

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

NORTH SHORE GAS COMPANY)	
)	
Proposed General Increase In Rates For)	
Gas Service)	12-0511
)	
)	(Cons.)
THE PEOPLE GAS LIGHT AND COKE COMPANY)	
)	12-0512
Proposed General Rate Increase In Rates For)	
Gas Service.)	

**POSITION STATEMENT ON REHEARING
OF THE CITIZENS UTILITY BOARD
AND THE CITY OF CHICAGO**

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**POSITION STATEMENT ON REHEARING OF THE CITIZENS UTILITY BOARD
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NOW COME the Citizens Utility Board (“CUB”), through its attorneys, and the City of Chicago by Stephen Patton, Corporation Counsel, (“City”, jointly, “CUB-City”), pursuant to section 200.810 of the Rules of Practice of the Illinois Commerce Commission (the “Commission” or “ICC”), (“Rules”), 83 Ill. Admin. Code § 200.810, and the schedule set by the Administrative Law Judges to file their Position Statement on Rehearing in the above-captioned proceeding.

Introduction

In the underlying case, CUB-City put forth evidence that demonstrated that the North Shore Gas Company (“North Shore” or “NS”) and the Peoples Gas Light and Coke Company (“Peoples” or “PGL”), (collectively “NS-PGL,” or “the Utilities”) should not be permitted to use certain tax accounting events to increase their rate bases. In particular, the CUB-City averred that the Utilities should not be allowed to reduce their accumulated deferred income taxes (“ADIT”) as a result of 2012 net operating losses (“NOLs”) that the Utilities knew about throughout the case but chose not to reflect until surrebuttal testimony. CUB-City argue that they were prejudiced by that delayed proposal, in the denial of a meaningful opportunity to oppose it in testimony. CUB-City maintain that the Commission’s Final Order of June 18, 2013 (“the Order”) allowed the Utilities to claim the NOLs, under the mistaken impression that the Utilities appropriately set forth their assumptions in their direct case and “new facts” occurred in

January 2013 which affected those assumptions. ICC Docket 11-0721, Final Order of June 18, 2013 at 99-100.

CUB-City filed an Application for Rehearing on July 19, 2013, requesting that the Commission reconsider the Order's determinations on a small number of issues concerning certain costs included in the Utilities' rates and the approved rate design for the Utilities. In particular, CUB-City sought reconsideration of the Commission's decision to allow the Utilities to reflect a NOL for 2012 in rate base, despite disqualifying evidence presented by CUB-City, the People of the State of Illinois, and supported by Commission Staff, and procedural problems that prejudiced ratepayers. At the Commission Bench Session on August 6, 2013, the Commission granted the Applications for Rehearing of NS-PGL, CUB-City and the People of the State of Illinois on the issue of the 2012 NOL.

Background

CUB-City explained that, for 2012, the Utilities were allowed to take advantage of 50% bonus tax depreciation for certain new depreciable assets with a recovery period of 20 years or less. *See* Smith, CUB-City Ex. 2.0, 45:996-1001. Therefore, rather than depreciating the asset equally over its life, a company (or utility) could depreciate 50% of the asset in its first year. For example, if a qualifying asset was worth \$250,000 and was expected to last 20 years, per normal accounting rules, \$12,500 should be charged per year to the company's expenses. Using bonus depreciation, the utility could deduct 50% of the purchase price of the asset, \$125,000, rather than only \$12,500, in 2012. If the company's net profit for 2012 was \$100,000, then after the \$125,000 deduction, the company would have a NOL of \$25,000.

A NOL, if caused by differences between book and federal income tax depreciation, is required by federal tax regulations to be normalized and that action increases rate base. The rate base increase occurs because NOL decreases ADIT, and ADIT decreases rate base. *See* Feb 8 tr. 82:7-21.

CUB-City note that throughout most of the underlying case, the Utilities stated that PGL-NS would incur an NOL for 2012 on a stand-alone basis, but its parent, TEG, would be able to use the PGL and NS NOLs for 2012 to reduce current or prior tax obligations of the consolidated group. Staff Cross Exhibits 12 and 13, ("Similarly, for 2013, Peoples Gas would incur a NOL on a stand-alone basis, but TEG consolidated was assumed to absorb it. This assumption was disclosed on Schedule G-5." (emphasis added)). That response was provided in October, 2012; thus, CUB-City aver, the Utilities were aware at that time that the 2012 tax benefit would result in an NOL for that year. Staff Cross Ex. 12, Staff Cross Ex. 13. CUB-City note that in all their case filings before surrebuttal, the Utilities maintained the propriety of that assumption and did not reflect any ADIT impact of 2012 NOLs in their rate base. Only in their surrebuttal testimony did the Utilities reverse the assumption that because the Utilities' 2012 deductions, including 2012 bonus tax depreciation, would be usable in the TEG consolidated return, the 2012 NOLs would have no ADIT impact on the utilities.

The Utilities' Change in Position Prejudiced CUB-City and Distorted the Commission's Decision

CUB-City aver that the Utilities changed their position dramatically on surrebuttal, at which point other parties had no opportunity to present rebutting evidence. While the Utilities made the appropriate adjustment to reflect the availability of 2013 bonus depreciation following the passage of the American Taxpayer Relief Act of 2012 (“ATRA”), CUB-City state that the Utilities suddenly reversed the assumption on which all testimony in the case was based and claimed the existence of stand-alone NOL amounts affecting the Utilities, not just for 2013 but also for 2012. NS-PGL Ex. 46.0, 36:868-76.

CUB-City point out that the Utilities’ update to reflect 2013 bonus depreciation, and the corresponding 2013 NOL, should have had *no* impact on a potential 2012 NOL. The ATRA impacted only 2013 bonus tax depreciation, and had no effect on 2012 taxes. No party disputes that. CUB-City aver that the Utilities acknowledged in Staff Cross Exhibits 12 and 13, that the 2012 NOLs were known for months prior to the filing of surrebuttal testimony, and the Utilities indicated that Integrys would be using the NOLs. The Utilities’ analysis, confirmed in their direct and rebuttal filings and in response to specific discovery on this matter, had informed other parties that their 2012 bonus tax depreciation would be fully utilized by TEG on the 2012 consolidated return in which NS and PGL participate. CUB-City note that the Utilities acknowledged that their decision in surrebuttal to claim NOLs for NS and PGL was a departure from their previous statements that the “consolidated group” (*i.e.* their parent company) “was forecasted to absorb those losses.” NS-PGL Init. Br. at 56.

CUB-City argue that by claiming that they first “found out” (NS-PGL Init. Br. on Reh’g at 9) in 2013 that the consolidated group could not absorb the 2012 NOLs, the Companies concede that their management assumptions, which they maintained for over a year, turned out to be incorrect. While the Companies imply that their change in position on the 2012 NOLs was no more than a function of their tax sharing arrangement with Integrys, CUB-City note that the passive language they use to describe their change in position is curious. For example, they say that it was not until the Integrys books closed for the year that they “found out” Integrys could not absorb the Utilities’ standalone 2012 NOLs. *Id.* They argue that “upon learning” of that fact, they updated their evidence at the first opportunity, in surrebuttal. *Id.* at 13. CUB-City maintain that the Companies argue implicitly that they had no indication less than two weeks before the end of the year that the consolidated group’s tax position might change, and that they had no obligation to disclose any increased chance of claiming an NOL to the Commission or to other parties. CUB-City aver that to allow the Companies then to adjust their revenue requirement to recognize a reversal of that assumption after other parties’ testimony was complete is patently unfair to ratepayers. CUB-City contend that prejudice is not cured by giving the Companies another opportunity (on rehearing) to bolster a position its testimony in the original proceeding could not support.

CUB-City maintain that the Companies still have not provided an adequate explanation of why their assumption, maintained for over a year (including through two data request responses and testimony), was incorrect. CUB-City notes that the Companies do not even

address the improbability that NS-PGL's or Integrys' accountants did not recognize any change in accounting circumstances (of the magnitude necessary for the NOLs to become useless to Integrys) two weeks before year-end. CUB-City note that the Companies simply state that things changed, and expect the Commission to allow them to update their revenue requirement accordingly. *See* NS-PGL Init. Br. on Reh'g at 11. That bald statement does not meet the necessary burden of proof to establish that the cost of the Companies' including the 2012 NOLs in their own rate bases was prudently incurred and the rates set are just and reasonable, say CUB-City.

CUB-City respond to the Companies' claim that other, revenue requirement reducing adjustments were made in January 2013, and that CUB-City and the AG only contest this adjustment because it increases rate base. CUB-City maintain that though that would be a convenient explanation, it is simply not true. The Companies point specifically to the CUB-City and AG proposal to include the impacts of the 2013 bonus depreciation, based on the enactment of the American Taxpayer Relief Act of 2012. NS-PGL Init. Br. on Reh'g at 11. CUB-City point out that particular adjustment is appropriate because a *new law* was passed, that affected the Companies' rate base. CUB-City note that no new law affected the Companies' 2012 NOLs. According to CUB-City, no new facts at all have been presented, other than that management apparently did a poor job in their financial forecasts, failed to recognize an impending multi-million dollar change in tax position two weeks before year-end, and failed to report a potential material revenue requirement change, despite the Commission's test year update rules intended to assure due process to other parties. *See* 83 Ill. Adm. Code 287.30. The Companies have not provided an adequate basis for reversing the assumptions on which intervenors relied for almost the entirety of the case, say CUB-City.

CUB-City argue that allowing the Companies to make such a significant change to their assumptions at the last possible opportunity, in surrebuttal testimony, places an impossible burden on ratepayer parties to respond meaningfully. CUB-City note that the evidentiary hearing began on February 5, 2013, just seven business days after the Companies filed their surrebuttal testimony where they first claimed the NOLs should be included in the Companies' rate bases. CUB-City maintain that intervenors had no opportunity to present evidence in their direct or rebuttal testimony on the Companies' use of the 2012 NOLs in their rate bases, given that the management decision communicated to parties during all rounds of Staff and Intervenor testimony was that the 2012 NOLs would be absorbed by Integrys.

Furthermore, point out CUB-City, the Commission has established rules that require consideration of other parties' opportunity to respond in determining whether to allow updates of test year data. 83 Ill. Admin. Code 287.30 ("A determination to . . . allow the submission of an update shall include . . . consideration of: . . . 3). Whether the Illinois Commerce Commission staff and other participants will have an adequate opportunity to review the updated information"). CUB-City further note that the Commission's rules require that its discretion be exercised to recognize parties' rights to due process and to avoid the prejudicial result the Companies insist on here. 83 Ill. Adm. Code 200.25(c) ("Fairness – Persons appearing in and affected by Commission proceedings must be treated fairly. To this end, parties which do not act diligently and in good faith shall be treated in such a manner as to negate any disadvantage or

prejudice experienced by other parties”). CUB-City contend that to allow the Companies’ last minute change, the Commission must disregard its own rules.

CUB-City argue that if utilities are allowed to make last minute changes based on the reversal of an internal management decision (like the NOL change the Companies offer in this case), other parties will be placed in an impossible position of rebutting the inclusion of costs incurred on the basis of last-minute decisions without the full benefit of additional discovery, and the Commission’s rules will lose their substantive meaning. CUB-City urge the Commission to hold the Companies to the only position they held when the other parties had an opportunity to respond meaningfully. To allow any other position is unfair to all other parties in the case, say CUB-City.

Commission’s Final Order

CUB-City note that, in its Final Order in this case, the Commission relied in part on the Utilities’ claim the NOL for 2012 was not known prior to surrebuttal testimony, because the ATRA was not signed until January 3, 2013. Final Order at 99. CUB-City point out that, though it is true that the 2013 bonus depreciation was not assured until the President signed the ATRA in 2013, the 2012 bonus depreciation has been known since the inception of this rate case. Any NOL effect of that depreciation could have and should have been claimed before the Utilities’ surrebuttal filing.

CUB-City further note that the Commission’s Final Order relied on the Utilities’ claim that closing 2012 books affected the 2012 NOL. Final Order at 99. CUB-City aver that claim is simply untrue. Closing their books for 2012 did not result in a yet-unknown NOL. CUB-City point out that, in response to discovery in October of 2012, the Utilities stated that “the assumed facts and circumstances were that North Shore would incur a NOL for 2012 on a stand-alone basis, but Integrys would have been able to use the North Shore NOL to reduce current or prior tax obligations of the consolidated group.” Staff Cross Exhibit 12. The same statement was made for Peoples Gas. Staff Cross Exhibit 13. In fact, CUB-City point to the fact that the Companies knew of and provided evidence about the standalone NOLs in their initial filing on July 31, 2012, in data request responses on October 23 and November 15, 2012, and in testimony on December 18, 2012. *See* NS-PGL Init. Br. on Rehearing at 7-9. CUB-City aver that the Companies admit that “[t]he evidence demonstrates that the Utilities’ stand-alone 2012 NOLs existed from the time of the Utilities’ direct filing on July 31, 2012, but that it was assumed they would be absorbed, subject to monitoring and updating.” NS-PGL Init. Br. on Reh’g at 11. CUB-City note that the Companies acknowledged that the assumptions contained in their financial forecasts -- specifically, in Schedule G-5 for each utility (which first reported the 2012 NOL) -- were based on those management assumptions. NS Ex. 5.1, Schedule G-5, p. 1; PGL Ex. 5.1, Schedule G-5, p. 1 (“This financial forecast presents, to the best of management’s knowledge and belief, the Company’s expected financial position... for the forecast period. Accordingly, the forecast reflects its judgment as of December 15, 2011... The assumptions disclosed herein are those that management believes are significant to the forecast.”).

CUB-City aver that for more than a full year thereafter, those management assumptions about how the NOL would be used (i.e. that it would be absorbed by Integrys) were not changed, and they were the basis of the Companies' filed testimony before this Commission. Predictably, say CUB-City, that management position (presented in testimony by the Companies) was relied upon by all other parties in the case. In Rebuttal testimony on December 18, 2012 - less than two weeks before the year-end closing of books, the Companies continued to testify that "no deferred tax asset exists at the end of 2012 due to the consolidated groups [sic] income." NS-PGL Ex. 30.0 Rev., 27:651-652. CUB-City argue that the Commission should not allow the Utilities to revise the assumptions on which they, Staff and other intervenors relied, just one month after the Utilities assured parties that it maintained the position it had held for a year (i.e. that the 2012 NOLs would be absorbed by Integrys).

CUB-City argue that the Commission should revisit this issue in light of the misstated facts upon which the Order's articulated reasoning was based. CUB-City note that the substantial evidence on the whole record required for Commission decisions must take account of the uncontroverted evidence that the Utilities were aware of the 2012 NOLs long before the Commission's Order and that ATRA did not affect 2012 NOLs. CUB-City aver that without substantial supporting evidence, the Order's decision on this issue is unlawful. It fails PUA standards requiring articulated reasoning based on record evidence and lawful proceedings that protect the rights of the parties, resulting in cost based rates. See 220 ILCS 5/10-201(e)(iii) and (e)(iv)D; 5/9-201; 5/16-108(c); *City of Chicago v. People of Cook County*, 133 Ill.App.3d 435, 444 (1st Dist. 1985).

Alleged Risk of Normalization Violation

CUB-City note that the Utilities requested rehearing on certain mathematical calculations that they characterize as errors, which they identified in the Appendices to the Final Order. NS-PGL App.n for Reh'g at 9. NS-PGL expressed concern that, if the Final Order's computations were not changed, it was at risk of a normalization violation of which it would have to notify the Internal Revenue Service ("IRS"), and which could impact their ability to utilize accelerated depreciation and bonus depreciation. *Id.* at 10-11. In testimony, the Utilities indicated that they had notified the IRS of the computational errors. NS-PGL Ex. 54.0 at 3-4:60-65.

CUB-City point out that the letter the Utilities sent to the IRS clearly states: "The Utilities believe that the above-described computational errors in the appendices to the Order should not be treated as giving rise to a violation of the normalization rules of section 168(i)(9) of the Code." NS-PGL Ex. 54.2 at 9. The letter states that it was sent as a "protective measure," as the Utilities hope that this rehearing corrects the computational errors. *Id.* CUB-City aver that despite the alarm expressed in their Application for Rehearing and their testimony, the letter they sent to the IRS demonstrates that the Utilities are not nearly as concerned about the risk of losing accelerated depreciation and bonus depreciation as they would have the Commission believe.

CUB-City further note that the Utilities acknowledge that they have had very limited history of interaction with the IRS regarding normalization. Staff Cross Ex. 1 at 1. CUB-City

point out that the Utilities stated that they are routinely audited by the IRS, but the qualification of their property for accelerated depreciation due to the impact of normalization rules has *never* been an issue. *Id.* In fact, note CUB-City, the Utilities are not aware of *any* Integrys affiliate losing its ability to use accelerated depreciation due to a violation of IRS normalization rules. Staff Cross Ex. 2 at 1. Therefore, say CUB-City, the Utilities' supposed concern about the Commission's decision violating normalization rules and impacting accelerated or bonus depreciation is a questionable basis for the Commission to modify its cost and rate determinations in this case. Bald references to what could conceivably happen, which do not represent PGL/NS's actual, historical experience, provide insufficient bases on which the Commission can conclude that the Utilities have met their burden of proof on this issue, say CUB-City. CUB-City maintain that the Utilities' attempt to bully the Commission into ignoring the burden of proof and the inappropriateness of this late adjustment should be given no weight in this rehearing.

CUB-City aver that, in an effort to compel the Commission to include the 2012 NOLs in rate base, the Companies imply that the Commission lacks discretion to review utility NOL costs under the otherwise applicable standards of the PUA, because the utility's tax decisions are exempt from these provisions. *See* NS-PGL Init. Br. on Reh'g at 14-17. However, say CUB-City, the Companies have not identified any definitive, controlling law that requires that their tax planning decisions control Commission rate-making. That is, the Companies do not cite a specific legal requirement that the Commission is bound to adopt, for ratemaking purposes, the Companies' last-minute decision to use the 2012 NOLs for tax purposes. CUB-City maintain that if the Companies believe that this issue is outside of the Commission's jurisdiction, as a result of supposed tax implications of the decision, they have not met their burden to demonstrate that. CUB-City contend that the Commission has jurisdiction to decide this issue on the same legal standards as used for any other adjustment. Consequently, say CUB-City, the Companies should not be permitted to nullify their failure of proof under the PUA with an internal tax planning decision, to produce rates based on costs that have not been shown to be prudently incurred and reasonable.

Dated: October 30, 2013

Respectfully Submitted,

THE CITIZENS UTILITY BOARD



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