

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

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Atmos Energy Corporation and	)	
Liberty Energy (Midstates) (Corp.)	)	
	)	
	)	Docket No. 11-0559
Application for Approval of Proposed	)	
Reorganization and Other Relief	)	

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**REPLY BRIEF OF STAFF OF THE**  
**ILLINOIS COMMERCE COMMISSION**

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Initial Brief. For the reasons stated below, Staff's recommendations should be adopted by the Commission.

## **II. RESOLVED ISSUES**

### **A. Section 7-204(b)(4)**

As noted in Staff's Initial Brief, Staff witness Freetly and the Joint Applicants agreed on two conditions that would demonstrate whether Liberty Utilities can raise the necessary debt. (Stipulation, Attachment A, p. 2) Before the closing of the proposed reorganization, Liberty Energy Midstates must file with the Chief Clerk (1) a letter from at least one credit rating agency stating its intention to assign a credit rating of BBB (low), BBB- or Baa3 or higher to the long-term debt to be issued by Liberty Utilities and loaned to Liberty Energy Midstates through an intercompany note as described on Joint Applicants Ex. 6.3; and (2) a certified statement either from the chief executive officer or chief financial officer of Liberty Utilities that certifies that the Company received no oral or written statements from any credit rating agency stating an intention to assign the proposed debt issuance a credit rating below investment grade. The letter and certification would indicate that Liberty Utilities can issue the proposed debt referenced above at reasonable cost. (Staff IB, pp. 5-6) Staff would like to point that that footnote 2 in which stated, "A credit rating of BBB- (Standard & Poor's and Fitch Ratings), Baa3 (Moody's Investor Service) or BBB (low) (Dominion Bond Rating Service), would not be sufficient to meet this proposed condition" was included in Staff's Initial Brief by error. The agreement between Staff and JA is found in the text of Staff's Initial Brief and in the "Agreed Stipulation Between Joint Applicants and Staff." ("Stipulation") (*Id.*; Stipulation, Attachment A, p. 2)

### III. CONTESTED ISSUES

The JA Initial Brief blatantly ignores the recommendations of Staff that the Commission should **deny** approval of the proposed reorganization due to concerns primarily related to cross-subsidization and the resultant inability of the Commission to make the necessary findings pursuant to Sections 7-204(b) (2), (3) and (5) of the Public Utilities Act (“Act” or “PUA”), as indicated in the rebuttal testimony of Staff witness Pearce (ICC Staff Exhibit 10.0). The Executive Summary states, in part:

No party disputes that the proposed reorganization, as a whole, is in the public interest and in fact Staff recommends that the Commission make all of the required findings necessary to approve the reorganization. The only open issues in this docket relate to certain specific conditions of one Staff witness in connection with findings relating to the proposed Affiliate Service Agreements (“ASAs”) between Liberty Energy Midstates and certain of its affiliated interests, and the associated Cost Allocation Manual (“CAM”). (JA Initial Brief, p. 2)

This stark contradiction to the recommendations cited in the rebuttal testimony of Staff witness Pearce is not only disingenuous, but also representative of the demeanor of the JA throughout this proceeding. In spite of numerous attempts on the part of Staff to convey Staff’s concerns related to the single ASA and outdated CAM the JA initially filed with their petition, Midstates refused to provide a separate ASA for each entity that could provide services to the Illinois utility. As a result, Staff witness Pearce drafted five separate ASAs, as well as a revised CAM to attach to her rebuttal testimony (ICC Staff Exhibit 10.0, Attachments A – F), in order to provide the Commission with ASAs that would be reasonably acceptable and might allow the Commission an alternative to denial of the proposed transaction. Only at the surrebuttal phase of this proceeding, in response to the Staff proposed ASAs and CAM, did the JA provide revised ASAs for

most (but not all) affiliates that could provide services to the Illinois utility. However, JA did not provide blackline versions that started with Staff's draft versions. Therefore, Staff was forced to spend even more time deciphering what changes the JA had accepted/not accepted and how their new version of the ASAs and CAM compared with Staff's proposed documents. Staff also spent considerable effort in proposing conditions that would address the remaining concerns cited by Staff witness Pearce in connection with the findings that the Commission is required by law to make, if the proposed transaction is approved.

In ICC Staff Exhibit 10.0, each of Staff's proposed conditions were identified with a particular finding that the Commission must make in this proceeding. Yet, in their Initial Brief, the JA dismiss the contested Staff revisions to the ASAs with the following statement: "Ms. Pearce flatly recommended changes without indicating the purpose of any change, or in what way the change relates to the statutory provisions she cited." (JA Initial Brief, p. 33) It is noteworthy that instead of accepting the conditions proposed by Staff, the JA challenge Staff to prove why each is necessary. Most of the revisions proposed by Staff are reflected in the ASAs of other Illinois utilities for the purpose of providing the Commission with ongoing information associated with utility regulation, like copies of internal audit reports, identification of new affiliates, summaries of transactions with affiliates, cost allocation templates that demonstrate the basis for allocation of costs, etc. These provisions are designed to preclude cross-subsidization and to ensure that the Commission and its staff will receive timely information from Illinois utilities to allow the Commission to do its job.

At the rebuttal phase, in recognition of the fact that (a) the JA had provided a single affiliate services agreement to cover the myriad transactions between all of APUC's affiliates and the Midstates Illinois utility; and, (b) in further recognition of the fact that the only record evidence that would reasonably provide separate ASAs for each service provider was included in Staff's rebuttal testimony; and, (c) in further recognition of the fact that Staff had no idea how the JA's would respond to Staff's proposed ASAs, Staff witness Pearce proposed a condition to require APUC and its affiliates to submit a petition under Section 7-101 of the Act for the Commission to consider the effectiveness of the ASAs approved in this proceeding prior to filing a request for an increase in rates. The rationale for this condition was explained by Staff witness Pearce during cross-examination. She indicated that even though there might be an approved ASA in place, this (condition) would provide an opportunity to assess if everything that's approved in this proceeding does work as all the parties believe it will and if the ASAs are effectively protecting the Illinois ratepayers (TR Jan. 31, 2012, p. 90, lines 4 – 11). Given the fact that JA provided four new ASAs and a CAM in the surrebuttal phase of this proceeding (JA Exhibits 9.6 – 9.10), which fail to incorporate all the revisions proposed by Staff in the rebuttal phase (ICC Staff Exhibit 10.0, Attachments A – F), it appears reasonable, if not absolutely necessary, to re-assess whether the ASAs and CAM function effectively to protect Illinois ratepayers from cross-subsidization, as required by Illinois law.

It is particularly disconcerting that after such time and effort by Staff, the JA attempt to diminish these concerns as 'declarative statements that do not constitute record evidence, particularly where all stated concerns have been addressed.' (JA Initial

Brief, p. 33) A cursory review of ICC Staff Exhibit 10.0, as well as the transcript of the JA's cross-examination of Staff witness Pearce (TR Jan. 31, pp. 67 – 96) indicates clearly that all stated concerns have not been addressed, unless the JA accept all of Staff's proposed revisions to the ASAs and CAM (ICC Staff Exhibit 10.0, Attachments A – F), and the conditions outlined in ICC Staff Exhibit 10.0, as cited in Staff's Initial Brief. Based on Staff's experience in attempting to resolve issues with the JA during the course of this proceeding, Staff is very concerned about the amount of time and effort that will be required to monitor the Illinois utility if the proposed transaction is approved. By the JA's own statements, it is apparent they are attempting to gloss over the record evidence rather than responding to Staff's concerns. However, the Commission should be aware of the findings it is required to make under Sections 7-204(b) (2), (3), and (5) of the Public Utilities Act. The Commission must be able to make these findings based on information that is contained in the record of this proceeding, rather than vague assurances and diminishment of the relevant facts (TR Jan. 31, 2012, p. 55, lines 11 – 22 and p. 56, lines 1 - 3).

The remainder of Staff's response to the JA Initial Brief will be organized according to findings the Commission must make and the Staff-proposed conditions that remain in dispute. For the Commission's convenience, attached to this Reply Brief is Attachment A. Attachment A is a list of the findings addressed by Staff witness Pearce and her corresponding recommended conditions.

**A. Section 7-204(b)(2); Section 7-204(b)(3); and Section 7-204(b)(5)**

Section 7-204(b)(2) of the Act requires that the Commission must find that "the proposed reorganization will not result in the unjustified subsidization of non-utility

activities by the utility or its customers.” (220 ILCS 5/7-204(b)(2)) Staff cannot recommend that the Commission make the finding pursuant to Section 7-204(b)(2) because Staff believes the Affiliated Service Agreements (“ASAs”) and Cost Allocation Manual (“CAM”) provided by the JA in its surrebuttal testimony (JA Exhibit 9.6 through 9.10) are inadequate to preclude cross-subsidization between the Illinois regulated utility (Midstates) and certain affiliated interests, as reflected in the Algonquin Power and Utilities Corp. (“APUC”) organization chart (Staff Initial Brief, Attachment B).

As explained in Staff’s Initial Brief, Staff identified various changes that need to be reflected in the ASAs and CAM, and offered the revised ASAs and CAM in its rebuttal testimony (ICC Staff Exhibit 10.0, Attachments A through F). However, Midstates did not adopt those documents and reflect their proposed revisions thereto. Instead, the JA offered new ASAs and CAM in its surrebuttal testimony (JA Exhibit 9.6 through 9.10), absent one ASA that Staff believes is necessary (ICC Staff Exhibit 10.0, Attachment F). In the event the Commission does approve the reorganization, Staff recommended that the Commission impose certain conditions, as set forth below, to ensure that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers as required by Section 7-204(b)(2) of the Act. (ICC Staff Exhibit 4.0, p. 3, lines 58 – 64) (ICC Staff Exhibit 10.0, pp. 12 - 13, lines 261 – 294) The JA, in their Initial Brief, criticize the conditions proposed by Staff witness Pearce as unsupported declarations, not required by law and, therefore, lacking any basis for consideration by the JA or the Commission. Those conditions, listed below, have a single objective, as is apparent throughout the direct and rebuttal testimony, and the cross-examination of Staff witness Pearce (ICC Staff Exhibits 4.0

and 10.0, respectively and TR Jan. 31, 2012, p. 69, lines 2 - 11): to preclude cross-subsidization by the Illinois utility. Regardless of the JA's attempts to diminish Staff's proposed conditions, the fact remains that the Commission must be able to make the findings required by law **prior to** approval of the proposed transaction. Section 7-204(b)(2) requires the Commission to evaluate the totality of record evidence to ensure the reorganization meets this requirement. As Staff indicated in rebuttal testimony (ICC Staff Exhibit 10.0, pp. 5 – 7, lines 99 – 158; pp 9 – 10, lines 201 – 212; pp. 10 – 11, lines 224 – 240; and p. 12, lines 259 – 270), the conditions proposed by Staff are the direct result of inadequacies in the ASAs and CAM, given the organizational structure of the JA (Staff Initial Brief, Attachment B).

Section 7-204(b)(3) of the Act requires that the Commission must find that “the costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes.” (220 ILCS 5/7-204(b)(3)) As stated in Staff's Initial Brief, Staff is unable to recommend the Commission make the finding pursuant to Section 7-204(b)(3) based on the JA proposal and therefore recommends the Commission deny approval of the proposed reorganization. (Staff IB, p. 35) In the event the Commission does approve the reorganization, Staff recommended that the Commission impose certain conditions in order to make this finding. (*Id.*) (ICC Staff Exhibit 4.0, p. 4, lines 68 – 83) (ICC Staff Exhibit 10.0, pp. 13 - 14, lines 296 – 338)

Section 7-204(b)(5) of the Act requires the Commission must find that “the utility will remain subject to all applicable laws, regulations, rules, decisions and policies

governing the regulation of Illinois public utilities.” (220 ILCS 5/7-204(b)(5)) As stated in Staff’s Initial Brief, Staff is unable to recommend the Commission make the finding pursuant to Section 7-204(b)(5) based on the JA proposal and therefore recommends the Commission deny approval of the proposed reorganization. (Staff IB, p. 36) In the event the Commission does approve the reorganization, Staff recommends that the Commission impose certain conditions as in order to make this finding. (*Id.*) (ICC Staff Exhibit 4.0, pp. 4 - 5, lines 86 – 131) (ICC Staff Exhibit 10.0, pp. 15 - 18, lines 340 – 391)

As laid out in Staff’s Initial Brief, Staff’s recommends conditions to satisfy Section 7-204(b)(3) and 7-204(b)(5) which are duplicative of Staff’s recommended conditions to satisfy Section 7-204(b)(2) with the addition of two uncontested conditions Staff has proposed to satisfy Section 7-204(b)(5). (Staff IB, pp., 35-37) Therefore, Staff’s discussion below is meant to discuss Staff’s proposed conditions with respect to findings under Section 7-204(b)(2), (3), and (5).

## 1. Contested Conditions

### 1. **Midstates will accept the proposed revisions to the Affiliated Service Agreements (“ASA”) and Cost Allocation Manual (“CAM”) as set forth in ICC Staff Exhibit 10.0, Attachments A through F.**

As stated in Staff’s Initial Brief, the JA accepted some of Staff’s revisions to the ASA and CAM, but not all. (Staff IB, p. 20) The most significant of Staff’s revisions that Midstates **did not accept** include the following:

- a) There should be an ASA for the services provided by Algonquin Power Company (“APCO”);

- b) The CAM should clearly identify the “Service Companies”; and,
- c) Each ASA should identify all parties to the agreement.

Based on further review of JA Exhibits 9.6 – 9.10, the cost allocation principles that Staff cited in subparts d) <sup>1</sup> and e)<sup>2</sup> of the Initial Brief (Staff IB, p. 22) have been substantially incorporated by the JA in either the ASAs or CAM. Accordingly, further discussion is deemed unnecessary. A discussion regarding each of Staff’s significant revisions which were not accepted by Midstates follows below.

a) There should be an ASA for the services provided by Algonquin Power Company

Staff asserts that a separate ASA is necessary for each entity that provides services to affiliates that result in charges being billed to Midstates, including an ASA between Algonquin Power Company, a Canadian Corporation, (“APCO”) and Liberty Utilities (Canada) Corp. (“LUC”), as proposed by Staff in ICC Staff Exhibit 10.0, Attachment F. APCO is a holding company as defined by FERC regulation 18 CFR section 366.1 (ICC Staff Exhibit 10.0, Attachment F, Schedule III) and is the parent company for the unregulated operations of APUC (JA Exhibit 9.10, p.2). In its recent Order approving the Nicor/AGL reorganization, the Commission stated,

Moreover, the structure of subsection 7-204(b) puts the burden of satisfying its sub-parts on the reorganization petitioner. That is, the text precludes merger approval *unless* the specified findings can be made. ... When applying these legal standards, the Commission has taken the position that “[g]enerally, relationships between affiliates merit greater

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<sup>1</sup> d) The principles of cost allocation should be incorporated into the ASAs;

<sup>2</sup> e) The principles of cost allocation should also be incorporated into the CAM.

scrutiny than relationships between unaffiliated entities due to the higher risk of improper behavior.”<sup>[4]</sup>

(Order, Docket No. 11-0046, December 7, 2011, p. 45)

The JA dispute the need for such an ASA between APCO and Liberty LUC based on the following arguments:

- 1) No such agreement exists and therefore, Midstates cannot modify an agreement that does not exist and to which it is not a party;
- 2) Staff has presented no evidence on its rationale for requesting such an agreement;
- 3) Transactions between LUC and APCO are not subject to Section 7-101; and,
- 4) Charges to the Midstates Illinois utility will be covered by one of the four other ASAs, which require cost-based charges and all necessary safeguards.

(JA Initial Brief, pp. 39-40)

Staff’s response to each of JAs arguments follows.

1) The JAs assertion that no such agreement exists and therefore, Midstates cannot modify an agreement that does not exist and to which it is not a party appears disingenuous, at best. Clearly, the other ASAs did not exist either, until the JAs included them in the surrebuttal testimony of Mr. Eichler (JA Exhibits 9.6 – 9.9). Moreover, the ultimate parent company of Midstates, APUC, or the indirect parent, LUC, could provide such an agreement if it wanted to do so, in order to gain approval for the proposed transaction. Alternatively, the JA could have revised the CAM to remove

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<sup>[4]</sup> Illinois American Water Company, Dckt. 02-0517, Order, Sept. 16, 2003 (“IAWC”), at 11.

entirely the portion that permits APCO and LUC to engage in affiliate transactions, the costs of which could be passed down to the Midstates Illinois utility.

2) The JAs argument that Staff has presented no evidence on its rationale for requesting such an agreement is also misleading. Staff stated its rationale that there should be a separate ASA for each entity that provides services to affiliates that result in charges being billed to the Midstates Illinois utility in direct and rebuttal testimony (ICC Staff Exhibit 4.0, p. 9, lines 197 – 200 and ICC Staff Exhibit 10.0, p. 5, lines 110 – 111 and pp. 6 - 7, lines 129 – 141). Specifically, in rebuttal testimony, Staff witness Pearce explained her rationale as follows:

I maintain my position that a separate agreement is necessary for each entity that is providing services to affiliates, because it is not clearly determinable within the Company's proposed ASA (JA Ex. 7.2 and 7.3): (a) which entity is providing services; (b) exactly what services are being provided; (c) which entities are receiving services; and, (d) the basis for allocation. Accordingly, Attachments A and B to my testimony contain my proposed modifications to the Company's ASA and CAM (JA Exhibit 7.2 and 7.3). In addition, I recommend including a separate proposed agreement for each entity that provides services to affiliates (See ICC Staff Exhibit 10.0, Attachments C through F).

(ICC Staff Exhibit 10.0, pp. 6 – 7, lines 129 – 141)

She also specified as one of her conditions to approval of the proposed transaction, that the JA should be required to modify the ASA and CAM consistent with her proposed revisions as set forth in Attachments A through F of her rebuttal testimony, ICC Staff Exhibit 10.0. Finally, Staff witness Pearce indicated that this condition would be necessary, in her opinion, for the Commission to make the findings pursuant to Sections 7-204(b) (2), (3) and (5), which generally require that the Commission find that the proposed transaction will not result in the unjustified subsidization of non-utility activities by the utility or its customers and ensure that costs

and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes. (ICC Staff Exhibit 10.0, pp. 12 – 16, lines 259 - 350)

During cross-examination, Staff witness Pearce reiterated her recommendation that separate agreements are necessary for each of the service providers that would be providing services whose costs would be allocated to the Liberty Midstates utility. She further indicated that the ASAs provided by the JA in the surrebuttal testimony of Mr. Eichler (JA Exhibits 9.6 – 9.10) did not satisfy her concerns as to the separate issue of those four agreements. She explained that she still has a concern that the Illinois ratepayers would not be protected from potential cross subsidization that could occur because of the organization of some of the affiliates whereby services and their related costs might be charged by one of the affiliates to another affiliate, who would then allocate those costs to the Illinois utility, and those costs would not be covered by an Affiliate Service Agreement or readily identifiable at the utility level. (TR Jan. 31, 2012, p. 68, lines 10 – 22 and p. 69, lines 1 – 11)

This concern forms the basis of Staff's proposed ASA between APCO and LUC (ICC Staff Exhibit F). If the JA were to provide such an agreement, and the Commission were to impose the conditions requested by Staff, APCO as the service provider, would be required to provide the Commission with annual internal audits of charges to LUC (the indirect parent of Midstates), whose costs are allocated to the regulated utilities, including the Midstates Illinois utility. Additionally, APCO would have

to provide the allocation templates, annual billing reports and triennial cost studies to support the charges from APCO to LUC.

3) The JA's argue that transactions between LUC and APCO are not subject to Section 7-101 because APCO will not provide any services to Midstates directly. However, the JA readily admit that Midstates understands that Section 7-101 requires approval of transactions between it and affiliated interests. Midstates further admits that APCO is a sister company owned by Algonquin ("APUC") and LUC is an indirect parent corporation of Liberty Energy Midstates (JA Initial Brief, p. 39). Accordingly, Staff avers that both LUC and APCO are affiliates of Midstates and, therefore, subject to Section 7-101. Whether APCO directly charges Midstates or indirectly charges Midstates, by directly charging LUC, who then allocates the costs down to Midstates is a distinction without a difference in Staff's reasoning. Therefore, in Staff's view, the ASA between APCO and LUC is required by Section 7-101.

4) The JA's argue that charges to the Midstates Illinois utility will be covered by one of the four other ASAs, which require cost-based charges and all necessary safeguards. Yet, the JA concede that should APCO provide a service to LUC, where cost is allocated to Midstates, Midstates will be required to prove the cost was prudently incurred, which would include at a minimum, providing invoices and other source documentation, just as it would with a third party vendor that provides services to LUC and whose costs are allocated to Liberty Midstates. (JA Initial Brief, p. 40) The problem with this scenario is that no ASA would govern the affiliate transactions between APCO and LUC, so that if cross-subsidization did occur in the form of LUC being overcharged by APCO, LUC would simply allocate those costs down to the regulated utilities and it

would not be apparent on the books of the Illinois utility which costs originated from APCO. Additionally, the argument is backwards because it assumes that Midstates will challenge the prudence of every charge from LUC. Even if Midstates were able to identify charges that originated from APCO, there would be no basis to challenge the costs, absent an ASA. This arrangement is impractical from a ratemaking standpoint and contravenes the intent of Section 7-101, which is to permit affiliate transactions only where the Commission has approved an agreement that identifies the parties involved, the types of services covered and the basis for charges. If the JA get their way, Midstates could indirectly receive charges from APCO that are not covered by an ASA. In Staff's view, this would conflict with the requirements of Section 7-101.

b) The CAM should clearly identify the "Service Companies"

Staff asserts that Section V. of Midstate's proposed CAM (JA Exhibit 9.10, p. 7, Section V., paragraph 1) would permit transactions by an unidentified Service Company that has not been identified within the CAM and for which Midstates has not submitted an ASA setting forth the method of cost allocations or the manner in which costs will be charged to the entities receiving service. Staff acknowledges that in response to questions under cross examination of JA witness Peter Eichler, Midstates filed Exhibit 12.0, attached to Staff's Initial Brief as Attachment C, that identified the Service Companies referred to in the CAM. (TR, Jan 31, 2012, pp. 41-42) However, the information in that document has not been incorporated into the CAM or any of the applicable ASAs. Also, the identification of a generic "Service Company" in the CAM is not limited by the filed Exhibit 12.0. The JA argue that the CAM proposed by Staff witness Pearce in her rebuttal testimony (ICC Staff Exhibit 10.0, Attachment B) simply

struck Section V. without providing any rationale. They assert that Section V. may not require too much attention, however, because Midstates does not intend to receive any services under that section. They propose to resolve this matter by agreeing to a condition that has the effect in Illinois “as if the provision had been removed.” (JA Initial Brief, p. 45) Their proposed condition states:

Section V of the CAM shall not apply to Liberty Energy Midstates in Illinois unless Liberty Energy Midstates seeks Commission approval to receive specific services from identified Service Companies.

The JA contend they cannot just simply remove Section V from the CAM because although Liberty Energy Midstates will not receive services under Section V, other utilities in jurisdictions outside of Illinois receive services under this provision. The JA aver that by eliminating the effect of Section V in Illinois, the question is rendered moot without causing difficulties in other jurisdictions. (JA Initial Brief, p. 46)

Staff rejects the proposed condition as a remedy to the concern that Section V of the CAM permits services to be provided by as yet unidentified entities (“Service Companies”) for which there is no ASA, a clear violation of Section 7-101 in Staff’s view. The condition would not have the effect of an amendment to the CAM and could easily be overlooked because parties will naturally refer to the CAM as the basis for affiliate charges, not the conditions associated with the proposed transaction.

c) Each ASA should identify all parties to the agreement

The JA assert that Section 7-101 does not contemplate approval of affiliate transactions that do not involve a public utility. The JA further argue that the ASAs are intended to cover services provided by an affiliated interest to the Illinois public utility

and that Staff's proposal to include parties that are not Illinois public utilities and that are not providing services to Midstates does not make sense. Moreover, they contend that the proposed ASAs differ from other shared services agreements approved by the Commission because Midstates' ASAs are not multidirectional. In other words, Midstates only receives services, it does not also provide services. (JA Initial Brief, pp. 42 – 43)

Staff asserts that each ASA should identify all parties to the agreement, and that those parties should be listed on a Schedule of each ASA, yet Midstates did not incorporate Staff's proposal that all parties to the agreement be identified in each of the ASAs; therefore, it is not clear which entities are receiving services, other than Midstates, under each ASA. It is necessary to clearly identify what services will be provided by what entity and for what entity (ICC Staff Exhibit 10.0, p. 5, lines 99 – 104) to know whether the costs being allocated to Midstates are appropriate. Having all parties that receive services from the entity providing services listed in the ASA is Staff's remedy to identifying all affiliates who could receive services from the providing entity under each respective ASA. Absent a list in the ASA or something comparable, the Commission will not know what other affiliates besides Midstates are receiving services from each entity, making it impossible to prevent cross-subsidization.

2. **Each service provider will provide the Manager of Accounting of the ICC with a template of all allocation percentages used to charge Midstates pursuant to each applicable ASA. Specifically, each template should account for 100% of each cost category being allocated, including the respective percentages allocated to other affiliates, as well as Midstates. The template should be provided within 60 days of closing the proposed transaction and should be updated annually, with a copy provided to the Manager of Accounting no later than March 31.**

Based on the JA Initial Brief, (JA IB, p. 47), Staff believes it necessary to clarify that the cost allocation template must include not only allocation percentages for all provider companies, but all detailed information described above in Staff's condition, including, **for each service provider** a separate template of allocation percentages used to charge Midstates pursuant to each applicable ASA, that shows:

- a) 100% of each cost category being allocated, i.e., the total dollar amount of each cost category; and,
- b) each percentage that is allocated to other affiliates besides Midstates, so that the total of all percentages add up to 100% for each cost category. (Staff IB, pp. 29-30)

3. **Each service provider will perform an annual internal audit that includes certain specific tests of costs allocated to Midstates pursuant to the applicable ASA, including compliance with the processes outlined in the ASA and including a review of the allocation factors and the calculation of each to verify that they are updated and calculated in accordance with the respective ASA, as stated in the Illinois Rider attached to the ASA.**

Based on the JA Initial Brief, (JA IB, pp. 47 – 48), Staff believes it necessary to clarify that a separate annual internal audit report should be provided **by each service provider** that includes the specified tests of costs allocated to Midstates, as more fully described above in Staff's propose condition. (Staff IB, pp. 30-31)

4. **Each service provider will conduct a full study of the cost of services provided under the applicable ASA on a triennial basis. A full study is necessary periodically to ensure that Midstates will be charged appropriately for the services it receives, with no over- or under-charging. The cost of services study shall be provided to the Accounting Department Manager no later than July 1 of the year following the initial three-year period, according to provisions of the Illinois Rider attached to the ASA.**

Based on the JA Initial Brief, (JA IB, pp. 48 – 49), Staff believes it necessary to clarify that the cost study would need to be performed and provided **by each service provider** for the costs charged to Midstates pursuant to each ASA. It is not possible for Midstates to perform an effective cost study on the costs that are allocated to it by the various service providers. The purpose of the cost study is to ascertain whether Midstates is being charged appropriately for the services it receives, with no over- or under-charging (ICC Staff Exhibit 10.0, p. 10, lines 207 – 211; Staff IB, p. 31).

5. **Each service provider will file annually by May 1 a billing report on the ICC’s e-Docket system in Docket No. 11-0559 with a copy to the ICC’s Accounting Department Manager and to the Office of the Chief Clerk of the ICC. The billing report should summarize the monthly charges billed to Midstates and each of the affiliated companies by each service provider under each applicable ASA.**

Based on the JA Initial Brief, (JA IB, p. 49), Staff believes it necessary to clarify that the billing report should include detail for charges from each service provider, as indicated by Ms. Pearce during cross-examination and in Staff’s Initial Brief:

And, again, just to clarify, the billing reports need to show the charges from each of the providers, not just one billing report at the utility level that shows a conglomeration of all charges coming. So it needs to be clear where the charges originated. (TR Jan. 31, 2012, pp. 79 – 80)

(See also, Staff IB, p. 32)

6. **Neither Midstates nor its affiliate Liberty Utilities (Canada) Corp. (“LUC”) nor any of its affiliated service companies, such as Liberty Energy Utilities (New Hampshire) Corp. may purchase gas supply from an affiliated entity following the closing of the proposed transaction without petitioning the Commission for authority.**

Based on the JA Initial Brief, (JA IB, p. 50), Staff believes it necessary to clarify the condition that prohibits Midstates from buying gas supply from an affiliate, as

addressed by Ms. Pearce during cross-examination. Staff witness Pearce proposed the following condition in her rebuttal testimony (ICC Staff Exhibit 10.0, pp. 13 – 14, lines 292 – 297):

Midstates, its affiliate Liberty Utilities (Canada) Corp. (“LUC”), and all of its affiliated service companies, such as Liberty Energy Utilities (New Hampshire) Corp. are prohibited from purchasing gas supply from an affiliated entity following the closing of the proposed transaction unless approval is petitioned for and granted by the Commission.

During cross-examination, Staff witness Pearce was referred to JA Exhibit 9.1, Section 4C, and was asked if the JA had proposed a condition that prohibits Liberty Energy (Midstates) from purchasing gas supply from an affiliated entity following the closing of the proposed transaction unless approval was petitioned for and granted by the Commission or unless such approval is not required under applicable law. She answered yes, and was then asked if that condition satisfied her concern that Midstates not be allowed to procure gas supply from an affiliated entity without approval, to which she also answered yes. However, it is necessary to clarify that according to the CAM (JA Exhibit 9.10, p. 8), Liberty Energy Utilities (New Hampshire) Corp. will procure gas for the natural gas subsidiaries of LUC, including Midstates. Accordingly, Midstates itself does not purchase any gas directly and will be allocated costs from the New Hampshire affiliate for the procurement services. Therefore, it is necessary to clarify that not only Midstates, but also the affiliates of Midstates, should be prohibited from purchasing gas supply from an affiliated interest, as the condition is stated in Staff witness Pearce’s rebuttal testimony. (ICC Staff Exhibit 10.0, pp. 13 – 14, lines 292 – 297; Staff IB, 32-33)

7. **APUC and its affiliates should be required to submit a petition under Section 7-101 of the Act for the Commission to consider the effectiveness of the ASAs approved in this proceeding prior to filing any request for an increase in rates, but in any case no later than September 30 of the year following the first full calendar year subsequent to closing the proposed transaction. The petition should indicate the costs recovered from Midstates for each accumulated calendar year through each ASA. The allocated common costs from each service provider should be supported by exemplar allocation percentages for each service provided and must include all allocation percentages to the various entities to account for 100% of the allocated costs. The direct charges to the various affiliates billed by each service company should also be included. After reviewing the results, the Commission may consider modifications to the ASAs.**

See discussion below. (See also, Staff IB, pp. 33-5)

#### **B. Section 7-101**

Section 7-101 of the Act sets forth the Commission's jurisdiction over transactions with affiliated interests. In accordance with Section 7-101 Midstate's proposed ASA and CAM must be adequate to safeguard the public interest. In its recent Order approving the Nicor/AGL reorganization, the Commission stated,

Our analyses, above, regarding subsidization and cost allocation, is also applicable here in the broader context of the public interest. Subsidization of a non-utility affiliate is not in the interests of the general public, the involved utility or the utility's customers. Fair and reasonable cost allocation among utility and non-utility activities, to facilitate proper ratemaking, serves those interests.

(Order, Docket No. 11-0046, December 7, 2011, p. 56)

The JAs argue that the evidence supports a finding that the ASAs are in the public interest (JA RB, pp. 63-64), however, Staff witness Pearce has expressed concerns related to Midstate's proposed ASA and CAM. In connection with the findings pursuant to Sections 7-204(b) (2),(3) and (5) and to ensure proposed ASA and CAM are

adequate to safeguard the public interest , Staff recommended the Commission impose the following condition, in the event the proposed transaction is approved:

**APUC and its affiliates should be required to submit a petition under Section 7-101 of the Act for the Commission to consider the effectiveness of the ASAs approved in this proceeding prior to filing any request for an increase in rates, but in any case no later than September 30 of the year following the first full calendar year subsequent to closing the proposed transaction. The petition should indicate the costs recovered from Midstates for each accumulated calendar year through each ASA. The allocated common costs from each service provider should be supported by exemplar allocation percentages for each service provided and must include all allocation percentages to the various entities to account for 100% of the allocated costs. The direct charges to the various affiliates billed by each service company should also be included. After reviewing the results, the Commission may consider modifications to the ASAs.**

According to the JA Initial Brief (pp. 55 – 56), Midstates does not accept this condition for the following reasons:

- a) The ASAs and CAM proposed by the JA contain numerous safeguards and oversight mechanisms that go beyond the requirements imposed on public utilities generally;
- b) These safeguards provide the Commission with the necessary information to evaluate the effectiveness of the ASAs, particularly where the Commission retains all oversight powers over Liberty Energy Midstates;
- c) Section 7-101 applies to proceedings to approve an agreement on a prospective basis; it does not contemplate multiple approvals of the same agreement, nor does it contain standards for a post-agreement review of transactions under approved agreements; and,

- d) The JAs contend this would be an altogether new type of proceeding under an inapplicable statute. (JA Initial Brief, pp. 55 – 56)

Staff strongly disagrees with the JA for the following reasons.

First, Staff is not aware that Section 7-101 precludes a Commission review of existing ASAs. In fact, the Commission has found otherwise in its recent Order that approved the Section 7-204 reorganization of Northern Illinois Gas and AGL:

Subsection 7-204A(b) gives the Commission discretionary power to review any such contract or arrangement “in the same manner as it may review any other public utility and its affiliated interest.” In our view, this latter clause invokes, *inter alia*, the powers residing in Section 7-101 (quoted above), including the broad power to safeguard the public interest.

Further, our administrative regulations declare that “[t]ransactions between a gas utility and its affiliated interests shall not be allowed to subsidize the affiliated interests.”<sup>[4]</sup> This provision applies to the OA, and any dealings pursuant to its terms and conditions, whether or not there is a pending reorganization request.

With particular regard to reorganization requests, inter-affiliate contract approval is not specifically addressed by statute. However, subsection 7-204(f) provides that “[i]n approving any proposed reorganization pursuant to this Section, the Commission may impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers.”<sup>[5]</sup> Subsection 7-204(f) does not exempt any component of utility operations from its purview. The Commission therefore concludes that the power to impose merger conditions extends to a utility’s inter-affiliate agreements, such as the OA here, and to utility conduct under the terms of those agreements<sup>[6]</sup>. (Order, Docket No. 11-0046, December 7, 2011, p. 44)

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<sup>[4]</sup> 83 Ill. Adm. Code 550.120(a).

<sup>[5]</sup> 220 ILCS 5/7-204(f).

<sup>[6]</sup> We note that the interests protected by subsection 7-204(f) are those of “the public utility and its customers.” There is substantial overlap of those interests and the public interest safeguarded by Section 7-101. Insofar as the latter interest may be broader than the former, it is not apparent that the difference is consequential in this case.

The Commission frequently reviews affiliate agreements that are proposed by long-established utilities operating in Illinois. For example, the recent Commission rate order for North Shore Gas Company and The Peoples Gas Light and Coke Company, Docket Nos. 11-0280 and 11-0281 (consol.), entered January 10, 2012 concluded the following:

The Commission agrees with Staff and finds that the Utilities have not properly interacted with their affiliates as evidenced by our conclusions in the above related sections. Staff's proposal for further Commission investigation of the Utilities' interactions with their affiliates is warranted and in the public interest. We believe the investigation is necessary to prevent ratepayers from continuing to subsidize the affiliates. ...Thus, the Utilities are required within 90 days of the Order in this case to file a petition and testimony demonstrating that the Utilities' affiliate interactions are in compliance with the STA and the Master AIA. Additionally, the petition and testimony must address any jurisdictional issues with the Master AIA agreement pending in Wisconsin. Finally this petition and testimony must provide full cost justification for the repair rates charged to ratepayers as well.  
(Order, Docket Nos. 11-0280 and 11-0281 (consol.), January 10, 2012, p. 98)

Another example is the Commission rate order for Northern Illinois Gas Company d/b/a Nicor Gas Company for Docket No. 08-0363 entered March 25, 2009 that included the following Finding:

(14) Nicor shall file a petition with 120 days of the date of a final Order in this proceeding seeking either re-approval of its current Operating Agreement or approval of a new affiliated interest transaction agreement; this petition shall address the criteria expressed by Staff, as is set forth in section XIV(C) herein; and it shall be supported by verified testimony;  
(Order, Docket No. 08-0363, March 25, 2009, pp. 183-184)

Specifically, Section 7-101(3) states in part:

If it be found by the Commission, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove such contract or arrangement. Every

contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.  
(220 ILCS 5/7-101(3))

Because Section 7-101 provides for Commission disapproval of contracts or arrangements that are not in the public interest, it stands to reason that the law does not preclude a review of existing affiliate agreements for the very purpose of determining whether they function according to the public interest.

Second, the aforementioned 'safeguards in the ASAs and CAM that provide the Commission with the necessary information to evaluate the effectiveness of the ASAs' would serve little purpose if it became apparent that the ASAs were not effective and the Commission were not allowed to revisit the existing affiliate agreements.

Finally, the ASAs and CAM that were proposed in ICC Staff Exhibit 10.0, Attachments A through F, may not include all the necessary provisions to preclude potential cross-subsidization. Moreover, the ultimate parent of Midstates, APUC, has an organizational structure which includes various levels of service providers and affiliates who may provide services for which Midstates ultimately is charged, either directly or indirectly (see Staff Initial Brief, Attachment B). As Staff witness Pearce indicated during cross-examination, her intent with this recommendation is to allow the Commission to consider the effectiveness of the ASAs approved in this proceeding prior to the filing of a request for an increase in rates. Ms. Pearce acknowledged that even though there might be an approved ASA in place, the Commission is not obligated to allow recovery of any charges for ratemaking purposes, but this condition would provide an opportunity to assess whether everything that has been approved in this proceeding effectively protects Illinois ratepayers. (TR Jan. 31, 2012, p. 82, line 16 through p. 90,

line 11). However, the JA appear to view the approval process somewhat backwards from Staff, as evidenced in the following assertion:

Because Liberty Energy Midstates' rates cannot include any of the charges under the ASAs until the Commission approves their inclusion in a rate case, the Commission can generally be assured that no unjust subsidization may occur.  
(JA Initial Brief, p. 35)

The primary objective of ASA approval is to prevent cross-subsidization from occurring; evaluation of resultant costs for rate recovery is secondary. Accordingly, Staff strongly supports this condition if the proposed transaction is approved.

#### **IV. CONCLUSION**

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations.

March 8, 2012

Respectfully submitted,

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**Attachment A**

**Findings Addressed by Staff witness Pearce with Proposed Conditions**

**(A) Part 505 - The JA's proposed accounting of the transaction is in compliance with 83 Ill. Adm. Code 505, the Uniform System of Accounts for Gas Utilities Operating in Illinois.**

- 1) The Company shall accept the corrections to its preliminary journal entries as described in the rebuttal testimony of Staff witness Pearce (ICC Staff Exhibit 10.0, pp. 3 – 4, lines 64 – 76). **(Uncontested)**
- 2) Midstates shall file the final accounting entries (with the corrections noted herein), including the actual amounts recorded by Midstates within 60 calendar days following the closing of the proposed transaction with the Chief Clerk of the Commission, with a copy of the filing to the Manager of the Accounting Department of the Commission. **(Uncontested)**

**(B) Section 5-106 - Each public utility shall have an office in one of the cities, villages or incorporated towns in this State in which its property or some part thereof is located and shall keep in said office all such books, accounts, papers, records and memoranda as shall be ordered by the Commission to be kept within the State. The address of such office shall be filed with the Commission. No books, accounts, papers, records or memoranda ordered by the Commission to be kept within the State shall be at any time removed from the State, except upon such conditions as may be prescribed by the Commission.**

**Each public utility shall be liable for, and upon proper invoice from the Commission shall promptly reimburse the Commission for, the reasonable costs and expenses associated with the audit or inspection of any books, accounts, papers, records and memoranda kept outside the State.**

Midstates shall be allowed to maintain its books and records in Missouri, with the provision that Midstates will be liable for, and upon proper invoice from the Commission will promptly reimburse for reasonable costs and expenses associated with the audit or inspection of any books, accounts, papers, records and memoranda kept outside of the State, pursuant to

Section 5-106 of the Act. Further, digital copies of all books and records will be available in Illinois and at the Commission's request hard copies will be made available in Illinois as well. (ICC Staff Exhibit 4.0, pp. 14 – 15, lines 318 – 329) **(Uncontested)**

**(C) The proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers as required under Section 7-204(b)(2) of the Act.**

- 1) Midstates will accept the proposed revisions to the Affiliated Service Agreements (“ASA”) and Cost Allocation Manual (“CAM”) as set forth in ICC Staff Exhibit 10.0, Attachments A through F. **(Contested)**
- 2) Each **service provider** will provide the Manager of Accounting of the ICC with a template of all allocation percentages used to charge Midstates pursuant to each applicable ASA. Specifically, each template should account for 100% of each cost category being allocated, including the respective percentages allocated to other affiliates, as well as Midstates. The template should be provided within 60 days of closing the proposed transaction and should be updated annually, with a copy provided to the Manager of Accounting no later than March 31. **(Contested)**
- 3) Each **service provider** will perform an annual internal audit that includes certain specific tests of costs allocated to Midstates pursuant to the applicable ASA, including compliance with the processes outlined in the ASA and including a review of the allocation factors and the calculation of each to verify that they are updated and calculated in accordance with the respective ASA, as stated in the Illinois Rider attached to the ASA. **(Contested)**
- 4) Each **service provider** will conduct a full study of the cost of services provided under the applicable ASA on a triennial basis. A full study is necessary periodically to ensure that Midstates will be charged appropriately for the services it receives, with no over- or under-charging. The cost of services study shall be provided to the Accounting Department Manager no later than July 1 of the year following the initial three-year period, according to provisions of the Illinois Rider attached to the ASA. **(Contested)**
- 5) Each **service provider** will file annually by May 1 a billing report on the ICC's e-Docket system in Docket No. 11-0559 with a copy to the ICC's Accounting Department Manager and to the Office of the Chief Clerk of

- the ICC. The billing report should summarize the monthly charges billed to Midstates and each of the affiliated companies by each service provider under each applicable ASA. **(Contested)**
- 6) Neither Midstates nor its affiliate Liberty Utilities (Canada) Corp. (“LUC”) nor any of its affiliated service companies, such as Liberty Energy Utilities (New Hampshire) Corp. may purchase gas supply from an affiliated entity following the closing of the proposed transaction without petitioning the Commission for authority. **(Contested)**
- 7) APUC and its affiliates should be required to submit a petition under Section 7-101 of the Act for the Commission to consider the effectiveness of the ASAs approved in this proceeding prior to filing any request for an increase in rates, but in any case no later than September 30 of the year following the first full calendar year subsequent to closing the proposed transaction. The petition should indicate the costs recovered from Midstates for each accumulated calendar year through each ASA. The allocated common costs from each service provider should be supported by exemplar allocation percentages for each service provided and must include all allocation percentages to the various entities to account for 100% of the allocated costs. The direct charges to the various affiliates billed by each service company should also be included. After reviewing the results, the Commission may consider modifications to the ASAs. **(Contested)**
- (D) The costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes as required under Section 7-204(b)(3) of the Act.**

Conditions C1 through C7.

- (E) The utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities as required under Section 7-204(b)(5) of the Act.**

Conditions C1 through C6; and,

- 1) Midstates will remain liable for all outstanding over-recovered purchased gas adjustment charges related to open dockets for

reconciliation periods ending prior to closing of the proposed transaction. **(Uncontested)**

- 2) Midstates shall file the executed copy of the Asset Purchase Agreement and the executed ASA with the Chief Clerk of the Illinois Commerce Commission with a copy to the Manager of the Accounting Department of the Commission within fifteen (15) calendar days of the receipt of all regulatory approvals required for the proposed transaction to take effect. If the proposed transaction has not been consummated within 60 calendar days of the date of the Order in this proceeding, a status report should be filed with the Chief Clerk with a copy to the Manager of Accounting, and further status reports every 90 calendar days until the executed copy of the final purchase agreement has been filed. **(Uncontested)**

**(F) The Affiliate Services Agreement is adequate to safeguard the public interest as required by Section 7-101 of the Act.**

Conditions A1 and A2, B, C1 through C5, C7, E1, and E2.