

**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 BRIEF ON EXCEPTIONS ON REHEARING
OF NORTH SHORE GAS COMPANY AND
THE PEOPLES GAS LIGHT AND COKE COMPANY**

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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 Exceptions on Rehearing.

I. INTRODUCTION

The Administrative Law Judges’ Proposed Order on Rehearing (at 19-20) correctly reaffirms the Illinois Commerce Commission’s (“the Commission” or “ICC”) June 18, 2013, final Order in these consolidated cases (“June 18 Order”), which determined that the Utilities’ rate bases should include deferred tax assets for their 2012 Net Operating Losses (“NOLs”). *See* June 18 Order at 99-100. Based on the evidence, the Proposed Order on Rehearing (at 20) finds the Utilities’ actions reasonable with respect to the 2012 NOLs. The Proposed Order on Rehearing (at 7) also corrects the calculation of the NOLs in the Utilities’ rate bases, primarily by conforming the calculations with the Commission’s direction in the June 18 Order that the average rate base method be used.

The Commission granted rehearing (1) at the request of the Utilities to address the correct figures for the NOLs in rate base; and (2) at the request of intervenors, the AG¹ and CUB-City², to allow them an additional opportunity to challenge the inclusion of the 2012 NOLs in rate base. *See* 8/6/13 Regular Open Meeting, Tr. at 10:25-11:11 (as corrected by memorandum). There now is no dispute regarding the correct figures for the NOLs in rate base, subject to the issue with respect to inclusion of the 2012 NOLs. However, when given another opportunity by the Commission on rehearing to address the facts, the AG and CUB-City expressly declined to offer any new evidence. On rehearing, Staff submitted evidence, but only on the calculation issue, which turned out to be uncontested.

Instead, Staff, the AG, and CUB-City again question the inclusion of the 2012 NOLs in the Utilities' rate bases, but they offer no new evidence and instead rely on factually unsupported arguments that misstate the evidence in the record. There is evidence in the record in the original proceedings of the 2012 NOLs, which the June 18 Order already found satisfactory. There is no evidence in the original proceeding or on rehearing that there are not 2012 NOLs. Moreover, no one disputes that, if there is an NOL, it belongs in rate base.³

Staff, the AG, and CUB-City claim that the Proposed Order inappropriately shifts the burden of proof to Staff and intervenors. This argument also misses the mark. Once the Utilities presented their *prima facie* case as they did in this proceeding, and also given that the June 18 Order already found that evidence to be sufficient, legally the burden of going forward with the evidence shifts to Staff and intervenors. Staff and intervenors did not present any such evidence on rehearing, however, and their arguments are unsupported by the record.

¹ The Illinois Attorney General (“AG”).

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

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.

Finally, while the correctness of the inclusion of the 2012 NOLs does not rest upon this point, Staff, the AG, and CUB-City all ignore the ramifications of their unsupported end-results driven arguments. Their position would risk the Internal Revenue Service (“IRS”) concluding that the Commission’s order violates the tax normalization rules. The Utilities submitted evidence explaining the tax normalization rules and the consequences of violating the rules, including the loss of the ability to claim accelerated depreciation. *Stabile Reb.*, NS-PGL Ex. 30.0 Rev., 26:647-33:796. The consequences of violating the tax normalization rules are severe to the Utilities and their customers. 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).

The Proposed Order on Rehearing draws the only conclusion possible based on the evidence and the arguments, the same conclusion that the June 18 Order reached, which is that the 2012 NOLs should be reflected in the Utilities’ rate bases. The Commission should reaffirm this here, rejecting the proposals by Staff, the AG, and CUB-City.

The Utilities urge that the Commission adopt the Proposed Order on Rehearing’s conclusions and 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.

II. THE 2012 NOLs ARE SUPPORTED BY THE RECORD AND ARE PROPERLY INCLUDED IN THE UTILITIES’ RATE BASES

The Proposed Order on Rehearing (at 19-20), like the Commission’s June 18 Order before it, correctly concludes that the Utilities’ 2012 NOLs are supported by the record and thus, are properly included in the Utilities’ rate bases. Staff, the AG, and CUB-City make various

incorrect and unsupported assertions about the evidence, such as CUB-City's repeated but baseless claim that the NOLs somehow were created by a "decision" of the Utilities' parent company, and, further, they all claim the Proposed Order incorrectly shifts the burden of proof to Staff and intervenors. Their factual assertions misstate the record, and their burden-shifting argument is a red herring. The Proposed Order on Rehearing correctly acknowledges that the Utilities provided evidence regarding the 2012 NOLs throughout the original proceeding, to which Staff and intervenors have not responded with opposing evidence despite the grant of rehearing. The Commission should adopt the Proposed Order on Rehearing's finding with respect to the inclusion of the 2012 NOLs in the Utilities' rate bases.

A. The Evidence Supports Inclusion of the 2012 NOLs in Rate Bases

Staff, the AG, and CUB-City argue that there is insufficient evidence of 2012 NOLs to support their inclusion in the Utilities' rate bases. Staff BOE on Rehg at 2-4; AG BOE on Rehg at 5-8; CUB-City BOE on Rehg at 7-10. As discussed herein and in Sections II.B and II.C, these arguments ignore the substantial evidence in the record regarding the existence of the 2012 NOLs and how and when they should be included in the Utilities' rate bases. Evidence of the 2012 NOLs was contained in:

- Schedule G-5, filed on July 31, 2012, included in the Utilities' direct testimony,

where they report that:

There is currently no forecasted net operating loss ("NOL") deferred income tax asset. This results from the assumption that while [the Utilities] may be generating taxable losses, the consolidated group is assumed to be able to use those losses. Under the Companies tax sharing agreement, [the Utilities] will be paid cash for the tax benefit of [their] loss, if any, generated on a standalone basis, and used to reduce consolidated tax obligations. [The Utilities] will therefore not have a deferred income tax asset for the NOL. This assumption will be monitored/updated at each step in the case.

NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11.
(Emphasis added)

- The Utilities' Response to Staff data request BAP 15.01 (dated October 23, 2012)

where the Utilities stated:

As of the point in time estimates were provided for this instant proceeding, the assumed facts and circumstances were that [the Utilities] would incur a NOL for 2012 on a stand-alone basis, but [Integrys consolidated group] would have been able to use the [Utilities] NOL to reduce current or prior tax obligations of the consolidated group.

The [North Shore] NOL Deferred tax asset would have been approximately \$1.9 million at the end of 2012. The NOL deferred tax asset balance at the end of 2013 would be zero as the 2012 NOL would have been used in 2013.

The [Peoples Gas] NOL Deferred tax asset would have been approximately \$51.6 million at the end of 2012. The NOL deferred tax asset balance at the end of 2013 is an iterative number that needs to reflect the impacts of the revenue increase and all adjustments. However, the amount "per book" is approximately \$53.4 million.

[The Utilities] will review the above assumptions related to the consolidated tax position at the time it is preparing its rebuttal testimony. Current estimates indicate that [Integrys consolidated group] may not be able to use the NOL as originally assumed. As such, [the Utilities] will be mindful of the normalization rules, and the requirement to include the NOL in rate base. [The Utilities] will propose an adjustment if the company believes it is appropriate and prudent to do so.

Staff Cross Exs. 12 and 13. (Emphasis added)

- The Utilities' Response to Staff data request BAP 19.01 (dated November 15, 2012) where the Utilities stated:

The [Utilities] will look at the latest estimates of taxable income for the consolidated group. For Peoples Gas and North Shore, amounts will be equal to the taxable income embedded in the [Utilities'] rebuttal

testimony. *If the consolidated group is in an NOL position under that measure, it will be prudent to introduce a deferred tax asset for the NOL.*

Staff Cross Exs. 14 and 15. (Emphasis added)

- Rebuttal testimony filed on December 18, 2012, where Utilities witness John P.

Stabile testified:

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 (emphasis added)

However, the depreciation deductions have now caused Peoples Gas to be in a tax loss position for 2011 and 2012.

Stabile Reb., NS-PGL Ex. 30.0 Rev., 28:692-693.

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 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.

Under accounting rules, the Utilities will establish deferred tax assets for their NOLs. *If an NOL arises, the Utilities request that the deferred tax asset to be established during 2012 and 2013 for the federal and state tax effect of the Utilities' 2012 and 2013 NOLs be included in rate base for the purpose of computing the Utilities' 2013 revenue requirement.*

Stabile Reb., NS-PGL Ex. 30.0 Rev., 30:723-727. (Emphasis added)

The evidence demonstrates that the Utilities were already *forecasting* stand-alone 2012 NOLs at the time they filed their direct testimony. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11. The direct testimony evidence also made clear that a deferred

tax asset for these 2012 NOLs was not included in the rate bases because the Integrys consolidated group was forecasted to absorb these losses and gave express notice that the forecast that the Integrys consolidated group would be able to absorb the NOLs could change. *Id.* Further, at the time they filed rebuttal testimony on December 18, 2012, the Utilities were still *forecasting* that the consolidated group's income would be able to absorb these losses but also again made clear that if the NOLs could not be absorbed then they should be included in the rate bases. Stabile Reb., NS-PGL Ex. 30.0 Rev., 27:649-652; Staff Cross Exs. 12 and 13. Thus, the Utilities indicated in direct testimony, discovery responses that are in evidence, and in rebuttal testimony that they would monitor the status of the 2012 NOLs and keep Staff and intervenors updated throughout the proceeding, and that if not absorbed, the NOLs should be included in the rate bases. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11; Staff Cross Exs. 14 and 15; *see also* the rebuttal testimony cited above. It was not until Integrys' books closed for the 2012 year and *actual* numbers were available, however, that the Utilities found out that the Integrys consolidated group was in a loss position and therefore could not absorb the Utilities' standalone 2012 NOLs. Stabile Sur., NS-PGL Ex. 46.0, 36:868-876. The 2012 NOLs, for which the Utilities had provided estimates (Staff Cross Exs. 12 and 13), resulted from unanticipated levels of bonus depreciation from the enactment of the Tax Relief Act of 2010, which extended bonus depreciation through 2012, and tax accounting method changes. Finally, once the Integrys consolidated group could not absorb the Utilities' stand-alone losses, the Utilities were required to reflect those losses in their respective rate bases. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11; Staff Cross Exs. 12 and 13; Stabile Reb., NS-PGL Ex. 30.0 Rev., 30:723-727. There was no parent company "decision" that created the 2012 NOLs.

The AG attempts to claim that the Utilities have mischaracterized the evidence. AG BOE on Rehg at 6-7. This argument falls flat. Beginning with their Schedules G-5, the Utilities indicated that the Utilities were generating taxable losses but the Integrys consolidated group was forecasted to absorb those losses. As such, no deferred tax asset was being forecasted. This situation remained the same through rebuttal testimony. Having ignored record evidence throughout the original proceeding and on rehearing, the AG now tries to misstate record evidence to support its untenable position. The Commission should reject this argument.

For the foregoing reasons and reasons stated in Sections II.B and II.C herein, the Proposed Order on Rehearing (at 19-20) correctly concludes that the un rebutted facts support the inclusion of the 2012 NOLs in the Utilities' rate bases.

B. The Utilities Did Meet their Burden of Proof Regarding the 2012 NOLs and the Proposed Order on Rehearing Does Not Inappropriately Shift the Burden to Staff and Intervenors

The AG argues that the Proposed Order on Rehearing inappropriately shifts the burden of proof to Staff and intervenors because “[i]t is not the obligation of the [AG], Staff or any other intervenors to attempt to explain the Companies addition to rate base” AG BOE on Rehg at 2. CUB-City argue that their arguments regarding the 2012 NOLs are “legal” and not “factual,” thus they did not have to respond to record evidence. CUB-City BOE on Rehg at 5. Both the AG and CUB-City argue that they do not have the resources to argue all issues. AG BOE on Rehg at 5; CUB-City BOE on Rehg at 11. Staff, who previously filed testimony acknowledging the stand-alone 2012 NOLs⁴, argues that it did its due diligence monitoring the issue and reserved the right to respond but did not have to substantively address any evidence or provide any responsive testimony. Staff BOE on Rehg at 5. Staff adds that it did not have the opportunity to respond to the Utilities' surrebuttal testimony. These arguments are contrary to

⁴ See Pearce Dir., Staff Ex. 4.0, 26:644-658; Pearce Reb., Staff Ex. 14.0, 23:492-505.

the facts as described in the Utilities' Initial Brief on Rehearing (at 7-13) and Section II.A. herein, as well as Illinois law.

A utility does bear the burden of proof that its proposed rates are just and reasonable, 220 ILCS 5/9-201(c), but once it presents a *prima facie* case, the burden of going forward with the evidence shifts to the other parties that challenge its costs to show unreasonableness due to inefficiency or bad faith.

In proceedings before the Commission, once a utility makes a showing of the costs necessary to provide service under its proposed charges, it has established a *prima facie* case. *City of Chicago v. People of Cook County*, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985). The burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith. *City of Chicago v. People of Cook County*, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985).

Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 327 Ill. App. 3d 768, 776, 762 N.E.2d 1172, 1173-1174 (3d Dist. 2002) ("*Illinois Bell*"). In addition, a utility does not bear the burden of proof on all the issues that conceivably are relevant to the reasonableness of its rates, nor is it required in its direct case to anticipate and disprove the objections that opposing parties might make. *City of Chicago*, 133 Ill. App. 3d at 442, 478 N.E.2d at 1375. The AG cites *People ex. Rel. Hartigan v. ICC*, 117 Ill.2d 120, ___ N.E.2d ___ (1987) ("*Hartigan*") to support its argument regarding burden of proof. However, *Hartigan* is inapposite. *Hartigan* addressed an electric utility's burden to establish the reasonableness of power plant construction costs under Section 9-213 of the Public Utilities Act (220 ILCS 5/9-213). Costs incurred by utilities for other purposes, such as NOLs, are subject to the traditional burden-shifting analysis in *Illinois Bell*. See *Apple Canyon Lake Prop. Owners' Ass'n v. ICC*, 2013 Ill. App. 3d 100832 *P54-55 (3d Dist. 2013).

As described in detail in the Utilities' Initial Brief on Rehearing (at 7-13) and in Section II.A. herein, the Utilities explained (1) that stand-alone 2012 NOLs existed and provided

estimates; (2) their inclusion in rate base was contingent upon whether the Integrys consolidated group could absorb the NOLs pursuant to the Commission-approved tax sharing agreement; and (3) what actions needed to be taken if it was determined that the Integrys consolidated group could not absorb the 2012 NOLs, *i.e.*, the 2012 NOLs needed to be included in the rate bases. The Utilities met their burden of proof. The June 18 Order already found the evidence to be sufficient. Thus, pursuant to Illinois law, the burden of going forward with the evidence shifted to Staff and intervenors “to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith.” Staff and intervenors did not respond to the Utilities’ evidence. The Utilities cannot be expected to provide evidence that would anticipate and disprove the objections that opposing parties might make.

For example, in their direct filing, the Utilities acknowledged that based on current forecasts, even though each of the Utilities was generating losses, the consolidated group was anticipated to absorb those losses; thus, no NOLs were included in rate base. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11. The Utilities noted that these assumptions would be monitored/updated at every stage in the proceeding. *Id.* Only Staff responded to this evidence indicating that it had outstanding data requests regarding the NOLs and reserved the right to propose adjustments in rebuttal testimony. Pearce Dir., Staff Ex. 4.0, 26:644-658. In direct testimony, the AG and CUB-City addressed other tax-related issues, including the proper tax accounting methodology to account for deferred taxes related to a change in state income tax rate⁵, the Invested Capital Taxes⁶ and the tax accounting methodology for overheads⁷. On rehearing, the AG through briefing only raised factual concerns about the propriety of the standalone 2012 NOLs and the methodology chosen by the

⁵ Brosch Dir., AG Ex. 1.0, 33:746-42:955; Smith Dir., CUB-City Ex. 1.0, 55:1519-67:1915

⁶ Brosch Dir., AG Ex. 1.0, 42:957-45:1033; Smith Dir., CUB-City Ex. 1.0, 105:3257-107:3313.

⁷ Effron Dir., AG Ex. 2.0, 15:325-17:374; Smith Dir., CUB-City Ex. 1.0, 22:527-45:1293.

Utilities regarding the NOLs. AG Init. Br. on Rehg Rev. at 4-5; AG Reply Br. on Rehg at 2-5; AG BOE on Rehg at 5. Similarly, on rehearing, CUB-City, who claim their arguments are “legal,” also raise *factual* concerns (through briefing only) regarding the tax sharing agreement between the Utilities and their parent and the application of the 2012 NOLs. CUB-City Init. Br. on Rehg at 2-4; CUB-City Reply Br. on Rehg at 8-10; CUB-City BOE on Rehg at 5. Yet, neither AG nor CUB-City addressed those concerns in testimony in the original proceedings or on rehearing.

Further, in the original proceedings, following Staff and intervenor direct testimony, the Utilities provided discovery and rebuttal testimony that provided further updates on the status of the Integrys consolidated group’s ability to absorb losses, estimates of the 2012 NOLs if they had to be included in the Utilities’ rate bases, how the 2012 NOLs were caused, an explanation of how the 2012 NOLs would need to be included in the Utilities’ rate bases, and an explanation of how the normalization rules would be violated if the 2012 NOLs were not included in rate base. Staff Cross Exs. 14 and 15; Stabile Reb., NS-PGL Ex. 30.0 Rev., 27:649-652, 28:692-693, 29:707-713, 30:723-727, 30:731-33:796. Again, in response to this evidence, Staff indicated that it had outstanding data requests regarding the NOLs and reserved the right to propose adjustments in supplemental rebuttal testimony. Pearce Reb., Staff Ex. 14.0, 23:492-505. In rebuttal testimony in the original proceeding, the AG and CUB-City again offered other tax-related testimony, including the proper tax accounting methodology to account for deferred taxes related to a change in state income tax rate⁸, the Invested Capital Taxes⁹, the tax accounting

⁸ Brosch Reb., AG Ex. 4.0, 34:749-42:917; Smith Reb., CUB-City Ex. 2.0, 25:534-45-990.

⁹ Brosch Reb., AG Ex. 4.0; 42:919-45:995; Smith Reb., CUB-City Ex. 2.0, 11:202-14:293.

methodology related to repairs¹⁰, and bonus depreciation¹¹. Yet again neither AG nor CUB-City addressed their *factual* concerns in rebuttal testimony in the original proceedings or on rehearing.

The Utilities met their burden of proof regarding the 2012 NOLs, and once they did, the burden of going forward with the evidence shifted to Staff and intervenors. Staff and intervenors had the opportunity in the original proceedings and on rehearing to respond to the Utilities' assumptions, application of the Commission-approved tax sharing agreement, 2012 NOL amounts, and the Utilities' methodology to include the 2012 NOLs in their rate bases should the Integrys consolidated group not be able to absorb the losses. Staff argues it had no opportunity in the original proceedings to respond to the Utilities' surrebuttal testimony; however, Staff filed both supplemental rebuttal and *surrebuttal* testimony regarding other issues.¹² Further, as demonstrated above, there were multiple opportunities to respond to evidence prior to the Utilities filing surrebuttal testimony. Citing the circumstances in ICC Docket No. 13-0301, Staff claims it has the "right and an obligation to consider the totality of the evidence, as well as positions of other parties, in its briefing in order to make a recommendation to the Commission." Staff BOE on Rehg at 3. Setting aside the fact that Staff's position on rehearing is its third different position relating to the 2012 NOLs¹³, the ability to provide a recommendation in

¹⁰ Effron Reb., AG Ex. 5.0, 4:74-9:198; Smith Dir., CUB-City Ex. 1.0, 22:527-45:1293.

¹¹ Effron Reb., AG Ex. 5.0, 14:307-15:342 and Schedules DJE-1.3N and DJE-1.4P; Smith Reb., CUB-City Ex. 2.0, 45:992-47:1025.

¹² 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.

¹³ 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. *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. On Rehearing, Staff argues that the 2012 NOLs should not be included in the Utilities' rate bases because they are not supported by the record. Staff Init. Br. on Rehg at 6.

briefing still must be supported by evidence and the arguments set forth by Staff, the AG and CUB-City are not in evidence.¹⁴

The AG and CUB-City arguments that they cannot expend the resources to address such issues are equally without merit. Interestingly, the AG provides contradictory arguments. On one hand, they argue that they cannot expend resources on what appeared to be a “non-issue,” acknowledging that the Utilities did provide evidence throughout the proceeding. AG BOE on Rehg at 5. On the other hand, the AG argues that the Utilities provided no evidence. AG BOE on Rehg at 5-8. Regardless, given that the AG and CUB-City addressed five tax-related issues, it is difficult to believe they did not have the resources to address all the evidence regarding the 2012 NOLs. Also, even assuming the intervenors’ resources lead them to choose to limit the number of issues they contest in a general rate case, that argument fails at the rehearing phase. On rehearing, inclusion of the 2012 NOLs in rate bases was the intervenors’ sole issue, and they elected to provide no evidence.

For all the foregoing reasons, the Proposed Order on Rehearing did not inappropriately shift the burden of proof to Staff and intervenors. The Utilities met their burden of proof, as the June 18 Order already found. The burden of going forward with the evidence shifted to Staff and intervenors, who failed to rebut any record evidence.

C. The Application of the 2012 NOLs Was Governed by Commission-Approved Tax Sharing Agreement

CUB-City continues to argue that the Utilities’ inclusion of the 2012 NOLs in their rate bases was a result of an internal management “decision”. CUB-City BOE on Rehg at 9. The AG

¹⁴ See for example, *Apple Canyon*, 2013 Ill. App. 3d 100832*P54-55, the Appellate Court found that the only evidence in the record was that submitted by the water utilities to support new accounting and billing systems. The intervenor did not impeach the utilities’ un rebutted evidence or provide testimony or other evidence. Arguments made by the intervenor in briefs that the water utilities’ costs were higher than the national average were not supported by testimony or other evidence.

argues that the Utilities should have included the 2012 NOLs in their rate bases in a manner contrary to the Commission-approved tax sharing agreement. AG BOE on Rehg at 8.

The Utilities are included in the consolidated United States income tax return filed by Integrys. NS Ex. 5.1, Schedule G-5, p. 4; PGL Ex. 5.1, Schedule G-5, p. 4. Further, the Utilities are parties to a federal and state tax allocation arrangement with Integrys and its subsidiaries under which each entity determines its provision for income taxes on a standalone basis. NS Ex. 5.1, Schedule G-5, p. 4; PGL Ex. 5.1, Schedule G-5, p. 4. Under this tax sharing agreement, which the Commission approved in ICC Docket No. 07-0458, the Utilities would be paid cash for the tax benefit of their losses, if any, that are used to reduce the consolidated group's tax obligations. NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, p. 10-11. 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 because they are being used by the consolidated group.* NS Ex. 5.1, Schedule G-5, p. 10; PGL Ex. 5.1, Schedule G-5, pp. 10-11; Stable Reb., NS-PGL Ex. 30.0 Rev., 27:649-652; Staff Cross Exs. 12 and 13. The factual assumptions supporting the Utilities' direct filing in the original proceeding 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. 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 with standards established by American Institute of Certified Public Accountants ("AICPA"), including AICPA Audit and Accounting Guide: Guide for Prospective Financial Information dated March 1, 2009. *Id.* This evidence is unrebutted.

Under their tortured logic, CUB-City and the AG would have the Utilities include the effects of NOLs in rate base when information available at the time would indicate that the NOLs would be used by the consolidated group and thus paid in cash to the Utilities. As such, it would have been improper to reflect the NOLs in the Utilities' rate bases at that point, as the Proposed Order on Rehearing (at 19-20) finds. Furthermore, it was not the Utilities' decision to suddenly use the NOLs themselves in January 2013, it was a function of the tax sharing agreement with Integrys and the closing of the Integrys books for the 2012 year, as the undisputed record evidence shows.

CUB-City characterize the Utilities' application of the Commission-approved tax sharing agreement as "internal tax planning positions" and then try to differentiate the 2013 NOLs which were created as a result of tax law. CUB-City BOE on Rehg at 9. The CUB-City argument fails because it is contrary to the facts. Notably, in making this "factual" argument, CUB-City provides no cites to the record. The 2012 NOLs were also created in part by a change in tax law, namely, the result of from unanticipated levels of bonus depreciation from the enactment of the Tax Relief Act of 2010, which extended bonus depreciation through 2012.¹⁵ *Stabile Reb., NS-PGL Ex. 30.0 Rev., 29:707-713*. Furthermore, the use of the 2012 NOLs is not a result of "an internal management decision." The only internal management decision occurred in 2007 when the Utilities entered into the tax sharing agreement, which they submitted for Commission approval. As a result, use of the 2012 NOLs is governed by the tax sharing agreement approved by the Commission.

Finally, CUB-City recommends that additional language regarding discovery and affiliates be added to the Order should the Commission correctly determine to reaffirm its

¹⁵ The 2012 NOLs were also created in part as a result of electing certain tax accounting method changes. *Stabile Reb., NS-PGL Ex. 30.0 Rev., 29:707-713*

decision to include the 2012 NOLs in the Utilities' rate bases. *See* CUB-City BOE CORR at 10, 15. The CUB-City argument is misplaced and should be rejected. The Utilities' evidence on the NOL status was informed by the tax position of the Integrys consolidated group. The Utilities did not fail to consider the effect of their affiliates' tax positions, nor did they ignore the affiliates' tax positions in their data responses. Moreover, in not objecting to the inclusion of the 2013 NOLs in the Utilities' rate bases, CUB-City did not request affiliate data.

Based on the foregoing, the Proposed Order on Rehearing (at 19) correctly concluded that the Utilities appropriately set forth their assumptions in their direct testimony filings and kept Staff and intervenors apprised of the status of the 2012 NOLs. Further, the Proposed Order on Rehearing (at 19-20) correctly finds that the 2012 NOLs were not available for the Utilities to use until surrebuttal testimony because up until that time, the Integrys consolidated group was forecasted to absorb those losses. Therefore, the Commission should reject the AG and CUB-City arguments.

D. The AG and CUB-City Did Have But Waived a Second Opportunity to Respond to the Utilities' Evidence Regarding the 2012 NOLs

The Proposed Order on Rehearing (at 20) correctly concluded that the AG and CUB-City waived filing direct testimony and chose not to file rebuttal testimony on rehearing. The AG and CUB-City claim that their Applications for Rehearing did not seek to respond to the evidence that the Utilities provided but only that the Commission should reconsider its decision regarding the 2012 NOLs based on the evidence already in the record. AG BOE on Rehg at 3-4; CUB-City BOE on Rehg at 4-5. At the same time they make this argument, the AG and CUB-City inconsistently 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 BOE on Rehg Rev. at 4; CUB-City BOE on Rehg at 7, 11-12. For all the reasons described in the Utilities' Initial Brief on

Rehearing (at 7-13), the Utilities' Reply Brief on Rehearing (at 14-15), and Sections II.A, II.B, and II.C. herein, these intervenors had opportunities in direct and rebuttal testimony in the original proceeding and on rehearing 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.

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. 8/6/13 Regular Open Meeting, Tr. at 10:25-11:11 (as corrected by memorandum). Even though the AG and CUB-City in their rehearing applications asked for reconsideration of the Commission's June 18 Order and did not ask to submit additional evidence pursuant to Section 200.880(c)¹⁶, 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. 8/22/13, Tr. 7:3-8:5. They also later chose to file no rebuttal testimony on rehearing. Tellingly, the AG and CUB-City are silent regarding the opportunity to respond to the 2012 NOLs evidence that the Commission provided as confirmed by the transcript.

The AG again implies that somehow the Utilities should have introduced additional evidence regarding the 2012 NOLs on rehearing. AG Reply Br. on Rehg at 9; AG BOE on Rehg at 2. The AG's argument is odd at best given its citations to the Commission's rules and comments of its Counsel on rehearing. The Commission's June 18 Order properly concluded that the 2012 NOLs should be included in the Utilities' rate bases. Thus, the Utilities did not request rehearing to introduce additional evidence on whether the 2012 NOLs should be

¹⁶ 83 Ill. Admin. Code § 200.880(c).

reflected in the Utilities' rate bases, a point on which the Commission already had ruled in their favor. Utilities Appl. Rehg at 11-15. Further, it was the AG and CUB-City that requested rehearing on the inclusion of the 2012 NOLs in the Utilities' rate bases. AG Appl. Rehg at 10-13; CUB-City Appl. Rehg at 7-11. Additionally, at the status hearing on August 22, 2013, Counsel for the AG stated:

It is our understanding that direct testimony is due to be filed on September 6th and will likely be limited to the Company's explanation of the error, if believed are currently present in the appendices of the Commission's final order. The Commission granted that aspect of the Company's rehearing, which is that in their application of a hearing was limited to that discussion, i.e., what the errors were for both in the appendices of the order related to the 2012 and 2013 NOLS.

In granting our -- the People's application for a hearing as well as Sub (*sic*) City's application for a hearing, it is our view that the Commission -- those applications simply sought reconsideration of the Commission's conclusion on the 2012 NOL. For that reason, it is unlikely that the ratepayer advocates would be filing any testimony related to that issue given that there was a lack of evidence on the 2012 NOL.

Also, the ratepayer advocate's applications for rehearing did not -- rules require to seek specific allegations of the need for additional evidence or a description of what evidence would be filed related to the 2012 NOL, though application for the rehearing addressed what we believe was a lack of evidence on the part of the Company to support the 2012 NOL.

8/22/13, Tr. 7:3-8:5. Thus, the AG not only was aware that the Utilities would not be submitting additional evidence supporting the 2012 NOLs, but said the Utilities were limited to the calculation issue in the Utilities' application for rehearing. The Commission should reject the AG's sleight of hand argument. On one hand, the AG argues that the Utilities are limited to the issue included in their application of rehearing, and on the other hand, the AG argues that the Utilities did not provide any additional evidence. This argument further reveals that the AG's position is a results-driven argument that is unconcerned with procedure or facts.¹⁷

¹⁷ At no time did the Utilities state that they objected to the AG or CUB-City submitting evidence on rehearing.

The Proposed Order on Rehearing properly concludes that these intervenors had ample opportunity to respond to the Utilities' evidence in the original phase of these proceedings and rehearing. The AG and CUB-City opted to waive these opportunities.

III. FAILURE TO INCLUDE THE 2012 NOLS IN RATE BASE LIKELY WOULD VIOLATE THE TAX NORMALIZATION RULES

As with all the evidence regarding the Utilities' 2012 NOLs, Staff, the AG, and CUB-City do not address or offer any evidence to the contrary that a tax normalization violation would likely occur if the Commission were to adopt their position. The evidence demonstrates that based upon the record in this proceeding, failure to include the 2012 NOLs in the Utilities' rate bases will likely lead to a tax normalization violation, resulting in the loss of the Utilities' ability to claim accelerated depreciation. As for Staff, this would be the second time in twenty-two years that it recommends that the Commission adopt a position that would cause the Utilities to violate the tax normalization rules.

The normalization rules for tax purposes address how a company must normalize the effect of accelerated depreciation. *Stabile Reb.*, NS-PGL Ex. 30.0 Rev., 30:731-735. By recording the effects of an NOL as a deferred tax asset, the tax benefit associated with accelerated depreciation is effectively eliminated until the time the loss is realized. *Id.* at 33:783-787. The result of violating this rule is severe to both the Utilities and their customers. *A violation would result in the Utilities not being able to claim the rate base-reducing impacts of accelerated and bonus depreciation.* *Id.* at 33:788-796; *Stabile Tr.* 2/8/13, 777:7-21. The consequences of violating the normalization rules are also unrebutted.

While an NOL may increase rate base for a short period of time, the loss of the ability to claim accelerated depreciation affects the entire life of an asset. Short-term thinking in this situation could have severe and significant long term harm to the Utilities' customers. 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 Private Letter Ruling (“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 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.

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.” *Illinois Commerce Comm’n On Its Own Motion: Adoption of 83 Ill. Adm. Code 556*, Docket No. 13-0458, Order (Oct. 23, 2013) at 3. The Commission should reaffirm this here and reject the proposals by Staff, the AG, and CUB-City.

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.

It is important to put the effect of a tax normalization violation in context. In the 1991 proceedings, the deferred income taxes for Peoples Gas and North Shore were \$168,716,000 and \$19,055,000 respectively. Docket No. 91-0586, 1992 Ill. PUC LEXIS 376, 194; Docket No. 91-0010, 1991 Ill. PUC LEXIS 636, 18. In the current consolidated proceedings, the deferred income taxes that should be properly included in the rate bases (including deferred taxes related to accelerated depreciation) for Peoples Gas and North Shore are \$449,674,000 and \$68,160,000 respectively. Staff Exs. 26.1, App. A at 5 and App. B at 5. Had the Commission adopted the Staff adjustments in the 1991 Rate Cases resulting in a normalization violation and the Utilities losing the ability to claim accelerated depreciation, instead of deferred taxes growing for Peoples Gas and North Shore by over \$280 million and \$49 million respectively, the deferred taxes would have begun to reverse and balances would be substantially less than they were in the 1991 Rate Cases. Annual revenue requirement impacts that do not reflect the level of deferred income taxes in rate base could be well in excess of ten times the amount of the short-term impact of properly including the 2012 NOLs in the Utilities' rate bases.¹⁹

When determining whether a normalization violation occurred, the IRS will look to the public utility commission and its actions. In granting relief to utilities that have had inadvertent errors, in PLRs, the IRS has noted that the error had to be inadvertent and not the result of the actions or insistence of a public utility commission. See, for example, Staff Cross Ex. 2 on Rehg, the Utilities' response to Staff data request ACC 2.01, Attach 05 at 5, PLR 201318004 (dated 05/03/2013). Thus, in determining whether a violation occurred, the IRS will look to the Commission's order as to why it is improper for the Utilities to include the 2012 NOLs in rate

¹⁹ For Peoples Gas, the total base rate revenues with the 2012 NOL reflected is \$590,881,000 and total base rate revenues without the 2012 NOL \$586,959,000. See Staff Exs. 26.1, App. B, p. 1 and 26.2, App. B, p. 1. Thus, the difference is \$3,922,000. For North Shore, the total base rate revenues with the 2012 NOL reflected is \$82,796,000 and total base rate revenues without the 2012 NOL \$82,688,000. See Staff Exs. 26.1, App. A, p. 1 and 26.2, App. A, p. 1. Thus, the difference is only \$108,000.

base in surrebuttal when the Commission allowed the rate base-reducing effects of 2013 bonus depreciation.²⁰

Furthermore, the situation is not easily rectified. If the Utilities are found to violate the normalization rules, to cure such a violation, the IRS may ask the Utilities to cure the violation by requiring a Commission Order that confirms the Commission's commitment to normalization and that provides rate relief for the period beginning on the effective date of the Order. Staff Cross Ex. 2 on Rehg, the Utilities' response to Staff data request ACC 2.01, pp. 2-3. In other words, a surcharge or other mechanism would have to be adopted to bring customer rates to a level they would have been if the violation did not occur effective for the period the rates were in effect. *Id.* However, the IRS may not provide an option to cure the violation as it did in the case of three California utilities in the 1970s. Staff Cross Ex. On Rehg 2, the Utilities' response to Staff data request ACC 2.01, pp. 1-2. In that case, those utilities only regained their ability to claim accelerated depreciation through an enactment of law and agreeing to various financial and administrative concessions. *Id.*

Staff and intervenors at times seem to suggest that the fact that public utility commissions and their staff seldom risk normalization violations means the risk here is small. That logic is false. Commissions and their staff normally seek to avoid any such risk, because of the severe consequences for customers as well as utilities, as illustrated above.

For all the foregoing reasons, the Commission should reject the 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. The Commission should reaffirm its decision to include the 2012 NOLs in

²⁰ Note that if the decision to include the 2012 NOLs in the Utilities' rate bases is reversed, the Order will also be relied upon by the Utilities to determine whether they will once again need to report a normalization violation to the IRS.

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 and Reply Brief on Rehearing, appearing of record, or reflected in their draft proposed Administrative Law Judges' Proposed Order, respectfully request that the Commission approve the Administrative Law Judges' Proposed Order issued on November 20, 2013, without exception.

Dated: December 6, 2013

By: 
Counsel for North Shore Gas Company and The
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CERTIFICATE OF SERVICE

I, Carla Scarsella, an attorney, hereby certify that I caused a copy of the Reply Brief on Exceptions on Rehearing to be served upon all parties on the service list in Docket Nos.12-0511 / 12-0512 by electronic mail on the 6th day of December, 2013.

A handwritten signature in cursive script that reads "Carla Scarsella". The signature is written in black ink and is positioned above a horizontal line.

Carla Scarsella