STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	
Proposed General Increase In Rates For Gas Service.	:	No. 12-0511
	:	and
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	No. 12-0512 Consol.
	:	
Proposed General Increase In Rates For Gas Service.	:	

Rebuttal Testimony of

JAMES F. SCHOTT

Vice President – External Affairs,
Integrys Energy Group, Inc., North
Shore Gas Company and The Peoples
Gas Light and Coke Company

On Behalf of
North Shore Gas Company and
The Peoples Gas Light and Coke Company

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I. INTRODUCTION AND BACKGROUND

A. Identification of Witness

Q. Please state your name and business address.

A. My name is James F. Schott. My business address is 130 E. Randolph Street, Chicago, Illinois 60601.

Q. Are you the same James F. Schott who submitted direct testimony on behalf of The Peoples Gas Light and Coke Company ("Peoples Gas") and North Shore Gas Company ("North Shore") (together, "the Utilities") in these consolidated dockets?

A. Yes.

B. Purposes of Rebuttal Testimony

Q. What are the purposes of your rebuttal testimony in this proceeding?

A. My rebuttal testimony has three overall purposes. First, I address implications of the proposals of Staff, the AG, and CUB-City to reduce dramatically the Utilities' plant investments allowed in rate base, especially Peoples Gas' Accelerated Main Replacement Program ("AMRP") projects.[1] Those proposals are made by Staff witnesses Brett Seagle and Daniel Kahle; AG witnesses David Effron and Michael Brosch; and CUB-City witness Ralph Smith.

Second, I present revised / updated pie charts showing the drivers of the Utilities' respective increases in their costs of service.

Finally, I identify the other witnesses presenting rebuttal testimony on behalf of the Utilities, and I briefly describe the subjects of their respective testimony.

[1] Illinois Commerce Commission ("Commission" or "ICC") Staff ("Staff"); the Illinois Attorney General's Office (the "AG"); and Citizens Utility Board ("CUB") / City of Chicago ("City") (together "CUB-City").

C. Summary of Conclusions

Q. Please summarize the conclusions of your rebuttal testimony.

A. Staff, the AG, and CUB-City propose dramatic reductions in the Utilities' recovery of their costs of plant investments in rate base. For example, and most severely, Staff proposes to remove from Peoples Gas' rate base an aggregate amount of well over a third of a billion dollars of plant investments, *i.e.*, $356,125,000,[2] which has the effect of reducing the utility's revenue requirement by over $36 million per the figures in Staff's testimony. Staff's proposed plant reductions include, among others, removing from rate base $296,440,000 of Peoples Gas' 2012 and 2013 investments under its AMRP. Staff proposes to disallow half of that amount, *i.e.*, $148,220,000, directly, and the other half, indirectly, through its "average rate base" methodology. Staff also proposes significant reductions as to North Shore's 2013 plant investments in rate base, primarily through the average rate base methodology. The AG and CUB-City proposals also result, through their average rate base methodology, in extremely large plant in rate base reductions, including reducing Peoples Gas' plant investments in rate base by $151,985,000, thereby removing about $110,375,000 of Peoples Gas' 2013 AMRP investments.

The Staff, AG, and CUB-City proposals to reduce recovery of plant investment costs have real world consequences in utility operations. No utility can sustain its plant investment program over time if its regulator does not afford the utility the real opportunity to recover the costs of those investments. In particular, Peoples Gas cannot sustain its investments in accelerated main replacement if the Commission were to approve Staff's and intervenors' proposed extremely large reductions in AMRP cost

[2] All plant amounts stated in my rebuttal testimony are gross plant amounts unless indicated otherwise. Also, all figures in my rebuttal testimony from Staff and intervenor testimony are presented "as is", *i.e.*, they do not include any corrections, unless stated otherwise.

recovery. Substantial cost under-recoveries also can reduce, over time, the ability of a utility to raise capital in the capital markets at a reasonable cost.

A regulatory decision that renders Peoples Gas unable to continue to fund its accelerated main replacement investments would be a major loss for customers over time in terms of delayed reductions in operating expenses; increased costs of capital; and, for some customers, delayed ability to use more energy efficient appliances and equipment. AMRP investment reductions also will result in significant losses in good-paying construction jobs that already have been created.

Other rebuttal witnesses on behalf of the Utilities address, with more specificity, the problems with Staff's and intervenors' proposed plant reductions.[3] I can say, however, that application of the average rate base methodology to the Utilities in these consolidated cases would be erroneous and unfair. The Staff, AG, and CUB-City argument for that methodology ultimately is based on the implicit assumption that, or is presented as if, the new rates resulting from the instant Dockets will go into effect on January 1, 2013. The proposed rates will not go into effect until July 2013, however, resulting in the Utilities experiencing the revenue impact of the new rates for less than half of 2013.

D. Itemized Attachments to Rebuttal Testimony

Q. Are there any attachments to your rebuttal testimony?

A. No.

[3] The Utilities' rebuttal testimony does accept some proposed plant adjustments in whole or in part, as quantified in the rebuttal testimony of John Hengtgen (NS-PGL Ex. 27.0).

II. THE NEED FOR RECOVERY OF THE COSTS OF PLANT INVESTMENTS

Q. You referred to Staff proposals that would reduce the Utilities' recovery of their plant investment costs. To what Staff proposals are you referring?

A. The Staff proposals to which I am referring are as follows:

- Staff proposes to reduce Peoples Gas' plant investments in rate base by $356,125,000, based on $353,848,000 of adjustments proposed in the aggregate by Staff witnesses Brett Seagle and Daniel Kahle plus $2,277,000 of adjustments proposed by Staff witness Mike Ostrander.[4]
- More specifically, Staff witness Mr. Seagle proposes Peoples Gas plant reductions of $357,695,000. That figure includes $296,440,000 of AMRP investments in 2012 and 2013. Half of those AMRP recovery reductions, *i.e.*, $148,220,000, are to be applied directly, and the other half are to be applied, indirectly, by virtue of Staff's average rate base methodology, which is advocated by Staff witness Mr. Kahle. After application of Mr. Kahle's average rate base methodology, Mr. Seagle's total direct adjustments are $184,395,000. Mr. Kahle's average rate base methodology reduces plant by an additional $152,372,000, and he proposes another $17,081,000 of direct adjustments. Mr. Ostrander proposes the remaining $2,277,000 of reductions relating to capitalized incentive compensation and non-union wages.[5]

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[4] Hathhorn Dir., Staff Ex. 1.0, Schedule ("Sched.") 1.03 P, line 1, and Sched. 1.04 P, line 1. As noted earlier, all figures in my rebuttal testimony from Staff and intervenor testimony are presented "as is", *i.e.*, they do not include any corrections, unless stated otherwise.

[5] Seagle Dir., Staff Ex 6.0, 3:62-76; Kahle Dir., Staff Ex. 2.0, 3:62 - 12:257, 24:524-538, and Scheds. 2.01 P, 2.02 P, 2.07P, 2.08P; Hathhorn Dir., Staff Ex. 1.0, Sched. 1.04 P, line 1. Staff's response to NS-PGL data request 3.30(d) indicates that the above figure of $184,395,000 should be $178,848,000.

- The Staff plant reduction proposals, per Staff's calculations, would reduce Peoples Gas' by over $36 million.[6]
- Staff proposes to reduce North Shore's plant investments in rate base by $12,548,000, of which $11,083,000 is due to the average rate base methodology.[7]

Q. You also referred to AG and CUB-City proposals that would reduce the Utilities' recovery of their plant investments. To what AG and CUB-City proposals are you referring?

A. The AG and CUB-City proposals to which I am referring are as follows: The AG and CUB-City each propose to reduce Peoples Gas' and North Shore's rate bases by $151,985,000 and $11,083,000, respectively, based entirely on the average rate base methodology advocated by AG witnesses Messrs. Effron and Brosch and CUB-City witness Mr. Smith.[8]

Q. How do the reductions in the Utilities' recovery of the costs of plant investments proposed by Staff, the AG, and CUB-City affect the Utilities' ability to maintain their plant investment programs?

A. The effects of the proposals by Staff, the AG, and CUB-City to dramatically reduce the Utilities' plant investments in rate base would be severe. For example, and most notably,

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[6] *See* Hathhorn Dir., Staff Ex. 1.0, Sched. 1.05 P, lines 7, 8, 10, 11, 15, 18; Sched. 1.02 P, line 18, col. (k) and (l).

[7] Seagle Kahle Dir., Staff Ex. 2.0, 3:62 - 12:257, 24:524-538, and Scheds.2.01 N, 2.02 N; Hathhorn Dir., Staff Ex. 1.0, Sched. 1.03 N, line 1, and Sched. 1.04 N, line 1.

[8] Effron Dir., AG Ex. 2.0, 4:70 - 8:165; AG Ex. 1.3, p. 1, col. (C); AG Ex 1.4, p. 1, col. (C); Smith Dir., CUB-City Ex. 1.0, 13:288 – 17:383; CUB-City Ex. 1.3, Sched. B.1; CUB-City Ex. 1.2, Sched. B.1. CUB-City also removes additional amounts of previously disallowed capitalized incentive compensation.

Peoples Gas cannot afford to keep investing in accelerated main replacement if its regulator reduces plant in rate base by as much as over a third of a billion dollars, i.e., $356,125,000 (per Staff), nor by $151,985,000 (per the AG and CUB-City), in a single rate case. The ability of Peoples Gas to sustain such an extremely large reduction in recovery of these costs inherently is limited. Peoples Gas' forecasted total capital in 2013 as of its direct testimony was $1,401,213,000.[9] Peoples Gas cannot keep to its planned levels of investing in its system without a cost recovery level that, over time, meets the costs of those investments. Significant cost under-recoveries also can erode the ability of a utility to raise capital in the capital markets at reasonable cost.

The plant investment implications are similar for North Shore, although the reductions are not as extreme because there are not proposed reductions comparable to the extremely large proposed AMRP reductions.

Q. What are the implications for customers of large plant investment cost recovery shortfalls over time?

A. With respect to the AMRP investments of Peoples Gas, in brief, the Commission already has found that the long-term benefits of those investments include, among other things, significant reductions in operating expenses, enhancements of reliability, and, as to customers served by the legacy low-pressure system, the ability to use more energy efficient appliances and equipment.[10] Other plant investments of Peoples Gas and North Shore are made to maintain and improve the adequacy, safety, and reliability of the

[9] PGL Ex. 2.1, line 10.

[10] See *North Shore Gas Co., et al.*, ICC Docket Nos. 09-0166, 09-0167 Cons. (Order Jan. 21, 2010) at 164-173 (reversed in part, on other grounds, by the Appellate Court).

system, or they support the back office work that also is essential to the utility's functions.

As I noted earlier, the Utilities cannot sustain their plant investments levels over time if they lack sufficient cost recovery, so these benefits to customers are at risk over time as well. Customers also face the risk of increased costs of capital.

Q. What are the implications for the loss of jobs if the Utilities, due to insufficient cost recovery levels, cannot sustain their plant investment levels?

A. Significantly less plant investment means significantly fewer construction jobs. With respect to AMRP investments, the Commission's final Order (at 169 and 172) in the 2009 rate cases recognized the testimony and the position of the Union regarding the program's benefit of substantial increases in construction jobs. At this point, with respect to the AMRP, 500 recently created highly skilled and desperately needed jobs are at risk. The employment of 120 Gas Workers Union Local 18007 field personnel to offset the added AMRP manpower support filled by our current seasoned, highly skilled craft personnel is also jeopardized. Also put at risk is a newly designed, first class apprentice training program partnership with the Utility Workers Union of America and the City Colleges of Chicago. In short, the extremely large proposed reductions in AMRP cost recovery destroy Peoples Gas' efforts to build and employ a diverse, highly skilled work force and unnecessarily contributes to the unemployment rate.

Q. You have indicated that almost half of the Staff-proposed reductions in Peoples Gas' plant in rate base are due to Staff's advocacy of the average rate base methodology. You also have indicated that nearly all of Staff's proposed plant reductions as to North Shore, and all of the AG and CUB-City proposed plant

reductions as to both Utilities, are due to the average rate base methodology. Why is the average rate base methodology not appropriate for determining the Utilities' rate bases in the instant Dockets?

A. This subject is addressed primarily for the Utilities by witness John Hengtgen in his direct and rebuttal testimony. However, as I stated in my direct testimony, an end of year rate base, not an average rate base, is appropriate in the instant cases, even though the latter was approved in the Utilities' 2009 and 2011 rate cases (the Utilities did not propose end of year rate base) and in other rate cases involving a future test year.[11]

The Utilities' revenue requirements are being determined here based on a forecasted 2013 test year, but the rates that will result from the instant Dockets will not go into effect until July 2013.[12] The timing of these cases reflects the fact that, under Sections 9-220(h) and 9-220(h-1) of the Act, the cases had to be filed on or before August 1, 2012. The Utilities, as a practical matter, could not be expected to file much earlier, nor to use a different test year, in these Dockets. The Appellate Court decision reversing the Commission's approval of the infrastructure rider associated with the AMRP was issued on September 30, 2011, but the Supreme Court of Illinois did not deny the petitions for leave to appeal of the Commission and the Utilities until January 25, 2012. Also, a rate case takes a long time to prepare. Preliminary analysis and related work generally begins roughly a year before filing, and a higher level of activity generally is needed for up to six months before filing. The Utilities have a fiscal year that

[11] The "end of year" versus "average" rate base methodology issue in these Dockets involves plant investment and most rate base items, but certain rate base items, it is agreed, are determined based on a 13 month average. *E.g.*, Hengtgen Dir., PGL Ex. 7.0, 4:73-76; PGL Ex. 7.1, Sched. B-1.

[12] Staff witness Mr. Kahle asserts that the new rates will go into effect around July 1, 2013. Kahle Dir., Staff Ex. 2.0, 5:97-98. AG witness Mr. Effron and CUB-City witness Mr. Smith do not deny, or otherwise discuss, the fact that the new rates will go into effect in July 2013.

is a calendar year, so choosing a test year other than a calendar year presents serious practical problems. For example, the Utilities do not forecast or budget for non-calendar years. So, such a forecast would have to be developed, which would be a very laborious process, even if the requisite data could be developed. Moreover, regardless of the test year, if the resulting rates are not in effect for the entirety of any given year, then the utility does not experience the full revenue impact of the new rates in that year. In addition, the Utilities are increasing the levels of their plant investments to better serve customers, which is better represented by an end of year rate base. Thus, while the Utilities did not do so in the 2009 and 2011 rate cases, the Utilities here have proposed end of year rate bases.

The fundamental logic of the average rate base methodology proposed by Staff, the AG, and CUB-City is that plant investment in any given year occurs over the course of that year, so the utility's "real" cost of plant investment during that year is reflected (at least in a simplified manner) in the average of its rate base figures as of the beginning and the end of that year.[13] That logic implicitly assumes, however, or is presented as if, the utility has in place throughout that year rates that reflect its costs during that year. That is not the case here. The Utilities' existing rates are based on a 2012 test year.[14] As noted above, the new rates, which (if calculated properly) will reflect 2013 costs, will not go into effect until July 2013. Thus, the average rate base methodology, of necessity, denies the Utilities recovery of a substantial part of their 2013 costs.

Staff witness Mr. Kahle acknowledges that the Utilities are increasing their levels of capital spending, although he seeks to dismiss that fact on the grounds that it is

[13] *E.g.,* Kahle Dir., Staff Ex. 2.0, 4:75 – 5:89.

[14] *E.g., North Shore Gas Co., et al.,* ICC Docket Nos. 11-0280, 11-0281 Cons. (Order Jan. 20, 2012), at 5.

"normal for the Companies to have increased investments after filing a rate case" and that an average rate base was used in their previous future test year rate cases.[15] He does not otherwise address the point that this fact means that the rates being set will not reflect higher levels of investment after 2013.

III. DRIVERS OF COST INCREASES

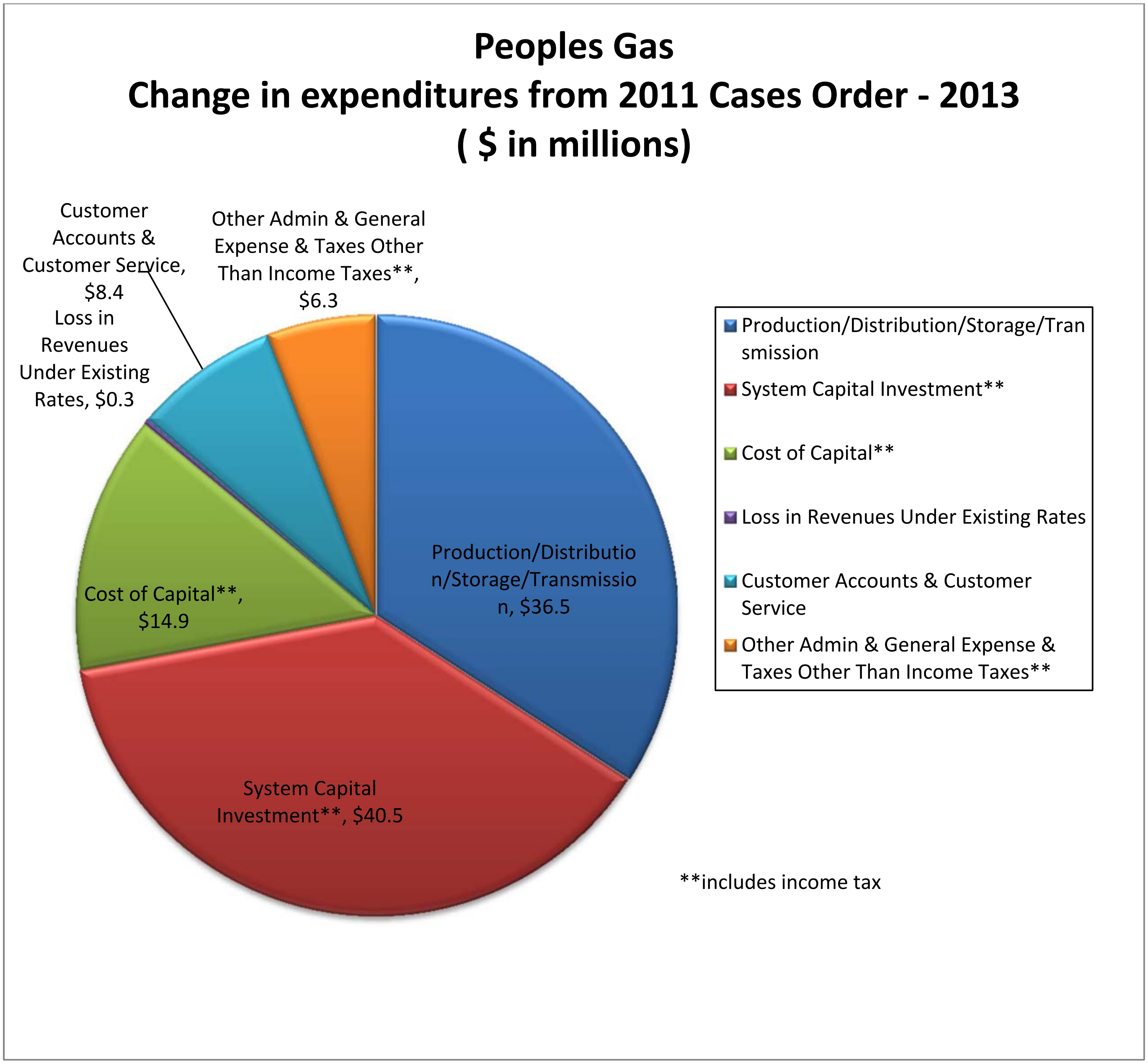
Q. In your direct testimony, you presented a pie chart for each utility that summarized the drivers of the net changes in their base rate costs of service and revenues versus the levels set in their 2011 rate cases. The Utilities subsequently presented supplemental direct testimony, and they also are presenting corrections and limited updates to their revenue requirements in rebuttal. Do you have revised / updated pie charts?

A. Yes. I present two revised / updated pie charts, one for each utility.

Q. Please present and describe the first pie chart.

A. The first pie chart shows the drivers of the base rate cost changes and revenues for Peoples Gas comparing the levels set in the 2011 cases versus the rebuttal on behalf of Peoples Gas in the instant Dockets.

[15] *See* Kahle Dir., Staff Ex. 2.0, 10:214 – 11:216.



The Peoples Gas change drivers generally are similar to the drivers discussed in my direct testimony, but there are two large changes in amounts and other smaller changes. The level of production / distribution / storage / transmission expense has increased by $19.5 million, essentially due to the costs relating to the Chicago Department of Transportation regulations ($13.9 million) and the costs associated with the cross bores issue ($5.7 million).

The level of capital investments in the utility's systems has increased by $5.6 million (revenue impact) primarily because of increases in AMRP projects.

The level of other Administrative and General expenses and Taxes Other Than Income Taxes has increased by $1.4 million primarily because of increases in pensions and benefits expenses, less decreases in omnibus and executive plan incentive compensation expenses. The level of cost of capital recovery has increased by $1.4 million because of the increase in the weighted average cost of capital in the utility's supplemental direct testimony, reduced slightly in rebuttal testimony. The level of Customer Accounts and Customer Services expenses has increased by $700,000 because of uncollectibles expense associated with the proposed change in revenues.

The substance of the costs making up the Utilities' base rate revenue requirements and their revenues are addressed by other witnesses on behalf of the Utilities. In presenting the Peoples Gas and North Shore pie charts and discussing the drivers, I am summarizing information from the applicable witnesses.[16]

Q. Please present and describe the second pie chart.

A. The second pie chart shows the drivers of the base rate cost changes and revenues for North Shore comparing the levels set in the 2011 cases versus the rebuttal on behalf of North Shore in the instant Dockets.

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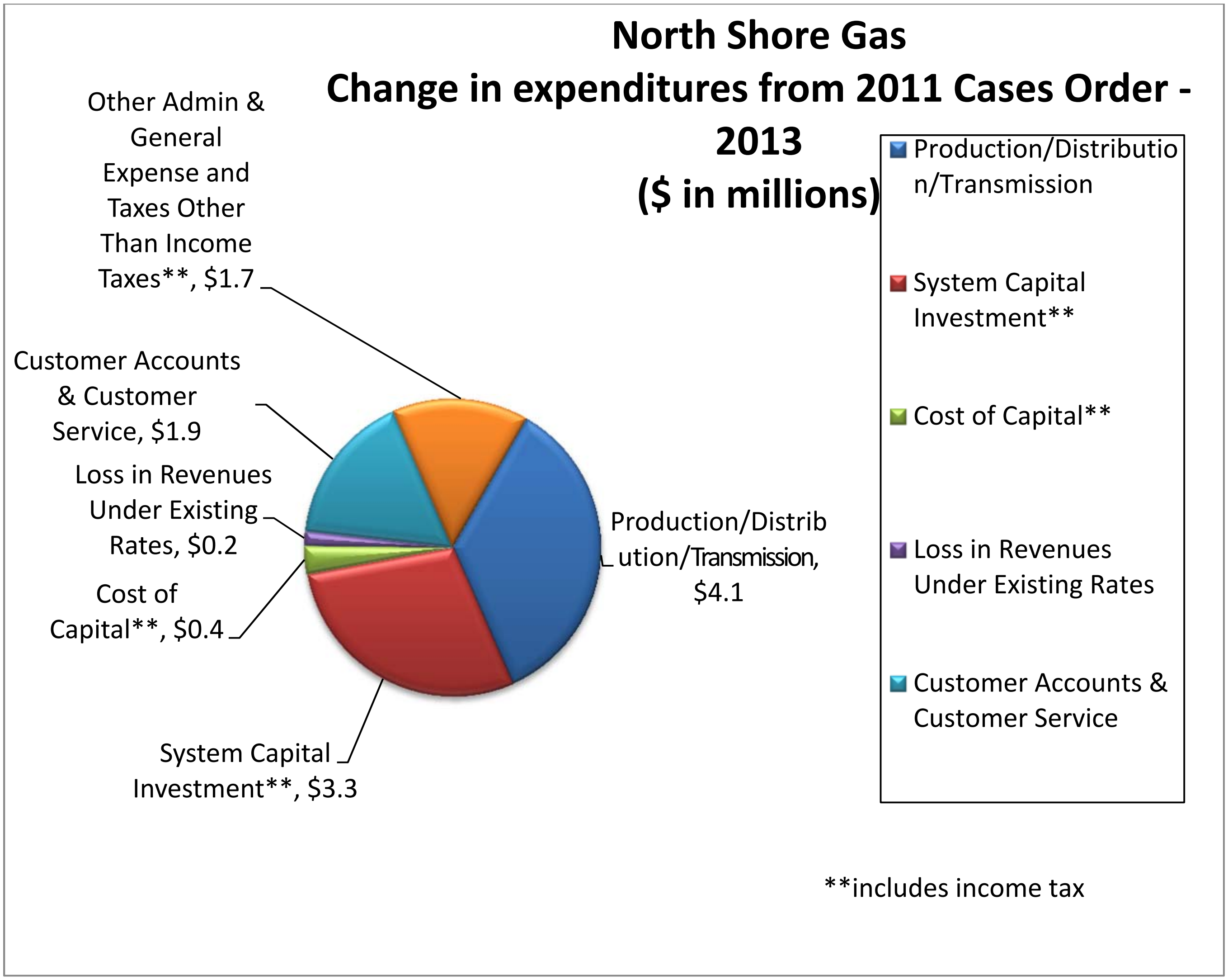
[16] The Utilities also have timely responded to an extremely large volume of discovery. As of December 14, 2012, the Utilities had responded to 1,200 data requests (not counting subparts), with an average response time of 14 days.



The North Shore change drivers generally are similar to the drivers discussed in my direct testimony, but there is one large change in amount and a few small changes. The level of production / distribution / storage / transmission expense has increased by $3.7 million primarily because of the costs associated with the cross bores issue.

The other categories did not change, or changed by much smaller net amounts, generally due to the net effects of multiple factors.

IV. OTHER WITNESSES PRESENTING REBUTTAL TESTIMONY ON BEHALF OF THE UTILITIES

Q. Please identify the other witnesses presenting rebuttal testimony on behalf of Peoples Gas and North Shore and the main topic or topics that each witness addresses:

A. The following witnesses are presenting rebuttal testimony on behalf of the Utilities.

- Lisa J. Gast, Manager, Financial Planning and Analysis for Integrys Business Support, LLC ("IBS") (NS-PGL Ex. 23.0), addresses Staff's and the AG's proposed adjustments to long-term debt costs, in particular Staff's and the AG's reliance on historical interest rates to forecast what interest rates will be during 2013, and Staff's objection to the Utilities' recovery of costs associated with a prudent interest rate swap. Ms. Gast also updates the Utilities' cost of capital schedules to reflect the updated Utilities' Test Year 2013 rate case budget presented in NG-PGL Exs. 26.2N and 26.2P (revised Schedule C-2), which are sponsored by Utilities' witness Ms. Sharon Moy.
- Paul R. Moul, Managing Consultant, P. Moul & Associates (NS-PGL Ex. 24.0), addresses Staff's and the AG's proposed adjustments to return on equity, in particular Staff's direct reliance on historical information to establish the Utilities' cost of equity during a future test year, other methodological flaws with Staff's Discounted Cash Flow and Capital Asset Pricing models, and the AG's selective and biased reliance on recent returns authorized for other utilities.
- Christine M. Gregor, Director, Operations Accounting, Peoples Gas and North Shore (NS-PGL Ex. 25.0), addresses Staff's and the AG's proposed adjustments to IBS costs, and the AG's proposed "productivity" adjustments.

- Sharon Moy, Rate Case Consultant, IBS (NS-PGL Ex. 26.0), addresses operating expenses adjustments proposed by Staff, the AG, and CUB-City that are not contested by the Utilities; certain other operating expenses and revenue adjustments proposed by Staff or intervenors; the updating of certain operating expenses items; additional and updated support and documentation of rate case expenses; and updated revenue (cost recovery) deficiency calculations.
- John Hengtgen, Consultant, Stafflogix Corporation (NS-PGL Ex. 27.0), responds to various adjustments Staff, the AG, and CUB-City propose to rate base, including average rate base, gross plant additions, and cash working capital.
- Kyle A. Hoops, General Manager, District Field Operations, Peoples Gas (NS-PGL Ex. 28.0), addresses adjustments made relating to forecasted additions to utility plant. He also testifies regarding Staff's and the AG's adjustments related to specific capital projects. Finally he addresses disallowances related to employee headcount.
- Noreen E. Cleary, Assistant Vice President, Total Compensation, Integrys (NS-PGL Ex. 29.0), addresses Staff's and GCI's proposed disallowances in incentive compensation (executive, non-executive, and stock plans). Ms. Cleary also addresses Staff's proposed reduction in the base wage increases.
- John P. Stabile, Tax Director, IBS (NS-PGL Ex. 30.0), addresses AG's and CUB-City's adjustments related to the state income tax and the capital investment tax. He also testifies concerning the risks associated with the tax accounting method changes. Finally, he addresses the need for a deferred asset for Net Operating Losses.

- Christine M. Phillips, Manager, Benefits Accounting, IBS (NS-PGL Ex. 31.0), addresses updated pension and other post-employment benefits ("OPEB") costs; updated medical/dental costs; the Staff, AG, and CUB-City proposed adjustments to retirement benefits-net; and the AG proposed adjustments to benefits in relation to vacancies.
- Valerie H. Grace, Consultant, Stafflogix Corporation (who served until her retirement effective June 1, 2012, as Manager, Gas Regulatory Services, IBS) (NS-PGL Ex. 32.0), addresses Staff and AG rate design proposals and Interstate Gas Supply of Illinois, Inc.'s ("IGS Energy") comments regarding certain transportation administrative costs and calculates revised rates.
- Joylyn C. Hoffman Malueg, Rate Case Consultant, IBS (NS-PGL Ex. 33.0), addresses certain cost of service principles raised by AG witness Scott Rubin and presents updated embedded cost of service studies.
- Philip M. Hayes, Director, Project Management, IBS (NS-PGL Ex. 34.0), testifies concerning Staff's adjustments related to AMRP costs. He also addresses comments made by AG witness Mr. Effron regarding Construction Work In Progress.
- Thomas L. Puracchio, Manager, Gas Storage, IBS (NS-PGL Ex. 35.0), addresses Staff's adjustment related to LNG Control System Upgrade project.
- Debra E. Egelhoff, Manager, Gas Regulatory Policy, IBS (NS-PGL Ex. 36.0), addresses IGS Energy's recommendations that the Commission require the Utilities to implement a residential customer purchase of receivables program and

that the Commission investigate gas utilities' continued role as the provider of last resort in Illinois.

Q. Does this complete your rebuttal testimony?

A. Yes.