

**Docket Nos. 1-08-2055, 1-08-2056, 1-08-2189, 1-08-2304,
 1-08-2451, 1-08-2452 and 1-08-2453 (cons.)**

**IN THE ILLINOIS APPELLATE COURT
 FIRST DISTRICT**

PEOPLE OF THE STATE OF ILLINOIS)	
<i>ex rel.</i> LISA MADIGAN, ATTORNEY	)	On Direct Appeal of
GENERAL OF STATE OF ILLINOIS, ET AL.	)	Orders of the Illinois
<i>Petitioners</i>	)	Commerce Commission
)	
v.)	
	)	Ill.C.C. Docket Nos.
ILLINOIS COMMERCE COMMISSION,	)	07-0241 and 07-0242
ET AL.	)	(cons.)
<i>Respondents</i>)	
)	

POINTS AND AUTHORITIES

	<u>Pages</u>
<u>ARGUMENT</u>	
I. GENERAL ISSUES.....	1-10
A. Jurisdiction.....	1-8
220 ILCS 5/10-201(a).....	1
220 ILCS 5/10-203.....	1
<i>North Shore Gas Co, et al. v. Illinois Commerce Commission,</i> Appeal Nos. 2-08-0364, 2-08-0839, 2-08-0390 and 2-08-0713, Order of August 26, 2008.....	1, A1*
1. <i>The right to appeal to the Appellate Court during the pendency of rehearing at the Commission: various rulings in this century.....</i>	2-4
220 ILCS 5/10-113(a).....	2

* Designation "A#" indicates document (or relevant portion) is contained in Separate Appendix of the Commission

Regarding evidentiary challenges, reviewing courts have determined that substantial evidence may support more than one possible finding, and possibly several. The evidence only need be such that a reasoning mind would accept as sufficient to support a particular conclusion. *CIPS v. Illinois Commerce Commission*, 268 Ill. App. 3d 471, 479 (4th Dist.1994) In fact, merely showing that the evidence presented can support a *different* conclusion than the one reached by the Commission is not sufficient. Rather, appellants must affirmatively demonstrate that the conclusion *opposite* to the one reached by the Commission is "clearly evident." *Continental Mobile Telephone Co. v. Illinois Commerce Commission*, 269 Ill. App. 3d 161, 171 (1st Dist. 1994).

This Brief will demonstrate that the various petitioners have failed to carry their burdens of proof. Their allegations of error are unpersuasive and fall short of overcoming the presumption of reasonableness accorded Commission orders. An affirmance of the Commission is, therefore, warranted.

II. RESPONSE TO THE PEOPLE, CUB AND THE CITY OF CHICAGO ("GCI")

A. The Adoption of Rider VBA was an Appropriate Exercise of the Commission's Discretionary Ratemaking Authority.

The Utilities proposed several new "tracker" riders, including Riders VBA. R. Vol. 5, C00865; R. Vol. 22, C04732. As noted by their expert witness, Russell Feingold, North Shore's and Peoples' business conditions present considerable challenges to their ability to achieve reasonable financial performance and stability. R. Vol. 5 C00868; R. Vol. 22, C-04735. Among these conditions are unpredictable and changeable weather conditions, volatile natural gas commodity prices, declining customer gas usage, and growth in the level of uncollectible accounts expenses on

Utilities' systems. These conditions have added elements of volatility and uncertainty to the utility's operations that necessitate a fundamental change to the traditional ratemaking process through the application of new ratemaking mechanisms, such as Rider VBA, to preserve North Shore's and Peoples' financial health.

To ameliorate the uncertainty of the Utilities' operation, they proposed Rider VBA, an automatic adjustment rider which was designed to (1) recognize the variability in use per customer and its impact upon the volumetric components of its base rates and (2) will adjust rates (up or down) on a monthly basis to enable the utility to recover its approved level of margin revenues. R. Vol. 5, C00877. Rider VBA provides the Utilities with a measure of assurance of recovery of the portion of the revenue requirement approved by the Commission in these proceedings that is to be recovered through volumetric charges. In other words, Rider VBA was designed to recover "margin revenues"¹ and would operate to adjust customer prices under Service Classifications Nos. 1 and 2 in a way that the Utilities' revenues are held constant despite changes in customer consumption (Order p. 138; R. Vol. 85, C20767).

The Utilities considered the Rider necessary because, although a very large percentage of their costs are fixed rather than variable, a significant portion of those fixed costs would be recovered through volumetric distribution charges. Rider VBA, was proposed to remove both the incentive utilities have to increase sales and the disincentives that utilities have to encourage energy efficiency for their customers.

¹ Margin revenues means the Utilities' total cost of service, exclusive of purchased gas expenses and "flow-through" items. R. Vol. 5, C-00879. Margin revenues are the equivalent of total distribution revenues, base revenues, or the revenue requirement. For consistency, the term "Margin Revenues" is best utilized for purposes of discussion of the Utilities' Rider VBA proposal, with the understanding that the Rider involves the portions to be recovered through volumetric charges.

Thus Rider VBA is a “decoupling mechanism” which would determine an adjustment on a monthly basis for the effects of weather and usage changes, such as those caused by conservation measures, on the Utilities’ rates.

Although the proposed adoption of this type of mechanism is a matter of first impression before the Commission, currently there are eleven (11) states that have approved revenue decoupling in some form, with fourteen (14) additional states (including the District of Columbia) currently addressing revenue decoupling issues (R., Vol. 55, C13044).

The People of the State of Illinois, the Citizens Utility Board and the City of Chicago (“Government & Consumer Petitioners” or “GCI”) oppose the Commission’s adoption of Rider VBA. Their objections are insufficient to overturn the Commission’s rate design in this case.

1. Rider VBA is an appropriate vehicle for recovering the Utilities’ revenue requirement

GCI claim that that the Utilities failed to prove that Rider VBA was needed. Br. p. 35. They point to the testimony of Staff witness Lazare and GCI witness Brosch in their attempt to undermine the Commission’s conclusions. However, Utility witnesses Feingold and Borgard responded to these witnesses’ contentions (R. Vol. 50, C11718; R. Vol. 50, C11829; R. Vol. 55, C13038; R. Vol. 55, C13095) and, in the end, the Commission was persuaded as to the correctness of the Utility position. R. Vol. 50, C11842 – C11843; R. Vol. 55, C13102 – 13103. The Commission’s decision regarding the appropriateness or need for Rider VBA is an evidentiary conclusion, supported by substantial evidence, which is owed deference by this court. *Abbott Laboratories, Inc. v. Illinois Commerce Commission*, 289 Ill. App. 3d 705, 713 (1st Dist. 1997).

The Commission extensively analyzed the record and the parties' arguments in this case (C20755-C20782) before arriving at the conclusion that Rider VBA is appropriate as it reflects the particulars of declining and variable customer usage patterns and the concomitant revenue recovery impacts for Peoples Gas and North Shore. Order p. 150, R. Vol. 86, C20779. In the Commission's view, record evidence of usage patterns and margin recovery fluctuations calls for a regulatory response. Order p. 150, R. Vol. 86, C20779. This conclusion is supported by substantial evidence in the record and should be affirmed. R. Vol. 5, C00871 – C00899; R. Vol. 22, C04735 – C04769; R. Vol. 1, C00152 – C00153, R. Vol. 19, C4237 – C4239. The fact that the record contains some evidence which would support a different conclusion is unremarkable and insufficient to overturn the Commission's order. In order to prevail GCI must affirmatively demonstrate that the conclusion *opposite* to the one reached by the Commission is "clearly evident." *Continental Mobile Telephone Co. v. Illinois Commerce Commission*, 269 Ill. App. 3d 161, 171 (1st Dist. 1994). This they have failed to do.

The Commission correctly concluded that Rider VBA is appropriate as it reflects the particulars of declining and variable customer usage patterns and the concomitant revenue recovery impacts for Peoples Gas and North Shore.

2. Rider VBA is consistent with ratemaking principles

The Commission has very broad discretionary power to design rates which will compensate utilities for rendering service. This is borne out by the fact that in entrusting the Commission with the power to set utility rates the legislature did not confine the Commission to a particular methodology. It neither mandated recovery

purely through base rates nor purely through riders nor through any particular mix of the two. In fact, the only statutory admonition to the Commission in designing rates is that rates and charges are to be “just and reasonable.” 220 ILCS 5/9-101. In one of the very first Illinois cases to discuss the nature of just and reasonable rates, the Illinois Supreme Court explained that what is a just and reasonable rate is a question of sound business judgment based upon the evidence and not one of “mere legal formula.” *State Public Utilities Commission v. Springfield Gas Company*, 291 Ill. 209, 218 (1920). The goal of ratemaking is “permit the utility to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made . . . on investments in other business undertakings which are attended by corresponding risks and uncertainties.” *Bluefield Waterworks & I. Co. v. Public Service Commission*, 262 U.S. 679, 692 (1922).

Automatic cost recovery mechanisms, such as cost recovery riders, are employed where circumstances warrant a recovery through such a mechanism. *Citizens Utility Board v. Illinois Commerce Commission*, 166 Ill. 2d 111, 138 (1995). The Illinois Supreme Court in *City of Chicago v. Illinois Commerce Commission*, 13 Ill.2d 607 (1958) described the question of the Commission’s authority in choosing between the employment of base rate versus rider recovery as being a matter “committed to the Commission’s sound discretion. . .” and which, “in the absence of an abuse of discretion, is not within the scope of the judicial process.” *City of Chicago v. Illinois Commerce Commission*, 13 Ill.2d 607, 618 (1958). Thus, the Commission undertook to set out in its Order a “sound and lawful analysis” sufficient to satisfy this court’s

judicial inquiry. Order p. 150 (R. Vol. 86, C20779) citing *City of Chicago v. Illinois Commerce Commission*, 281 Ill. App. 3d 617, 622 (1st Dist. 1996).

GCI's main opposition (Br. p. 23) to the adoption of Rider VBA is that it runs afoul of ratemaking principles which GCI imply suggest that just and reasonable rates cannot guarantee specific levels of revenue such as margin revenue, citing *Fed. Power Commission v. Hope Gas Co.*, 320 U.S. 591, 610 (1943); *Fed. Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942). While those cases certainly provide that regulation, as it existed at the time of those cases, was not required to insure that utility businesses would be guaranteed to "produce net revenues", neither did they hold that regulation was prohibited from insuring that utilities were guaranteed to recover some or all of their net revenues.

In addition, GCI contends that proposed Rider VBA violates the Commission's and Illinois law's test-year principles by selecting only one component of the revenue requirement, in this case a slice of overall revenues (margin revenues per customer in the Rate 1 and 2 classes), then tracking changes in that revenue requirement component and assessing rate adjustments to recognize this change. As demonstrated below in Section II. A. 5 of this brief, pp. 18-19, this argument is without merit.

While GCI note that no provision of the Act authorizes a revenue decoupling rider such as Rider VBA (Br. p. 25), the reverse is also true. GCI fails to cite a single provision of the Act which forbids a revenue decoupling rider.

3. Rider VBA does not violate strictures against single-issue ratemaking

The prohibition against single issue ratemaking is based on the regulatory principle that a utility's revenue requirement should be based on the aggregate costs

and demand of the utility. *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 146 Ill. 2d 175 (1991). Accordingly, when the Commission sets about to establish a utility's revenue requirement in a general rate case, such as the present case, it is improper for the Commission to consider changes to components of the revenue requirement in isolation. *Citizens Utility Company v. Illinois Commerce Commission*, 166 Ill. 2d 111, 136-137 (1995). The instant case does not run afoul of single-issue ratemaking prohibitions for the simple reason that the Commission established the Utilities' revenue requirement in the traditional way. GCI does not suggest otherwise. GCI's complaint lies not with the establishment of the Utilities' revenue requirement but with the rate design mechanism the Commission has implemented to recover that revenue requirement.

4. Rider VBA does not Violate Strictures Against Retroactive Ratemaking

After a thorough analysis of applicable case law the Commission concluded that Rider VBA presented no violation of the rule against retroactive ratemaking (Order p. 145; R. Vol. 85, C29774). Retroactive ratemaking occurs where the Commission revisits rate treatment granted in a previous order and attempts to correct mistakes in that order by making a retroactive adjustment. *Citizens Utilities Co. v. Illinois Commerce Commission*, 124 Ill. 2d 195, 206-07 (1988). In other words, the Commission cannot in one rate order retroactively deny rate treatment granted in a previous order. As determined by the Commission, Rider VBA does not disturb either the current order or any of the Commission's prior orders (Order p. 145; *Id.*). Nor does Rider VBA disallow charges or benefits previously ordered.

GCI's argument (Br. p. 31) rests on the faulty premise that Rider VBA circumscribes the prospective nature of ratemaking, by allowing utilities to increase changes to make up for demand levels that are below what they describe as an artificial per-customer revenue benchmark. Nothing, however, circumscribes the Commission's authority to establish a new schedule of rates in the future in another rate proceeding.

GCI closes with the inaccurate claim that had Rider VBA been in effect from 2000 to 2006 that "rates would *not* be what they were – they would have been \$242 million more." Br. p. 32. This misapprehends the situation. It is not the rates which would have changed but the revenues generated by the rates. The problem with retroactive ratemaking, as identified by the court in *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 136 Ill. 2d 192, 209 (1989), is that if the utility's earnings (in that case Commonwealth Edison Company) were excessive in any particular year, the Commission could order a refund in the following year. The Rider in this case does not attempt to adjust the Utilities' rates to reflect excess or insufficient earnings.

In the end, the rate schedule approved by the Commission in this case hews to the requirements of *City of Chicago v. Illinois Commerce Commission*, 13 Ill. 2d 607 (1958) where the court explained:

[An adjustment] clause is nothing more or less than a fixed rule under which future rates to be charged the public are determined. It is simply an addition of a mathematical formula to the filed schedules of the Company under which the rates and charges fluctuate as the wholesale cost of gas to the Company fluctuates. Hence, the resulting rates under the escalator clause are as firmly fixed as if they were stated in terms of money.

City of Chicago, supra, 13 Ill. 2d at 613.

Under *City of Chicago's* guidance, where, as here, a rate schedule approved by the Commission contains a mathematical formula for making future changes in the rate schedule, it is not unlawful under the doctrine of retroactive ratemaking. As such, the GCI's argument is unfounded.

5. *Rider VBA is Consistent with Test-Year Principles*

The purpose of a test year is to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 146 Ill. 2d 175, 238 (1991); *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 136 Ill. 2d 192, 219 (1989). The rates established by the Commission in this case were generated, just as in any other traditional general rate case proceeding, by examining the costs and expenses submitted in compliance with the Commission's test year rules and establishing a revenue requirement. GCI's makes no claim otherwise.

As such, the base rates that are approved in this case and which are the basis for the margin revenues to be recovered under Rider VBA have been evaluated in accordance with the appropriate test year prescriptions. The fact that a portion of the revenue requirement will be recovered through a rider does not alter the situation. Riders have been generally determined not to be single issue ratemaking. As the Illinois Supreme Court observed in *Citizens Utility Board v. Illinois Commerce Commission*, 166 Ill. 2d 111 (1995):

[A] rider mechanism merely facilitates direct recovery of a particular cost, without direct impact on the utility's rate of return. The prohibition against single-issue ratemaking requires that, in a general base rate proceeding, the Commission must examine all elements of the revenue requirement formula to determine the

interaction and overall impact any change will have on the utility's revenue requirement, including its return on investment. The rule does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such treatment.

Citizens Utility Board, supra, 166 Ill. 2d at 138

Additionally, the Illinois Supreme Court has been clear that a rider does not violate test year prescriptions when it is accompanied by a reconciliation feature:

[T]he test-year rule seeks to avoid a problem not present when expenses are recovered through a rider. The reconciliation formula used to determine the amount of the rider charge includes a matching of costs incurred with revenue realized.

Citizens Utility Board, supra, 166 Ill. 2d at 139

GCI's claims regarding alleged test year violations are without merit.

6. Rider VBA does not Result in Unlawful Rate Discrimination

GCI claim that the application of VBA to two classes of residential ratepayers violates the Act's prohibition against unlawful rate discrimination. There is no unlawful discrimination as that term is understood under the Act. Section 9-241 of the Act provides, in part, that:

No public utility shall, as to rates or other charges, services, facilities or in other respect, make or grant any preference or advantage to any corporation or person or subject any corporation or person to any prejudice or disadvantage. No public utility shall establish or maintain any *unreasonable* difference as to rates or other charges, services, facilities, or in any other respect, either as between localities or as between classes of service.

* * *

Any public utility, with the consent and approval of the Commission, may as a basis for the determination of the charges made by it classify its service according to the amount used, the time when used, the purpose for which used, and *other relevant factors*.

220 ILCS 5/9-241 (emphasis added).

In general, the test to be applied in determining whether there has been a violation of the discrimination provisions of the Act is whether the difference is

reasonable and not arbitrary. *Citizens Utilities Company v. Illinois Commerce Commission*, 50 Ill. 2d 35 (1971).

As the Commission observed, it is Rate 1 and 2 (residential) customers who will benefit under energy efficiency measures and also these customers that have the best opportunity to conserve (Order p. 148; R. Vol. 86, C20777). It is not discrimination per se, but unreasonable discrimination that must be established, a burden GCI has failed to carry. 220 ILCS 5/10-201(d).

B. The Commission Properly Reduced the Utilities' Cost of Equity By Ten (10) Basis Points

As an alternative proposal, GCI (Br. at 38-40) suggest that 60 basis points be removed from the cost of common equity because of the existence of Rider VBA. The Commission determined that a 10-basis point adjustment was appropriate. *See* Section III.B. of this Brief, pp. 37-39, which contains the Commission's response to the Utilities' reciprocal claim that no adjustment to the cost of common equity for Rider VBA should have been made. The Commission's authority to exercise a sound business judgment on the amount of the adjustment cannot be questioned. *City of Alton v. Illinois Commerce Commission*, 19 Ill. 2d 76, 82 (1960) [Commission chose a 25% depreciation rate, where witnesses recommended either 15% or 26%]; *People ex rel. Hartigan v. Illinois Commerce Commission*, 202 Ill. App. 3d 917, 951-953 (1st Dist., 1980) [Commission adjusted the auditors' calculation while rejecting the calculations of the auditors, Commission staff, the Attorney General and the Joint Intervenors]; and *Institute of Shortening and Edible Oils Inc. v. Illinois Commerce Commission*, 45 Ill. App. 3d 98, 100-1 and 104 (4th Dist., 1977) [Commission sustained against a "no

Gen No. 1-08-2055

**IN THE APPELLATE COURT OF ILLINOIS
FOR THE FIRST JUDICIAL DISTRICT**

NORTH SHORE GAS COMPANY AND THE)	Gen. No. 1-08-2055
PEOPLES GAS LIGHT AND COKE COMPANY,)	
)	Consolidated Cases
Petitioners-Appellants,)	1-08-2055, 1-08-2056,
)	1-08-2189, 1-08-2304,
v.)	1-08-2451, 1-08-2452,
)	and 1-08-2453
THE ILLINOIS COMMERCE)	
COMMISSION, et al.,)	Appeals from Orders
)	of the Illinois Commerce
Respondents-Appellees.)	Commission in its
)	Docket Nos. 07-0241 /
[Complete List of Parties on Inside Cover])	07-0242 Consolidated

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**BRIEF AS RESPONDENTS-APPELLEES OF
PETITIONERS-APPELLANTS NORTH SHORE GAS COMPANY
AND THE PEOPLES GAS LIGHT AND COKE COMPANY**

John P. Ratnaswamy
Christopher W. Zibart
Foley & Lardner LLP
321 North Clark Street, Suit 2800
Chicago, Illinois 60654
(312) 832-4500

Mary Klyasheff, Senior Counsel
Integrays Energy Group, Inc.
130 East Randolph Drive
Chicago, Illinois 60601
(312) 240-4470

Bradley D. Jackson
Foley & Lardner LLP
150 East Gilman Street, Verex Plaza
Madison, Wisconsin 53703
(608) 258-4262

Emmitt C. House
Timothy W. Wright III
Gonzales, Saggio and Harlan, L.L.C.
35 East Wacker Drive, Suite 500
Chicago, Illinois 60601
(312) 638-0012

**Counsel for Petitioners-Appellants North Shore Gas Company
and The Peoples Gas Light and Coke Company**

April 10, 2009

ORAL ARGUMENT REQUESTED

the ICC's rejection of their attempts to reduce the Utilities' rate bases by increasing their depreciation reserves, also is incomplete and inaccurate. The facts and the law on the GC Petitioners' two issues are discussed in Sections I and II of the Statement of Facts and Sections II and III of the Argument, below.

Multiut's formulation of its Issue Presented for Review (Multiut Brf. Applnt., p. 3), like its "Nature of the Appeal" section, incorrectly characterizes the ICC, as to certain Rider FST issues, as having approved a non-unanimous settlement not supported by evidence in the record. The facts and the law on this subject are discussed in Section III of the Statement of Facts and Section IV of the Argument, below.

STATEMENT OF FACTS

The facts asserted in the opening briefs of the GC Petitioners and Multiut are incomplete or inaccurate in several important respects. Accordingly, the Utilities set forth here certain facts established by the record. The facts also are discussed further in Sections II, III, and IV of the Argument, below.

I. FACTS RELATING TO THE ICC'S ESTABLISHMENT OF RIDER VBA

The proceedings below were natural gas utility "rate cases" (requests for general rate increases), which means, in brief, that they involved setting rates for distribution and customer service and establishing other terms and conditions of service. *See, e.g., R. Vol. 19, C-04230; R. Vol. 23, C-05143 – C-05144; R. Vol. 24, C-05198 – C-05200.* Charges for the supply of gas, for customers that purchase gas from the Utilities, are set outside of rate cases, as provided in 220 ILCS 5/9-220. *See also* 83 Ill. Admin. Code Part 525.

The Utilities' costs of providing distribution and customer service are almost entirely fixed costs. A-000164 (95% for Peoples Gas and 99% for North Shore) (citing

evidence in the record). The Utilities' charges for distribution service generally are "volumetric", however, *i.e.*, they are based on the volume of gas distributed to the customer. *See, e.g.*, R. Vol. 24, C-05198 – C-05200.

Rider VBA requires the Utilities to compute monthly adjustments to reconcile collections of the distribution service costs recovered through distribution charges of certain customer classes as approved by the ICC in the Order.⁴ The operation of Rider VBA can result in either a credit or charge adjustment to the bills of the applicable customer classes. The adjustments increase or decrease collections from customers so that the amount collected through the applicable rates matches the specified amount of margin revenues (*i.e.*, costs) per customer approved for recovery through those rates by the ICC in the Order. Rider VBA incorporates an adjustment mechanism which, in effect, provides a credit when the utility "overcollects" the applicable costs in the ICC-approved revenue requirement and a charge when the utility "undercollects" those costs. Rider VBA is therefore nothing more than a means of enabling the Utilities to fully recover their ICC-approved revenue requirement, no more and no less.⁵ The foregoing description of Rider VBA and its mechanics is supported by detailed evidence in the record. *E.g.*, R. Vol. 62, C-14880; R. Vol. 62, C-14825 – C-14826. As noted,

⁴ These distribution service costs are part of the base rate costs of service or "revenue requirement" (also sometimes referred to as the "margin revenues") approved for each of the Utilities in the Order. Revenue requirements of gas utilities include their distribution and customer services costs but not their gas supply costs, as indicated above. The GC Petitioners suggest that the term margin revenues is a novel term (GC Brf. Applnt., p. 7, fn. 2), but the term, when used generally by the Utilities, is simply another term for the revenue requirement. *E.g.*, R. Vol. 22, C-04748; R. Vol. 55, C-13043.

⁵ A public utility is entitled under long-established federal and Illinois constitutional law and Illinois ratemaking law to rates that allow it the opportunity to recover fully its revenue requirement. NS-PGL Brf. Applnt., pp. 18, 21-22.

above, the Utilities filed a pending motion requesting judicial notice that Rider VBA, to date, has resulted in net credits of approximately \$12 million to customers.

The Utilities introduced evidence, which was largely un rebutted, that detailed the new business challenges facing the Utilities and why a rate mechanism like Rider VBA is justified.⁶ The challenges include: (1) weather trending warmer; (2) continued reductions in natural gas usage per customer that accompany warmer weather, the greater emphasis on energy efficiency and conservation measures, and higher natural gas prices; (3) a volatile natural gas price environment; (4) increased costs of doing business in an environment of rising costs that affects the Utilities' operating expenses and capital expenditures; and (5) a need to balance the recovery of the Utilities' mostly fixed costs and customers' desire for low and stable bills. R. Vol. 62, C-14764; R. Vol. 62, C-14730; R Vol. 22, C-04739 – C-04740; R. Vol. 5, C-00871 – C-00872. "Each of the [five major] challenges [discussed above] negatively impacts the [Utilities'] ability to earn [their] approved margin revenues, i.e., [their] cost of service exclusive of purchased gas and flow-through items." R. Vol. 62, C-14764; R. Vol. 62, C-14730. The decline in the Utilities' recovery of margin revenues since 2003 is uncontested, *see, e.g.*, R. Vol. 50, C-11727 – C-11729; R. Vol. 50, C-11787 – C-11789, although certain intervenors presented confused testimony on the subject, as the Utilities' witness explained, *id.*

There is extensive evidence in the record that demonstrates that the above described business conditions present considerable challenges to the Utilities' ability to

⁶ The GC Petitioners claim the Utilities did not prove Rider VBA's "extraordinary relief was needed, and therefore reasonable." GC Brf. Applnt., p. 35. There is no explanation why Rider VBA is "extraordinary relief," or why the reasons shown by the Utilities to justify Rider VBA are unreasonable. In any event, the "extraordinary relief" characterization is not a basis to disturb the ICC's findings and decision.

achieve reasonable financial performance and stability. *See, e.g.*, R. Vol. 22, C-04735, C-04739 – C-04740; R. Vol. 5, C-00868, C-00871 – C-00872. The evidence establishes that continued declines in usage per customer have been experienced. *See, e.g.*, R. Vol. 19, C-04262 (residential customers); R. Vol. 19, C-04263 (General Service customers); R. Vol. 1, C-00176 (residential customers). Indeed, the record shows that those business challenges have introduced elements of considerable and recurring variability, unpredictability, and uncontrollability to the Utilities' costs of delivery service and the gas usage factors used to set their base rates to recover such costs. *See, e.g.*, R. Vol. 22, C-04741; R. Vol. 5, C-00873.

The evidence demonstrates that Rider VBA also would effectively address important policy interests by enhancing the promotion of energy conservation and efficiency through the “decoupling” feature, which removes the effects of weather and customer usage from the determination of how much of the utility's revenue requirement is recovered. The Utilities, under that structure, have no incentive to sell any particular level of gas, because the revenue requirement is met with less emphasis on the amount of gas sold or transported, and no disincentive to promote energy conservation and efficiency programs. *See, e.g.*, R. Vol. 22, C-04756; R. Vol. 5, C-00868, C-00887.

The record shows that under Rider VBA, when usage (the amount of gas distributed) differs from design levels, the Utilities would recover no more and no less than the applicable portion of the revenue requirement allocated to volumetric charges, as noted above. For example, when weather is colder than the average weather on which rates were set, customers would typically pay less than they would otherwise pay without Rider VBA for the Utilities' fixed costs of delivery service and the Utilities would not

over-recover volumetric margin revenues. Conversely, when weather is warmer than the weather on which rates have been set, customers typically would pay slightly more than they would otherwise pay without Rider VBA and the Utilities would not under-recover volumetric margin revenues. Finally, the record shows that Rider VBA is an effective ratemaking method to address cost recovery volatility and would enable the Utilities to promote energy conservation and efficiency programs without the continual threat of cost recovery losses due to declining gas sales per customer. *E.g.*, R. Vol. 50, C-11764.

II. FACTS RELATING TO THE ICC’S REJECTION OF THE AG’S AND CUB’S ATTEMPT TO REDUCE THE UTILITIES’ RATE BASES BY INCREASING THEIR DEPRECIATION RESERVES

A. The “Test Year”, the “Revenue Requirement”, and “Pro Forma” Adjustments

Under the ICC’s rules, a public utility that files a rate case may use either an historical “test year” or a future “test year”. 83 Ill. Adm. Code § 287.20. The test year, under either approach, is a 12 month period that is used as the foundation of the calculation of the utility’s revenue requirement (costs of service), but, if an historical test year is used, then the test year data is subject to “*pro forma* adjustments”, as discussed below. 83 Ill. Adm. Code §§ 287.20, 287.40; see also 83 Ill. Admin. Code Part 285.

The utility’s revenue requirement consists of: (1) the utility’s operating expenses plus (2) a reasonable rate of return of and on its capital investments. *E.g.*, *Commonwealth Edison Co. v. Illinois Commerce Comm’n*, 322 Ill. App. 3d 846, 849, 751 N.E.2d 196, 199 (2d Dist. 2001). The capital investments to which the rate of return is applied are referred to as the utility’s “rate base”. *E.g.*, *id.*

Second, the GC Petitioners again cite Section 9-201(c) for the point that the ICC must establish rates that are just and reasonable, but again fail to note that the rates must be just and reasonable not only to customers, but also to the utility and its stockholders. *BPI II*, 146 Ill. 2d at 208, 585 N.E.2d at 1045; 220 ILCS 5/9-201(c).

Third, the GC Petitioners cite Section 1-102 of the Act, 220 ILCS 5/1-102. While the cite is accurate, they fail to note that Section 1-102 is part of the findings of the Act and is not an operative provision of the Act. *E.g., Monarch Gas Co. v. Illinois Commerce Comm'n*, 261 Ill. App. 3d 94, 99, 633 N.E.2d 1260, 1264-1265 (5th Dist. 1994).

Finally, the GC Petitioners mischaracterize the ICC as having “approved (1) a novel revenue guarantee mechanism and (2) rate bases inflated by one-sided post-test year adjustments”, imposing “rates that harm almost a million customers in and around Chicago”. Those assertions are shown to be incorrect in Sections II and III of this Argument section, below. They are particularly problematic when the GC Petitioners attack the ICC’s establishment of Rider VBA. The Utilities have asked the Court to take judicial notice that the credits to customers under the rider, to date, has resulted in net credits of approximately \$12 million to the customers covered by the rider.

II. APPROVAL OF RIDER VBA IS WELL WITHIN THE AUTHORITY OF THE ICC

It is well settled that the ICC has broad authority to set utility rates. *Bus. and Prof. People for the Pub. Interest v. Illinois Commerce Comm'n*, 136 Ill. 2d 192, 204, 555 N.E.2d 693, 698 (1989) (“*BPI I*”). The ICC has wide discretion in its ratemaking.

[T]he power of the Commission is not limited to the mere charge of a particular rate..., but it has the power to change under certain conditions, any part of a filed schedule, rate, rule or regulation that in any manner affects the rates charged or to be charged.

City of Chicago v. Illinois Commerce Comm’n, 13 Ill. 2d 607, 611-613, 150 N.E.2d 776, 779 (1958) (“*City of Chicago*”). That authority includes the ability to employ riders in appropriate circumstances. *See generally*, *Citizens Util. Bd. v. Illinois Commerce Comm’n*, 166 Ill. 2d 111, 651 N.E.2d 1089 (1995) (“*CUB*”); *City of Chicago*.

The ICC’s revenue requirement determinations are guided by a formula that has been approved by the courts, i.e., the formula discussed in Section II(A) of the Statement of Facts, *supra*. *See also* NS-PGL Brf. Applnt., pp. 18, 21-22; *A. Finkl & Sons Co. v. Illinois Commerce Comm’n*, 250 Ill.App.3d 317, 324-325, 620 N.E.2d 1141, 1146-1147 (1st Dist. 1993) (citing *Citizens Utilities Co. v. Illinois Commerce Comm’n* 124 Ill. 2d 195, 200-201, 529 N.E.2d 510, 512-513 (1988) (“*Citizens Utilities*”).

The ICC determined the revenue requirement by applying this well-accepted formula. *E.g.*, A-000048 – A000049, A000081 – A000083, A-000111, A000327 – A000328. Rider VBA is nothing more than a mechanism that permits the Utilities to recover the applicable portions of the very revenue requirements that the ICC determined to be appropriate in the Order. Rider VBA is specifically designed to permit full recovery of those ICC-approved costs by means of an adjustment mechanism that ensures that the specific amount of the revenue requirement approved by the ICC to be recovered through Rider VBA is recovered, no more and no less. Full recovery of the revenue requirement is not prohibited under Illinois law and the GC Petitioners can cite no authority to the contrary. A public utility has a right to rates that allow it to recover fully recover its costs of service. NS-PGL Brf. Applnt., pp. 18, 21-22; *see also* fn. 4, 5, *supra*.

It is indisputable that the only costs recovered under Rider VBA are the portions of the Utilities’ revenue requirements to be recovered through the distribution charges to

certain customer classes. As such, these costs are properly and lawfully recovered in the rates established by the ICC. This basic and dispositive fact has not been challenged by the GC Petitioners. Thus, Rider VBA is an appropriate and lawful exercise of the ICC's authority. The GC Petitioners have only raised vague or indirect allegations that the mechanics of the operation of Rider VBA are unlawful or otherwise unreasonable.

The GC Petitioners claim that Rider VBA is not a "traditional" rider mechanism because of characteristics the Rider has and does not have:

It does not facilitate the direct recovery of a unique cost. (C10525). Instead, it facilitates guaranteed revenue recovery for the Utilities. It does have a direct impact on the rate of return; that is what it was designed by the utilities to achieve. Moreover, Rider VBA does not alleviate a burden imposed by unexpected, volatile or fluctuating expenses. (C10524).

GC Brf. Applnt., p. 26. While the significance of that claim is unclear, it does not assert a basis for finding Rider VBA to be unlawful, nor does it establish that the ICC acted arbitrarily in adopting Rider VBA nor show that Rider VBA is inconsistent with the ICC's clear authority to employ riders under *City of Chicago* and later cases. *See, e.g., City of Chicago v. Illinois Commerce Comm'n*, 264 Ill. App. 3d 403, 636 N.E.2d 704 (1st Dist. 1993) (affirming an ICC order that approved with modification, a rider for recovery of the marginal cost of providing non-standard service); *Central Illinois Light Co. v. Illinois Commerce Comm'n*, 255 Ill. App. 3d 876, 626 N.E.2d 728 (3rd Dist. 1993) (finding no abuse of discretion in the ICC's ordering of coal tar remediation cost recovery through a rider mechanism), *aff'd in relevant part by CUB*; *City of Chicago v. Illinois Commerce Comm'n*, 281 Ill. App. 3d 617, 169 N.E.2d 1212 (1st Dist. 1996) (upholding the ICC's order for rider recovery utility franchise costs); *Illinois Power Co. v. Illinois Commerce Comm'n*, 339 Ill. App. 3d 425, 790 N.E.2d 377 (5th Dist. 2003) (recognizing that the ICC sets rates in two ways, by base rates or by an automatic cost recovery mechanism). As the above cited cases

demonstrate, riders have been employed in a variety of circumstances. There is simply no concept of a “traditional” rider, as suggested by the GC Petitioners.

The ICC’s Order thoroughly establishes the propriety of the ICC’s authority to employ riders in general, A-000149 - A000-151, and Rider VBA, in particular,¹¹ A-000151 - A000164. The Order sets forth a thorough and detailed analysis of the ICC’s rider authority. Absent showing that this analysis is unlawful, GC Petitioners’ characterizations are hollow and unavailing. The GC Petitioners have not offered any clear or cogent arguments why the approval of Rider VBA is unlawful.

A. The GC Petitioners Have Not Met Their Burden of Proof

The GC Petitioners have not met their burden of proving that Rider VBA is unjust and unreasonable as a matter of law or that it is not supported by substantial evidence. The GC Petitioners have merely asserted that Rider VBA violates longstanding rate principles and pointed to selective principles of ratemaking to support the assertions. The GC Petitioners argue that Rider VBA is not just and reasonable by citing various principles of utility ratemaking without explaining how Rider VBA violates those principles or how those principles apply to Rider VBA. *See* GC Brf. Applnt., pp. 22-24.

The GC Petitioners argue that the Utilities have not proven that Rider VBA is “necessary,” by pointing to arguments in the record that have been explicitly or implicitly¹² rejected by the ICC. For example, they cite assertions by Staff and the GC

¹¹ In numerous instances (GC Brf. Applnt, pp. 8-10, 21, 23, 25, and 35), the GC Petitioners mention ICC Staff’s pre-Order opposition to Rider VBA and arguments. Obviously, the ICC’s Order represents the final findings and conclusions of the ICC.

¹² In several instances, e.g., GC Brf. Applnt., pp. 12-13, 29, the GC Petitioners imply that the revenue from additional or new customers are improperly treated under

Petitioners' witnesses concerning the Utilities' margin revenues and financial condition, per customer versus overall margin distinctions, and the effect of Rider VBA on customer and stockholder interests, GC Brf. Applnt., pp. 35-37, as proof that Rider VBA is not needed.¹³ The ICC rejected the evidence to which they point when it concluded:

The record in this case persuades the ICC that Rider VBA is appropriate as it reflects the particulars of declining and variable customer usage patterns and the concomitant revenue recovery impacts for Peoples Gas and North Shore. In our view, this evidence of usage patterns and margin recovery fluctuations calls for a regulatory response. This, we note, is not a novel idea.

A-000161. The ICC goes on to analyze in detail why Rider VBA is reasonable in view of the evidence of record and sound policy considerations. A000161 - A000164.

Indeed, the Order carefully and thoroughly recites the evidence of record both in support of Rider VBA and in opposition to it. A-000137 – A000149. In approving Rider VBA, the ICC rejected the evidence and arguments in opposition to Rider VBA and based its decision on the considerable amount of evidence it cited in support of Rider VBA. The GC Petitioners have offered no analysis as to how the ICC's analysis is either not supported by substantial evidence or is against the manifest weight of the evidence. They have instead merely repeated their arguments below that were rejected by the ICC in its extensive and reasoned analysis. Thus, the GC Petitioners have utterly

Rider VBA. The Utilities submitted evidence that showed that customer growth should not factor into the consideration of Rider VBA. R. Vol. 50, C-11730 – C-11733 Customer growth is accompanied by the costs of serving that growth. *Id.*, C-11731.

¹³ The GC Petitioners also cite the November 26, 2007, ALJ Proposed Order ("ALJPO") as supportive of their position on this issue. GC Brf. Applnt., pp. 21, 25. The ALJPO later was modified by the ALJ's in a Post Exceptions Proposed Order that rejects the very propositions that the GC Petitioners cite from the ALJPO. R. Vol. 81, C-19665.

failed to meet their burden of proving that the ICC's approval of Rider VBA is not supported by substantial evidence or against the manifest weight of the evidence.

As earlier noted, the main focus of the GC Petitioners' argument that Rider VBA is unjust and unreasonable seems to be on the Utilities' ability to collect fully the applicable portions of their revenue requirements through the adjustment feature of the Rider. GC Brf. Applnt., p. 26. This point alone, however, does not render Rider VBA unlawful nor otherwise the burden of proof required in order to reverse the ICC's approval of Rider VBA. There is simply no legal basis for finding that the ICC acted unlawfully in employing Rider VBA and its adjustment feature in the Utilities' rates. While it is urged that the ability to collect fully the applicable portions of the Utilities' revenue requirements through Rider VBA "is an unprecedented regulatory objective, the wrong legal standard, and constitutes reversible error" (GC Brf. Applnt., p. 24), neither the Act nor the case law cited by GC Petitioners supports this conclusion. 220 ILCS 5/9-201 does not in any way limit the ICC's discretion to employ a particular rate design mechanism or otherwise limit the ICC's ability to establish any particular methodology for the collection of a utility's revenue requirement. Likewise, there is nothing in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) ("*Hope*"), or *BPI II* that limits or otherwise prescribes how the ICC must make rate design decisions or handle the collection of revenue requirements in rates.

As the GC Petitioners correctly note, there is no provision in the Act that expressly authorizes a decoupling mechanism such as Rider VBA. See GC Brf. Applnt., p. 25. Indeed, the Act does not prescribe a decoupling approach or any other particular rate design mechanism to be applied by the ICC. Rather, the "legislature has vested in

the Commission the ratemaking function which ‘involves the making of pragmatic adjustments’”, *City of Chicago*, 13 Ill. 2d at 618-619, 150 N.E.2d at 782, citing *Hope*, 320 U.S. at 602; *Federal Power Comm’n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942). It simply cannot plausibly be argued that the Act or the courts limit the ICC’s authority to establish a rate such as Rider VBA in the appropriate circumstances, and the GC Petitioners have not set forth any credible arguments as to how the ICC acted improperly or otherwise exceeded its authority.

In deciding to authorize Rider VBA, the ICC exercised its authority under the Act by utilizing the revenue requirement formula and applying a pragmatic adjustment (the monthly adjustment mechanism) to rates in order to allow the Utilities to collect the applicable portion of their revenue requirements.¹⁴ This is precisely the scheme contemplated by the Act, and the exercise of ICC discretion to provide for such cost recovery has been approved by the Supreme Court in *City of Chicago* and *CUB*. The Act does not prescribe a specific rate design methodology, volumetric or otherwise, as suggested in the GC Petitioners’ brief at pp. 24-25, that the ICC must apply at any time or all of the time. Rate design decision-making at such a granular level has never been dictated by the legislature or the courts. The exercise of such expertise and discretion rests with the ICC and involves analysis that the ICC is uniquely qualified to make. As this Court affirmed in *Bus. and Prof. People for the Pub. Interest v. Illinois Commerce Comm’n*, 171 Ill. App. 3d 948, 957, 525 N.E.2d 1053, 1057-1058 (1st Dist. 1988):

Moreover, it is well-established that decisions of the Illinois Commerce Commission are entitled to great deference because they are judgments of a

¹⁴ The two-month lag in the application of the adjustment is merely another pragmatic adjustment that the ICC approved. R. Vol. 23, C-05186.

tribunal appointed by law and informed by experience. (*Village of Apple River v. Illinois Commerce Comm'n* (1960), 18 Ill. 2d 518, 165 N.E.2d 329.) And, such deference is especially appropriate in the area of fixing rates. *Iowa-Illinois Gas & Electric Co. v. Illinois Commerce Comm'n* (1960), 19 Ill. 2d 436, 167 N.E.2d 414.

The monthly adjustment feature results in either a credit or a charge against the rate (derived from the revenue requirement) determined by the ICC. The adjustment is symmetrical because it adjusts upward and downward in accordance with a specific ICC-established formula. This mechanism fairly balances the interests of consumers and investors.¹⁵ These considerations certainly present a sufficient basis on which the ICC could determine that the Rider VBA adjustment feature is just and reasonable. The GC Petitioners' arguments amount to little more than a disagreement over the ICC's findings of facts. There is no ground to change the ICC's findings based on that disagreement.

**B. Rider VBA is Consistent With
Established Principles of Ratemaking**

**1. Rider VBA Does Not Violate
Proscriptions Against Single Issue Ratemaking**

Rider VBA creates no single issue ratemaking concern. Contrary to the assertions in the GC Petitioners' brief at pp. 28, 29, Rider VBA makes no changes to any component of the revenue requirement, and there is no separate recovery of selected elements of the revenue formula. The adjustments do not enable the Utilities to change

¹⁵ While the GC Petitioners point to the hypothetical effect of Rider VBA had it been in effect during certain past years, such evidence is theoretical and not useful because it does not necessarily reflect current or future conditions. *E.g.*, R. Vol. 50, C-11724, C-11726 – C-11731. More relevant comparisons, for example, would be the actual effect of Rider VBA over the past year in which it has been in effect (*see* the Utilities' motion for judicial notice) or the months immediately before that. *See* Affidavit of Valerie H. Grace dated March 21, 2008 (R. Vol. 87, C-21174 – C-21205), which sets forth data concerning the effect of Rider VBA had it been in effect during the period December 2007 through February 2008, the winter period just prior to its effectiveness.

the amounts of the revenues (costs) the Order allows them to collect through the volumetric charges involved in Rider VBA. Rider VBA is merely a mechanism that allows them to actually collect the amounts the ICC established, no more and no less.

Finkl does not bear upon any single issue ratemaking concerns that pertain to Rider VBA. *Finkl* turned on the ICC's isolation of one element of operating expenses (demand side management costs) for recovery without considering the totality of the revenue requirement. In the instant case, the ICC evaluated the totality of the Utilities' revenue requirements. The Rider VBA adjustment is simply a mathematical means of limiting the Utilities' recovery to the costs approved for recovery in Rider VBA, giving rise to no single issue ratemaking issues.

The GC Petitioners infer that the attempt to collect "lost revenues" raises single issue ratemaking concerns prohibited in *Finkl*. First, the Rider VBA adjustment does not collect any lost revenues, but is simply a credit or charge to collect approved revenues (based on proven costs of service). Second, while the *Finkl* case rejected the particular rider at issue there, the fact that the rider in question would recover revenues was neither argued nor decided. *Finkl* involved a proposal by Commonwealth Edison ("ComEd") (made outside of a rate case, and thus without the establishment of a revenue requirement) to recover lost revenues pertaining to a demand-side management program in a proposed Rider 22. The Court rejected Rider 22 because it found that the costs associated with the lost revenues were not "unexpected, volatile or fluctuating expenses which Edison cannot control" *Finkl*, 250 Ill. App. 3d at 327, 620 N.E.2d at 1148. Thus, there was no rejection of Rider 22 in *Finkl* because it involved "revenues". Indeed, the *Finkl* Court did not seem concerned at all that Rider 22 involved lost revenues as the

Court mentions this feature numerous times in the decision without criticizing or rejecting that aspect of Rider 22. Rather, the Court focused on the incremental expenses associated with the demand-side management program and not the lost revenue aspect of Rider 22 and this interpretation has been articulated subsequent to the *Finkl* decision. *CILCO*, 255 Ill. App. 3d 876, 884-888, 626 N.E.2d 728, 734 (3rd Dist. 1993) (“In *Finkl* ... the Court ... found that demand-side management expenses were not of such a nature as to require rider treatment....”). In sum, Rider VBA simply does not present any single issue ratemaking issues.

2. Rider VBA Does Not Constitute Retroactive Ratemaking

There is no retroactive ratemaking under Rider VBA, as the ICC thoroughly discussed in the Order. A-000153 - A000156. Contrary to the claims of GC Petitioners, Rider VBA does not allow the Utilities to impose a “surcharge” when gas usage is low and refund when gas usage is high. (Rider VBA is not a credit or charge for gas at all.) Rider VBA uses amounts established by the Order -- margin revenues (costs) for distribution service based on an established number of customers -- and computes an adjustment based on those approved amounts. The Rider VBA adjustments are merely the application of a mathematical formula, using factors established by the Order, that ensures that collection is limited to the amounts fixed by the ICC. This is nothing more than a pragmatic adjustment to rates as contemplated and approved in *City of Chicago*.

The GC Petitioners suggest that the two month lag in the adjustment and the annual reconciliation features of Rider VBA constitute retroactive ratemaking. These procedures, however, constitute nothing more than additional practical adjustments the

ICC has the power to approve. The lag simply reflects that data needs to be compiled and applied through the formula set by the ICC. *See, e.g.*, R. Vol. 23, C-05186.

The GC Petitioners have not shown and cannot show that the monthly adjustments allowed under Rider VBA or the two month lag change the rate (or revenue requirement) that the ICC approved in the Order. Having failed to do so, they can not make a valid claim that Rider VBA constitutes retroactive ratemaking. The discussion in *CILCO*, 255 Ill. App. 3d at 885, 626 N.E. 2d at 735, makes it clear that the ICC may establish an appropriate rider without violating the rule regarding retroactive ratemaking.

3. Rider VBA Does Not Violate Test Year Rules

GC Petitioners argue that Rider VBA violates the ICC's test year proscriptions, citing *BPI I*. GC Petitioners reason that because Rider VBA selects only the applicable portions of the revenue requirements (distribution costs for serving the applicable customer classes), tracks changes in the recovery of that component, and assesses rate adjustments to recognize those changes, test year principles are violated. GC Brf. Applnt., p. 33. That analysis misapprehends the test year doctrine as discussed in *BPI I* and elucidated in *CUB*. The mismatch which is the focus of the test year doctrine is utilizing data from different years to make rate decisions when there is not a valid reason to do so. *See BPI I*, 136 Ill. 2d at 219, 555 N.E.2d at 705. There is no requirement that all elements of a utility's expenses and revenues for a given test period must be frozen in a rate that can never be changed or modified to comply with test year rules. Such an extreme interpretation of test year rules would prevent a utility's rates from ever changing, even under a rider. Such an interpretation has clearly been rejected in view of

the Supreme Court's finding that test year proscriptions are not violated by rider adjustments. *See CUB*, 166 Ill. 2d at 139-140, 651 N.E.2d at 1103.

C. There Is Substantial Evidence to Support the ICC's Rider VBA Decision

The Utilities have amply demonstrated the need for Rider VBA, as set forth in detail in Section I of the Statement of Facts, *supra*, and the Order details the facts that were established in the record, A-000137 - A000149. The Utilities presented considerable evidence that changing customer usage patterns and variability caused by weather and other factors have created circumstances in which the Utilities may "under-recover" or "over-recover" their ICC-approved margin revenues from month-to-month or on an annual basis. The record is rife with testimony and other evidence that the Utilities have experienced persistent revenue (cost recovery) shortfalls and that climate and usage conditions impair their ability to fully recover approved revenues under previous ratemaking approaches and that those same factors could also cause customers to pay more than the approved revenue level. *See, e.g.*, R. Vol. 22, C-04741; R. Vol. 5, C-00873; R. Vol. 50, C-11764. *See also* R. Vol. 19, C-04262, and R. Vol. 19, C-04263.

As noted earlier, the unchallenged evidence of record is that, due to warming weather and customer conservation, margin revenues and usage per customer have been and continue to be in decline and that the traditional assumptions of stability no longer exist. No evidence was submitted that rebuts the proof that the Utilities have been increasingly unable to fully recover margin revenues (costs of service) since 2003. The Utilities met their burden of proof by sufficiently demonstrating their inability to reasonably recover margin revenues in today's environment, and no participant offered

any actual evidence to the contrary.¹⁶ Thus, there is substantial evidence to support the ICC's decision to implement Rider VBA and little to support a different conclusion.

The essence of GC Petitioners' position is that the ICC's "traditional" ratemaking determinations must not in any way be adjusted to address the changing conditions that the Utilities amply demonstrated. Irrespective of the evidence, those parties continue to maintain that the new challenges do not warrant the application of a different ratemaking method, such as the decoupling that underlies Rider VBA. The Utilities have presented the issue squarely to the ICC and after a full and fair consideration, the ICC thoughtfully and carefully evaluated Rider VBA and arrived at a just and reasonable decision based on the specific evidence presented, as well as the most cogent policy considerations. There is no basis upon to lawfully overturn the ICC's decision.

D. Rider VBA Does Not Unreasonably Discriminate

Rider VBA does not unreasonably discriminate against the affected customer classes, as urged by GC Petitioners (GC Brf. Applnt., pp. 34-35). Under the Act, the Utilities may not "unreasonably" discriminate. 220 ILCS 5/9-241; *Citizens Utils. Co. of Illinois v. Illinois Commerce Comm'n*, 50 Ill. 2d 35, 46, 276 N.E.2d 330, 336 (1971) (the Act "prohibits only unreasonable differences [in rates], not differences"). The GC Petitioners note that Rider VBA applies to only two customer classes (residential and General Service customers, the vast majority of customers), but they have not shown that constitutes unreasonable discrimination. They state: "Plainly, increased or decreased gas

¹⁶ Two witnesses disagreed that the Utilities' financial need justified a rate design that focused on margin revenues, GC Brf. Applnt., pp. 35-38, but they offered no actual evidence that the Utilities' margin revenue recoveries were not in decline.

usage due to weather or energy savings efforts applies across the board to all its customers.” GC Brf. Applnt, p. 34. They cite no evidence for that. Nor do they contest the ICC’s finding that “it is Rate 1 and 2 customers who will benefit under energy efficiency measures... and that have the best opportunity to conserve.” A-000159. As the Order notes, those energy efficiency and conservation impacts, and the movement toward greater fixed cost recovery, justify any “discriminatory” impact Rider VBA might have on Rate 1 and 2 customers. It was reasonable for the ICC to find that usage of those customers will be the most impacted by weather and conservation and that such a finding would justify applying Rider VBA only to those classes. The ICC therefore found that there is no unlawful or unreasonable discrimination against Rates 1 and 2 customers. The GC Petitioners have pointed to no evidence that warrants a different conclusion.

E. The ICC’s Reduction of the Utilities’ Allowed Return on Equity to Reflect the Approval of Rider VBA Should Be Reversed

The GC Petitioners claim that the ICC’s 10-basis point reduction to the Utilities’ allowed return on equity should be reversed because no witness proposed that specific adjustment. GC Brf. Applnt., p. 40. Staff’s witness opined that Rider VBA would reduce the Utilities’ “operating” risk, but did not calculate a specific adjustment. R. Vol. 45, C-10437. CUB’s witness Christopher Thomas agreed, and proposed a reduction of 60-plus basis points for each utility. His adjustments were based on an analysis of weather insurance purchased in the past by the Utilities’ corporate parent (not the Utilities, as the GC Petitioners assert). GC Brf. Applnt., pp. 39-40; *see* A-000087.

The Utilities agree with the GC Petitioners that the ICC’s 10-basis point adjustment should be reversed, but for different reasons. *See* NS-PGL Brf. Applnt.,

Gen. No. 2-11-0380

IN THE APPELLATE COURT OF ILLINOIS
FOR THE SECOND JUDICIAL DISTRICT

NORTH SHORE GAS COMPANY AND	)	Gen. No. 2-11-0380
THE PEOPLES GAS LIGHT AND)	
COKE COMPANY,)	
)	
Petitioners-Appellants,)	
)	
v.)	
)	
THE ILLINOIS COMMERCE	)	Appeals from Orders
COMMISSION, et al.,	)	of the Illinois Commerce
	)	Commission in its
Respondents-Appellees.	)	Docket Nos. 07-0241 /
	)	07-0242 Consolidated

**SUPPLEMENTAL BRIEF OF
NORTH SHORE GAS COMPANY AND
THE PEOPLES GAS LIGHT AND COKE COMPANY**

Petitioners-Appellants and Respondent-Appellees, North Shore Gas Company and The Peoples Gas Light and Coke Company (together, the “Utilities”), by and through their counsel, submit this Supplemental Brief regarding the applicability of *Commonwealth Edison Co., v. ICC*, 405 Ill.App.3d 389 (2010) (“*Rider SMP Decision*”) and *People ex rel Madigan v. ICC*, 2011 IL App (1st) 100,654 (“*Rider ICR Decision*”) (together, the “Decisions”) to the Rider-Volume Balancing Adjustment (“Rider VBA”) issues in the instant appeal.

DISCUSSION

These consolidated appeals are appeals from a Final Order (“Final Order”) (Joint Appendix of Petitioners-Appellants at A-000001 – A-000331, A-000565 – A-000593; C-20619 – C-20818, C-20819 – C-20965) of the Commission in the Utilities’ 2007 rate cases in ICC Docket Nos. 07-0241/07-0242 Cons. The Final Order, among other things, established Rider VBA in the Schedules of Rates of the Utilities. (A-000149 – A-000153). The GC Petitioners’⁶ appeals challenge that portion of the Final Order, pertaining to Rider VBA. As Respondent-Appellee in this case, the Utilities have participated with respect to the issue of whether Rider VBA is lawful⁷.

The *Rider SMP Decision* and the *Rider ICR Decision* involve Appellate Court reviews of two utility riders, the same general broad type of tariff that is the subject of the instant case, *i.e.*, Rider VBA. The Courts in the Decisions determined that the two riders there at issue were unlawful because they violated the regulatory proscription against single issue ratemaking and because none of the exceptions that each Decision identified applied. *Rider SMP Decision*, 405 Ill.App. 3d at 409-416, *Rider ICR Decision*, 2011 Ill. App 100,654 at 2-10. Thus, in the *Rider ICR Decision*, the Court found that the Rider ICR costs were for capital improvements “that are likely to have a direct impact on the Utility’s actual rate of return.” *Rider ICR Decision* at 26-27. Similarly, perhaps because the rider there on appeal imposed no charges at all, the *Rider SMP Decision* emphasized that the type of investment ultimately addressed by the rider could affect the revenue requirement in the long term.

In fact, ComEd proposed Rider SMP precisely because the improvements are expected to reduce other expenses and

⁶ Collectively, the Office of the Attorney General of Illinois (“AG”), the Citizens Utility Board and the City of Chicago.

⁷ The Utilities are Petitioners-Appellants in respect of three other issues in the case, which are the subject of a Motion to Withdraw which was filed on October 7, 2011.

increase income in the long term, which affects the utility's revenue requirement. To allow Rider SMP would be to improperly consider in isolation changes in a particular portion of a utility's revenue requirement. (citations omitted)⁸

In contrast, Rider VBA has no incremental impact on the Utilities' rate of return or revenue requirement, whether in the short- or long-term and thus, by definition, does not constitute single issue ratemaking.⁹ Riders found by the *Rider SMP Decision* and *Rider ICR Decision* to be lawful are those that, like Rider VBA, do not change a utility's rates by affecting the revenue requirement or rate of return

The nature of the particular element being recovered in a specific rider and its effect on the utility's revenues are crucial determinants in analyzing the lawfulness of the rider under the test set forth in the Decisions. An analysis of those factors in respect of Rider VBA demonstrates that Rider VBA is not single issue ratemaking. Indeed, Rider VBA is unlike any rider that has been previously reviewed by the Illinois courts, including those at issue in the *Rider SMP Decision* and the *Rider ICR Decision*. Rider VBA does not even determine a cost. It is essentially a mathematical adjustment to *ensure* that the Utilities neither over-recover nor under-recover their approved revenue requirements, which were approved through the normal rate case method. Hence, Rider VBA can never violate the principal risk that the prohibition against single issue ratemaking is intended to avoid, i.e., "risking understatement or overstatement of the overall revenue requirement." *Rider SMP Decision* 405 Ill.App.3d at 411,

⁸ 405 Ill.App.3d at 415.

⁹ The rider has no impact at all on the revenue requirements. The rider simply trues up the recovery of the portions of the Commission approved revenue requirements that the Commission allocated to the volumetric charges to which the rider applies. The Final Order did direct a 10 basis point reduction in the Utilities' approved rates of return on common equity in recognition of the existence of the rider and its arguable effect on risk. (C-20215-C-20217). The Utilities do not agree that there is any impact on the rate of return nor that there should be any adjustment, but, in any event, the Commission as finder of fact made that adjustment. Thus, the rider has no incremental impact on the rate of return that has already been approved by the Commission.

citing, *Citizens Utility Board v. ICC*, 166 N.E.2d 111, 137, 209 Ill.Dec. 641, 651 N.E.2d 1089 (1995). Indeed, Rider VBA works to prevent the very problem that the Commission intended to prevent by instituting its policy against single issue ratemaking.

By contrast, in the *Rider SMP Decision*, the Court treated the rider at issue as if it were one that could ultimately recover separately the costs of new advanced metering infrastructure investments which would traditionally have been recovered in the utility's base rates. The opinion expresses concern that those same investments could affect ComEd's other costs and thus increase the utility's revenues between rate cases more than a holistic review of ComEd's costs would support. Similarly, in the *Rider ICR Decision*, the utility sought to recover in the rider the costs of certain utility infrastructure that would have been incurred between rate cases. The expenditures for that infrastructure would have been incurred in the future after the utility's revenue requirements had been established by the Commission and the costs recovered under the rider would have been incremental to the revenue requirement previously established by the Commission. Rider ICR isolated those costs and removed them from base rates.

Rider VBA, however, isolates no cost and poses no analogous risks. Rider VBA does not change the costs of the utility, in whole or in part, in the short-term or the long term. Rider VBA is little more than a mathematical formula which ensures that actual collections of the Utilities match the total revenue requirement established by the Commission with respect to the charges to which the rider applies. No category of costs are carved out or recovered in a special rate. Rider VBA has more of a rate design impact, rather than a cost recovery impact. As such, there is no way that Rider VBA can recover the costs of any additional expenditures or other costs of the Utilities that have not already been included in the revenue requirements established by the

Commission. Simply put, Rider VBA is revenue neutral and has no effect on the Utilities' aggregate costs.

In addition, even if the rationales behind the Decisions applied to Rider VBA, the Rider meets the tests for validity that the Decisions outlined, as discussed in prior briefing with respect to the subject of single issue ratemaking.

Thus, Rider VBA conforms to what this Court has described as "a guiding principle for testing a rider's validity..."¹⁰ This Court has described that test as whether:

- (1) The cost is imposed upon the utility by an external circumstance over which the utility has no control and (2) the cost does not affect the utility's revenue requirements.¹¹

As noted above, Rider VBA's purpose is to enable the Utilities to actually collect the revenue requirements established by the Commission, to protect against external circumstances, such as weather, that could otherwise cause it to over-recover or under-recover their Commission-approved costs. Achieving the goal of matching collections by the Utilities with the exact revenue requirements approved by the Commission is only feasible by application of a rider, a rate adjustment mechanism that has been employed by the Commission for over 50 years.

Moreover, the Court in the *Rider ICR Decision* case indirectly describes why Rider VBA is lawful.

Our supreme court has recognized a rider mechanism: 'merely facilitates direct recovery of a particular cost, without direct impact on the utility's rate of return. The prohibition against single-issue ratemaking requires that, in a general base rate proceeding, the Commission must examine

¹⁰*Rider SMP Decision*, 405 Ill. App.3d at 414.

¹¹ *Id.*

all elements of the revenue requirement formula to determine the interaction and overall impact any change will have on the utility's revenue requirement, including its return on investment.'

Our supreme court has also recognized that the single-issue rules 'does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such treatment.' Because the Commission's has the power to authorize riders in a proper case, such authorization will not be reversed absent an abuse of discretion. (citations omitted.)

Rider VBA has no incremental impact on the Utilities' rate of return and does not effect any change on the Utilities' revenue requirements. Rather, Rider VBA facilitates the precise recovery of the overall revenue requirement, not any particular "single issue" within it, and the overall revenue recovered is no more and no less than the Commission has authorized. The Commission did not therefore abuse its discretion in approving implementation of Rider VBA.

In summary, Rider VBA is a rate adjustment mechanism for which the Commission has exercised appropriate discretion in approving it. Rider VBA has no effect whatsoever on utility expenses or earnings and does not in any way increase or decrease the approved revenue requirements of the Utilities. Rider VBA is necessary to address the unpredictable actual collection of the Utilities' revenue requirements which necessarily occurs because of factors, such as the impact of weather and energy efficiency on usage, factors which are influenced by externalities beyond the control of the Utilities.