STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Ameren Illinois Company **d/b/a Ameren Illinois**	: :	
	:	**Docket No. 13-0192**
Proposed General Increase in Gas Rates (Tariffs Filed January 25, 2013).	: :	

REPLY BRIEF ON EXCEPTIONS OF THE STAFF

OF THE ILLINOIS COMMERCE COMMISSION

(PUBLIC)

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Table of Contents

Page

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Ameren Illinois Company d/b/a Ameren Illinois **Proposed General Increase in Gas Rates (Tariffs Filed January 25, 2013).**	: : : : :	**Docket No. 13-0192**

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NOW COME the Staff Witnesses of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (“Commission”), 83 Ill. Adm. Code Section 200.830, and respectfully submit this Reply Brief on Exceptions (“RBOE”) responding to the briefs on exceptions (“BOEs”) filed by the Ameren Illinois Company d/b/a Ameren Illinois (“Ameren,” “AIC,” or “Company”); by the Illinois Competitive Energy Association (“ICEA”) and the Retail Energy Supply Association (“RESA”); the Retail Gas Suppliers (“RGS”); the Illinois Industrial Energy Consumers (“IIEC”); the Citizens Utility Board (“CUB”); and the People of the State of Illinois (“People”) which were filed on or before November 22, 2013 in response to the Proposed Order ("PO”) issued by the Administrative Law Judge (“ALJ”) on November 14, 2013. Staff addresses issues to which it replies in the order in which they appear in the PO.

I. PROCEDURAL BACKGROUND

II. NATURE OF AIC'S OPERATIONS

III. TEST YEAR

IV. RATE BASE

A. Resolved Issues

B. ADIT – Step-up Basis Metro

C. Cash Working Capital

D. Other Rate Base Issues

E. Approved Rate Bases

V. OPERATING REVENUES AND EXPENSES

A. Resolved Issues

B. Pension/OPEB Expense - Employee Benefits Adjustment

C. Non-Union Wages

D. Forecasted Labor Expenses

Staff maintains its position that the Company should improve its forecast documentation and eliminate the deficiencies noted in supporting documentation provided in this proceeding. Staff also maintains its position that because AG/CUB witness Michael L. Brosch did not identify any specific activities that he considers to be unnecessary for the Company to perform, and does not associate any of the Company's proposed increases in gas only positions with unnecessary activities, Staff cannot agree with Mr. Brosch's proposed adjustment. (Staff IB, 11-13.)

E. Forecasted Non-Labor Expenses

1. JULIE Locate Requests

2. Sewer Cross Bore Inspections

3. Accelerated Leak Repairs

4. Right of Way Clearing

5. Watch and Protect Damage Protection Program

6. Corrosion Control Painting

<u>Response to AIC</u>

The Company accuses the PO of micromanaging its operational functions and claims that its cost projections are reasonably accurate. (AIC BOE, 18.) The PO appropriately reduces the amount of forecasted corrosion control painting expenditures based on the Company's historical spending levels: this is proper rate setting, not micromanagement. The Company has not shown that its proposed level of expenditures can reasonably be attained. Even in the current year, the Company has reduced its "Group 1" painting by 20% or a 15% overall decrease of the total budget for both groups. (Staff RB, 12-13.)

F. Rate Case Expense

G. Charitable Contributions

<u>Response to AIC</u>

Ameren argues that the ALJ decision was arbitrary (AIC BOE, 22) because it did not break down the proposed amount of forecasted contributions on a per customer basis and it did not compare that amount with the Commission decision in the separate case of <u>North Shore Gas Co.</u>, ICC Order Docket Nos. 12-0511/12-0512 (Cons.) (June 18, 2013) (currently pending rehearing) (*hereinafter*, "12-0511 Order"). Ameren misunderstands both Section 9-227 of the Act, 220 ILCS 5/9-227, as well as the Commission decision in the 12-0511 Order. As an initial matter, AIC has not provided any legal support for the notion that the Commission must compare on a per customer basis the amounts considered reasonable in different, unrelated, dockets. Section 9-227 has no such requirement. Id. In each case, the applicant utility provides its own unique support for its rate case, including the forecasted contribution expense and the rationale for the estimate. These differ from case to case and company to company. A finding in one docket does not necessarily equate to reasonableness in another docket with a different set of facts, circumstances and evidentiary support.

In the 12-0511 Order, the expenses at issue were educational expenses. The Commission adopted Staff's proposed adjustment to disallow donations to universities out of Illinois (Wisconsin, Indiana, New York, and South Carolina to name a few). 12-0511 Order at 166-167. While the Commission allowed donations to universities within Illinois, it did not make any findings that the assessment of reasonableness of the amount must be based on a per customer basis as Ameren now alleges. Id. Nor did the Commission indicate any new standard that would suggest such a requirement or necessity to make such a comparison. Id. Therefore, while Staff took exception with the PO on this issue for other reasons (Staff BOE, 7-11), Staff does not agree with AIC's allegation of arbitrary decision making, or with the rationale asserted, on this issue.

H. Forecasted Advertising Expenses

Response to AIC

Staff disagrees with AIC's exception to the Forecasted Advertising Expense allowed under the PO. Staff believes that: (1) the Company failed to demonstrate that the unreasonably high 2014 advertising budget is necessary for incremental gas-only educational initiatives on safety; (2) the record may not specifically demonstrate that any of the planned incremental activities “were imprudent”, but neither does the record demonstrate that any of the planned activities are prudent. More importantly, Staff is concerned that some of the activities may not occur at all, as evidenced by the Company’s abandonment of its 2012 fourth quarter media campaign; and (3) the record *clearly* demonstrates that AIC’s 2014 advertising budget is unreasonable.

AIC’s BOE provides descriptions of general types of 2014 advertising projects; however, the record does not clearly demonstrate the necessity of the incremental spending level for the much higher-- a 65% --increase in the test year advertising budget. (AIC BOE, 22.) The Company attempts to use Staff to support its increased budget with the assertion that: “Even Staff agrees with the Commission’s own publicly stated goals, that, through education about safe digging practices, time and money can be saved and utility gas systems can be safer. Id. Of course Staff agrees with the Commission’s goal to support safe and reliable delivery of gas to ratepayers. However, Staff does not agree that this mission can only be achieved by allowing AIC to unduly burden ratepayers with a projected level of spending that may or may not materialize. AIC’s assertion is too broad to be supportive of the sharply increased level of advertising expense the Company is asking ratepayers to shoulder in the 2014 test year. Id. at 26.

The Company’s assertion that Staff did not show the budgeted advertising activities are imprudent is equally without merit. Staff’s adjustment is not based on an analysis of individual test year expenses because a detailed analysis of actual program spending is not available in a future test year filing. Instead, Staff compared the 2014 budget to AIC's actual spending in 2012 and to a four-year average spending level for the years 2009-2012. Using the average spent (since it was the greater of the AIC actual spending in 2012 and the four-year average spending level for the years 2009-2012), Staff escalated the 2013 and 2014 projection to allow two percent inflation for each year. (Staff BOE, 12.) Staff asserts that this estimate constitutes a more reasonable proxy for likely future actions than does a budget, which is highly subject to change, as evidenced by the Company's abandonment of its fourth quarter media campaign in 2012. Staff contends the Company has every incentive to inflate this highly discretionary expense in its test year revenue requirement because every dollar that is not spent will accrue to the benefit of shareholders. Id. at 13.

Finally, the record clearly demonstrates that AIC's 2014 advertising budget is unreasonable based on Staff's analysis that compared the Company's 2014 budget to actual advertising expense for 2012 and to the average level of advertising expense during the four-year period from 2009-2012. AIC's 2014 forecasted advertising budget, which is a 65% increase in spending compared to the greater of AIC's actual 2012 spending and the four-year average actual spent, is clearly unreasonable.

I. Sponsorship Expense

Response to AG

Staff agrees with the AG's assertion that the PO inappropriately applied the standard presented in the most recent Peoples Gas/North Shore Gas rate case order, which allowed those Companies to recover sponsorship expenses for organizations that are charitable in nature. (AG BOE, 16.) Staff further agrees that charitable expenses are recoverable under Section 9-227 of the Act and sponsorship expenses may be recoverable as advertising expenses under Sections 9-225 of the Act. However, the Act does not provide that sponsorship expenses may be recovered as charitable expenses. Id. Staff agrees with the AG that the Company should have sought recovery of these expenses as charitable contributions at the outset of the proceeding if AIC wished the sponsorship expenses to be considered as charitable contributions. Moreover, the Company failed to demonstrate that the disputed costs are valid charitable expenses that would be recoverable under Section 9-225.

However, Staff disagrees with AG/CUB's adjustment (AG/CUB Ex. 5.0, 55:1365-66.) to remove just under $30,000 of sponsorship expenses based on the outcome of Docket No. 12-0293 and the Commission's disallowance in Docket No. 12-0293 of 77% of the event sponsorship costs incurred by the Company in 2011. Staff maintains its adjustment to remove approximately $74,000 of sponsorship expenses based on a specific analysis of actual sponsorships during 2012 is a more appropriate proxy for the 2014 test year.

The Commission should adopt Staff's adjustment to reduce the Company's sponsorship expenses as promotional/goodwill advertising that is not recoverable under Section 9-225 of the Act. (Staff BOE, 17-18.)

Response to CUB

Staff agrees with CUB that the sponsorship issue in the instant proceeding is identical or very similar to the credit card issue in Docket No. 13-0301, AIC's electric FR 3. (CUB BOE, 9.) Given the similarity of record evidence, the Commission should adopt similar conclusions in both dockets: specifically, the Commission should adopt Staff's adjustment to remove these expenses from the test year revenue requirement for the reasons stated in Staff's IB and RB. (Staff BOE, 14-18.)

J. Credit Card Expenses

<u>Response to CUB</u>

Staff agrees with CUB that the credit card issue in the instant proceeding is identical or very similar to the credit card issue in Docket No. 13-0301, AIC's electric FR 3. (CUB BOE, 11.) Given the similarity of record evidence, the Commission should adopt similar conclusions in both dockets: specifically, the Commission should adopt Staff's adjustment to remove these expenses from the test year revenue requirement for the reasons stated in Staff's IB and RB. (Staff BOE, 18-24.)

K. Software Rental Revenues

L. Revenue Issue

M. Approved Operating Statements

VI. CAPITAL STRUCTURE AND RATE OF RETURN

A. Overview

B. Resolved Issues and Immaterial Differences

B. Short-Term Debt Balance

D. Long-Term Debt Balance

<u>Response to AIC</u>

The Company claims that the PO penalizes AIC for prudently refinancing $87.1 million of its 9.75% bonds with lower cost debt. It claims that the PO is suggesting that AIC should not have redeemed $50 million of its 9.75% bonds. (AIC BOE, 13.) That is patently untrue. When it refinanced a <u>portion</u> of its 9.75% bonds, AIC had $350 million of 9.75% that the Commission had implicitly concluded had been prudently issued and

$50 million of 9.75% bonds that the Commission concluded had been imprudently issued. Since AIC refinanced only $87.1 million of the 9.75% bonds (as opposed to all $400 million), it reduced the outstanding 9.75% bonds to $312.9 million. (Staff Ex. 5.0R, 6:118-119.) Ameren now had a choice. How should it reduce the amount of 9.75% bonds for ratemaking purposes? Should it assume that only prudently issued 9.75% bonds had been retired or should it assume that some or all of the $50 million of imprudently issued bonds had been retired? If it chose the former, the outstanding balance of prudently issued bonds would fall to $262.9 million. (i.e. $350 million – $87.1 million). If it assumed that all the $50 million of imprudently issued bonds had been retired, only $37.1 million of the $87.1 million of proceeds would be left to be assigned to the prudently issued 9.75%, leaving that balance at $312.9 million. (i.e., $350 million – $37.1 million). AIC chose the latter, which obviously would have been more expensive to ratepayers, since the amount of 9.75% bonds included in the Company's cost of debt would be $50 million higher. (Staff Ex. 14.0C, Sch. 14.02.) The table below illustrates the issue, with the question marks designating the allocation decision:

	total	prudent	imprudent
9.75% bonds issued	$ 400,000,000	$ 350,000,000	$ 50,000,000
9.75% bonds redeemed	$ (87,100,000)		
9.75% bonds after partial redemption	$ 312,900,000	?	?
AIC chosen allocation	$ (87,100,000)	$ (37,100,000)	$ (50,000,000)
9.75% bonds outstanding after AIC chosen allocatioı	$ 312,900,000	$ 312,900,000	$ -
Allocation necessary to recover 100% of redemption costs	$ (87,100,000)	$ (87,100,000)	$ -
9.75% bonds outstanding after alternative allocation	$ 312,900,000	$ 262,900,000	$ 50,000,000

As Staff stated in its reply brief, the problem is not that AIC refinanced 9.75% bonds. The problem is that AIC seeks to assign the costs of refinancing 9.75% bonds to the $50 million bonds the Commission found were issued imprudently. If AIC had assigned the entire $87.1 million in proceeds to the prudently issued 9.75% bonds, recovery of the associated refinancing costs would not be an issue in this proceeding.

AIC claims that a 3.1% disallowance would be fairer. It compares the amount of interest that was essentially disallowed in Docket No. 11-0282 to the total amount of interest AIC incurs on the 9.75% bonds, or 3.1%. (AIC BOE, 14.) That calculation has two problems. First, it switches denominators. The 3.1% disallowed interest compares disallowed $1.18 million of interest (i.e. [9.75% - 7.39%] x $50 million imprudently issued bonds) to the total interest $39 million of interest AIC paid on $400 million of 9.75% bonds (i.e., 9.75% x $400 million). The resulting fraction, $1.18 million disallowed interest / $39 million total interest equals 3%.[1] AIC then proposes to apply this fraction to the refinancing costs of the $87.1 million of 9.75% bonds redeemed. Thus, AIC switches the denominator from the $87.1 million of redeemed 9.75% bonds to the total amount of 9.75% outstanding prior to redemption bonds. Since the redemption costs involve only $87.1 million of 9.75%, it would be more appropriate to calculate the disallowed interest as a fraction of redeemed bonds, not total bonds.

AIC claims “the Proposed Order’s disallowance also assumes that $50 million of the 9.75% debt redeemed in 2012 was the same $50 million the Commission disallowed in Docket 09-0306, rather than any of the $350 million that the Commission approved.”

[1] Ameren estimates 3.1% because it rounds downward the fraction of allowed interest on the $50 million of imprudently issued bonds to 75% from 75.8%. (AIC BOE, 14.)

(AIC BOE, 14.) As the discussion above should make abundantly clear, it was AIC that assumed that "$50 million of the 9.75% debt redeemed in 2012 was the same $50 million the Commission disallowed in Docket 09-0306, rather than any of the $350 million that the Commission approved." (AIC BOE, 14.) As stated above, Staff would not have argued that any of the costs associated with the $87.1 million in 9.75% redemptions should be disallowed had AIC assumed that all $87.1 million of 9.75% bond redemptions had been to the $350 million in allowed bonds (reducing that amount to $262.9 million) rather than assigning $50 million of the redemptions to the disallowed 9.75% bonds. The blame for this falls squarely on AIC, not the PO, and not Staff.

AIC offers one last alternative regarding the recovery of 9.75% redemption costs. It suggests lowering the percentage of disallowed costs to 12.5% on the grounds that the Commission found that 12.5% of the 9.75% bonds had been issued imprudently. (AIC BOE, 14.) This proposal would be sensible if AIC had assigned 12.5% of the $87.1 million of proceeds to the $50 million of imprudently issued 9.75% bonds and the remaining 87.5% to the prudently issued 9.75% bonds. AIC did not do this. It assigned 57.41% of the $87.1 million of proceeds to the imprudently issued 9.75% bonds, not 12.5%. (Staff Ex. 5.0R, 6-7:119124.)

The guiding principle regarding the recoverability of 9.75% bond redemption costs should be whether the redeemed 9.75% were prudently issued or imprudently issued. As such, the proportion of recoverable redemption costs should equal the proportion of the $87.1 million in redemptions that AIC assigned to prudently issued 9.75% bonds. If AIC had assumed that 100% of 9.75% redemptions were to prudently issued 9.75% bonds then 100% of redemption costs should be recoverable. If AIC had assumed that 50% of 9.75% redemptions were to prudently issued 9.75% bonds then 50% of redemption costs should be recoverable. Unfortunately, the record is not sufficient to implement this option since the method for adjusting the amount of unamortized debt discount and expense, and annual amortization of the same for the 9.75% bonds, both prudently and imprudently issued, has not been addressed in this proceeding. Therefore, the Commission should affirm the PO's disallowance of 57.41% of 9.75% bond redemption costs because AIC assigned 57.41% of the redeemed 9.75% bonds to the portion that was imprudently issued.

E. Common Equity Balance

1. Purchase Accounting/Goodwill

2. Adjustment to Month-end Balances

3. Non-Utility Investment

4. Forecast Equity Infusion

F. Cost of Short-Term Debt, Including Credit Facility Fees

G. Embedded Cost of Long-term debt

H. Cost of Equity

Response to AIC Exception 1

[**begin confidential**] XXXX[**end confidential**] is the number the Commission should keep in mind when considering AIC's exceptions to the PO's recommendation on cost of common equity. (Staff Ex. 14.0C (Confidential), 17, Attach C.) In January 2013, AIC filed its proposal to increase gas rates. AIC's proposed revenue requirement included AIC witness Robert Hevert's 10.4% rate of return on common equity calculated from data ending November 30, 2012.[2] In February 2013, AIC received another estimate of its cost of common equity of [**begin confidential**] XXXX [**end confidential**] from Duff and Phelps ("D&P"). Id. AIC hired D&P to estimate its cost of common equity in order to assess whether the former's balance of goodwill had become impaired. (Staff Ex. 14.0C, 17.) AIC is unable to reconcile the difference between Mr. Hevert's and D&P's estimates. Mr. Hevert correctly noted that the purpose of the estimates differed (AIC Ex. 34.0, 43:705-707), but the difference in purpose does not explain the difference in the cost of equity estimates. There is nothing in D&P's report that indicates it made any adjustments to the inputs of its cost of equity model, which comprised a [**begin confidential**] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX[**end confidential**] Further, D&P has estimated a 9% rate of return for the market as a whole, which is comprised of a 4% risk-free rate and 5% market risk premium. This 9% rate of return on the market, [**begin confidential**] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX, [**end confidential**] is published on D&P's web site and was not created for the sole purpose of AIC's impairment study. (Staff Ex. 14.0C, 30:553-561.) Obviously, low risk utilities such as AIC will have a lower cost of common equity than the market as a whole. Thus, AIC failed to provide a credible reason why Mr. Hevert's estimate is so widely divergent from that of D&P. Consequently, the Commission should be skeptical of any AIC claim that its authorized rate of return on common equity is too low.

[2] Mr. Hevert updated his analysis of AIC's cost of common equity two more times during the proceeding, for the rebuttal and surrebuttal phases. Curiously, despite changes in his model results, his recommendation for the rate of return on common equity never changed from 10.4%.

AIC's first criticism of the PO's rejection of its CAPM estimate is the alleged lack of finding in the PO that Mr. Hevert's CAPM must be rejected in its entirety. (AIC BOE, 4.) Curiously, in the very next paragraph that AIC levels this criticism, AIC recites the exact reasons contained in the PO for rejecting Mr. Hevert's CAPM: 1) Mr. Hevert relied on betas measured over too short a time interval; and 2) Mr. Hevert erroneously included non-dividend paying companies in his constant-growth DCF analysis of the required rate of return on the market. (AIC BOE, 4-5.) Clearly, AIC knows why Mr. Hevert's CAPM estimates were rejected.

AIC's second and third criticisms of the PO's rejection of its CAPM estimate is that "criticism of two assumptions of AIC's CAPM methodology is not grounds to disregard the CAPM estimate in its entirety." (AIC BOE, 4.) This statement is truly astonishing. The CAPM has 3 inputs: The risk-free rate, beta, and the market required rate of return. (Staff Ex. 5.0R, 25-26:471-481.) A problem with any <u>one</u> of those estimates invalidates the model results. This is why Mr. Hevert's DCF estimate should be excluded from the final authorized ROE. His growth rate assumptions are implausibly high because they require the gas utilities in the sample to earn more than 19.2% on common equity indefinitely, a requirement that Mr. Hevert did not even attempt to defend . (Staff Ex. 5.0R, 41-2:746-757.) Consider this hypothetical: A risk free rate of 3.6%, a beta of 0.6 and a market risk required rate of return of 20%. The first two estimates were used in Ms. Phipps' CAPM analysis, rounded to the nearest 0.1 to simplify the calculations. (Staff Ex. 14.0C, Sch. 14.09.) The last is obviously an outlier. The resulting CAPM estimate would be equal to 13.44% (3.6% + 0.6 x (20% - 3.6%)). In this analysis, only one of the three inputs is invalid, the 20% estimate of the market rate of return. Thus, under Ameren's reasoning, this estimate of the cost of common equity is twice as good as Mr. Hevert's because it contains only one invalid input rather than Mr. Hevert's two invalid inputs. However, its resulting estimate of the cost of common equity is even higher than Mr. Hevert's estimates, which range from 9.94% to 11.23%. (Ameren Ex. 34 (Rev), 57, Table 4b.) Clearly, basing an authorized ROE on the number of invalid inputs is not sufficient.

AIC's third criticism of the PO's rejection of its CAPM estimate is that Mr. Hevert's methodology was similar to a methodology the Commission included in its order in the North Shore Gas Co. ("NS") and Peoples Gas Light and Coke Co. ("PGL") (together "NS/PGL") last rate case (AIC BOE, 8.) is unfounded. Unlike Mr. Hevert, the NS/PGL CAPM did not use 18 month or 24 month beta estimates. It relied on Value Line beta estimates (North Shore Gas Co., ICC Order Docket Nos. 12-0511/12-0512 (cons.), 199 (June 18, 2013) ("NS/PGL Order") which are calculated using 5-years of data. (Staff Ex. 5.0R, 33:597-603.) Further, the NS/PGL Order does not indicate that NS/PGL's rate of return on the market estimation methodology is anything like that of Mr. Hevert's. It only states that NS/PGL relied on forecasted data from Value Line and the Standard & Poor's 500 (without stating what forecast data was used and how) and historical data from Ibbotson Associates. NS/PGL Order at 199. The most one can say is that NS/PGL estimate used historical data that Mr. Hevert did not (i.e., Ibbotson Associates) and that both Hevert and Peoples used Value Line and the Standard & Poor's 500 data <u>in some way</u>.

Ameren also suggests that Mr. Hevert's CAPM, shorn of its 18 and 24-month beta estimates, should be accepted. (AIC BOE, 7-8.) However, that estimate would have the Commission adopt Mr. Hevert's estimate of the market of 13.15%-13.29% (AIC Ex. 34.4).[3] That Mr. Hevert's estimate of the rate of return on the market is unrealistically overstated becomes obvious considering that D&P, the investment advisory firm AIC hired to estimate the latter's cost of common equity for the goodwill impairment study, estimates the rate of return on the market to be 9%. (Staff Ex. 14.0C, 30:553-561.) Of course, there is no reason to incorporate Mr. Hevert's CAPM estimate into the authorized rate of return for the Value Line beta estimates only since Staff's CAPM analysis already incorporates the Value Line betas. (Staff Ex. 14.0C, 8:144-153.)

Ameren complains that it is not aware of any jurisdiction that has approved an approach like Staff's method for estimating the market rate of return. (AIC BOE, 8-9.) In fact, the record is silent as to the methodologies used in other jurisdictions to estimate the market rate of return. Therefore, the same can be said for Mr. Hevert's estimates of the market rate of return.[4] Nonetheless, the record is very clear why Staff's method is superior. Both Staff and Mr. Hevert relied on a constant-growth DCF model to estimate the required rate of return on the market. Mr. Hevert's model assumes that the rate of <u>dividend</u> growth is constant. (Staff Ex. 5.0R, 31-32:571582, 45:802-813.) Thus, the constant growth DCF model is unsuitable for companies that do not pay

[3] For some unexplained reason, Mr. Hevert's estimate of the rate of return on the market changes with the risk-free rate; although the formula for the market risk premium clearly shows that it equals the market rate of return less the risk free rate. Therefore, if the risk-free rate of return changes and the market rate of return does not change, then the market risk premium must change. (Staff Ex. 5.0R, 26-27:471-477.) This error is just one more reason to disregard Mr. Hevert's estimate of the rate of return on the market.

[4] The same could also be said about Mr. Hevert's reliance on 18 and 24-month betas, his risk premium analysis and has DCF analysis.

dividends since dividend growth is obviously not expected to be constant. For an unknown period during which those companies pay no dividends, the growth rate will be zero. (Staff Ex. 5.0R, 45:809-810.) After dividends commence, dividend growth will become positive. Therefore, dividend growth for a non-dividend paying company perforce is non-constant and ill-suited for a constant-growth DCF analysis. Mr. Hevert's analysis assumes that the non-dividend paying companies' "dividends" are growing at 13-14% (Staff Ex. 14C, 29-30:542544) when at least for some of that time, the growth rate in dividends is 0%. Further, D&P's 9% estimate of the rate of return on the market suggests that, if anything, Staff's estimate of the market rate of return is too high, not too low.

AIC's fourth exception pleas for a rate of return closer to NS/PGL's 9.28%. (AIC BOE, 9.) There are two problems with that comparison. First, the Commission must base its rate of return on the record in this proceeding, not the NS/PGL proceeding, and the record in this proceeding does not support a rate of return on equity of 9.28%. In fact, the PO only achieved 9.08% by including DCF estimates that it concluded were too high (i.e., IIEC and AIC) with one in which it found no flaws whatsoever (i.e., Staff). In other words, the record clearly shows that AIC's cost of equity is no higher than Staff's 8.81%. (Staff Ex. 14.01.) Further, there is the matter of D&P's [**begin confidential**] XXXX [**end confidential**] estimate. If the Commission had a similar estimate for NS/PGL, the authorized return on equity in Docket No. 12-0511 might very well have been much lower.

I. Authorized Return on Rate Base

VII. COST OF SERVICE

A. Introduction

B. Cost of Service Study

The Commission should reject IIEC's exceptions to the PO regarding the allocation of the fixed cost of the T&D mains (both plant and expenses) using a peak and average allocation method.

The PO correctly adopts the peak and average method to allocate the fixed costs of the T&D mains (both plant and expenses) which is supported by AIC, Staff, the AG, and CUB. (PO, 160-172.) The peak and average method is appropriate as it recognizes that two key factors drive investment in transmission and distribution plant. First is the need to meet peak demands, not just for individual classes, but, for the system as a whole. (Staff IB, 57.) This is why coincident peak demands are used as one component of the allocator. Id. Second, the allocator recognizes the role of year-round demands in shaping transmission and distribution investments through the average demand component. Id. The investments associated with a distribution system cannot be justified solely by demands on a peak day; rather, they are dictated by year-round demands by all ratepayers. Id.

Contrary to IIEC's assertion, using the peak and average demand method is consistent with general practice in Illinois. Id. AIC has allocated T&D Mains in this proceeding and several prior proceedings using the Peak and Average allocation method. Id. The Commission has an established pattern of approving the peak and average method to allocate the costs associated with T&D mains. Id. Therefore, the

Commission should adopt the language in the PO with respect to the peak and average method to allocate the fixed costs of the T&D mains (both plant and expenses).

VIII. RATE DESIGN

A. Resolved Issues

B. Rate GDS-1

C. Rate GDS-4

IIEC takes exception to the PO's rejection of IIEC's recommendation that the existing rate structure for Rate Zone GDS-4 be maintained and that the individual rate components be increased uniformly by the class average percent increase. (IIEC BOE, 18-21.)

The PO correctly adopts AIC proposed rate increase restrictions for each class to no more than 1.5 times the overall system average increase. The PO also correctly rejects IIEC's recommendation that the rate structure for Rate Zone II GDS-4 be maintained and the increase of all components of the existing GDS-4 rate design be calculated on a uniform percentage. The Commission's rationale balances the competing interests of moving rate classes to full cost of service ("COS") recovery and avoids unreasonably high increases for customers in any given class. (PO, 202.)
This methodology mitigates the concern of adopting the full COS results and the prospect of unfavorable rate impacts that could otherwise result for some rate classes. (Staff IB, 61.) The amount of revenue requirement which is unrecovered, because the rate increase would exceed the cap, would be allocated to the other rate classes, i.e., recovered from the rate classes that have not reached the cap. Id.

The 1.5 times the system average increase constraint represents a reasoned judgment of how much progress can be made towards cost-based revenue allocations while addressing bill impact concerns. Id. This methodology would follow the decision in Ameren's last rate case, Docket No. 11-0282, where the Commission approved a rate cap mechanism that limited class increases to 1.5 times the overall average increase allocated to the respective Rate Zone. Ameren Illinois Co., ICC Order Docket Nos. 11-0282 et al (Cons.), 135 (Jan. 10, 2012) ("11-0282 Order"). Additionally, no parties raised concerns about the issue in Ameren's last rate proceeding. Id.

While Staff recommends that the Commission continue with the 1.5 times the system average increase constraint for all classes in all rate zones in this case, Staff also recommends that the Commission evaluate the progress of each customer class toward full cost of service recovery in future rate cases and make any changes it deems appropriate at that time. Id. at 61-62.

IX. PROPOSED SMALL VOLUME TRANSPORTATION PROGRAM

A. Introduction

B. Positions of Parties

C. Commission Conclusions

The PO concludes that an SVT program is in the public interest, and orders AIC to file SVT tariffs. (PO, 236.) CUB does not agree that it has been shown that an SVT program is in the public interest. (CUB BOE, 18-21.) Staff does not oppose the implementation of an SVT program, and in its BOE Staff recommended that the Commission accept AIC's offer to file tariffs and litigate them in a separate tariff proceeding. (Staff BOE, 49-50.) Several parties echo that recommendation in their BOEs. (RGS BOE, 3; ICEA/RESA BOE, 3-4; AIC BOE, 31-33.) AIC and RGS further propose that the order mandate a workshop before the tariff proceeding begins. (AIC

BOE, Appendix A, 14; RGS BOE, 5.) Staff does not oppose the language in these exceptions.

AIC wants the Commission to clarify which issues are decided in this docket's order. (AIC BOE, 30-33.) Staff agrees that there are several tariff issues that were litigated in this docket for which apparent consensus (or non-opposition) between the parties was reached. Staff believes that it is proper for the Commission to include those agreements in its order in this docket to streamline the tariff proceeding and avoid litigating the same issues twice. For those issues on which the parties did not reach consensus, Staff recommends that these be litigated in the tariff proceeding. Below, Staff identifies those issues that should be addressed by the Commission in its order in this docket, and those that should be resolved in the tariff proceeding.

In its Exception 8, AIC suggests changes to the PO to clarify what issues are being decided in this docket. (AIC BOE, 30-33; AIC Appendix A, 14.) Staff does not disagree with that principle, or with most of the issues AIC identifies. AIC argues that Rider GTA (AIC BOE, 32.) and Rider GSIC (Id., 33-34.) are agreed to by all parties. Staff, in particular, does not oppose Rider GTA, since AIC agrees to a three year sunset provision for the Rider. (PO, 239.) Similarly, Staff does not oppose Rider GSIC, since AIC agrees to file a list of assets whose costs are recovered under the rider each year. (Id., 205.) However, for one issue, Staff is concerned that AIC has not accurately represented Staff's position. While not discussed in AIC's BOE, (AIC BOE, 33-34.) AIC also claims consensus for a paragraph in its Appendix A that "…storage inventory transactions associated with Rider GSIC will occur at a first-of-the-month index, and the cost of any storage inventory transaction will be recovered in Rider GSIC, not Rider

PGA, as agreed upon by the parties." (Id., Appendix A, 15.) Staff is unsure where it indicated agreement with this proposal and there is no cite to the record for this agreement. Further, Staff is unclear what "storage inventory transactions" are or how they are defined. Therefore, the Commission should not adopt this paragraph of AIC's Exception 8.

Several issues remain unresolved and should be addressed in the tariff proceeding. CUB proposed several measures to protect consumers from misleading advertising and door-to-door sales practices. (CUB IB, 39-41.) The PO declined to adopt these protections. (PO, 237-238.) In its BOE, CUB continues to advocate for those protections and offers exceptions to implement them. (CUB BOE, 21-24.) These are strongly opposed by the marketers. (RGS IB, 15-18; ICEA/RESA IB, 20-22.) In addition, ICEA/RESA also states that the issue of "rescission periods" is unresolved. (ICEA/RESA BOE, 5-6.) Staff recommends that these issues be litigated in the tariff proceeding.

Further, the PO orders ORMD to provide an annual report on market performance. (PO, 239.) RGS, for example, recommends that data collection be restricted to a marketer's customer numbers and complaints. (RGS BOE, 3-5, Exception 2, 5-6.) In contrast, ICEA/RESA argues for the elimination of the reporting requirement altogether from the PO. (ICEA/RESA BOE, Exception 2, 4-5.) Staff recommends that these issues be litigated in the tariff proceeding where they can be developed in more depth.

Finally, Staff supports the proposed changes offered in CUB's Exception 9 that delete references in the PO to CUB's participation or lack thereof in the Docket No. 11-

0282 workshops. (CUB BOE, 25-27.) The workshops are intended to provide the freedom to parties to participate as they wish, and a Commission decision should not be based on perceptions about their performance during the workshops. (Staff RB, 63.)

X. OTHER RECOMMENDATIONS

XI. FINDINGS AND ORDERING PARAGRAPHS

XII. CONCLUSION

WHEREFORE, for the reasons set forth in Staff's Initial Brief, Reply Brief, Brief on Exceptions, and this Reply Brief on Exceptions, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations regarding the Company's request for a general increase in gas rates.

Respectfully submitted,

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