

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTHERN ILLINOIS GAS COMPANY)	
d/b/a NICOR GAS COMPANY)	
)	
Petition Pursuant to Rider 29 of Schedule of)	Docket No. 10-0567
Rates for Gas Service to Initiate a Proceeding to)	
Determine the Accuracy of the Rider 29)	
Reconciliation Statement)	

**REPLY BRIEF OF
NICOR GAS COMPANY**

February 16, 2012

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Northern Illinois Gas Company d/b/a Nicor Gas Company (“Nicor Gas” or the “Company”) hereby files with the Illinois Commerce Commission (“Commission”) its Reply Brief in accordance with the Administrative Law Judge’s (“ALJ”) established schedule.

I. INTRODUCTION

The Commission approved Nicor Gas’ voluntary pilot Energy Efficiency Plan in the Company’s last rate case, Docket No. 08-0363 (“2008 Rate Case”). Docket No. 08-0363, Order at 156-59 (Mar. 25, 2009 and Oct. 7, 2009, collectively “Rate Case Order”). In this reconciliation proceeding, the Company has calculated that more than \$2 million will be credited to the relevant customer groups under Nicor Gas’ Rider 29 – Energy Efficiency Plan (“EEP”) for the Plan Period at issue. Martino Dir., Nicor Gas Ex. 1.0, 6:124, 7:134. Even though they do not contest Nicor Gas’ compliance with Rider EEP or Nicor Gas’ accounting under the rider, the Commission Staff (“Staff”), the Citizens Utility Board and the Office of the Attorney General (collectively “CUB/AG”) seek to increase that amount by arguing that certain costs should not be included as recoverable EEP expenses under the rider. The proposed disallowances should be rejected as they are improper and unsupported by the record evidence.

II. ARGUMENT

A. The Commission Should Reject Staff's Proposed Disallowances Because They Are Inappropriate And Unsupported

Although not quantified in their Initial Brief, Staff continues to advocate for two disallowances that total approximately \$18,500:

- an adjustment for the wages and benefits paid to a Nicor Gas employee after he transferred within the Company to the newly formed Energy Efficiency Department in 2009 because those costs were purportedly already recovered in base rates; and
- an adjustment related to incentive compensation because those costs also were purportedly recovered in base rates and the Company did not demonstrate a so-called “nexus” to energy efficiency.

Staff Init. Br. at 3-5; *see also* Jones Dir., Staff Ex. 1.0, 3:56-4:73, 5:84-100 and Sch. 1.02. For the reasons set forth below, the Commission should reject both of Staff's proposed disallowances of costs that Nicor Gas has demonstrated are valid EEP expenses properly recoverable under Rider 29.

First and foremost, the evidence shows that these costs were prudently incurred and reasonable. Martino Reb., Nicor Gas Ex. 3.0, 3:45-47, 3:49-54, 6:115-17. Indeed, no party disputes that the costs were prudently incurred, reasonable and necessary, or that they were actually incurred by Nicor Gas related to the administration of the EEP for the first plan year. *Id.* Accordingly, the costs qualify as “EEP Expenses” under Rider 29 and are recoverable under the provisions of the rider. *Id.* at 3:47-48, 6:117-19.

In addition, Staff's disallowances are based upon the incorrect and unsupported assumption that Nicor Gas has already recovered these costs through Nicor Gas' existing base rates. *Id.* at 3:42-45; Martino Sur., Nicor Gas Ex. 5.0, 8:167-69. Staff presented no evidence in support of their “double recovery” argument because no evidence exists to support such a claim. All expenses related to Rider 29 EEP were excluded from current base rates when they were

established in accordance with the Rate Case Order. Martino Sur., Nicor Gas Ex. 5.0, 8:167-69. In particular, the Rate Case Order approved a specific revenue requirement and the Company established base rates to recover its allowed revenue requirement, excluding any costs associated with Rider 29 expenses, inclusive of incentive compensation. *Id.* at 8:169-72.

Further, as to the wages and benefits disallowance, Staff argues that the Company “incurs no additional expense related to the transferred employee whose position was filled through a reorganization of existing employees, since no new employee was hired to fill that position.” Staff Init. Br. at 4. Nicor Gas demonstrated in its Initial Brief that this argument is directly contrary to the ratemaking principles endorsed by the Commission that generally provide that base rates do not track and recover actual costs incurred by a utility in future periods, nor do they assure the utility that it will earn any particular rate of return in any year or be able to recover any specific actual expenses incurred in any year. Nicor Gas Init. Br. at 6. Thus, in approving Nicor Gas’ revenue requirement in the 2008 Rate Case, the Commission examined the total costs to conduct Nicor Gas’ operations over a forecasted test year period, which costs were assumed to be representative of the costs Nicor Gas would incur in the future. Martino Supp., Nicor Gas Ex. 7.0, 3:51-55. Staff’s suggestion that the salary of any individual employee can be traced to Nicor Gas’ Commission-approved base rates is contrary to the very philosophy behind using a representative test year in a rate case proceeding.

Staff’s argument also ignores the fact that Nicor Gas’ current base rates were established using a forecasted 2009 test year and the financials used for that test year did not include any expenses related to the Energy Efficiency Department. Martino Sur., Nicor Gas Ex. 5.0, 2:37-40. Contrary to Staff’s contention (Init. Br. at 4), the record evidence demonstrates that the wages and benefits associated with employees in the Energy Efficiency Department represent

entirely new costs that Nicor Gas incurred as a result of establishing and implementing its EEP. *Id.* at 2:41-44. Staff has already conceded as much by approving the cost of one EEP employee's salary "in allowable Rider 29 expenses." Jones Reb., Staff Ex. 2.0, 4:79-80. That this particular employee's former position was filled by another employee does not change the fact that both EEP employees began working solely on the EEP after their transfer to that department, and their former activities are entirely performed by other Nicor Gas personnel or have been discontinued. Martino Sur., Nicor Gas Ex. 5.0, 3:50-53.

Nicor Gas presented additional evidence demonstrating that these were new costs that Nicor Gas incurred specifically related to the administration of the EEP in the form of its annual internal audit results. Nicor Gas Ex. 3.1. Staff argues that the audit does not support recovery because it did not consider whether the costs were already recovered in base rates. Staff Init. Br. at 5. Yet, one of the tests conducted as part of the audit is to ensure that the costs being recovered under the rider are not otherwise being recovered through other existing, Commission-approved tariff mechanisms. Martino Reb., Nicor Gas Ex. 3.0, 4:66-69. The final audit report submitted into the record concluded that the costs being recovered through Rider 29 for the first plan year are not being recovered through other existing, Commission-approved tariffs. *Id.* at 4:70-72; Nicor Gas Ex. 3.1. Staff does not contest the conclusions of the final audit report. Martino Reb., Nicor Gas Ex. 3.0, 4:73-74. And the audit workpapers referenced by Staff (Init. Br. at 5) do not change the tests conducted as part of the audit under Rider 29 or the ultimate conclusion of the audit that the costs being recovered through Rider 29 for the first plan year *are not* being recovered through other existing, Commission-approved tariffs. Nicor Gas Ex. 3.1.

Finally, there is no merit to Staff's argument that there must be a "nexus" between incentive compensation costs and the EEP in order for Nicor Gas to recover those costs under

Rider 29. Staff Init. Br. at 1, 3. The Commission never required Nicor Gas to establish performance metrics specific to Rider 29 or the EEP. Martino Sur., Nicor Gas Ex. 5.0, 7:158-61. And it would not have been reasonable for Nicor Gas to do so in light of the short duration of the Rider 29 pilot. Martino Reb., Nicor Gas Ex. 3.0, 7:147-53. The Commission approved Rider 29 as a 4-year pilot program, and the rider as approved did not include specific therm savings goals, nor did it have any formal performance metrics. *Id.* at 7:144-46. At the time the Commission approved the Company's Rider 29 proposal, legislation was already pending that would supersede Rider 29; that legislation, now in effect, requires gas utilities to implement energy efficiency programs with significantly higher spending requirements. *Id.* at 7:147-51. The fact that Nicor Gas agreed to implement a separate incentive compensation plan with metrics specific to the success of a future energy efficiency plan – now the Company's Commission-approved Rider 30 – is irrelevant to the determination of whether Rider 29 costs are prudent, reasonable and recoverable.

Instead, Nicor Gas need only establish that the incentive compensation costs at issue fall within Nicor Gas' current, Commission-approved incentive compensation plan, which is based on customer performance metrics independent of departmental functions. *Id.* at 6:122-30. The evidence shows that incentive compensation related to Rider 29 falls squarely within the Company's existing incentive compensation plan because EEP programs by their very nature are intended to benefit customers through reduction of energy consumption. Martino Reb., Nicor Gas Ex. 3.0, 7:134-39; Martino Sur., Nicor Gas Ex. 5.0, 7:143-48. Based on this evidence, it is unreasonable to construe, as Staff does, incentive compensation related to Rider 29 as devoid of customer benefits in the context of energy efficiency. Staff Init. Br. at 3.

B. The Commission Should Reject CUB/AG's Proposed Disallowance Because It Is Inappropriate And Unsupported

CUB/AG continue to maintain their sole claim in this proceeding—that the Commission should disallow over \$100,000 for consultant costs related to the development of Nicor Gas' EEP in 2009. CUB/AG Init. Br. at 4. CUB/AG's proposed disallowance should be rejected because their arguments ignore the facts and circumstances surrounding the establishment and implementation of Nicor Gas' EEP and are unsupported by the evidence.

1. The Commission-Approved Advisory Board

Established in accordance with the Rate Case Order, the Board of Directors of Efficiency Programs, Inc. ("EPI") is a not-for-profit organization created and operated "to serve as the Advisory Board, described by the Illinois Commerce Commission ... in its final order in Docket No. 08-0363 ... overseeing the implementation of energy efficiency programs" in Nicor Gas' service territory. Jerozal Dir., Nicor Gas Ex. 2.0, 2:31-38; CUB/AG Ex. 1.1 at 1. The EPI Board consists of voting members from CUB/AG, the Natural Resources Defense Council, the North American Insulation Manufacturers Association, Commonwealth Edison Company, and Nicor Gas, as well as Staff as a non-voting participant. Jerozal Dir., Nicor Gas Ex. 2.0, 3:55-63.

In approving the management structure of the Advisory Board, the Commission balanced competing proposals and ultimately settled on a compromise approach. Rate Case Order at 162-63. In the first year of the EEP, which is the time period at issue in this docket, the Commission approved Nicor Gas' proposal "to place the decisions regarding what portfolio of programs would best serve Nicor's customers and service territory under the control of a qualified, experienced and independent board." *Id.* at 160. Nicor Gas proposed this arrangement because it recognized that it had limited experience in offering energy efficiency programs and desired to implement such programs as quickly as possible. *Id.* After the first year of the EEP, the

Commission determined that the Advisory Board would “act solely in an advisory capacity.” *Id.* at 163. In choosing that compromise, the Commission concluded as follows:

Logically, in the beginning the Advisory Board will be determining what programs best suit ratepayers in Nicor’s service territory. It will also commence the process of setting up those programs. Thus, the funds spent during this period of time would largely be on setting up energy efficiency programs. Therefore, in the beginning of the program there is less risk of imprudent or malfeasant expenditures.

Id. at 162.

The expenses that CUB/AG now seek to disallow were spent on the exact activities contemplated by the Commission for the first year of the EEP, *i.e.*, “setting up energy efficiency programs.” In particular, because Nicor Gas did not have sufficient experience or capability to implement the EEP (*see* Rate Case Order at 160), Nicor Gas looked to outside consultants—KO Solutions and Bass & Company (“Bass”)—to provide the necessary experience and capabilities to guide Nicor Gas in (i) understanding how an Advisory Board would be constituted and who would be involved, (ii) performing research and planning on the Advisory Board’s design, and (iii) coordinating the Advisory Board’s initial efforts. Jerozal Sur., Nicor Gas Ex. 6.0, 6:126-31. CUB/AG presented no evidence contesting these facts.

The evidentiary record contains specific detail regarding the services provided by the consultants in the fall of 2009, particularly by the primary consultant at Bass, which included management advice, technical research, authorship of two implementation RFPs, negotiation with parties, and coordination among the organizations involved. Nicor Gas Ex. 6.1, NR29 000149. As detailed in Nicor Gas Exhibit 6.1, Bass expended significant time and effort to achieve the goal of establishing and implementing Nicor Gas’ EEP. Without the assistance from Bass and KO Solutions, the start-up process for Nicor Gas’ EEP would have taken longer, resulting in a later starting date for the EEP. Jerozal Sur., Nicor Gas Ex. 6.0, 6:131-7:133. The

efforts by the consultants clearly were within the scope of the implementation work endorsed by the Commission in the Rate Case Order.

CUB/AG also try to cast doubt on the consultant expenses at issue due to the fact that Nicor Gas began incurring such expenses before the Advisory Board convened, approved its Bylaws or a consultant contract was in place. CUB/AG Init. Br. at 3-4. All of this is pure rhetoric on the part of CUB/AG given that the Commission expressly endorsed allowing Nicor Gas “to commence the process of setting up its programs immediately....” Rate Case Order at 163. CUB/AG also conveniently ignore that the delays they reference were not caused by Nicor Gas. For example, the delay in passing the Bylaws was due almost entirely to the fact that the AG representative on the Board failed to timely comment on the proposed Bylaws introduced at the first board meeting on July 21, 2009. *See, e.g.*, Nicor Gas Ex. 4.1 at 2 (July 21, 2009 meeting minutes noting that comments on the proposed bylaws were due by July 31, 2009 and contemplating approval of the Bylaws at meeting on August 12, 2009); CUB/AG Ex. 1.3 at 1 (August 31, 2009 meeting minutes showing that the board member from the AG’s office had not returned comments on the draft Bylaws as of that date). Indeed, even when the Bylaws were finalized, the AG dissented from the approval. CUB/AG Ex. 1.5 at 1.

2. There Is No Evidence That The Disputed Expenditures Were Imprudent

CUB/AG seize upon the term “imprudent” from the Rate Case Order and attempt to cast the disputed expenditures as such. *See, e.g.*, CUB/AG Init. Br. at 5, 7. CUB/AG specifically point to the fact that the Company’s EEP was not available to customers until after the heating season of 2009 and the allegedly “questionable” manner in which the expenses were billed and reported by the consultants. *Id.* at 7. The record demonstrates that CUB/AG’s criticisms are without merit.

Instead of ordering a deadline for implementation of the Company's EEP, the Commission simply targeted a timeframe for implementation. Jerozal Sur., Nicor Gas Ex. 6.0, 9:201-10:212. Any delay in implementing Nicor Gas' EEP was due to the fact that the consultants were trying to follow and implement directives from the Advisory Board. *Id.* at 10:215-16. For example, the AG and CUB representatives on the Advisory Board demanded that Nicor Gas partner with or make EEP offerings similar to those offered by Chicagoland Natural Gas Program ("Chicagoland"), the then existing energy efficiency program affiliated with The Peoples Gas Light & Coke Company and North Shore Gas Company. Jerozal Sur., Nicor Gas Ex. 6.0, 10:219-22; Nicor Gas Ex. 6.1, NR29 000149-154. The evidence shows that the Advisory Board's efforts to align with Chicagoland changed the scope of Bass' work, thereby impacting timing of deliverables. Jerozal Sur., Nicor Gas Ex. 6.0, 11:234-40; Nicor Gas Ex. 6.1. Additional work included Bass serving as "the primary drafting agent for both Chicagoland and Nicor for the joint RFP creation, review and finalization process" and supporting "the review and vetting process of these joint RFPs with Chicagoland Plan Administrator, Chicagoland Board, Illinois Stakeholders, and the Nicor EEP Advisory Board." Nicor Gas Ex. 6.1, NR29 000150-51. In other words, it was the partnering effort undertaken at the request of the AG and CUB representatives on the Advisory Board that directly caused the delay CUB/AG complain about here.

As far as CUB/AG's argument about the manner in which the expenses were billed, there is nothing in the record to show that EEP expenses must be documented in a particular fashion in order to be recoverable under the rider. To the extent the disputed expenditures were ultimately higher than estimated, that is because the amount payable to the consultants increased along with the additional work necessary to follow the directives of the Advisory Board, including the effort

to partner with Chicagoland at the specific request of the Advisory Board. Jerozal Sur., Nicor Gas Ex. 6.0, 13:294-14:307.

CUB/AG have never attempted to refute these facts. Indeed, in opposing recovery of the disputed expenditures, they blithely ignore the causal connection between their demands as part of the Advisory Board and the lengthened process and increased expense. CUB/AG also fail to recognize that the Commission concluded that EEP expenses were highly unlikely to be imprudent or malfeasant to the extent they were spent on “setting up energy efficiency programs.” Rate Case Order at 162. Because the evidence overwhelmingly demonstrates that the disputed expenditures were spent exactly on such efforts to set up energy efficiency programs, CUB/AG’s proposed disallowance should be rejected.

3. No Approval Of The Expenditures Was Required

In approving Rider 29 in the Rate Case Order, the Commission did not require the Advisory Board to approve EEP-related expenditures. Jerozal Reb., Nicor Gas Ex. 4.0, 5:85-86. Instead, the Commission expressly recognized the limited authority of the Advisory Board as “determining what programs best suit ratepayers in Nicor’s service territory” and beginning “the process of setting up those programs.” Rate Case Order at 162. And, contrary to CUB/AG’s assertion, there is nothing in the Advisory Board’s duties as outlined in the Bylaws requiring approval of expenses beyond approval of the budget for 2009. CUB/AG Init. Br. at 3-4 (quoting from CUB/AG Ex. 1.1 at 3).

In fact, in their Initial Brief (at 5), CUB/AG concede that the Commission did not mandate that the Advisory Board approve EEP-related expenditures. Nonetheless, CUB/AG devote much of their Initial Brief to various arguments intended to show that the Advisory Board is “to have financial oversight of program expense during 2009” as a means to convince the Commission to retroactively require such approval. *See, e.g.*, CUB/AG Init. Br. at 2-3, 5-7. No

matter how many ways CUB/AG try to argue the point, there is absolutely no requirement that the Advisory Board *approve* the EEP expenses in order for them to be recoverable under Rider 29, whether in any statutory authority, Commission rule or Order.

Moreover, the record reflects that Nicor Gas engaged, consulted, and updated the Advisory Board as the EEP was being developed, which the Commission did envision in the Rate Case Order. Jerozal Reb., Nicor Gas Ex. 4.0, 5:96-98. For example, the Advisory Board was heavily involved in implementing Nicor Gas' EEP, including, (i) by unanimously choosing KO Solutions to operate as the Board Facilitator, (ii) approving the Board Facilitator Roles and Responsibilities that reflect that, as Board Facilitator, KO Solutions would be responsible for assisting in the search for the Plan Administrator and other entities involved in the implementation of the EEP, and (iii) requesting the negotiation of charges with Bass, which resulted in reduced charges. Nicor Gas Exs. 4.1-4.3. Put simply, there can be no question that the Advisory Board was well informed about the work that both KO Solutions and Bass were doing with respect to setting up Nicor Gas' EEP. Jerozal Reb., Nicor Gas Ex. 4.0, 6:123-7:143, 10:199-205.

Finally, even assuming that the Advisory Board had some type of role in approving EEP expenditures, CUB/AG have provided no evidence that the Advisory Board disallowed, rejected or "purposefully denied the expenses" at issue. CUB/AG Init. Br. at 8. On the contrary, at the November 18, 2009 Advisory Board meeting a vote on the RFP Consultant Support budget amount of \$70,800 resulted in a two-to-two tie with one abstention. Jerozal Reb., Nicor Gas Ex. 4.0, 8:155-57; Nicor Gas Ex. 4.4. While the matter did not pass, it was not rejected as testified to by Nicor Gas witness Jerozal who personally attended that meeting, unlike the CUB/AG witness. Jerozal Sur., Nicor Gas Ex. 6.0, 11:256-12:257, 12:266-67. CUB and AG were the two Advisory

Board parties that voted against the RFP Consultant Support expenses. Jerozal Reb., Nicor Gas Ex. 4.0, 8:161-65. Importantly, the evidence shows that CUB and the AG have never voted to approve any Rider 29 EEP expenses while at the same time they have voted to have work performed and expenses incurred. *Id.* at 8:171-9:176. The Commission should reject the wholly one-sided arguments of CUB/AG.

III. CONCLUSION

The Initial Briefs of Staff and CUB/AG fail to rebut the record evidence showing that the EEP Expenses reflected in the Statement are prudent and reasonable costs incurred in the administration of the EEP for the first plan year. Accordingly, for the reasons set forth herein and in Nicor Gas' Initial Brief, the Commission should enter an Order approving Nicor Gas' Statement and rejecting the adjustments proposed by Staff and CUB/AG.

Dated: February 16, 2012

Respectfully submitted,

NORTHERN ILLINOIS GAS COMPANY
D/B/A NICOR GAS COMPANY

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