

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

NORTH SHORE GAS COMPANY	:	No. 12-0511
	:	
Proposed general increase in rates for gas service.	:	(Cons.)
	:	
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	No. 12-0512
	:	
Proposed general increase in rates for gas service.	:	On Rehearing

**REPLY POST-HEARING BRIEF ON REHEARING
OF NORTH SHORE GAS COMPANY AND
THE PEOPLES GAS LIGHT AND COKE COMPANY**

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October 30, 2013

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North Shore Gas Company (“North Shore” or “NS”) and The Peoples Gas Light and Coke Company (“Peoples Gas” or “PGL”) (together, the “Utilities”), by their counsel, submit this Reply Brief on Rehearing.

I. INTRODUCTION

The Illinois Commerce Commission’s (“the Commission”) June 18, 2013, final Order in these consolidated cases (“June 18 Order”) correctly included in the Utilities’ rate bases deferred tax assets for their 2012 and 2013 Net Operating Losses (“NOLs”). June 18 Order at 99-100. The Commission granted rehearing (1) to address the correct figures for the NOLs and (2) to allow intervenors AG¹ and CUB-City² an additional opportunity to challenge the 2012 NOLs. *See* Appendix A hereto, 8/6/13 Regular Open Meeting, Tr. at 10:25-11:11 (as corrected by memorandum).

Remarkably, and tellingly, on rehearing, the AG and CUB-City chose to present no evidence challenging the 2012 NOLs. Nor did Staff. Yet, even though the June 18 Order already found that the Utilities had submitted sufficient and timely evidence of the 2012 NOLs

¹ The Illinois Attorney General (“AG”).

² The Citizens Utility Board (“CUB”) – The City of Chicago (“City”).

and approved its inclusion in rate base, the AG and CUB-City, joined by Staff, now urge the Commission to reverse its ruling, despite the fact that they chose to submit no evidence supporting a reversal. Their position is both wrong and reckless.

Staff, the AG, and CUB-City all set forth factually unsupported arguments that misstate the evidence in the record. There is evidence of the 2012 NOLs, which the June 18 Order already found satisfactory. There is no evidence that there are not 2012 NOLs. No one disputes that, if there is an NOL, it belongs in rate base.³ The June 18 Order made the only right ruling, and there is literally nothing on rehearing that supports a reversal.

Further, Staff, the AG, and CUB-City make their proposals with utter disregard of the tax normalization violation consequences to the Utilities and thus to the Utilities' customers, *i.e.*, risking the loss of accelerated depreciation, which would drive up the Utilities' costs and as a result increase customer bills. In fact, as to Staff, this will be the second time in 22 years that it recommends that the Commission approve a proposal that would cause the Utilities to violate the tax normalization rules.

As reflected in the June 18 Order (at 99), the evidence demonstrates that the Utilities provided evidence regarding the 2012 NOLs at every stage of the original phase of this proceeding: direct, rebuttal, and surrebuttal.⁴ The Utilities' assumptions upon which they filed

³ The fact that neither Staff nor intervenors contest the inclusion of the 2013 NOLs in rate base highlights the consensus on the question of whether NOLs are properly included in rate base.

⁴ In their July 31, 2012, tariff filing and supporting materials, including direct testimony attachments, that initiated these consolidated Dockets, the Utilities informed Staff and intervenors that both North Shore and Peoples Gas were forecasted to have stand-alone Net Operating Losses (NOLs). NS Exhibit ("Ex.") 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11. The Utilities also indicated, however, that these deferred tax assets were not included in the Utilities' rate bases because at the time it was assumed that their parent company's, Integrys Energy Group, Inc. ("Integrys"), consolidated group would be able to absorb those losses. *Id.* The Utilities even expressly indicated that this assumption would be monitored and updated at each step of the case. *Id.* In rebuttal testimony, the Utilities provided a status on the 2012 NOLs and informed Staff and intervenors that they would request the inclusion of deferred tax assets in the Utilities' rate bases should the Integrys consolidated group not be able to absorb those 2012 NOLs. *Stabile Reb.*, NS-PGL Ex. 30.0 Rev., 27:649-652, 30:723-727. In surrebuttal testimony, after it turned out that the Integrys group could not absorb the losses, the Utilities made such a request. *Stabile Sur.*, NS-PGL Ex. 46.0, 36:868-876.

their direct cases were examined by independent certified public accountants in accordance with standards established by the American Institute of Certified Public Accountants (“AICPA”). Gregor Dir., PGL Ex. 5.0 Rev., 9:189-196; NS Ex. 5.0 Rev., 8:178-9:189; *see also* 83 Il. Admin. Code § 285.7010. Further, the 2012 NOLs were used in accordance with the Commission-approved tax sharing agreement among Integrys companies. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11. There was no management decision to create the 2012 NOLs. They are the product of the 2012 results and the inability of the Integrys group to absorb the 2012 NOLs, a fact which became known only once the 2012 Integrys books were closed. Notwithstanding the substantial amount of evidence provided throughout the original proceeding to which the AG and CUB-City did not respond, they instead feigned surprise when the Utilities proposed to include the 2012 NOLs in their rate bases once it became known the NOLs could not be absorbed. Staff, perhaps more perplexing, submitted testimony in the original proceedings acknowledging the 2012 NOLs, which it now claims are unsupported, and requested that the Utilities provide updates throughout the proceeding, which the Utilities did. Pearce Dir., Staff Ex. 4.0, 26:644-658; Pearce Reb., Staff Ex. 14.0, 23:492-505.

Even though they complained that they were deprived of a meaningful opportunity to respond to the Utilities’ surrebuttal testimony, did the AG and CUB-City seek to introduce new evidence in the original proceedings to rebut the Utilities’ evidence regarding the 2012 NOLs? No.⁵ Despite this failure, the Commission in approving the AG’s and CUB-City’s applications for rehearing on this subject provided these intervenors a meaningful opportunity to respond to the evidence. Indeed, Commissioner McCabe, in moving that their request be granted, made clear that this opportunity included the ability to offer new evidence. *See* Appendix A hereto, 8/6/13 Regular Open Meeting, Tr. at 10:25-11:11 (as corrected by memorandum) (emphasis

⁵ The AG and CUB-City certainly could have done so. Staff did so on this same subject. June 18 Order at 5.

added). The AG and CUB-City then rejected this opportunity. Twice. Instead, they chose to rely on arguments that misrepresent the evidentiary record and are factually unsound. The Utilities submit that such behavior both in the original phase of this proceeding and on rehearing is not the “best use” of Commission resources.

Furthermore, Staff, the AG, and CUB-City appear flippant about the harmful consequences of their proposals. The Utilities submitted evidence explaining the tax normalization rules and the consequences of violating the rules. *Stabile Reb.*, NS-PGL Ex. 30.0 Rev., 26:647-33:796. Ironically, before flip-flopping positions, Staff cited the Utilities’ evidence regarding normalization as a reason to include the 2012 NOLs in the Utilities’ rate bases, which it now questions. Staff Initial Brief at 40-41. Public utility commissions, and generally their Staffs, are aware of the tax normalization rules and avoid taking action that would cause a violation. *See, e.g.*, 83 Ill. Admin. Code § 285.7035; Rate Case and Audit Manual, pp. 24-25 (NARUC Staff Subcomm. on Accounting and Finance Summer 2003). However, for the Utilities, this will be the second time in 22 years that Staff is recommending that the Commission take such an action. The Utilities note that in a recent rulemaking Order, the Commission confirmed “the importance of correctly calculating ADIT [Accumulated Deferred Income Taxes], not merely in the implementation of these rules but to preserve the Utilities’ ability to continue to use accelerated depreciation by remaining in compliance with the IRS’ normalization requirements.” *Illinois Commerce Comm’n On Its Own Motion: Adoption of 83 Ill. Adm. Code 556*, ICC Docket No. 13-0458 (Order Oct. 23, 2013) at 3. The Commission should reaffirm this here, rejecting the proposals by Staff, AG and CUB-City.

The Utilities urge that the Commission reaffirm its decision in the June 18 Order to include the 2012 NOLs in the Utilities' rate bases as it is supported by substantial evidence and opposed by no evidence. To do otherwise, would be reversible error.

The Commission should correct the figures for the NOLs in rate bases. The evidence of Staff and the Utilities is uncontradicted as to what are the correct figures. The main calculation error was simply failing to divide part of the calculation by 2 to reflect the Commission's adoption of the average rate base method.

II. THE COMMISSION SHOULD APPROVE CORRECTED SCHEDULES PROPERLY REFLECTING THE 2012 AND 2013 NOLs IN RATE BASE

For all the reasons stated herein and in the Utilities' Initial Brief on Rehearing, the Commission should reaffirm its decision to reflect both the 2012 and 2013 NOLs in the Utilities' rate bases and should approve the schedules identified as Staff Ex. 26.1, Appendices A and B, to correct the figures. Staff now argues, remarkably, that correcting NOLs in a Commission Order is not the "best use" of Commission resources on rehearing. Staff IB on Rehg. at 4. First, as explained in the Utilities' Initial Brief on Rehearing (at 3-5), contrary to Staff's assertions, the Utilities in the original proceedings through testimony, discovery, and briefs provided all the information necessary to correctly reflect the 2012 and 2013 NOLs in the Utilities' rate bases. Second, in their application for rehearing, the Utilities requested that an amendatory order be issued correcting the main errors regarding the NOLs in the June 18 Order's Appendices, namely the calculations: (1) for Peoples Gas and North Shore where calculations failed to divide one figure by 2 (dividing by 2 was required to reflect use of the average rate base method), and then (2) for Peoples Gas, where a calculation subtracted that incorrect figure from a number in the wrong column. Utilities' Appl. Rehg. at 9, 11. The Commission, rather than issue an amendatory order, granted rehearing on the issue of the correct calculations. Staff's claim that

this is not the “best use” of rehearing is contrary to the Commission’s decision to grant rehearing. Having this opportunity to correct the calculations, it is important to reflect the resulting derivative and associated adjustments as well, although simply correcting the two above errors would eliminate the major errors.

Further, with respect to the Staff proposal recommending that the Commission order the Utilities in future proceeding to reflect the impacts on their positions of all pending adjustments, as clarified in Staff’s Initial Brief on Rehearing (at 4-5), this proposal continues to be unworkable. The errors in Staff’s schedules in the original phase in this proceeding that are reflected in the Appendices to the June 18 Order and its body would have been cured if Staff made the same adjustments to the income statement as it did to rate base. Furthermore, the schedules that Staff proposes that the Utilities prepare as part of rebuttal and/or surrebuttal testimony would hardly be useful to the Commission as they would reflect one party’s position on permutations and combinations of all adjustments. Generally, a Commission Order reflects approvals of various utility, Staff, and intervenor proposals. Finally, such a time intensive endeavor would occur when the Utilities have just days to prepare surrebuttal testimony. For example, in the original phase of these consolidated proceedings, the Utilities had about one month to prepare rebuttal testimony and just nine calendar days to prepare surrebuttal testimony. The Utilities’ Initial Brief on rehearing (at 5) gave the example that just five proposed adjustments to operating expenses could yield 32 different Cash Working Capital figures for each utility. The Commission should decline adopting Staff’s ill-conceived proposed new requirement, as clarified, for submitting schedules that reflect the impacts on the Utilities’ positions of all pending adjustments. However, if the Commission were to adopt Staff’s proposal, this new requirement should apply to all utilities and to Staff and intervenor adjustment

proposals as well, because there is no reasonable or fair basis for distinguishing their proposals from the rationale of the Staff position.

III. THE 2012 NOLS ARE SUPPORTED BY THE RECORD AND ARE PROPERLY INCLUDED IN THE UTILITIES' RATE BASES

As explained in this Section III of this Reply Brief on Rehearing, the Staff, AG, and CUB-City arguments are unsupported by the evidence and, at times, internally inconsistent. Further, given opportunities to respond to the Utilities' evidence in the original phase of these proceedings and then again in rehearing, Staff, the AG, and CUB-City opted to provide no evidence challenging the existence of the 2012 NOLS and instead rely on arguments that misstate the evidentiary record and that are factually incorrect. The evidence demonstrates that the 2012 NOLs, which result from the extension of bonus depreciation through 2012 under the Tax Reform Act of 2010, and the inability of the Integrys group to absorb the NOLs, are supported by the evidence. Furthermore, the inclusion of the 2012 NOLs in the Utilities' rate bases is consistent with the Commission rules related to rate cases. The Utilities applied the NOLs consistent with the Commission-approved tax sharing agreement. Finally, the un rebutted evidence demonstrates that a Commission Order excluding the 2012 NOLs from the Utilities' rates bases will likely result in a violation of the tax normalization rules harming not just the Utilities but their customers.

A. There Is Substantial Evidence in the Record Supporting the 2012 NOLs

In its ever-evolving position regarding the 2012 NOLs⁶, Staff now joins the AG's argument that there is insufficient evidence supporting the 2012 NOLs in evidence. Staff argues

⁶ First, Staff argued that the 2012 NOLs should be reflected in the Utilities' rate bases. See Staff Response to AG's motion to strike dated Jan. 31, 2013 at ¶¶ 5,6; Staff Initial Brief in the original proceedings at 40-41. Second, Staff later argued that the 2012 NOLs should not be included in the Utilities' rate bases because reflecting the derivative impacts was too complicated and the record did not contain the necessary information to perform the calculations.

that “after further reflection upon the lack of evidence supporting the 2012 NOLs,” Staff recommends that the 2012 NOLs be excluded from rate base. Staff IB on Rehg. at 6. Staff, the AG, and CUB-City all argue that the 2012 NOLs are not explained by the extension of bonus depreciation through 2013. Staff IB on Rehg. at 6; AG IB on Rehg. Rev. at 5-6; CUB-City IB on Rehg. at 5. That is true, but irrelevant. The 2012 NOLs are not based on 2013 bonus depreciation, as indicated above. As for the AG, it also recycles many of the same incorrect arguments it made in the original phase of these proceedings, including that there is only one statement in surrebuttal testimony that supports the 2012 NOLs and that the introduction of the 2012 NOLs in surrebuttal is contrary to the Commission Rules. AG IB on Rehg. Rev. at 4-6. All these arguments must be rejected as they are contrary to the record. The Utilities set forth in their Initial Brief on Rehearing (at 7-10) the substantial evidence in the record regarding the 2012 NOLs and they will not repeat that evidence here. However, there are assertions that Staff, the AG, and CUB-City make regarding the evidence supporting the 2012 NOLs that the Utilities will address in this Reply Brief on Rehearing.

1. Staff Reviewed and Testified Concerning the Evidence Supporting the 2012 NOLs

Staff’s new position that there is insufficient evidence to include the 2012 NOLs in the Utilities’ rate bases is extremely curious given the testimony that Staff submitted in the original phase of these proceedings. Staff now appears to be backing away from the testimony of its own witness, Bonita Pearce, who not only noted in direct and rebuttal that she had outstanding data requests regarding the NOLs, but also *reserved the right to propose adjustments* in rebuttal testimony or in supplemental rebuttal testimony regarding the NOLs. Pearce Dir., Staff Ex. 4.0, 26:644-658; Pearce Reb., Staff Ex. 14.0, 23:492-505. Staff did not propose any adjustment in

See Staff pleadings in the original phase of these consolidated proceedings: Staff Rep. Br. at 35; Staff BOE at 14-18; Staff RBOE at 26-27.

rebuttal testimony. Also, even though it requested leave to and filed supplemental rebuttal testimony and surrebuttal testimony for certain witnesses⁷ to which the Utilities did not object, Staff did not seek leave to file supplemental rebuttal testimony for Ms. Pearce. Furthermore, in response to Staff's discovery, the Utilities also provided estimates for the 2012 NOLs. Specifically, the 2012 NOLs at October 23, 2012, were estimated to be \$1.9 million for North Shore and \$51.6 million for Peoples Gas. Staff Cross Exs. 12 and 13, Utilities' responses to Staff data requests BAP 15.01. Staff had the opportunity to review these estimates and raise any concerns with respect to these estimates. It did not. While Staff complains that correcting schedules on rehearing is "not the best use of Commission resources" (Staff IB on Rehg. at 4), what certainly is not the best use of Commission resources is ignoring record evidence in both the original phase of these consolidated proceedings and on rehearing and then making unsupported arguments about "extend[ing] the eleven month rate case process" and disregarding that the Commission chose to grant rehearing on this subject.

2. The 2012 NOLs Are a Direct Result of the Enactment of the Tax Relief Act of 2010 That Extended Bonus Depreciation Through 2012

Staff, the AG, and CUB-City all argue that the 2012 NOLs are not supported by the American Taxpayer Relief Act of 2012 (enacted January 2, 2013), which extended bonus depreciation through 2013. Staff IB on Rehg. at 6; AG IB on Rehg. Rev. at 7; CUB-City IB on Rehg. at 5. That is correct, but irrelevant. The Utilities *never* claimed that the 2012 NOLs resulted from the extension of bonus depreciation through 2013. In fact, Utilities' witness John Stabile succinctly explained what caused the 2012 NOLs:

The Utilities' NOLs are the result of the unanticipated levels of bonus depreciation. A 50% bonus depreciation was enacted for the years 2008 and 2009, and then in September 2010, it was extended through the end of

⁷ Staff filed the supplemental rebuttal testimony of Daniel Kahle on January 24, 2013, and the surrebuttal testimony of Staff witnesses Daniel Kahle and Michael Ostrander on February 11, 2013.

2010. Then, in December 2010, the Tax Relief Act of 2010 extended bonus depreciation through 2012 and expanded the bonus to 100% for qualifying assets acquired and placed in service from September 9, 2010 through December 31, 2011. In addition, the Utilities have elected the previously described tax accounting method changes, which have created deductions as well.

Stabile Reb., NS-PGL Ex. 30.0 Rev., 29:707-713. Thus, the 2012 NOLs resulted from unanticipated levels of bonus depreciation from the enactment of the Tax Relief Act of 2010, which extended bonus depreciation through 2012, along with the inability of the Integrys group to absorb the 2012 NOLs, a fact which did not exist until the 2012 books were closed, and under the Commission-approved tax sharing agreement. This evidence is unrebutted. Thus, the attempts of Staff, the AG, and CUB-City to misstate or confuse the record must be rejected.

3. Inclusion of the 2012 NOLs in the Utilities' Rate Bases Is Supported By Evidence and Is Consistent With the Commission Rules

The AG continues to raise the same incorrect arguments that it did in the original phase of these proceedings, namely that there is only one statement in surrebuttal testimony that supports the 2012 NOLs and that the introduction of the 2012 NOLs in surrebuttal is contrary to Commission Rules. AG IB on Rehg. Rev. at 4-6. The AG's argument that only one statement in surrebuttal testimony supports the 2012 NOLs is not new and must be rejected based on the record evidence detailed in the Utilities Initial Brief on Rehearing (at 7-10). The Utilities will not repeat that evidence here.

Furthermore, the AG's argument that the Utilities' inclusion of 2012 NOLs in surrebuttal testimony is contrary to Section 287.30 of the Commission Rules⁸ is equally without merit. The AG maintains that "[u]nder the Commission's rules, utilities must present proposed ratemaking adjustments in the Direct phase of their case." AG IB on Rehg. Rev. at 6. The AG adds that the Utilities could have "raise[d] the possibility" of the adjustment previous to surrebuttal testimony.

⁸ 83 Ill. Admin. Code § 287.30.

Id. (The Utilities did so, as the AG’s own briefing proves, as discussed below.) The Utilities’ understanding, based on the language of Section 287.30 and the absence of invocation of Section 287.30 in previous rate cases to limit individual rebuttal and surrebuttal adjustments, in brief, is to prohibit more than one across the board update to a utility’s revenue requirement during a future test year rate case.⁹ It does not indicate that utilities must make all adjustments in their Direct case. Furthermore, Section 287.30 does not prevent the use of new data in isolated instances, and as to updating of individual items, it only has a specific provision regarding updating the rate of return in rebuttal. In the decade since Section 287.30 was adopted, to the best of the Utilities’ knowledge, the Commission has never interpreted or applied it to bar individual item adjustments. In fact, in the instant cases, Staff used actual year-end 2012 data to update one of its adjustments. See Kahle Supp. Reb., Staff Ex. 23.0, 2:26-3:51. The AG has not cited any past rulings that support the application of Section 287.30 as the AG proposes. In contrast, updates in surrebuttal are routine. Moreover, the AG’s argument conveniently and unjustifiably ignores that the Utilities also made other adjustments in surrebuttal that reduced their revenue requirements. Under the AG theory, that would be improper, too.

Oddly, the AG falsely argues that Utilities did not even present the “possibility” of including the 2012 NOLs in direct and rebuttal testimony. AG IB on Rehg. Rev. at 6. Yet the AG quotes from the Utilities’ Schedules G-5 that were filed in the Utilities’ *direct* case (in both the “Part 285” filings and in direct testimony attachments) and that clearly state that because it was assumed that the NOLs would be absorbed by the Integrys consolidated group, there is no forecasted NOL deferred tax assets. See AG IB on Rehg. Rev. at 4; see also NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11. The Schedules G-5 add that the

⁹ The rule arguably is ambiguous about whether this limit includes or excludes across the board updates in scheduled rebuttal or surrebuttal testimony, but that question need not be addressed here.

assumption regarding the consolidated group absorbing the 2012 NOLs would be monitored/updated at each step in the case. *Id.* Thus, this information indicated that there was a “possibility” that the Utilities would need to include the 2012 NOLs in their rate bases. Then in rebuttal testimony, the Utilities notified parties that:

Inclusive of adjustments proposed in my rebuttal testimony and based on the Utilities’ revised revenue requirement request, is [that] the Utilities are not in an NOL position at any point during 2013, and no deferred tax assets exists at the end of 2012 due to the consolidated groups income.

Stabile Reb., NS-PGL Ex. 30.0 Rev., 27:649-652. Again, the Utilities alerted Staff and Intervenors regarding the “possibility” that the 2012 NOLs will need to be reflected in their 2012 rates bases. The Utilities even informed Staff and intervenors as to what would need to occur in these consolidated proceedings should the Integrys consolidated group not be able to absorb the 2012 NOLs. Stabile Reb., NS-PGL Ex. 30.0 Rev., 30:723-727. Thus, the AG’s argument is completely unsupported by the record as well as its own Initial Brief on Rehearing.

B. Use of the 2012 NOLs Is Consistent with the Commission-Approved Tax Sharing Agreement and Tax Accounting for Consolidated Groups

CUB-City argue that that the Utilities could have used the 2012 NOLs for themselves in direct and rebuttal testimony. City-CUB IB on Rehg. at 5-6. The CUB-City argument is factually incorrect and also is inconsistent with tax accounting for a consolidated group as explained in the Utilities’ Initial Brief on Rehearing (at 12-13). The Utilities will not repeat those arguments here.

CUB-City also claim that the closing of the Integrys consolidated group’s books did not result in the Utilities’ 2012 standalone NOLs. The Utilities never claim that the closing of the books *caused* the 2012 NOLs. The application of the NOLs is governed by the tax sharing agreement that was approved by the Commission in Docket No. 07-0458. Under that agreement, to the extent that the Integrys consolidated group can absorb the NOLs of Peoples Gas and North

Shore, no NOLs are needed to be reflected in rate base. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11; Stabile Reb., NS-PGL Ex. 30.0 Rev., 27:649-652; Staff Cross Exs. 12 and 13. Thus, once the books were closed and it was determined that the consolidated group could not absorb the 2012 NOLs, pursuant to the tax sharing agreement, the standalone NOLs must be reflected in the Utilities' rate bases.

Further, CUB-City assert that “[i]f utilities are allowed to modify the factual assumptions of their test years – based on nothing more than a tentative change in an internal management decision, which the utility remains free to reverse again – ratepayers will be profoundly disadvantaged and the integrity of the Commission proceedings will be less certain.” CUB-City IB on Rehg. at 6 (emphasis in the original). CUB-City provide no cites to the record to support this statement. It cannot because there is nothing factually correct about it. It is based solely on innuendo. First, the factual assumptions that the Utilities believe that CUB-City refer to are contained in the Schedules G-5, which are entitled “Summary of Significant Accounting Policies and Assumptions Used in the Forecast for the Year Ending December 31, 2013.” Schedule G-5 is mandated by Part 285, of course. These assumptions were examined by an independent Certified Public Accountant, Deloitte and Touche LLP. Gregor Dir., PGL Ex. 5.0 Rev., 9:189-196; NS Ex. 5.0 Rev., 8:178-9:189. The examination was performed in accordance AICPA standards, including AICPA Audit and Accounting Guide: Guide for Prospective Financial Information dated March 1, 2009. *Id.* In the Utilities' Schedule G-5, it was made clear that the status of those NOLs is dependent upon the Integrys consolidated group's ability to absorb those losses. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11. Second, there is nothing “tentative” about the consolidated group's ability to absorb those losses once the books closed and actual data was available. Third, the use of the 2012 NOLs is not at the whim of “an

internal management decision.” The only internal management decision occurred in 2007 when the Utilities submitted the tax sharing agreement for Commission approval. Thus, use of the 2012 NOLs is governed by the tax sharing agreement approved by the Commission.

The facts do support that the Utilities did not reflect the 2012 NOLs in their direct and rebuttal rate bases because the Integrys consolidated group was forecasted to absorb those losses. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11; Stabile Reb., NS-PGL Ex. 30.0 Rev., 27:649-652. These actions were consistent with their Significant Assumptions that were examined by Deloitte and Touche LLP and within the constraints of their Commission-approved tax sharing agreement and forecasts available at the time. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11; Gregor Dir., PGL Ex. 5.0 Rev., 9:189-196; NS Ex. 5.0 Rev., 8:178-9:189. Upon learning that the consolidated group could not absorb the NOLs, the first opportunity for the Utilities to update the evidence was in surrebuttal testimony. Stabile Sur., NS-PGL Ex. 46.0, 36:868-876. The Commission properly concluded that the 2012 NOLs should be reflected in the Utilities’ rate bases. June 18 Order at 99-100.

C. The AG and CUB-City Had But Waived the Opportunity to Respond to the Inclusion of the 2012 NOLs in the Utilities’ Rate Bases and They Even Rejected a Second Opportunity to Respond

The AG and CUB-City continue to complain that they were denied a meaningful opportunity to respond to the inclusion of the 2012 NOLs in the Utilities’ rate bases. AG IB on Rehg. Rev. at 7; CUB-City IB on Rehg. at 8. For all the reasons described in the Utilities’ Initial Brief on Rehearing (at 7-13), these intervenors had opportunities in direct and rebuttal testimony to respond to the evidence regarding the 2012 NOLs, including the propriety of the standalone NOLs, the methodology chosen regarding the NOLs, the tax sharing agreement or the application of the 2012 NOLs. However, they opted not to respond to the Utilities’ evidence. Further, as indicated in Section III.A.3 of this Reply Brief on Rehearing, in moving that the

Commission approve the AG and CUB-City requests for rehearing with respect to the 2012 NOLs, Commissioner McCabe stated that these intervenors should have an opportunity to respond with evidence to the Utilities' inclusion of the 2012 NOLs in their rate bases. *See* Appendix A hereto, 8/6/13 Regular Open Meeting, Tr. at 10:25-11:11 (as corrected by memorandum). Even though the AG and CUB-City merely asked for reconsideration of the Commission's June 18 Order and did not ask to submit additional evidence pursuant to Section 200.880 (c)¹⁰, the Commission allowed them the opportunity to provide evidence. Given a second bite at the apple to respond to the evidence, the AG and CUB-City categorically rejected the opportunity. Appendix B hereto 8/22/13, Tr. 7:3-8:5. They also later chose to file no rebuttal testimony on rehearing.

The Commission should disregard the AG and CUB-City's arguments that they had no meaningful opportunity to address the 2012 NOLs. These intervenors had ample opportunity to respond to the Utilities' evidence in the original phase of these proceedings. Then they were provided another opportunity by the Commission, which they rejected.

D. The Evidence Demonstrates that Failure to Include the 2012 NOLs in the Utilities' Rate Bases Would Likely Lead to a Normalization Violation

Staff, the AG, and CUB-City all question whether failure to include the 2012 NOLs in the Utilities' rate bases would lead to tax normalization violation. Staff claims the Utilities make "blanket conclusions" regarding the possible violation and flippantly asks questions such as: how are the normalization rules being violated; and which sections of the Internal Revenue Code are being violated. Staff IB on Rehg. at 6-7. Staff cannot seriously suggest that it does not know what provisions govern normalization, particularly when it had a witness testify on the subject.¹¹

¹⁰ 83 Ill. Admin. Code § 200.880(c).

¹¹ Moreover, in a recent rulemaking (*Illinois Commerce Comm'n On Its Own Motion: Adoption of 83 Ill. Adm. Code 556*, ICC Docket No. 13-0458), Commission Staff filed verified reply comments concerning a proposed definition

Staff and CUB-City question the Utilities' sincerity because no Private Letter Ruling ("PLR") has been filed. Staff IB on Rehg. at 7; Cub-City IB on Rehg. at 9. Staff, AG and CUB-City all claim there is a lack of precedent supporting the Utilities' position. Staff IB on Rehg. at 7; AG IB on Rehg. Rev. at 9-10; CUB-City IB on Rehg. at 8-9.

The foregoing is pernicious nonsense. Unfortunately, as with much of the evidence presented in the original proceedings in this matter, Staff and intervenors choose to ignore rather than rebut evidence. Furthermore, the Utilities submitting a PLR that supposes the 2012 NOLs are not included in rate base when the Commission's June 18 Order approved their inclusion in rate base would be premature, to say the least. Finally, there are a number of recent PLRs regarding normalization violations, including a ruling related to a Staff position taken in two of the Utilities' rate cases. As such, all these arguments must be rejected, as explained in further detail in the following paragraphs. The Utilities note that it is uncontested that if an NOL does exist, it properly is included in rate base. Thus, even if the Staff and intervenor attempt to cloud the normalization violation risk issue somehow were allowed to overcome the facts and law, the 2012 NOLs still would belong in rate base.

Staff's argument that the Utilities have provided no support for their position regarding the tax normalization violation is contrary to the evidence. Interestingly, in its Initial Brief (at 40-41) in the original phase of these consolidated proceedings, Staff acknowledged Utilities witness Mr. Stabile's testimony and cited it as a reason why the 2012 NOLs should be included in rate base so as to not violate the tax normalization rules. Mr. Stabile, Tax Director with

of "Accumulated Deferred Income Taxes" that referenced Internal Revenue Code Sections 167 and 168 and the Treasury Regulations related to those sections. Staff's verified Reply Comments stated "Staff does not accept the inclusion of a definition for "Accumulated Deferred Income Taxes" as suggested by Ameren Illinois and Peoples Gas. It is not necessary for a Commission rule to state that the amount representing 'Accumulated Deferred Income Taxes' should be consistent with the rules and regulations of the IRS. Since all utilities should continuously comply with all IRS rules and regulations, the proposed definition is unnecessary." *See also*, Docket No. 13-0458, Order (Oct. 23, 2013) at 3.

Integritys Business Support, LLC, who has over 25 years' experience in the Utilities' Corporate Tax Department¹², explained that accelerated depreciation is the depreciation method used for income tax purposes, which recovers more of the cost of an asset in the early years of an asset's useful life that would result from using the straight line method of depreciation¹³. Stabile Reb., NS-PGL Ex. 30.0 Rev., 27:665-667. Using accelerated depreciation defers income taxes in the early years of an asset's life by reducing taxable income in those early years in exchange for increased taxable income in future years. *Id.* at 27:667-669. Further, accelerated depreciation benefits utilities by encouraging capital investments and benefits customers by reducing the rate base upon which the Utilities earn their returns. *Id.* at 27:669-28:673. Bonus depreciation is an additional investment incentive that increases the amount of first year federal tax depreciation beyond what is allowed under accelerated depreciation. *Id.* at 28:680-682.

The 2012 NOLs were caused in part by the enactment of the Tax Relief Act of 2010, which extended 50% bonus depreciation through the end of 2012. *Id.* at 29:707-713. Under accounting rules, a deferred tax asset must be established for NOLs and failure to do so violates the tax normalization rules. *Id.* at 30:722-727. The Tax Reform Act of 1969 mandated the normalization requirements for the effects of accelerated depreciation.¹⁴ *Id.* at 31:754-757. Normalization generally means the tax expense that is recovered from customers is that tax expense that would be computed if the company was to deduct the depreciation computed for regulatory purposes in its tax computation. *Id.* at 31:745-747. Under normalization, the

¹² Stabile Dir., PGL Ex. 10.0, 1:18-2:24; NS Ex. 10.0, 1:18-2:24.

¹³ The straight line method of depreciation recovers an asset's cost in equal amounts over the expected useful life of the asset. Stabile Reb., NS-PGL Ex. 30.0 Rev., 28:676-678.

¹⁴ In 1954, when accelerated depreciation first came into effect, the normalization rules generally referred to for rate making purposes, the tax benefit could be "flowed through" to customers currently or "normalized." Stabile Reb., NS-PGL Ex. 30.0 Rev., 30:731-31:743.

difference between the tax expense computed and the tax expense in the return is credited to a deferred income tax liability. *Id.* at 31:747-749.

The normalization rules require that an NOL be included as a deferred tax asset in rate base in order to eliminate the tax benefit recorded in the deferred tax liability until such time as the loss is realized. *Stabile Reb., NS-PGL Ex. 30.0 Rev., 32:781-32:787.* Failure to record the effects of an NOL would be in violation of Internal Revenue Code Sections 167 and 168¹⁵. *Id.* at 32-763-780. The effects of a normalization violation would be devastating to both the Utilities and their customers. The Utilities would lose the ability to continue to claim rate base reducing impacts of accelerated and bonus depreciation. *Id.* at 33:788-796.

This evidence is unrebutted. Any claim that the Utilities did not submit substantial evidence regarding normalization is without merit. Staff had the opportunity to respond to this evidence in the original phase of these proceedings and it did not. The Utilities are not making “blanket conclusions.” The Utilities analysis is based on the knowledge of its tax personnel, the Internal Revenue Code, case law, and PLRs.

Staff, the AG and CUB-City all imply that the likelihood of a normalization violation is small because the Utilities or their affiliates have not previously violated the tax normalization rules and the Utilities have only provided one example from the 1970s. First and foremost, the Utilities and their regulated affiliates are cognizant of the tax normalization rules and have consistently followed accounting practices aimed at remaining in compliance with them. Staff Cross Ex. On Rehg. No. 1, Utilities’ response to Staff data request ACC 1.08. Further, with the apparent new exception of Staff as discussed below, public utility commissions and utilities are

¹⁵ See Sections 168(f)(2), 168(i)(9)(A), and 168(i)(9)(B) of the Internal Revenue Code and Treasury Regulations 1.167(1)-1(h)(1)(i) and 1.167(1)-1(h)(1)(iii). See also PLR 8818040 and Section 285.7035 of the Commission’s own, 83 Ill. Admin. Code s 285.7035 (expressly referencing Section 168(i)(9)(B) and normalization); Rate Case and Audit Manual, pp. 24-25 (NARUC Staff Subcomm. on Accounting and Finance Summer 2003).

aware of the extreme consequences of violating the normalization rules and have exercised great care and caution to avoid any violation. The fact that there are so few known violations indicates that public utility commissions and utilities do not allow violations to occur. As the Utilities explained in their Initial Brief on Rehearing (at 16) and as demonstrated by the California utilities in the 1970s¹⁶, once the normalization rules are violated, it is not easily cured, to the detriment of utilities and their customers. Setting aside the AG and CUB-City arguments, as their motives are short-sighted and results driven, the Commission should be concerned about Staff's recommendation given that it did not respond to Mr. Stabile's testimony and explain why the Commission approval of its position would not result in a violation of the normalization rules.

Second, this is the second time in 22 years that the Commission Staff will be recommending that the Commission approve a proposal that would cause the Utilities to violate the tax normalization rules. Staff, the AG, and CUB-City all ignored what occurred in the Utilities' 1991 Rate Cases¹⁷. In the 1991 North Shore Rate Case, Staff proposed to change the proration formula to estimated accruals for the deferred income tax balances, which was contrary to the tax normalization rules.¹⁸ While noting it agreed with Staff, the Commission declined to adopt the Staff position because the PLR received from the IRS did not definitively address the issue. 1991 North Shore Rate Case Order, 1991 Ill. PUC LEXIS 636, 12-13. The Commission recommended that the Utilities obtain a second PLR to resolve the issue. *Id.* However, by the time the Commission issued its Order in the 1991 Peoples Gas Rate Case, the second PLR was

¹⁶ Staff Ex. On Rehg. No.1, Utilities' response to Staff data request ACC 1.08, Attach 01.

¹⁷ *North Shore Gas Company*, ICC Docket No. 90-0010 (Order Oct. 6, 1992) ("1991 North Shore Rate Case"); *Peoples Gas Light and Coke Company*, ICC Docket No. 91-0586 (Order Nov. 8, 1991) ("1991 Peoples Gas Rate Case") (together, the "Utilities 1991 Rates Cases").

¹⁸ Staff Cross Ex. On Rehg. 1, Peoples Gas' Response to Staff Data Request ACC 1.08, Attach 01, pp. 1-2; Docket 91-0010, 1991 Ill. PUC LEXIS 636, 10-13; Docket 91-0586, 1992 Ill. PUC LEXIS 376, 40-42.

received from the IRS clearly indicating that *Staff's* recommendation, if adopted by the Commission, would violate the tax normalization rules. 1991 Peoples Gas Rate Case Order, 1992 Ill. PUC LEXIS 376, 44-46; *see also* PLR dated December 17, 1992, attached to the Utilities' response to Staff data request ACC 1.08 (Staff Cross Ex. On Rehg. No. 1). Interestingly, in the 1991 Peoples Gas Rate Case, in rejecting two separate proposals, one by CUB and one by Staff, the Commission acknowledged the importance of not violating the normalization rules as "having adverse consequences to [Peoples Gas'] ratepayers." 1991 Peoples Gas Rate Case Order, 1992 Ill. PUC LEXIS 376, 40-42; 44-46.

As noted earlier, the Commission recently confirmed "the importance of correctly calculating ADIT [Accumulated Deferred Income Taxes], not merely in the implementation of these rules but to preserve the utilities' ability to continue to use accelerated depreciation by remaining in compliance with the IRS' normalization requirements." Docket No. 13-0458, Order (Oct.23, 2013) at 3. The Commission should reaffirm this here and reject the proposals by Staff, AG and CUB-City.

Finally, the Utilities provided a number of examples of PLRs, one dated as recently as 2013, where the IRS responds to inquires as to whether a particular Commission's action would violate the tax normalization rules. *See* Staff Cross Ex. On Rehg No. 1, the Utilities' response to Staff data request ACC 1.08 and Attach 01. Thus, the Staff, AG, and CUB-City arguments that such violations do not occur falls flat.

Staff and CUB- City illogically that because the Utilities have not requested a PLR regarding the 2012 NOLs issue, they apparently are not really concerned that a violation would occur. Staff IB on Rehg. at 7; CUB-City IB on Rehg. at 9. CUB-City note that the Utilities have already sent a letter to the IRS regarding the inconsistent nature of the June 18 Order and do not

mention the issue regarding the 2012 NOLs. CUB-City IB on Rehg. at 9. First, as explained in the Utilities Initial Brief on Rehearing (at 4), pursuant to Treasury Regulation Section 1.167(l)(h)(6), the Utilities notified the IRS within 90 days of the issuance of the June 18 Order because the mathematical errors could be viewed as resulting in an order inconsistent with normalization. *See* NS-PGL Ex. 54.2. That is unlike the 2012 NOLs, which the final Commission's Order approved including in rate base. Rather, with respect to the mathematical errors, the Utilities had a problematic final Commission Order that actually existed, they were aware of a potential violation, and they notified the IRS based upon the *known* Commission ruling and related facts. It was the order that triggered the 90-day notice period. Second, other than granting rehearing on the issue, the Commission's actions to date have not violated the normalization rules with respect to the 2012 NOLs. The Administrative Law Judges' ("ALJs") denied the AG's motion to strike testimony related to the 2012 NOLs (2/7/13 Tr. 533:8-16) and the ALJs' Proposed Order correctly concluded that the NOLs should be reflected in the Utilities' rate bases (Proposed Order (Apr. 26, 2013) at 99-100). The June 18 Order also correctly concluded that the 2012 NOLs be included in the Utilities' rate bases. Furthermore, in its final Order in Docket Nos. 11-0280/0281, the Commission also found that the NOLs should be reflected in the Utilities' rate bases. Docket Nos. 11-0280/0281, Order (Jan. 10, 2012) at 10. Thus, the Utilities do not have a finding, an explanation, or any other related data for the IRS to consider and issue a PLR as to the 2012 NOLs. As such, seeking a PLR at this time would be premature. As it can be a costly exercise, the Utilities do not want to find themselves in the same position as in the 1991 Utilities Rate Cases having to seek a second PLR from the IRS. Furthermore, the September 17, 2013, letter to the IRS concerning the June 18 Order

demonstrates how concerned the Utilities are with respect to violations of the tax normalization rules.

For all the foregoing reasons, the Commission should reject the reckless arguments set forth by Staff, the AG and CUB-City, who make baseless accusations. They have twice rejected an opportunity to submit testimony responding to the Utilities' evidence regarding the normalization rules. Having already recognized the "adverse consequences to [] ratepayers," should a tax normalize occur (1991 Peoples Gas Rate Case Order, 1992 Ill. PUC LEXIS 376, 40-42) and provided several opportunities for Staff and intervenors to explain their position, the Commission should reaffirm its decision to include the 2012 NOLs in rate base not only because they are supported by the evidence but also to remain consistent with the tax normalization rules.

IV. CONCLUSION

Therefore, North Shore Gas Company and The Peoples Gas Light and Coke Company, for all reasons set forth above and in their Initial Brief on Rehearing, appearing of record, or reflected in their draft proposed Administrative Law Judges' Proposed Order, respectfully request that the Commission (1) reaffirm its decision in its Order dated June 18, 2013, that included both the 2012 and 2013 Net Operating Losses in rate bases and (2) approve the schedules in Staff Ex. 26.1 or the applicable substance thereof to attach as Appendices to its Order on Rehearing and correct the NOLs in rate base for rate purposes.

Dated: October 30, 2013

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