidence to show that future utility service will fall short of statutory standards. Rather, they have challenged, as they are entitled to do, the nature and weight of JA's evidence, insisting that it is insufficient to render the finding required by subsection 7-204(b)(1). Thus, our task is not to sift through competing information - indeed, Staff's position is that the JA "have provided no evidence for the Commission to consider"⁴⁹ - but to determine what information the statute requires and whether the JA have placed it in the record.

As Staff sees it, the JA's evidentiary case principally consists of recitations about NG's pre-merger service quality, AGL's track record with previous mergers, declarations of good intentions and a pledge not to reduce NG's aggregate staffing for three years⁵⁰. Therefore, Staff charges, the JA have "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."⁵¹ AG/CUB concur that "the record lacks evidence" pertaining to actual utility operations⁵².

With one significant exception, the JA do not cite any evidence that differs materially from Staff's characterization of the record. That exception concerns the integration planning process the JA have conducted since the Reorganization was announced. Specifically, JA explain, several hundred employees of AGL, NI and NG have worked since January 2011 on understanding and meshing the "processes, structures and practices" of the merging entities⁵³. JA state that these integration planning endeavors "assess the current state for each and every area of the two companies."⁵⁴ The JA further assert that their work on final operating plans will continue "until the Reorganization is closed."⁵⁵ JA underscore that approximately 3500 pages of documentation generated by JA's integration planners were submitted to Staff and presented during the evidentiary hearings in this case⁵⁶.

Staff acknowledges receiving JA's integration planning documents, but did so less than a week before evidentiary hearings commenced⁵⁷. Moreover, Staff contends, the JA "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 [NG's] provision of utility service."⁵⁸ Staff additionally categorizes much of the submitted information as overly general, trivial and, at times, duplicative⁵⁹.

⁴⁹ Staff IB at 11.

⁵⁰ Staff RB at 6.

⁵¹ *Id.* at 8.

⁵² AG/CUB IB at 8.

⁵³ JA RB at 7-8.

⁵⁴ JA Ex. 13.0 at 11.

⁵⁵ *Id.* at 13.

⁵⁶ *Id.* at 7-8; JA Ex's. 20 & 21.

⁵⁷ Staff RB at 9.

⁵⁸ *Id.*

⁵⁹ *Id.* at 9-10.

Again, the essential question posed by the foregoing arguments is whether the information and declarations JA have offered are appropriate and sufficient for supporting a finding that NG's post-merger ability to provide quality service will not be diminished. Staff and AG/CUB do not appear to believe that evidence regarding the prior performance of the acquiring entity - that is, its "track record" - is pertinent to the post-reorganization performance of the utility being acquired. While the Commission agrees that track record evidence is not necessarily determinative, it is certainly relevant and has whatever probative weight the would-be acquirer's track record deserves.

In this instance, JA have shown that AGL has acquired natural gas distribution utilities on three previous occasions⁶⁰ and (as catalogued above) now controls six such companies with 2.3 million customers in six states⁶¹. That experience in acquisition and management within the pertinent industry, and the expertise presumably derived from such experience, is unquestionably probative of an ability on the part of AGL to manage NG without diminish the utility's quality of service. Stating that in the reverse, it would not be sensible to ignore an acquirer's prior and continuing achievements (or failures) regarding the very functions it will have to perform to meet the statutory standards involved here. Comparable evidence was adduced in the 2007 merger involving Peoples Gas and North Shore Gas, without challenge to its probity from any party⁶². Analogously, applicants for alternate gas supplier certification must show they "possess sufficient technical, financial and managerial resources and abilities to provide the [intended] service,"⁶³ which, under our associated rules, necessitates presentation of what is, in essence, "track record" evidence⁶⁴.

In addition to the track record evidence here, the JA emphasize that certain decisions they have made will increase the likelihood that the Merger will not diminish NG's ability to supply quality service. They point to their commitment (described above, in section II.C. of this Order) to maintain the utility' aggregate staffing level for three years, with a five-year commitment for specific staffing and programs concerning pipeline safety (discussed in connection with subsection 7-204(b)(5) ("Finding 5") below). The JA also stress the specific measures they have promised in order to protect NG's financial health and access to capital (discussed in connection with subsection 7-204(b)(4) ("Finding 4") below), as well as NG's pre-existing financial strength. The Commission views the foregoing commitments as both empirically sound in their own right and indicative of an intention to maintain future utility service quality.

⁶⁰ JA Ex. 8.0 at 5.

⁶¹ JA Ex. 1.0 at 4.

⁶² *WPS Resources et al.* (application pursuant to Section 7-204 of the Act), Dckt. 06-0540, Order, Feb. 7, 2007 at 11.

⁶³ 20 ILCS 19-110(e)(1).

⁶⁴ *E.g.*, 83 Ill. Adm. Code 551.100 (requiring proof of four years of experience performing essential management functions). Similarly, when a prospective telecommunications provider seeks certification to provide local exchange service under 220 ILCS 5/13-405, the attributes and expertise of the applicant (its "technical, financial, and managerial resources and abilities") are what the relevant statute addresses and what the Commission, in fact, considers in such cases. *XO Communications Services, Inc.*, Dckt. 04-0519, Order, Dec. 15, 2004 (as a "garden variety" example of such proceedings).

Beyond their evidence of prior and ongoing operating experience, and of specific pledges in support of future operations, the JA point to the ongoing process of integrating the merging entities, as described above. The fact that the JA are conducting this process with a significant commitment of personnel is itself evidence that service quality will be maintained after reorganization. Indeed, it is, conceptually, exactly what needs to occur to achieve a smooth integration of the merging entities. The question really raised by the objections of Staff and AG/CUB is whether the integration process must be *completed* before the Commission can reasonably render the finding required by subsection 7-204(b)(1).

Staff (particularly through Mr. Maple) and AG/CUB are correct that evidence of the completion of integration planning (and, for that matter, the completion of integration implementation) would afford greater certainty for the requisite statutory finding. The JA respond, however, that culmination of the integration process cannot reasonably be required before the merger is actually approved⁶⁵. That argument has merit, since integration prior to this Commission's decision would have to be unwound if we rejected the proposed Merger, leaving behind wasted resources and disrupted operations. Even approval with additional conditions could cause comparable, if less severe, reworking of integration activities. A more appropriate test is whether the ongoing integration process is soundly conceived, adequately staffed and progressing satisfactorily. The JA claim that it is⁶⁶ and no party argues to the contrary.

The Commission holds that it is unnecessary to await completion of the company integration processes in this particular case. The intention of the statute is to sustain the utility's service quality status quo, not to achieve quality improvements. No one contends here that NG's service quality is presently sub-standard or vulnerable to slippage for any reason unrelated to merger. After merger, staffing levels will be maintained, generally by the same people in place now⁶⁷. The JA have no apparent incentive to compromise any of the attributes of service quality appearing in subsection 7-204(b)(1), and there is no evidentiary track record here of having done so in AGL's previous mergers elsewhere. Therefore, we assume that standard and predictable objectives - to increase revenues, avoid sanctions and sell unregulated services and products under a common brand⁶⁸ - will incent the post-merger entity to preserve utility service quality. If service quality nevertheless diminishes after reorganization, the Commission has statutory mechanisms for identifying imprudent and unreasonable management⁶⁹.

⁶⁵ JA RB at 5.

⁶⁶ A document entitled the "Current State Assessment," dated June 28, 2011, has been presented to the Chief Executive Officers of AGL and Nicor. JA Ex. 13.3 (confidential). It summarizes the integration activities preceding the presentation of the document and describes future tasks and objectives.

⁶⁷ Specifically, the NG employees "operating the system today will *largely* be the same group responsible for the activities following the Reorganization." JA Ex. 13.0 at 9 (emphasis added).

⁶⁸ "Certainly utilities are not added [sic] customers in either of our markets today. So the real opportunity of this deal is around those other businesses." Tr. 680 (Lingenfelter).

⁶⁹ For example, under Section 8-102 of the Act, the Commission can conduct an investigation or management audit of a public utility to "examine the reasonableness, prudence, or efficiency of any aspect of the utility's operations, costs, management decisions or functions that may affect the adequacy,

2. IBEW Objections

The IBEW asserts that the JA's evidentiary pledge to honor union contracts and maintain staffing levels is "vague and inconsistent," thereby undermining the JA's claim that the merger will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service⁷⁰. Ironically, IBEW's own position is clouded by vagueness and inconsistency. By way of relief, IBEW initially requests that we condition merger approval on a "clear commitment" by JA "to honor the existing union contract and maintain current staffing levels in Illinois for a minimum of three years."⁷¹ Subsequently, however, IBEW requests something more finite – a commitment to continue the current Illinois staffing levels "in each of the classifications covered by the collective bargaining agreement [between, specifically, NG and Local 19, IBEW]."⁷² Among its arguments supporting the latter relief, the IBEW considers it significant that the JA have not pledged "to maintain the jobs of individual employees,"⁷³ but IBEW does not demand that specific individual employees be retained in any of its requests for relief.

Consequently, the Commission is uncertain about the outcome IBEW seeks in this docket. Insofar as IBEW wants, as an unequivocal condition of merger approval, that the JA "honor the existing union contract and maintain current staffing levels in Illinois for a minimum of three years," the union can be readily obliged. Those actions are precisely what the JA have pledged to do, and we would reflect those pledges in merger conditions in any event.

However, insofar as IBEW wants maintenance of staffing levels in each CBA classification, or, even more narrowly, retention of current individual employees, the union has hardly aided its own cause. The JA have repeatedly stated their intentions regarding CBAs and employee staffing in their Application and in their direct, rebuttal and surrebuttal testimonies. They have also responded to data requests from other parties on these subjects⁷⁴. The IBEW, however, filed no responsive testimony, served no discovery, filed no motions and did not appear at (much less participate in) our evidentiary hearings. While IBEW is certainly free to file post-hearing briefs anyway, it does so with the risk that the evidentiary record will not support any relief it seeks in briefs.

That is the IBEW's dilemma here. There is no evidence or analysis in the record that addresses the contents, including the personnel classifications, of any CBA. Accordingly, we do not know what JA's CBA obligations are with respect to personnel classifications or whether a refusal to maintain staffing levels in any such classification -

safety, efficiency or reliability of utility service or the reasonableness or prudence of the costs underlying rates or charges for utility service." 220 ILCS 5/8-102.

⁷⁰ IBEW IB at 1.

⁷¹ *Id.*

⁷² *Id.* at 5. IBEW repeats this relief request in its RB at 2.

⁷³ *Id.* at 3.

⁷⁴ *E.g.*, AG Cross-Ex's. 6, 15 & 16.

if that is, in fact, what JA intend to do - would contradict JA's promise to "honor" their existing CBAs. Likewise, even if a refusal to maintain staffing levels in a personnel classification would contravene a CBA, the Commission has no basis for determining whether that would likely diminish service quality, which would be necessary to invoke our power under subsection 7-204(b)(1). The same evidentiary vacuum prevails with regard to individual employees, creating the same obstacles to analysis and findings⁷⁵.

It was up to the IBEW to lay the groundwork for the relief it seeks in its briefings, but it did not do that. It did not even use its opportunity to probe the JA's promises and intentions through cross-examination. To the extent that there is additional clarity in the record on JA's personnel-related commitments, it is because other parties⁷⁶ and our ALJ⁷⁷, not the direct representatives of NG's workers, asked questions. The answers, however, did not establish an evidentiary basis for findings or conclusions supporting the IBEW's proposed merger conditions concerning personnel classifications or individual employees.

b) Commission Conclusion

The Commission concludes that there is sufficient record evidence to support the finding required by subsection 7-204(b)(1) that the merger will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. Evidence of AGL's and Nicor's prior and ongoing experience in the operation of natural gas distribution utilities, of AGL's experience with previous mergers of such utilities, of the JA's binding operational and financial commitments (as described in this Order and included in Merger conditions), and of the ongoing activities to integrate the utility with the acquiring entity, collectively satisfies the statute. No contradictory inferences are supported by the record.

With respect to NG's workforce, the Commission approves the JA's commitments to honor NG's existing CBAs and to maintain its current Illinois staffing levels for three years (and, in some cases, five years) after completion of the Reorganization, as these commitments are described in section II.C of this Order. Lacking any supporting evidence, the IBEW's request for a continuation of the staffing levels in each classification in the Local 19, IBEW CBA will not be explicitly included in a merger condition. However, if the terms of the Local 19 CBA would require continued per-classification staffing, then the JA, through their promise to fully honor existing CBAs, will retain that obligation. Job retention for individual employees will also not be included as a merger condition here, again for complete lack of evidence supporting it.

⁷⁵ The only difference is that the JA have plainly declined to commit to retention of individual employees (in contrast to aggregate staffing). JA Ex. 13.0 at 10. JA contend it is "not practical" because a number of individual employees will leave the utility for a variety of voluntary or involuntary reasons. *Id.*

⁷⁶ *E.g.*, Tr. 588 *et seq.* & Tr. 644 *et seq.*

⁷⁷ *E.g.*, Tr. 577 *et seq.* & Tr. 665 *et seq.*

2. **Finding 2: “the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers,” and**

Finding 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”

a) Issues Presented and Analysis

With respect to subsections 7-204(b)(2) and (b)(3) of the Act, the parties have principally focused on whether each of several inter-affiliate agreements and transactions are compliant with these statutory requirements. Pursuant to their Reorganization request, the JA seek approval of the following arrangements involving NG and its affiliates: 1) the OA, which will continue to govern transactions between NG and its current affiliates, as well as transactions with AGL and AGSC; 2) a SA between NG and AGSC; 3) four existing agreements with Sequent - a Gas Exchange agreement, an Interstate Hub Service Agreement, an Intrastate Hub Service Agreement, and a NAESB - as well as capacity release arrangements between NG and Sequent from time to time in accordance with FERC’s capacity release rules; and 4) the TAA, as amended to include the surviving NI companies as parties to that agreement.⁷⁸ The issues arising under subsections 7-204(b)(2) and (b)(3) are, respectively, whether any of the agreements result in unjustified subsidization or fail to meet specified allocation requirements.

As agreements between and among affiliates, the foregoing arrangements must also satisfy the requirements for inter-affiliate transactions established by statute and regulation. Primarily, these are Sections 7-101 and 7-102 and subsection 7-204A(b) of the Act, and Section 550.120 of our regulations⁷⁹.

We stated earlier in this Order (and will discuss in much greater detail below) that NG initially applied for approval of its OA in another proceeding, then successfully requested transfer of that application to this docket. The Commission will reserve all analysis of the OA for a later section of this Order (with the exception of specific and limited references in this section). Accordingly, our analysis in this section is confined (unless expressly stated otherwise) to three of the categories of agreements listed above - the SA, the Sequent agreements and capacity release arrangements and the TAA.

JA witnesses testify that the Reorganization includes appropriate contractual requirements, allocation standards, and compliance processes to ensure that AGL’s

⁷⁸ Application at 6, 8, 12-13 and Att. A, *Information Required Pursuant to 220 ILCS 5/7-204A(a)(5)*; JA Ex. 5.0 at 2; JA Ex. 6.0 at 4, 12-13; Staff Ex. 8.0 at 18 and Att. B.

⁷⁹ 83 Ill. Adm. Code 550.120.

non-utility activities, including the activities of its non-regulated subsidiaries, will not be subsidized by either NG or its customers⁸⁰. Moreover, they assert, the operations of one regulated subsidiary will not be subsidized by another⁸¹ and corporate costs and inter-company transfers will be properly allocated⁸². AGL and NG further maintain that their systems will ensure accurate allocation of costs and facilities between utility and non-utility activities⁸³. They emphasize that NG will continue to adhere to the Commission's Uniform System of Accounts for Gas Utilities⁸⁴.

Staff witness Hathhorn recommends that the Commission approve the SA and the TAA, and that the Reorganization be found in compliance with subsections 7-204(b)(2) and (b)(3), if JA are subject to the following conditions: 1) add an access to records paragraph to the SA; 2) require that changes in allocation methods in the SA be filed with the Commission; 3) require an annual internal audit for the SA; 4) require a triennial cost study of the services provided under the SA; 5) require annual filing of a Billing Report for the SA; 6) require that human resources-related costs be directly charged or assigned; 7) require that JA file an executed copy of the TAA on e-Docket; and 8) require that JA file the final disposition of journal entries on e-Docket⁸⁵. Ms. Hathhorn additionally recommends that the Commission approve the OA, if we require AGSC to pay NG fully distributed cost ("FDC") for services provided to AGSC. JA accept the foregoing conditions to the Commission's approval of the Merger for purposes of compliance with Sections 7-204(b)(2) and (b)(3), as further clarified through rebuttal and surrebuttal testimony⁸⁶.

Staff witness Rearden also made several recommendations with respect to affiliate transactions. Pertinent to this section of the Order, he recommended that: 1) the JA consult with Staff and receive Commission approval before signing an asset management agreement⁸⁷; 2) Sequent not be a party to the NG inter-affiliate OA⁸⁸; 3) the four existing agreements between NG and Sequent for which JA seek approval under Section 7-204A(a)(5) be approved⁸⁹; and 4) there be no right of last refusal for Sequent on spot gas purchases.⁹⁰ The JA accepted these recommendations⁹¹.

No party objected to JA's request for approval for NG to enter into capacity release arrangements with Sequent from time to time in accordance with FERC's capacity release rules.

⁸⁰ Application at 8; JA Ex. 5.0 at 4-11; JA Ex. 6.0 at 7-12.

⁸¹ *Id.*

⁸² *Id.*

⁸³ Application at 9; JA Ex. 5.0 at 4-11; JA Ex. 6.0 at 12.

⁸⁴ Application at 9.

⁸⁵ Staff Ex. 8.0 at 4-20.

⁸⁶ JA Ex. 10.0 at 2; Staff Ex. 14.0 at 7-8; JA Ex. 15.0 at 1-2.

⁸⁷ Staff Ex. 16.0 at 6.

⁸⁸ Staff Ex. 10.0 at 14.

⁸⁹ Staff Ex. 10.0 at 7, 13.

⁹⁰ *Id.* at 13-14.

⁹¹ JA Ex. 8.0 at 11-13; JA Ex. 11.0 at 8-9; JA Ex. 13.0 at 6-7.

Regarding JA's accounting entries associated with the proposed Reorganization, Staff notes that analysis cannot be concluded until the first financial statements for NG are filed with the Securities and Exchange Commission⁹². Consequently, as noted above, Staff requests public posting of final entries on our e-Docket system at a later time. There are no directly disputed issues in this case concerning accounting entries. However, future accounting entries may be indirectly affected by the resolution of disputed issues or by the conditions imposed in this Order.

b) Commission Conclusion

With the conditions proposed by Staff and accepted by the JA, the Commission concludes that the JA have satisfied the requirements of subsections 7-204(b)(2) and (b)(3) of the Act. This conclusion does *not* include or apply to the inter-affiliate OA, which is evaluated in a separate section of this Order, below⁹³. Additionally, the inter-affiliate agreements discussed above (other than the OA) also comply with the terms of Sections 7-101 and 7-102 and subsection 7-204A(b) of the Act, and Section 550.120 of our regulations.

Subject to the condition that final entries will be timely posted on e-Docket and served upon Staff, the JA's accounting entries associated with the proposed Reorganization are prospectively approved, with the proviso that any impact on such entries resulting from our resolution of disputed issues or our imposition of merger conditions in this Order must be reflected in such entries, in a manner consistent with the rationale, determinative principles, findings and conclusions of this Order.

3. Finding 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"

a) Issues Presented & Analysis

JA and Staff submitted testimony addressing whether the proposed Reorganization would satisfy the criteria subsection 7-204(b)(4) of the Act. No other party presented testimony on this issue.

The JA maintain that the Reorganization will not impair NG's ability to raise capital on reasonable terms or to maintain a reasonable capital structure⁹⁴. Given what they view as AGL's and NG's favorable financial positions (both present and post-

⁹² Staff Ex. 8.0 at 19.

⁹³ The sole exceptions to this admonition are that we approve Staff's recommendations (accepted by the JA for purposes of this proceeding) that Sequent will not be permitted to be a party to the OA, and AGSC will pay NG's FDC for services provided to AGSC. These conditions are among the indispensable bases for our conclusion that the JA are in compliance with the statutory and regulatory requirements discussed in this section of the Order.

⁹⁴ Application at 9; JA Ex. 3.0 at 2-9.

merger), the JA assert that NG will continue to have access to both the long-term and short-term capital markets at a reasonable cost⁹⁵.

Staff agrees that NG and AGL are each currently able to raise necessary capital on reasonable terms⁹⁶. Staff points out that, though, that NG may have to refund substantial amounts (up to approximately \$286 million) to its customers, depending upon the result of the Commission's ongoing review of NG's performance-based rate ("PBR") plan for 1999-2002⁹⁷. However, Staff analyzed the impact of a worst-case outcome for NG and concludes that "refunds up to \$286.5 would not have a significant adverse effect on [NG's] financial metrics."⁹⁸ JA's position is that the PBR review, which has been in progress for several years, is independent of the merger request and, for that reason, unrelated to the question of the impact of *the Reorganization* on NG's capital procurement⁹⁹.

Overall, while Staff witness Phipps expects some post-merger increase in NG's cost of capital (discussed in a later section of this Order), she nevertheless avers that, with certain conditions in place, the Reorganization "will not *significantly* impair the utility's ability to raise necessary capital on reasonable terms."¹⁰⁰ Those conditions (without which, she asserts, the Reorganization will not satisfy the requirements of subsection 7-204(b)(4)) are that the JA, first, create and maintain a separate credit facility for NG, as soon as is reasonably practicable, and, second, file with the Commission, following reorganization, a compliance report addressing the first merger condition, accompanied by copies of NG's post-merger credit facilities, with service of a copy of the filing to the Manager of the Commission's Finance Department¹⁰¹. JA accepted these recommendations as conditions to the Commission's approval of the Merger, consistent with the JA's own proposal to continue to maintain a separate commercial paper program to meet NG's short-term borrowing needs¹⁰².

b) Commission Conclusion

Based on the evidence of record and in light of JA's acceptance of the conditions proposed by Staff, the Commission concludes that the Reorganization will not significantly impair NG's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure, provided NG complies with Staff's proposed conditions, and the JA's own commitments, as described above. Accordingly, the Commission finds that the proposed Reorganization satisfies the criteria of subsection 7-204(b)(4) of the Act.

⁹⁵ *Id.*

⁹⁶ Staff Ex. 9.0 at 4-7.

⁹⁷ That review is being conducted in our Dockets 01-0705, 02-0067 & 02-0075 (consol.) (on reopening).

⁹⁸ Staff Ex. 9.0 at 10-11.

⁹⁹ JA Ex. 9.0 at 4-5.

¹⁰⁰ Staff Ex. 9.0 at 10-11 (emphasis in original).

¹⁰¹ *Id.* at 14.

¹⁰² JA Ex. 9.0 at 2-4.

The Commission observes that in this particular reorganization docket, NG's cost of capital has been presented for review under two statutory provisions - subsection 7-204(b)(4), because that is what the instant subsection expressly addresses, and subsection 7-204(b)(7), because Staff and AG/CUB have framed a disputed capital cost issue (analyzed below) under that provision. With respect to the interplay between the two subsections, Staff's position, as we construe it¹⁰³, is that even after the post-merger capital cost increase Staff predicts in its analysis under subsection 7-204(b)(7), NG's cost of capital and capital structure would remain within the zone of reasonableness required by subsection 7-204(b)(4). Thus, the latter provision is about NG's ability to raise capital, while subsection 7-204(b)(7) is - in this particular case - about the result of raising capital at a purportedly merger-induced higher cost. It follows that the Commission does not intend that our conclusions regarding subsection 7-204(b)(4) will resolve the dispute framed under subsection 7-204(b)(7), below.

4. Finding 5: “the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities”

a) Issues Presented & Analysis

By its terms, subsection 7-204(b)(5) of the Act can simply pose a single question that, practically speaking, calls for nothing more than a “yes” or “no” answer (*i.e.*, will the post-reorganization remain a public utility, which is *ipso facto* subject to Illinois law and regulation?). Responding to that elemental question, JA witnesses testified that NG will not, itself, merge or change corporate form as a consequence of the Reorganization; it will remain an Illinois public utility following the Reorganization¹⁰⁴. As a result, the JA state that NG will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities¹⁰⁵. Staff agrees¹⁰⁶ (and no party disagrees with the JA on this fundamental question).

Subsection 7-204(b)(5) can also be construed to pose particular questions about the reorganized entity's continued subjection to specific legal requirements. In this regard, Staff, through witness Burk, raised several concerns pertaining to NG's post-merger compliance with pipeline safety provisions¹⁰⁷. As testimonial filings and negotiations progressed, the JA agreed to have a number of conditions relating to pipeline safety placed in this Order. Thus, the JA have committed for a period of five years following the closing of the Reorganization to:

1. Maintain in Illinois the current number of FTEs - 51 full and 24 partial - in the following areas: Corrosion Control; the Technical Compliance Department; the Locating Services Department; the Transmission Integrity

¹⁰³ Staff does not explicitly address this.

¹⁰⁴ Application at 9; JA Ex. 1.0 at 12; JA Ex. 2.0 at 6-7; JA Ex. 6.0 at 4.

¹⁰⁵ Application at 9-10; JA Ex. 1.0 at 12; JA Ex. 2.0 at 6-7; JA Ex. 6.0 at 4-5.

¹⁰⁶ Staff Ex. 6.0 at 9.

¹⁰⁷ Staff Ex. 12.0 at 2-23; Staff Ex. 18.0 at 7-8.

Management Program; and the Distribution Integrity Management Program¹⁰⁸;

2. Maintain in Illinois management personnel directly responsible for the day-to-day supervision of the positions identified in paragraph 1¹⁰⁹;
3. Maintain in Illinois the current level of training and quality assurance programs for compliance monitoring activities¹¹⁰; and
4. Meet with the Commission Staff's Pipeline Safety Program Manager, or his/her designee(s), to discuss any proposed material change(s) to the job duties for any of the positions identified in paragraph 1¹¹¹.

In accordance with Staff's recommendations, JA also agree that NG will petition the Commission 90 days prior to the end of the five-year period to determine whether NG's performance concerning pipeline safety issues is reasonably comparable to pre-reorganization levels at NG, or whether an extension is required, for the commitment period for the items identified in paragraphs 1 and 2, beyond five years¹¹². Further, JA agree that NG will review the petition and pipeline safety performance with Staff 60 days before filing such petition¹¹³. With these agreements from JA, Staff concluded that the Reorganization can be found to comply with Section 7-204(b)(5)¹¹⁴.

b) Commission Conclusion

Based on the evidence presented by JA and Staff witnesses, and JA's acceptance of the conditions proposed by Staff, the Commission concludes that NG will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities. Accordingly, the Commission finds that the proposed Reorganization satisfies the criterion of Section 7-204(b)(5) of the Act.

5. **Finding 6: "the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction"**

a) Issues Presented & Analysis

JA witnesses testified that the proposed Reorganization should have no significant adverse impact on the competitive retail gas markets in Illinois¹¹⁵. They emphasize that, pursuant to the Act and NG's tariffs, NG's retail gas customers may purchase their gas supply from suppliers other than NG and have those third-party gas

¹⁰⁸ Staff Ex. 12.0 at 20-23; Staff Ex. 18.0 at 7; JA Ex. 12.2; JA Ex. 13.0 at 4, 8.

¹⁰⁹ Staff Ex. 18.0 at 7; JA Ex. 13.0 at 4, 8.

¹¹⁰ Staff Ex. 18.0 at 7; JA Ex. 13.0 at 4, 8.

¹¹¹ Staff Ex. 18.0 at 8; JA Ex. 13.0 at 4, 8.

¹¹² Staff Ex. 18.0 at 8; JA Ex. 13.0 at 4, 8.

¹¹³ Staff Ex. 18.0 at 8; JA Ex. 13.0 at 4, 8.

¹¹⁴ Staff Ex. 18.0 at 7-8; JA Ex. 13.2.

¹¹⁵ Application at 10; JA Ex. 1.0 at 12-13; JA Ex. 6.0 at 3, 5-7.

supplies delivered to them over NG's gas distribution systems; these competitive activities will not be adversely affected as a result of the Reorganization¹¹⁶.

Staff witness Rearden recommends that the Commission make the required finding under subsection 7-204(b)(6) that the proposed transaction is not likely to have a significant adverse effect on competition for either the small customer transportation market or the large customer transportation market¹¹⁷. After negotiations with the JA, RESA and IGS withdrew direct testimony relating to such competition.¹¹⁸ No party is contending that the Application and supporting evidence are insufficient with respect to subsection 7-204(b)(6).

b) Commission Analysis and Conclusion

Based on record evidence and Staff's recommendations, the Commission concludes that the proposed Reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction. Accordingly, the Commission finds that the proposed Reorganization satisfies the requirements of subsection 7-204(b)(6) of the Act.

6. Finding 7: "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers"

a) Issues Presented & Analysis

The sole dispute under subsection 7-204(b)(7) of the Act is whether reorganization will cause a diminution of NG's credit rating that, in turn, is likely to adversely impact NG's retail rates. As Staff posits it, NG's credit ratings are expected to decline when it becomes a subsidiary of AGL, an entity with higher financial risk. The rating cut would engender higher debt costs, thereby leading to higher equity costs due to elevated risk. The result would likely be a rate increase to account for NG's greater cost of capital¹¹⁹. AG/CUB concurs with Staff's analysis that a credit rating downgrade will occur and that it will lead to adverse retail rate impacts¹²⁰.

JA reply that a rating reduction is far from likely, particularly in view of measures they have proposed to cushion NG's risk status from negative consequences. JA further argue that even if a downgrade is imposed, a resulting increase in credit costs is uncertain and may, in any event, have no discernible rate impact. Moreover, NG claims, the Commission is required by Section 9-230 of the Act¹²¹ (on which Staff and AG/CUB also rely) to remove, in any future NG rate case, the effect of non-regulated affiliated entities on the utility's capital costs, thus precluding the adverse rate impact

¹¹⁶ Application at 10; JA Ex. 6.0 at 5-7.

¹¹⁷ Staff Ex. 10.0 at 3-7; Staff Ex. 16.0 at 1-2.

¹¹⁸ NG Ex. 8.0.

¹¹⁹ Staff IB at 13 (for all Staff contentions in this paragraph).

¹²⁰ AG/CUB IB at 13.

¹²¹ 220 ILCS 5/9-230.

NG's opponents predict. Also, JA objects that a rate impact projection based on a single cost element (here, capital cost), rather than aggregate costs, contravenes the rule against single-issue ratemaking¹²².

As the Commission sees it, the initial question is whether a credit rating downgrade is indeed likely to be imposed on NG if the proposed merger is consummated. Staff maintains that two of the three principal rating agencies - Standard & Poor's ("S&P") and Moody's - expect to issue a post-merger downgrade¹²³. On March 22, 2011, S&P noted that it had placed NG on "CreditWatch" in December 2010, based on its calculation that, post-merger, AGL's *pro forma* credit metrics would be "materially worse than Nicor's."¹²⁴ Since S&P expects "to use a consolidated ratings approach on the new company and will equalize the corporate credit ratings of all entities in the corporate structure,"¹²⁵ it would follow that NG's rating would drop to AGL's lower level. S&P did not quantify post-merger rating, but stated its expectation that the consolidated entity would have a credit rating "no lower than BBB+"¹²⁶. NG's current S&P credit rating is AA¹²⁷ and AGL's current rating is A- (with its current financing subsidiary, AGL Capital Corporation rated BBB+)¹²⁸.

S&P's stated expectations are unequivocal and unqualified by the potential impact of any identified future events. The Commission accordingly concludes that a post-reorganization credit rating downgrade by S&P is, at the least, likely.

Moody's presents a different picture, however. On December 7, 2010, Moody's affirmed NG's rating at A2 (Moody's uses a different nomenclature than S&P), but "changed its outlook to negative from stable"¹²⁹. Moody's observed that AGL is a "more leveraged" entity that "is expected to fund the roughly \$1 billion cash portion of the consideration [for the acquisition of Nicor] with corporate debt, which the Nicor subsidiaries, principally [NG] will help to service along with the AGL subsidiaries." Consequently, Moody's projects downgrading NG by "one notch," to conform with certain lower-rated AGL subsidiaries. However, the alignment of NG's post-merger ratings with those AGL's subsidiaries "assumes that [NG] will become part of AGL's money pool arrangement in which subsidiary funds are managed centrally." Moody's added that NG's ratings outlook could be "stabilized" if the Commission constrained NG's ability to "upstream" dividends to its corporate parent *or* if NG "were not to be included in AGL's money pool." After the ratings agencies' cautionary announcements,

¹²² JA IB at 22-26 (for all contentions in this paragraph).

¹²³ Staff IB at 13-14 (based on Staff Ex's. 15.01 & 15.02. According to the JA, the third rating agency, Fitch,"reaffirmed all of [NG's] ratings after the Merger announcement." JA Ex. 3.0 at 6.

¹²⁴ Staff Ex. 15.01. Credit metrics are certain statistical ratios that financial rating agencies use to evaluate the financial risk profile of an enterprise. These typically include, among other things, the ratio of funds from operations to total debt and the ratio of total debt to capital. *Id.* Staff also uses these metrics to analyze company financial strength and risk. *E.g.*, Staff Ex. 9.0, Att. 9.1 (confidential).

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ Staff Ex. 9.0 at 7.

¹²⁹ Staff Ex. 15.02 (for all Moody's-related facts in this paragraph).

the JA determined that NG will not be included in the money pool. The result, JA contend, is that “there will be no credit unity between [NG] and the lower-rated operating companies post reorganization.”¹³⁰

In view of NG’s subsequent exclusion from AGL’s intended money pool, the Commission finds that Moody’s ratings announcement does not support the conclusion that Moody’s will downgrade NG if merger is approved. The evidentiary record does not address whether the JA altered their earlier plan to include NG in the money pool to satisfy Moody’s¹³¹, but it does not matter. Moody’s identified two alternate measures that would potentially sustain NG’s credit rating and the JA have agreed to implement one. As all parties addressing this issue agree, the future actions of a credit rating agency cannot be foretold with precision. As a question of likelihood, however, we cannot find it likely that Moody’s (in contrast to S&P) will impose a downgrade, which removes Moody’s as an obstacle to the JA’s meeting their burden of proof on subsection 7-204(b)(7).

The next question, then, is whether the probable S&P downgrade is likely to increase the utility’s cost of capital. The Commission concurs with Staff that a diminished credit rating will cause NG’s capital costs to rise. Irrespective of the magnitude of the increase, it is inevitable that a reduced credit rating, and the inferior credit metrics associated with that lower rating, will “lead to higher debt costs, which in turn, would lead to higher equity costs as well, since higher debt costs increase financial risk.”¹³² That does not necessarily mean, though, that the capital cost increase will result in an impact upon the utility’s rates. Indeed, the JA assert that no such impact will occur.

The JA cite Section 9-230 of the Act, which excludes from utility rate of return (“ROR”) calculations any 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.”¹³³ The JA argue that in any future NG rate proceeding, the Commission will apply Section 9-230 to bar any increased capital cost related to AGL and its affiliates. The Commission agrees with the JA that proper application of Section 9-230 would scour any capital cost increase from NG’s ROR if it arises from affiliation with a non-utility.

Staff responds, however, that the Commission is obliged to “use its authority to prevent that increase in the cost of capital from occurring in the first place.”¹³⁴ As a legal principal, that is simply incorrect. Section 9-230 does not prohibit a utility from

¹³⁰ JA Ex. 14.0 at 4.

¹³¹ The JA did, however, revise their money pool commitment to satisfy Staff’s concern that NG not be permitted to make cash advances to non-utility affiliates (although NG could borrow from such entities), as set forth in Staff Ex. 9.0, Att. 9.2. JA Ex. 9.0 at 11. Staff had insisted, and NG concurred, that the relevant AGL affiliates would not have been eligible under 83 Ill. Adm. Code 340.40(b) to borrow from NG under extant circumstances. Staff Ex. 9.0 at 22; NG Ex. 9.0 at 11.

¹³² Staff Ex. 9.0 at 15.

¹³³ 220 ILCS 5/9-230, cited at JA IB at 24-25.

¹³⁴ Staff RB at 19.

incurring costs, including capital costs. It prohibits the inclusion of such cost from the utility's ROR calculation when affiliation with an unregulated entity caused the cost. While Staff is correct, per judicial ruling, that literally *any* such cost must be excluded from the ROR, down to the last "iota,"¹³⁵ Section 9-230 does not require - or even empower - the Commission to prevent the cost from occurring.

Alternatively, Staff raises a practical concern about the application of Section 9-230 in future ratemaking. Staff avers that it has become "far more challenging" than a decade ago to "remove the incremental costs and risk due to non-utility affiliates."¹³⁶ Staff attributes this situation to shrinkage in the number of gas utilities suitable for establishing benchmarks when estimating a gas utility's cost of equity¹³⁷. Staff acknowledges that this has not precluded the Commission from implementing Section 9-230¹³⁸, but maintains that the foregoing analytic difficulties reduce the probability that the Commission will successfully perform its Section 9-230 duty to remove all affiliate-related risk and cost from NG's ROR in a future docket¹³⁹. That is the adverse rate impact that Staff contends must be addressed now, under the rubric of subsection 7-204(b)(7), before the Reorganization can be approved.

Staff has a proposal for accomplishing that task, presented in oral testimony during evidentiary hearings. Staff recommends that in a future rate-setting, debt would be increased within NG's capital structure, with equity (a more costly source of capital¹⁴⁰) correspondingly reduced, until NG's resulting financial metrics are consistent with its post-merger credit rating¹⁴¹ (which, again, will presumably be below its pre-merger lever, since, as noted, S&P will rate NG on a consolidated basis with the rest of post-merger AGL). This alignment of NG's post-merger capital structure and post-merger capital costs would "effectively remove any incremental cost resulting from a potential mismatch" between those elements, Staff believes¹⁴².

As the Commission construes it, Staff's recommendation is that we determine today that we will nullify the impact of a post-merger credit rating reduction by revising NG's post-merger capital structure in a future proceeding, until total capital cost would equal what it would have been had no credit rating downgrade been imposed. Although this recommendation is offered for the sake of greater efficiency and relative simplicity, it would not necessarily yield a capital structure or capital cost that the Commission would actually approve, since its purpose is solely to remove affiliate-

¹³⁵ Illinois Bell Telephone v. Illinois Commerce Commission, 283 Ill. App. 3d 188, 207, 669 N.E. 2d 919, 933 (2nd Dist. 1996) ("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.")

¹³⁶ Staff RB at 20.

¹³⁷ *Id.*

¹³⁸ Tr. 780 (Phipps).

¹³⁹ Staff RB at 20.

¹⁴⁰ Citizens Utility Board v. Commerce Commission, 276 Ill. App. 3d 730, 744, N.E. 2d 1194, 1205 (1st Dist. 1995).

¹⁴¹ Tr. 792-93 (Phipps).

¹⁴² Staff IB at 21.

related cost from the ROR reasonableness assessment, not to set a reasonable ROR¹⁴³. Indeed, Staff says that its proposal should only establish a “ceiling” for the post-merger equity in NG’s capital structure, “in order to provide interested parties the opportunity to propose capital structures, capital structure adjustments or a hypothetical capital structure in future rate cases.”¹⁴⁴ It is thus not clear to the Commission that Staff’s proposal will reduce the complexity of setting a reasonable ROR, since it will identify only a cost/risk element that must be eliminated from consideration. A gas utility sample will still need to be constructed to ultimately determine capital costs.

The JA also offer a proposal intended to address the potential impact of the likely credit rating downgrade on NG’s post-reorganization rates. They would use NG’s *pre-merger* credit rating to determine NG’s debt and equity costs in any rate-setting proceeding during the three-year period immediately following closure of the Reorganization¹⁴⁵. JA describe this as a pledge to “freeze” their existing AA S&P credit rating for the three-year period, which would preclude them from later arguing that NG’s credit rating had changed for “reasons unrelated to the merger, or that another rating is more cost-effective.”¹⁴⁶

Staff objects, however, that without a predetermined adjustment to NG’s capital structure (to limit the equity portion), the use of NG’s pre-merger credit rating will not conform to NG’s true post-merger capital costs, which will reflect the anticipated credit rating downgrade. While that “mismatch” could indeed materialize, ratepayers would not pay the difference, though, if Section 9-230 is properly applied. That is, under Section 9-230, any higher capital cost resulting from NG’s merger would become the burden of shareholders, with ratepayers responsible only for a reasonable ROR – *i.e.*, an ROR based on NG’s pre-merger credit standing. We are not pre-approving NG’s current capital structure for future ratemaking, as Staff suggests¹⁴⁷. A revision to NG’s capital structure could still be part of arriving at a reasonable ROR, but we do not perceive a need to decide that now. When NG’s next ratemaking takes place, then extant circumstances (along with NG’s pledge to freeze its pre-merger credit rating within the defined three-year period) will determine NG’s appropriate capital structure¹⁴⁸.

That does not conclude our discussion of this issue, however. NG’s commitment to its pre-merger credit rating has a three-year shelf life. Similarly, as an outgrowth of negotiations with Staff, the JA have agreed that NG’s base rates shall be fixed in their

¹⁴³ “[A]ll reasonable rates exclude any incremental risk or increased cost of capital due to affiliation; however, the simple exclusion of such risk or cost does not, *a fortiori*, make rates reasonable.” Illinois Bell Telephone v. Illinois Commerce Commission, *supra*, 283 Ill. App. 3d at 207, 669 N.E. 2d at 933.

¹⁴⁴ Staff IB at 21.

¹⁴⁵ JA Ex. 14.0 at 7.

¹⁴⁶ JA RB at 18. The Commission notes that even if another rating were more “cost-effective,” 9-230 would still require removal of affiliate-related risk and cost.

¹⁴⁷ Staff IB at 17.

¹⁴⁸ A “violation of Section 9-230 does not, *per se*, require the adoption of a hypothetical capital structure.” Bell Telephone v. Illinois Commerce Commission, *supra*, 283 Ill. App. 3d at 210, 669 N.E. 2d at 935.

current position for three years from the date the proposed reorganization closes¹⁴⁹. There are qualifiers and ambiguities to this commitment by NG that concern the Commission (which we address below and section IV.B. of this Order). Assuming our concerns are relieved, however, it is not likely that NG's retail rates can be impacted, within the meaning of subsection 7-204(b)(7), by an S&P credit rating reduction during the three years immediately following the Reorganization's closing. Nevertheless, since subsection 7-204(b)(7) (and, for that matter, Section 9-230) contains no time-limiting provision, we have to consider the potential rate impact of reorganization after the third year ends.

Initially, we note that JA's commercial paper commitments are not material here. As already noted, the JA pledged to maintain a separate commercial paper program for NG, with a credit facility backstop, solely to fund NG's cash working capital¹⁵⁰. JA later accepted Staff's recommendation to clarify that NG's renewed backstop credit facility would be associated only with NG¹⁵¹. JA also agreed to a Staff-proposed compliance reporting requirement to facilitate Staff oversight of NG's stand-alone credit obligations¹⁵². While the Commission approves these measures, commercial paper is short-term debt, which is ear-marked for NG's cash working capital needs. The credit downgrading expected by S&P concerns long-term debt, which is rated apart from commercial paper by the rating agencies. We therefore exclude JA's pledges with regard to commercial paper from our analysis here.

Also, the Commission cannot avoid considering adverse rate impacts after year three of the Reorganization even though the JA stress that NG will have no long-term debt maturities until 2016 and is "not projected to need to be in the capital markets to raise any new long-term debt or equity prior to that maturity."¹⁵³ There is no commitment from the JA to abjure additional long-term debt before maturity of its existing debt. Moreover, Moody's states that "AGL is expected to fund the roughly \$1 billion cash portion of the [Nicor acquisition] with corporate debt, which the Nicor subsidiaries, principally [NG], will help to service along with the AGL subsidiaries."¹⁵⁴ If NG's funds from operations prove unequal to that task (and NG does not predict customer growth through 2015¹⁵⁵), NG could, at least in theory, become a post-merger vehicle for additional long-term debt financing. Even if the post-merger NG did refrain from raising more long-term debt until the maturity of current long-term debt approached, that would simply delay debt activity until some time in 2015, which would be the year the JA's commitments to freeze base rates and rely on NG's pre-merger credit rating would likely expire.

¹⁴⁹ *Agreed Stipulation Between Joint Applicants and Staff*, filed August 24, 2011. Much of the text of the Stipulation appears in section IV.B. of this Order.

¹⁵⁰ JA Ex. 3.0 at 8. JA Ex. 14.0 at 6.

¹⁵¹ JA Ex. 9.0 at 2; Staff Ex. 9.0 at 14.

¹⁵² JA Ex. 9.0 at 2; Staff Ex. 9.0 at 14.

¹⁵³ JA Ex. 3.0 at 5.

¹⁵⁴ Staff Ex. 15.02.

¹⁵⁵ *E.g.*, Staff Group Cross-Ex. 2 (un-numbered page in exhibit, page 33 in original document).

To the point, JA agree that, whenever the three-year period after the Reorganization's closing ends, they will file a study analyzing the impact of NG's affiliation with AGL and its subsidiaries on NG's cost of capital¹⁵⁶. In a curious confluence, however, *both* NG and Staff disparage the usefulness of the proposed study. Staff is at least consistent with its objection to the proposal when it asserts that "the value of a study that compares post-merger [NG] with a [NG] that no longer exists would surely diminish as the time horizon lengthens."¹⁵⁷ But NG simply undermines its own promise when it declares that determining what NG's credit ratings, capital structure and capital costs would have been absent reorganization becomes an "exercise in speculation" over time and "unreasonable" after three years¹⁵⁸.

Nevertheless, there are components of such a study that would likely prove helpful to the Commission (whether, as is likely, to implement Section 9-230, or, absent that statute, to implement our present intention to preclude adverse rate impact from post-merger affiliations). Inherently, information pertaining to the initial three years after reorganization would be included with information associated with any subsequent interval prior to ratemaking. Neither party dismisses the value of that information. Furthermore, NG states that trustworthy debt-related data will be available for a period beyond three years¹⁵⁹. Accordingly, we will hold the JA to their commitment to file, in connection with any rate-making proceeding in progress after the end of the third post-closing year¹⁶⁰, a study analyzing the impact of NG's affiliation with AGL and its affiliates on NG's cost of capital (both debt and equity). The Commission will determine the efficacy of that study when it is filed¹⁶¹.

¹⁵⁶ JA Ex. 14.0 at 7-8. The JA characterize this as a study "addressing applicable requirements of Section 9-230." That is potentially too limited. In this proceeding we are acting to preclude the adverse rate impact prohibited by subsection 7-204(b)(7). If, as the JA themselves suggest (JA Ex. 14.0 at 7-8), Section 9-230 no longer applies for some reason three years after closing, the Commission's present intention to establish a condition to avert adverse rate impact from merger-related affiliates will remain in force.

¹⁵⁷ Staff IB at 20.

¹⁵⁸ JA RB at 17-18.

¹⁵⁹ Tr. 524-25 (Cave).

¹⁶⁰ In prefiled testimony, JA refers to the proceedings in which it commits to filing its studies as proceedings "where the cost of capital is an underlying determinant factor." JA Ex. 14 at 7. At hearing, JA clarified that it was referring to "any proceeding where the cost of capital is an issue that determines rates." Tr. 522 (Cave). JA further clarified that it was not their intention to limit their filing commitment to cases in which cost of capital disputes were of sufficient magnitude to affect the final rate to the customer. So that there is no misunderstanding, the Commission expects, and conditions any merger approval on, submission of the pledged studies in any ratemaking proceeding in which NG's cost of capital is addressed.

¹⁶¹ We will assuage some of Staff's logistical concerns today, however. Staff IB at 16. The studies described in JA Exhibit 14 - for the three years immediately following reorganization *and* for the indeterminate period thereafter - are voluntarily offered for the purpose of securing merger approval. The Commission, in turn, conditions any merger approval on, among other things, expected production of those studies. Therefore, the costs of the studies are among the costs of accomplishing the proposed Reorganization, which cannot be recovered from ratepayers, in keeping with the August 24, 2011 Stipulation filed in this case. Moreover, the studies shall be presented to Staff, with all supporting data and work-papers, within a sufficient time to receive Staff recommendations before filing.

Finally, the Commission will make explicit several principles that have been implicit in our subsection 7-204(b)(7) analysis thus far. First, we firmly reject JA's argument that the "adverse rate impacts" prohibited by the statute cannot occur unless the "totality" of a merger, rather than a limited number of cost elements, will likely affect the utility's retail rates¹⁶². Absolutely nothing in the subsection states or implies that only the "totality" of a proposed merger can have the precluded adverse impact. Subsection (b)(7) bars "any" likely adverse rate impact, of whatever cause associated with reorganization. Indeed, the Commission cannot perceive what would constitute the "totality" of merger, why the legislature would not protect retail customers from adverse rate impacts resulting from less than a "totality," or why resources should be expended debating or implementing a "totality" standard.

Second, we dismiss as irrelevant JA's repeated assertion that "the proposed reorganization includes no rate increase."¹⁶³ The JA may not *intend* for NG's rates to increase due to the merger, but that hardly means that rates will not increase anyway. Furthermore, the statute looks at adverse rate *impact*, which is not synonymous with a rate *increase*. The fundamental requirement for a rate is that it must be just and reasonable¹⁶⁴, and a proposed rate change must also be just and reasonable¹⁶⁵. A rate must also be non-discriminatory¹⁶⁶, and, as discussed above, it cannot, per Section 9-230, reflect capital costs associated with non-regulated affiliates. Accordingly, a merger proposal that would likely render a rate unjust, unreasonable, discriminatory or infused with prohibited capital cost is adversely affecting that rate within the meaning of subsection 7-204(b)(7), irrespective of whether the rate will increase. Moreover, a merger proceeding involves a change of ownership, not ratemaking. Indeed, if ratemaking were allowed, the Commission would have to do the very thing the JA have decried throughout this proceeding - set rates without a full assessment of costs and revenues in a test year.

Third, the prohibition against single-issue ratemaking is not, as JA claim¹⁶⁷, violated by focusing, in a reorganization proceeding, on fewer than all of the cost elements that the Commission considers when setting rates. Again, this is not a ratemaking case - a distinction the General Assembly certainly understood when it established different schemes for, respectively, reviewing merger requests and setting rates. Yet JA's interpretation of subsection 7-204(b)(7) would transform that subsection into a full-blown rate investigation. Patently, the legislature intended that the Commission, through 7-204(b)(7), would only identify characteristics of the proposed merger that were *likely* to adversely impact rates in subsequent rate proceedings, and to withhold or condition merger approval - not establish rates - when such

¹⁶² JA IB at 22. We additionally reject JA's contention that "only one cost component" is impacted by the proposed merger. *Id.* at 25. Staff's position is that when a credit downgrade affects the cost of debt, the utility's equity cost is also affected, and the capital structure may also need revision. Staff Ex. 9.0 at 15. We agree.

¹⁶³ *Id.* at 21.

¹⁶⁴ 220 ILCS 5/9-101.

¹⁶⁵ 220 ILCS 5/9-201.

¹⁶⁶ 220 ILCS 5/9-240.

¹⁶⁷ JA IB at 25.

characteristics were present. Furthermore, JA undermined their own position when they asserted that “improve[d] cost efficiency over time” would negate the rate impact of increased cost of capital¹⁶⁸. Even if JA had supported that contention with sufficient proof¹⁶⁹, “cost efficiency” is itself a single issue that does not involve the aggregate analysis of utility costs and rate base items required for ratemaking. The flaw in JA’s position is not, of course, that they cited cost efficiency, but that they did so while asserting the necessity of full-blown ratemaking analysis under 7-204(b)(7).

b) Commission Conclusion

Subsection 7-204(b)(7) obliges the Commission to determine whether the proposed reorganization will likely result in an adverse retail rate impact in subsequent rate proceedings. Here, a likely credit rating downgrade by S&P, due to NG’s post-merger relationship with AGL and its affiliates, will negatively affect NG’s cost of long-term debt, which will, in turn, negatively affect its cost of equity. An increased cost of capital would almost certainly impact NG’s retail rates (even if by only a single basis point), because a utility is entitled to an opportunity to recover its precise cost of capital through its rates. That impact can only occur, however, if Section 9-230 is inadequately applied. When Section 9-230 is properly implemented, no scintilla of capital cost attributable to an unregulated affiliate can be included in ratemaking. To facilitate our application of 9-230, the JA have pledged to base future ratemaking, during the three-year interval after closing of the Reorganization, on NG’s pre-merger credit rating. We approve this pledge and condition merger approval in this proceeding upon it¹⁷⁰.

We also approve the JA’s commitment to refrain from increasing NG’s base rates before the end of the third year following closure of reorganization. That commitment is also a condition of merger approval in this case. Since there are exceptions to that commitment (see below and section IV.B. of this Order), we expect that JA’s pledge to rely upon NG’s post-merger credit rating would be implemented in any rate-setting proceeding commencing before the three-year period expires¹⁷¹.

NG’s retail rates might next be set at some time after the three-year period following closing. Section 9-230 would apply then, just as it will during the initial three-year interval. To facilitate implementation, JA have committed to filing a study analyzing the impact of NG’s affiliation with AGL and its subsidiaries on NG’s cost of capital. The Commission approves the filing of that study, on the terms described above, and makes that another condition of reorganization approval.

¹⁶⁸ JA Ex. 9.0 at 10.

¹⁶⁹ To the contrary, JA has adamantly maintained that “no party in this proceeding has identified any *real* savings directly attributable to this reorganization.” JA Ex. 8.0 at 20 (emphasis in original).

¹⁷⁰ To preclude misunderstanding, the Commission notes here that the commitment to use NG’s pre-merger credit rating shall apply to any test year JA select in a future rate proceeding.

¹⁷¹ The Commission also establishes as conditions for merger approval JA’s promises to maintain a separate commercial paper program for NG, with a credit facility backstop, solely to fund NG’s cash working capital, and their promise to file the compliance reports requested by Staff (as described earlier).

One of the exceptions to the commitment to freeze NG's base rates for three years after closing is as follows: "The [JA] retain the right to request that the Commission waive the timing provision...if the financial integrity of [NG] is jeopardized to the extent of negatively affecting customers."¹⁷² By approving this commitment as a merger condition, the Commission affords NG only what the commitment describes - an opportunity to "request" a waiver. NG cannot commence a rate proceeding during the three-year period without first obtaining the waiver, and it will obtain the waiver only by bearing the burden of proving that NG's diminished financial integrity, in particular, is negatively affecting customers of regulated services to a non-trivial degree. Moreover, insofar as jeopardy to NG's financial integrity is the result of imprudent or unreasonable action or inaction by NG or its affiliates, the Commission undertakes no commitment here to requiring ratepayers, rather than shareholders, to bear the costs of easing that jeopardy.

In view of the expected effect of proper implementation of Section 9-230, which will be aided by fulfillment of the JA commitments described here, the Commission does not conclude that the proposed merger is likely to result in an adverse rate impact on retail customers.

B. Section 7-204(c): Treatment of Costs and Savings

1. Issues Presented & Analysis

As noted earlier in this Order, Section 7-204(c) precludes reorganization approval without ruling on, first, "the allocation of any savings resulting from the proposed reorganization" and, second, whether the applicants 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."¹⁷³ The Commission has been "afforded great discretion" in implementing the statute¹⁷⁴.

Initially, several disputes were joined between the JA and, in opposition, Staff and AG/CUB. These disagreements were both factual and legal and concerned both costs and savings. Subsequently, JA and Staff resolved their contested issues, as memorialized in the Stipulation filed on August 24, 2011. In the Stipulation, JA state that they "agree with Staff witness Bridal's stated position [in Staff Ex's. 7.0 and 13.0]," with the clarifications and conditions reflected in the following paragraphs:

1. JA and Staff agree that achieved savings at NG resulting from the proposed Reorganization, if any, shall be flowed through to NG customers

¹⁷² *Agreed Stipulation Between Joint Applicants and Staff*, filed August 24, 2011. The Commission notes that there will be no "Joint Applicants" after merger, so we assume that NG, the regulated utility, would be the party requesting waiver.

¹⁷³ 220 ILCS 5/7-204(c).

¹⁷⁴ *Illinois-American Water Co. v. Illinois Commerce Commission*, 322 Ill. App. 3d 365, 369, 751 N.E. 2d 48, 53 (3rd Dist 2001).

as part of costs associated with the regulated intrastate operations for consideration in a future rate case filed by NG.

2. 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, JA and Staff agree that the base rates of NG shall be fixed at their current rates for a period of three years following the closing of the proposed Reorganization. NG 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, NGs' base rates shall be fixed until November 1, 2014. NG 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.) JA retain the right to request that the Commission waive the timing provision set forth above if the financial integrity of NG 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.

3. Sections 9-220(h) and (h-1) of the Act, as set forth in Public Act ("PA") 097-0096 and PA 097-0239, require NG, 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 August 24, 2011, NG had not yet made such an election. Although it is unlikely at this time that NG would not enter into the referenced SNG sourcing agreements, if NG should elect not to enter into such a sourcing agreement, the Act then requires that NG file biennial rate cases in 2012, 2014, and 2016. Notwithstanding the forgoing paragraph, rate case filings under such statutes are permitted.

4. JA 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 JAs' 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 rates¹⁷⁵.

¹⁷⁵ The Commission has addressed the Stipulation elsewhere in this Order, and our analysis and qualifications are applicable in this subsection as well.

AG/CUB are not parties to the foregoing Stipulation and contend that it is “not a substitute for the requisite Commission findings” under 7-204(c), particularly with regard to merger-related savings within the meaning of subsection 7-204(c)(i)¹⁷⁶. Staff concurs with AG/CUB that JA have not presented evidence identifying merger-related savings, but maintains that “in the immediate proceeding, no quantification is necessary,” because of JA’s agreement that “all savings shall flow through to the costs associated with the regulated intrastate operations for consideration in setting rates.”¹⁷⁷ The JA agree with Staff on the latter point¹⁷⁸.

The issue, then, is whether the Stipulation, if approved by the Commission would be sufficient to support the findings required by the two sub-parts of subsection 7-204(c). The resolution of that issue is found within the interplay between the pertinent statutory text and the first numbered paragraph above. Subpart (i) of the statute contemplates an “allocation of any savings.” Both before and after the Stipulation was filed, the argument between the JA and AG/CUB focused on the implications of the word “any” (that is, whether there will be savings, when they will occur, their quantification, and the degree to which they will arise from regulated business). In our view, the Stipulation moves the necessary analysis to the word “allocation,” which we construe as a directive to determine the *beneficiaries* of savings and to *apportion* their respective shares. Under the first indented paragraph above, the *only* beneficiaries are NG’s ratepayers. Thus, whether savings result or not, and whatever their magnitude, they must all flow to ratepayers to reduce NG’s purported recoverable costs in a ratemaking proceeding. In statutory terms, that is the requisite allocation of any and all savings generated by the proposed Reorganization.

AG/CUB emphasize, however, that the Stipulation contains certain loopholes that the JA can exploit to ratepayers disadvantage. First, they stress that the three-year prohibition on base rate increases “is waived” if NG claims financial distress during that period¹⁷⁹. Similarly, they note that the Stipulation permits NG to initiate a rate case as early as next year if it does not enter into a substitute natural gas sourcing agreement¹⁸⁰. While these observations are correct, they do not affect the savings allocation specified in the first numbered paragraph. Whether NG’s next rate case begins during the three-year interval after merger or sometime later, savings will still be allocated only to ratepayers.

The same principle applies to AG/CUB’s additional concern that the Stipulation will not limit NG’s choice of test year in its next rate proceeding. Although it is true that NG will therefore be free to “strategically select the most advantageous test year”¹⁸¹ (in a manner consistent with test year rules), the allocation of all savings to ratepayers will not change. That said, the Commission does understand that AG/CUB’s theory is that

¹⁷⁶ AG/CUB RB at 17.

¹⁷⁷ Staff RB at 4.

¹⁷⁸ JA RB at 20.

¹⁷⁹ AG/CUB RB at 17. In fact, the Stipulation grants NG only the right to *request* a waiver (although this distinction does not affect our analysis here).

¹⁸⁰ AG/CUB RB at 18.

¹⁸¹ *Id.* at 18.

NG will endeavor to raise rates before savings are fully realized in its cost structure, so that it can over-earn later, when its actual costs shrink¹⁸². Putting that another way, AG/CUB claim that NG will pass *all* savings to ratepayers when *all* savings are still relatively small. But even if we assume, for the sake of argument, that NG would choose its test year to facilitate such a strategy, we do not assume our subsection 7-204(c)(i) authority (and duty) to *allocate* savings empowers us to override our test year regulations, which afford utilities specified test year “options.”¹⁸³ The fact that one of those options is more “advantageous” does not preclude NG from selecting it¹⁸⁴.

By the same token, the Commission cannot allow the JA-Staff Stipulation to contravene our test year rules either. The first and second numbered paragraphs of the Stipulation summary above describe the savings that will flow through to ratepayers as “achieved.” While such savings should certainly flow through, so, too, should any additional savings that would otherwise be recognized under the test year rules in Part 287 or in prior Commission rulings. For illustration, if an historical test year were employed, and known and measurable savings were certain to occur in the pertinent future time frame, they could not be ignored, insofar as our test year rules would recognize them. Therefore, the first two numbered paragraphs above (numbered paragraphs three and four of the Stipulation as filed) must be revised in order to be approved as appropriate conditions for merger approval¹⁸⁵.

Additionally, there is a fundamental flaw in the first numbered paragraph above that would allow NG to flow *less than all* merger-related savings to ratepayers under certain circumstances. By its terms, the paragraph only applies to rate cases “filed by” NG. Consequently, in a rate proceeding filed *by the Commission*, NG’s voluntary allocation of all merger-related savings to ratepayers would not apply. Subsection 7-204(c)(i) therefore compels the Commission to provide a savings allocation for any later ratemaking proceedings initiated by us. Consistent with our previous decisions in reorganization proceedings, on which the JA rely¹⁸⁶, the Commission holds that any and all merger-related savings shall be allocated to ratepayers in *any* future NG ratemaking

¹⁸² AG/CUB define the “most advantageous test year” as “that which provides the utility with the highest revenue increase, and reflects the least amount of net savings for customers.” *Id.*

¹⁸³ 83 Ill. Adm. Code 287.20.

¹⁸⁴ Moreover, as a practical matter, the available test year options under our rule (historic and future) would enable NG to withhold no more than 12 months of incremental savings from the ratemaking process - and even then, the utility would need to avoid the *pro forma* adjustments or updates required by Part 287 and Commission decisions. Further, all other cost elements (e.g., prevailing cost of capital) would have to align with the strategy to make it worthwhile.

¹⁸⁵ Such revision appears in the Required Conditions of Approval attached as Appendix A to, and incorporated in, this Order.

¹⁸⁶ In Frontier Communications Corp., et al., Dckt. 09-0268, the Commission concluded “that the allocation of any savings resulting from the proposed reorganization would flow through to the costs associated with regulated intrastate operations for consideration in setting rates by the Commission in any future rate request.” Order, April 21, 2010, at 39. Similarly, in Illinois-American Water Co., Dckt. 01-0832, we held “under Section 7-204(c)(i) that, to the extent any synergy savings resulting from the proposed Reorganization are reflected in future rate case test years, such savings should be allocated in full to customers.” Order, Nov. 20, 2002, at 18-19. Both of these quoted passages appear in JA RB at 21.

proceeding conducted by the Commission. Therefore, the final eight words (“a future rate case filed by Nicor Gas”) in numbered paragraph three in the August 24, 2011 Stipulation (which is identical to the first numbered paragraph above, except for an abbreviation) must be disapproved and replaced by the words “any future rate case involving Nicor Gas.”¹⁸⁷

With respect to costs incurred in accomplishing the Reorganization, the initial question framed by the statute is whether the merging companies should be allowed to recover such costs at all. In the fourth numbered paragraph above (which is identical to numbered paragraph six in the August 24, 2011 Stipulation) the JA agree that no such costs (as defined in that paragraph) can be recovered through Illinois jurisdictional regulated rates in any future proceeding. The Commission approves that agreement, which produces the same result (no reorganization cost recovery) as our previous decisions in reorganization proceedings.

2. Commission Conclusion

The Commission concludes that subsection 7-204(c) of the Act shall be applied in the instant case by allocating all reorganization-related savings to ratepayers and precluding recovery by NG of any costs incurred in accomplishing the Reorganization (as defined above). Irrespective of when, how or by whom a future NG ratemaking proceeding is initiated, all savings must flow through to the costs associated with regulated operations under our jurisdiction.

C. Section 7-204A of the Act

1. Issues Presented & Analysis

Subsection 7-204A(a) describes the information that must be provided in connection with a reorganization application. Organization cannot be approved without the specified information. The JA contend that they have satisfied all the information filing requirements in the statute¹⁸⁸. No party challenges the JA’s contention.

Subsection 7-204A(b), as already noted, establishes contract requirements for the use of utility employee services by, and the supply of utility property to, utility affiliates. Such contracts are subject to Commission action to protect the interests of the utility and its customers. Earlier in this Order, we considered certain inter-affiliate agreements within the rubric of subsections 7-204(b)(2) and (b)(3) of the Act, for the purpose of precluding unjustified subsidization and ensuring proper cost allocation. The same agreements must also be evaluated under subsection 7-204A(b).

The pertinent contracts are the SA, the TAA and four existing agreements between NG and Sequent (a Gas Exchange agreement, an Interstate Hub Service

¹⁸⁷ This revision appears in the Required Conditions of Approval attached as Appendix A to, and incorporated in, this Order.

¹⁸⁸ JA IB at 36.

Agreement, an Intrastate Hub Service Agreement, and a NAESB). Also, the JA request approval of capacity release arrangements between NG and Sequent executed from time to time in accordance with FERC's capacity release rules. No party objects to approval of these agreements under subsection 7-204A(b). Staff recommends Commission approval of the SA and the TAA subject to certain conditions to which JA have agreed. Staff also recommends approval of the agreements with Sequent.

2. Commission Conclusion

The Commission finds that the JA have met the minimum information requirements set out in Subsection 7-204A(a). Regarding Subsection 7-204A(b), the evidence presented by JA and Staff supports approval of the SA and the TAA, consistent with the interests of the public, the public utility and its customers, subject to the conditions described above. Approval is also warranted, for the same reasons, for the four existing agreements between NG and Sequent and the capacity release arrangements between NG and Sequent entered into in accordance with FERC's capacity release rules.

Again, all analysis of the OA appears in a later section of this Order (with the exception of specific and limited references in a previous section). Our analysis in this section is confined to the SA, TAA and the agreements and arrangements concerning Sequent.

D. Approval Under Section 7-102 of the Act

1. Issues Presented & Analysis

JA's Application references Section 7-102¹⁸⁹, which requires Commission approval whenever a "public utility may by any means, direct or indirect, merge or consolidate its franchises, licenses, permits, plants, equipment, business or other property with that of any other public utility."¹⁹⁰ It also requires Commission approval for a public utility to "assign, transfer, lease, mortgage, sell (by option or otherwise), or otherwise dispose of or encumber the whole or any part of its franchises, licenses, permits, plant, equipment, business, or other property...."¹⁹¹

JA emphasize that Section 7-204(e) expressly provides that "[n]o other Commission approvals shall be required for mergers that are subject to this Section."¹⁹² Consequently, JA aver that subsections 7-102(A)(c) and (d) do not apply to the Reorganization, because there is no direct or indirect merger or consolidation of two utilities' businesses or property and no sale or disposition of a utility's business or property; instead, there is a proposed change in control, subject to Sections 7-204 and 7-204A¹⁹³. However, JA state that if the Commission were to determine that the

¹⁸⁹ Application at 11-12.

¹⁹⁰ 220 ILCS 5/7-102(A)(d).

¹⁹¹ 220 ILCS 5/7-102(A)(c).

¹⁹² Application at 12, quoting 220 ILCS 5/7-204(e).

¹⁹³ *Id.* at 12.

Reorganization is also subject to Section 7-102, the information submitted in support of the Application is sufficient to meet the requirements of that statute, so that any approval deemed necessary pursuant to Section 7-102 should be granted¹⁹⁴. No party other than JA presented evidence regarding Section 7-102.

Subsection 7-102(A)(d) applies to mergers of two public utilities “by any means, direct or indirect.” Whether the instant Reorganization, which will join NG and several other gas distribution utilities in the same corporate family, is an “indirect” merger of utilities within the meaning of the subsection is a nuanced question¹⁹⁵. With no analysis from the parties about the inter-relationship between Sections 7-102 and 7-204, and no practical reason to address the issue - since both provisions require Commission approval, both essentially apply a public interest test¹⁹⁶, and both authorize Commission discretion to impose conditions - we are not inclined to embark on a lengthy analysis or render conclusions that can needlessly limit the Commission in the future.

The foregoing analysis does not apply, though, to the Nicor inter-affiliate OA, which we evaluate in a separate section of this Order, below. There is no question that 7-102 applies to the OA in its own right (that is, apart from the OA’s legal significance as a component of the proposed merger).

2. Commission Conclusion

The Commission declines to ruling on the applicability of 7-102 insofar as this proceeding concerns the JA’s merger application. If, however, we were to assume solely for the sake of discussion that Section 7-102 applies to the instant merger request, we would agree with JA that satisfaction of Section 7-204 would also satisfy Section 7-102. Both impose an essentially comparable public interest test.

With regard to the proposed OA for NG and its post-merger affiliates, Section 7-102 does apply, in the manner the Commission will discuss in detail in section IV.E. below.

E. The Nicor Inter-Affiliate Operating Agreement

As discussed preliminarily earlier in this Order, NG requested, in Docket 09-0301, re-approval of the agreement under which NG and its affiliates provide one another with, or share, certain services, facilities and assets. While that proceeding progressed, the JA filed the instant reorganization Application, in which the JA introduced the OA for consideration when determining whether, and under what terms, their proposed merger would be authorized. The JA asserted that the OA (with

¹⁹⁴ *Id.*

¹⁹⁵ Moreover, that question is complicated by the fact that the AGL gas distribution utilities are not in Illinois or subject to our jurisdiction.

¹⁹⁶ Section 7-204, of course, also requires the seven specific findings in subsection (b) and the treatment of costs and savings described in subsection (c).

revisions proposed or accepted in Docket 09-0301 by NG¹⁹⁷, and by the JA in this case) would comply with the statutory requirements for reorganization approval¹⁹⁸. Accordingly, the JA requested that pre-filed testimony in Docket 09-0301 be received and considered in this docket¹⁹⁹. The ALJ approved that request²⁰⁰, with appropriate designations for the Docket 09-0301 testimony²⁰¹.

As a result, the OA will be analyzed for two purposes in this proceeding - first, to determine its sufficiency under the Act as a basis for transactions among Nicor affiliates and, second, to assess whether, and under what conditions, it sustains the JA's request for merger approval. The active participants in this case maintain that the legal standards applicable to each of those inquiries are virtually the same²⁰². Assuming, without further discussion, that those parties are correct, the Commission nonetheless notes that the practical outcomes of the two inquiries could differ. That is, in theory, we could reapprove the OA without approving the merger or reject the OA while concluding that merger prerequisites have been satisfied by other means.

1. Settled and Withdrawn Disputes

Since staking out their initial positions in Docket 09-0301, NG (and now the JA) and Staff have, through negotiation, dramatically reduced their OA-related disputes. Specifically, JA agreed to modifications addressing all of Staff witness Hathhorn's recommendations and all but one of Staff witness Sackett's recommendations²⁰³. Among other things, the JA have consented to the following: 1) broadening the definition of "prevailing price" and making other pricing changes in the OA²⁰⁴; 2) requiring an annual internal audit that tests compliance with the OA's terms²⁰⁵; 3)

¹⁹⁷ In Docket 09-0301, NG did not initially propose any changes or amendments to the OA. NG Ex. 1.0 at 2. As litigation proceeded in that docket, however, NG accepted certain modifications proposed by Staff, while rejecting others. *E.g.*, NG Ex. 2.0 at 19. During subsequent negotiations with Staff, NG acceded to additional revisions. All of the foregoing changes are included in the version of the OA that the JA propose for their post-merger entity. JA Ex. 7.1.

¹⁹⁸ JA Ex. 6.0 at 11 *et seq.*

¹⁹⁹ *JA Request for Administrative Notice*, filed Mar. 24, 2011. The JA also requested that Docket 09-0301 be suspended. *Motion to Suspend Proceeding*, filed Dec. 30, 2010 in Docket 09-0301.

²⁰⁰ Tr. 133-34 (status hearing of April 6, 2011). Prior to that approval, all of the active parties in this docket supported the JA request and assented to the conditions under which the ALJ determined that issues pertaining to the Nicor OA would be addressed in this docket. See generally, Transcript of April 6, 2011.

²⁰¹ That is, exhibits sponsored by NG prior to the JA merger request retain the Nicor-only designation (*e.g.*, "NG Ex. 1.0") and certain OA-related testimony filed in this docket after the merger Application also has that designation (for continuity). All other documentary evidence filed in this docket by NG or the JA bears the JA designation (*e.g.*, "JA Ex. 1.0").

²⁰² Tr. 118-23.

²⁰³ The resolution of all OA matters between JA and Staff was reflected in a Stipulation dated May 20, 2011 and admitted into evidence at the May 23, 2011 evidentiary hearing (JA Ex. 7.0). Attached to the Stipulation was a copy of the proposed OA containing the text agreed upon by JA and Staff. JA Ex. 7.1.

²⁰⁴ *Id.* at 9-10, Section 5.1(b)(iv).

²⁰⁵ *Id.* at 15-16, Section 10.1.

disclosing certain written sub-agreements²⁰⁶; and, 4) removing non-descriptive phrases from the OA²⁰⁷.

The JA also agreed that the OA would no longer authorize NG to perform repair services on behalf of its affiliate, Nicor Energy Services (“NS”), in fulfillment of NS’s customer service obligations under NS’s Gas Line Comfort Guard “GLCG”) product²⁰⁸. Additionally, the JA concurred that NG would provide billing services for affiliate products pursuant to the OA only if NG offers similar billing services under specified circumstances to non-affiliated participants in the NG Customer Select program or their affiliates²⁰⁹. Further, the JA agreed that, under the OA, NG would use website links to transfers users from a webpage describing NG products or services directly to a webpage soliciting affiliate products or services only if the transfer is clearly and conspicuously disclosed²¹⁰.

Furthermore, RESA and IGS withdrew OA-related prefiled testimony, after entering into a stipulation with the AGL²¹¹. This stipulation terminated all disputes framed by those parties, whether in this proceeding or in Docket 09-0301²¹².

2. The Remaining OA Dispute

The sole remaining disputed issue pertaining to the OA concerns a provision by which NG facilitates the solicitation of services sold by its affiliate, NS. In particular, the parties disagree about the lawfulness and propriety of soliciting NS services through call centers operated by, or associated with, NG.

NG maintains call centers for customer contacts. The call centers receive “myriad inquiries from customers,” including gas leak reports, billing questions, requests to start, stop or transfer service and other inquiries²¹³. Currently (*i.e.*, up to and including the date of this Order), once a caller’s inquiry has been addressed, NG’s call center representatives endeavor to interest eligible callers in subscribing to an NS service (the “NG Solicitations”). NG’s representatives earn a monetary commission when a caller does subscribe, paid by NS²¹⁴. NG personnel monitor call center activities, including solicitations, and they review and approve sales scripts²¹⁵. The representatives do not solicit or otherwise offer enrollment for products or services purveyed by NS’s competitors²¹⁶.

²⁰⁶ *Id.* at 6, Section 2.4.

²⁰⁷ *Id.* (throughout the OA).

²⁰⁸ *Id.* Section 2.2(iii)(A).

²⁰⁹ *Id.* Section 2.2(iii)(B).

²¹⁰ *Id.* at 6, Section 2.2(iii)(C).

²¹¹ RESA and IGS *Notice of Withdrawal of Testimony*, filed May 19, 2011, which refers to the JA *Stipulation* also dated and filed on that day.

²¹² NG Ex. 8,0

²¹³ NG Ex. 1.0 at 11.

²¹⁴ NG Ex. 2.0 at 58.

²¹⁵ *Id.* at 59.

²¹⁶ *Id.* at 46.

NG states that its telephone marketing for NS is an inter-affiliate service authorized under Section 2.2 of the current Nicor OA²¹⁷. NS pays NG a fee, in an amount ostensibly equal to NG's fully distributed costs, for the portion of a call devoted to marketing NS services. This fee is governed by Section 5.1 of the current OA.

NS also has a call center, which is operated by IBT, a wholly-owned subsidiary of NS²¹⁸. That center handles a percentage of NG's "moving calls" - requests to initiate new NG gas service at a location²¹⁹. As with inbound calls to NG's centers, representatives at the NS/IBT center will attempt to market NS services after completing the initial purpose of a call²²⁰ (the "NS Solicitations"). NG pays IBT a fee to handle the customer's request to commence new service²²¹, and IBT purportedly pays a fee to NG "for the use of the phone line for the period of time it markets [NS] products."²²² These fees are also determined by Section 5 of the current OA.

Staff, through witness Sackett, recommends that the OA be revised to preclude NG solicitation on behalf of any Nicor affiliate²²³. This would end the NG Solicitations. Staff also proposes that the OA prohibit NG from receiving any service from an affiliate that facilitates the marketing of an affiliate's product to NG customers. This would terminate the NS Solicitations.

AG/CUB focuses specifically on NS's GLCG service, recommending that either NG be excluded from GLCG solicitation or that GLCG be treated as a utility service and sold at a regulated price with certain disclosures regarding the purported benefits of that service²²⁴.

NG opposes any prohibition on inter-affiliate call center solicitation under the OA. NG argues that the foregoing opposition to solicitation lacks legal and policy support and is, at most, dissatisfaction with the *price* paid by NS and IBT for the use of NG's facilities, personnel and brand, rather than a viable critique of solicitation itself²²⁵. That dissatisfaction is misplaced, NG contends, because NS and IBT pay no less than FDC for solicitation opportunities, which helps ratepayers by reducing the fixed costs they pay for through rates²²⁶.

Staff and NG have distilled their dispute to a single, extended clause in subsection 2.2(e) of the proposed OA, which describes permissible inter-affiliate support

²¹⁷ NG Ex. 1.0 at 11.

²¹⁸ Staff Ex. 2.0 at 58.

²¹⁹ *Id.* at 34. In late 2009-early 2010, IBT/NS handled about 60% of NG's moving calls. *Id.*, Att. Q.

²²⁰ NG Ex. 2.0 at 35.

²²¹ NG also pays for related IBT services, such as training. Staff Ex. 2.0, Att. C (confidential).

²²² NG Ex. 2.0 at 35.

²²³ Staff Ex. 3.0, Att. A, p. 4

²²⁴ AG/CUB Ex. 1.0 at 13. Alternatively, AG/CUB witness Efron proposes that profits from GLCG be credited toward NG's revenue requirement or that NS pay NG a royalty for the competitive advantage derived from its association with NG's utility operations.

²²⁵ *E.g.*, NG Ex. 2.0 at 35.

²²⁶ *Id.* at 34-35.

activities. NG would include the underlined passage in the following indented quote, while Staff would delete it.

(e) customer support services, printing, mailing and bill insert services, public communications services, customer relations services, call center services provided by Nicor Gas and call center services provided to Nicor Gas as long as customers are clearly informed by call center representatives when the utility portion of the call is concluded and the customer is given the opportunity to terminate the call before being solicited to purchase any products or services of a Party other than Nicor Gas, utility service enrollment and termination processing, complaint resolution and customer inquiry referral services, sales and marketing services on behalf of Nicor Enerchange LLC (“Nicor Enerchange”) to purchase service offered by Nicor Enerchange made by employees who are assigned on a full-time basis to work for Nicor Enerchange, administration of ICC Rate 21 and Nicor Gas FERC Operating Statement services and provision of customer lists and other customer-related information²²⁷.

Although the disputed language pertains to products and services generally, the parties’ evidence and briefings have almost exclusively addressed NS’s GLCG. Whether denominated a product or service, GLCG presently involves a \$4.95 monthly charge, for which NS will provide parts and labor (up to \$600 per service call) to repair “leaks to completely exposed interior gas pipes or connectors” resulting from specified circumstances²²⁸. NS will also replace “non-leaking uncoated brass connectors” as requested, but will add a trip charge for dispatching a technician. GLCG applies only to piping and connectors on the “customer side” of the gas meter, not the “utility side” (where NG bears repair responsibility)²²⁹. NS imposes several “conditions of service” (e.g., “piping must be readily accessible”) and service is expressly excluded under certain circumstances (e.g., service to pipe negligently damaged by the customer). GLCG service is renewed annually, but the customer can cancel at any time, while remaining responsible for the cost of repair and replacement services already rendered (capped at the sum of remaining monthly charges in the service year).

²²⁷ JA Ex. 7.1, p. 5. AG/CUB did not participate in the Stipulation that produced opposing versions of subsection 2.2(e). If the Commission adopts Staff’s version, however, then AG/CUB’s recommended outcome - a prohibition of GLCG solicitation by NG - would be achieved. If, instead, the Commission approves NG’s request to continue inter-affiliate solicitation, then AG/CUB’s alternative proposals for regulating GLCG solicitation will need to be addressed.

²²⁸ Facts in this paragraph regarding GLCG are derived from Staff Ex. 2.0, Att. B.

²²⁹ Almost all GLCG repair work (98%) is now performed by NG personnel on NS’s behalf. Staff Ex. 2.0 at 17. NG charges NS a fee for these repairs, based on NG’s FDC, which equals the price NG charges non-GLCG customers for such repairs. NG Ex. 1.0 at 13. However, with approval of the OA jointly agreed to by the JA and Staff, the OA would no longer authorize NG to provide GLCG repair services for NS.

GLCG is variously described among the parties as a warranty, an insurance plan, a gas line repair agreement and an HVAC (heating, ventilating and air conditioning) service. For our purposes here, the title of the service only matters if legal significance attaches to the title. Functionally, the Commission views GLCG as a fixed-price repair/replacement service contract for certain gas lines and connectors, with a monetary cap per service call. Our view is consistent with NG's assertion that GLCG is regulated under the state Service Contract Act by the Illinois Department of Insurance²³⁰.

a. Applicable Law

With respect to inter-affiliate transaction agreements in their own right (that is, irrespective of the pendency of a merger request), the necessity for Commission approval, as well as the source of Commission authority to impose conditions when approving such agreements, is set out in Section 7-101 of the Act:

[N]o contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission... *The Commission may condition such approval in such manner as it may deem necessary to safeguard the public interest.* If it be found by the Commission, after investigation and a hearing, that any such contract is not in the public interest, the Commission may disapprove such contract or arrangement. Every such contract or arrangement not consented to or excepted by the Commission as provided in this Section is void²³¹.

Additional approval authority over utility transactions, whether with affiliates or others, appears in Section 7-102 of the Act, which states that Commission approval is required before a utility may “use, appropriate or divert any of its moneys, property or other resources in or to any business or enterprise which is not, prior to such use, appropriation or diversion essentially and directly connected with or a proper and necessary department or division of such public utility.”²³² Commission approval is

²³⁰ NG Ex. 2.0 at 31. Under the Service Contract Act, a “service contract” is “a contract or agreement whereby a service contract provider undertakes for a specified period of time, for separate and identifiable consideration, to perform the repair, replacement, or maintenance, or indemnification for such services, of any...system....” 215 ILCS 152/5. “‘System’ means the heating, cooling, plumbing, electrical, ventilation, or any other similar system of a home.” *Id.*

²³¹ 220 ILCS 5/7-101(3) (emphasis added).

²³² 220 ILCS 5/7-102(A)(g). Arguably, the NG Solicitations, which involve the use of NG equipment on NS's behalf, are also governed by 220 ILCS 5/7-102(A)(c) (“[n]o public utility may assign, transfer, lease, mortgage, sell...or otherwise dispose of or encumber the whole or any part of its...plant, equipment, business or other property” without Commission consent, waiver or exemption). Since the necessity of

contingent upon the finding that it “should reasonably be granted, and that the public will be inconvenienced thereby.”²³³ The Commission is authorized “to attach[] such conditions as it may deem proper.”²³⁴

Also, subsection 7-204A(b) of the Act states that “[n]o public utility may permit the use of any public utility’s employee’s services by any affiliated interest except by contract or arrangement.”²³⁵ For our purposes here, subsection 7-204A(b) is implicated by the use of NG customer service employees to solicit NS products during the NG Solicitations²³⁶. Subsection 7-204A(b) gives the Commission discretionary power to review any such contract or arrangement “in the same manner as it may review any other public utility and its affiliated interest.” In our view, this latter clause invokes, *inter alia*, the powers residing in Section 7-101 (quoted above), including the broad power to safeguard the public interest.

Further, our administrative regulations declare that “[t]ransactions between a gas utility and its affiliated interests shall not be allowed to subsidize the affiliated interests.”²³⁷ This provision applies to the OA, and any dealings pursuant to its terms and conditions, whether or not there is a pending reorganization request.

With particular regard to reorganization requests, inter-affiliate contract approval is not specifically addressed by statute. However, subsection 7-204(f) provides that “[i]n approving any proposed reorganization pursuant to this Section, the Commission may impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers.”²³⁸ Subsection 7-204(f) does not exempt any component of utility operations from its purview. The Commission therefore concludes that the power to impose merger conditions extends to a utility’s inter-affiliate agreements, such as the OA here, and to utility conduct under the terms of those agreements²³⁹.

Additionally, the Commission concurs with the assumption of all active parties here that certain general prerequisites for merger approval in Section 7-204 of the Act apply to inter-affiliate contracts involving the merging entities. First, under subsection 7-204(b)(2), reorganization is precluded unless the Commission finds that it “will not result in the unjustified subsidization of non-utility activities by the utility or its customers.”²⁴⁰

Commission approval is already established in Sections 7-101 and 7-102 (and 7-204, for reorganization purposes), we need not reach a conclusion on the applicability of subsection 7-102(A)(c) here.

²³³ 220 ILCS 5/7-102(C).

²³⁴ *Id.*

²³⁵ 220 ILCS 5/7-204A(b).

²³⁶ This subsection would presumably not apply to the NS Solicitations, which are not performed by utility employees or during calls received by utility employees.

²³⁷ 83 Ill. Adm. Code 550.120(a).

²³⁸ 220 ILCS 5/7-204(f).

²³⁹ We note that the interests protected by subsection 7-204(f) are those of “the public utility and its customers.” There is substantial overlap of those interests and the public interest safeguarded by Section 7-101. Insofar as the latter interest may be broader than the former, it is not apparent that the difference is consequential in this case.

²⁴⁰ 220 ILCS 5/7-204(b)(2).

The JA acknowledge (and no other party disagrees) that the terms of, and operations under, the OA must satisfy this criterion for merger approval²⁴¹.

Second, subsection 7-204(b)(3) provides that merger approval is dependent upon a finding that “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.”²⁴² Again, the JA recognize (and no other party disagrees) that the terms of, and operations under, the OA must satisfy this criterion for approval of a reorganization²⁴³.

Moreover, the structure of subsection 7-204(b) puts the burden of satisfying its sub-parts on the reorganization petitioner. That is, the text precludes merger approval *unless* the specified findings can be made. Thus, the adverse consequence of presenting insufficient evidence to make the requisite findings falls upon the JA here.

Pursuant to the foregoing statutory provisions, taken together, the JA must show, and the Commission must find, as a prerequisite for merger approval, that solicitation under the OA: 1) does not result in unjustified subsidization of an NG affiliate; 2) does produce a fair and reasonable allocation of costs and facilities that enables identification of all ratemaking items; and 3) serves the public interest and the interests of the utility and its customers. We observe that the parties’ contentions principally address the first and third of these prerequisites. The third prerequisite is also the statutory criterion for evaluating the OA in its own right, apart from the reorganization request. When applying these legal standards, the Commission has taken the position that “[g]enerally, relationships between affiliates merit greater scrutiny than relationships between unaffiliated entities due to the higher risk of improper behavior.”²⁴⁴

As proceedings regarding the OA initially progressed, other sections of the Act were addressed in the parties’ positions and disputes. The importance of those statutes to decision-making in this docket diminished as positions were refined and compromised. Nonetheless, so that it cannot be argued in future proceedings that those laws are inapplicable or inconsequential to Commission review of inter-affiliate agreements, we emphasize that, in addition to the statutes and regulations discussed above, Sections 240²⁴⁵ and 241²⁴⁶ of the Act may be important to the outcome in other cases, depending upon the issues and evidence presented.

²⁴¹ JA Ex. 1.0 at 10-11; JA Ex. 6.0 at 11-12. We note that subsection 550.120(a) of our regulations, discussed above, prohibits “subsidization,” while the statute refers to “unjustified subsidization” in the merger context.

²⁴² 220 ILCS 5/7-204(b)(3).

²⁴³ JA Ex. 1.0 at 11; JA Ex. 6.0 at 12.

²⁴⁴ Illinois American Water Company, Dckt. 02-0517, Order, Sept. 16, 2003 (“IAWC”), at 11.

²⁴⁵ 220 ILCS 5/9-240 (“nor shall any such public utility...extend to any corporation or person any form of contract or agreement...or any facility or privilege except such as are regularly and uniformly extended to all corporations and persons”).

²⁴⁶ 220 ILCS 5/9-241 (“No public utility shall, as to...services, facilities or in other respect, make or grant any preference or advantage to any corporation or person or subject any corporation or person to any prejudice or disadvantage”).

b. Unjustified Subsidization

NG asserts that “the Commission’s review and approval of the proposed [OA] is primarily intended to ensure that [NG’s] gas customers are not taken advantage of by inappropriately subsidizing non-utility activities.”²⁴⁷ Staff and AG/CUB respond that the NG Solicitations at NG’s call centers, and the NS Solicitations performed at NS’s call center, do provide unjustified subsidies for NS’s non-utility activities (primarily, the GLCG service). These parties acknowledge that NS pays NG a fee for the NG Solicitations that equals NG’s FDC. They also recognize that NG pays a fee to NS for the NS Solicitations that is purportedly less than NS’s FDC²⁴⁸. Nonetheless, as these parties see it, even payment of full FDC fails to compensate NG for the *value* NG furnishes to NS in the form of marketing opportunities during utility customer contacts at Nicor call centers. (E.g., “[NG] ratepayers are not receiving adequate compensation for the *value* of the services that [NG] is providing for [NS]”²⁴⁹). According to Staff and AG/CUB, this additional value, for which NS pays nothing, is a subsidy to NS. NG rejects this contention²⁵⁰.

The question, then, is whether NS does, in fact, derive additional (beyond FDC) and compensable value from its call center arrangements with NG. Staff and AG/CUB perceive such value in several attributes of the NG and NS Solicitations. These attributes include the timing, certainty and exclusivity of direct telephone contact with customers, the purchasing convenience created by the utility for consumers of non-utility services, and the exploitation of the Nicor brand during dual-purpose telephone conversations.

With respect to timing, Staff asserts that the opportunity to have NG call center personnel sell NS products (GLCG in particular) during customer service calls “is extremely valuable, since it give [NS] the *first pass* at all prospective new customers.”²⁵¹ This first-mover advantage is magnified because contact is initiated *by the customer*, rather than by a provider hoping to sell a product. Given the purpose of customer-initiated calls to the gas utility, customers are inherently prepared to discuss matters associated with their gas service. In contrast, a provider making a “cold call” may well initiate contact at a time that the customer finds inopportune for discussing gas service (or any other subject). Also, nothing in the record suggests that getting to the retail

²⁴⁷ JA RB-OA at 5.

²⁴⁸ NS’s per-call FDC for the NS Solicitations is calculated at \$3.02, and NG pays NS \$2.82 for each such call. Staff Ex. 2.0 at 60; NG Ex.2.12.

²⁴⁹ Staff Ex. 4.0 at 6 (emphasis in original).

²⁵⁰ E.g., NG Ex. 4.0 at 4; NG Ex. 7.0 at 37-39.

²⁵¹ Staff Ex. 4.0 at 6 (emphasis added). The Commission observes that Staff’s point is overstated here. It is unlikely that, literally, *no* customer contacting NG via telephone has been previously marketed, in some fashion, by an unaffiliated provider of interior gas line service or service contracts. That said, we believe it highly likely that the great majority of Nicor customers without such a contract have not been so marketed. There is no record evidence of current marketing by any other provider, and NS has virtually all of the customers with a gas line repair service contracts in Nicor’s service territory. Staff Ex. 4.0 at 36.

customer first is less important for gas line service contracts than for any other service or product.

As a matter of customer convenience, NS enjoys the advantage of eliminating the necessity for additional customer phone calls (presumably preceded by internet research or similar efforts by the customer) to other gas line service providers. NG recognizes that “[t]his support [*i.e.*, NG’s customer solicitation on NS’s behalf] results in lower search and information costs to consumers.”²⁵² NG further acknowledges that this proposition applies to the NS Solicitations²⁵³ as well as the NG Solicitations.

The Commission concurs that customers preoccupied with changing residences would be especially interested in the convenience of addressing both their new service connection and gas line safety concerns in a single phone call. NG certainly understands this, since customers contacting the Nicor call centers for any utility reason are actively encouraged to seize the convenience of addressing potential service interruptions and safety concerns at the same time they address the matter that prompted their call to the gas utility²⁵⁴.

The Nicor call center arrangements also afford NS certainty in reaching utility customers. Indeed, both the NG and NS call centers are designed for *inbound* calls²⁵⁵, from present and prospective NG customers, who have initiated contact precisely for a gas-related purpose. Thus, unlike other marketers, personnel selling NS services never waste time with unanswered calls and seldom speak with someone who is not a customer of record (or other household occupant) or disinterested in gas service issues.

Also, NG makes the opportunity to sell non-utility services during inbound utility calls exclusively available to NS. No competing gas line service contract provider or any other provider of inspection and repair (or any other) service is accorded that opportunity²⁵⁶. NG points out that there are complications and risks that militate against attempting to furnish comparable rights to non-affiliates²⁵⁷. Whether those concerns are reasonable or not, the fact, and value, of exclusivity remain patent.

The foregoing advantages bestowed on NS have commercial value for which enterprises typically pay some margin over and above the provider’s bare cost of

²⁵² NG Ex.4.0 at 13.

²⁵³ “[C]onsider the situation where a potential [NG] customer who has moved into a new residence calls [NG] to inquire about a new connection. The Nicor Gas [*sic*] employee can also provide the potential customer with information about the GLCG program. This permits the potential customer to obtain information about a product that the consumer may value highly and *reduces the amount of time and effort the consumer must incur* to obtain such information.” *Id.* (emphasis added).

²⁵⁴ E.g., “[I]n a gas leak emergency...the property owner (such as yourself) may have to find and hire an independent contractor to come in, do an inspection, and make those repairs. This can be expensive, and it could also mean days without any gas to heat the home, cook, and so on...Now, *when you enroll in the [GLCG] program today*, you won’t have to worry about any of that.” Staff Ex. 2.0, p. 1 (emphasis added).

²⁵⁵ Tr. 242 (O’Connor).

²⁵⁶ Staff Ex. 2.0 at 37.

²⁵⁷ NG Ex. 7.0 at 36.

service. In contrast, NG treats the unique solicitation right it grants to NS as if it were valueless. Yet NG (like other utilities) requires compensation for placing other companies' advertising inserts in utility billings²⁵⁸ - and businesses in general demand fees for their customer lists, and marketers of all kinds mine internet traffic for customer leads. If anything, the targeting, convenience and certainty afforded by the call center contacts involved here are *more* valuable, because bill inserts can be discarded unread and customer leads do not guarantee customer contact.

Indeed, in IAWC, which also addressed an inter-affiliate agreement concerning a repair service contract, the utility proposed only to support the affiliate in "distributing promotional materials"²⁵⁹ (the affiliate's call center would be "specifically dedicated" to affiliate business and *not* handle utility calls²⁶⁰), yet the utility would still receive a share of the affiliate's *profits* (that is, an amount *above* the FDC associated with utility support)²⁶¹. Such is the value of utility solicitation assistance, even without the timing, certainty, convenience and exclusivity afforded by the participation in utility telephone calls here.

That value is magnified by the Nicor brand identity shared by NG and NS. The brand itself has value, derived from the name recognition and customer goodwill that NG both earned as a long-serving public utility and paid for with promotional activities²⁶². Thus, the parent corporation, Nicor, Inc., takes care "to protect its brand name and corporate goodwill"²⁶³ from diminution, precisely because it is commercially valuable. Through the call centers, NS is positioned to add that value to customer calls originated to NG for utility business²⁶⁴. Of course, NS, by virtue of its name, shares the reputation of the Nicor brand in any context. However, in a seamless, dual-purpose telephone conversation, in which the corporate commonality of the two Nicor entities is emphasized by the salesperson²⁶⁵, Nicor's brand reputation takes on even greater weight than it has in other contexts²⁶⁶.

²⁵⁸ NG Ex. 4.0 at 23. We note that NS can utilize this marketing channel itself. See, IAWC at 6 ("Nicor's affiliate is permitted to pay for the use of a monthly bill insert to send to customers").

²⁵⁹ IAWC at 9.

²⁶⁰ *Id.* at 12.

²⁶¹ The utility proposed to receive "15% on top of its [FDC]," which it intended to split evenly between ratepayers and shareholders. *Id.* at 5.

²⁶² In its most recent rate case, Nicor identified \$264,000 in expenses to promote and maintain its brand. Docket 08-0363, Order, March 25, 2009, at 25.

²⁶³ NG Ex. 5.0 at 33.

²⁶⁴ Nicor recognizes the potency of brand commonality among the Nicor entities. To explain why NS's GLCG customers are often also customers of Nicor Advanced Energy's ("NAE's") Customer Select gas service, NG witness O'Connor stated: "Typically when a customer has a favorable experience with a Customer Select supplier, it would be logical for that customer to have a higher propensity to purchase additional products and services offered by *that supplier*." JA Ex. 5.0 at 28 (emphasis added). The reference to "that supplier" is significant, since NAE and NS are, in fact, nominally distinct entities - but they share the reputation of the Nicor brand. Tr. 233 (O'Connor).

²⁶⁵ For example, representatives at the call centers tell customers that, with GLCG, "a *Nicor* technician will repair any gas leaks on exposed interior piping, and replace faulty appliance connectors or shut off valves." AG/CUB Ex. 1.1 at 1 (emphasis added).

²⁶⁶ *E.g.*, Nicor's alternative gas supplier, NAE, has a much smaller market share, and many more active competitors, in Nicor's service area than does NS's GLCG. Staff Ex. 4.0 at 47-48 (the exact quantification

The exceptional commercial value of solicitation during dual-purpose, inbound utility calls is reflected in, and confirmed by, NS's sales performance. Regarding movers calls in particular, NS declares, via website:

Mover calls comprise, on average, 20 percent of a utility's total call center volume...[W]e have proven our ability to achieve *unheard-of scale* by handling service calls and skillfully transitioning into product service offerings....

We consistently achieve a *25 percent acceptance rate* versus *two percent* in a typical direct mail program. That provides the scale necessary to generate significant recurring revenues and earnings²⁶⁷.

The salient fact in this quotation is NS's consistent one-in-four marketing success rate. The Commission shares NS's view that this constitutes an "unheard of" scale of sales success. As a comparison, another gas line service contract provider, Santana Energy Services ("SES"), realized a 2% success rate through phone solicitation independent of a utility²⁶⁸. That is the same rate NS attributes to a "typical direct mail program" in the website quote above. It is inconceivable that a marketing channel producing the superior results NS enjoys would have no value above the mere cost of providing it.

The commercial value of selling NS products during inbound utility calls is similarly evidenced by the market dominance NS has achieved for GLCG. Staff calculates that over 99% of the customers selecting a gas line service contract in Nicor's service territory have chosen GLCG²⁶⁹. The two other providers of a comparable gas line service contract indentified in this case (SES and Manchester Group) have, combined, fewer than 2000 of the approximately 451,500 gas line warranty customers in NG's territory²⁷⁰. Each provider has now given up marketing its gas line product in that territory²⁷¹.

is confidential). In contrast to the sales opportunities it accords NS, NG is prohibited by Commission regulation from joint marketing with NAE. 83 Ill. Adm. Code 550.30(a).

²⁶⁷ Staff Ex. 2.0 at 35 (emphasis added), quoting information derived from a "Nicor National" website. "Nicor National" is a brand name used by NS, not a distinct Nicor-affiliated entity. Tr. 209 (O'Connor). The percentages within the indented quote above are not specific to NG's Illinois service territory, although approximately 91% of NS' GLCG customers were in that territory in June 2010. Staff Group Cross-Ex. 1 at 21. During July 2008 to June 2009, the success rate for GLCG solicitation during NG moving calls was 19.6%. Staff Ex. 2.0 at 24.

²⁶⁸ Staff Ex. 4.0, Att. I (626 of 32,800 SES gas customers as of October 2010).

²⁶⁹ Staff Ex. 4.0 at 36.

²⁷⁰ *Id.* at 35-36.

²⁷¹ *Id.* SES attributed its marketing termination to NG's refusal to collect SES's gas line service contract fees on NG's bills, rather than to NS's ability to market its competing product during NG's inbound calls. *Id.* at 35. Manchester Group ("Manchester") includes NS's utility call center marketing privileges among the reasons for cessation of Manchester's gas line service contract marketing in NG's territory. ("These

The commercial value of NS's opportunity to participate in customer calls initiated for utility business is further reflected in NS's inferior sales results when it does not have that opportunity. In northern Illinois, Peoples Gas and North Shore Gas ("PG/NoS") allow their mutual affiliate²⁷², Peoples Home Services, to solicit its Pipeline Protection Plan ("PPP") during consumer-initiated calls to the utilities to apply for gas service²⁷³. NG characterizes PPP as "a similar product to GLCG" and describes the support services (including telephone solicitation) that PG/NoS furnish for PPP as "quite similar" to the services NG supplies for GLCG.²⁷⁴ As of June 30, 2010, NS had 441,366 GLCG customers in NG's service territory and 2655 customers in the combined service territories of PG/NoS.²⁷⁵ NS thus realizes vastly greater success in NG's territory, where it participates in the affiliated utility's phone conversations with customers, than in the PG/NoS service territories, where it competes against another utility's affiliate with comparable phone solicitation privileges in those territories. In the other states where NS offers GLCG²⁷⁶, similar results have apparently occurred²⁷⁷.

NG acknowledges that if Staff's quantification of NS's market share in NG's service area were correct, "this implies near-monopoly power."²⁷⁸ However, NG maintains that Staff is not correct, because it "has defined the relevant product market much too narrowly."²⁷⁹ NG avers that the relevant market includes (in addition to gas line service contracts like GLCG) comprehensive utility line service contracts (that also cover, for example, electricity and water lines) home warranty products (covering home infrastructure, as well as lines) and customer "self-insurance" (*i.e.*, no coverage at all)²⁸⁰. When these alternative strategies for maintaining customer-owned gas lines are included in market share calculations, NG argues, NS's market dominance (and the inference that NS receives a valuable, market-distorting subsidy from NG) is disproved.

The Commission accepts NG's general premise that the sub-set of consumers who prospectively address future interior gas line repair expenses can choose among services specifically tailored for such expenses and services that cover those expenses along with a broader range of residential repair expenses. That does not, however,

'shared services' have created such an unfair advantage for [NS] that [NG/NS] effectively have closed the market for competitors.") *Id.*, Att. J. at 2.

²⁷² PG and NS are gas utilities and affiliates of each other, with separate service territories.

²⁷³ Staff Group Cross-Ex. 1 at 28-29.

²⁷⁴ NG Ex. 5.0 at 21.

²⁷⁵ Staff Group Cross-Ex. 1 at 21.

²⁷⁶ The number of states is uncertain. In testimony filed in July 2009, NG mentioned to "up to 17 states." NG Ex. 1.0 at 13. However, a detailed discovery response identified eight states, as of June 2010. Staff Group Cross-Ex. 1 at 20-21. Also, eight states are identified in NG Ex. 4.2, p. 1, filed in August 2010.

²⁷⁷ Working under a comparable telephone solicitation arrangement with an Indiana utility, Tr. 210 (O'Connor), NS had 29,113 GLCG customers in that state as of June 2010. Staff Group Cross Ex. 1 at 21. The record does not establish whether NS does or does not have telephone solicitation support from utilities in Ohio (9899 GLCG customers), Georgia (406 customers), Texas (135) or Kentucky, Nevada and Tennessee (three or fewer customers in each). *Id.*

²⁷⁸ NG Ex. 7.0 at 6.

²⁷⁹ *Id.* at 7.

²⁸⁰ *Id.* at 29.

affect our conclusion that NS's GLCG is overwhelmingly dominant among gas line service contracts in particular. Nor does it meaningfully affect our view that GLCG is dominant among *all* types of service contracts that include interior gas line repair. NG's effort to expand the relevant market "denominator" by adding utility line service contracts and home warranties simply falls short. With respect to utility line service contracts, NG supplies no quantification to add to the denominator in Staff's computation. Moreover, any quantification would likely be trivial. The only utility line service contract providers in Nicor territory that NG identifies (Manchester²⁸¹ and SES²⁸²) have ceased marketing their services there²⁸³.

Concerning home warranty contracts, NG relies on estimates derived from national data that, even if reliable²⁸⁴, would not appreciably reduce the market dominance of NG's GLCG. That is, NG suggests that "there could be up to 90,000...home warranty customers in [NG] service territory."²⁸⁵ Therefore, if, for the sake of argument, we combine the maximum estimate of such potential customers with the approximately 451,500 gas line warranty customers calculated by Staff²⁸⁶, we arrive at a market share for home warranty providers of approximately 17%, with GLCG holding virtually all of the remaining 83% of those customers that have chosen a service contract covering gas lines.

As for "self-insurance," the Commission does not find NG's paradigm useful. To begin, GLCG is not an insurance policy²⁸⁷. As we stated above, it is a fixed-price repair service contract that is not limited to future adverse events²⁸⁸ - indeed, customers can request repairs for pipes that are, in fact, already leaking or faulty, as well as non-leaking brass connectors already in place, when the customer subscribes to GLCG²⁸⁹.

²⁸¹ NG Ex. 4.2 at 3; NG Ex. 7.3.

²⁸² NG Ex. 4.2.

²⁸³ Furthermore, Manchester's service ("Utility Shield") can include either a gas line service contract or a more comprehensive utility line service contract, NG Ex. 4.2 at 3 & NG 7.3, so the latter may already be included in Staff's calculations (because gas line and utility line contracts are not quantified separately in Staff's testimony).

²⁸⁴ NG's principal statistical inputs are estimates (taken from a warranty managers' newsletter) of, first, the gross national total of premiums paid for home warranties (apparently, for all dwelling configurations) in 2009 and, second, the national home warranty market share held by the largest home warranty provider. With the assumption that those national estimates are mirrored proportionally in NG's service territory, NG applies them to another estimate of the number of single-family and duplex units in the territory. NG Ex. 7.0 at 18-19. No source is identified for another essential statistical input - "the average monthly price of a home warranty product," *id.* at 18 - and the price charged by the largest home warranty provider is apparently not included in whatever calculation was performed. NG Ex. 4.5. This matters because NG estimates the number of home warranty customers (nationally and in NG territory) by dividing total premiums by contract price.

²⁸⁵ NG Ex. 7.0 at 19.

²⁸⁶ Staff Ex. 4.0 at 36.

²⁸⁷ After much evidentiary divergence on this question, NG itself ultimately characterizes GLCG as a "warranty product" in briefings. JA IB-OA at 10.

²⁸⁸ NG also describes GLCG as if it were not associated with adverse events (or, in insurance parlance, "losses") at all. "GLCG provides inspections of customer piping to identify and replace faulty piping *before a leak occurs.*" NG Ex. 3.0 at 17 (emphasis added).

²⁸⁹ Staff Ex. 2.0, Att. B. Service to pre-existing piping conditions is excluded, but only if NG or NS has identified them. There is no pre-existing exclusion at all for already-installed uncoated brass connectors,

Furthermore, GLCG explicitly excludes service when “insurable events” have caused gas pipe damage²⁹⁰. Additionally, insofar as GLCG is subject to the Service Contract Act, NS is a “service contract provider” within the meaning of that law and, as such, cannot be an insurer under the statute²⁹¹.

Nonetheless, even if the Commission regarded GLCG as a form of insurance, we do not perceive it to be in competition with a service called “self-insurance.” The market in which GLCG competes is comprised of commercial enterprises that inspect and repair gas lines and connectors. Those enterprises compete with each other to sell services to utility customers. They do not *compete* with utility customers²⁹². When utility consumers decline to purchase a service, they are not *winning* a competition. They are simply declining to buy – and no service contractor receives the monthly or annual fee associated with a service contract. Indeed, if all potential customers are inherently competitors, then all markets are maximally competitive. The Commission rejects that logic and thus rejects the notion that the number of pertinent competitors here includes residential and small business utility end-users. Accordingly, we exclude customers from our quantitative analysis of NS’s market success with GLCG.

Another dispute among the parties concerns whether the opportunity to sell NS services during inbound utility calls constitutes an “essential input” to NS’s business operations. While this debate was often more academic than useful, it is material insofar as it facilitates our assessment of whether NS receives a meaningful subsidy. The more or less essential an input may be, the more or less meaningful the subsidy (if any) it presumably affords. Staff describes an essential input as “necessary for all providers” but “not easily duplicated.”²⁹³ NG adds more criteria for essentiality – whether it is controlled (but sharable) by a monopolist, unavailable from other sources and not feasibly duplicated, and essential to the sustainability of competition (but not the sustainability of any particular competitor)²⁹⁴.

We need not select the better definition, because the solicitation right NS receives from NG is an essential input under either one. While we agree with NG that competing gas line repair service contract providers can, in fact, solicit customers by other means, that is not the point. The input here is not the general capacity to solicit, but the specific right to sell gas line repair service under the aegis of the monopoly gas delivery utility during inbound consumer calls initiated for utility business. That input is not duplicable (because NG will furnish it only to NS), yet it is apparently critical to

in keeping with Nicor’s apparent, and sound, policy to proactively remove these “very hazardous” customer-owned items. NG Ex. 3.0 at 9 & 14.

²⁹⁰ Staff Ex. 2.0, Att. B.

²⁹¹ 215 ILCS 152/5. Furthermore, a “service contract provider” is “not subject to any provision of the Illinois Insurance Code.” 215 ILCS 152/10.

²⁹² Thus, insofar as an NG witness emphasizes that the GLCG sales script contains a response to customers who assert they will make their own repair arrangements, NG Ex. 7.0 at 10; Tr. 285 (Ros), the Commission regards this as a standard sales tactic to overcome customer resistance, not a counter-thrust against competitors.

²⁹³ *Id.* at 31.

²⁹⁴ NG Ex. 4.0 at 19.

competition and necessary for all providers, since NS is the only remaining active seller of gas line service contracts in NG's territory.

The Commission thus concurs with AG/CUB that “[w]hile it would be possible for a prospective competitor to ‘cold call’ gas distribution customers to offer this service, it is hard to imagine that such efforts would be successful.”²⁹⁵ We are unwilling to adopt the fictions that all marketing channels are fungible and none are essential to competitive sustainability. NS has approximately one-quarter of the addressable utility customer base for gas line repair service and (depending on whether home warranty providers are included), from 83% to virtually all of the customers that have chosen a fixed-price service contract for gas line repair. With no record evidence that NS's success is attributable to superior gas line repair service²⁹⁶, the essential and distinguishing input underlying NS's market dominance is the unique solicitation right it derives from NG.

There is also disagreement among the parties about the extent of GLCG's profitability. Although this debate is principally associated with the public interest implications of NG's support for NS's products (discussed below), it also bears upon the subsidy issue here, insofar as hefty profit is consistent with, and likely attributable in some measure to, receiving a commercially valuable input without paying for it. Staff calculates that GLCG after-tax profits exceeded costs by over 900% in 2007 and 2008, and by 854% in 2009²⁹⁷. AG/CUB computed pre-tax GLCG profit margins in 2008 and 2009 at 94.1% and 93.5%, respectively²⁹⁸. NG responds that the foregoing estimates fail to include significant costs NS incurs to provide GLCG and other services²⁹⁹. Moreover, NG stresses, Staff and AG/CUB attribute a profit to GLCG alone that exceeds the combined profits of NS and the two other Nicor affiliates (Nicor Advanced Energy and Nicor Solutions) that comprise NI's retail group of companies³⁰⁰ (described in NI's financial filings as “other energy ventures” (“OEV”)). The net profit, as a percentage of revenue, for the OEV was 8.1% in 2010, 6.95% in 2009 and 6.49% in 2008³⁰¹.

The Commission cannot make a definitive finding on the profitability of GLCG, because, first, the intra-NS costs identified by NG (which are in addition to the costs

²⁹⁵ AG/CUB Ex. 1.0 at 9. We note here that NS does not initiate “cold calls” to consumers. Whether NS currently uses other marketing channels, other than a website, is not clear. Tr. 274 (Ros).

²⁹⁶ In fact, to support the proposition that GLCG is subject to competitive pressure, NG stresses that *any* plumber or HVAC professional can repair inside gas lines. NG Ex. 7.0 at 10. NG counted 2289 plumbers and 261 HVAC professionals in its service territory, NG Ex. 4.0 at 27, with the assumption that *all* were proficient. Also, NG itself provides the same repair service as NS (in fact, NG presently performs almost all of NS's repair services, AG/CUB Ex. 1.0 at 5, and avers that there is “no difference in the services available to the customer”). NG Ex. 2.0 at 44.

²⁹⁷ Staff Ex. 4.0 at 62. For perspective, we note that Staff estimated GLCG revenues at about \$22 million in 2007, *id.*, and Staff and AG/CUB both used estimates of approximately \$24.8 million in 2008 and \$26.2 million in 2009. Staff Ex. 2.0 at 40; AG/CUB Ex. 1.0 at 7.

²⁹⁸ AG/CUB Ex. 1.0 at 7. AG/CUB did not attempt to quantify post-tax profit.

²⁹⁹ NG Ex. 2.0 at 48-50. These include, among other things, “in-house” office, personnel and management expenses and carrying costs for NS's assets.

³⁰⁰ *Id.* at 50.

³⁰¹ NG Ex. 5.4.

identified by Staff and AG/CUB) have not been apportioned among NS's multiple products. Likewise, we cannot make a definitive finding on the profitability of either NS or GLCG because the revenues and profits of the three individual Nicor OEV companies (including NS) are not segregated³⁰². Thus, we cannot confirm that GLCG profits exceed 90%, as Staff and AG/CUB assert, or that either NS or GLCG profits are in the 7-8% range achieved by the combined OEV companies, as NG implies.

Nonetheless, the Commission notes NG's declaration that "GLCG is profitable."³⁰³ Since NG has that knowledge, it could have furnished evidence to quantify the profitability of GLCG, to disprove the inference of subsidy suggested here by Staff's and AG/CUB's evidence of high profitability. Although NG and NS are nominally distinct entities, NG has gone to considerable lengths in this proceeding to defend NS's ability to solicit its services in NG's utility-related telephone calls, and it has successfully obtained (and submitted as evidence) confidential intra-NS documents that support that defense.³⁰⁴ Therefore, while we cannot and do not find that the profitability of GLCG specifically, or NS generally, sustains an inference of subsidy to NS, the evidentiary ambiguity concerning profitability does not help NG negate the inference of subsidy permitted by other evidence previously discussed. Again, under subsection 7-204(b)(2) of the Act, the burden is on NG to show that a reorganization with inter-affiliate solicitation will *not* result in unjustified subsidization.

Furthermore, in addition to the value NS receives from its exclusive involvement in NG's utility calls, NS derives additional subsidy from the scope and scale of NG's utility operations, which are funded by ratepayers. NG's own witness explains this best:

Typically, there are economies of scope and scale in centralizing certain functions of a business entity which lower unit costs...For example, utilizing spare capacity on a computer or utilizing under-used employees of the utility to answer calls can lower overall unit cost to the utility, *its affiliated interests*, and in turn, the customers of both the utility and *its affiliated companies* by spreading the fixed costs of these assets over a larger output level. The Agreement allows [NG] and *its affiliates* to take advantage of these economies³⁰⁵.

³⁰² The fact that the profit estimates of Staff and AG/CUB exceed the reported profits for the combined OEV companies is not, by itself, meaningful. As AG/CUB suggest, other OEV services could be unprofitable without "the same marketing advantages conferred on GLCG." AG/CUB Ex. 2.0 at 6. The salient point, however, is that no party's inference about profitability is sustainable without additional evidence.

³⁰³ NG Ex. 2.0 at 47.

³⁰⁴ *E.g.*, NG Ex. 2.12 (confidential).

³⁰⁵ NG Ex. 4.0 at 6 (emphasis added). The Commission notes that this scope-and-scale paradigm among affiliates is one of the underlying rationales for the proposed Reorganization itself. *E.g.*, "the real opportunity in this deal was those complementary or related businesses around marketing, asset management, trading, those types of things, retail services under a bigger footprint, saving the duplication of those, and increasing the market opportunity in those businesses." Tr. at 679 (Lingenfelter).

Importantly, the fact that the scope of scale of NG's call centers is large enough to lower unit costs of solicitation, for utility and *non-utility* business alike, is because of *utility* distribution operations. Indeed, NG claims that NS/IBT contributes *nothing* to that scope and scale, because the NG Solicitations merely use the spare capacities of call centers staffed solely for utility needs³⁰⁶. Consequently, when it pays NG's full FDC for solicitation, NS still gets the lower unit cost attributable to a utility operation with more than two million customers. There is no reason to believe NS could achieve such unit costs without its involvement with NG. Moreover, no other provider of gas line service contracts or other service contracts can achieve the lower solicitation costs associated with NG's ubiquitous operations. The result is lower, and subsidized, solicitation costs for NS alone.

As for NG's argument that customer solicitation by or on behalf of affiliates is not barred by Part 550 of our regulations³⁰⁷, the Commission agrees that solicitation is neither specifically precluded nor permitted by Part 550. However, as discussed above, subsidization is precluded by Section 550.120. The Commission concludes here that the right to market NS services to customers during utility business calls has commercial value that exceeds NG's mere costs, and the transfer of that value without compensation constitutes a subsidy for NS.

c. Cost Allocation

Under subsection 7-204(b)(3), reorganization approval requires a finding that cost allocation among utility and non-utility activities will be fairly and reasonably allocated, so the Commission can identify the costs and facilities properly included in utility ratemaking. During the course of Docket 09-0301, and earlier in this docket, certain parties had framed disputes associated with cost allocation under the OA. Those disputes have now been resolved among the interested parties³⁰⁸, and no other party opposes that resolution. The Commission has reviewed the terms of the proposed OA, as agreed to by Staff and the JA, and concludes that those terms adequately support the finding required by subsection 7-204(b)(3). Specifically, the Commission is satisfied that the proposed OA, as modified by this Order, will fairly and reasonably allocate costs among utility and non-utility activities, enabling us to identify those costs and facilities properly included by the proposed reorganized utility for ratemaking purposes.

d. Public Interest

As already noted, the Commission is empowered by subsection 7-204(f) of the Act to condition our approval of the instant merger as we deem necessary to protect the

³⁰⁶ NG Ex. 2.0 at 37; Tr. 242 (O'Connor).

³⁰⁷ NG Ex. 4.0 at 23.

³⁰⁸ JA Ex's. 7.0 & 7.1; JA IB-OA at 8-9.

interests of the public utility and its customers. We are also authorized by Section 7-101 of the Act to impose conditions on inter-affiliate agreements to safeguard the public interest. Our analyses, above, regarding subsidization and cost allocation, is also applicable here in the broader context of the public interest. Subsidization of a non-utility affiliate is not in the interests of the general public, the involved utility or the utility's customers. Fair and reasonable cost allocation among utility and non-utility activities, to facilitate proper ratemaking, serves those interests. Accordingly, our preceding analyses are incorporated into this subsection of our Order.

In addition to subsidy and cost allocation, the parties have raised other issues regarding the effect on the public interest of NG's participation in NS's solicitation efforts. According to Staff and AG/CUB, GLCG solicitation is both affirmatively misleading and marred by the omission of material facts. Staff and AG/CUB argue that consumers are given several false impressions, principally that: NG does not perform (on an as-needed basis) the same pipe and connector work NS offers; GLCG is necessary to avert temporary gas shutoffs; and repairs are typically more frequent and costly than actually occurs³⁰⁹. These parties further assert that GLCG is neither necessary nor appropriately priced. Staff and CUB/AG therefore urge the Commission to protect the public interest by prohibiting further solicitation under the OA or requiring several disclosures to consumers during the sales process. NG counters that, under its sales protocols, customers are fully informed that the purchase of NS services is unrelated to service reliability from NG, that all representations are accurate and lawful, and that NS is not a public utility. NG also contends that NS's solicitation practices are under the jurisdiction of the Illinois Department of Insurance ("IDI"), not this Commission³¹⁰.

To begin, NG is correct that the IDI has jurisdiction of those matters assigned to it by the Service Contract Act, and that certain written disclosures are required by that law³¹¹. Nevertheless, the Commission also has authority over such activities when conducted by an entity we regulate, to the extent necessary to carry out our own statutory duties. Additionally, we have previously held, in other contexts, that the Commission can exert power over misleading marketing by public utilities³¹². However, as NG underscores, neither NS nor its services have been placed under our statutory authority³¹³. It follows that we cannot mandate changes to NS's sales scripts, service agreements or disclosures, including those involving GLCG.

Whether the public interest is undermined by the entanglement of NG (an entity we *do* regulate) in NS solicitations is another matter, however. Staff and CUB/AG contend that NG's pervasive involvement with GLCG adversely affects the public

³⁰⁹ AG/CUG IB-OA at 19 & 24; Staff IB-OA at 19-2.

³¹⁰ JA IB-OA at 20-24.

³¹¹ JA IB-OA at 20; 215 ILCS 152/30. NS does not appear to have a written GLCG agreement that the customer signs. Service confirmation and enrollment occur orally during the solicitation call, Staff Ex.2.0 Att. G, and the customer receives written terms and conditions later. *Id.* Att. B. The disclosures required by the Service Contract Act are apparently in that document.

³¹² *E.g.*, CUB v. Illinois Bell Telephone, Dckt. 00-0043, Order, Jan. 24, 2001.

³¹³ JA IB-OA at 20.

interest by facilitating NS's misleading marketing during NG's inbound utility calls. The Commission has already held, in IAWC, that circumstances can warrant a finding that it is not in the public interest for a utility "to lend its name and assistance in *marketing* [an affiliate's service] to Illinois ratepayers."³¹⁴ IAWC involved a petition for approval of an agreement between a water utility and an affiliate. The Commission declined to approve the proposed affiliate agreement "to the extent it would authorize [the water utility and affiliate] to engage in an unknown number of unknown arrangements without the benefit of Commission review" of the public interest impact of such arrangements³¹⁵.

Also in IAWC, the Commission considered the single affiliate service identified by the petitioner - a water line repair service contract analogous to GLCG here³¹⁶. In return for certain utility support services connected with marketing that service (which did not include solicitation privileges during utility telephone calls) the affiliate would pay the utility's FDC associated with those services, plus a 15% mark-up. We concluded that the public interest would not be served by allowing the utility to lend assistance to the marketing of a service that was neither "properly priced" nor "legitimately necessary."³¹⁷ Consequently, the parties here have argued at length about the pricing and necessity of GLCG. In our view, the greater importance of IAWC here comes from the principles recited above: that marketing affects the public interest and that the Commission, through its authority over the involved utility, will not approve inter-affiliate agreements that involve the utility in diminishing that interest.

That said, the Commission still believes that an affiliate's product can be so inefficiently priced or so devoid of consumer benefit that, in defense of the public interest, the utility should be precluded from abetting the affiliate's marketing and solicitation³¹⁸. Consequently, the Commission will consider here the pricing and necessity associated with the affiliate's product, as we did in IAWC. (We will then return to the question of whether the solicitation of GLCG involves the utility in disseminating misleading information, which would cause us to safeguard the public interest by precluding NG's participation in such solicitation.)

1.) Pricing and Necessity

Unlike IAWC, there is pricing evidence in the record here. As already stated, NS currently charges \$4.95 per month for covered services, with a \$600 cap per occurrence. In comparison, SES, NS's erstwhile competitor, imposed the same monthly

³¹⁴ IAWC at 16 (emphasis added).

³¹⁵ IAWC at 11.

³¹⁶ IAWC at 5 & 12. We note that, as in IAWC, the Commission is again confronted with a disagreement that is primarily about a single affiliate service, while the nominal dispute concerns broadly applicable contract language. (Here, the disputed service is not even mentioned in the affiliate agreement.)

³¹⁷ IAWC at 16.

³¹⁸ Indeed, NG agrees with the principle that the Commission can take an affiliate's unregulated conduct into account as part of our oversight of inter-affiliate transactions involving regulated utilities ("the Commission's public interest evaluation of affiliate transactions should not ignore illegal or clearly abusive business practices by a non-regulated affiliate"). NG Ex. 2.0 at 36.

charge for its gas line service contract, with a \$1000 cap per visit and a \$3000 annual limit³¹⁹. Manchester, another former competitor, charged \$2 per month, with different coverage and monetary cap than GLCG. This evidence thus shows comparable charges among the three gas line service contract providers. The fact that SES and Manchester have ceased marketing in Nicor territory was, as we found above, reasonably attributable to the solicitation advantage NS receives from NG. It was not attributable to pricing activity by NS.

AG/CUB and Staff still insist, however, that GLCG is improperly priced because of the magnitude of profit they believe NS (and the Nicor corporate family) reaps from GLCG³²⁰. However, as noted earlier in this Order, the record does not enable us to render a definitive finding on the profitability of GLCG. We are left, therefore, with inferences derived from general economic principles. If GLCG were, in fact, earning “too much” profit, competitors would likely have successfully undercut it with more sensibly priced alternatives. The opposite occurred, however, as SES and Manchester, lacking either price advantage or NS’s utility-linked solicitation advantage, curtailed new sales in Nicor territory. Therefore, the record here does not suggest improper pricing for GLCG and does not, *for that reason*, justify rejecting Nicor’s OA on public interest grounds³²¹.

With regard to necessity, Staff and AG/CUB have treated this as a pliable concept. First, they cast necessity in terms of safety. According to AG/CUB, there is “no evidence that [NG] customers were at any greater risk before GLCG was available.”³²² NG replies with extensive testimony and argument about the dangers of gas leaks³²³. Although NG presented that evidence for sound litigation reasons in light of IAWC, this was an unnecessary debate. There is no question that gas leaks can trigger catastrophic consequences. To avoid such calamity, a customer can look to the utility or an HVAC contractor on an as-needed basis, or enter into a service contract with monthly payments and a benefit cap, like GLCG. Assuming these alternatives actually provide security from peril in customer-owned gas lines, none are invalid, even though none provide the sole, or necessary, means of achieving gas line safety. There is record evidence that some customers have derived actual safety benefit from GLCG³²⁴. Accordingly, the Commission does not conclude that GLCG fails to enhance safety and, *for that reason*, diminishes the public interest.

Next, AG/CUB and Staff present necessity as a question of alternatives, stressing that NG itself will perform gas line inspections and repairs, so that GLCG

³¹⁹ The facts in this paragraph are derived from NG Ex. 4.4.

³²⁰ AG/CUB IB-0A at 22-23; Staff IB-0A at 23.

³²¹ Conceivably, NS (or Nicor, Inc.) intends to raise the price of GLCG after exploiting its solicitation advantage to eliminate competing gas line service contract providers from the market. While that notion might be warranted under economic theory, there is no evidence of such intention in the record and the Commission will therefore not infer it.

³²² AG/CUB IB-0A at 23.

³²³ NG Ex’s. 3.0 & 6.0.

³²⁴ *E.g.*, NG Ex. 3.0 at 6.

provides “no unique benefit.”³²⁵ The Commission, however, is not inclined to administer a “unique benefit” test on products and suppliers, especially those beyond our agency purview. Moreover, the legislature has mandated more competitive choice among providers, not less, for utility customers³²⁶, and a unique benefit test would be inconsistent with that mandate. Providing a familiar product at a lower price, or more reliably, or with better customer service, is often as beneficial as providing a “unique” benefit.

Additionally, AG/CUB and Staff characterize necessity as a cost-benefit matter. They present the following facts (uncontroverted by NG) to show that GLCG is unlikely to benefit the customer financially: fewer than 2% of GLCG customers had repairs performed in 2009; about three-fourths of leak repairs provided by NG technicians for non-GLCG customers in 2009 were for less than \$50, with an average charge of about \$47; and fewer than 3% of the leaks repaired by NG technicians for non-GLCG customers exceeded \$100³²⁷. NG responds with evidence that tens of thousands of repairs have occurred through GLCG³²⁸.

The Commission is hesitant to determine what constitutes enough economic benefit for customers of service contracts we do not directly oversee. The evidence does show that some customers obtain satisfactory inspections and repairs under GLCG. Rather than contrive a cost-benefit benchmark for service contracts, the Commission will address (below) whether NS supplies customers with sufficient information to decide whether a service contract meets their needs and expectations. We do not conclude, therefore, that GLCG is unnecessary and, *for that reason*, unsuitable for the utility’s solicitation support under the OA.

2.) Misleading Solicitation

Both NG and NS are responsible for the GLCG sales messages communicated to customers through the NG and NS/IBT call centers. NS furnishes sales scripts, which are submitted to NG for approval regarding legal and regulatory compliance³²⁹. Staff and AG/CUB assert that those scripts, when presented to Nicor’s utility customers, suggest that GLCG is the only service provided by a Nicor entity for inspection and repair of customer-owned gas line infrastructure³³⁰. That is a misleading message, these parties maintain, because NG will provide the same services included in GLCG,

³²⁵ Staff IB-OA at 18.

³²⁶ *E.g.*, the Alternative Gas Supply Law, 220 ILCS 5/19-100 *et seq.* (enabling alternative gas suppliers to provide the *same* service as the utility, competing principally on price); the Electric Supplier Choice and Rate Relief Law of 1997, 220 ILCS 5/16-101 *et seq.*; 220 ILCS 5/13-103 (“competition in all telecommunications service markets should be pursued as a substitute for regulation in determining the variety, quality and price of telecommunications services”).

³²⁷ AG/CUB Ex. 1.0 at 17.

³²⁸ NG Ex. 3.0, Att. H (showing over 20,000 replaced connectors and over 65,000 “other repairs” over approximately 11 years). We note that the statistical evidence from both sides of this issue distinguishes the present case from IAWC, where a prospective (rather than existing) affiliate service was at issue.

³²⁹ Staff Ex. 2.0 at 21.

³³⁰ Staff IB-OA at 19; AG/CUB IB-OA at 18.

on terms that customers may find more advantageous. NG responds that its telephone sales practices do not mislead consumers³³¹.

The Commission has concluded before, and reiterates here, that the “net impression test,” as developed by the United States Federal Trade Commission (“FTC”) and incorporated into Illinois law³³², provides us with the best guidance with respect to protecting utility customers from misleading sales representations. In the docket in which we adopted that test, its operative principles were set forth verbatim as developed by the FTC:

A deceptive ad is one that contains a misrepresentation or omission that is likely to mislead customers acting reasonably under the circumstances about a material fact. Material facts are those that are important to a consumer’s decision to buy or use a product. Information pertaining to the central characteristics of the product or service is presumed material. The cost of a product or service is an example of an attribute presumed material.

Advertisers are responsible for substantiating all objective express and implied claims that an ad conveys to reasonable consumers, regardless of whether the advertiser intended to convey those claims. In determining the claims that an ad conveys, the FTC looks to the “net impression” conveyed to the consumers - often described as “the entire mosaic, rather than each tile separately.” [Footnote omitted.] Even if the wording of an ad may be literally truthful, the net impression conveyed to the consumers may still be misleading. The entire advertisement, transaction or course of dealing will be considered. The issue is whether the act or practice is likely to mislead, rather than whether it causes actual deception.

An ad may be deceptive by omission. For example, an ad may be deceptive if it fails to disclose qualifying information that, in light of the representations made, would be necessary to prevent consumers from being misled. The failure to disclose is examined in light of expectations and understandings of the typical buyer regarding the claims made [footnote omitted].³³³

³³¹ NG IB-OA at 22.

³³² 815 ILCS 515/2.

³³³ CUB v. Illinois Bell Telephone, Dckt. 00-0043, Order, Jan. 24, 2001, at 13, quoting In the Matter of Joint FCC/FTC Policy Statement for the Advertising of Dial-Around and Other Long-Distance Services to Consumers, File No. 00-72, March 1, 2000, at 2-3.

Although we embraced the foregoing guidelines in a proceeding involving printed materials, we stated that:

[W]e will apply those principles to *all* of the communications media (e.g., billing inserts and telemarketing) by which [the utility] conveys information to customers...The adverse impact of a deceptive or misleading misrepresentation during a *telephone conversation with a customer* may well exceed the impact of a similarly deceptive or misleading advertisement on that customer.³³⁴

The Commission will apply the net impression test to the claims of misrepresentation lodged here by Staff and AG/CUB.

There is no disagreement that NG - on its own and not on behalf of NS - performs inspection and repair of its customers' leaking gas lines and connectors³³⁵. Under NG's standardized and company-wide protocols, NG technicians will perform "[p]ermanent repair of leaks on appliances or on exposed customer piping" and "[r]eplacement of brass connectors to customer's facilities/appliances."³³⁶ Moreover, NG acknowledges that "there is no difference in the services available to the customer," irrespective of whether the NG technician is performing work for a customer with or without GLCG³³⁷. It follows that it would be deceptive to convey the net impression that GLCG was the only available Nicor gas line repair service for customer-owned facilities.

Do NG and NS convey that impression during customer calls to the utility? Under the scripts currently provided to call center personnel, after the utility business initiated by the calling customer is addressed, the Nicor representative will transition the conversation to "products and services offered by our affiliate company, Nicor Services."³³⁸ Regarding GLCG specifically, the representative is instructed to say:

As you probably know, Nicor Gas is responsible for repairing any gas leaks outside of your home. However, customers are responsible for repairing any gas leaks that occur inside the home. With [GLCG], a Nicor technician will repair any gas leaks on exposed interior piping, and replace faulty appliance connectors or shut off valves, up to \$600 per

³³⁴ *Id.* at 14 (emphasis added).

³³⁵ *E.g.*, "Customers "can have gas line repair services performed by [NG] technicians but not as part of the GLCG program." NG Ex. 4.0 at 27.

³³⁶ Staff Ex. 2.0, Att. I, p. 6 ("Standard Practice Customer Care Services"). In fact, NG, appropriately, does not permit its technicians to ignore a customer's gas leak. "When a gas leak is discovered on a customer's premise, it *must be* repaired or the leaking gas line or appliance disconnected or valved off." *Id.* (emphasis added).

³³⁷ NG Ex. 2.0 at 44.

³³⁸ Staff Ex. 2.0, Att. G, p. 1.

incident. The cost of the program is just \$4.95 per month, and is conveniently added to your Nicor Gas bill³³⁹.

The Commission finds that this language does communicate the net impression that GLCG enrollment is the sole means for obtaining Nicor repairs on the customer side of the gas meter. The availability of service from NG is never mentioned. Indeed, NG itself is only referred to in a manner that implies NG does *not* perform customer-side repairs (“*customers* are responsible for repairing any gas leaks that occur inside the home”³⁴⁰). This impression is strengthened by stating that “with” GLCG, a *Nicor* technician will repair or replace gas lines, connectors and valves. The customer is left to assume that *without* GLCG there will be no service from Nicor, who, the representative has emphasized, is only responsible for gas leaks “outside your home.”

Additionally, when customers hesitate to purchase GLCG, Nicor personnel are instructed to offer scripted “rebuttals” that reinforce the misimpression that NG does not repair customer facilities. Reluctant customers are told: “Remember, the utility is only legally responsible to make the situation safe or make repairs to *its own* facilities.”³⁴¹ Customers are further advised that, with GLCG, they “won’t have to try to make the repair themselves or call an independent contractor to come out and do the work,”³⁴² and “won’t have to worry about *who you should call* to perform the repairs in a gas leak emergency.”³⁴³ Requesting service *directly from NG* is not included as an option and, impliedly, a request would be futile, since “Nicor technicians” are associated solely with GLCG during the sales presentation. Further, customers are informed that, with GLCG, they can “make just one call *to the utility*” for GLCG service³⁴⁴, again reinforcing the message that “Nicor technicians” are deployed only for GLCG subscribers. Customers would reasonably assume that if NG itself offered inspection and repair services for customer-owned infrastructure, it would disseminate that information in order to realize the associated revenue.

NG’s own consulting witness acknowledges that a customer receiving the GLCG sales presentation might derive the inference that Nicor technicians are available only to GLCG customers³⁴⁵. Although that witness does state, appropriately, that each customer’s impression is dependent upon the information that each particular customer already has when solicited³⁴⁶, the Commission must make findings appropriate to customers *in toto* - the majority of whom, we believe, are unfamiliar with Nicor’s internal arrangements³⁴⁷. In sum, the sales scripts at Nicor call centers convey the false

³³⁹ *Id.*

³⁴⁰ Emphasis added.

³⁴¹ *Id.* (emphasis added).

³⁴² *Id.*, p. 2.

³⁴³ *Id.* (emphasis added).

³⁴⁴ *Id.*, pp. 1 & 2 (emphasis added).

³⁴⁵ Tr. 272 (Ros).

³⁴⁶ *Id.*

³⁴⁷ This is especially so when, as here, NG’s inspection and repair services are not set forth in a public tariff. Staff Ex. 4.0. Att. O, p. 1; Tr. 213 (O’Connor). Moreover, even NG’s testifying Senior Vice President was not fully apprised of NG’s inspection and repair services. “In my rebuttal testimony, I

impression that the customer's sole means of securing Nicor assistance for gas leak repairs to customer-owned pipes and connectors is to subscribe to GLCG³⁴⁸.

Is this a material fact - that is, is it "important to a consumer's decision to buy or use" the GLCG product? The Commission holds that it is. We assume that NG customers typically have a favorable impression of NG's brand and associate their local gas distribution utility with expertise and reliability regarding natural gas safety³⁴⁹. For those customers, the availability of services directly from NG is "information pertaining to the central characteristics of the product or service," which is "presumed material" under the net impression test.

When the customer is misled to the material misimpression that NS is the only source of Nicor repair service, the purchase decision becomes "GLCG versus outside contractor." In contrast, if the customer knows that NG is also available for emergency repairs, and that there is "no difference in the services available to the customer [with or without GLCG]," except "differences in the cost to the customer,"³⁵⁰ then the purchase decision focuses on cost and likelihood of trouble (a steady \$4.95 per month, whether or not trouble arises, versus as much as \$600 per incident, but only if trouble actually occurs). Furthermore, since the customer is given the incorrect impression that Nicor repair service is not even available without GLCG, the customer gets no cost information for NG's own service - and, under the net impression test, cost information is presumed material to the purchase decision. In sum, the fact that customers can obtain the same Nicor reliability on their side of the meter during a gas leak emergency from *either* NG or NS is a material fact for the consumer's buying decision.

The net impression test does not assess the *intentions* of the seller that conveys the deceptive message. The focus is on the message itself. The Commission nonetheless observes that NG's own repair services for customer gas lines and connectors are furnished at FDC³⁵¹. As discussed earlier, GLCG is provided at a profit. Moving customers toward GLCG thus yields greater benefit for the Nicor corporate family. Whether or not that fact illuminates *why* the GLCG solicitations convey a misleading impression, it is certainly consistent with our view that those solicitations *do* convey a misleading impression.

stated that [NG] would not conduct inspections for dangerous connectors absent a report of a leak by a customer...I was incorrect". NG Ex. 5.0 at 22.

³⁴⁸ In contrast, at the premises of a customer without GLCG, if an NG technician finds a gas leak, "[t]he customer is informed at the time of the field visit that either Nicor Gas or a qualified contractor may be hired to make a repair." Staff Ex. 4.0, Att. O, p. 1. The Commission notes that, during the field visit, it serves NG's interest to inform the non-GLCG customer of its own services, before the customer seeks third-party repairs.

³⁴⁹ NG and the JA make the same assumption frequently in our record here. One JA witness describes NG's reputation "in Illinois and nationally" as an "excellent reputation for providing safe and reliable service in a cost-effective manner." JA Ex. 8.0 at 7. He promises that, after reorganization, the utility will continue "the safety legacy that [NG] has built in Illinois." JA Ex. 13.0 at 8. NG's Executive Vice President of Operations states that NG, along with its merger partner AGL, are "industry leaders in safety and operational efficiency." JA Ex. 2.0 at 7.

³⁵⁰ NG Ex. 2.0 at 44.

³⁵¹ Staff Ex. 2.0, Att. D.

The Commission concludes that the GLCG solicitations performed during consumer calls to the utility are misleading with respect to the material fact that inspection and repair of customer-owned gas lines and brass connectors is available directly from NG on an as-needed basis. It is not in the public interest for NG to continue facilitating such solicitation.

3.) Other Public Interest Indicators

Beyond the impact of unjustified subsidization and misleading solicitation on the public interest, the parties advance other arguments pertaining to the relationship between the public interest and call center solicitation of NS products. First, NG avers that if GLCG were truly harming the public interest, that would be reflected in the volume of customer complaints concerning that service. However, NG asserts, the GLCG complaint rate, whether considered in absolute numbers or as a percentage of GLCG billed customers, is “extremely low.”³⁵² By comparison, the complaint rate concerning Nicor’s Customer Select Program (in which customers choose alternative gas suppliers) is substantially higher³⁵³. NG adds that GLCG sales scripts contain no inaccuracies³⁵⁴ and that there is no evidence of abusive behavior by customer service personnel³⁵⁵, who are subject to internal monitoring and quality control measures³⁵⁶.

Staff replies that customers are unlikely to complain when the existence of the very facts that would matter to them - principally, the availability of inspection and repair service from NG (and, also, the infrequency of high cost repairs) - is undisclosed by the Nicor entities during solicitation³⁵⁷. AG/CUB make the same point³⁵⁸.

The Commission does not agree with NG that the volume of GLCG-related complaints is meaningfully probative about the public interest impact of GLCG solicitation. Customer satisfaction with the GLCG service itself is not the issue. Nor is the conduct of Nicor personnel during solicitation. Rather, the pertinent issue is whether solicitation of an affiliate’s services during inbound calls initiated for utility purposes diminishes the public interest. We have found in this Order that GLCG solicitation conveys a misleading impression of material fact and that NS receives commercially valuable and exclusive solicitation rights as a subsidy from NG’s ratepayers. These

³⁵² *Id.* at 40; NG Ex. 2.5. p. 1. The complaint total collectively recorded by Staff, CUB and the AG from 2005 through 2009 was 119, an annual average of 24, and less than a hundredth of a percentage point of billed GLCG customers.

³⁵³ NG Ex. 2.5. p. 2.

³⁵⁴ NG Ex. 2.0 at 62.

³⁵⁵ *Id.* at 59.

³⁵⁶ *Id.* at 59-60.

³⁵⁷ Staff Ex. 2.0 at 54.

³⁵⁸ AG/CUB Ex. 2.0 at 7.

circumstances, which the Commission holds are contrary to the public interest, are not apparent to utility customers³⁵⁹ and, accordingly, unlikely to evoke complaints.

Second, NG emphasizes that (as discussed above) the other principal gas utilities in northern Illinois, PG and NoS, are permitted to facilitate solicitation of their affiliate's gas line repair service, known as PPP, during application-for-service calls to the utilities. NG reasons that prior approval of PG/NoS affiliate agreements establishes precedent for approval of the solicitation support at issue here³⁶⁰. Staff counters that PPP "is marketed with an express admission of [PG or NoS]-provided repairs"³⁶¹, thus distinguishing the solicitation of, respectively, PPP and GLCG.

Preliminarily, the Commission observes that our prior Orders do not constitute binding precedent (although we cannot arbitrarily ignore previous decisions in like cases). That said, no party cites any prior Commission proceedings that directly addressed solicitation support for PPP. There are often matters that do not receive Commission scrutiny until our Staff or another party raises an issue for our attention. That hardly means that when an issue is expressly framed in a Commission proceeding, we must ignore it because it was not framed in an earlier proceeding. If anything, the assessment of GLCG in this Order would appropriately trigger a review of the PG/NS affiliate agreements and PPP solicitation, in the same manner as our Order in Docket 08-0363³⁶² led to the specific OA review in Docket 09-0301, which later became part of this docket.

Substantively, one significant difference between GLCG solicitation and PPP solicitation is that the latter does not appear to convey the impression that repairs to customer pipes and connectors is unavailable from the involved utilities. Although Staff exaggerates when it says PPP is marketed with an "express admission" that PG/NS provide repairs, it is at least implicit in the PPP marketing script that gas line repair is available from the utility³⁶³. Since PPP is neither fully discussed nor defended by the involved utilities in this docket, the Commission cannot determine here whether PPP marketing is misleading under the net impression test (or whether PG/NoS's affiliate pays an appropriate premium for the commercially valuable opportunity to solicit during inbound utility calls). The Commission does conclude, though, that the current absence of disapproval for PPP solicitation does not warrant approval for solicitation of GLCG (or

³⁵⁹ We have already determined that customers are not informed of NG's own inspection and repair services during GLCG solicitation – and, logically, this information would not be conveyed to GLCG customers during GLCG field visits. As for subsidization, customers will not typically be aware of Nicor's inter-affiliate compensation arrangements.

³⁶⁰ NG Ex. 5.0 at 21; NG RB-OA at 15.

³⁶¹ Staff RB-OA at 9.

³⁶² Nicor Gas Co., Order, March 25, 2009, at 182.

³⁶³ The script says: "Without [PPP], repairs to inside gas leaks would cost a minimum of \$70 for the first ½- hour of service." Staff Group Cross-Ex. 1 at 29.

other NS services) during calls to NG. Rather, this Order will generate consideration of PPP solicitation³⁶⁴.

Third, Staff and AG/CUB contend that NG, through solicitation of NS services during utility calls, is according NS an insurmountable and anti-competitive advantage that drives similar gas line service contractors from the market, for the benefit of the Nicor corporate family³⁶⁵. NG responds, as previously discussed, that when the competitive market is more broadly defined, the number of competitors rises and NS's market share falls, each to a point that negates the characterization of NS's solicitation privileges as anti-competitive³⁶⁶.

In an earlier section of this Order, the Commission discussed much of the evidence and argument pertaining to competition among service contract providers. In that discussion, which we incorporate here, we found that no gas line service contractors still market their services in NG's territory, that estimates of whole-home service contractors in that territory, even if reliable, do not meaningfully diminish GLCG's market dominance, and that consumers without service contracts are not "competitors" of service contractors. They are, instead, *potential* customers of service contractors (NS included) and of "as-needed" tradespersons (such as HVAC professionals), none of whom will receive revenue to sustain their enterprises until the customer chooses their services. Since none of the other gas line service contractors and tradespersons NG regards as GLCG competitors have the direct contact with consumers that NS enjoys during calls to the public utility, their likelihood of transforming potential customers into active customers is far lower than NS's. It is that anti-competitive difference in customer access (made even more beneficial to NS by the solicitation unit cost advantage derived from the utility's scope and scale), rather than any difference in service quality or innovation, that accounts for the paucity of non-Nicor service contracting in Nicor's service area.

Additionally, NG and Staff each offered a study, performed by their respective testifying witnesses for use in this docket, ostensibly demonstrating that there is (NG) or is not (Staff) meaningful competition for GLCG in Nicor's service area. Staff's study looks at price elasticity - that is, the effect of price increases on customer demand for GLCG - and asserts that actual historic increases have not slowed subscriber growth at a rate commensurate with a competitive market³⁶⁷. NG objects that Staff failed to account for relevant variables (consumer income and preference and the price of substitutes) and responds with a demand model that purportedly correlates customer demand for a product with the factors affecting that demand³⁶⁸. NG's model is an amalgamation of assumptions and proxies that yields concededly "mixed" results on price elasticity - *i.e.*, that demand decreased modestly when price increased in the

³⁶⁴ As noted earlier in this Order, NS, with only 2655 GLCG customers, has barely penetrated the combined service territories of PG/NoS. Staff Group Cross-Ex. 1 at 21. The Commission is concerned that this is the result of a market-distorting advantage derived from affiliate solicitation during utility calls.

³⁶⁵ Staff IB-OA at 24-24; AG/CUB IB-OA at 25-26.

³⁶⁶ JA IB-OA at 32-33.

³⁶⁷ Staff Ex. 4.0 at 38-39 (the precise calculations are confidential).

³⁶⁸ NG Ex. 7.0 at 14; NG Ex. 7.1.

longer measured term (42 months), but actually *increased* in the more recent and shorter term (22 months)³⁶⁹. Thus, insofar as the studies investigate the same thing (price elasticity), neither shows significant demand response to GLCG price increases.

However, NG's study additionally posits a positive correlation between plumbers' wages and GLCG demand, which NG regards as proof that customers perceive plumbers as NS's competitors for gas line repair and choose them less frequently when their wages rise³⁷⁰. The Commission is not persuaded. The hypothetical increase in GLCG demand is minimal (from 1.7% to 5%³⁷¹) and NG's witness forthrightly acknowledges that he has no evidence that "consumers are aware of plumber wages and rely on that information to choose to purchase GLCG."³⁷² Nor is there evidence that even a substantial number of those plumbers who serve residential and small business customers also receive wages (as opposed to fees for service rendered) or that enterprises that employ plumbers and pay wages adjust their customer prices (at all or at any known rate) for gas line work when their employees' wages rise.

Moreover, NG's study is simply misdirected. The salient issue is not whether some modicum of customers turn to professionals other than NS or repair their own gas leaks. No one can reasonably claim otherwise. Rather, the salient issue is whether the involvement of NG - the incumbent gas distribution utility - in GLCG solicitation distorts the competitive marketplace to its unregulated affiliate's (and corporate parent's) advantage. If so, action in the public interest is necessary, because a government-sanctioned distribution monopoly is not intended for exploitation in ancillary competitive markets. In this case, there is no evidence that any stand-alone gas pipe inspection and repair service, or any provider for whom such service is a substantial source of revenue, can withstand the competition-suppressing advantage NG provides to NS. There is, on the other hand, evidence that marketing of such stand-alone service was withdrawn from Nicor territory by SES and Manchester. Given NG's repeated insistence that it has no obligation to continue offering its own inspection and repair service for customer-owned gas pipes³⁷³, it is not in the public interest to allow NG to abet reduction of the services or providers available to its customers.

The JA also emphasize that, as described earlier, they have executed a Settlement Agreement in this proceeding with three intervening parties from the natural gas industry. Per that agreement, the signatories are collectively "of the opinion that the competitive issues [here]...including customer solicitation...are resolved through the fulfillment by [the JA] of their commitments under this agreement."³⁷⁴ The JA imply that this agreement reflects their competitors' view that joint NG/NS solicitation is not anti-

³⁶⁹ NG Ex. 7.1 at 4. NG's study included a hypothetical and smaller price increase, while Staff used an actual and larger increase in GLCG price. Staff found a diminished *rate* of demand growth. We are not certain whether NG is also referring to a diminishing growth rate or an absolute reduction in demand.

³⁷⁰ NG Ex. 7.0 at 15.

³⁷¹ *Id.*

³⁷² Staff Group Cross-Ex. 1.0 at 26.

³⁷³ E.g., NG IB-OA at 13.

³⁷⁴ NG Ex. 8.0 (fourth un-numbered page).

competitive³⁷⁵. AG/CUB reply that the Settlement Agreement - which substantively pertains to proposed legislation for purchases of receivable accounts by gas utilities and to operational changes in NG's transportation of customer-owned gas - demonstrates only that certain industry intervenors prioritized their interests as alternative gas suppliers above any interests they may have as gas line service contractors³⁷⁶. Therefore, AG/CUB contend, the Settlement Agreement does not address "the adverse competitive impact" of NG's involvement in GLCG.

As the Commission perceives it, the industry intervenors likely did accept a "trade off" among their priorities. Their intentions do not matter, however, because an agreement among fewer than all parties cannot constitute the basis for Commission decision-making. Our Staff and AG/CUB have raised, and continue to maintain, a dispute about the public interest impact of purportedly anti-competitive GLCG solicitation and the Illinois Supreme Court requires that we resolve that issue on the instant record, irrespective of any settlement among other parties³⁷⁷.

The Commission therefore concludes that NS's solicitation privileges during inbound customer calls to NG have substantial anti-competitive impact in NG's service territory, which is antithetical to the public interest. Again, it is not necessary to find that customers are utterly devoid of alternatives for gas line inspection and repair. It is sufficient to find that NS enjoys a consequential competitive advantage, unavailable to all other commercial gas line repair providers (of whatever kind), derived from the distribution utility's solicitation support, which has resulted in patent market dominance.

Finally, NG suggests that the Commission would encroach upon the jurisdiction of the IDI if we take action with respect to the solicitation arrangement between NG and NS³⁷⁸. Although the Commission concurs with NG that "there is no authority under the Act for the Commission to regulate the affiliate's product,"³⁷⁹ no such regulation is intended in this Order. NS and GLCG are not subject to our jurisdiction. NG, however, and its affiliate transactions and its reorganizations are squarely within our purview. This Order constrains only the conduct and property of the utility. Evidence pertaining to NS and GLCG is material here only insofar as it demonstrates what the *utility* is doing and how *utility* property is being used.

In sum, NG's entanglement with NS's solicitation at call centers handling public utility business is, for the reasons discussed above, antithetical to the public interest and must cease.

³⁷⁵ JA IB-OA at 12.

³⁷⁶ AG/CUB RB-OA at 22.

³⁷⁷ BPI, et al. v. Illinois Commerce Commission, 136 Ill. 2d 192, 555 N.E. 2d 693 (1990).

³⁷⁸ *E.g.*, NG RB-OA at 10.

³⁷⁹ *Id.*

3. Remedies

Given our conclusions about subsidization and the adverse public interest impact of NG's involvement in solicitation, the Commission may take corrective action – and *must* do so with respect to subsidization, in order to approve the proposed merger. Regarding stand-alone approval of the proposed OA (irrespective of whether the proposed reorganization is approved), the Commission “may condition such approval in such manner as it may deem necessary to safeguard the public interest.”³⁸⁰ Also with regard to affiliate transactions, subsection 7-102(C) of the Act provides that “the Commission shall make such order...as it may deem proper and as the circumstances may require, attaching such conditions as it may deem proper.”³⁸¹ With respect to reorganization approval, the Commission “may impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers.”³⁸² Concerning subsidization in particular, we cannot approve reorganization without finding that it “will not result in the unjustified subsidization of non-utility activities by the utility or its customers.”³⁸³

a. End of NG Involvement in NS Product Solicitation

Staff and AG/CUB each recommend that the Commission prohibit solicitation of NS services (especially GLCG) via call centers receiving utility telephone requests³⁸⁴. Specifically, Staff's proposed text for the Nicor OA would be adopted and both the NG Solicitations and the NS solicitations would end.

NG and the JA propose to continue solicitation under their preferred text for the OA³⁸⁵. They do not expressly offer a secondary recommendation in the event the Commission concludes, as we do here, that the Nicor telephone solicitations involve an unjustified subsidy. NG witness O'Connor did note, for the sake of argument, that if the Nicor solicitations were improperly subsidized, that would raise an issue of “the way in which transactions are priced under the [OA],” rather than preclude solicitation entirely³⁸⁶. However, the utility provided no evidence or advocacy for altering the price NS pays for solicitation. Consequently, even if there were no public interests concerns compelling termination of solicitation, the Commission would have no reliable

³⁸⁰ 220 ILCS 5/7-101(3).

³⁸¹ 220 ILCS 5/7-102(C).

³⁸² 220 ILCS 5/7-204(f).

³⁸³ 220 ILCS 5/7-204(b)(2).

³⁸⁴ Staff IB-OA at 16; AG/CUB IB-OA at 32.

³⁸⁵ JA IB-OA at 4.

³⁸⁶ NG Ex. 2.0 at 35.

evidentiary basis for adjusting the price NG charges for solicitation privileges, in order to terminate the subsidy NS receives³⁸⁷.

Similarly, with respect to the public interest, NS could, in theory, vitiate the misleading nature of the NS and NG Solicitations by revising its sales scripts to eliminate the false impressions currently conveyed. However, as NG has adamantly and correctly maintained, the Commission has no authority over NS, and (assuming solely for argument's sake that we were willing to authorize NG's continued involvement in NS solicitations) our power to add disclosures to those mandated by the Service Contract Act and overseen by the IDI is uncertain.

Also, the anti-competitive advantage NS enjoys from its exclusive solicitation rights during utility calls could theoretically be nullified by requiring NG to accord comparable rights to other gas line repair providers (or, more narrowly, to other gas line service contract providers). NG opposes this, however, maintaining that it would not want to risk its brand reputation by involving unaffiliated service providers in its customer service telephone calls³⁸⁸. Moreover, it is not clear to the Commission that there is a practical and efficacious way to transition customer calls to one or more alternative service providers. There is no record evidence addressing such matters.

Thus, the Commission perceives no available remedy other than severing NG's connection to solicitation we find misleading and inimical to the public interest.

Accordingly, regarding the NG Solicitations, the Commission directs NG to cease allowing its own call center personnel to solicit the services and products of NG's affiliates during customer calls. With respect to the NG Solicitations, NG must also cease permitting its moving calls to be handled by the personnel of any affiliate that solicits the services and products of NG's affiliates during customer calls. Therefore, Staff's recommended subsection 2.2(e) of the proposed OA is approved and NG's recommended text is disapproved. Putting this in the terms of the applicable statutes discussed above, cessation of solicitation is a condition we impose on the OA, in the public interest, in order to approve it as an affiliate agreement pursuant to subsections 7-101(3) and 7-102(C) of the Act, and under Section 550.120 of our Rules. For reorganization purposes, termination of solicitation eliminates unjustified subsidization of non-utility activities within the meaning of subsection 7-204(b)(2) of the Act and is necessary to protect the interests of the public utility and its customers, within the meaning of subsection 7-204(f) of the Act.

In requiring the foregoing corrective action, the Commission dismisses NG's warning that we "eliminate entirely the opportunity for [NG's] customers to hear about

³⁸⁷ In *IAWC*, *supra*, as noted, the utility proposed to receive an additional 15% beyond its FDC. *IAWC* at 5. We cannot presume that a comparable mark-up would be appropriate for NG today. Ideally (and if the public interest concerns discussed in this Order would not otherwise necessitate terminating call center solicitation), we would have a (preferably independent) assessment of the fair market value (or prevailing price, *see*, generally, NG Ex. 7.1, Sec. 5.1) of solicitation privileges during inbound utility business calls.

³⁸⁸ NG Ex. 7.0 at 36.

affiliate products and services during any customer service phone call.”³⁸⁹ The opportunity to solicit business for affiliates *during utility customer service calls* is precisely what we intend to eliminate. That certainly does not mean, however, that NS cannot solicit customers via other channels (including NG bill inserts³⁹⁰). NG itself suggests several alternatives (“door-to-door sales, print, television, radio, internet, telephonic and newsletters”) that it regards as entirely satisfactory for NS’s competitors³⁹¹. Moreover, NS will continue to enjoy the benefit of the Nicor brand as it sells its products and services via such alternative channels.

The Commission is mindful of the JA’s claim that NS’s call center solicitations benefit ratepayers financially, because NS purportedly absorbs a portion of NG’s call center FDC by paying fees to NG³⁹². If NS did not provide that contribution, the JA argue, ratepayers would have to make up the difference. For several reasons, the Commission finds that the JA’s contention cannot and does not alter our duty to curtail solicitation of NS’s service during utility business calls.

To begin, the Commission cannot lawfully abide an affiliate agreement that facilitates an unjustified subsidy, misleading marketing and suppression of competition, even if the involved utility receives appropriated compensation. Whether the OA is evaluated for reorganization purposes or as stand-alone document, we cannot allow the utility to be paid, pursuant to the terms of that agreement, to award subsidies to affiliates and contravene the public interest.

Moreover, the financial benefit to ratepayers is hardly consequential. Through the filing of its rebuttal testimony, NG continued to insist that the annual benefit from its support of NS’s unregulated commercial activities (as quantified for 2009) was “approximately \$1 million.”³⁹³ However, only \$50,370 of that asserted contribution came from NG call center solicitation³⁹⁴. Consequently, almost all of the 2009 contribution was derived from NG’s performance of GLCG inspections/repairs, as well as from billing for NS services. Further, during this proceeding, the JA voluntarily agreed to cease GLCG inspections and repairs by NG. Thus, the JA themselves have elected to dramatically reduce the FDC contribution from NS to NG. When the remaining benefit ostensibly derived from the NG Solicitations, \$50,370, is spread over NG’s cost structure and approximately 2.2 million customers³⁹⁵, the loss of contribution to NG’s FDC will have no rate impact.

Additionally, the Commission is hardly convinced that NG’s ratepayers reap the net financial contribution from the NG Solicitations that the utility claims. Staff and AG/CUB both contend that NG’s call center costs are swollen by the need to furnish

³⁸⁹ NG IB-OA at 12.

³⁹⁰ NG Ex. 4.0 at 23. We assume that NS inserts would not convey the false impression that repairs are unavailable from NG.

³⁹¹ *Id.*

³⁹² NG Ex. 2.0 at 39.

³⁹³ NG Ex. 2.0 at 38. More precisely, the amount was \$1,068,720. Staff Ex. 2.0 at 50.

³⁹⁴ Staff Ex. 2.0 at 59.

³⁹⁵ JA Ex. 2.0 at 3.

sufficient personnel, supplies, workspace and equipment to accommodate NS's non-utility solicitation during utility calls³⁹⁶. The JA assert in response that its call centers are typically "manned to handle the inbound call traffic to the gas company" and not for "expected sale solicitation activity."³⁹⁷ NG also states, however, that its call center staffing is based in part on call duration, and it acknowledges that call duration is extended by selling products³⁹⁸. Thus, when determining call center personnel requirements, NG anticipates both the number of inbound calls it will receive for utility business and the total time, per call, that will be spent on the combination of utility and non-utility business. It follows that some greater increment of personnel is needed to handle that combination (as compared to handling utility business alone), unless the time devoted to solicitation is trivial. The evidence does not suggest triviality, however. In an internal NS/IBT analysis of the NS Solicitations, a significant portion of the average call time during the period studied was dedicated to the sale of NS services³⁹⁹. That is predictable, since the scripts contain time-consuming rebuttals to a variety of anticipated customer reasons for refusing to purchase NS's products.

Since no party quantified for the record the actual cost of staffing NG's call centers, the Commission is unwilling to presume that the substantial allocation of personnel time to solicitation has no incremental impact on call center staffing. Accordingly, the Commission will not rely on the assertion that, through the NG solicitations, NG reaps a net \$50,370 contribution toward its true call center costs⁴⁰⁰. For this additional reason (that is, in addition to the *de minimis* effect of approximately \$50,000 within NG's rate structure), we do not conclude that termination of solicitation will have any adverse rate impact for utility customers.

Similarly, although NG claims that NS/IBT pay solicitation-related FDC-based contribution to NG⁴⁰¹ for the NS Solicitations, no quantification was provided for the record⁴⁰². As recounted earlier in this Order, IBT ostensibly pays NG "for the use of the

³⁹⁶ Staff RB at 10; AG/CUB RB-OA at 14.

³⁹⁷ Tr. 242 (O'Connor).

³⁹⁸ *Id.* at 261-62.

³⁹⁹ NG Ex. 2.12, p. 4 (confidential). Moving calls go only to the NS/IBT call center, not to the NG call centers. However, GLCG (along with other NS services) is sold after completion of utility business at all three call centers, pursuant to *common* sales scripts. We consequently assume that the time allotments in moving calls are not meaningfully different than the allotments in other utility business calls.

⁴⁰⁰ In testimony, NG characterized a challenge to its cost assumptions as a "collateral attack on past Commission judgments" regarding the prudence and used and usefulness of NG's call center facilities. NG Ex. 4.0 at 18. However, in addition to the Commission's power to revisit its prior rulings, and in addition to the fact that personnel costs are not rate base items in any event (see, 220 ILCS 9-212), we clearly stated in the Order mandating further review of NG's OA that we intended to investigate contractual "facilitation of affiliate endeavors through utility activities." Dckt. 08-0363, Order, Oct. 25, 2009, at 182. Therefore, nothing in prior decisions obliges the Commission to accept NG's call center cost assumptions here.

⁴⁰¹ NG Ex. 2.0 at 39. Again, IBT is a wholly-owned subsidiary of NS that does not have its own direct or fully assigned employees. NG Ex's. 2.7 & 2.12.

⁴⁰² Indeed, the only quantifications of NS's asserted contribution to NG's costs was proffered for the record by Staff (Staff Ex. 2.0 at 50 & 59 (for the NG Solicitations)), not by NG. Given the centrality of cost contribution to NG's defense of its solicitation support for NS, this is a curious omission.

phone line for the period of time it markets [NS] products.”⁴⁰³ The Commission might have surmised that this means IBT pays for the cost of telecommunications usage and infrastructure, and perhaps some increment of personnel cost, associated with the portion of moving calls spent on NS’s marketing. But the pertinent call center belongs to NS/IBT, not to NG, and it is apparently staffed by NS/IBT personnel⁴⁰⁴. In fact, IBT’s fully distributed telephone and personnel costs are recovered *from NG*, not vice versa⁴⁰⁵. It may be that NG receives an offset against IBT’s call center FDC, commensurate with the portion of a call spent on NS business, but that is speculation on our part and, in any case, that offset would reflect NS/IBT’s FDC, not NG’s. Consequently, the Commission cannot conclusively determine what NG cost the purported NS/IBT contribution recovers, how it is paid or how much it is⁴⁰⁶. Accordingly, the Commission cannot conclude that termination of the NS Solicitations will deprive NG of any cost contribution.

b. Current GLCG Enrollment & Information Disclosure

AG/CUB also request that all current customer enrollments in GLCG be terminated and that NG be required to communicate certain information to existing GLCG customers, who would then have to affirmatively indicate that they want to resume GLCG enrollment⁴⁰⁷. However, since the Commission has no authority over NS, we have no power to terminate its customer enrollments or establish conditions for continued enrollment.

With regard to mandating dissemination of the information AG/CUB identify, the Commission is confident of its authority to require the utility to communicate with its own customers. However, since we are separating NG from solicitation of its affiliates’ services, our power to command the utility to, in essence, challenge the value of those

⁴⁰³ NG Ex. 2.0 at 35.

⁴⁰⁴ NG Ex. 2.12 at 1 (confidential).

⁴⁰⁵ *Id.*

⁴⁰⁶ Staff reports that NG pays NS/IBT \$0.20 *less than* the latter’s per-call FDC, ostensibly saving NG about \$60,000 annually. Staff Ex. 2.0 at 59-60. Neither NG nor Staff explains why NS charges NG less than its FDC. The discrepancy may be attributable to the acknowledged estimates, approximations and work-arounds underlying NS’s FDC 2007 calculations (that is, NS may have been taking care not to overcharge NG in case its estimates were incorrect). NG Ex. 2.12 (confidential). Or it could be that the twenty cents per call constitutes the “fee” NS/IBT pays for solicitation privileges. Adding to the mystery, in 2005, NS offered to handle NG’s moving calls for only \$0.95, or less than one-third of NS’s 2007 FDC. Staff Ex. 2.0 at 61. The questions arising from this evidence ought to have been addressed by the parties, and the failure to do so falls upon the JA. The Commission cannot base its decision-making on ambiguous and incomplete information, and cannot give the benefit of the doubt to the party with the burden of proof.

⁴⁰⁷ AG/CUB IB-OA at 28-29. The required information is that: 1) NG technicians are available to make repairs to leaks in customer-owned infrastructure; 2) fewer than 2% of GLCG customers had repairs performed in 2009; 3) about three-quarters of leak repairs by NG technicians for non-GLCG customers in 2009 were under \$50, with an average cost of \$47, and only 3% of those repairs exceeded \$100; 4) the average monthly repair cost per enrolled GLCG customer was ten cents.

services is unclear⁴⁰⁸. We understand that AG/CUB view their recommendation as a remedial measure aimed at past solicitations. Nonetheless, the Commission will refrain from exercising whatever power we might have to compel dissemination of such information after joint solicitation ends. The potential for customer confusion, unintended consequences and additional litigation outweighs the potential benefits of the requested action. We note that there are no GLCG termination fees, so that GLCG customers acquiring pertinent information by other means are free to act on it as they see fit.

c. GLCG as a Utility Service

In the event the Commission approved NG's continued support of NG's solicitation, AG/CUB recommend that we treat GLCG as a utility service, sold at a price based on NG's cost of service⁴⁰⁹. Alternatively, AG/CUB proposed that CLCG profits be credited to fulfillment of NG's revenue requirement or that NS be obliged to pay NG a royalty as compensation for the competitive advantage NS derives from NG's involvement in selling and provisioning GLCG⁴¹⁰. Since this Order will prohibit NG's participation in solicitation of NG products, and since NG has agreed to cease dispatching utility personnel for GLCG work, we need not render any decision concerning AG/CUB's alternative requests.

That said, the Commission will address the disputes that arose in this case concerning NG's oft-repeated declaration that, as NG witness O'Connor put it, NG "has no intention of offering GLCG and it is not obligated to do so."⁴¹¹ The witness explains that a "principal reason[] for this product to be appropriately sold by an affiliated company and not by the utility" is that it would be imprudent for NG to assume the risks involved in customer-owned gas lines that NG did not install⁴¹². GLCG does not involve open-ended risk, however. It imposes a monetary cap on the services provided to the premises owner, and it has significant exclusions. Protected by those limitations, NS has chosen to enroll several hundred-thousand GLCG customers over a decade's time and NG has fought vigorously in this case to continue facilitation of NS's customer acquisition. There is no question that GLCG is profitable⁴¹³ and no apparent reason why NG would not realize the same profit, since it has been performing virtually all customer premises repairs under GLCG.

⁴⁰⁸ If the Commission had decided to allow NG's continued participation in its affiliates' solicitation, we would have likely required communication of some or all of the information recommended by AG/CUB and, additionally, Staff. Staff IB-0A at 29.

⁴⁰⁹ AG/CUB IB-OA at 32.

⁴¹⁰ *Id.* at 32-33.

⁴¹¹ NG Ex. 2.0 at 51.

⁴¹² *Id.* at 55 & 51.

⁴¹³ *Id.* at 47. At a minimum, that profit is 8.1%, which is the return on revenues earned by Nicor Inc's retail companies in 2010. NG Ex. 5.4. NG did not quantify the profit derived specifically from GLCG, despite being requested to by other parties. *E.g.*, AG/CUB Ex. 2.0 at 4. As already discussed, Staff and AG/CUB estimate that NS's return on GLCG is much greater than 8.1%. Staff Ex. 4.0 at 62; AG/CUB Ex. 1.0 at 7.

There is, however, a question regarding NG's ability to provide GLCG itself at a markedly lower price than NS. Staff estimates that NG could offer GLCG at an annual price below NS's monthly price⁴¹⁴. AG/CUB contend that NG's GLCG price would be about 30 cents per month⁴¹⁵. NG responds that its opponents' estimates are seriously flawed because they overlook material costs borne by NS to furnish services to customers⁴¹⁶. However, that argument concerns NS's cost structure, not NG's, and there is no way on the present record to determine whether those cost elements - which are not even quantified for NS, much less for NG (assuming NG would bear the same cost elements) - would materially alter the price at which NG could offer GLCG.

Nonetheless, even if we presume that NG could offer GLCG at a substantially lower price than NS does now, the Commission's authority to order NG to do so is not manifest. As NG established, a 2004 decision of the Illinois Supreme Court⁴¹⁷ determined that a gas utility has no common law duty, absent actual or constructive knowledge of a dangerous condition, to take any action regarding customer-owned gas piping and connectors. Even with such knowledge, the utility's common law duty is to provide warning and stop gas flow, not to repair. NG could go beyond its common law duties via tariff, but it has not chosen to do so. Can the Commission require NG to file a GLCG-like tariff? Insofar as this proceeding is a review of an affiliate agreement, it is hardly clear that our power to impose conditions on an agreement includes the power to require a new utility service - particularly when, as here, we are effectively removing that service from the very agreement that triggers our power to impose conditions.

Insofar as this docket is a review of a proposed reorganization, the Commission is, as stated above, authorized under subsection 7-204(f) of the Act to impose "such terms, conditions or requirements" as we deem "necessary to protect the interests of the public utility and its customers." AG/CUB cites that authority in support of its alternate recommendation to treat GLCG as a utility service⁴¹⁸. But AG/CUB's proposal assumed NG would still be involved in NS's offering of GLCG. It is another thing to require NG to offer *its own* tariffed service (which, we note, would not necessarily stop NS from continuing to offer GLCG⁴¹⁹). In the context of this case, in which the authority, costs and consequences associated with mandating a tariffed service as a merger condition are inadequately delineated, the Commission is disinclined to act. In light of our decision to disengage NG from NS's solicitation, along with NG's voluntary withdrawal of its technical personnel from GLCG repair work, a tariffed utility version of GLCG is not necessary to protect the utility and its customers during reorganization, within the meaning of subsection 7-204(f) of the Act, or safeguard the public interest, within the meaning of subsection 7-101(3) of the Act.

⁴¹⁴ Staff Ex. 2.0 at 43.

⁴¹⁵ AG/CUB Ex. 1.0 at 19.

⁴¹⁶ *E.g.*, NG Ex. 5.0 at 29-30.

⁴¹⁷ *Adams v. Nicor*, 211 Ill. 2d 32, 809 N.E. 2d 1248 (2004).

⁴¹⁸ AG/CUB IB-OA at 29.

⁴¹⁹ The Commission is not empowered to forbid an unregulated entity from offering a non-utility service.

Ironically, NG maintains that GLCG is often “the most efficient means to obtain the needed repairs.”⁴²⁰ Putting aside the question of why the most efficient service would need the advantage of direct and exclusive utility solicitation to succeed competitively, NG is in effect saying that the *utility* has been the most efficient source of customer-owned gas line repair, since the utility has performed almost all such repairs for NS. As explained by NG’s witness: “Typically when a customer notices a smell of gas in the home, they will call [NG]. So from the perspective of the first line of contact is with the gas company and the gas company responds very promptly to leaks of gas, that is a very efficient method of dealing with the call.”⁴²¹ It follows that a utility service that mimics GLCG – by offering efficient repair while limiting the utility’s cost exposure through a cap on benefits and coverage exclusions - would enhance the public interest. Again, however, enhancing the public interest is arguably distinct from our statutory mandate to “protect” and “safeguard” the public interest, so the Commission will not alter the status quo in this Order beyond terminating utility call center support for affiliate business.

4. Commission Conclusion

The Commission approves the proposed OA, both for the purposes of the proposed Reorganization and as an inter-affiliate agreement. However, as an indispensable condition of approval, the OA must include Staff’s recommended subsection 2.2(e) and must not include JA’s version of that subsection. This condition is necessary to safeguard the public interest, within the meaning of Section 7-101 of the Act, and necessary to protect the interests of the utility and its customers, within the meaning of subsection 7-204(f) and subsection 7-204(A)(b). This condition is also necessary for the public convenience, and one which we deem proper, within the meaning of subsection 7-102(C) of the Act. It is also a required condition so that the OA does not involve the use, appropriation or diversion of NG’s property and other resources to NS, which is not essentially and directly connected with, or a necessary component of, NG’s business. Moreover, it is a condition premised on our findings that call center solicitation of an affiliate’s service during inbound utility business calls diminishes the public interest by subsidizing the affiliate, by conveying misleading information and by anti-competitively reducing the choices available to customers connected to the utility’s distribution system.

The foregoing condition is also required in order for the JA to comply with the requirement in subsection 7-204(b)(2) that the proposed reorganization not result in unjustified subsidization of non-utility operations by the utility or its customers (as well as the prohibition in Section 550.120 of our regulations that transactions between utilities and their affiliates not subsidize the latter).

The Commission also finds that the OA, as approved and conditioned above, reasonably allocates costs and facilities so that the Commission can identify which of

⁴²⁰ NG Ex. 2.0 at 29.

⁴²¹ Tr. 219 (O’Connor).

those are properly included by the utility for ratemaking purposes, within the meaning of subsection 7-204(b)(3).

F. Section 6-103 and Other Approvals

1. Issues Presented & Analysis

Staff witness Phipps made two recommendations with respect to approval of the proposed transaction, derived from additional legal requirements not addressed above. JA agreed to comply with these recommendations in conjunction with Commission approval of the Reorganization⁴²².

First, pursuant to Section 6-103 of the Act⁴²³, Staff's witness proposes that NG file a post-merger report, with a copy to the Manager of the Commission's Finance Department, describing NG's post-merger capital structure and identifying capital structure adjustments that result from the Reorganization. If the Securities and Exchange Commission should require fair value ("push down") accounting adjustments to NG's balance sheet, then Staff recommends that NG also file a petition seeking Commission approval of a fair value study and resulting capital structure⁴²⁴.

Second, the witness proposes (as previously discussed in this Order) that NG revise its short-term borrowing addendum to the OA, consistent with the proposed changes presented in Staff Ex. 9.0, Attachment 9.2, to comply with the Commission's Part 340 money pool rules⁴²⁵, by permitting NG to borrow from non-utility affiliates but not permitting NG to make any cash advances to non-utility affiliates⁴²⁶.

Also, Staff witness Hathhorn recommended that, as a condition of the Reorganization's approval, JA be required to file a semi-annual compliance report on the ICC's e-Docket system in Docket 11-0046, reporting on the progress of all conditions imposed by the Commission in this case⁴²⁷. Ms. Hathhorn recommended that this reporting requirement remain in effect until all conditions have been satisfied or JA petition the Commission and receive approval to cease such reporting requirement, whichever comes first⁴²⁸. JA witness Reese accepted this recommendation, acknowledging that it will apply to all the conditions accepted by the JA in this docket⁴²⁹.

⁴²² JA Ex. 9.0 at 3, 10-11.

⁴²³ 220 ILCS 5/6-103.

⁴²⁴ Staff Ex. 9.0 at 19.

⁴²⁵ 83 Ill. Adm. Code Part 340.

⁴²⁶ Staff Ex. 9.0 at 22.

⁴²⁷ Staff Ex. 14.0 at 6-7.

⁴²⁸ *Id.* at 7.

⁴²⁹ JA Ex. 15.0 at 2-3. To be clear, the compliance reporting requirement must address *all* conditions required by this Order, whether accepted by the JA or imposed over JA objection.

2. Commission Conclusion

Staff's compliance reporting recommendations will enable the Commission to better monitor post-merger events, both predictable and unforeseen. The proposed borrowing and money pool arrangements will safeguard utility funds and financial standing, to the benefit of ratepayers. These arrangements will also avoid contravention of Part 340 of our regulations. Each of the foregoing Staff recommendations, which the JA accept for purposes of securing merger approval, should be adopted. JA's acceptance permits the Commission to conclude that approval of the proposed Reorganization will result in compliance with Section 6-103⁴³⁰.

V. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) NG is an Illinois corporation that is engaged in the distribution of natural gas to the public at retail in this State; NG is a "public utility" as that term is defined in Section 3-105 of the Act;
- (2) the Commission has jurisdiction over the parties hereto and the subject matter herein;
- (3) the recitals of fact set forth in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact;
- (4) an Appendix ("Appendix A") should be attached to this Order and fully incorporated into this Order; it should contain the Required Conditions of Approval established by this Commission in this Order, which are indispensable conditions for approval of the proposed Reorganization and for approval of all other relief sought or granted in this Order;
- (5) for the reasons set forth in this Order, and subject to the conditions established in this Order (enumerated in Appendix A), the proposed Reorganization will not adversely affect NG's ability to perform its duties under the Act, within the meaning of Section 7-204 of the Act; this finding

⁴³⁰ JA had contended that Section 6-103 is "inapplicable to this Reorganization." JA Ex. 9,0 at 3. There is scant discussion of this legal issue in the record, although in a Commission decision cited by JA, Frontier Communications Corp., et al., Dckt. 09-0268, the Commission treated Section 6-103 as applicable in merger proceedings under Section 7-204. Order, April 21, 2010, at 43 & Finding (6) & First Ordering Paragraph. We note, though, that the debate may have little practical significance. Even if we assume, solely for the sake of argument, that subsection 7-204(e) ("No other Commission approvals shall be required for mergers that are subject to this Section") pushes Section 6-103 issues out of merger cases, the post-merger entity would be immediately subject to the latter provision anyway. Consequently, it would not be sensible for a merger applicant to go forward without addressing its capitalization in conjunction with its request for merger approval. In any event, the JA have acceded to Staff's conditions.

is dependent upon the conditions established in this Order and would not be rendered in the absence of those conditions;

- (6) pursuant to Section 7-204 of the Act, and subject to the conditions established in this Order (enumerated in Appendix A), the Commission finds that:
- a) the proposed Reorganization will not diminish NG's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;
 - b) subject to the condition imposed in finding (7) of this Order (in addition to the conditions enumerated in Appendix A), the proposed Reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;
 - c) under the proposed Reorganization, costs and facilities will be 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;
 - d) the proposed Reorganization will not significantly impair the ability of NG to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
 - e) after approval of the proposed Reorganization, NG will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities;
 - f) the proposed Reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction; and
 - g) the proposed Reorganization is not likely to result in any adverse rate impact on retail customers;
- (7) the inter-affiliate OA should be approved with Staff's recommended subsection 2.2(e) and without JA's version of that subsection, which is disapproved; this is an indispensable condition of approval of the proposed Reorganization and approval of the OA as an inter-affiliate agreement under the Act, without this condition, neither the Reorganization nor the OA would be approved;
- (8) without the condition imposed in finding (7) above, the inter-affiliate OA would be contrary to the public interest and contrary to the interests of the public utility and its customers;

- (9) without the condition imposed in finding (7) above, the inter-affiliate OA would contravene the prohibition against subsidization of an affiliate by a gas utility in 83 Ill. Adm. Code 550.120;
- (10) for purposes of subsection 7-204A(b) of the Act, the SA, the TAA, the four existing agreements between NG and Sequent, and the capacity release arrangements between NG and Sequent entered into in accordance with FERC's capacity release rules, should be approved, subject to the conditions described in this Order (enumerated in Appendix A);
- (11) subject to the conditions established in this Order (enumerated in Appendix A), the JA comply with the minimum information requirements set out in subsection 7-204A(a) of the Act for an application for approval of reorganization;
- (12) subject to the conditions established in this Order (enumerated in Appendix A), and in the manner described in those conditions, any savings resulting from the proposed Reorganization shall be allocated to NG's ratepayers and no costs incurred in accomplishing the proposed Reorganization shall be recovered by the JA, or by NG individually, through Illinois jurisdictional regulated rates;
- (13) It is unnecessary for the Commission to rule on the applicability of Section 7-102 of the Act insofar as this proceeding concerns the JA's Reorganization application; Section 7-102 does apply to the inter-affiliate OA, which would contravene Section 7-102 without the condition imposed in finding (7) above; and
- (14) subject to compliance with the conditions set out in this Order (enumerated in Appendix A), the proposed Reorganization will not be inconsistent with Section 6-103 of the Act, insofar as that statute applies to the subject matter of this proceeding.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that, subject to each and all of the required conditions of approval set forth in this Order (in Finding (7), above, and enumerated in Appendix A), the Joint Applicants' request to engage in the Reorganization, through which Nicor Gas will become a subsidiary of AGL Resources Inc., is hereby approved.

IT IS FURTHER ORDERED that, subject to each and all of the required conditions of approval set forth in this Order (in Finding (7), above, and enumerated in Appendix A), as applicable, Nicor Gas' request to enter into, first, an Operating Agreement governing transactions between Nicor Gas and its current affiliates, as well as with AGL Resources Inc. and AGSC, and, second, a Services Agreement governing allocations to Nicor Gas from AGSC, and third, four agreements with Sequent Energy Management, LP (a Gas Exchange agreement, an Interstate Hub Service Agreement, an Intrastate Hub Service Agreement, and a Base Contract for Sale and Purchase of

Natural Gas), as well as capacity release arrangements between Nicor Gas and Sequent entered into in accordance with the Federal Energy Regulatory Commission's capacity release rules, and, fourth, the Tax Allocation Agreement Among Members of the AGL Resources Inc. Affiliated Group, as amended to include the surviving NI companies as parties to that agreement, is hereby approved.

IT IS FURTHER ORDERED that, subject to each and all of the required conditions of approval set forth in this Order (enumerated in Appendix A), as applicable, the proposed accounting entries associated with the Reorganization are approved, on the condition that any effect on such entries resulting from our resolution of disputed issues or our imposition of merger conditions must be reflected in such entries, in a manner consistent with the rationale, determinative principles, findings and conclusions of this Order.

IT IS FURTHER ORDERED that, in carrying out and completing the Reorganization, and in all subsequent Nicor Gas activities and operations subject to the jurisdiction of this Commission, the Joint Applicants shall comply with each and all of the required conditions of approval set forth in this Order (in Finding (7), above, and enumerated in Appendix A), unless expressly relieved of such obligation, in whole or in part, by directive of this Commission.

IT IS FURTHER ORDERED that subject to the conditions established in this Order (enumerated in Appendix A), and in the manner described in those conditions, any savings resulting from the proposed Reorganization shall be allocated to NG's ratepayers and no costs incurred in accomplishing the proposed Reorganization shall be recovered by the Joint Applicants, or by Nicor Gas individually, through Illinois jurisdictional regulated rates.

IT IS FURTHER ORDERED that any objections, motions or petitions filed in this proceeding that remain unresolved should be disposed of in a manner consistent with the ultimate conclusions contained in this Order.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Act and 83 Illinois Administrative Code 200.880, this Order is final, it is not subject to the Administrative Review Law.

DATED:
BRIEFS ON EXCEPTIONS DUE:

September 29, 2011
October 13, 2011

David Gilbert
Administrative Law Judge