STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	**Docket No. 11-0280**
Proposed General Increase in Rates for Gas Service	:	
	:	**(cons.)**
The Peoples Gas Light and Coke Company	:	
	:	**Docket No. 11-0281**
Proposed General Increase in Rates for Gas Service	:	

REPLY BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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Table of Contents

Page

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	**Docket No. 11-0280**
Proposed General Increase in Rates for Gas Service	:	
	:	**(cons.)**
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STAFF OF THE ILLINOIS COMMERCE COMMISSION

Now comes the Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Rules of Practice of the Illinois Commerce Commission ("Commission"), 83 Ill. Adm. Code Section 200.830, respectfully submits this Reply Brief on Exceptions to the briefs on exceptions ("BOEs") filed by North Shore Gas Company ("North Shore" or the "Company") and The Peoples Gas Light And Coke Company ("Peoples Gas" or the "Company") (collectively referred to as the "Companies" or "Utilities") ("the Companies' BOE" or "Companies BOE"); the People Of The State Of Illinois ("AG's BOE"); the Citizens Utility Board And the City Of Chicago ("CUB-City's BOE" or "CUB-City BOE"); the Illinois Industrial Energy Consumers and Constellation NewEnergy-Gas Division, LLC ("IIEC-CNE-Gas' BOE" or "IIEC-CNE-Gas BOE"); and Interstate Gas Supply of Illinois ("Interstate Gas Supply BOE" or "IGS BOE") which were filed on or before

November 17, 2011 in response to the Administrative Law Judges' Proposed Order ("Proposed Order" or "PO") issued November 3, 2011.

I. INTRODUCTION

A. Overview/Summary

II. TEST YEAR (Uncontested)

III. REVENUE REQUIREMENT

IV. RATE BASE

A. Overview

B. Uncontested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

C. Contested Issues

1. Plant (All Subjects Relate to NS and PGL Unless Otherwise Noted)

a. Forecasted Test Year Capital Additions

i. Utility Plant in Service

The AG's Exception No. 1 (AG BOE at 2) argues for Mr. Effron's adjustment rather than Staff's. The AG contends that the Companies' rate of actual spending compared to the budget is too low to justify the Companies' forecasted levels of capital additions. The AG later states that Staff's adjustment reduced 2010 year-end plant-in-service and no modification or analysis was presented to forecasted plant additions. This is incorrect. Staff did propose adjustments to forecasted plant. Staff Ex. 1.0, p. 15 and Staff Ex, 10.0, p. 16. Staff still finds its own analysis, which included a comparison of total expenditures to planned expenditure over a three year period, to be more appropriate than a single year analysis.

ii. Capital Additions Related to Accelerated Main Replacement – AMRP (PGL)

CUB-City's Exception No. 1 (CUB-City BOE at 2) contends that the PO may include both Staff's and Mr. Effron's adjustments to forecasted plant additions, excluding overlap. Staff maintains its position as stated in testimony and in its reply brief. While Staff does not find fault with Mr. Effron's analysis, CUB-City did not offer a calculation of the overlap between Staff's and Mr. Effron's adjustments. For that reason, the Commission should accept only Staff's adjustment.

The AG's Exception No. 2 (AG BOE at 8) argues for Mr. Effron's adjustment rather than Staff's. The AG's argument here is essentially the same as that offered for Utility Plant in Service. The AG does provide a solution to solving the issue of overlap between Staff's and Mr. Effron's adjustments by recommending rejecting Staff's adjustment and accepting Mr. Effron's adjustment. BOE at 11. While Staff acknowledges that the AG's solution would eliminate double counting, Staff still finds its own analysis, which included a comparison of total expenditures to planned expenditures over a three year period, to be more appropriate than a single year analysis.

2. Materials and Supplies – Computation of Associated Accounts Payable

3. Gas in Storage – Computation of Associated Accounts Payable

4. Cash Working Capital

a. Pass-Through Taxes

b. Prepayments (Uncontested)

c. All Other (Uncontested)

5. Retirement Benefits, Net

6. Accumulated Deferred Income Taxes –

a. 50/50 Sharing Related to Tax Accounting Method Changes

The Commission should reject the Exceptions proposed by CUB-City and the AG regarding a 50/50 sharing related to tax accounting method changes. CUB–City BOE at 4 and AG BOE at 13. Staff believes that having utilities assume all of the risk of uncertain tax positions, as CUB-City and the AG propose, would discourage utilities from taking tax positions that have some risk associated with them when such positions are appropriate and could benefit ratepayers. The Companies may benefit from ratepayer provided —free or low cost capital in the short term, but if the Companies prevail, ratepayers will receive 100% of the benefit of reduced rate base in succeeding rate cases. Staff Ex. 10.0, pp. 23-24.

b. Derivative Adjustments from Contested Adjustments

D. Accumulated Depreciation (Uncontested Except for Derivative Adjustments from Contested Adjustments)

E. Approved Rate Base

V. OPERATING EXPENSES

A. Overview

B. Uncontested Issues

C. Contested Issues

1. Incentive Compensation

The Companies, in discussing Incentive Compensation ("IC") in their BOE, focus on the PO's 70% disallowance of costs for the Executive Plan related to its EPS metric and 50% disallowance of costs for the Non-Executive Plan related to O&M cost control metric.[1] Companies BOE, pp.43-48. The PO reached the appropriate conclusion on both these issues.

<u>Executive Plan</u>

In the argument for the Executive Plan EPS metric, the Companies failed to demonstrate how ratepayers benefit at all from the EPS metric. The Companies begin by addressing the mechanics of the derivation of EPS that no party has disputed but fail to point out the very crucial fact – that the primary focus of EPS is the shareholders. The Companies then criticize Staff evidence that top executives foregoing a wage increase to improve EPS was "*de minimis*." However, this statement was made by the Companies in response to Staff discovery. Staff Exhibit 12.0, Attachment A(N) and Attachment A(P). The Companies themselves admit that the impact of the foregone

[1] While the Companies also disagree with the conclusion on the Omnibus Incentive Compensation Plan, the Companies did not file an Exception on that conclusion.

wage increase was *de minimis* on both the EPS metric and on the Incentive Plan payout. The Companies' alternate proposal that, at a minimum, the Commission should approve recovery of $127,082 of the costs related to the EPS metric is misleading. Companies BOE, p. 45. The $127,802 is the amount of the wage increase that was foregone and is not the amount of the IC payout related to the foregone wage increase. Therefore, even if the Commission accepts the Companies' argument on this point, which it should not, no adjustment amount has been provided.

<u>Non-Executive Plan</u>

In its argument addressing the Non-Executive Plan, the Companies argue that simply controlling or lowering operating expenses satisfies the Commission's criteria for recovery of IC costs in base rates, citing to other Commission decisions. Companies BOE, pp. 45-48. During Cross examination on this issue, Staff witness Ebrey stated that while some showing of ratepayer benefit may have been made in those cases, no such evidence has been provided to support the claim of ratepayer benefit in the instant case. Tr., August 30, 2011, pp. 235-239. The PO's conclusion on this portion of the IC issue should be retained.

2. Non-union Base Wages

The Companies attempt to discredit the studies cited to by Staff in testimony as support for its position to decrease the amount of non-union base wage increase to be recovered in base rates. Companies BOE, pp. 49 – 52. Staff provided in-depth discussion in testimony as to why the documentation supporting its position was superior to that provided by the Companies. Staff Exhibit 12.0 Corrected, pp. 13 – 17, lines 233 – 307. The PO appropriately concluded that the evidence and analysis presented by Staff are more reasonable than that proposed by the Companies.

3. Headcounts

4. Self-Constructed Property

5. Uncollectibles Expenses – Use of Net Write-Off Method

The Commission should not change the PO's conclusion regarding the appropriate methodology to determine the amount of uncollectible costs to be recovered in base rates. The Commission should reject the Companies' proposed replacement language that would use the percentage of revenue method rather than the net write-off method to calculate uncollectibles expense with respect to base rates.

The Companies attempt to elevate the integrity of their proposed method of calculating uncollectible expense over the use of the net write-off method which uses actual data. The Companies' Exception No. 9 (Companies BOE at 52-54) implies that its preferred method is more accurate because it uses a fixed percentage and produces predictable results. The Companies' proposal is flawed because it uses allocations, estimates and journal entries unrelated to write-offs (ICC Staff Ex. 10.0, pp. 17 – 18, lines 371 – 391). The Companies' proposed percentage of revenue method may or may not produce predictable results; however, the Commission should not adopt a flawed methodology just because it might be predictable. The Commission should reject the Companies' proposed methodology.

The Companies once again argue that if actual data is used, a six-year average should be used. Companies BOE, p. 54. This proposal would result in the recovery of a normalized amount. While Staff did not argue against recovery of a normalized amount, Staff did note that a normalized amount could be provided through base rates without the need for a rider. ICC Staff Exhibit 10.0, p. 18, lines 392 – 397. This argument should be rejected unless accompanied with a proposal to eliminate Rider UEA.

6. Administrative & General

a. Injuries and Damages Expenses

b. Adjustment to Account 921 – Office Supplies and Expenses

c. Rate Case Expenses

i. Rate Case Expenses – Docket Nos. 11-0280/081 (cons)

ii. Amortization of Rate Case Expenses associated with Docket Nos. 09-0166/0167 (cons)

The PO (at 84) approved Staff's adjustments to exclude rehearing and appeals costs for the 2009 rate case Dockets. The Companies erroneously argue that the facts do not warrant disallowance of the rehearing and appeals costs. The Companies' argument ignores the single most important fact, that the Commission did not consider such costs in the 2009 rate cases when it approved rate case expense in the 2009 rate case Dockets. Since those expenses (costs for rehearing and appeals) were never approved by the Commission as rate case expense back in the 2009 cases (Staff Ex. 11.0, p. 8), the amortization of that rate case expense in this docket must not include those costs and therefore the disallowance is justified. The Commission should accept the PO's conclusion to disallow recovery of the rehearing appeals costs for the 2009 rate case Dockets.

iii. Normalization of Rate Case Expenses

d. Gas Transportation Administrative Costs

e. Solicitation Expense

The Companies take exception to the finding of the PO regarding the Companies' Pipeline Protection Plan ("PPP"). Specifically they object to the adjustment for solicitation revenues, the requirement to charge their affiliate the same charge that the ratepayers pay for the same services and the requirement to have an investigation into these matters.

Staff agrees entirely with the PO's decisions in these matters for the reasons set forth in its briefs. Staff will respond to certain arguments put forth in the Companies brief on exceptions.

First, regarding the PO's finding that the Companies must adjust their revenue rates down to account for Staff's estimate of the market value of the solicitation of the Companies' customers on behalf of their affiliate, the Companies list three "errors."

"First, the Utilities have reflected appropriate and reasonable cost-based figures for those IBS solicitation revenues to be credited against IBS expenses." NS-PGL BOE p. 58. Of course the Companies allege that these amounts are included but have not provided sufficient proof in the record. Without any discernible evidence to support this claim, the Commission would be required to take the word of the Companies witness who has changed her testimony several times. Staff RB, p. 44.

"Second, before they discovered that the above $16,572 credit already had been forecasted and applied, the Utilities, in their rebuttal, reduced their expenses in their revenue requirements by an additional $11,000 and $60,000 as to North Shore and Peoples Gas, respectively, based on the average solicitation expenses from 2005 to

2007, adjusted for inflation, and the Utilities again included those reductions in their surrebuttal." NS-PGL BOE p. 59. This is not a factual account of the record. In surrebuttal testimony, the Companies claimed that the $16,572 credit was included in direct testimony and removed the $71,000 amount proposed in rebuttal testimony. NS-PGL Ex. 38.0, pp. 7-8. The adjustments that were on line 20 of column G on page 3 of the Companies' Rebuttal Summary of Proposed Adjustments to Operating Income (NS-PGL Ex. 22.2 N&P) are not in the Surrebuttal Summary of Proposed Adjustments to Operating Income (NS-PGL Ex. 39.2 N&P). Thus, the Companies' claim that the credit had already been forecasted and applied in rebuttal is inaccurate.

Finally, the Companies argue Staff's proposal is punitive, retroactive, grossly excessive, and wrong. To modify correct 2012 test year amounts based on past errors by IBS is punitive and retroactive. NS-PGL BOE p. 59.

Staff has shown that the Commission cannot rely on the Companies inconsistent testimony and the PO appropriately reflects this. It is the loss of creditability that leaves the Commission with no other choice but to require this adjustment; thus the adjustment is the fault of the Companies and is not punitive.

Furthermore, the adjustment recommended by Staff is for foregone revenue from the market value of a single year of IBS' solicitation services for PEHS that occurs in the test year. Staff IB, p. 46. Therefore the adjustment is neither retroactive nor excessive.

7. Depreciation

8. Revenues

a. Repair Revenues

Staff notes that regarding repair revenue adjustments, the Companies will not take exception to the amount. However, they do except the "applicable principles" - NS-PGL BOE p. 61 - which results in them removing the requirement that they charge their affiliate at equal rates to what their ratepayers pay for repairs. NS-PGL Exceptions Order, p. 99.

The PO correctly determines that an "alternate pricing mechanism" must be determined (PO, p. 94) and the only one supported by the record is Staff's proposal to charge affiliates the same amount as ratepayers.

b. Other Issues Relating to PEHS and PEPP, Including Staff Request for Investigation

Staff proposed an investigation into the interactions that the Companies have with their affiliates. The PO approved the investigation. The Companies claim that the amounts don't warrant an investigation (NS-PGL BOE, p.61) but they appear to warrant an exception. Despite the Companies claim, the amounts here are not small (NS-PGL IB, p. 82) but, regardless, the PO is correct that the Commission must to follow up on this clear pattern of the Companies not properly interacting with their affiliates. PO, p. 96.

c. Warranty Products (Revenue and Non Revenue)

D. Taxes Other Than Income Taxes (Payroll and Invested Capital Taxes) (Uncontested Except for Derivative Adjustments from Contested Adjustments)

E. Income Taxes (Including Interest Synchronization) (Uncontested Except for Derivative Adjustments from Contested Adjustments)

F. Gross Revenue Conversion Factor

G. Total Operating Expenses

VI. RATE OF RETURN

A. Overview

B. Capital Structure

True to form, the Companies again fail to provide the Commission with any analysis of their own on whether there is any difference in risk between the Companies and Integrys. Instead, the Companies purport to carry their burden of proof by merely attacking Staff and by making further attempts to confuse the record. Primarily, the Companies continue to criticize Staff for using "historical" data, which as the PO points out, is entirely on what the Companies based its proposal. PO, at 106.

Further, as the PO notes the Companies also failed to "distinguish the situation before us from the controlling case law." *Id*. The Companies made no attempt to address or refute the controlling case law.

As the Staff noted in its Briefs (Staff IB, at 55-57; Staff RB, at 34), Section 9-230 provides in relevant part that:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission *shall not* include *any* (i) incremental risk, [or] (ii) increased cost of capital … which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.
>
> 220 ILCS 5/9-230 (emphasis added).

Illinois courts have interpreted this provision strictly against the inclusion of *any* incremental risk or increased cost of capital in a utility's rate of return, if such incremental risk or increased cost of capital results from association with unregulated affiliates. In *Illinois Bell Telephone Co. v. Commerce Comm'n*, 283 Ill. App. 3d 188, 669 N.E.2d 919 (2nd Dist. 1996) (*IBT*), the Appellate Court for the Second District ruled that:

> Section 9-230 does not allow the Commission to consider what portion of a utility's increased risk or cost of capital caused by affiliation is "reasonable" and therefore should be born by the utility's ratepayers; the legislature has determined that *any increase whatsoever* must be excluded from the ROR determination. It is impermissible for the Commission to substitute its reasonableness standard for the legislature's absolute standard. The Commission may not define a portion of the Act in a way that conflicts with a specific directive contained in the Act. [citation] 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.
>
> *IBT*, 283 Ill. App. 3d at 207, 669 N.E.2d at 933 (emphasis added; citation omitted).

The Companies have entirely failed to address this threshold issue, other than to criticize Staff's analysis, without disagreeing with Staff's conclusions, leaving Staff's position substantively unrebutted. The Companies failed to contest Staff's position that Section 9-230 precludes the Commission from considering the reasonableness of a proposed capital structure until it makes a threshold determination that the capital structure in question satisfies the requirements of Section 9-230. Likewise, the Companies failed to contest Staff's position that Section 9-230 absolutely bars, as a matter of law, the adoption of a capital structure which, as a result of affiliation, results in increased risk or increased cost of capital. The Companies failed to perform any risk analysis of its own between the Companies and Integrys. Moreover, the Companies do not even dispute Staff's conclusion that Integrys carries more risk, they merely quibble over how Staff arrived at its conclusions. The PO, however, cut through the Companies' pedantic prattle and correctly concluded that: "Both the Companies' credit ratings and financial ratios indicate that their affiliation with unregulated Integrys, its corporate parent, has increased their risk." PO, at 106.

The only new feature in the Companies' BOE, is they purport to make an "alternative" proposal in which they would accept Staff's proposed capital structure if "adjusted to remove short term debt." Companies BOE, at 4 and 19. According to the Companies, this would result in capital structures of 53.9% equity and 46.1% long term debt for North Shore and 51.6% equity and 48.4% long term debt for Peoples Gas. *Id.*

This seemingly "magnanimous" gesture of accepting Staff's capital structure if short-term debt is removed is misleading. In fact, it is not really an alternative at all, but a slightly different version of the Companies' fatally flawed original proposals. The capital structures they would "alternatively" propose would add the short-term debt balance to the equity balance thus increasing the amount of equity in the capital structure while continuing to violate section 9-230. As Staff pointed out in Brief before (Staff RB, at 3-4), since equity is generally a more expensive form of capital than debt, a greater percentage of equity in a utility's capital structure equates to a higher rate of return. *IBT*, 283 Ill. App. 3d at 204, 669 N.E.2d at 931.

Staff witness Sheena Kight-Garlisch demonstrated that the Companies are considered by ratings agencies to be better credit risks and otherwise less financially risky than their parent company, Integrys. Staff Ex. 4.0 at 5-8; Staff Ex. 13.0C at 4-8. This means, logically, that the Companies' capital structures should be weighted more heavily towards debt than that of Integrys. This is not, however, what the Companies "alternatively" propose; instead, they advance the counterintuitive, and in this case unlawful, argument that would add the short-term debt balance to the equity balance, thus further increasing the amount of equity in the capital structure, which would continue to violate section 9-230.

As the court in *Citizens Utility Board v. Illinois Commerce Comm'n*, 276 Ill. App. 3d 730, 744 (First Dist. 1995)("*CUB*"), explained:

> When a larger corporation owns a utility, the corporation is generally motivated not to establish an optimal, lowest cost capital structure for the utility, but to use instead a structure with a greater percentage of equity than is optimal, thereby allowing the corporation to realize a greater return. The assured profits from the regulated utility can then bolster the security of the corporation, allowing it to sell its own debt instruments at lower cost and use the debt capital to finance riskier, unregulated and competitive ventures.

These incentives for Integrys to propose a capital structure with a greater percentage of equity allowing it to realize greater returns based upon ratepayers costs is exactly what Section 9-230 is designed to preclude, absolutely. The Companies "alternative" proposal only exacerbates the fatal flaws found in the Companies' original proposal.

Staff, for all the reasons above, continues to recommend its proposed capital structure, as adopted by the PO, and reject the Companies' proposals including its "alternative" proposal.[2]

[2] If, however, the Commission determines that short-term debt should be excluded from the capital structures for NS and PG, the proper capital structures are 50% equity and 50% debt and 49% equity and 51% debt, respectively.

C. Cost of Long-Term Debt

D. Cost of Short-Term Debt

The Companies argue that the PO's conclusion on short term debt is wrong because it is "contrary to the evidence that the Companies do not use short term debt to fund rate base." Companies BOE, at 19-20. In fact, the evidence demonstrates that the Companies do use short term debt to fund rate base. In adopting Staff's position the PO reasoned that:

> The Companies have stated that these funds are used for gap financing between rate base and permanent capital. Short term debt is used, primarily, to fund the purchase of gas in storage. Gas in storage, while not a "permanent" asset like land, is included in rate base – based upon the average amount in storage during the test year. To the extent short term debt is used to fund the acquisition of assets whether permanent or not, it should be included in the capital structure. The Companies' assertion that short-term debt is not part of its capital structure is unsupportable.
> PO, at 109.

The Companies fail to address the PO's point, which is that the Companies acknowledge they use short term debt and have not demonstrated that it is not used for rate base when funding the acquisition of assets. The Companies acknowledge that they use short-term debt for the difference between rate base and permanent capital. Staff RB, at 39; NS-PGL Ex. 35.1N and 35.1P. The Companies also acknowledge they use short-term debt as bridge financing for long-term debt. See 11-0269 Interim Order, at 1.[3] Rather than addressing the PO's reasoning, the Companies rely solely upon what

[3] *Peoples Gas Light and Coke Company*, Informational statement pursuant to Section 6-102(d) Of the Public Utilities Act, ICC Docket No. 11-0269, Interim Order (May 4, 2011)("11-0269 Interim Order").

the Commission has done in the past. While purportedly relying on the Peoples 2009 Order,[4] the Companies ignore the Commission's conclusion in that Order that states:

> This Commission has essentially treated short term debt on a case by case basis. We continue to do so today and focus on the facts and circumstances of record at hand.
> 2009 Order, at 93.

As a consequence of relying solely upon the Commission's past actions, the Companies ignore the "facts and circumstances of record at hand." *Id*. The Companies have the burden of proof to demonstrate that the short term debt it acknowledges it uses is not used for rate base. The Companies have utterly failed to carry that burden of proof.

E. Cost of Common Equity

The Companies' third exception to the Proposed Order deals with the cost of common equity ("ROE"). The PO rejected the Companies' ROE analysis, noting that it "is largely dependent upon subjective judgments of their expert reflecting a consistent upward bias unsubstantiated by objective data." PO, p. 136. Excepting a slight adjustment for the correction of the error noted in Staff's BOE, the Commission should accept the PO's conclusions in its final Order and authorize an ROE of 8.75% for both North Shore and Peoples Gas. Staff BOE, pp. 13-14.

The vast majority of the Companies' third exception simply repeats, often word-for-word, arguments made previously. The Companies' position has not only been thoroughly refuted by Staff, but considered and rejected by the ALJs. Nonetheless, Staff will attempt to address certain specific arguments presented in the Companies'

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[4] *North Shore Gas Co., et al.,* ICC Docket Nos. 09-0166/09-0167 (cons.), Order Jan. 22, 2010 ("Peoples 2009").

BOE. In summary, as Staff explained in its RB, the cost of common equity produced by current market data applied to the market-based models the Commission has consistently relied on for many years supports a cost of common equity of 8.75%. The Companies, of course, would prefer a higher number, so they have manufactured arguments in an attempt to obfuscate the facts. Those distractions aside, the difference between the Companies' and Staff's cost of common equity recommendations is due almost entirely to Mr. Moul's adjustments to the Commission-accepted, market-based models, or the results thereof; his growth rate; and his inclusion of a risk premium model. Both the adjustments he applied and the use of a risk premium model have been <u>repeatedly</u> rejected by this Commission in prior proceedings <u>without exception</u>, while the derivation of his growth rate estimate represents an unexplained and unfounded departure from the approach he used in the Companies' last rate proceeding. Without those inappropriate alterations, the Companies' ROE result would be almost identical to Staff's. The record demonstrates that current market environment, interest rates, objective market-based models, the falling ROEs indicated by both Staff and Companies witnesses' recommendations in this case and the Companies' last rate case, and even the unadjusted ROE resulting from the Companies' inputs in this proceeding <u>all</u> support a cost of common equity similar to Staff's estimate. None support the Companies' recommended ROE. Moreover, Staff performed its analysis six additional times to confirm the normalcy of its original results, in keeping with the Commission directive for parties to "check" their results. Order, Docket Nos. 09-0166/0167 (Cons.), January 21, 2010, pp. 125-126. The results of those seven analyses were all within 17 basis points, which further confirms that Staff's

8.75% ROE is reasonable and that the Companies' proposed ROE of 10.85% is greatly overstated. Staff RB, pp. 55-56 and 71-72.

<u>The Proposed Order's ROE</u>

The Companies begin with broad arguments that the ROE adopted in the PO, which is based on Staff's recommendation, is too low. NS-PGL BOE, p. 20. The Companies present nothing new here. Their arguments have been addressed in Staff's IB and RB. Staff IB, pp 69-70; Staff RB, pp 46-48. The general theme of the Companies' arguments is that Staff did not provide a "contextual showing" that sufficiently meets with the Companies' approval. Specifically, they continue to suggest that the Commission's ROE decision should rely on prior returns authorized in other proceedings. However, quoting the evidentiary standard set forth in a prior Commission Order, the PO noted that the record is devoid of the necessary information from such other decisions to show that the circumstances from those cases are comparable to those in the instant docket. Thus, the PO correctly concluded that such information cannot be used as a basis upon which to make its ROE decision. PO, pp. 133-134.

The Companies provide nothing to challenge that conclusion. Instead, the Companies illogically dispute the PO's <u>specific</u> finding regarding other authorized ROEs by noting the Commission's <u>general</u> instruction to "consult general financial market information to ensure the model results presented are consistent with real world conditions." NS-PGL BOE, p. 21. That instruction in no way suggests that ROEs from other cases are relevant to the Commission's ultimate ROE decision in this proceeding, particularly when the pertinent details of the "real world conditions" contemporaneous with those cases are unknown. As the PO correctly found, they are not. This issue is really quite simple. While authorized ROEs over the last two decades may be of some limited value, inasmuch as they provide a broad, highly imprecise indicator of utility ROEs, they are useless for determining the specific return to authorize in a given case, particularly when the details underlying those prior ROEs are unknown.[5] The Commission addressed this issue quite well in the Companies' 2007 rate case, summarizing succinctly, "Plainly, although the notion that the Utilities should enjoy at least an average ROE is superficially seductive, it is an unworkable and improper basis for determining utility returns." Order, Docket Nos. 07-0241/07-0242 (Cons.), February 5, 2008, p. 90. That the Companies are still advocating the use of prior authorized ROEs after this issue has been fully litigated and rejected numerous times, is merely a waste of time for all but those paid to litigate this case by the hour.

The Companies continue their "lack of contextual showing" argument by stating that "for Staff, the models are all knowing." NS-PGL BOE, p. 21. This is nonsense. In fact, the Companies are well aware that that statement is false, since, in their own cross examination of Mr. McNally, he testified to the contrary, agreeing that "determining a firm's ROE or setting an authorized ROE for a utility isn't as simple as running a model and getting a result." Tr., August 31, 2011, p. 504-505. Indeed, the Companies' BOE itself explicitly quotes Mr. McNally's acknowledgement that each model has its own

[5] Contrary to the Companies' claim, the relatively large number of previously authorized ROEs the Companies present does <u>not</u> address the fundamental flaw in using previously authorized ROEs to determine the proper ROE specific to this proceeding. Further, the use of that 93-observation "sample" is <u>not</u> analogous to Staff's use of the 8-company Gas Group. NS-PGL BOE, pp. 24-25. Each of those 93 ROEs reflects different facts and circumstances, including different time periods with different market environments and different companies with different risk characteristics. They are simply not representative of the cost of equity in this proceeding. The Companies' argument that if 8 observations are good, then any 93 observations must be at least as good (or better), would be like a researcher using crash test data for all automobiles over the last 20 years as an indicator of the safety of the 2011 Honda Accord. No credible scientist would even suggest that, regardless of the sample size.

shortcomings.[6] NS-PGL BOE, p. 24. Those were not idle words. As previously noted, Staff thoroughly analyzed the "real world context" and found that market volatility, market prices, interest rates, the Companies' current risk levels, the Companies' model results when adjusted for consistency with the last case, and even the ROE trend indicated by both Staff's and the Companies' current recommendations relative to those in the Companies' last rate case <u>all</u> support Staff's 8.75% recommendation and show the Companies' 10.85% proposal to be inconsistent with the current market environment. Staff IB, pp. 69-70, 72-73, and 78-79; Staff RB, pp. 46-48, 55-56, and 72. Moreover, Staff performed six additional analyses to confirm the normalcy of its original results, in keeping with the Commission directive to "check" results, which the Companies cited. Staff RB, p. 71. Clearly, Staff's scrutiny of its results is not indicative of a party that believes "the models are all knowing." Further, it is clear that Staff does not believe the models should "control over reality," as the Companies imply, but that the model inputs and results should reflect reality. Thus, the foregoing demonstrates that, contrary to the Companies' suggestion, Staff is "acutely attuned to [the market] environment," and that a "contextual showing" has been made, as the Commission has requested. Staff RB, pp. 49-50 and 71-72.

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[6] In fact, the Companies cite to the testimony of each ROE witness in this proceeding wherein they acknowledge the existence of shortcomings in all models. NS-PGL BOE, p. 24. Unfortunately, the Companies mischaracterize the testimony they cite in their attempt to portray the results of established, market-based models as unreliable and stir sympathy for their plea to ignore those results. Nowhere in the citations provided does any witness impute a degree of magnitude to the potential margin for error in the model results. The Companies' assertion that those witnesses testified that the model results are subject to a "wide margin for error" constitutes a clear distortion of the facts. In fact, the closest that testimony came to assigning a scale to the margin of error were words indicating, if anything, a minimal degree, such as "not optimal" and "not perfect." Moul, NS Ex. 3.0, p. 13; Thomas, Tr., September 6, 2011, p. 946. To state that a model is not perfect is a far cry from acknowledging a <u>wide</u> margin for error.

Footnote 17 to the Companies' BOE states, "This point [that "each of the cost of equity mathematical models has its <u>theoretical</u> shortcomings that can misstate a firm's cost of equity"] is unassailable, yet Staff has accused the Utilities of mischaracterization." NS-PGL BOE, p. 24. The Companies' "point' is a verbatim reiteration of an incorrect statement in the Companies' IB that Staff addressed in its RB. Staff's response merely corrected what appeared to be confusion (or carelessness) on the Companies' part. Staff RB, p. 49. Specifically, the Companies' IB cited to the transcript, in which Mr. McNally answered "Yes" to the Companies' question, "Would you also agree that each of the models that analysts use have their own shortcomings that can result in misstating a firm's cost of equity?"[7] TR., August 31, 2011, pp. 504-505. Yet, the Companies' IB and, now, BOE, added the word "theoretical" to that sentence when making their "point." Staff's RB clarified that the shortcomings of the models are shortcomings of implementation rather than theory. Thus, the Companies' point is unassailably false.

The Companies also claim that "neither Staff nor the PO explain how the Utilities' cost of common equity could have gone from 10.19% for Peoples Gas and 9.99% for North Shore in February 2008 to 10.23% and 10.33% in January 2010 and then fallen to 8.75% now." NS-PGL BOE, p. 22. The Companies now seem to be demanding that Staff address the facts in prior cases as well as those in the instant docket. However, each proceeding is to be judged on the facts in its respective record, and neither the parties nor the Commission is required to explain the circumstances surrounding prior

[7] Although Staff acknowledges that all models have shortcomings, any ROE estimate will necessarily involve modeling. This was more fully discussed in Staff's RB. Staff RB, pp. 49-50. Therefore, it is important to use the least flawed models available and to take measures to minimize bias in their implementation.

Commission decisions and identify the specific causes for differing conclusions in other cases. Nor are they required, or necessarily even able, to explain market behavior or changes therein. Significantly, the Companies have not explained why the authorized ROE should be *increased* "against <u>this Commission's</u> ROE decisions for <u>these Utilities</u>" in the last two cases, as *they* request. In fact, their own witness's testimony indicates that the ROEs for the Companies have fallen substantially. Staff Ex. 14.0, pp. 2-3. Thus, if anything, the Companies should explain why they are recommending an increase to the authorized ROE when their own witness has estimated a significant decrease consistent with the decrease estimated by Staff.

<u>Use of spot data</u>

The Companies argue that Staff's models are invalid because they rely on "data from a single day months ago." NS-PGL BOE, p. 26. Although that data was the most recent available at the time of Staff's analysis, the Companies label that data as "historical," thereby attempting to paint Staff's use of the most recent data in the same light as their use of data that was at least three years old, and as much as 36 years old, at the time of their analysis. That absurd semantics-based argument was fully addressed in Staff IB and RB. Staff IB, pp. 71-73; Staff RB, pp. 71-73. As Staff explained, while even the most recent data will be historical by the time an Order in this proceeding is produced, the most recent data will always be more timely than a historical average and is, thus, preferable. [8, 9] By using the most current data, Staff

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[8] The Companies' BOE incorrectly states that Staff's briefs present a new argument when noting that Staff's use of the most recent data available is preferable. This argument is not new, as it was presented in Mr. McNally's rebuttal testimony, which was cited in Staff's IB. Staff IB, pp. 71-72.

[9] The Companies argue whether or not a current ROE estimate is possible under their definition of the word "historical." It is not. By their definition, any mathematical calculation of the cost of

obtains the most current estimate of the ROE. That estimate reflects all information that is available and relevant to investors at the time of that analysis. Thus, to the extent investors are influenced by historical and forecasted data, that data is reflected in the most current ROE. In contrast, Staff's criticism was of Mr. Moul's use of truly historical data that was well out of date at the time of his analysis. Analyses using such stale data reflect information that the market no longer considers relevant, a fact the Companies' witness acknowledges. Therefore, use of a historical average requires the analyst to subjectively determine what data is no longer relevant, needlessly and inappropriately replacing the collective judgment of all investors with his own. Staff IB, p. 71.

The Companies note that the Commission rejected spot data in the Companies' 2007 rate case because "because it generated 'anomalous' results." NS-PGL BOE, pp. 26-27. The key portion of that sentence is, of course, the latter part. The Commission has accepted analyses based on spot data in countless instances. In fact, the Commission accepted Staff's CAPM results, which reflect spot data, in the Companies' 2007 rate case. Order, Docket Nos. 07-0241/07-0242 (Cons.), February 5, 2008, pp. 79-80 and 100. Indeed, in that very case the Commission, itself, noted that use of spot data is a practice the Commission has traditionally relied upon and, in fact, is reluctant to deviate from. Order, Docket Nos. 07-0241/07-0242 (Cons.), February 5, 2008, p. 92.

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common equity is rendered historical as soon as a new stock price is established, which can be within seconds. Staff Ex 14.0, p. 11. Therefore, by the time current data is entered and an estimate is produced, the data (and the resulting ROE estimate) is no longer current. Regardless, the Companies concede that, by their definition, all analyses would be equally categorized as historical by the time they are presented and an Order is produced, which, of course, is the Companies' intent. However, as explained above, Staff's use of the most recent data available is preferable to the Companies' use of data that was at least three years old at the time of their analysis.

The Companies' BOE repeats their claim that Staff ignored the Commission's directive to "check" its results. Staff has exposed that claim as the absolute falsehood it is. Staff RB, pp. 71-72. In fact, one of the "checks" proposed by the Commission was "the use of an alternative sample date." Staff not only provided an alternative date, but six of them. Staff RB, p. 72. The Companies now decree that satisfying the Commission's directive is insufficient. They claim that Staff failed to provide the "contextual information" for any of its analyses. NS-PGL BOE, pp. 26-27. That too is false. As explained above, Staff went to great lengths to test its results to demonstrate that they were not anomalous. In addition to the six updates Staff provided, Staff also notes that the VIX index measures of market volatility, market prices, interest rates, and relative ROE trends all support Staff's conclusions. Staff IB, pp. 69-70, 72, 78-79. Those factors also show that, contrary to the Companies' claim, it is clear that Staff is "acutely attuned to [the market] environment" and that a "contextual showing" has been made, as the Commission desires. Staff RB, pp. 71-72.

The Companies claim that Staff's risk-free rate is inconsistent with U.S. Treasury bond yield forecasts. NS-PGL BOE, p. 28. This issue, too, has been litigated numerous times, and the Commission has repeatedly rejected the use of interest rate forecasts in favor of current Treasury bond yields. The Commission has concluded that Treasury bond yields, which are a direct result of actual investor decisions, reflect market forces. Order, Docket Nos. 02-0798, 03-0008 & 03-0009 (Cons.), October 22, 2003, pp. 85-86. In contrast, forecasts, which reflect only analysts' opinions, do not reflect market forces. The true risk-free rate is reflected in the return investors are willing to accept in the market, and as of May 12, 2011, investors were willing to accept a 4.42% return on 30-

year U.S. Treasury bonds. Moreover, forecasts are notoriously inaccurate. No one can forecast with any certainty the timing, direction, or magnitude of long-term interest rate changes. Interest rates are constantly adjusting, and accurately forecasting the movements of interest rates is problematic. In fact, by the time of the hearing, the forecasts the Companies proposed had already been adjusted downward. Tr., August 31, 2011, p. 491. Furthermore, the current U.S. Treasury yields Staff used to estimate the risk free rate reflect all relevant, available information, including investor expectations regarding future interest rates. Consequently, investor appraisals of the value of forecasts are also reflected in current interest rates. Therefore, if investors believe that the forecasts are valuable, that belief would be reflected in current market interest rates. Likewise, if investors believe that the forecasts are not valuable, that belief would be reflected in current market interest rates. In summary, if one uses current market interest rates in a risk premium analysis, speculation of whether investor expectations of future interest rates equals those from a particular forecast reporting service is unnecessary. Finally, the Companies' emphasis on forecasts is even more curious, when one considers the Companies' election to file rate cases rather than enter into a sourcing agreement with a clean coal SNG brownfield facility means they will be filing another rate case within 7 months of the Order in this case.

The Companies continue to suggest that Staff has not provided a "contextual showing" in terms of overall market volatility.[10] NS-PGL BOE, p. 29. The Companies' IB claimed that "Staff did not disclose the relative stock market volatility around any of the

[10] The Companies suggest that Staff provided no "contextual showing" prior to filing its RB. This is factually incorrect. Staff clearly provided contextual showing in its initial brief. Staff IB, pp. 69-70, 72-73, and 74-75.

other days it selected, so it apparently expects the Commission to accept at face value that there was nothing anomalous about those other dates." NS-PGL IB, p. 114. In direct response to that claim, Staff presented the relative stock market volatility information and explained that the below average volatility on the days of Staff's analyses demonstrates that those days were not anomalous. Staff RB, p. 72. The Companies now argue that Staff's observation of below average volatility is "meaningless" since the volatility remains slightly elevated relative to the volatility prior to the 2008 financial crisis, when the Commission authorized a higher ROE than Staff is now proposing. First, the Companies' shifting argument does not render Staff's point meaningless, as the volatility data establishes Staff's analysis date as a normal trading day, absolutely contravening the implication in the Companies' IB that Staff's cost of equity estimates are the a result of anomalous market data. Second, the Companies' new argument is based on the faulty premise that the Companies' ROE can be expected to move in lockstep with market volatility. As Staff explained, natural gas utility stock movements are not synchronized with the overall market, as evidenced by the well below average beta of the Gas Group, making overall market volatility a poor indicator of what investors expect for natural gas utility returns. Indeed, it is precisely in times of high overall volatility that investors redirect their investment dollars to relatively low risk investments, such as utility stocks, in a "flight to safety," which Companies witness Moul acknowledged. Staff IB, p. 72; Staff RB, pp. 72; PGL Ex 3.13D, p. 4; NS Ex 3.13D, p. 4.. Therefore, it is not surprising that utility ROEs might fall despite slightly higher volatility levels in the broader stock market.

Reliability of the DCF results

The Companies continue to argue that lower growth rates combined with lower dividend yields cannot be sustained, causing the DCF model to produce unreliably low results. NS-PGL BOE, p, 30. However, the Companies have yet to provide any legitimate basis for that claim. As the PO correctly noted,

> The low growth rates and low interest rate environment Mr. Moul finds troubling may simply indicate that the cost of capital is low. A relatively low cost of capital is not a reasonable rationale for dismissing the results of a model that reflects those low costs. If the Companies' costs of capital are low, their authorized rates of return should be low for cost-based rate setting purposes.

PO, pp 134-135. This issue was thoroughly addressed in Staff's IB and RB. Staff IB, pp. 77-80; Staff RB, pp. 73-74. The only "support" the Companies present for their position is a faulty comparison of Mr. Moul's DCF result to (1) other model results that were inappropriately inflated through techniques that have been repeatedly rejected by the Commission and (2) the results from Mr. Moul's Combination Group, which reflects higher risk electric utility operations. PGL Ex. 3.0, p. 4; Staff Ex. 14.0, p. 16. In fact, the evidence demonstrates that the Companies' argument for discarding the DCF results is both inconsistent with Mr. Moul's recommendation in the Companies' last rate case and contrary to his arguments regarding volatility. Staff IB, p. 78-80.

Despite the Companies' claim to the contrary, Staff has in no way conceded that the DCF results are "unreasonably low" or that the market conditions underlying the DCF results are currently "anomalous" or were "even more anomalous" in the Companies' last rate case. Likewise, the Companies' claim that Staff's results for 31 utilities within the S&P 500 supports their conclusion is also false. NS-PGL BOE, p. 31.

This was fully explained in Mr. McNally's rebuttal testimony. Staff Ex. 14.0, pp. 16-17. Mr. Moul provided nothing to suggest that that 31 company sample reflects the same risk as the Gas Group, but acknowledged those 31 companies include electric utilities owning significantly riskier generation operations. In fact, Mr. McNally presented a principal components analysis that confirmed that the 31 company sample is, in fact, riskier than both of the Companies. Therefore, one would expect the DCF results for the Gas Group to be lower, as is the case.

The Companies also dispute Staff's conclusion that Mr. Moul's growth rate estimate was unsustainably high and argue that growth rate data selection is "indisputably within the discretion of the analyst." NS-PGL BOE, p. 32. Rather than provide evidence of alleged reasonableness of Mr. Moul's chosen growth rate, the Companies' BOE provides obfuscation. Staff never suggested that the Companies could not choose their own growth rate sources or that Morningstar is an inherently improper source. Rather, Staff's perfectly valid criticism was that Mr. Moul had not only changed his growth rate sources from the last proceeding without any justification, but in so doing, eliminated the lowest of the three growth rates he utilized in the Companies' last rate case and, instead, substituted a clear outlier growth rate that is 27% higher than the next highest estimate. Moreover, Staff provided two analyses that demonstrated that the Morningstar growth rate was unsustainable. The Companies have provided no response to those analyses, except to proclaim them incorrect and present a flawed counter analysis that rests on the clearly erroneous assumption that all new shares are sold for market price, which overstates the level of sustainable growth. This was fully addressed in Staff's RB. Staff RB, pp. 75-78.

Validity of the Companies' risk premium analysis

To Staff's knowledge, a risk premium analysis such as the one the Companies present has never been accepted by the Commission, despite repeated attempts by various utilities. Nevertheless, the Companies once again implore the Commission to reconsider. NS-PGL BOE, pp. 32-34. And once again, Staff has outlined the fatal flaws in the Companies' analysis. Staff IB, pp. 76-77. The Companies present nothing to address those defects, only the canard that Staff used historical price data "to suit its purposes" and the observation that the Illinois legislature recently adopted a risk premium model for its formula rates in the Smart Grid legislation. As explained above, Staff's price data was not historical, but rather, the most recent available, which is always more timely than, and therefore preferable to, a historical average like that used by the Companies to estimate their risk premium. Also, although the Illinois legislature adopted a risk premium model for its formula rates, they did not calculate the risk premium in the same manner as the Companies propose, which highlights the subjectivity that is a primary flaw in the risk premium analysis. Further, the risk premium adopted in the Smart Grid legislation applies only to a very specific, narrowly applied regulatory regime that places additional requirements on the participating utilities to which the Companies are not subject. If the General Assembly wanted to apply that risk premium formula to the Companies, it could have done so. It did not.

CAPM analysis

The Companies criticize the regression beta used in Staff's CAPM analysis as "unnecessary and biased." Once again, the Companies charge Staff with impropriety, stating that published beta estimates "were not sufficient for Staff's purposes." NS-PGL

BOE, p. 35. This is merely a reiteration of an argument for the Companies' IB, which was fully addressed in Staff's RB. NS-PGL IB, pp. 120-121; Staff RB, pp. 82-83. Staff's regression beta is not biased and has been accepted by the Commission in countless rate cases, including the Companies' last rate case, in which the Commission found Staff's use of multiple beta estimates preferable to the Companies' lone source. Likewise, the Companies' argument should be rejected in this proceeding as well.

<u>Leverage Adjustment</u>

The Companies continue to argue for the approval of a leverage adjustment to their DCF and CAPM analyses, despite the Commission having rejected those arguments repeatedly. However, their persistent repetition of their arguments and use of absolute descriptors such as "unassailable," "indisputably," and "irrefutable" does not make their adjustment valid. NS-PGL BOE, pp. 36-38. This issue was fully addressed in Staff IB and RB. Staff IB, pp. 84085; Staff RB, pp. 78-82.

The Companies now claim that Staff witness McNally "admitted" that it is "indisputably true" that "a company's risk, and therefore its cost of equity, is higher if its capital structure is valued at a lower book value than if it is valued at a higher market value." NS-PGL BOE, p. 36. That claim is not only absolutely false, but a clear distortion of Mr. McNally's testimony. Mr. McNally did <u>not</u> agree that the Companies' premise is true, much less indisputably true. In fact, the Companies' premise is, as Staff noted, absurd. The Companies selectively cobbled together bits and pieces of Mr. McNally's testimony, interspersed with their own language, in an attempt to turn Mr. McNally's testimony on its ear. His full response was:

> If a Company's equity ratio was – if you take the same com- -- the same sample, all else equal, and the only difference is the equity ratio is 55

> percent, it will have a higher degree of financial risk than if that same company had a 66 percent equity ratio; but a company cannot be riskier than itself at any point at time. So you cannot have a 66 and a 55 measured on the same scale.

Tr., August 31, 2011, p. 518. The Companies, once again, added language in their representation of Staff testimony that completely distorts the actual testimony. Mr. McNally indicated, hypothetically, that "all else equal" a company with a 55% equity ratio will be riskier than if it had a 66% equity ratio. However, the Companies inserted language into their argument that nullifies Mr. McNally's "all else equal" condition. Specifically, contrary to the Companies' claim, Mr. McNally did not compare a 55% equity ratio "at book value" to a 66% equity ratio "based on market value." In fact, his disclaimer of "all else equal" and his clarification that, of course, a company cannot have both a 55% equity ratio and a 66% equity ratio at the same time, measured on the same scale makes that clear.

The Companies attempt to explain away the Commission's prior rejections of their arguments with baseless speculation that the Commission may be confused. NS-PGL BOE, pp. 37-38. In fact, if any party is confused, it is the Companies, who apparently do not understand what "intrinsic risk" is, despite Staff's attempts to elucidate. Nevertheless, despite professing their lack of understanding of intrinsic risk,[11] the Companies specifically deny this issue is about intrinsic risk. Moreover, if any party has tried to confuse the issue, it is the Companies, who introduce the issue of risk but then deny it is about intrinsic risk and spend multiple paragraphs describing their

[11] The Companies' BOE states, "'intrinsic risk' (whatever that is)." NS-PGL BOE, p. 36.

adjustment in terms of applying market value to book values, but then adamantly deny their adjustment is a market to book adjustment.

Size Adjustment

The Companies' response to the PO's rejection of the size adjustment they applied to their CAPM result is to suggest that the parties essentially agree to disagree and split the difference. NS-PGL BOE, pp. 38-39. The Companies' arguments were thoroughly refuted in Staff's IB. Staff IB, pp. 85-88. Contrary to the Companies' implication, this is not simply an irresolvable dispute between experts for which a compromise is a reasonable resolution. The Companies have presented no valid evidence to support this adjustment, which the Commission has repeatedly rejected in prior cases. In contrast, Staff submitted several pages of testimony outlining the problems with the Companies' proposed size adjustment, including a study that specifically found no justification for a size premium for utilities. The only "evidence" the Companies have presented that even addresses the issue of a size premium for utilities is a single sentence reference to an article that, as Staff explained, provides no insight into the relationship between small utilities and large utilities and no support for Mr. Moul's size premium adjustment. A size premium for utilities is simply not warranted and should, once again, be rejected by the Commission.

Rider UEA

The Companies argue that Staff's proposed 10 basis point downward adjustment to reflect the reduction in risk associated with Rider UEA is excessive and should be rejected. NS-PGL BOE, pp. 39-40. The Companies' argument focuses on the recovery of their uncollectible expense. However, the Companies' cost of equity is a function of their risk, which is reduced by Rider UEA. Indeed, the Companies' BOE acknowledges that "Rider UEA merely ensures that the Utilities will recover their uncollectible expense, no more and no less." It is precisely that certainty of recovery that reduces the Companies' risk, necessitating a downward adjustment to their ROE. As Staff noted, "Since Rider UEA reduces the volatility and uncertainty of cash flows, it reduces the Companies' risk. Therefore, downward adjustments to the Companies' rates of return on common equity are appropriate to recognize the reduction in risk associated with the use of a bad debt rider." Staff Ex. 14.0, p. 19. That is why the Commission adopted a 10 basis point downward adjustment to the Companies' costs of common equity for Rider UEA in their last rate case and why they should do so again in this proceeding.

F. Weighted Average Cost of Capital

VII. WEATHER NORMALIZATION (Uncontested)

VIII. RIDERS – NON-TRANSPORTATION

A. Riders UEA and UEA-GC

The Commission should not change the PO's conclusion regarding the appropriate methodology to calculate the amount of uncollectible costs to be recovered through Riders UEA and UEA-GC. The Commission should reject the Companies' proposed replacement language that would use the percentage of revenue method rather than the net write-off method to calculate uncollectibles expense with respect to Riders UEA and UEA-GC.

To support their Exception No. 15, the Companies cite to their arguments for their Exception No. 9 which Staff has addressed above. In addition, the Companies argue here that there will be additional work involved in revising the Riders' language and formulae. Staff does not disagree that additional work may be required, but sees no legitimate argument against the use of the net write-off method, other than compliance with the Proposed Order may involve some difficulties. The arguments here are not persuasive and should not be considered. Companies BOE at 62.

The Companies also contend that the PO's recommended uncollectible accounts expense percentages of 2.7927% and 0.5936% for Peoples Gas and North Shore, respectively were not used to derive the Uncollectible Accounts Expense amounts reflected in the Proposed Order. Companies BOE at 63. This argument should be ignored for the following reasons:

- Net write-off amounts are used to calculate the adjustment to uncollectibles expense in the PO. PO, Appendix A and B, p. 15;
- The uncollectible accounts expense percentages are calculated using these same net write-off amounts. Staff Ex. 1.0, p. 23, footnote 4;
- The uncollectible accounts expense percentages appear on the Gross Revenue Conversion Factor "GRCF" schedule. PO, Appendix A and B, p. 10; and
- The uncollectible accounts expense percentages from the GRCF schedule are used on page 1 of Appendix A and B to adjust uncollectibles expense in columns "f" and "h" of line 6.

Despite the Companies' arguments to the contrary, the uncollectible accounts expense in the PO does reflect the uncollectible accounts expense percentages in the PO.

B. Rider VBA

C. Rider ICR

IX. COST OF SERVICE STUDY

X. RATE DESIGN

A. Overview

B. General Rate Design

C. Service Classification Rate Design

D. Tariffs – Other Non-Transportation Tariff Issues

1. Uncontested Issues - North Shore and Peoples Gas

a. Terms and Conditions of Service

b. Service Activation Charges

c. Service Reconnection Charges

d. Rider 2

e. Rider 9

E. Bill Impacts

XI. Transportation Issues

A. Overview

B. Uncontested Issues

C. Administrative Charges

D. Large Volume Transportation Program

1. Administrative Charges

2. Transportation Storage – Issues

The Companies, although disagreeing with the PO's conclusions regarding the major findings on transportation issues took only five exceptions. NS-PGL BOE, p. 74. Staff supports three of these exceptions.

The first exception that the Companies raise is that the order adopts Staff's proposed critical day ("CD") withdrawal amount. NS-PGL BOE, p. 74. It is unclear if this includes a linkage of this amount to the fall injection target. Since the Companies sell gas to the transportation customers up to the point the minimum injection target is reached, the value of the Storage Withdrawal Factor ("SWF") is necessarily one. Therefore, there is no practical difference between the Companies proposal and Staff's position.

The second exception deals with the Operational Flow Order ("OFO") language. Staff does not support this exception because the evidence presented shows that the current tariff provisions are adequate to protect the system, as explained in its BOE. Staff BOE, pp. 23-26. As explained in Staff's BOE at page 24, the record is clear that Staff did contest this issue; however as pointed out by the IIEC-CNEG BOE, Staff witness Harden is not the witness that contested this issue as she does not mention the OFO definition in her direct or rebuttal testimony. IIEC-CNEG BOE pp. 2- 3. Therefore, Staff supports this exception by IIEC-CNEG. Staff supports the elimination of the approval of the OFO definition being removed from the Proposed Order.

The third exception is that the PO does not specifically state that it approves the Companies proposed method for subscribing to bank day. NS-PGL BOE, p. 75. Staff supports this process and this exception.

The fourth exception is that the PO does not specifically state that it approves the Companies proposal to eliminate standby service under Rider SST. NS-PGL BOE, p. 75. Staff supports this exception.

The language proposed by the Companies (Exceptions Nos. 22-25) has some flaws and accordingly Staff has revised the Companies language to address those flaws. Staff recommends that the language below be adopted by the Commission.

Staff and IIEC/CNEG clearly disagree with the Utilities' proposals that go beyond unbundling the Rider SST bank from standby service. Staff and IIEC/CNEG maintain that the Utilities' additional proposals of: (1) a stand-alone storage banking service under which customers select the amount of storage capacity, (2) monthly inventory targets with monthly cashouts, (3) daily injection and withdrawal limits with daily cashouts, (4) daily tolerance around the daily ranges and (5) eliminate the no-notice standby service, clearly are not necessary to accomplish the goal of unbundling Rider SST from standby service. We agree with Staff and IIEC/CNEG and find that Rider SST is a functional LVT Service with the flaw of having the storage access and standby linked. There is no need to alter the service. The aim of unbundling the storage services from standby service is to increase flexibility for transportation customers by retaining the full flexibility currently in the Rider SST tariff and giving those customers an option to select the size of the bank independent of the level of standby. The Utilities' additional proposals reduce daily and monthly flexibility. As mentioned, the only proposal which received universal support at the workshop was the recommendation to unbundle the Rider SST bank from standby service and the Utilities' go far beyond this. Further, such attempts to make these proposed changes to LVT programs have been rejected by the Commission in prior dockets. The Commission concludes that the Utilities have not demonstrated the need for their proposed monthly storage limits and daily delivery restrictions and that the only parameter that should be changed is the Critical Day withdrawal amount pursuant to Staff witness Sackett's proposal of 2.5% of the customers AB for Peoples Gas and 2.6% of the customers AB for North Shore Gas; there is no need to link this amount to the fall injection target.

The Commission finds that it is reasonable, and no party objects, to eliminate from the proposed unbundled tariff standby service and, therefore, to eliminate allocating any storage rights based on the amount of standby service that a customer selects. Instead, customers may subscribe to the amount of storage they wish under a subscription process defined by the Companies, and not opposed by Staff or any party.

The new unbundled storage service, Rider SBS, shall largely mirror the existing Rider SST, except for any terms and conditions dependent upon standby service.

The fifth exception is discussed in XI.,D.3.e. below.

3. Associated Rider Modifications

a. Rider SBS/SST

b. Rider FST

c. Rider P

d. Rider SSC

e. Transition Riders

The fifth exception mentioned above concerns the PO's conclusion that transition riders are unnecessary. PO, p. 226. The Companies disagree. NS-PGL BOE pp. 77-78.

Staff, like the Companies, supports the use of transition riders. Specifically the transition riders are needed to set up the changes regarding the calculation of the days of bank. Also, the timing of the rates and the elimination of standby service and the imposition of a single charge for all storage costs for each rider as noted by the Companies. The Companies' BOE argued the following:

> The Utilities currently have an orderly annual process by which large volume transportation customers select their services for the upcoming program year. The annual rollover process is based on a May 1 contract year. McKendry Dir., NS Ex. 15.0, 7:138-140; PGL Ex. 15.0, 7:138-140. To allow the Utilities and customers time to select preferred levels of storage and to adjust to the elimination of standby service in making those selections, the Commission should approve a transition period tied to May 1, 2012. Accordingly, the various proposed transition riders, with any modifications required to implement the Commission's Order, should be approved through April 30, 2012.
>
> NS-PGL BOE p. 77.

However, those riders need to reflect the Commission's decisions rejecting certain proposals by the Companies. Therefore, Staff supports the Companies' Exception No. 26 as written.

<u>The Commission does not agree with the Companies that the proposed transition period to August 1, 2012, is needed, but a transition period is appropriate for the</u>

Companies, customers and suppliers to have time to select new storage quantities and adjust for services that no longer include standby service. The Companies' existing annual contract rollover process, with a May 1 date, is a reasonable date to effectuate the changes. Accordingly, the Commission approves as reasonable a transition through May 1, 2012, and the proposed transition riders shall remain in effect through April 30, 2012, with any changes needed to comply with this Order. ~~The Commission agrees with IIEC/CNEG in that the adoption of Staff Witness Sackett's proposals for unbundled storage services negates the need for transition riders. Staff's proposals do not cause the change to current storage requirements that would require such transition riders.~~

E. Small Volume Transportation Program (Choices for You[SM] or "CFY")

XII. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this consolidated docket.

Respectfully submitted,

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