

Docket No: 11-0046
Bench Date: 1/25/12
Deadline: 1/29/12

MEMORANDUM

TO: The Commission

FROM: Glennon Dolan, Administrative Law Judge

DATE: January 18, 2012

SUBJECT: AGL Resources Inc., Nicor Inc. and Northern Illinois Gas Company d/b/a Nicor Gas Company

Verified Application for Rehearing of the Attorney General and the Citizens Utility Board (with Confidential Attachment)

RECOMMENDATION: Deny Application for Rehearing.

On January 9, 2012, the Illinois Attorney General and the Citizens Utility Board (“AG-CUB”) filed a verified application for rehearing in the above captioned docket.

According to AG-CUB, in its final order in this case, the Commission approved the petition of AGL Resources, Inc. and Northern Illinois Gas Company, d/b/a Nicor Gas Company (“Joint Applicants” or “JA” or “AGL/Nicor”) for reorganization pursuant to Section 7-204 of the Public Utilities Act (“the Act”). In doing so, the Commission concluded that the Companies satisfied their burden of proving, among other provisions, that “the merger will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service,” and that the merger “is not likely to result in adverse rate impacts on retail customers.” Order at 15, 31, citing 220 ILCS 5/7-204(b)(1), 220 ILCS 5/7-204(b)(7).

AG-CUB disagree that the evidence in the proceeding allows the Commission to make the required findings pursuant to 7-204(b)(1) and (b)(7) of the Act for approval of the proposed reorganization. Although ultimately recommending approval of the merger, the October 22, 2011 Memorandum of the Administrative Law Judge to the Commission specifically highlighted the paucity of the evidence supporting the Section 7-204(b)(1) finding:

Staff and the intervenors are correct that the JA’s evidence is largely general and reliant on previous experience and present aspiration. Its sufficiency is ultimately dependent upon a regulator’s degree of confidence that prior

experience, self-interest, moderate restraints and relatively general plans will likely produce a satisfactory outcome. Consequently, a different conclusion for the first necessary finding (which would essentially deny the merger application) would not be legally erroneous.

Memorandum at 3.

AG-CUB continue to have concerns about the evidentiary basis for the Commission to make findings necessary for approval of the merger under Section 7-204(b)(1). In addition, AGL/Nicor spreadsheets created in February of 2011 and obtained after the close of the record, which compared full-time employee (“FTE”) numbers and departmental dollar comparisons for “Rolled Up Functional Areas” between departments of AGL and Nicor as part of the integration process, warrant further explanation by the Joint Applicants. Such investigation is necessary so that the Commission can be certain that the statutory requirements that Nicor’s service remain “least cost” and that the reorganization “is not likely to result in any adverse rate impacts on retail customers” have been truly satisfied. 220 ILCS 5/7-204(b)(1), (b)(7). While AG/CUB offer no conclusions about the content of the documents, attached to this application as Confidential Exhibit A, the Commission and its Staff should have the opportunity to investigate the meaning of the information contained in the spreadsheets, and how the FTE differentials and dollar figures listed therein, and reorganization plans associated with the integration of the companies, will affect the reorganized company and ratepayers going forward.

Moreover, by failing to address the Joint Applicants’ insistence that no savings to the regulated utility will result from the merger despite its admission that a savings analysis has not been performed and that no savings are currently “identifiable or quantifiable,” the Commission leaves open the possibility that Nicor Gas could experience significant savings, and earn more than its authorized return by enjoying the benefit of reduced operating costs, while simultaneously denying rate payers the benefit of these efficiencies. The Commission must be able to track the post-merger savings so that Section 7-204(c), which requires a ruling on the allocation of any savings resulting from the merger, can be satisfied. 220 ILCS 5/7-204(c).

AG-CUB urges the Commission to grant rehearing on three issues, as discussed below.

- I. Commission Should Grant Rehearing and Revisit its Finding that the Reorganization Will Not Diminish Nicor Gas’ Ability to Provide Adequate, Reliable, Efficient and Least Cost Public Utility Service and Will Not Adversely Impact Customer Rates, Pursuant to Section 7-204(b)(1) and (b)(7) of the Act.

According to AG-CUB, the Order is wrong when it alleges that the AG and CUB are insisting that integration activities “...must be completed before the Commission can reasonably render the finding required by subsection 7-204(b)(1),” Order at 13. Rather

the main reason for the AG-CUB's objection was they feel that the process produced almost no information that the Commission could rely on to render a decision on Section 7-204 analysis. The evidence suggests that while the two merging corporations may feel comfortable with their plans for corporate merger and reorganization, the record lacks evidence as to what the Commission and Nicor Gas ratepayers can expect related to the AGL/Nicor Inc./Nicor Gas reorganization, particularly as it relates to the statutory standard that the reorganization not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service. 220 ILCS 5/7-204(b)(1). The value of the integration process notwithstanding, the AGL/Nicor application has not provided sufficient information for the Commission to make this finding and the reasoning supplied in the Proposed Order does not change this fact.

Accordingly, the Commission's conclusion that the Joint Applicants met their burden of demonstrating that the merger will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service, pursuant to Section 7-204(b)(1) of the Act is contrary to law, not supported by substantial evidence, arbitrary and capricious and beyond the jurisdiction of the Commission, contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this position, the People incorporate by reference pp. 6-10 from the AG/CUB Initial Brief, pp. 2-5 from the AG/CUB Reply Brief and pp. 4-8 from the AG Corrected Brief on Exceptions. The Commission should grant rehearing and reconsider its conclusion on this point, based on the applicable law and the evidence of record.

AG-CUB basically presents the same arguments that were made during the hearing and in their briefs. There has been no new evidence or information that is not already in the record on this issue. The conditions placed on the company as a result of the final order will not change with rehearing on this issue.

II. The Commission Should Grant Rehearing and Require the Companies to Explain the Significance of Newly-Obtained Information to Ensure that the Reorganization Will Not Diminish Nicor Gas' Ability to Provide Adequate, Reliable, Efficient and Least Cost Public Utility Service and Will Not Adversely Impact Customer Rates, Pursuant to Sections 7-204(b)(1) and (b)(7) of the Act.

AG-CUB argue that new evidence obtained by the Attorney General's Office since the close of the record, suggests further investigation of these findings is necessary.

After being contacted by an employee of Nicor Gas regarding the existence of certain spreadsheets created back in February of 2011 that compared full-time employee ("FTE") numbers and departmental dollar comparisons for "Rolled Up Functional Areas" between departments of AGL and Nicor as part of the integration process, the OAG contacted counsel for the Companies regarding the existence of said documents. Counsel for the Companies then forwarded the spreadsheets, attached as Confidential Exhibit A, on November 18, 2011.

In an email accompanying the forwarded spreadsheets, counsel for the Companies stated that

...the contents of this document were ultimately rolled into the work papers that supported the Current State Assessment that the Integration Planning Team presented to the CEOs of AGL and Nicor Inc. in June 2011. The Current State Assessment was produced as a supplement to RWB 3.08, and the work papers and other materials relating to the activities of the Integration Planning Team, were produced in response to Staff DRs served in July 2011. The documents produced were based upon an agreement with Staff concerning the scope and breadth of their DRs.

The citation to discovery served in "July 2011" is a reference to scores of documents provided by the Joint Applicants just days before the evidentiary hearings. The discovery was forwarded following the Commission's receipt of an anonymous *ex parte* letter, which generated the Commission Staff submitting a general data request to the Joint Applicants that requested, *inter alia*, "(w)ork papers, analyses, studies, memoranda, or any other document prepared by (individuals involved in preparing for the integration of Nicor and AGL) in conjunction with the integration..." A review of the documents provided by Joint Applicants in response to that data request reveals that the February Excel spreadsheets do not appear to have been included therein. Pages 33-36 of the Attachment show dollar comparisons between AGL and Nicor operational departments. Page 35, in particular, reveals significant dollar differences between AGL's and Nicor's Legal Department expense categories. It is unlikely that such a detailed review was conducted for just the Legal departments. While some of the attachments to Staff DR 1.01 include some cost comparison information between the two companies, it is unclear how it relates to the February data contained in the Excel spreadsheets. Presumably, such comparisons exist for other functional areas within AGL/Nicor Gas, and a rehearing would provide the opportunity for the Commission to investigate the relevance of the February FTE and cost comparisons, and their meaning for future Nicor Gas operations.

While AG/CUB offer no conclusions about the content of the documents, attached to this application as Confidential Exhibit A, the Commission and its Staff, as well as all parties, should have an appropriate opportunity to investigate the meaning of the information contained in the spreadsheets, and how the FTE differentials and dollar comparisons listed therein, and reorganization plans associated with the integration of the companies, will affect the reorganized company and ratepayers going forward. The Companies should be required to explain their reorganization plans in light of the documents, and thereby permit the Commission to determine whether additional conditions need to be added to the merger order to ensure that Nicor's rates remain "least cost" and that "no adverse rate impacts" result from the reorganization. 220 ILCS 5/7-204(b)(1), (b)(7). Given the paucity of evidence supplied by the Joint Applicants regarding the integration plans for the post-merged company, and that integration decisions presumably have been made since the close of the record, the Joint Applicants should be required to update the Commission, in light of this new evidence,

to ensure that the statutory findings under Section 7-204(b)(1) and (b)(7) of the Act have, in fact, been met.

While it is agreed that this document should have been disclosed by AGL/Nicor, the only conclusion that can be reached from this investigation is whether the company is saving money or eliminating jobs. In the final order the Commission placed the following conditions on the Joint Applicants post merger.

- Nicor Gas shall maintain, for a period of three years after closing of the Reorganization, 2,070 full-time equivalent employees working in support of Nicor Gas' business, and shall maintain, for the same three-year period, that same level of full-time equivalent employees working in the State of Illinois. Nicor Gas shall also honor and abide by all union contracts in effect prior to completion of the Reorganization.
- Achieved savings at Nicor Gas resulting from the proposed Reorganization, if any, and any additional savings resulting from the proposed Reorganization that would otherwise be recognized under 83 Ill. Adm. Code Part 287 or prior Commission test year rulings, if any, shall be flowed through to Nicor Gas customers as part of costs associated with the regulated intrastate operations for consideration in any future rate case involving Nicor Gas.

Since these conditions are covered by the final Order, rehearing on this issue should be denied.

III. The Commission Should Reconsider its Finding that Section 7-204(c) of the Act Has Been Satisfied.

AG/CUB state, that Section 7-204(c) provides 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." 220 ILCS 5/7-204(c). In analyzing this statutory requirement, the Order focuses on the stipulation entered into between the Joint Applicants and Staff, which provides for the following:

- JA and Staff agree that achieved savings at NG resulting from the proposed Reorganization, if any, shall be flowed through to NG customers as part of costs associated with the regulated intrastate operations for consideration in a future rate case filed by NG."
- NG's rates will be fixed at their current rates for a period of three years following the close of the merger "[i]n order to provide rate certainty for customers for a period following the Reorganization, and to allow the effect of savings, if any, to materialize".

- JAs 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.” *Id.* 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, according to the stipulation.¹

Order at 31-32.

In assessing the stipulation, the Order then concludes:

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. Order at 33.

Here, the Commission reasons, essentially, that under Section 7-204(c), the Commission need not delve into the issue of whether savings will, in fact, occur when addressing how any savings will be allocated. While the Order argues that the “allocation” is only at issue, due to the fact that all savings, if any, would be allocated to ratepayers in a future NG rate case, it fails to describe how any savings would be tracked, especially in light of the new AGL services company arrangement that presumably impacts how costs and any merger savings would be allocated among the affiliates. The promise of receiving “all savings, if any” at some point in the future

¹ Under the stipulation, 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. 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 rates.

through embedded cost of service numbers is an empty promise if there is no specific mechanism or system in place to track any merger savings. Likewise, the promise is a hollow one if the Commission accepts, or fails to comment on, the JAs' insistence that there will, in fact, be no merger savings for Nicor Gas customers.

The AG-CUB brief detailed inconsistency after inconsistency in the evidence supplied by the JAs on the subject of potential savings. These inconsistencies are not addressed in the Order.

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

Notwithstanding their insistence throughout this case that the merger will only produce savings for the two corporate parent companies, AGL and Nicor, Inc. ("NI"), and that there are no identifiable savings or even estimates to be quantified for the regulated utility, the JA also state that "To date, no analyses have been performed to determine any areas where synergies or savings may be potentially achieved as a result of the reorganization."² This intransigence on the issue of identifying savings and costs comes despite the fact that the JA testified that an integration planning process has been ongoing since January of 2011. Tr. at 383. The claim that no savings will accrue to the regulated utility simply is not credible in light of the following facts:

- In nearly every merger/reorganization petition presented to the Commission since Section 7-204(c) became law, the merger petitioners specifically identified anticipated savings at both the corporate parent level and the regulated utility level in their petitions and/or pre-filed testimony. For example, the WPS Resources Corporation/Peoples Energy Corporation/The Peoples Gas Light & Coke Company/North Shore Gas Company petition provided *at the start of the docket* that the petitioners estimated that annual savings in personnel costs of \$33.8 million could be expected, with 79% of that savings coming from reductions to corporate staffing.³
- Assuming savings are achieved at the corporate level only, the parent company costs that are allocated to the regulated utility, Nicor Gas, in every

² AG Cross Ex. 7 (JA Response to AG 1.19).

³ AG Ex. 3.0 at 5.

rate case, stand to be reduced if the JA claims about corporate efficiencies are to be believed.⁴

- Despite their alleged inability to identify synergies or savings, the JA *have* identified expected separation costs of \$21 million, plus additional separation costs associated with the highest ranking Nicor Inc executives. Such separation costs would be incurred in conjunction with a reduction to the number of administrative, management, and executive employees enabled by the merger. As noted by AG/CUB witness David Efron, “there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs.”⁵
- While the JA claim that the merger “is really based on long term best practices and scale and scope that can keep costs, over the long term low for our customers,”⁶ the JA witnesses were unable to come up with a consistent definition of “long term,” thereby creating doubt about their claims that near term synergies or savings are not identifiable in the short run, long run or otherwise.
- The JA stand to gain additional efficiencies through their commitment to maintain the number of gas distribution “full time equivalent employees” (“FTEs”) at a level comparable to the current level.⁷ Moreover, this commitment does not apply to Nicor Gas administrative employees and Nicor, Inc. employees, a portion of whose salaries are allocated to Nicor Gas.
- Savings can be achieved as a result of the merger in areas other than staffing, such as facilities integration, professional services, purchasing and information technology.⁸
- The Commission Staff believes the JAs failed to provide sufficient information to determine what effect the proposed reorganization would have on Nicor Gas’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service.⁹
- Staff also testified that the applicants failed to conduct a thorough due diligence review, and as such the merger should be denied.

AG/CUB argue, that because the JAs failed to quantify any level of savings at all, this does not constitute sufficient evidence for the Commission to render a ruling on “(i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether

⁴ See AG Cross Ex. 5, Tr. at 383-398.

⁵ AG/CUB Ex. 3.0 at 5.

⁶ JA Ex. 11.0 at 7.

⁷ Tr. at 461, *Id.* at 576.

⁸ *Id.* at 4.

⁹ Staff Ex. 11.0 at 3.

the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.” 220 ILCS 5/7-204(c).

AG/CUB witness David Efron testified that he believed the merger would result in immediate savings that can and should be quantified. For example, the JAs provided an estimate of merger related costs in their information responsive to the requirements of 220 ILCS 5/7-204(a)(3). One of the items is “Separation Costs” of \$21.0 million (Update as of April 22, 2011). Such separation costs would be incurred in conjunction with a reduction to the number of administrative, management, and executive employees enabled by the merger. In response to AG Data Request 2.03, the Applicants had stated that they had not quantified the annual reduction to personnel cost that could be achieved as a result of such employee separations. However, there would be no purpose to such separation costs, unless the anticipated savings from the employee separations were significantly greater than the costs. AG/CUB Ex. 4.0 at 6. AG/CUB incorporates by reference arguments presented at pages 14-17 of the AG/CUB Brief on Exceptions.

Accordingly, the Commission’s conclusion with respect to the 7-204(c) finding is contrary to law, not supported by substantial evidence, arbitrary and capricious and beyond the jurisdiction of the Commission, contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this position, the AG incorporate by reference pp. 15-37 from the AG/CUB Initial Brief, pp. 8-19 from the AG/CUB Reply Brief and pp. 9-21 from the AG Corrected Brief on Exceptions. The Commission should grant rehearing and reconsider its conclusion on this point, based on the applicable law and the evidence of record.

These were the same arguments that AG-CUB presented during the hearings and in their briefs. There has been no new evidence or information that is not already in the record on this issue. The conditions placed on the company as a result of the final order will not change with rehearing on this issue.

Therefore, the Application for Rehearing on this docket should be denied.

DG:fs