STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	No. 14-0224
Proposed General Increase In Rates For Gas Service.	:	and
	:	No. 14-0225
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	Consol.
	:	
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INITIAL BRIEF OF NORTH SHORE GAS COMPANY
AND THE PEOPLES GAS LIGHT AND COKE COMPANY

October 21, 2014

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INITIAL BRIEF OF NORTH SHORE GAS COMPANY AND THE PEOPLES GAS LIGHT AND COKE COMPANY

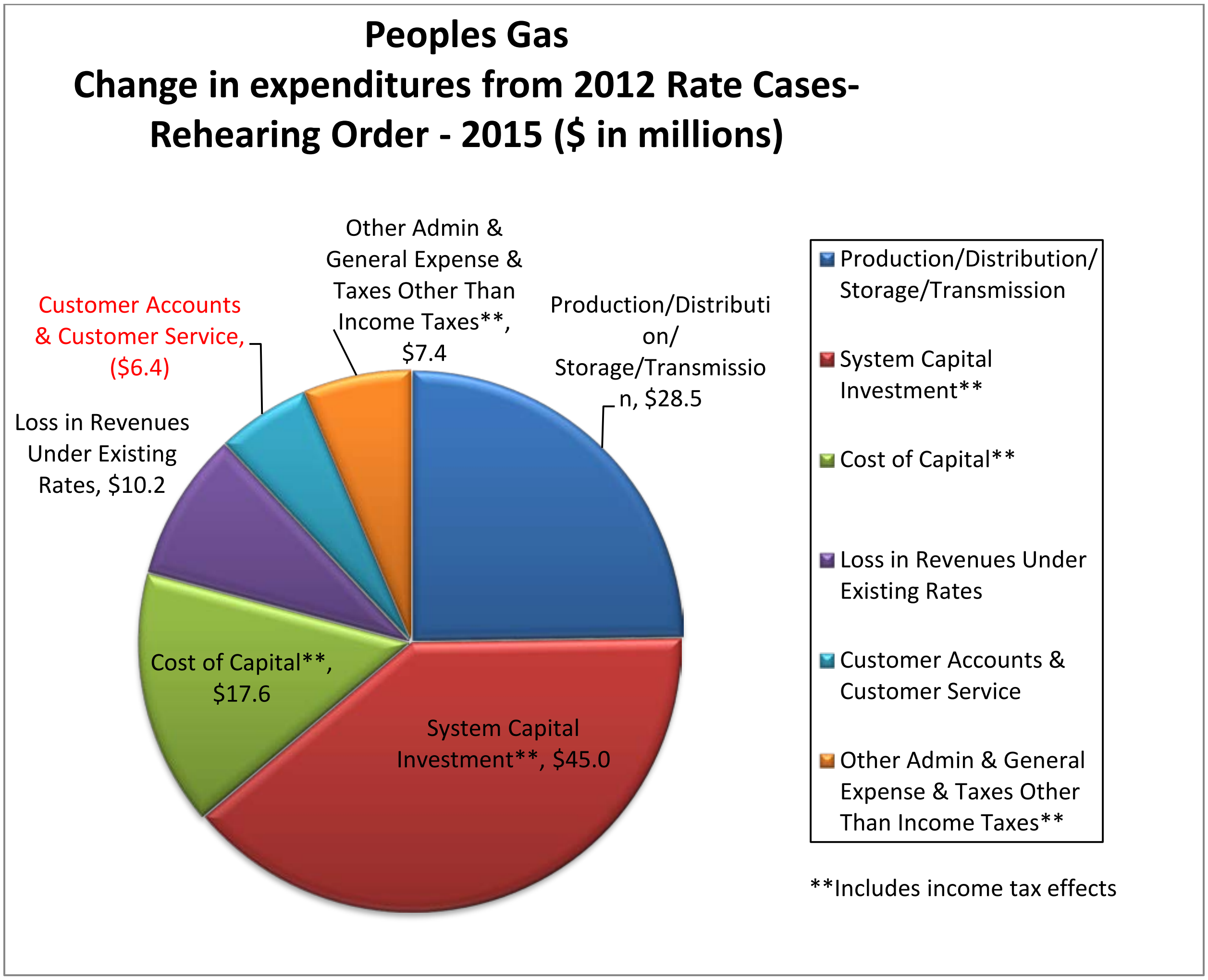
North Shore Gas Company ("North Shore") and The Peoples Gas Light and Coke Company ("Peoples Gas") (together, the "Utilities"), by their counsel, submit this Initial Brief.

I. INTRODUCTION/STATEMENT OF THE CASE

North Shore and Peoples Gas request that the Illinois Commerce Commission ("Commission" or "ICC") establish natural gas distribution service rates (1) to go into effect in 2015 that reflect the Utilities' expected costs of serving customers in 2015, subject to (2) removing from Peoples Gas' "revenue requirement" (cost of service calculation) its 2015 qualifying infrastructure plant ("QIP") costs that will be recovered through its statutory Rider QIP. The use of 2015 as the forecasted "test year" in these cases is uncontested.

The Costs of Serving Customers Has Increased. The Utilities' existing rates, which were set in their 2012 rate cases based on forecasted 2013 costs, ICC Docket Nos. 12-0511/12-0512 Cons. (Order June 18, 2013; Order on Rehearing Dec. 18, 2013) ("*Peoples Gas 2012*"), fall far short of recovering their expected 2015 costs, after removing 2015 QIP costs.

The number one driver of the Utilities' aggregate cost recovery shortfall is **plant investments** made in order to serve customers, including the 2014 costs of Peoples Gas' Accelerated Main Replacement Program ("AMRP"). The following chart shows the drivers of the difference between Peoples Gas' 2015 costs versus the cost level reflected in its existing rates. As the chart shows, as to Peoples Gas, capital investment is by far the largest driver, and increased operations and maintenance ("O&M") expenses is the second largest driver, with increased costs of capital in third place.



Derricks Rebuttal ("Reb."), NS-PGL Exhibit ("Ex".) 17.0, 3:60 – 6:105.[1]

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[1] The above chart reflects Peoples Gas' revenue requirement as calculated in its rebuttal testimony. Peoples Gas made a slight reduction to its revenue requirement in its surrebuttal. This reduction does not significantly change the chart. Derricks Surrebuttal ("Sur."), NS-PGL Ex. 33.0, 4:74-81.

The primary driver of the Peoples Gas capital investments cost recovery shortfall figure, which holds constant the rate of return approved in *Peoples Gas 2012*, is the utility's ongoing significant investments in its distribution system, including the costs to retire and replace cast and ductile iron main in the City of Chicago, among which are the 2014 costs of the Accelerated Main Replacement Program. Derricks Reb., NS-PGL Ex. 17.0, 4:75 – 5:80.

North Shore's top two cost recovery shortfall drivers are O&M expenses and capital investments, with increased costs of capital being a very small factor in fourth place. Derricks Reb., NS-PGL Ex. 17.0, 6:106 – 8:142.[2]

The Utilities' cost recovery shortfalls are large and they are not sustainable. Peoples Gas' expected cost recovery shortfall in 2015 under existing rates (including Other Revenues under-recoveries) is $100,541,000, while North Shore's is $6,524,000. Moy Sur., NS-PGL Ex. 36.0, 3:52-59.

As the Commission found in the *Peoples Gas 2012* Order (at 6-7), timely and adequate cost recovery is essential over the long term in order for the Utilities to continue to provide adequate, safe, and reliable service and to access at a reasonable cost the capital needed for this purpose. *Accord* Derricks Direct ("Dir."), PGL Ex. 1.0, 4:85 - 5:88.

<u>Staff and Certain Intervenors Nonetheless Make Proposals that Would Cause Continued Major Cost Recovery Shortfalls</u>. The two largest areas of proposed adjustments are (1) large reductions in the Utilities' weighted average costs of capital ("rates of return") and (2) a large reduction in recovery of the costs of Peoples Gas' 2014 AMRP plant investments (and associated costs of removal). For example, Staff proposes a rate of return for Peoples Gas of 6.59% that

[2] The North Shore cost drivers pie chart is set forth in Section III.A of this Initial Brief.

would reduce its revenue requirement by $20,357,000. Hathhorn Reb., Staff Ex. 6.0, Schedule ("Sched.") 6.05P, line 7. For a further example, the Illinois Attorney General's office ("AG") proposes to reduce Peoples Gas' 2014 AMRP costs in rate base by a gross $65,877,000 plus another $17,231,000 for associated costs of removal (along with derivative adjustments). Effron Reb., AG Ex. 7.0, 3:58 – 4:67; AG Ex. 7.2, p. 3.

The Proposed Reductions in the Utilities' Costs of Capital Are Erroneous. Staff's proposed reduced rates of return are driven predominately by Staff's recommendation that the Utilities' authorized rate of return on common equity ("ROE") be reduced from 9.28% to 9.00%, compared with the Utilities' requests for an increase to 10.25%, with Staff's proposed reduced costs of debt as a secondary factor. *See, e.g.*, Freetly Reb., Staff Ex. 8.0, 1:12-13 and Sched. 8.01. Intervenors the City of Chicago / Citizens Utility Board / Illinois Industrial Energy Consumers ("City/CUB/IIEC" or "CCI") propose an ROE of 9.15%. *E.g.*, Gorman Dir., CCI Ex. 1.0, 2:29-33 and CCI Ex. 1.1.

Staff's proposed costs of debt are faulty because they are based on what interest rates were several months ago, as opposed to what interest rates are likely to be in 2015. Staff's reliance on historical "spot day" measurements of interest rates (and other cost of capital parameters) ignores the unbiased published forecasts on which investors routinely rely. Whether those forecasts prove to be accurate in the future is irrelevant, as that can be determined only with the benefit of hindsight. The relevant question is whether the forecast is reasonable and objective at the time it is made.

Staff's and CCI's proposed ROEs are too low to be credible, as discussed in Section VI.E of this Initial Brief. First and foremost, a reduction in the Utilities' ROE at this time, when all economic indicators point to an improving economy and the ROEs for other natural gas utilities are increasing (averaging 9.84% in the second quarter of 2014, according to CCI),[3] would send a strong negative signal to the financial market regarding this Commission's willingness to support the Utilities' financial strength. Moreover, the Staff and CCI ROEs suffer from numerous methodological flaws. For example, Staff's ROE figure is based 50% on Staff's discounted cash flow ("DCF") calculation, but Staff's DCF result (8.71%) is biased downward through a reduced dividend yield forecast and double counting of forecasted reductions in natural gas dividend yields, whereas Staff's CAPM result (9.27%) is biased downward through historical interest rates and a lowered beta.

For these reasons, the Utilities' cost of capital figures should be adopted.

<u>The AG's Proposed Reductions in Peoples Gas' 2014 AMRP Costs Are Flawed and Unreasonable</u>. With respect to Peoples Gas' 2014 AMRP costs (including the associated costs of removal), the Commission has before it two sets of figures, but only one set is reliable.

As discussed in Section IV.C.1.a of this Initial Brief, Peoples Gas' forecasted 2014 AMRP costs were reduced by the Utilities in their rebuttal to reflect actual experience, including the fact that unusually cold winter weather delayed 2014 construction work and the fact that the plans of contractors to make up for those delays would make up for some, but not all, of the delays. The Utilities' updated rebuttal figures were supported by testimony from a General Manager of District Field Operations who has responsibility for managing AMRP work. In contrast, the AG's witness in rebuttal proposed sharply reduced figures based simply on extrapolating from January through July 2014 data, with no recognition of the contractors' plans to partly make up for how the unusual cold weather had delayed work in that period, and no

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[3] Gorman Reb., CCI Ex. 2.0, p. 5 table.

recognition of the fact that the January through July period is not representative of the full year activity level in any year, because it does not reflect the construction cycle. The additional data presented with the General Manager's surrebuttal and through a Staff exhibit on August 2014 capital expenditures and plant additions, respectively, are consistent with the Utilities' rebuttal figures, and further undercut the AG witness' simplistic and flawed extrapolation. The only reasonable figures for 2014 AMRP costs are those presented by the Utilities' rebuttal. The AG also has suggested that even if its figures are too low, that will be fixed by Rider QIP, but the AG has not properly analyzed how the rider works, and there is no good reason to get the numbers wrong in the first place. Staff's rebuttal stated that Staff would support the direct testimony version of the AG's proposal, subject to the AG's direct testimony proposal being updated and corrected, but Staff provided no testimony other than very brief speculation addressing the merits of any version of the AG proposal. Peoples Gas' rebuttal's reduced 2014 AMRP costs figures should be adopted.

The Proposed Wisconsin Energy Corporation ("WEC") – Integrys Energy Group, Inc. ("Integrys") Transaction. The proposed reorganization is pending before the Commission under Section 7-204 of the Public Utilities Act (the "Act"), 220 ILCS 5/7-204, in ICC Docket No. 14-0496.[4] Any issues regarding the proposed reorganization must and should be addressed in that Docket, not here. Moreover, the Utilities' and Staff's respective witnesses on this subject agree that no adjustments to the Utilities' revenue requirements should be made here based on the proposed reorganization, for a variety of reasons, as discussed in Section III.C of this Initial Brief, except Staff proposes one very minor change to one amortization period as discussed in

[4] The Utilities use the term "reorganization" because that is the term used in Section 7-204.

Section V.C.4. No intervenor has proposed any adjustment based on the proposed reorganization, although AG witness Mr. Effron, in arguing for his proposed adjustments to costs of the Integrys Customer Experience ("ICE") project, a project designed to improve customer service for the Utilities' customers, speculated that the reorganization, if approved, might lead to cancellation of the ICE project. Any such issue should be addressed in the other Docket, but, in any event, the AG witness' conjecture does not make sense. The ICE project is far along and will go into service in full in 2015. The potential reorganization, if approved, is expected to close in summer 2015. The AG's witness' speculation must be rejected. *See also* Section V.C.3.a.v of this Initial Brief.

Staff does discuss some potential steps that might be proposed in the reorganization Docket, but any such proposal must and should be addressed there, not here. The Utilities do not understand Staff to suggest otherwise. *See* Section III of this Initial Brief.

<u>The Commission Must Establish New Rates That Allow the Utilities the Opportunity to Recover Fully Their Costs of Service, Both as a Matter of Legal and Regulatory Principles and in the Long-term Interests of Customers and Shareholders Alike</u>. The evidence in the record and the applicable regulatory and legal principles support the adoption of the Utilities' proposals. The Utilities' proposals will result in rates that are just and reasonable for the Utilities and their investors and customers.

The Commission is legally required to establish rates that are just and reasonable to the utility and its stockholders as well as customers. 220 ILCS 5/9-201(c); *Bus. and Prof. People for the Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 208, 585 N.E.2d 1032, 1045 (1991); *Peoples Gas 2012* Order at 7.

As the Commission stated in the *Peoples Gas 2012* Order:

> "Under long established federal and Illinois constitutional law, and Illinois ratemaking law, **a utility's rates must be set so as to allow it the opportunity to obtain full recovery of its prudent and reasonable costs of service, including its costs of capital**." *North Shore Gas Co., et al.*, ICC Docket Nos. 11-0280, 11-0281 Cons. (Order Jan. 10, 2012) ("*Peoples Gas 2011*") at 5. The legal standards governing a utility's right to a fair and reasonable rate of return, in particular, are well-established and familiar. A public utility has a constitutional right to a return that is "reasonably sufficient to assure confidence in the financial soundness of the utility and [is] adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of the State of West Virginia*, 262 U.S. 679, 693 (1923). The authorized return on equity "should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). The Commission "fully embraces the principles set forth" in the *Bluefield* and *Hope* cases. *In re Consumers Ill. Water Co.*, ICC Docket No. 03-0403 (Order April 13, 2004) at 41; *Peoples Gas 2011* Order at 5. **Allowing a utility the opportunity to recover fully its costs of service, including its costs of capital, is in the long-term interests of customers, because this is necessary in order for the utility to be able to provide adequate, safe, and reliable service over time at the least long-term cost**. *Peoples Gas 2011* Order at 5.

Peoples Gas 2012 Order at 6-7 (emphases added).

II. <u>TEST YEAR</u> (UNCONTESTED)

The Utilities proposed calendar year 2015, the twelve months ending December 31, 2015, as the forecasted ("future") test year. Moy Dir., NS Ex. 6.0, 5:99-103; Moy Dir., PGL Ex. 6.0, 5:100-104. The forecasted 2015 test year data were based on careful analyses and appropriate adjustments.[5] The proposed test year is reasonable (Moy Dir., NS Ex. 6.0, 2:41-43; Moy Dir., PGL Ex. 6.0, 2:41-43) and is uncontested.

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[5] Moy Dir., NS Ex. 6.0, 5:99-100, 7:141-142; Gregor Dir., NS Ex. 5.0, 4:89 – 5:91; Moy Dir., PGL Ex. 6.0, 5:100-101, 7:142-143; Gregor Dir., PGL Ex. 5.0 Rev., 4:89 – 5:92.

III. REVENUE REQUIREMENT

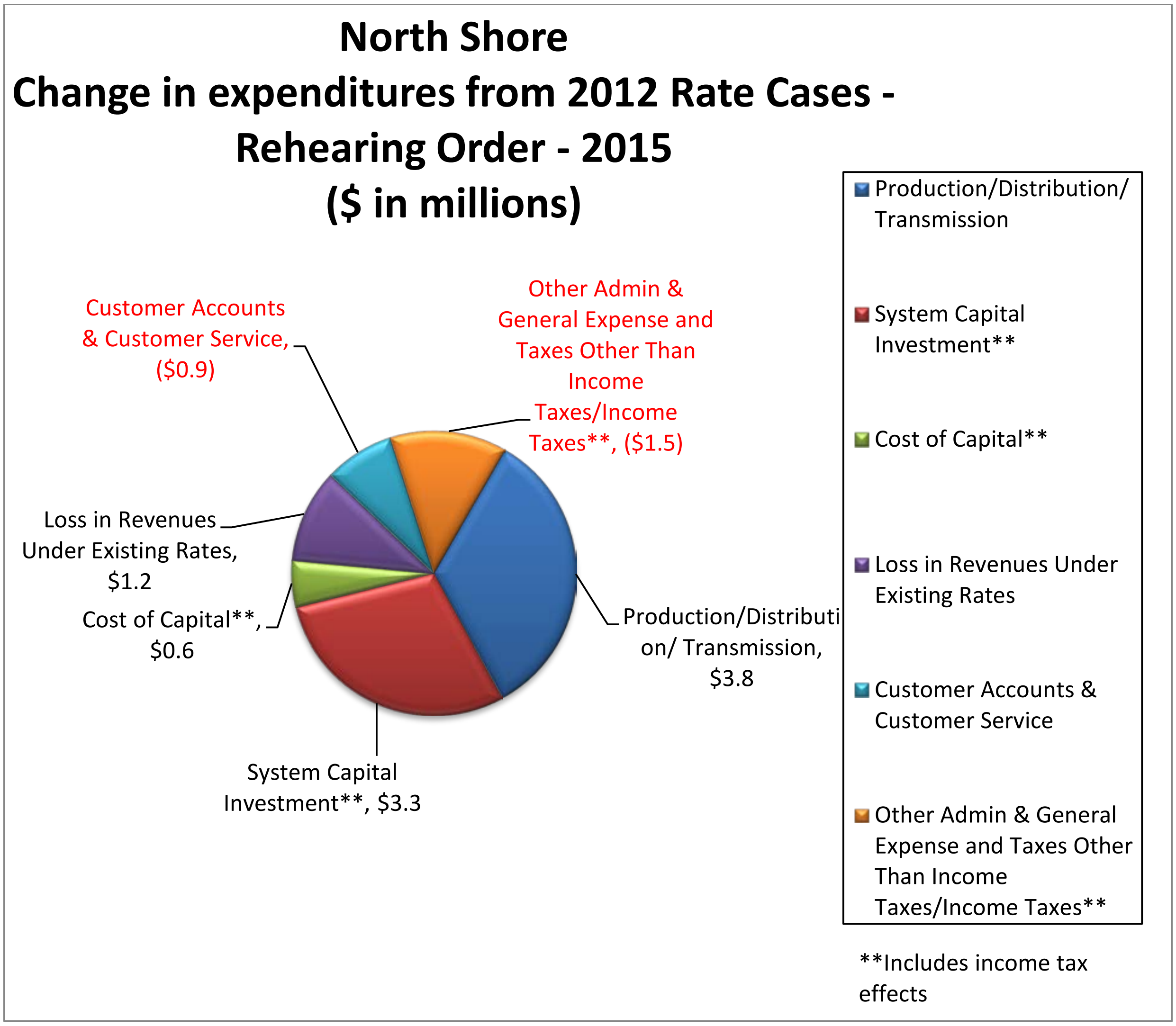
As discussed in the Introduction of this Initial Brief, a utility legally is entitled to rates that allow it the opportunity to recover its costs of service (revenue requirement), *i.e.*, (1) its prudent and reasonable operating expenses plus (2) a reasonable return of and on its rate base (the capital investments on which it is entitled to a recovery). As discussed in the Introduction, that principle is in the long term interests of customers and investors alike.

A. North Shore

North Shore's final proposed base rate revenue requirement is $88,181,000, or $89,778,000 if costs recovered as Other Revenues ($1,597,000) are included, and is just and reasonable based on the testimony and other exhibits in evidence. *E.g.*, Moy Reb, NS-PGL Ex. 21.0, 3:59-63; Moy Sur., NS-PGL Ex. 36.0, 3:52-59, fn. 1; NS-PGL Ex. 21.1N, lines 1, 5, 10, and 11, col. [G]. (North Shore updated and revised its revenue requirement in rebuttal but did not make any further changes in surrebuttal.)

At the direct and rebuttal testimony stages, the Utilities presented pie charts showing the drivers of the net changes in their distribution costs of service and revenues forecasted for 2015 versus the levels expected in 2015 under their existing rates, which the Commission set in its Order on Rehearing in *Peoples Gas 2012*.[6] The North Shore rebuttal pie chart is as follows:

[6] Derricks Reb., NS-PGL Ex. 17.0, 3:60 – 8:142.



Derricks Reb., NS-PGL Ex. 17.0, 7:112.

The Utilities provided a high level explanation of the drivers of the changes in cost for each utility,[7] discussion and support for the Utilities' major additions to plant in service since

[7] Derricks Dir., NS Ex. 1.0, 6:107 – 7:132; Derricks Dir., PGL Ex. 1.0, 7:132 – 8:161; Derricks Reb., NS-PGL Ex. 17.0, 4:75 – 6:105; 7:115 – 8:142.

Peoples Gas 2012,[8] and discussion and explanation of the significant variances in the Utilities' operating expenses since *Peoples Gas 2012*.[9]

As the chart shows, North Shore's top two cost recovery shortfall drivers are O&M expenses and capital investments, with increased costs of capital being a very small factor in fourth place. Derricks Reb., NS-PGL Ex. 17.0, 6:106 – 8:142.

In addition, of course, the Utilities provided evidence fully supporting their entire revenue requirements. *See, e.g.*, the discussion in Sections IV.A, V.A, and VI of this Initial Brief. North Shore's rebuttal revenue requirement should be approved.

B. Peoples Gas

Peoples Gas' final proposed base rate revenue requirement is $680,801,000, or $697,407,000 if costs recovered as Other Revenues ($16,606,000) are included, and is just and reasonable based on the testimony and other exhibits in evidence. *E.g.*, Moy Sur., NS-PGL Ex. 36.0, 3:52-59; NS-PGL Ex. 36.1P, lines 1, 4, 9, and 10, col. [G]. (Peoples Gas updated and revised its revenue requirement in rebuttal and made slight additional reductions in surrebuttal.)

The Peoples Gas rebuttal pie chart is set forth in the Introduction of this Initial Brief, but it is repeated here for the convenience of the reader.

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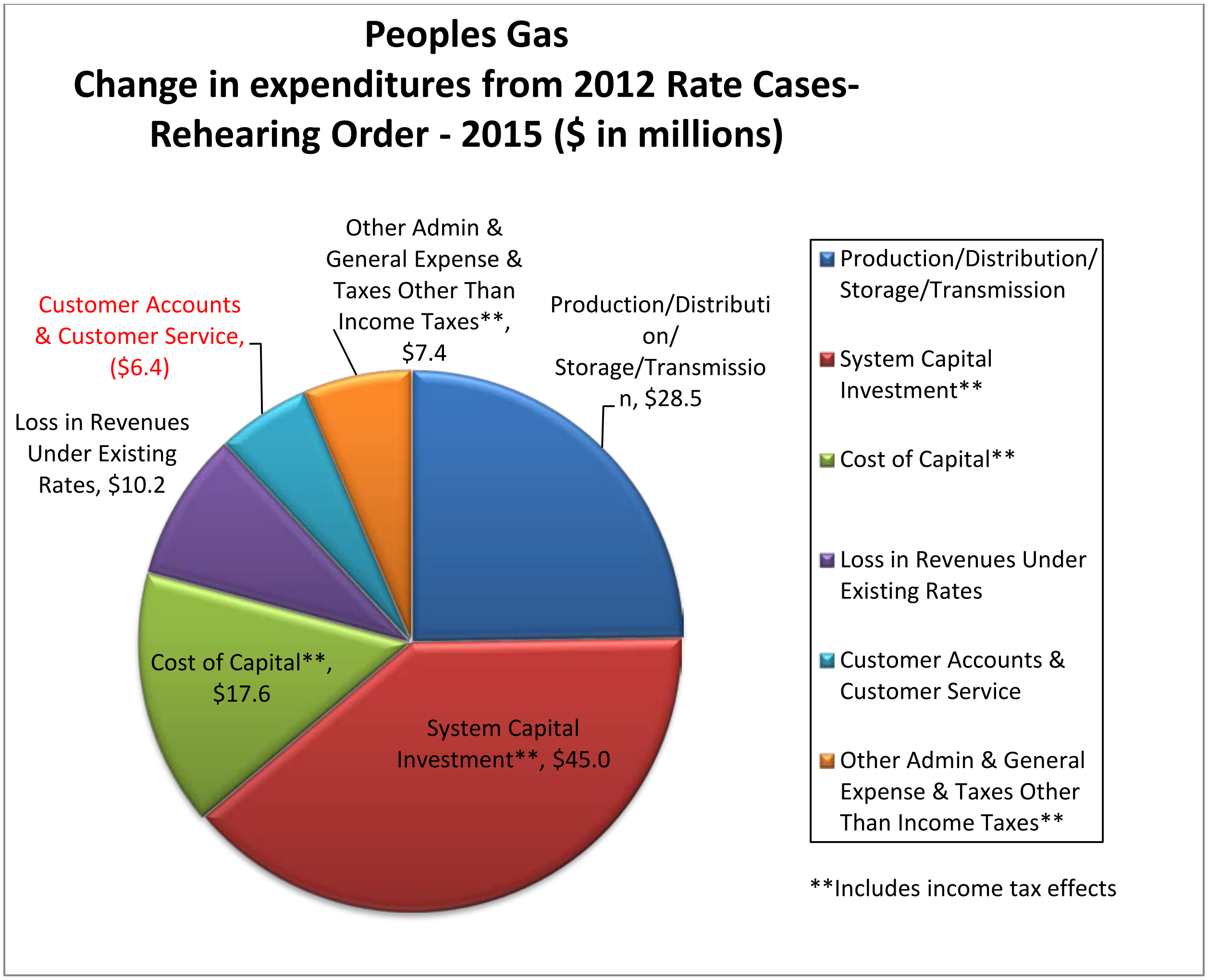
8 Lazzaro Dir., PGL Ex. 8.0 2nd REV.; Kinzle Dir., NS Ex. 8.0.
9 Gregor Dir., NS Ex. 5.0, 11:242 – 15:333; Gregor Dir., PGL Ex. 5.0 Rev., 11:242 – 16:357.



Derricks Reb., NS-PGL Ex. 17.0, 4:72.

As the chart shows, as to Peoples Gas, capital investment (which includes AMRP investment) is by far the largest driver, and increased O&M expenses is the second largest driver, with increased costs of capital in third place. Derricks Reb., NS-PGL Ex. 17.0, 6:106 – 8:142.

In addition, of course, as noted above, the Utilities provided evidence fully supporting their entire revenue requirements. *See, e.g.*, the discussion in Sections IV.A, V.A, and VI of this Initial Brief. Peoples Gas' surrebuttal revenue requirement should be approved.

C. **Proposed Reorganization**

The proposed acquisition by WEC of the ultimate parent company of the Utilities, Integrys, is pending before the Commission in ICC Docket No. 14-0496. That is the proper forum for any proposals relating to whether, or on what terms, the reorganization should be approved. 220 ILCS 5/7-204; Derricks Reb., NS-PGL Ex. 17.0, 2:40-43.

In any event, there is no proposal by Staff or any intervenor, nor any basis in the evidence in the record, for any revenue requirement adjustments or other changes to the Utilities' proposals in the instant cases based on the proposed reorganization. Staff agrees, as discussed below.[10]

AG witness David Effron, in his direct testimony, filed on July 2, 2014, noted the June 23, 2014, announcement of the proposed WEC-Integrys transaction, which referred in part to anticipated "operational and financial benefits". Effron Dir., AG Ex. 1.0, 4:84 – 5:90. Mr. Effron did not point to anything in the merger announcement (or any other information), however, that identified any specific potential benefits that would or might result in net savings by the Utilities in relation to their distribution costs of service in 2015 (or at any specific time). In fact, he went on to state in part: "It is unclear the extent to which the Companies' costs of service will be affected by the 'operational and financial benefits' referenced in the merger announcement or the extent to which these benefits should be incorporated into the determination of the Companies revenue requirements and rates. The Companies should describe and quantify the expected operational and financial benefits of the proposed merger in their Rebuttal testimony and should explain why it would or would not be appropriate to

[10] Staff proposes one change to one amortization period as discussed in Section V.C.4 of this Initial Brief.

incorporate those expected operational and financial benefits into the determination of their test-year revenue requirements." *Id*. at 5:91-99.

Again, while no adjustments have been proposed based on the proposed transaction, the evidence would not support any adjustment, in any event. Dennis Derricks, in his rebuttal testimony, filed on August 3, 2014, stated in part:

> The proposed transaction is the acquisition of the ultimate parent company of the Utilities, Integrys Energy Group, Inc., by Wisconsin Energy Corporation ("WEC"). The Utilities are not being directly acquired by WEC. The proposed transaction is subject to approval by the Commission and several other state and federal governmental entities. Whether all of the required approvals will be received is unknown. With respect to Illinois, the application for approval that must be filed with the Commission under Section 7-204 of the Public Utilities Act has not yet been filed. In addition, it is possible that future regulatory approvals, if obtained, will be subject to conditions. Thus, whether the transaction will close, whether it will be subject to conditions, the substance of the conditions, if any, and when the transaction will close are unknown.

Derricks Reb., NS-PGL Ex. 17.0, 10:163-172.

The joint applicants filed their application for approval of the reorganization on August 6, 2014, and, as noted above, it is pending before the Commission in ICC Docket No. 14-0496.

Staff agrees that no revenue requirement adjustments should be made based on the proposed reorganization (subject to the minor amortization item noted earlier). Staff witness Dianna Hathhorn, in her rebuttal testimony, filed on September 4, 2014, discussed materials that she had reviewed that were filed in ICC Docket No. 14-0496 as well as data request responses of the Utilities in the instant cases relating to the proposed reorganization, some of which materials she quoted and/or attached to her rebuttal.[11] Hathorn Reb., Staff Ex. 6.0, 23:469 – 25:517 and

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[11] Throughout the instant cases, Staff and intervenors have served data requests on the Utilities, of course. As of September 10, 2014, the Utilities had answered 1,409 data requests, not counting subparts. Derricks Sur., NS-PGL Ex. 33.0, 4:72-73.

Attachment B. She concluded, based on her analysis, as follows:

> **Q. Is it reasonable that the Companies' 2015 test years do not reflect future costs savings for the Reorganization?**
>
> A. **Yes**, in light of the fact that the Reorganization is not guaranteed and even if it is approved, the conditions and timing of its approval cannot be known, **it is reasonable that future cost savings are not reflected in this rate proceeding**. In addition, based on the information provided by the Companies as to their current expectations with respect to the Reorganization, it is also reasonable that the Companies' 2015 test years do not reflect future cost savings from the Reorganization due to the expected timing of the closing of the Reorganization and Integrys' expectation of savings and shareholder benefits to earnings occurring outside of the test year.

Id. at 24:496 – 25:507 (emphasis added in Answer).

Ms. Hathhorn added that, under some circumstances, if savings[12] were realized sooner than expected, it is her understanding that the Commission could investigate and enter a temporary order fixing a temporary schedule of rates, and that the Commission could condition its approval of the reorganization on a sharing of savings or other conditions. Hathhorn Reb., Staff Ex. 6.0, 25:507-517. Those legal points are not pending and need not be briefed here, but, without discussing specifics of the scope of the Commission's authority and the procedures through which and grounds upon which it may act, it is correct that the Act contains provisions regarding interim rate orders (220 ILCS 5/9-202) and conditions upon approvals of a reorganization (220 ILCS 5/7-204).

AG witness Mr. Effron, in his rebuttal, speculated that the proposed reorganization might lead to cost savings, but he neither proposed, nor presented facts supporting, any adjustment to the Utilities' revenue requirements based on the proposed reorganization, except that, in relation

[12] The Utilities infer that Ms. Hathhorn means applicable net savings (*i.e.*, after consideration of the applicable costs incurred to achieve the savings) in the costs of distribution service. The Commission in past rate cases and in its rules has recognized that costs incurred to achieve savings may be recovered. *See, e.g.,* 83 Ill. Adm. Code § 285.3215.

to his proposed adjustments to Integrys Customer Experience project costs, he speculated that the proposed reorganization, if approved, might lead to cancellation of the ICE project. *See* Effron Reb., AG Ex. 7.0, 22:470 – 23:493, 23:509 – 25:538. Any such issue belongs in the other Docket. His illogical conjecture about cancellation of the ICE project is addressed in Section V.C.3.a.v of this Initial Brief.

Utilities witness Mr. Derricks, in his surrebuttal testimony: (1) discussed Ms. Hathhorn's rebuttal testimony, largely agreeing with it; (2) pointed out that Mr. Effron's rebuttal testimony's speculation is just that, speculation, as also shown by several data request responses of Mr. Effron; (3) pointed out that Mr. Effron's rebuttal's speculation does not make sense given the timeline of the proposed reorganization and other facts, *e.g.*, that the transaction, if approved, is not expected to close until Summer 2015; and, moreover, (4) noted that speculation about hypothetical future cost reductions that might offset the needed rate increases is unwarranted, because the reality is that Peoples Gas is experiencing a significant increase in paving costs that is not reflected in its proposed revenue requirement. Derricks Sur., NS-PGL Ex. 33.0, 5:100 – 8:158; NS-PGL Ex. 33.1. *See also* NS-PGL Cross Ex. 3 at AG data request NS-PGL-AG 6.09 (also illustrating that Mr. Effron's speculation lacks any basis); Lazzaro Sur., NS-PGL Ex. 38.0, 8:159-163; NS-PGL Ex. 38.2 (regarding Peoples Gas' paving costs, showing they are almost $8 million over the forecast for the first eight months of 2014).

The proposed reorganization, in terms of approval and possible conditions, is not a part of the instant cases, is not a basis for any adjustment in the instant cases, and must and will be addressed in ICC Docket No. 14-0496, not here.

IV. RATE BASE

A. Overview/Summary/Totals

1. North Shore

North Shore's rebuttal testimony presented an average rate base[13] of $219,786,000, reflecting adjustments proposed by Staff and intervenors that the utility agreed with or accepted in whole or in part and certain updates. Hengtgen Reb., NS-PGL Ex. 22.0 REV., 3:57-59; NS-PGL Ex. 22.1N, line 15, col. [F]. See the following subsection of this Initial Brief for discussion of the evidence supporting North Shore's rate base.

2. Peoples Gas

Peoples Gas' surrebuttal testimony presented an average rate base[14] of $1,759,289,000, reflecting adjustments proposed by Staff and intervenors that the utility agreed with or accepted in whole or in part and certain updates. Hengtgen Sur., NS-PGL Ex. 37.0, 2:37-40; NS-PGL Ex. 37.1P , line 15, col. [F].

North Shore's and Peoples Gas' rate bases are supported by extensive, detailed evidence, including the testimony of John Hengtgen (overall rate base and the underlying calculations and supporting various components of rate base);[15] Christine Gregor (the test year forecast, including

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[13] The Utilities are using the average rate base methodology, based upon the average balances as of December 31, 2014, and December 31, 2015. The exception is that certain items, namely Materials and Supplies, Gas in Storage, and Budget Plan Balances, are calculated based on 13-month averages consistent with past Commission decisions. Hengtgen Dir., NS Ex. 7.0, 4:71-75, 5:102-104; Hengtgen Dir., PGL Ex. 7.0, 4:75-79, 5:105-107.

[14] *See* footnote 13, *supra*.

[15] Hengtgen Dir., NS Ex. 7.0 (entire); NS Ex. 7.1 REV.; Hengtgen Dir., PGL Ex. 7.0 (entire); PGL Ex. 7.1 REV.; Hengtgen Reb., NS-PGL. Ex. 22.0 REV. (entire); NS-PGL Exs. 22.1N through 22.3N, 22.6N, 22.8N through 22.13N; 22.1P through 22.11P, 22.13P, 22.14P REV., 22.15; Hengtgen Sur., NS-PGL Ex. 37.0 (entire); NS-PGL Exs. 37.1P, 37.2P, 37.3P REV., 37.4P, 37.5P.

the Capital Budget);[16] Noreen Cleary (capitalized incentive compensation costs);[17] Christine Hans (updating the pension and other post-employment benefits ("OPEB") liability figures and the pension asset);[18] Thomas Puracchio (certain capital projects)[19]; as to North Shore in particular, Mark Kinzle (key components of Gross Utility Plant and certain capital projects)[20]; and, as to Peoples Gas in particular, David Lazzaro (key components of Gross Utility Plant and certain capital projects)[21].

B. Potentially Uncontested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

1. Gross Utility Plant

a. 2013 Plant Balances

In direct testimony, the Utilities provided actual plant balances for 2011 and 2012, six months actual data and six months forecasted data for 2013, and forecasts for 2014 and 2015 plant balances. *See* NS Ex. 7.1 REV.; PGL Ex. 7.1 REV. In response, based on discovery, CCI witness Mr. Gorman noted that Peoples Gas' actual distribution plant balance as of December 31, 2013, was less than the forecasted level reflected in the Utilities' forecast for December 31, 2013, and he recommended that the Utilities develop a forecasted rate base

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[16] Gregor Dir., NS Ex. 5.0 REV. (entire); NS Ex. 5.1 REV.; Gregor Dir., PGL Ex. 5.0 REV. (entire); PGL Ex. 5.1 REV.; Gregor Reb., NS-PGL Ex. 20.0 (entire); NS-PGL Exs. 20.1N, 20.1P.

[17] Cleary Dir., NS Ex. 10.0 (entire); NS Exs. 10.1, 10.2; Cleary Dir., PGL Ex. 10.0 (entire); PGL Exs. 10.1, 10.2; Cleary Reb., NS-PGL Ex. 24.0 (entire); NS-PGL Exs. 24.1, 24.2.

[18] Hans Dir., NS Ex. 12.0 (entire); NS Exs. 12.1, 12.2, 12.3; Hans Dir., PGL Ex. 12.0 (entire); PGL Exs. 12.1, 12.2, 12.3; Hans Reb., NS-PGL Ex. 26.0 (entire); NS-PGL Exs. 26.1N, 26.2N, 26.1P, 26.2P, 26.3; Hans Sur., NS-PGL Ex. 40.0 (entire).

[19] Puracchio Dir., NS Ex. 16.0 (entire); NS Exs. 16.1, 16.2; Puracchio Dir., PGL Ex. 16.0 (entire), PGL Exs. 16.1, 16.2, 16.3, 16.4; Puracchio Reb., NS-PGL Ex. 30.0 (entire); Puracchio Sur., NS-PGL Ex. 44.0 (entire).

[20] Kinzle Dir., NS Ex. 8.0 (entire); NS Exs. 8.1, 8.2, 8.3; Kinzle Reb., NS-PGL Ex. 31.0 (entire), Ex. 31.1; Kinzle Sur., NS-PGL Ex. 45.0 (entire).

[21] Lazzaro Dir., PGL Ex. 8.0 2nd REV. (entire); PGL Exs. 8.1 REV., 8.2, 8.3, 8.4, 8.5; Lazzaro Reb., NS-PGL Ex. 23.0 2nd REV. (entire), NS-PGL Exs. 23.1, 23.2, 23.3, 23.4, 23.5; Lazzaro Sur., NS-PGL Ex. 38.0 (entire), NS-PGL Exs. 38.1, 38.2.

reflecting the 2013 actual data. Gorman Dir., CCI Ex. 1.0, 51:1125 – 52:1138. Mr. Gorman did not address North Shore's actual 2013 plant balances which exceeded its forecasted 2013 balances. Hengtgen Reb., NS-PGL Ex. 22.0 REV., 12:274-275. In rebuttal testimony, the Utilities partially agreed with Mr. Gorman's recommendation, and made an adjustment to "each Utility's respective net utility plant balances and ADIT to reflect the actual plant, accumulated depreciation and ADIT for calendar year 2013 as compared to the '6&6' forecast balances." *Id*. at 12:270-272. Mr. Gorman did not further address this issue in rebuttal testimony. *See* Gorman Reb., CCI Ex. 2.0. No witness contested the updated 2013 figures.

b. <u>2014 Plant Balances</u> (Other than PGL AMRP Additions and associated items addressed in Section IV.C.1.a)

As noted above, in direct testimony, the Utilities provided, among other things, forecasts for 2014 plant balances. *See* NS Ex. 7.1 REV.; PGL Ex. 7.1 REV. In response, CCI witness Mr. Gorman and AG witness Mr. Effron presented their respective proposals to adjust the 2014 forecast (in Mr. Effron's case, focusing specifically on AMRP additions, costs of removal associated with the AMRP additions, and costs of removal associated with other plant additions). Gorman Dir., CCI Ex. 1.0, 51:1125 – 52:1138; Effron Dir. AG Ex. 1.0, 5:103 – 11-246. In rebuttal testimony, the Utilities updated their forecasted 2014 plant balances, as also is discussed in Section IV.C.1.a of this Initial Brief. Hengtgen Reb., NS-PGL Ex. 22.0 REV., 13:279-281; NS-PGL Exs. 22.4P, 22.5P, 22.8N and 22.8P. Mr. Gorman did not further address this issue in rebuttal testimony. *See* Gorman Reb., CCI Ex. 2.0. In his rebuttal testimony, Mr. Effron dropped his general costs of removal adjustment, but presented revised adjustments for AMRP costs and the associated costs of removal, as discussed in Section IV.C.1.a. Staff rebuttal witness Ms. Hathhorn proposed to adopt Mr. Effron's direct testimony proposal, subject to it being updated and corrected, although she did not present testimony on the actual merits of the proposal, other than brief speculation, as also is discussed in Section IV.C.1.a. Thus, apart from the 2014 AMRP costs and associated costs of removal, the Utilities' 2014 plant balances as updated in rebuttal are uncontested (subject to a slight correction of Peoples Gas' figure in surrebuttal that the Utilities understand is uncontested, discussed in Section IV.B.1.c.viii, below).

c. 2015 Forecasted Capital Additions

i. In General

As noted above, in direct testimony, the Utilities provided, among other things, forecasts for 2015 plant balances to be included in rate base. *See* NS Ex. 7.1 REV.; PGL Ex. 7.1 REV.[22] The forecasted 2015 plant additions (as revised in rebuttal, where applicable) are uncontested and should be approved.

The Utilities note that, pursuant to 83 Ill. Admin. Code § 285.6100, Peoples Gas' direct testimony identified major capital projects added to rate base since *Peoples Gas 2012* as a project with a cost greater than the lower of 0.2% of net plant or $10,000,000. Peoples Gas' net plant at December 31, 2012, was $2,131,077,763, and, thus, a major project is one that costs more than $4,262,000. Lazzaro Dir., PGL Ex. 8.0 2nd REV., 9:178-183. Peoples Gas identified six major capital projects: (1) AMRP, (2) Calumet System Upgrade Project, (3) 2015 casing remediation project, (4) 2014 Gathering System Pipe Replacement project, (5) 2015 Gathering System Pipe Replacement project, and (6) the LNG Control System Upgrade. *Id.* at 9:186-189. These projects (as revised in rebuttal, where applicable) are uncontested as to 2015, as discussed below.

[22] The forecasted 2015 plant additions in rate base do not include Peoples Gas' 2015 qualifying infrastructure plant costs that will be recovered through its statutory Rider QIP.

Similarly, pursuant to 83 Ill. Admin. Code § 285.6100, North Shore identified major capital projects as a project with a cost greater than the higher of 0.2% of net plant or $1,000,000. North Shore's net plant at December 31, 2012, was $263,103,698, and, thus, a major project is one that costs more than $1,000,000. Kinzle Dir., NS Ex. 8.0, 9:173-178. North Shore identified three major capital projects: (1) Wildwood/Gages Lake, (2) Grayslake Gate Station, and (3) Casing Remediation Program. *Id.* at 9:181-183. These projects (as revised in rebuttal, where applicable) as to 2015 are uncontested, as discussed below.

2014 AMRP costs are discussed in Section IV.C.1.a of this Initial Brief. For the convenience of the reader, the other major capital projects are discussed below, including both 2014 and 2015 costs, rather than splitting them between years for separate discussion.

ii. <u>Calumet System Upgrade</u> (PGL)

Peoples Gas, in its rebuttal testimony, reduced the Calumet System Upgrade costs to reflect the updated cost of work that will be completed in 2014, which reduced the 2014 expenditures from $43.1 million to $36.3 million. Peoples Gas noted that of this reduced amount, $15.0 million will be in service in 2014 and the remaining $21.3 million will be accounted for as construction work in progress at December 31, 2014. Lazzaro Reb., NS-PGL Ex. 23.0 2nd REV., 5:102-106. These costs are not contested.

iii. <u>Casing Remediation</u> (PGL)

Peoples Gas forecasted capital additions in 2014 and 2015 of $10 million for the casing remediation program. Lazzaro Dir., PGL Ex. 8.0 2nd REV., 20:430-432; PGL Ex. 8.1 REV line 3, col. (D). These costs are not contested.

iv. **<u>Gathering System Pipe Replacement Project</u> (PGL)**

In direct testimony, Peoples Gas presented two major capital projects for 2014 and 2015: the 2014 Gathering System Pipe Replacement Project and the 2015 Gathering System Pipe Replacement Project. These projects exceeded the major capital project threshold of $4,262,000. Puracchio Dir., PGL Ex. 16.0, 10:220-223. Peoples Gas forecasted capital costs of $5,525,000 for the 2014 Gathering System Pipe Replacement Project, to be expended during calendar year 2014. *Id.* at 11:247-248. Peoples Gas forecasted capital costs of $6,000,000 for the 2015 Gathering System Pipe Replacement Project, to be expended during calendar year 2015. *Id.* at 13:271-272. These costs are uncontested.

v. **<u>LNG Control System Upgrade</u> (PGL)**

In direct testimony, Peoples Gas forecasted capital additions for its Liquefied Natural Gas ("LNG") Control System Upgrade Project of $8,800,000, to be expended during calendar year 2014. Puracchio Dir., PGL Ex. 16.0, 13:284 - 15:323. This item was not contested.

vi. **<u>LNG Truck Loading Facility</u> (PGL)**

In rebuttal, the Utilities withdrew their proposal to develop a LNG Truck Loading Facility to be added to rate base in the 2015 test year. Puracchio Reb., NS-PGL Ex. 30.0, 2:37-39. Staff insists, even though the LNG Truck Loading Facility proposal has been withdrawn, that the Commission <u>rule in this docket</u> that the Utilities should, prior to developing any potential LNG Truck Loading Facility or entering into any contracts related to the sale of LNG from such a facility, make a filing seeking approval under 220 ILCS 5/7-102. Seagle Reb., Staff Ex. 10.0, 5:103-119. At this time, such a ruling by the Commission is premature. There is no LNG Truck Loading Facility proposed for consideration in front of the Commission. A categorical ruling by the Commission on any possible scope, scale, or structure of some yet to be designed and constructed LNG Truck Loading Facility runs the risk of the Commission requiring approvals that may not be applicable for a potential future development.

vii. <u>Reclassification of Costs to Plant in Service</u> (PGL)

In surrebuttal, the Utilities noted that an adjustment to reclassify certain costs from O&M expenses to Plant in Service was inadvertently omitted from Peoples Gas' rebuttal revenue requirement. Moy Sur., NS-PGL Ex. 36.0, 10:208-210. The Utilities updated this adjustment in surrebuttal, and noted that the adjustment was made in response to Staff data request ENG 1.29 (NS-PGL Ex. 36.3P) and reflects the reduction to O&M expense offset by derivative depreciation expense and income taxes on Plant in Service. Moy Sur., NS-PGL Ex. 36.0, 10:210-212. *See also* Hengtgen Sur., NS-PGL Ex. 37.0, 7:144-151; NS-PGL Exs. 37.1P, 37.3P. The Utilities' understanding is that this item is uncontested.

viii. <u>Wildwood/Gages Lake</u> (NS)

North Shore forecasted capital additions for its Wildwood/Gages Lake project of $2,400,000 for 2014 and 2015. Kinzle Dir., NS Ex. 8.0, 10:198-208; NS Ex. 8.1, line 1, col. (D). This item was not contested.

ix. <u>Grayslake Gate Station</u> (NS)

North Shore forecasted capital additions for its Grayslake Gate Station project of $6,525,000 for 2014 and 2015. Kinzle Dir., NS Ex. 8.0, 11:216-227; NS Ex. 8.1, line 2, col. (D). This item was not contested.

x. <u>Casing Remediation</u> (NS)

North Shore forecasted capital additions for its casing remediation program project of $6,250,000 for 2014 and 2015. Kinzle Dir., NS Ex. 8.0, 12:241-242; NS Ex. 8.1, line 3, col. (D). This item was not contested.

xi. <u>Locker Room</u> (NS)

North Shore withdrew the Locker Room project from this rate case. Kinzle Reb., NS-PGL Ex. 31.0, 2:36 – 3:50; Seagle Dir., Staff Ex. 5.0, 17:356 – 22:456. The calculation of the resulting plant reductions as presented in North Shore's rebuttal testimony is uncontested. Hengtgen Reb., NS-PGL Ex. 22.0 REV., 11:232-240; Hathhorn Reb., Staff Ex. 6.0, 4:73-76.

d. Original Cost Determinations as to <u>Plant Balances as of December 31, 2012</u>

Staff and the Utilities agree to the original cost determinations of $443,539,000 for North Shore and $3,285,370,000 for Peoples Gas as of December 31, 2012. Hengtgen Dir., NS Ex. 7.0, 14:298-303; Hengtgen Dir., PGL Ex. 7.0, 17:366-371; Hathhorn Dir., Staff Ex. 1.0, 29:639-645; Hengtgen Reb., NS-PGL Ex. 22.0 REV., 5:97-100. The language proposed for this purpose by Staff should be included in the Findings and Ordering Paragraphs of the Commission's final Order. That language is:

> It is further ordered that the $443,539,000 original cost of plant for North Shore at December 31, 2012 and the $3,285,370,000 original cost of plant for Peoples Gas at December 31, 2012, as presented in Staff Exhibit 1.0, are unconditionally approved as the original costs of plant.

Hathhorn Dir., Staff Ex. 1.0, 29:650 – 30:655.

2. <u>Accumulated Provisions for Depreciation and Amortization</u> (Including new depreciation rates and including derivative impacts other than in Section IV.C.1.a)

The inclusion of Plant in Service in rate base is subject to reduction for the associated applicable Accumulated Provisions for Depreciation and Amortization. The balances for accumulated depreciation and amortization, subject to derivative impacts, if any, as presented by the Utilities are $200,691,000 for North Shore and $1,245,048,000 for Peoples Gas, based on actual per book data and projected data as applicable.[23] Hengtgen Reb., NS-PGL Ex. 22.0 REV., 14:306 – 15:337; NS-PGL Ex. 22.1N, line 2, col. (F); Hengtgen Sur., NS-PGL Ex. 37.0, 7:144 – 8:154; NS-PGL Ex. 37.1P, line 2, col. (F). This subject is uncontested, apart from derivative impacts, if any, of the items discussed in Section IV.C.1.a of this Initial Brief.

The Utilities note that the depreciation rates used in these cases are new rates based on a study supported by independent expert Utilities witness John Spanos, and that this reflects the Commission's past direction that the Utilities prepare a new study every five years. Spanos NS Dir., NS Ex. 9.0; NS Ex. 9.1; Spanos PGL Dir., PGL Ex. 9.0; PGL Ex. 9.1. The new rates are uncontested.

3. <u>Cash Working Capital</u> (Other than Section IV.C.2)

In brief, cash working capital ("CWC") is the amount of funds required to finance the day-to-day operations of a utility. *E.g.*, Hengtgen Dir., PGL Ex. 7.0, 18:391-393. CWC usually is calculated using a "lead/lag study", which is a study of the applicable cash flows, and that is how it has been calculated in the instant cases. *E.g.*, *id.* at 1:13-14.[24]

The final CWC calculations presented by the Utilities based on their lead/lag studies as updated in rebuttal (North Shore) and surrebuttal (Peoples Gas) are $(1,721,000) for North Shore and $10,783,000 for Peoples Gas. NS-PGL Ex. 22.1N, line 4, col. (F); NS-PGL Ex. 37.1P, line 4, col. (F). This subject is uncontested with the exception of the "expense lead" for OPEB expenses, discussed in Section IV.C.2.a of this Initial Brief, and derivative impacts on the inputs

[23] Again, all forecasted 2015 rate base balances, such as these figures, reflect the average rate base methodology unless it is stated that an average is not applicable (*i.e.*, the cash working capital figures) or that the 13-month average method was used.

[24] The CWC figure is independently calculated for the test year, so it is not an average.

to the CWC calculation, if any, of contested operating expense adjustments. Setting aside the OPEB lead issue, Staff and the Utilities agree on the calculation of CWC. Hathhorn Dir., Staff Ex. 1.0, 9:181 – 10:195. The Utilities and Staff also agree that the final balances of CWC will be established using the applicable final inputs ultimately approved by the Commission in this proceeding. Hengtgen Reb., NS-PGL Ex. 22.0 REV., 5:103-106.

4. Materials and Supplies, Net of Accounts Payable

The capital costs associated with materials and supplies are another element of rate base. Consistent with the Commission's Orders in the Utilities' recent rate cases, the Utilities presented the 13-month average balances of materials and supplies, net of accounts payable, based on actual per book data and projected data as applicable. The 13-month averages (net) for test year 2015 are $1,928,000 for North Shore and $15,302,000 for Peoples Gas. Hengtgen Dir., NS Ex. 7.0, 10:216 – 11:237; NS Ex. 7.1 REV., Sched. B-8.1; Hengtgen Dir., PGL Ex. 7.0, 12:264 - 3:285; PGL Ex. 7.1 REV., Sched. B-8.1. This subject is uncontested.

5. Gas in Storage

The capital costs associated with Gas in Storage are another element of rate base. Consistent with the Commission's Orders in the Utilities' recent rate cases, the Utilities presented the 13-month average balances of Gas in Storage based on actual per book data and projected data as applicable. The 13-month averages for test year 2015 are $6,238,000 for North Shore and $47,405,000 for Peoples Gas. Hengtgen Dir., NS Ex. 7.0, 11:239 – 12:252; NS Ex. 7.1 REV., Sched. B-1.1; Hengtgen Dir., PGL Ex. 7.0, 13:287 – 14:299; PGL Ex. 7.1 REV., Sched. B-1.1. This subject is uncontested.

6. Budget Plan Balances

Budget Plan Balances may be a component (reduction) of rate base when they provide a source of capital. The Utilities presented the 13-month average balances of Budget Plan Balances based on actual per book data and projected data as applicable. The 13-month averages for test year 2015 are $831,000 for North Shore and $10,847,000 for Peoples Gas. Hengtgen Dir., NS Ex. 7.0, 12:254-260; NS Ex. 7.1 REV., Sched. B-14; Hengtgen Dir., PGL Ex. 7.0, 14:301-308; PGL Ex. 7.1 REV., Sched. B-14. In addition, the Utilities accepted Staff's recommended adjustment to reflect the use of the Commission's ordered interest rate of 0% to be paid on customer deposits as the rate at which budget payment plan balances will accrue interest. Moy Reb., NS-PGL Ex. 21.0, 4:84 – 5:91; Hathhorn Dir., Staff Ex. 1.0, 24:527-532. This subject is uncontested.

7. Accumulated Deferred Income Taxes

The inclusion of Plant in Service in rate base also is subject to reduction for the applicable associated Accumulated Deferred Income Taxes ("ADIT"). The final ADIT balances presented by the Utilities are $(79,725,000) for North Shore and $(520,978,000) for Peoples Gas, adjusted for deferred taxes associated with incentive compensation and Net Operating Losses ("NOLs"), as discussed below. NS-PGL Ex. 22.1N, line 10, col. (F); NS-PGL Ex. 37.1P, line 10, col. (F). This subject is uncontested with the exception of ADIT as a derivative impact of the items discussed in Sections IV.C.1.a and IV.C.3 of this Initial Brief.

a. Incentive Compensation

The Utilities had included accumulated deferred income taxes ("ADIT") related to previously disallowed capitalized incentive compensation costs. As indicated in their responses to Staff data request DGK 6.05, the Utilities agreed to remove, from rate base, the ADIT related to the capitalized incentive compensation costs previously disallowed by the Commission. *See* Kahle Dir., Staff Ex. 2.0, 25:545-547, 26:559-561, Scheds. 2.10N and 2.10P. Utilities witness Mr. Hengtgen provided the ADIT adjustments with his rebuttal. *See* Hengtgen Reb., NS-PGL Ex. 22.0 REV, 5:94-96; NS-PGL Exs. 22.10N and 22.10P.

b. Net Operating Losses

The Utilities and Staff agree that the stand-alone federal NOLs and the related federal deferred tax assets ("DTAs") balances at the end of calendar year 2014 and test year 2015 are zero, and, therefore, the average rate bases used for the test year should not include any NOLs or DTAs. Stabile Reb., NS-PGL Ex. 25.0 REV., 4:73-74; Stabile Sur., NS-PGL Ex. 39.0, 2:29-35; Effron Reb., AG Ex. 7.0, 8:154-162. These items are not included in the Utilities' rate bases. This subject is uncontested.

c. Derivative Impacts (Other than in Section IV.C.1.a)

The only contested issues related to ADIT are the derivative impacts on ADIT of the items discussed in Sections IV.C.1.a and IV.C.3 of this Initial Brief.

8. Customer Deposits

Customer Deposits may be a component (reduction) of rate base when they provide a source of capital. The Utilities' original projected balances of Customer Deposits were $(1,996,000) for North Shore and $(23,657,000) for Peoples Gas, based on actual per book data and projected data as applicable. Hengtgen Dir., NS Ex. 7.0, 12:268 – 13:271; NS Ex. 7.1 REV., Sched. B-13; Hengtgen Dir., PGL Ex. 7.0, 15:316-319; PGL Ex. 7.1 REV., Sched. B-13. In addition, the Utilities accepted Staff's recommended adjustment to reflect the use of the Commission's ordered interest rate of 0% to be paid on customer deposits. Moy Reb., NS-PGL Ex. 21.0, 4:84 – 5:92; Hathhorn Dir., Staff Ex. 1.0, 23:513-517. This subject is uncontested.

9. <u>Customer Advances for Construction</u>

Customer Advances for Construction may be a component (reduction) of rate base when they provide a source of capital. The Utilities proposed a credit balance for this item of $562,000 for North Shore and a credit balance of $1,494,000 for Peoples Gas, based on actual per book data and projected data as applicable. Hengtgen Dir., NS Ex. 7.0, 13:273-275; NS Ex. 7.1 REV., Sched. B-1.3; Hengtgen Dir., PGL Ex. 7.0, 15:322-324; PGL Ex. 7.1 REV., Sched. B-1.3. This subject is uncontested.

10. <u>Reserve for Injuries and Damages</u>

The Reserve for Injuries and Damages may be a component (reduction) of rate base when it provides a source of capital. The Utilities proposed a credit balance of $1,082,000 for North Shore as the projected balance for the Reserve for Injuries and Damages at December 31, 2014, and December 31, 2015. North Shore noted that it is not projecting any amounts assumed to be reimbursed by insurance companies. Hengtgen Dir., NS Ex. 7.0, 13:277-284; NS Ex. 7.1 REV., Sched. B-1.4.

For Peoples Gas, the Utilities proposed a credit balance of $7,615,000 as the projected balance at December 31, 2014, and a credit balance of $7,613,000 as the projected balance at December 31, 2015, for an average of $7,614,000. Peoples Gas noted that beginning in 2012, amounts related to claims that were expected to be reimbursed from insurance companies were recorded by increasing the reserve for injuries and damages and recording an offsetting accounts receivable from the insurance company. Hengtgen Dir., PGL Ex. 7.0, 15:326-333; PGL Ex. 7.1 REV., Sched. B-1.4.

This subject is uncontested.

11. Other

The Utilities are unaware of any other issues related to rate base that are required to be discussed here.

C. Potentially Contested Issues (All subjects relate to NS and PGL unless otherwise noted)

1. Plant

a. 2014 AMRP Additions and Associated Costs of Removal (Including derivative impacts on Accumulated Depreciation and Accumulated Deferred Income Taxes) (PGL)

With respect to Peoples Gas' 2014 AMRP costs (including the associated costs of removal), the Commission has before it two sets of figures, but only one set is reliable. The figures presented in the Utilities' rebuttal testimony should be adopted.

Background. In fiscal year 1981, Peoples Gas decided to replace its predominantly cast iron and ductile iron main system with cathodically protected steel and plastic main. In that year, cast iron and ductile iron main represented 3,450 miles out of the total of 4,031 miles of main in Peoples Gas' distribution system, or 86%. Lazzaro Dir., PGL Ex. 8.0 2nd Rev., 9:194 – 10:197. A 1981 study recommended replacement in certain soil types by 2030, but updates to the study concluded it would be reasonable and prudent to complete all main replacement by 2050. *Id*. at 10:197-201.

Peoples Gas later determined, however, that acceleration of the program would be beneficial, and the Commission agreed. Lazzaro Dir., PGL Ex. 8.0 2nd Rev., 10:205-214. In the Utilities' 2009 rate cases, ICC Docket Nos. 09-0166/09-0167 (cons.) ("*Peoples Gas 2009*"), the Commission approved a rider that, in brief, would allow Peoples Gas to recover incremental costs of accelerating its cast iron and ductile iron main replacement program. The Commission found that the benefits of accelerating the program include increased safety for the public and

Peoples Gas crews, construction and Operating and Maintenance cost savings, creation of jobs, reduction in environmental impacts, and increased functionalities. *Peoples Gas 2009* Order at 195. Even though a 2011 Appellate Court decision reversed the portion of the *Peoples Gas 2009* Order that allowed for rider recovery, on single issue ratemaking grounds (without questioning the merits of accelerating the program),[25] Peoples Gas moved forward with the AMRP. Lazzaro Dir., PGL Ex. 8.0 2nd Rev., 10:214-216. In 2013, Section 9-220.3 of the Act, 220 ILCS 5/9-220.3, was enacted to allow rider recover of qualifying infrastructure plant, which includes (but is not limited to) accelerated main replacement costs.

There are four main system upgrade goals for AMRP: (1) to retire 1,870 miles of cast iron/ductile iron gas distribution mains, (2) to upgrade approximately 300,000 service pipes, (3) to relocate gas meters from inside of customer facilities to outside, and (4) to upgrade the gas distribution system from a low pressure to a medium pressure system. Lazzaro Dir., PGL Ex. 8.0 2nd Rev., 11:220-223. The overarching goal of these four main construction goals is to accomplish them in a manner that delivers increased safety to the public and Peoples Gas employees, quality of workmanship, and efficiency of cost to customers and other stakeholders. *Id*. at 11:224-226. Peoples Gas uses a Main Ranking Index ("MRI") to decide which mains to replace. *E.g., id*. at 11:227 – 12:263. The MRI is discussed in more detail in Section VII.A of this Initial Brief. The AMRP is coordinated with the City of Chicago and has extensive management oversight. Lazzaro Dir., PGL Ex. 8.0 2nd Rev., 12:264 – 14:294.

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[25] *People ex rel. Madigan v. Illinois Commerce Comm'n*, 2011 IL App (1st) 100654 (Sept. 30, 2011) ("*Peoples Gas 2009 Appeal*") at ¶¶ 40-42, *appeal denied*, 963 N.E.2d 246 (Ill. 2012).

The Utilities' primary witness related to the AMRP, David Lazzaro, is a General Manager of District Field Operations for Peoples Gas. He is a highly experienced engineer, and he is responsible for all gas distribution utility field operations in the Peoples Gas Central District, including customer service, distribution system maintenance, and construction. Lazzaro Dir., PGL Ex. 8.0, 1:3-8, 3:67 – 4:76.

In his direct testimony, Mr. Lazzaro presented and supported, among other things, the original forecasted 2014 AMRP additions (including the associated costs of removal). Lazzaro Dir., PGL Ex. 9.0, 9:192 – 17:358.

<u>The AG's Unreliable Proposals</u>. AG witness Mr. Effron, in his direct testimony, proposed huge reductions in the forecasted 2014 AMRP additions (including the associated costs of removal), *i.e.*, a reduction in the 2014 AMRP additions of a gross $172,651,000, plus another $27,391,000 for the associated costs of removal (the adjustments also have derivative impacts on accumulated depreciation, ADIT, and depreciation expense). Effron Dir., AG Ex. 1.0, 7:134 – 9:200; AG Ex. 1.2, p. 3. His proposal was based on simply extrapolating from data on actual costs from January through May 2014. Effron Dir., AG Ex. 1.0, 7:134-142.

Mr. Effron's education is in economics, business administration, and accounting. He has spent over 25 years as a regulatory consultant. Before that, he worked for two years as a "supervisor of capital investment analysis and controls" for the conglomerate Gulf & Western Industries and before that for two years as a consultant and staff auditor at an accounting firm. Effron Dir., AG Ex. 1.0, 1:6 – 2:43. He is not an engineer and he does not appear to have any experience managing a utility capital project or any other infrastructure project.

Mr. Effron's direct testimony proposal made no sense and was wrong, because, among other things, his simplistic extrapolation from the first five months of 2014 failed to take into account the effects of the unusually cold winter weather on the pace of construction, failed to take into account plans to remediate those delays, and failed to take into account the annual construction cycle, basically missing the peak construction season. Lazzaro Reb., NS-PGL Ex. 23.0 2nd Rev., 3:60 – 6:117. Mr. Effron's proposal also included errors in calculating the derivative impacts (the accumulated depreciation, ADIT, and depreciation expense impacts) associated with his recommended reductions. Hengtgen Reb., NS-PGL Ex. 22.0 REV, 11:242 - 12:263.

In contrast, the Utilities, in their rebuttal testimony, presented updated reduced costs of the 2014 AMRP additions (and addressed the associated costs of removal) that (1) reflected the slowed pace of construction in the beginning of the year; (2) took into account the contractors' plans to remediate some, but not all, of the delays; and (3) factored in the construction cycle. Lazzaro Reb., NS-PGL Ex. 23.0 2nd Rev., 3:60 – 6:117.

Mr. Effron's rebuttal testimony significantly reduced his recommended adjustments, but he still proposes to reduce Peoples Gas' 2014 AMRP costs by a gross $65,877,000 plus another $17,231,000 for associated costs of removal (the adjustments also have derivative impacts on accumulated depreciation, ADIT, and depreciation expense). Effron Reb., AG Ex. 7.0, 3:58 - 4:67; AG Ex. 7.2, p. 3. His proposal is based on simply extrapolating from data on actual costs from January through July 2014. Effron Reb., AG Ex. 7.0, 3:58 – 4:67. Thus, his rebuttal proposal does not cure the fundamental flaws of his earlier simplistic extrapolation, although the addition of two months of data to his extrapolation reduced the size of his recommended adjustment.

Meanwhile, Staff witness Ms. Hathhorn's rebuttal testimony stated that Staff would support the direct testimony version of the AG's proposal, subject to the AG's direct testimony proposal being updated and corrected. Hathhorn Reb., Staff Ex. 6.0, 17:346 – 18:366. Staff provided no testimony actually addressing the merits of any version of the AG proposal, however, apart from Staff's speculation that Peoples Gas' rebuttal's reduced figures did not appear attainable. *Id.*

Mr. Lazzaro's surrebuttal testimony pointed out that Mr. Effron's rebuttal testimony proposal was incorrect for the same reasons as Mr. Effron's direct testimony proposal. Lazzaro Sur., NS-PGL Ex. 38.0, 2:39-41, 3:57 - 5:94. Mr. Lazzaro added that (1) data for August 2014 further showed that Mr. Effron's proposal was unreasonable, *i.e.*, August 2014 AMRP expenditures were $38.5 million; and (2) expected expenditures for the four remaining months of the year are $25 million to $30 million per month. *Id.* at 4:78 – 5:85; NS-PGL Ex. 38.1; Lazzaro Tr. at 129:10-21; *see also* Lazzaro Tr. at 131:19 – 132:12 (explaining that Peoples Gas has taken advantage of new opportunities for construction that developed since the revised budget was prepared). Not only that, but Staff's own cross-examination exhibit shows that August 2014 AMRP additions were $27,364,786.36. Staff Group Cross Ex. 1 at Peoples Gas' response to Staff data request DLH 34.04. The evidence supports the Utilities' rebuttal figures and negates the AG's proposal and the Staff witness' speculation.[26]

There is only one reasonable set of figures for 2014 AMRP additions and the associated costs of removal. Those figures are reflected in the Utilities' rebuttal testimony. Peoples Gas' rebuttal's reduced 2014 AMRP costs figures (including the removal costs) should be adopted.

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[26] Also, the derivative adjustments Mr. Effron calculated in rebuttal were less inaccurate than those in his direct testimony proposal, but they still were incorrect. Hengtgen Sur., NS-PGL Ex. 37.0, 5:95 - 7:135; NS-PGL Ex. 37.5P.

The AG Witness' Suggestion that Rider QIP Will Fix an Incorrect Adjustment of 2014 AMRP Costs Is Misguided. The AG's witness also has suggested that, if his proposed adjustment to 2014 AMRP and associated removal costs turns out to be incorrect, then the mechanism of Rider QIP will correct for the error. *E.g.,* Effron Dir., AG Ex. 1.0, 8:177 – 9:188. The Staff witness appeared to accept that reasoning. Hathhorn Reb., Staff Ex. 6.0, 19:390-394.

That is a highly problematic over-simplification. If the Commission reduces the 2014 AMRP costs and related removal costs as urged by the AG (and Staff), and it turns out that 2014 costs are higher than Mr. Effron speculated they will be, then the amount of QIP investment that Peoples Gas can make and recover under Rider QIP while staying with the annual average revenue cap in 2015 (and in all subsequent years until new base rates are set and in effect) will be reduced. Egelhoff Sur., NS-PGL Ex. 43.0, 15:316 – 16:343. That could potentially adversely impact future QIP projects, mainly the AMRP, unless Peoples Gas was to file another rate case. *Id*. at 16:340-343; *see also* Egelhoff Reb., NS-PGL Ex. 29.0, 26:566-572.[27]

Peoples Gas' rebuttal's reduced figures for 2014 AMRP additions and the associated costs of removal should be approved. The AG's (and Staff's) speculation is no basis for any reduction, much less the still huge reduction that the AG proposes in rebuttal.

2. Cash Working Capital

Cash working capital essentially is the amount of funds (positive or negative) required to finance the day-to-day operations of a utility. The CWC requirement is included in each of the Utilities' rate bases for ratemaking purposes. Hengtgen Dir., NS Ex. 7.0, 15:324-329; Hengtgen Dir., PGL Ex. 7.0, 18:392 – 19:397. To determine the CWC requirement, a lead-lag study

[27] *Also see* Section IX.D.2.c of this Initial Brief regarding Rider QIP.

analyzes the differences between the revenue and collection lags and the expense leads of a utility in order to measure and quantify the impact and timing of the utility's cash flow. Hengtgen Dir., NS Ex. 7.0, 15:331-333; Hengtgen Dir., PGL Ex. 7.0, 19:399-401. Three broad categories of leads and lags are considered in such a study: (1) lag times associated with the collection of revenues owed to the utility; (2) lag and lead times associated with the collection and payment of what are commonly called "pass-through" taxes and "energy assistance charges"; and (3) lead times associated with the payment for goods and services received by the utility. Hengtgen Dir., NS Ex. 7.0, 16:338-342; Hengtgen Dir., PGL Ex. 7.0, 19:406-410. In order to determine the leads and lags in the CWC analysis, the Utilities utilized data from the Utilities' Accounts Payable, Customer Service, Payroll, General Ledger, and Tax Systems, as well as records from the Utilities' bank accounts. Hengtgen Dir., NS Ex. 7.0, 16:345-348; Hengtgen Dir., PGL Ex. 7.0, 19:413-416. As discussed in Section IV.B.3 of this Initial Brief, the Utilities' CWC figures are not contested, apart from the figures for the OPEB lead and any derivative impacts of contested operating expense adjustments that affect the applicable inputs to the CWC calculations.

a. <u>OPEB Lead</u>

Based on an analysis of payments to a trust for OPEB during calendar year 2012 (the last full year for which data was available at the time the CWC lead-lag studies were prepared), the Utilities calculated lead expenses of negative 66.64 days for North Shore and negative 99.09 days for Peoples Gas. Hengtgen Dir., NS Ex. 7.0, 27:583-585; Hengtgen Dir., PGL Ex. 7.0, 31:660-662.

While the use of a lead-lag study to calculate the Utilities' CWC requirement is not contested, Staff contests the Utilities' OPEB expense lead. Hathhorn Dir., Staff Ex. 1.0, 9:180-182. Staff argues that the Utilities' cash payments for OPEB during calendar year 2012 were not made in accordance with "normal practice," and that a payment date of December 18, 2012, is more reasonable than the Utilities' January 9, 2012, payment date. Hathhorn Dir., Staff Ex. 1.0, 9:193 – 10:201. Based on this adjustment, Staff argues that the OPEB CWC factor should be adjusted to a positive lead of 170.00 days for North Shore and a positive lead of 169.91 for Peoples Gas. *Id.* at 9:188-191.

Staff's proposal, to reject the actual cash flow data from 2012 relating to the OPEB leads and to substitute hypothetical later payments, is flawed, inconsistent with the position taken by Staff and adopted by the Commission in prior rate cases, and one-sided. The Utilities' OPEB leads are based upon the most recent calendar year data that were available at the time the lead-lag studies were conducted. Hengtgen Sur., NS-PGL Ex. 37.0, 3:59-61. In accordance with customary practice, the Utilities considered the timing of all of the payments made during the year and dollar weighted them, resulting in proposed negative lead values of 66.64 for North Shore and 99.09 for Peoples Gas. *Id.* at 3:63 – 4:66.

Staff's adjustment is based solely on its subjective opinion that a payment made at the end of the year is more appropriate than a payment made at the Company's discretion, when funds were available. In fact, as Staff admits, the OPEB trust payments did not have specific due dates. Hathhorn Dir., Staff Ex. 1.0, 9:195-196. Staff bases its adjustment on a limited historical view of the Utilities' OPEB payments, arguing that, based on payments made in 2013 and pending payments in 2014, "it appears the normal practice is to pay in December." *Id.* at 10:199-201. In fact, as the Utilities demonstrated, in two out of the last three full calendar years, the Utilities made OPEB payments very early in the year. Hengtgen Reb., NS-PGL Ex. 22.0 REV., 8:165-169. Staff's assertion that the Utilities' OPEB trust payments were inconsistent with "normal practice" is unsupported and based on a subjective and selective evaluation of the Utilities' historical practices. Staff's adjustment should be rejected.

In addition, Staff's position is inconsistent with its position taken in *Peoples Gas 2012*. In *Peoples Gas 2012*, Staff argued that the OPEB lead should be set at the intercompany billing lead. *Peoples Gas 2012* Order at 80; Hengtgen Reb., NS-PGL Ex. 22.0 Rev., 6:115 – 7:153. In the instant proceeding, Staff does not propose to continue the use of the intercompany billing lead, but instead bases the adjustment to the OPEB Expense Lead on the cash flows provided by the Utilities during calendar year 2012 as adjusted by Ms. Hathhorn. This adjustment results in lead changes from negative to positive, resulting in a decreased CWC. Hengtgen Reb., NS-PGL Ex. 22.0 REV., 7:151 – 8:160. Staff has offered no valid justification for this inconsistency.

Staff bases its adjustment on an inapposite and irrelevant Commission Order in an unrelated docket. As support for her adjustment to the Utilities' cash flow data, Ms. Hathhorn cited to the Commission's final Order in an Ameren Illinois Company ("AIC") docket, ICC Docket No. 13-0192, arguing that the Commission "previously ruled that CWC factors should be calculated based on payment due dates rather than internal policies." Hathhorn Dir., Staff Ex. 1.0, 10:211 – 10:234. This argument is unsupported and unrelated to the issue of OPEB trust payments made in the absence of *any* specific due dates. In ICC Docket No. 13-0192, the Commission examined challenges to AIC's payment of pass-through taxes based on billing dates rather than collection dates, in contravention of statutory due dates or due dates prescribed by municipal ordinances. *Ameren Illinois Company*, ICC Docket No. 13-0192 (Order Dec. 18, 2013), at 15-20. In adopting the proposals propounded by Staff and various intervenors, the Commission noted that "AIC's practice of remitting pass-through taxes earlier *than required* increases rate base by increasing CWC." *Id.* at 19 (emphasis added). In clear contrast to the

AIC docket, the OPEB trust payments at issue in the instant proceeding have no required due date, either through statute, municipal ordinance, or prior Commission decision. Staff's reliance on ICC Docket No. 13-0192 as support for its adjustment is misplaced and should be rejected.

In addition, the Utilities' lead-lag studies are based on data that consists of hundreds of thousands of cash transactions, and Staff has shown no sound reason to modify only the OPEB lead payment dates, particularly when that would result in significantly reducing the cash working capital available to meet day-to-day operational needs. Hengtgen Sur., NS-PGL Ex. 37.0, 4:73-81.

Staff's proposal also is incorrect because the OPEB liability already is a rate base deduction, meaning the lead should be zero days, and making Staff's proposal a double-counted reduction to rate base (Hengtgen Reb., NS-PGL Ex. 22.0 Rev., 6:129-131, 10:211-219), although the Utilities recognize that the Commission did not adopt their view that the lead should be zero days in *Peoples Gas 2012*.

Finally, Staff's proposal is one-sided. Customers have the benefit of the actual payment date in the form of reduced OPEB expenses that resulted from the actual payment date (the "early" payment according to Staff) being included in the calculation of operating expenses in the Utilities' revenue requirements. OPEB expenses, all else being equal, are reduced by contributions to the OPEB trust and the earnings on the assets resulting from those contributions. *See, e.g.*, Hans Dir., PGL Ex. 12.0, 11:234 – 13:276. The Staff position would deny the Utilities the time value of the actual payment date, while giving customers the benefit of the actual payment date. That is unfair and unreasonable.

Staff's proposal should be rejected. The Utilities' CWC figures should be approved.

3. **Retirement Benefits, Net**

The Utilities recognize that the Commission, in the Utilities' 2007, 2009, 2011, and 2012 rate cases, found that: (1) the Peoples Gas pension asset (and the North Shore pension liability or asset, as applicable) should not be included in the calculation of rate base; and (2) the Utilities' OPEB liabilities nonetheless should be included in the calculation; and, further, (3) that the *Peoples Gas 2009* Order was affirmed on appeal on this subject.[28] While the Utilities agree with the Commission's past findings that, if a pension asset is excluded, then a pension liability also should be excluded, the Utilities respectfully request that the Commission reconsider whether to include Peoples Gas' pension asset in the instant proceeding, and, alternatively, whether to include specific pension liabilities in rate base or to exclude amounts related to pensions. The Commission should reject Staff's proposal to exclude the Peoples Gas pension asset from rate base while including the North Shore pension liability, which is contrary to the *Peoples Gas 2007* and *Peoples Gas 2009* Orders.

Using average rate base, as updated in rebuttal testimony, North Shore's pension liability is $(8,000) and Peoples Gas' pension asset is $17,350,000. NS-PGL Ex. 22.9N, Sched. B-1.2, line 11, col. (G); NS-PGL Ex. 22.9P, Sched. B-1.2, line 11, col. (G).

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[28] ICC Docket Nos. 07-0241, 07-0242 (Order Feb. 5, 2008) ("*Peoples Gas 2007*") at 32-36; *Peoples Gas 2009* Order at 35-37, *aff'd in relevant part, Peoples Gas 2009 Appeal* (finding that the Commission's conclusion was not clearly against the manifest weight of the evidence); *Peoples Gas 2011* Order at 33. *Peoples Gas* 2012 Order at 80-90. The Appellate Court upheld the Commission's decision to allow Commonwealth Edison Company a debt rate of return on its 2005 pension contribution, *Commonwealth Edison Co*., ICC Docket No. 05-0597 (Order on Rehearing Dec. 20, 2006), at 28, *aff'd, Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 398 Ill. App. 3d 510, 521, 924 N.E.2d 1065, 180 (2d Dist. Sept. 17, 2009), *reh'g denied*, April 6, 2010), *appeal denied*, 237 Ill. 2d 554, 938 N.E.2d 519 (Sept. 29, 2010). The *Peoples Gas 2009 Appeal* decision contained references to the latter Appellate Court decision but did not discuss its ruling on this subject.

The Commission's past decisions to exclude the Peoples Gas pension asset (and, when applicable, North Shore's) from rate base were based on findings that the asset is, or at least has not been shown not to be, the product of customer-supplied funds. *E.g., Peoples Gas 2007* Order at 36. Staff advances that same position in the instant cases, while the AG simply proposes to apply the prior Commission decisions. *E.g.,* Hathhorn Dir., Staff Ex. 1.0, 14:285-286; Hathhorn Reb., Staff Ex. 6.0, 10:200-205; Effron Dir., AG Ex. 1.0, 12:249 - 13:267.

The Commission should reconsider approving inclusion of the pension asset(s) in rate base because:

(1) The premise that customers, by paying utility bills, should be treated as if they had paid for the utility's assets, is incorrect as a matter of law. Customers pay for service, not for the property used to render it. *Bd. of Pub. Utility Commissioners, et al. v. New York Tel. Co.,* 271 U.S. 23 (1926).

(2) The pension asset is part of the utility's balance sheet and, with respect to defined benefit plans, which is what is involved here, the utility owns the assets via the trust that holds the assets, with the employees being the beneficiaries of the trust. Hans Dir., NS Ex. 12.0, 14:307-310; Hans Dir., PGL Ex. 12.0, 14:312-315.

(3) The rates on which customers' bills are based reflect the accrual of pension expense. Hans Dir., NS Ex. 12.0, 14:310 – 15:323; Hans Dir., PGL Ex. 12.0, 14:315 – 15:328.

(4) Normal operating revenues of a utility include amounts collected through rates to repay the utility's cost of capital, and the portion of amounts collected from customers that end up as net income is retained earnings, and thus is part of shareholder's equity, to the extent it is not paid out in dividends. Hans Dir., NS

Ex. 12.0, 15:323-328; Hans Dir., PGL Ex. 12.0, 15:328-335; Hans Reb., NS-PGL Ex. 26.0, 9:174-183.

(5) Cumulative pension contributions, that is, direct contributions into the trust, have exceeded cumulative recognized Generally Accepted Accounting Principles ("GAAP") pension expense. Hans Dir., NS Ex. 12.0, 15:331-334; NS Ex. 12.3; Hans Dir., PGL Ex. 12.0, 15:338 – 16:342; PGL Ex. 12.3.

In particular, point 4, above, first was raised by the Utilities in *Peoples Gas 2011*, but Staff and the applicable intervenors did not refute it there nor in *Peoples Gas 2012* nor in the instant Docket. In the instant proceeding, Staff offers a limited response in rebuttal testimony, asserting that the facts between the instant proceeding and the prior Commission Orders are unchanged and that the Utilities' arguments are based solely on theoretical contributions. Hathhorn Reb., Staff Ex. 6.0, 12:241-247. However, Staff continues to fail to provide a sound reason the above points are incorrect or do not support the inclusion of the pension assets in rate base. In addition, the Commission Analysis and Conclusion in *Peoples Gas 2011* Order (at 33) did not expressly address this argument, nor did the *2012 Rate Cases* Order. The data in point 5, above, has only been presented in the *2012 Rate Cases* and here, although somewhat similar points sometimes were made in the previous rate cases. Thus, the Commission has sufficient grounds for reconsidering this issue and, of course, the decision should be based on the evidence in the record of the instant Dockets. 220 ILCS 5/10-103; 220 ILCS 5/10-201(e)(iv)(A).

Thus, the Commission should: (1) allow inclusion of the Utilities' pension asset and liability in rate base, specifically, the North Shore pension liability of $(8,000) and the Peoples Gas pension asset of $17,350,000; or, in the alternative, (2) exclude the amounts related to pensions from rate base, whether asset or liability, to be consistent. NS-PGL Ex. 22.9N, Sched. B-1.2, line 11, col. (G); NS-PGL Ex. 22.9P, Sched. B-1.2, line 11, col. (G); Hans Reb., NS-PGL Ex. 26.0, 10:215-219.

Finally, while Staff espouses adherence to the prior Orders as to exclusion of Peoples Gas' pension asset from rate base, Staff's rebuttal (Hathhorn Reb., Staff Ex. 6.0, 11:220-229) inconsistently argues for subtracting the North Shore pension liability, even though that same Staff proposal was rejected in the 2007 and 2009 rate cases Orders. More specifically, Staff made the same proposal in the Utilities' 2009 rate cases, and the *Peoples Gas 2009* Order (at 36-37) rejected it, just as had occurred in the Utilities' 2007 rate cases. Staff has not provided any change in circumstances or any basis for a different outcome here. Hans Sur., NS-PGL Ex. 40.0, 7:131-139. Even the AG's witness opposes the inclusion of the North Shore pension liability in the rate base calculation if the Peoples Gas pension asset is excluded. Effron Dir., AG Ex. 1.0, 13:286-293.

Accordingly, the Commission (1) should approve the inclusion of Peoples Gas' pension asset and North Shore's pension liability in rate base, or (2) should adopt the Utilities' alternative position, but (3) should not adopt the Staff proposal to exclude the Peoples Gas pension asset but include the North Shore pension liability.

Finally, if the Peoples Gas pension asset is not included in rate base, then the Utilities respectfully contend that consistency of reasoning would require removal of the OPEB liabilities from rate base (Hans Reb., NS-PGL Ex. 26.0, 3:42-44; Hans Sur., NS-PGL Ex. 40.0, 6:119-128), although the Utilities acknowledge that the Commission rejected that contention in past rate cases.

V. OPERATING EXPENSES

A. Overview/Summary/Totals

1. North Shore

North Shore's properly calculated base rate operating expenses, including income taxes, and reflecting the Staff and intervenor-proposed adjustments with which the utility agreed or accepted in whole or in part, corrections, and updates, are $74,635,000. Income taxes comprise $7,141,000 of North Shore's total operating expenses. *E.g.*, NS-PGL Ex. 21.1N, line 33, col. [G]. See the next subsection of this Initial Brief regarding the evidence supporting North Shore's operating expenses.

2. Peoples Gas

Peoples Gas' properly calculated base rate operating expenses, including income taxes, and reflecting the Staff and intervenor-proposed adjustments with which the utility agreed or accepted in whole or in part, corrections, and updates, are $570,562,000. Income taxes comprise $61,032,000 of Peoples' Gas total operating expenses. *E.g.*, NS-PGL Ex. 36.1P, line 32, col. [G].

North Shore's and Peoples Gas' operating expenses are supported by extensive, detailed evidence, including the testimony of Sharon Moy (the test year, the overall revenue requirement, operating expenses, operating income, and rate case expenses, and the Gross Revenue Conversion Factor, and underlying calculations and support of numerous components of operating income and expenses);[29] Christine Gregor (the test year forecast and associated

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[29] Moy Dir., PGL Ex. 6.0 (entire); PGL Ex. 6.1; Moy Dir., NS Ex. 6.0 (entire); NS Ex. 6.1; Moy Reb., NS-PGL Ex. 21.0 (entire); NS-PGL Exs. 21.1N, 21.1P, 21.2N, 21.2P, 21.3N, 21.3P, 21.4N, 21.4P, 21.5N, 21.5P, 21.6 (Public and Confidential), 21.7 (Public and Confidential), 21.8 (Public and Confidential), 21.9 (Public and

(footnote cont'd)

"Part 285" Schedules, significant variances year over year from prior years to the test year in amounts recorded in operating expense Accounts, uncollectible expense, depreciation and amortization expense, taxes other than income taxes expense, and intercompany costs);[30] Mark Kinzle (as to North Shore) (including employee headcounts and Sched. C-4 account variances);[31] David J. Lazzaro (as to Peoples Gas) (including employee headcounts and Sched. C-4 account variances);[32] Noreen Cleary (incentive compensation program expenses and non-union base wage increases);[33] John Stabile (net operating loss and deferred income taxes);[34] and Christine M. Hans (employee benefits operating expenses, including savings and investment plans, pensions, OPEB, group insurance, and Integrys Business Support ("IBS")-billed benefits).[35]

(footnote cont'd)

Confidential), 21.10 (Public and Confidential), 21.11 (Public and Confidential), 21.12, 21.13 (Public and Confidential) , 21.14, 21.15 (Public and Confidential), 21.16 (Public and Confidential), 21.17 (Public and Confidential), 21.18, 21.19 (Public and Confidential), 21.20 (Public and Confidential), 21.21 (Public and Confidential), 21.22 (Public and Confidential), 21.23 (Public and Confidential), 21.24, 21.25; Moy Sur., NS-PGL Ex., 36.0 (entire); NS-PGL Exs. 36.1P, 36.2P, 36.3P, 36.4N, 36.4P, 36.5, 36.6, 36.7, 36.8, 36.9, 36.10, 36.11, 36.12, 36.13, 36.14, 36.15, 36.16, 36.17.

[30] Gregor Dir., PGL Ex. 5.0 Rev. (entire); PGL Ex. 5.1 Rev.; Gregor Dir., NS Ex. 5.0 (entire); NS Ex. 5.1 Rev.; Gregor Reb., NS-PGL Ex. 20.0 (entire); NS-PGL Exs. 20.1P, 20.1N.

[31] Kinzle Dir., NS Ex. 8.0 (entire); NS Exs. 8.1, 8.2, 8.3; Kinzle Reb., NS-PGL Ex. 31.0 (entire), Ex. 31.1; Kinzle Sur., NS-PGL Ex. 45.0 (entire).

[32] Lazzaro Dir., PGL Ex. 8.0 2nd Rev., 20:422 – 435, 22:466 – 25:548; PGL Exs. 8.1 Rev., 8.2, 8.3, 8.4, 8.5 (Public and Confidential); Lazzaro Reb., NS-PGL Ex. 23.0 2nd Rev., 9:180 – 11:227; NS-PGL Exs. 23.1, 23.2, 23.3, 23.4, 23.5; Lazzaro Sur., NS-PGL Ex. 38.0, 7:125 – 140; NS-PGL Exs. 38.1, 38.2;

[33] Cleary Dir., PGL Ex. 10.0 (entire); PGL Exs. 10.1, 10.2 (Public and Confidential); Cleary Dir., NS Ex. 10.0 (entire); NS Exs. 10.1, 10.2 (Public and Confidential); Cleary Reb., NS-PGL Ex. 24.0 (entire); NS-PGL Exs. 24.1, 24.2.

[34] Stabile Dir., PGL Ex. 11.0 (entire); Stabile Dir., NS Ex. 11.0 (entire); Stabile Reb., NS-PGL Ex. 25.0 Rev. (entire); NS-PGL Exs. 25.1, 25.2, 25.3; Stabile Sur., NS-PGL Ex. 39.0 (entire).

[35] Hans Dir., PGL Ex. 12.0, (entire); PGL Exs. 12.1, 12.2, 12.3; Hans Dir., NS Ex. 12.0 (entire); NS Exs. 12.1, 12.2, 12.3; Hans Reb., NS-PGL Ex. 26.0 (entire); NS-PGL Exs. 26.1N, 26.1P, 26.2N, 26.2P, 26.3N.

B. <u>Potentially Uncontested Issues</u>

1. <u>Other Revenues</u>

The Utilities proposed Other Revenues figures are not contested. NS-PGL Ex. 21.1N, line 10, col. [G]; NS-PGL Ex. 36.1P, line 9, col. [G].

2. <u>Resolved Items</u>

a. <u>Incentive Compensation</u>

It is a well-established principle that a utility is entitled to recover its prudent and reasonable costs of service. *See, e.g., Citizens Utility Board v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 121, 651 N.E.2d 1089, 1095 (1995). It is settled law, moreover, that employee salaries are operating expenses and, as such, are recoverable in full so long as they are prudent and reasonable. *See, e.g., Villages of Milford v. Illinois Commerce Comm'n*, 20 Ill. 2d 556, 565, 170 N.E.2d 576, 581 (1960) ("*Milford*"). With respect to incentive compensation costs, the Commission's standard for recovery is whether the incentive compensation expenses "can reasonably be expected to provide net benefits to ratepayers." *See In re Illinois Power Co.*, ICC Docket No. 01-0432 (Order Mar. 28, 2002), pp. 42-43. *See also Peoples Gas 2009 Appeal* at ¶¶ 51, 55 (holding that the Commission's use of a customer benefit standard for the recovery of incentive compensation costs was appropriate).

The Utilities submitted evidence of the benefits provided to ratepayers by the metrics contained within their Non-Executive Incentive Compensation Plan. Cleary Dir., NS Ex. 10, 15:298 – 22:466; Cleary Dir., PGL Ex. 10, 15:297 – 22:467. No party has opposed the recovery of the costs related to the Utilities' Non-Executive Incentive Compensation Plans. Accordingly, the Commission should allow the Utilities to recover the expenses of their Non-Executive Incentive Compensation Plans.

In order to narrow the issues for the Commission's determination, the Utilities agreed not to contest proposed disallowances to portions of their Executive Incentive Compensation Plan expenses as calculated by Staff and to all of their Omnibus Incentive Compensation Plan expenses, without any waiver of their right to assert arguments or otherwise contest such disallowances in future rate cases or other proceedings. *See* Kahle Dir., Staff Ex. 2.0, 20:414 – 25:542, Cleary Reb., NS-PGL Ex. 24.0, 3:58 – 5:91, 8:165 – 9:186. With respect to the Omnibus Incentive Compensation Plan expenses, this is consistent with the positions taken by the AG and CCI. *See* Effron Dir., AG Ex. 1.0, 26:577-579; Gorman Dir., CCI Ex. 1.0, 58:1283-1290).

With respect to the Executive Incentive Compensation Plan expenses, the Utilities' agreement not to contest Staff's proposed disallowances to portions of their Executive Incentive Compensation Plan expenses is consistent with the position taken by the AG. *See* Effron Dir., AG Ex. 1.0, 26:579-581. While CCI's witness Mr. Gorman originally had sought a larger disallowance of Executive Incentive Compensation Plan expenses than recommended by Staff in his direct testimony (*see* Gorman Dir., CCI Ex. 1.0, 55:1201 – 58:1282), he did not respond to Ms. Cleary's explanation for why Staff's recommended disallowance would be more appropriate. *See* Cleary Reb., NS-PGL Ex. 24.0, 5:92 – 8:164. Accordingly, the Commission should adopt the level of disallowances recommended by Staff for the Utilities' Executive Incentive Compensation Plan expenses ($4,216,000 out of $4,926,000 for Peoples Gas' and $655,000 out of $766,000 for North Shore's Executive Incentive Compensation Plan operating expenses)

b. Executive Perquisites

In his direct testimony, Staff witness Mr. Kahle proposed adjustments to remove the amounts forecasted for executive perquisites included in test year operating expenses, but the amount of the adjustments proposed were based on the historical amounts for "perquisite" items in 2013, rather than the amounts forecasted for the 2015 test year. Kahle Dir., Staff Ex. 2.0, 10:221-11:247; Cleary Reb., NS-PGL Ex. 24.0, 9:188 – 14:209. In rebuttal testimony, to narrow the contested issues in this proceeding, the Utilities agreed to accept adjustments to remove the amounts forecasted for executive perquisites included in test year operating expenses, but only for the amounts forecasted for these items in the 2015 test year – $44,000 for Peoples Gas and $7,000 for North Shore. Cleary Reb., NS-PGL Ex. 24.0, 9:188 – 14:209; Moy Reb., NS-PGL Ex. 21.0, 13:276 – 14:283. In his rebuttal testimony, Mr. Kahle agreed that the forecasted 2015 test year amounts set forth in Ms. Cleary's rebuttal testimony are the correct amounts for these adjustments. Kahle Reb., Staff Ex. 7.0, 2:37-41.

c. Interest

i. Budget Payment Plan

The Utilities accepted Staff's proposed adjustments of interest expense on budget payment plans based on the December 18, 2013, Commission ruling setting the 2013 rate of interest to be paid at 0%. Hathhorn Dir., Staff Ex. 1.0, 24:519-532; Moy Reb., NS-PGL Ex. 21.0, 4:84 – 5:91. This subject is uncontested.

ii. Customer Deposits

The Utilities accepted Staff's proposed adjustments of interest expense on customer deposits based on the December 18, 2013, Commission ruling setting the 2014 rate of interest to be paid at 0%. Hathhorn Dir., Staff Ex. 1.0, 24:519-532; Moy Reb., NS-PGL Ex. 21.0, 4:84 - 5:92. This subject is uncontested.

iii. **<u>Synchronization</u> (including derivative adjustments)**

The Utilities accepted Staff's proposed adjustments to interest synchronization. Hathhorn Dir., Staff Ex. 1.0, 6:125-136.; Moy Reb., NS-PGL Ex. 21.0, 4:84 - 5:93. This subject is uncontested.

d. <u>Lobbying</u>

The Utilities accepted Staff's proposed adjustments removing certain inadvertently included lobbying-related expenses. Kahle Dir., Staff Ex. 2.0, 16:340 – 17:358.; Moy Reb., NS-PGL Ex. 21.0, 4:84 - 5:95. This subject is uncontested.

e. <u>Fines and Penalties</u> (PGL)

The Utilities accepted Staff's proposed adjustments to remove fines and penalties from Peoples Gas' revenue requirement. Staff's proposed adjustment does not apply to North Shore (because none were included). Kahle Dir., Staff Ex. 2.0, 26:567 – 27:575.; Moy Reb., NS-PGL Ex. 21.0, 4:84 - 5:97. This subject is uncontested.

f. <u>Plastic Pipefitting Remediation Project</u> (PGL)

The Utilities accepted Staff's proposed adjustments to remove costs associated with the Plastic Pipefitting Remediation Project from Peoples Gas' O&M expenses. The Utilities noted that these costs were inadvertently included in Peoples Gas' O&M expenses and submitted amended schedules reflecting the removal of these expenses. Seagle Dir., Staff Ex. 5.0, 5:102 - 6:121.; Moy Reb., NS-PGL Ex. 21.0, 4:84 - 5:99. This subject is uncontested.

3. **Other Production** (PGL)

The proposed Other Production expense for Peoples Gas was not contested. NS-PGL Ex. 36.1P, line 14, col. [G].

4. **Storage** (PGL)

The Utilities' proposed Storage expense for Peoples Gas was uncontested. NS-PGL Ex. 36.1P, line 15, col. [G].

5. **Transmission**

The Utilities' proposed Transmission expense was uncontested. NS-PGL Ex. 21.1N, line 17, col [G]; NS-PGL Ex. 36.1P, line 16, col. [G].

6. **Distribution**

The Utilities' proposed Distribution expense was uncontested. NS-PGL Ex. 21.1N, line 18, col [G]; NS-PGL Ex. 36.1P, line 17, col. [G].

For Peoples Gas, this includes the proposed three-year amortization recovery of costs associated with the Section 8-102 of the Act two-phase AMRP investigation as ordered in the *Peoples Gas 2012* Order. Moy Dir., PGL Ex. 6.0, 17:365-369; PGL Ex. 6.1, Sched. C-2.16.

7. **Customer Accounts – Uncollectibles**

The Utilities proposed that the net write-off method be used. Additionally, the Utilities proposed that the bad debt expense at present rates as adjusted would be the average of the actual write-offs for calendar years 2010-2012, which was $22,648,000 for Peoples Gas and $1,105,000 for North Shore (and addressed the allocation of recovery between base rates and Rider UEA-GC, Uncollectible Expense Adjustment – Gas Costs). Gregor Dir., PGL Ex. 5.0 Rev., 16:358 – 17:363; Gregor Dir., NS Ex. 5.0, 15:334 – 16:339; Gregor Reb., NS-PGL Ex. 20.0, 2:23-37; NS-PGL Exs. 20.1P and Ex. 20.1N. The Utilities' proposals are uncontested. Staff agreed that its previously proposed adjustment to uncollectible expense and any resulting adjustments were not necessary and withdrew its proposed adjustment to uncollectible expense. Kahle Reb., Staff Ex. 7.0, 3:57-59.

8. <u>Customer Accounts – Other than Uncollectibles</u>

The Utilities' proposed Customer Accounts – Other than Uncollectibles expense was uncontested. NS-PGL Ex. 21.1N, line 20, col. [G]; NS-PGL Ex. 36.1P, line 19, col. [G].

9. <u>Customer Services and Information</u>

The Utilities' proposed Customer Services and Informational Services expense was uncontested. NS-PGL Ex. 21.1N, line 21, col. [G]; NS-PGL Ex. 36.1P, line 20, col. [G].

10. <u>Administrative & General</u> (Other than items in Section V.C.3)

The Utilities' proposed Administrative and General ("A&G") expenses are unchallenged with the exception of items addressed in Section V.C.3 of this Initial Brief. Gregor Dir., PGL Ex. 5.0 Rev., 15:323 – 16:357; PGL Ex. 5.1 Rev.; Gregor Dir., NS Ex. 5.0, 15:314-333; NS Ex. 5.1 Rev.

11. <u>Depreciation Expense</u> (Including derivative impacts other than in Section IV.C.1.a)

The Utilities proposed depreciation expense, reflecting the new rates discussed in Section IV.B.2 of this Initial Brief, is uncontested except for the impacts of the 2014 AMRP costs discussed in Section IV.C.1.a. NS-PGL Exs. 36.1P, 36.2P; NS-PGL Ex. 21.1P.

12. <u>Amortization Expense</u> (Including derivative impacts)

The Utilities proposed Amortization Expense (including derivative impacts) is uncontested. NS-PGL Ex. 21.1N, line 26, col [G]; NS-PGL Ex. 36.1P, line 25, col. [G].

13. Rate Case Expense (Other than amortization period in Section V.C.4)

a. Rate Case Expenses for the Present Rate Cases

The evidentiary record contains substantial evidence demonstrating that the Utilities' revised proposed rate case expenses are just and reasonable. Moreover, the record evidence is more than sufficient for the Commission to specifically assess the justness and reasonableness of those expenses as required by Section 9-229 of the Act, 220 ILCS 5/9-229. Indeed, the Staff witnesses who examined the voluminous evidence the Utilities introduced into the record to support the recovery of their rate case expenses concluded that the amounts sought by the Utilities were just and reasonable based on that evidence. Kahle Dir., Staff Ex. 2.0, 4:67-83; Kahle Reb., Staff Ex. 7.0, 13:269-272, 14:292 – 16:343; Freetly Reb., Staff Ex. 8.0, 20:396 – 21:407. Based on the evidentiary record, the Commission should find that the amounts the Utilities have requested for rate case expense in their revenue requirements – $1.947 million for North Shore and $2.945 million for Peoples Gas – are just and reasonable, and allow them to be recovered in the Utilities' rates on an amortized basis. Moy Reb., NS-PGL Ex. 21.0, 14:298 – 15:305; NS-PGL Exs. 21.3N, 21.3P; Moy Sur., NS-PGL Ex. 36.0, 13:272-278; NS-PGL Exs. 36.4N and 36.4P; Kahle Reb., Staff Ex. 7.0, 16:349-353 and Scheds. 7.06N, 7.06P.[36]

It is well-established that a utility is entitled to recover rate case expenses, which have been found by the Supreme Court of Illinois to be ordinarily, properly and fairly allowable as an operating expense. *DuPage Util. Co. v. Illinois Commerce Comm'n*, 47 Ill. 2d 550, 553, 561, 267 N.E.2d 662, 664, 668 (1971) ("rate-case expense is ordinarily properly and fairly allowed as

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[36] The Utilities request that these rate case expenses be amortized over two years for ratemaking purposes, based on the Utilities' experience as to the time between its past rate cases, whereas Staff proposes that the amortization period be changed to 2.5 years based on the proposed reorganization pending approval in ICC Docket No. 14-0496. This issue is addressed below in Section V.C.4.

an operating expense"). *See also People ex rel. Lisa Madigan v. Illinois Commerce Comm'n*, 2011 IL App (1st) 101776, ¶ 13 (1st Dist. Dec. 9, 2011) ("*Illinois-American Water*"), *appeal denied* (Ill. S. Ct. Sept. 26, 2012) ("Illinois courts have allowed utilities to recover rate case expense because '[t]he costs incurred by a utility to prepare and present a rate case are properly recoverable as an ordinary and reasonable cost of doing business.'") (citations omitted). The guiding standard for the Commission in setting any rates for a public utility – that the rates be "just and reasonable"[37] – extends to a public utility's recovery of rate case expenses in its rates, as well. *See, e.g., Northern Illinois Gas Co.*, ICC Docket No. 04-0779 (Order Sept. 20, 2005), p. 51 ("The amortization period for rate case expense is guided by the requirement that the final rates be just and reasonable"); *Consumers Illinois Water Co.*, ICC Docket No. 03-0403, (Order April 13, 2004), p. 22 ("the components of . . . rates, including rate case expense, must themselves be just and reasonable").

Section 9-229 of the Act did not change this standard. Indeed, Section 9-229 expressly mandates that "justness and reasonableness" is the standard by which rate case expenses must be judged. Rather, Section 9-229 places an additional requirement on the Commission to "specifically assess the justness and reasonableness" of a public utility's rate case expenses and expressly address this issue in its final order in a rate case proceeding.[38] The Appellate Court in *Illinois-American Water* held that this language in Section 9-229 requires the Commission to "'expressly address' the basis for its findings" – *i.e.*, include "explanation or discussion" – as to

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[37] 220 ILCS 5/9-201(c); *Bus. and Prof. People for the Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 208, 585 N.E.2d 1032, 1045 (1991).

[38] Section 9-229's title and text are: "Consideration of attorney and expert compensation as an expense. The Commission shall specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. This issue shall be expressly addressed in the Commission's final order."

the justness and reasonableness of a public utility's rate case expenses in its final order. *Illinois-American Water*, 2011 IL App (1st) 101776 at ¶¶ 47-48. With respect to the type of information the Commission should address in making this finding, the appellate court in *Illinois-American Water* in dicta suggested that the Commission could look to cases involving the award of attorney fees in the context of statutory or contractual fee-shifting provisions.[39] *Id*. at ¶ 51. Based on this guidance, the Commission has stated that a public utility must provide detailed information concerning what actual expenses have been or will be incurred, by whom, for what purpose and why such expenses were necessary in order for the Commission to make an informed determination regarding the justness and reasonableness of recovering rate case expenses from customers. *See Peoples Gas 2012* Order at 174; *In re Charmar Water Co., et al.*, ICC Docket Nos. 11-0561 – 11-0566 (consol.) (Order May 22, 2012) at p. 19; *In re Charmar Water Co., et al.*, ICC Docket Nos. 11-0561 – 11-0566 (consol.) (Order on Rehearing Nov. 28, 2012), p. 14.

In *Commonwealth Edison Co. v. Illinois Commerce Commission*, 2014 IL App (1st) 130302 ("*ComEd*"), the Appellate Court of Illinois affirmed this standard for addressing the requirements of Section 9-229. Specifically, the court in *ComEd* stated that "the applicable standard" for what evidence would be sufficient to support a Commission determination that rate case expenses are just and reasonable was previously provided in the Commission's final Order

[39] "While we make no finding as to the amount of attorney and expert fees requests, we point the Commission to other cases involving an award of attorney fees, in which the party seeking attorney fees must specify (1) the services performed, (2) by whom they were performed, (3) the time expended, and (4) the hourly rate charged. . . . Similar to cases before the trial court, the Commission has the ability to consider the factors presented to establish the amount of attorney fees requested. We believe that these cases regarding an award of attorney fees can provide guidance to the Commission and the parties to comply with Section 9-229." *Illinois-American Water*, 2011 IL App (1st) 101776 at ¶¶ 51-52 (citations omitted).

in *In re Commonwealth Edison Co.*, ICC Docket No. 10-0467 (Order May 24, 2011) and the appellate court's decision in *Madigan*. *See ComEd* at ¶ 87. As the court summarized in *ComEd*, the evidence necessary to satisfy this standard is "proof of what services were performed, the necessity of those services, and proof that the rates at issue for the services are reasonable for the services performed" or "evidence that specifies: (1) the services performed; (2) by whom they were performed; (3) the time expended; and (4) the hourly rate charged." *Id*. The court in *ComEd* referred to these standards as "guidance" as to what must be submitted into evidence to allow the Commission to specifically assess the justness and reasonableness of a utility's attorney and technical expert expenses under Section 9-229 of the Act. *ComEd* at ¶¶ 90-96.

The evidentiary record here contains an abundance of detailed information presented by the Utilities establishing the actual expenses that have been or will be incurred, the persons providing the services for which those expenses were billed to the Utilities, what services were performed and for what purpose, and why those services were necessary. The record also contains evidence concerning the skill and experience of the attorneys and technical experts, the negotiation of rates, the nature and complexity of the work involved, the comparability of those rates to market rates for similar attorneys and technical experts of their skill and experience levels, and the comparability of rates and the amounts charged in other rate cases before the Commission. With respect to their rate case expenses generally, the unrebutted record evidence established that the Utilities: (1) work to achieve efficiencies in rate case expenses from the simultaneous preparation and consolidation of their rate case proceedings, (2) select outside counsel and expert resources with extensive experience both in Illinois rate cases and related proceedings generally and with the Utilities specifically; (3) negotiate appropriate estimated hours of work that would be reasonable for the scope of and matters reasonably expected to be involved in these rate cases, as well as hourly rates that are just and reasonable in light of the market rates for experienced counsel and technical experts in Chicago generally and for practice before the Commission in Chicago specifically; (4) use IBS cost effectively to provide rate case support services; and (5) need outside counsel and technical experts to assist with the extensive procedures involved in prosecuting their rate cases after they were filed, including the discovery process, analysis of Staff and intervenor direct and rebuttal testimonies, assistance with preparation of the Utilities' rebuttal and surrebuttal testimonies, the evidentiary hearing, post-hearing briefs and reply briefs, analysis of the Administrative Law Judges' Proposed Order, briefs and reply briefs on exceptions, preparation and participation in oral argument, analysis of the final Commission Order, and preparation of a compliance filing. Moy Dir., NS Ex. 6.0, 19:405 – 21:454; Moy Dir. PGL Ex. 6.0, 20:422 – 22:472.

The evidence also demonstrates the justness and reasonableness of the Utilities' rate case expenses in that the Utilities negotiated agreements with their outside legal counsel whereby their bills would not exceed established budgeted amounts estimated for the work necessary to prepare and litigate the rate cases. Further, the Utilities' witness testified that the Utilities review the invoices submitted by their outside legal counsel and consultants to ensure that they describe the work being performed, no unreasonable amounts of time have been billed for particular tasks, and there has not been inappropriate redundancy whereby multiple counsel or consultants unnecessarily bill time for performing the same task on the same project. The Utilities required that both their affiliated IBS employees and outside consultants working on the rate cases provide detailed invoices. With respect to amounts charged by IBS employees, the Utilities review the documentation to ensure that there is no "double-counting" of expenses for rate case work performed by IBS personnel. Moy Dir., NS Ex. 6.0, 21:455-462; Moy Dir. PGL Ex. 6.0, 22:473-480. Additionally, the Utilities' rate case expenses witness, Ms. Moy, testified that the amounts of rate case expenses for which recovery is sought either have been or will be incurred in support of these rate cases. Moy Sur., NS-PGL Ex. 36.0, 11:227-229.

Specifically for each law firm and consultant, the following is a summary of the record evidence that provides detailed information concerning what actual expenses have been or will be incurred, by whom, for what purpose and why such expenses were necessary, which establishes the justness and reasonableness of their costs that are sought to be recovered as rate case expenses:

Outside Legal Services

The record evidence shows that the Utilities retained the services of two law firms – Foley & Lardner LLP and Rooney Rippie & Ratnaswamy LLP – to assist in the preparation and prosecution of the present rate cases. The primary attorneys from these firms working on these rate cases are the same attorneys who worked on the 2009, 2011, and 2012 North Shore and Peoples Gas rate cases. The Utilities negotiated an appropriate estimate of hours of work that would be reasonable for the scope of and matters expected to be involved in these rate cases. Further, the Utilities negotiated discounted hourly rates with both firms that are comparable to the market rates for experienced counsel in Chicago generally and for practice before the Commission in Chicago specifically. Moy Reb., NS-PGL Ex. 21.0, 18:390 – 19:399. The Utilities introduced evidence into the record concerning the terms of the Utilities' engagements with the law firms (*i.e.*, engagement letters with each firm), including details regarding discounts and not-to-exceed fee arrangements, estimated hours, estimated fees and hourly rates for individual attorneys. *Id*. at 19:399-406; NS-PGL Ex. 21.6.

The record evidence further contains detailed invoices received and summaries of services performed from Foley & Lardner LLP and Rooney Rippie and Ratnaswamy LLP that identify each attorney or support staff (*i.e.*, paralegal) who has billed time to the rate cases, describe the services performed with detailed daily time entries stating the amount of time expended and describing what was done during that time, and the hourly rate charged, as well as descriptions of work performed, work that is expected to be performed prior to the end of the rate cases, and the fees applicable to both categories Moy Reb., NS-PGL Ex. 21.0, 19:407 – 20:428; Moy Sur., NS-PGL Ex. 36.0., 13:286 – 14:308; NS-PGL Exs. 21.7, 21.8, 36.5, 36.6, 36.7 and 36.8.

In addition, Staff witness Mr. Kahle testified that the law firms and attorneys have extensive history and experience practicing before the Commission, that the hourly rates charged by the attorneys here are consistent with hourly rates approved by the Commission in other similar rate cases, and that the amounts billed to date are consistent with amounts billed at a similar juncture in the Utilities' previous rate cases. Kahle Reb., Staff Ex. 7.0, 15: 25 – 16:343.

Stafflogix/ProUnlimited ("Stafflogix")

The record evidence shows that Stafflogix provides witnesses and other support to assist in the preparation and prosecution of the present rate cases. Mr. John Hengtgen worked on working capital issues for Stafflogix before creating his company, Hengtgen Consulting, LLC (discussed below). Mr. Allan Ikoma provided support in preparing the Utilities' cost of service studies. The evidence shows that Stafflogix's rates are reasonable based on their long experience working in the utility industry generally and with the Utilities specifically. Both Mr. Hengtgen and Mr. Ikoma spent many years working at the Utilities, allowing them to provide their particular knowledge and expertise of the Utilities to their testimony and support of other witnesses. Moy Reb., NS-PGL Ex. 21.0, 21:442-450; Moy Sur., NS-PGL Ex. 36.0, 15:320-323. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services, and qualifications of Stafflogix. Moy Reb., NS-PGL Ex. 21.0, 21:450-455; NS-PGL Ex. 21.9.

The record evidence further contains detailed invoices and summaries of services performed from Stafflogix that show services performed, by whom, the amount of time expended and the hourly rate charged, as well as descriptions of work performed, work that is expected to be performed prior to the end of the rate cases, and the fees applicable to both categories. Moy Reb., NS-PGL Ex. 21.0, 21:456 –22:465; Moy Sur., NS-PGL Ex. 36.0, 15:324-330; NS-PGL Exs. 21.10 and 36.9.

<u>Centric Consulting ("Centric")</u>

The record evidence shows that Centric will provide support on information technology necessary to prepare, test and implement the new tariffs approved in these rates cases. Centric's rates are reasonable based on its consultants' long experience working in the utility industry generally and with the Utilities specifically. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services and qualifications of Centric. Moy Reb., NS-PGL Ex. 21.0, 22:472-477; NS-PGL Ex. 21.11.

The record evidence further contains summaries of services to be performed by Centric to implement the new tariffs after the Commission issues its final Order in this proceeding that show the services to be performed, by whom, the amount of time to be expended and the hourly rate to be charged, and the fees applicable to those services. Moy Reb., NS-PGL Ex. 21.0, 22:478 – 23:486; Moy Sur., NS-PGL Ex. 36.0, 15:332 – 16:344; NS-PGL Exs. 21.12 and 36.10.

Hengtgen Consulting, LLC

The record evidence shows that Mr. Hengtgen appeared as a witness for the Utilities, providing testimony on rate base and cash working capital issues, as well as overseeing the filing and process management of the rate cases. Mr. Hengtgen's rates are reasonable based on his long experience working in the utility industry generally and with the Utilities specifically. Further, Mr. Hengtgen spent many years working at the Utilities, allowing him to provide particular knowledge and expertise of the Utilities to their testimony. Moy Reb., NS-PGL Ex. 21.0, 23:491-496; Moy Sur., NS-PGL Ex. 36.0, 16:348-350. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services and qualifications of Hengtgen Consulting, LLC. Moy Reb., NS-PGL Ex. 21.0, 23:496-500; NS-PGL Ex. 21.13.

The record evidence further contains detailed invoices and summaries of services performed from Hengtgen Consulting, LLC that show services performed, by whom, the amount of time expended and the hourly rate charged, as well as descriptions of work performed, work that is expected to be performed prior to the end of the rate cases, and the fees applicable to both categories. Moy Reb., NS-PGL Ex. 21.0, 23:501 – 24:511; Moy Sur., NS-PGL Ex. 36.0, 16:350 - 17:362; NS-PGL Exs. 21.14, 36.11 and 36.12.

S.FIO Consulting

The record evidence shows that S.FIO Consulting provides strategic consulting and advice on the development and presentation of particular rate case issues based on consultant Mr. Salvatore Fiorella's history and experience in and knowledge of the Illinois natural gas industry in general and the Utilities in particular. Mr. Fiorella was a long-time employee of the Utilities and has particular knowledge of matters related to the Utilities' rate bases, capital expenditures, revenue requirement and capital structure. Mr. Fiorella uses his knowledge and experience to provide assistance to the Utilities in the preparation and prosecution of their rate cases. S.FIO's services are necessary because the employees of the Utilities, their affiliates and/or other consultants have assignments and obligations with respect to the present rate cases as well as other matters that do not allow them the time to perform the work that Mr. Fiorella performs for the Utilities with respect to the present rate cases. Further, Mr. Fiorella brings knowledge, experience and perspective that are different than and thus non-duplicative of the employees of the Utilities and their affiliates or other consultants involved in these rate cases. Moy Reb., NS-PGL Ex. 21.0, 24:516 – 25:531; Moy Sur., NS-PGL Ex. 36.0, 17:366-371. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services and qualifications of S.FIO Consulting, including detailed explanations for how its services in these rate cases were non-duplicative, necessary, and different from other rate cases in which recovery for its services as rate case expense was not allowed. Moy Reb., NS-PGL Ex. 21.0, 25:532-537; NS-PGL Ex. 21.15.

The record evidence further contains summaries of services to be performed by S.FIO Consulting that show services to be performed, the amount of time to be expended, the hourly rate to be charged, and the applicable fees. Moy Reb., NS-PGL Ex. 21.0, 25:538-547; Moy Sur., NS-PGL Ex. 36.0, 17:372-378; NS-PGL Exs. 21.16 and 36.13.

Deloitte

The record evidence shows that Deloitte provided services as independent accountants to examine the forecasted statements of financial position – regulatory basis for the Utilities, and the related forecasted statement of operations – regulatory basis and forecasted statements of cash flows – regulatory basis, to comply with Section 285.7010 Schedule G-2 of Part 285 of the

Commission's filing and information requirements in connection with the filing of these rate cases. Moy Reb., NS-PGL Ex. 21.0, 26:552-557; Moy Sur., NS-PGL Ex. 36.0, 18:382-387. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services, and qualifications of Deloitte. Moy Reb., NS-PGL Ex. 21.0, 26:557-561; NS-PGL Ex. 21.17. The record evidence further contains detailed invoices from Deloitte that show the services performed, by whom, the amount of time expended and the hourly rates charged. Moy Reb., NS-PGL Ex. 21.0, 26:562-566; Moy Sur., NS–PGL Ex. 36.0, 18:387-389; NS-PGL Ex. 21.18.

P. Moul & Associates

The record evidence demonstrates that P. Moul & Associates provided expert analysis and testimony concerning return on equity for the Utilities. Mr. Paul Moul has appeared as a witness for the Utilities in this capacity in their last several rate cases, and was able to apply his existing knowledge and expertise with respect to his analysis of and testimony on the Utilities' return on equity. Moy Reb., NS-PGL Ex. 21.0, 26:571-574; Moy Sur., NS-PGL Ex. 36.0, 18:393-394. The Utilities introduced evidence into the record regarding the particular terms of P. Moul & Associates' engagement, its hourly rates, its services and the qualifications of Mr. Moul, including information concerning the change in Mr. Moul's fees from prior rate cases. *Id*. at 26:574 – 27:578; NS-PGL Ex. 21.19. The record evidence further contains detailed invoices from P. Moul & Associates that show the services performed, by whom, the amount of time expended and the hourly rates charged, as well as descriptions of work performed, work that is expected to be performed prior to the end of the rate cases, and the fees applicable to both categories. Moy Reb., NS-PGL Ex. 21.0, 27:579-588; Moy Sur., NS-PGL Ex. 36.0, 18:394-403; NS-PGL Exs. 21.20 and 36.14.

Gannett Fleming, Inc.

The record evidence demonstrates that Gannett Fleming, Inc., provides expert analysis and testimony on the Utilities' request to the Commission for approval of change in depreciation rates to incorporate new service lives and net salvage components. Mr. Spanos has appeared as a witness on behalf of Gannett Fleming, Inc., for the Utilities in this capacity in their last several Commission depreciation study filings, the most recent filed in the 2009 rate cases. Moy Reb., NS-PGL Ex. 21.0, 27:593-597; Moy Sur., NS-PGL Ex. 36.0, 19:407-409. As Mr. Spanos explained in his direct testimony, the depreciation studies performed by Gannett Fleming, Inc., are necessary because in ICC Docket Nos. 95-0031 and 95-0032 the Commission ordered North Shore and Peoples Gas, respectively, to perform depreciation studies at least every five years, and the Utilities were due to comply with this requirement. Spanos Dir., NS Ex. 9.0, 7:147-156; Spanos Dir., PGL Ex. 9.0, 8:168-177. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services, and qualifications of Gannett Fleming, Inc. Moy Reb., NS-PGL Ex. 21.0, 27:597 – 28:601; NS-PGL Ex. 21.21. The record evidence further contains detailed invoices from Gannett Fleming, Inc. that show the services performed, by whom, the amount of time expended and the hourly rates charged. Moy Reb., NS-PGL Ex. 21.0, 28:602-611; Moy Sur., NS–PGL Ex. 36.0, 19:409-418; NS-PGL Exs. 21.22 and 36.15.

Towers Watson

Towers Watson provided actuarial services in support of Utilities' witness Ms. Christine Hans' testimony regarding items related to Pensions and Benefits, as well as support during the discovery process. Moy Reb., NS-PGL Ex. 21.0, 28:616-618; Moy Sur., NS-PGL Ex. 36.0, 19:423-425. The record contains further information supporting the justness and reasonableness of Towers Watson's fees, along with detailed invoices provided by Towers Watson for its services. Moy Reb., NS-PGL Ex. 21.0, 28:618 – 29:622; Moy Sur., NS-PGL Ex. 36.0, 19:425426; NS-PGL Ex. 21.23.

Intercompany Billings from IBS

The record evidence shows that the Utilities rely upon IBS to provide cost-effective rate case support, and ensure that the IBS costs for which they seek recovery as rate case expense are not also included elsewhere in their O&M costs. Moy Reb., NS-PGL Ex. 21.0, 29:627-629; Moy Sur., NS-PGL Ex. 36.0, 20:431-433. The Utilities introduced into evidence detailed documentation that shows for each two week pay period the identity of IBS employees charging time to the rate cases, the time and amounts charged by each such employee, and a description of what services that person performed, along with information regarding overhead loadings billed and descriptions of work performed, work that is expected to be performed prior to the end of the rate cases, and the fees applicable to both categories. Moy Reb., NS-PGL Ex. 21.0, 29:629-640; Moy Sur., NS-PGL Ex. 36.0, 20:433-443; NS-PGL Exs. 21.24, 36.16 and 36.17.

b. Rate Case Expenses for Prior Rate Cases

Unrecovered Rate Case Expense Approved in Prior Rate Cases.

If the Commission approved the recovery of rate case expense in a prior rate case to be amortized over a number of years, and the utility files another rate case before the recovery period has been completed, then it is appropriate for the Commission to include the amount of previously approved but unrecovered rate case expense to be recovered in the subsequent rate case expense amortization period. *See generally Illinois American Water*, 2011 IL App. (1st) 101776 at ¶¶18-37; 83 Ill. Admin. Code § 285.3085(d) ("If amortization of previous rate case expenses are included within test year jurisdictional operating expense at proposed rates on

Schedule C-1, provide the amount of amortization expense associated with each rate case by docket number."). Here, the Utilities have approved but unrecovered prior rate case expense from (a) 2009 and 2011 rate case rehearings and (b) their 2012 rate cases, shown on NS-PGL Exs. 36.4N and 36.4P. Moy Dir., NS Ex. 6.0, 15:313-318; Moy Dir., PGL Ex. 6.0, 15:315-320. No party has submitted testimony opposing the recovery of these expenses. Accordingly, the Commission should approve the recovery of these amounts over the same two-year amortization period sought for rate case expenses from the current proceedings.[40]

Rehearing and Appeal Costs From Prior Rate Cases.

As the Commission concluded in *Peoples Gas 2011*, "rehearing and appeal expenses are part and parcel of the litigation expenses in most every significant rate case proceeding," and that nothing in Section 9-229 of the Act prohibits the Commission from allowing their recovery in a subsequent rate case. *Peoples Gas 2011* Order at pp. 85-86 (approving amortized recovery of rehearing and appeal costs for the Utilities' 2009 rate cases as part of the Utilities' rate case expenses in their 2011 rate cases). Here, the Utilities have incurred rehearing and/or appeal costs related to their 2012 rate cases for which they seek amortized recovery as part of the rate case expenses in the present cases.[41] The record evidence contains detailed invoices introduced by the Utilities related to the rehearing and/or appeals of their 2012 rate cases that identify each attorney or support staff (*i.e.*, paralegal) who has billed time to the rate cases, describe the services performed with detailed daily time entries stating the amount of time expended and

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[40] For the 2009 rate cases (ICC Docket Nos. 09-0166/09-0167 (cons.)): $25,000 for North Shore and $61,000 for Peoples Gas. For the 2011 rate cases (ICC Docket Nos. 11-0280/11-0281 (cons.)): $20,000 for North Shore and $30,000 for Peoples Gas. For the 2012 rate cases (ICC Docket Nos. 12-0511/12-0512 (cons.)): $476,000 for North Shore and $695,000 for Peoples Gas. NS-PGL Exs. 36.4N and 36.4P.

[41] For the 2012 rate cases (ICC Docket Nos. 12-0511/12-0512 (cons.)): $118,000 for North Shore and $180,000 for Peoples Gas. NS-PGL Exs. 36.4N and 36.4P.

describing what was done during that time, and the hourly rate charged. Moy Reb., NS-PGL Ex. 21.0, 30:645-949; NS-PGL Ex. 21.25. Moreover, in the appeals from the 2012 rate cases, the Utilities are only defending the appeals. Moy Reb., NS-PGL Ex. 21.0, 30:649-652.

No party has submitted testimony opposing or challenging the recovery of these rehearing and/or appeal expenses. As concluded by the Commission in *Peoples Gas 2011*, recovery of such expenses is appropriate and the Commission should approve recovery of the rehearing and/or appeal costs for the Utilities' 2012 rate cases in the same two-year amortization period sought for rate case expenses from the current proceedings.

c. <u>Suggested Language From Staff for Final Order</u>

In his rebuttal testimony, Staff witness Mr. Kahle recommends that the Commission's final Order express the following Commission conclusion concerning rate case expenses. *See* Kahle Dir., Staff Ex. 7.0, 16:347 – 17:358. The Utilities agree with the Commission adopting language similar to that recommended by Mr. Kahle, except modified to adopt a 2 year amortization period rather than the 2.5 year period suggested by Staff. The language that the Commission should adopt in its final Order is:

> The Commission has considered the costs expended by the Companies to compensate attorneys and technical experts to prepare and litigate these rate case proceedings and assesses that the total rate case costs for these proceedings of $1,947,000 and $2,945,000 for North Shore and Peoples Gas, respectively, which are amortized over 2 years and included as rate case expenses in the revenue requirements of $974,000 and $1,473,000 for North Shore and Peoples Gas, respectively, are just and reasonable. The total rate case costs are detailed in NS-PGL Exs. 36.4N and 36.4P.

See Moy Sur., NS-PGL Ex. 36.0, 12:265 – 13:279. In light of the *Illinois-American Water* and *ComEd* decisions, however, the Utilities recommend that the Commission's conclusion section of its final Order contain a further discussion or explanation regarding its consideration of the evidence in determining that the Utilities' rate case expenses are just and reasonable in addition to this language recommended by Staff. The Utilities will include suggested language of this nature in their Draft Proposed Order.

14. <u>Taxes Other Than Income Taxes</u> (Including derivative impacts)

The Utilities' revised proposed Taxes Other Than Income expense was uncontested. NS-PGL Ex. 21.1N, line 27, col [G]; NS-PGL Ex. 36.1P, line 26, col. [G].

15. <u>Income Taxes</u> (Including derivative impacts)

The Utilities' final revised proposed Income Taxes expense was uncontested except for derivative impacts of contested items. NS-PGL Ex. 21.1N, line 28, col [G]; NS-PGL Ex. 36.1P, line 27, col. [G].

16. <u>Reclassification of Costs to Plant in Service</u> (PGL)

The Utilities acknowledged in response to a Staff data request (NS-PGL Ex. 36.3P) that they inadvertently omitted in Peoples Gas' rebuttal revenue requirement an adjustment to reclassify certain costs from O&M expense to Plant in Service. The Utilities' corrected and, they believe, uncontested, adjustment shows the reduction to O&M expense offset by derivative depreciation expense and income taxes on Plant in Service. Moy Sur., NS-PGL Ex. 36.0, 10:204-212.

17. <u>Gross Revenue Conversion Factor</u>

The Utilities' Gross Revenue Conversion Factors (Moy Dir., PGL Ex. 6.0, 19:405-421; Moy Dir., NS Ex. 6.0, 19:412 – 425) are uncontested.

18. <u>Other</u>

As ordered by the *Peoples Gas 2012* Rehearing Order, the Utilities provided a status report in testimony at each stage of the rate case proceeding to identify any pending adjustments which required further instructions to calculate the impact of federal NOL on current and deferred income taxes. *E.g.,* Moy Sur., NS-PGL Ex. 36.0, 21:465 – 22:477. As indicated in Section IV.B.7.(b) of this Initial Brief, the Utilities and Staff agreed that the stand-alone federal NOLs and the related federal DTAs balances at the end of calendar year 2014 and test year 2015 are zero. Therefore, there are no pending adjustments to be identified that require further instructions to calculate the impact of federal NOLs on current and deferred income taxes.

The Utilities are unaware of any other issues related to operating expenses that are required to be discussed here.

C. <u>Potentially Contested Issues</u> (All subjects relate to NS and PGL unless otherwise noted)

1. <u>Test Year Employee Levels</u>

a. <u>Peoples Gas</u>

Peoples Gas' forecasted 2015 test year employee level should be approved. The AG proposes an adjustment to Peoples Gas' forecasted 2015 test year employee level based on its assertion that "the number of [Peoples Gas] employees has been relatively steady through 2012 and 2013 and there is no discernible upward trend in the number of employees."[42] Effron Dir., AG Ex. 1.0, 15:334-336; Effron Reb., AG Ex. 7.0, 10:207-214. In rebuttal, Mr. Effron adjusted his proposal to reflect a reduction in the test year employee levels to 1,319 full time equivalent ("FTE") employees, which would reduce the forecasted test-year operation and maintenance expense by $1,904,000 and related payroll taxes by $129,000. Effron Reb., AG Ex. 7.0, 10:210-214; Sched. DJE PGL C-1. The AG's adjustment is unsupported and should be rejected.

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[42] In his direct testimony, CCI witness Mr. Gorman (CCI Ex. 1.0), recommended an adjustment to Peoples Gas' employee levels, reducing the number of forecasted FTE to 1,296. Gorman Dir., CCI Ex. 1.0, 54:1176-1179, 1186-1192. Although the Utilities responded to Mr. Gorman's adjustment in rebuttal testimony, Mr. Gorman did not address the issue in his rebuttal testimony.

Peoples Gas forecasted an increase in its headcount from 1,306 FTE employees at the end of 2013 to 1,356 employees at the end of 2014 and throughout the entire 2015 test year. Lazzaro Dir., PGL Ex. 8.0 2nd REV., 23:504-505. This forecast was based on an increased need for employees to address stricter standards of compliance with pipeline safety rules as well as increased work on AMRP. *Id.* at 24:512-515, 25:534-540. Although Mr. Effron admits that he does not "dispute that Peoples Gas will [b]e hiring new employees from time to time," he argues that the AG's significant adjustment is justified by the supposition that "other employees will be simultaneously retiring or leaving for other reasons." Effron Reb., AG Ex. 7.0, 10:197-199.

Peoples Gas has provided ample evidence to justify its increased test year employee levels – for example, Peoples Gas noted that a number of positions related to pipeline safety compliance and AMRP work have been recently filled. Lazzaro Dir., PGL Ex. 8.0 2nd REV., 25:542. Additional detail regarding these positions, including identification of the pool of workers from which the positions are filled, was provided in the Utilities' rebuttal. Lazzaro Reb., NS-PGL Ex. 23.0 2nd REV., 9:194 – 10:201. In addition, Peoples Gas identified thirty-three positions for which interviews were currently being conducted. *Id.* at 10:203-208. In surrebuttal, the Utilities noted that approximately twenty positions will be filled by Utility Workers who graduated from the Power for America training program at Dawson Technical Institute in Chicago in September 2014. Lazzaro Sur., NS-PGL Ex. 38.0, 7:128-135. The AG's adjustment does not take into account the recent additions to the Peoples Gas workforce, nor does it acknowledge the positions that are currently being filled. As explained by Mr. Lazzaro, these Utility Workers participate in a six-week long internship through Peoples Gas, wherein the workers are assigned to a district shop and are evaluated by management staff, supervisors, and peers. Transcript ("Tr.") at 110:21-111:15. As noted by Mr. Lazzaro, Peoples Gas seeks to hire those individuals who successfully complete the internship program as full-time utility workers. Tr. at 111:8-9.

During the evidentiary hearings held on September 23, 2014, the AG entered certain cross-exhibits into the record reflecting Peoples Gas' actual employee levels as of December 2013 and July 2014. Tr. at 106:15-109:3; AG Cross Ex. 10, pp. 4, 11. In doing so, the AG noted that the actual total FTE employee count as of December 2013 was 1,299.5, while the actual total FTE employee count as of July 2014 was 1,314.6. *Id.* Although the AG correctly identified the actual employee levels for Peoples Gas in July 2014, the AG's adjustment does not take into account Peoples Gas' planned hiring activities – in particular, the probable hiring of approximately 20 of the utility workers graduating from the Dawson Technical Institute training program, as identified and discussed in surrebuttal and in cross-examination. Lazzaro Sur., NS-PGL Ex. 38.0, 7:128-135; Tr. at 110:5-111:9. Peoples Gas has clearly identified planned hiring practices in the near future, including the probable number of qualified and trained FTE employees.

During the evidentiary hearings in this proceeding, the AG also introduced a discovery response related to certain proposed FTE commitments proposed in the WEC-Integrys transaction docket, ICC Docket No. 14-0496. Tr. at 114:7-115:7; AG Cross Ex. 11. This discovery response indicated that testimony filed in the separate WEC-Integrys transaction docket, by a witness that has not appeared in the instant proceeding, committed to maintaining an overall minimum number of FTE positions in Illinois for two years after the closing of the transaction, showing 1,294 FTE positions through Peoples Gas within that minimum. Tr. at 117:6-10; AG Cross Ex. 11. This information does not support the AG's proposed adjustments to headcount levels (whether at Peoples Gas or North Shore). As an initial matter, as the Utilities have emphasized, the WEC-Integrys transaction is subject to approval by the Commission and several other state and federal governmental agencies, and, if approved, it is not expected to close until Summer 2015. Derricks Reb., NS-PGL Ex. 17.0, 10:165-166; Tr. at 117:11-17. As such, the proposed commitment is subject to the proposed transaction, which has not yet been approved. In addition, the proposed commitment identifies a minimum number of FTE positions, but the response itself makes clear that the proposed commitment is for 1,953 FTEs in Illinois, and not for the breakdown shown among Peoples Gas, North Shore, and IBS. AG Cross Ex. 11. The information from the WEC-Integrys transaction docket simply reflects a proposed commitment to maintain at least 1,953 FTEs in Illinois – it does not preclude Peoples Gas from maintaining the forecasted 1,356 employees, for which Peoples Gas has identified a need. Moreover, the public announcements and data request responses do not indicate that employment levels would be decreased although potential reductions may occur due to natural attrition. Derricks, Tr. 38:7-12. The Commission should reject this discovery response as not probative as to the proceeding at hand.

Finally, Staff agrees with Peoples Gas' forecasted employee levels, and notes that the adjustment proposed by the AG and CCI do not take into account Peoples Gas' recent and planned hiring. Kahle Reb., Staff Ex. 7.0, 18:381-385; Kahle Tr. at 160:7 – 161:9, 168:11 - 169:5.

The Commission should reject the adjustments proposed by the AG and CCI, and should adopt Peoples Gas' test year employee level.

b. <u>North Shore</u>

North Shore's forecasted 2015 test year employee level should be approved. The AG proposes an adjustment to North Shore's forecasted 2015 test year employee level based on its assertion that "the number of [North Shore] employees has been relatively steady through 2012 and 2013 and there is no discernible upward trend in the number of employees."[43] Effron Dir., AG Ex. 1.0, 15:334-336. Mr. Effron recommended that North Shore's 2015 test year payroll expense be reduced to reflect a January 2014 through May 2014 average employee count of 166 FTEs, which would reduce the forecasted test-year operation and maintenance expense by $670,000 and related payroll taxes by $48,000. *Id.* at 16:339-346; Sched. DJE NS C-1. The AG's adjustment is unsupported and should be rejected.

North Shore forecasted an increase in its headcount to 178 FTEs throughout 2014 and 2015. In support of this forecast, North Shore noted that the proposed adjustments to the test year employee headcount do not take into account existing and future additions to employee count. Kinzle Reb., NS-PGL Ex. 31.0, 3:61-63. As support for its increased test year employee levels, North Shore provided evidence demonstrating that interviews were being conducted to fill thirteen open positions, and that an additional two positions were anticipated to be filled in the fourth quarter of 2014. *Id.* at 4:65-69. In addition, North Shore noted that the increased employee levels are necessary and reasonable, as the company's current employee levels has forced it to operate at levels below the budgeted headcount, resulting in an inefficient reliance on overtime and contractors to supplement its workforce. Kinzle Sur., NS-PGL Ex. 45.0, 2:39 - 3:45.

During the evidentiary hearings held on September 22, 2014, the AG entered certain cross-exhibits into the record reflecting North Shore's actual employee levels as of December

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[43] In his direct testimony, CCI witness Mr. Gorman (CCI Ex. 1.0), recommended an adjustment to North Shore's employee levels, reducing the number of forecasted FTE to 165. Gorman Dir., CCI Ex. 1.0, 54:1180-1183, 1186-1192. Although the Utilities responded to Mr. Gorman's adjustment in rebuttal testimony, Mr. Gorman did not address the issue in his rebuttal testimony.

2013 and July 2014. Tr. at 52:21-53:5; AG Cross Ex. 1, pp. 2, 5.[44] In doing so, the AG noted that the actual total FTE employee count as of December 2013 was 164.7, while the actual total FTE employee count as of July 2014 had decreased to 163.68. Kinzle Tr. at 53:21-54:22. Although the AG correctly identified the actual FTE employee count for North Shore, these numbers do not take into account North Shore's expressed planned hiring goals for 2014 – indeed, as the AG noted in cross-examination, North Shore is currently interviewing candidates for 13 open positions, four of which are for internal company construction inspector positions. Kinzle Tr. at 55:22 - 57:14. North Shore has clearly identified a need for additional FTE employees in specific positions that fill core functions of the utility.

Finally, Staff agrees with North Shore's forecasted employee levels, and notes that the adjustment proposed by the AG and CCI do not take into account North Shore's recent and planned hiring. Kahle Reb., Staff Ex. 7.0, 18:381-385.

The Commission should reject the adjustments proposed by the AG and CCI, and should adopt North Shore's test year employee level.

2. <u>Medical Benefits</u>

a. <u>Peoples Gas</u>

The Utilities' medical benefits costs for Peoples Gas and North Shore - and those of IBS cross-charged to the Utilities, falling within Section V.C.3.a.11 of this Initial Brief - are based on reports of the Utilities' (and IBS') independent actuary, which is the normal basis for the determination of these expenses before the Commission, and is a proper basis, applied to the

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[44] AG Cross Ex. 1 inadvertently was not entered into the record during the evidentiary hearings on September 22, 2014. The exhibit was entered into the record on September 23, 2014. Tr. at 67:22-68:13.

employee base. Hans Dir., NS Ex. 12.0, 5:100 – 7:136; Hans Dir., PGL Ex. 12.0, 8:162 – 9:198; Hans Reb., NS-PGL Ex. 26.0, 11:232 - 12:250.[45]

Because medical benefits are self-insured, the independent actuary appropriately considers claims experience over a trailing 24-month period in the development of insurance premium rates. Hans Reb., NS-PGL Ex. 26.0, 11:232-236. The independent actuary also takes into accounts differences between administrative and union employees in developing rates per FTE. *Id*. at 11:237-239. The independent actuary also takes into account changes in plan design. *Id.* at 11:239-241. The detailed calculations of rates per FTE that were used to calculate the Utilities' medical benefits expenses and the cross-charges from IBS for medical benefits were provided to Staff and intervenors in the Utilities' response to Staff data request PGL DGK 8.09. Hans Reb., NS-PGL Ex. 26.0, 11:241-243.

In contrast, AG witness Mr. Effron, based on nothing other than his personal opinion that the independent actuary should have used lower medical inflation rates, proposes to reduce the medical benefits expenses in each of the Utilities' revenue requirements. His proposal is arbitrary and lacks any merit. Mr. Effron's original proposal arbitrarily rejected the analysis of the independent actuary and instead was based on his focusing on actual costs in a single year, 2013, while he ignored, among other factors, the increase in numbers of employees. Hans Reb., NS-PGL Ex. 26.0, 11:227 – 12:250. His rebuttal proposal also is based on 2013, although as to

[45] The Utilities' rebuttal testimony proposed to update their medical benefits costs based on an updated report from the independent actuary that was expected to be provided after rebuttal but before surrebuttal. Hans Reb., NS-PGL Ex. 26.0, 12:257-261. Staff's rebuttal did not address that proposal, and AG witness Mr. Effron in rebuttal said that the new report should not be automatically accepted. Effron Reb., AG Ex. 6.0, 12:257 – 13:265. Accordingly, the Utilities' surrebuttal testimony provided the new data but did not adjust their revenue requirements to reflect the new data. Hans Sur., NS-PGL Ex. 40.0, 4:64 – 5:90. The new data would reduce Peoples Gas' revenue requirement by a net $570,000 and that of North Shore by a net $98,000. *Id*. The Utilities are willing to accept these reductions in the Commission's final Order, if no other reductions to these expenses are ordered.

Peoples Gas only he added an additional inflation rate as a proxy for increases in the numbers of employees. Hans Sur., NS-PGL Ex. 40.0, 2:34 – 3:44. His rebuttal proposal is no more worthy of adoption, for it arbitrarily ignores the higher inflation rate supported by the independent actuary for 2015, uses different rates for IBS depending on whether he is calculating costs for Peoples Gas or North Shore, ignores the increase in the number of North Shore employees, and even as to Peoples Gas makes an adjustment only for the 2014 increase in the number of employees, not the 2015 increase. *Id*. at 3:45-57. There is no valid reason to reject the figures resulting from the information provided by the independent actuary, which is based on trend information, properly reflects changes in numbers of employees, and is consistently and correctly calculated. *Id*. at 3:58-63.

The Commission has approved data based on actuarial reports for benefits costs in a host of rate cases. For example, in *Central Illinois Light Co., et al.*, ICC Docket Nos. 09-0306, etc., Cons. (Order on Rehearing Nov. 4, 2010), where the issue was whether to approve a *pro forma* adjustment to pension and OPEB expense based on an independent actuary report, the Commission approved the adjustment, and stated in part:

> Having had the opportunity to review the entire record more closely, it appears that the Commission's concern about the proposed pro forma adjustment being adequately identified and supported in AIU's Direct Testimony was misplaced. While it is true that AIU modified its proposed adjustment from its original June 5, 2009, proposal relying on the January 2009 actuarial report to its July 27, 2009, proposal relying on the July 2009 actuarial report, **the fact remains that the Commission commonly relies on actuarial reports for such adjustments**. AIU identified its proposed pro forma adjustments in its Direct and Supplemental Direct Testimony as well as the source for each adjustment, i.e. the respective actuarial reports. **In addition, the Commission's past reliance on actuarial reports for ratemaking purposes is generally indicative of their usefulness and reliability**. Even Staff acknowledges the usefulness of actuarial reports by relying on one, albeit an older one, in its position on this issue.

Id. at 69 (emphasis added).

In *Commonwealth Edison Co.*, ICC Docket No. 10-0467, 2011 Ill. PUC Lexis 268 (Order May 24, 2011), the Commission approved use of the most recent actuarial report in determining pension and OPEB expense, rejecting the AG's and CUB's claim that the study had too high an increase versus the prior year. *Id*. at 93-95. The Commission stated in part:

> The Commission approves ComEd's actuarially determined amount relating to its 2010 pension cost in its entirety and rejects the adjustments proposed by the AG/CUB. The record shows that ComEd relied on actuarial reports in Docket Nos. 07-0566 and 05-0597 that were comparable to the March 2010 report, and were accepted as providing known and measureable verification of ComEd's pension and post-retirement benefit costs. No evidence has been presented that the Towers Watson report contained any errors.

Id. at 95.

In Peoples Gas' 1992 rate case, *The Peoples Gas Light and Coke Company*, ICC Docket No. 91-0586, 1992 Ill. PUC Lexis 376 (Order Oct. 6, 1992), at **65-66, the Commission approved use of the most recent actuarial study for pension expense for the forecasted test year, 1993, over the objections of Staff and CUB. Staff wanted to use the study for 1992, on the theory that the study as to 1993 was a "rough estimate", and CUB took a similar position. *Id*. The Commission approved use of the study for 1993, and rejected the Staff and CUB position, stating: "In a situation such as this, the most current information available is the most accurate; of necessity, any actuarial study or report is an informed forward-looking estimate. If the Commission accepts the actuarial study, it clearly should accept the actuarial estimate for the test year. The 1992 fiscal year estimate is simply not as accurate as the 1993 estimate for ratemaking purposes." *Id*. at *66.

AG witness Mr. Effron himself argued, successfully, for use of the most current actuarial study to set pension expense in *Illinois Power Co.*, ICC Docket No. 91-0147, 1992 Ill. PUC Lexis 97 (Order Feb. 11, 1992), at **177-178. The Commission there found arguments against use of the study "too speculative". *Id.* at 179.

The Utilities are not saying that an independent actuarial report can never be rejected. Here, no error has been identified in the report, however, and the AG's witness simply wishes to substitute his hunches about how much medical benefits expenses will increase. That is no basis for rejecting the figure based on the independent actuary's report, as the past Orders cited above show.

Staff also opposes the AG's proposed medical benefits adjustments as lacking in merit. Kahle Reb., Staff Ex. 7.0, 18:387-396. The AG cross-examined Staff witness Mr. Kahle on this point, but the questions essentially assumed away the independent actuary report, which makes them irrelevant and of no probative value. *See, e.g.*, Kahle Tr. at 182:6 – 183:2, 184:19 – 186:2.

The AG's arbitrary and deeply flawed proposals should be rejected. The Utilities' figures, which are derived from the independent actuary's information, should be approved.

b. <u>North Shore</u>

See the preceding subsection of this Initial Brief.

3. <u>Other Administrative & General</u>

a. <u>Integrys Business Support Costs</u>

The Utilities' revenue requirements (subject to the updates they provided in rebuttal testimony) accurately and properly reflect the forecasted 2015 cross-charges (direct charges and allocations) to them from their affiliated business services company, Integrys Business Support, and the cross-charges are consistent with the Commission-approved Master Regulated Affiliated Interest Agreement. *E.g.*, Kupsh Dir., NS Ex. 13.0; NS Ex. 13.1; Kupsh Dir., PGL Ex. 13.0; PGL Ex. 13.1. The AG's witness challenges certain IBS items, but his proposed adjustments lack merit.

i. **Labor**

AG witness Mr. Effron proposed to adjust the expected level of IBS employees, but his proposals are inconsistent and without merit, and Staff also recommends that they not be adopted. His direct testimony proposal used one method for Peoples Gas and a different one for North Shore, and did not take into account any other factors that impacted labors costs between 2013 and 2015. Kupsh Reb., NS-PGL Ex. 27.0, 3:43-54. In particular, his direct testimony proposal ignored the three primary reasons that these labor costs increased: (1) the increased services provided to the Utilities and the requisite increases in IBS labor to provide those services, (2) increased FTEs at IBS, and (3) a proper shift in the allocation percentages. *Id.* at 3:55 – 4:79; NS-PGL Exs. 27.1P and 27.1N. Mr. Effron's rebuttal proposal did not correct for any of the above flaws in his direct testimony proposal; rather, all it did was correct for his using incorrect allocation percentages. Hans Sur., NS-PGL Ex. 40.0, 2:40 - 3:61. Staff agrees that the AG's proposal should not be adopted. Kahle Reb., Staff Ex. 7.0, 18:397 – 19:409. The Utilities' figures should be adopted.

ii. **Benefits**

The AG's proposed adjustments to medical benefits expense, including medical benefits cross-charged by IBS, lack merit and should be rejected. *See* Section V.C.2.a of this Initial Brief.

iii. **Postage**

The AG's proposed adjustments to cross-charged postage expense are incorrect. The AG's proposal considers only a flat postage rate increase, and ignores the expected increase in volume of mail, which is driven by the ICE project. Kupsh Reb., NS-PGL Ex. 27.0, 5:104 - 6:111; Kupsh Sur., NS-PGL Ex. 41.0, 4:67-74. Staff also opposes the AG's postage adjustments. Kahle Reb., Staff Ex. 7.0, 20:436 – 21:446. The AG's proposal should be rejected.

iv. Legal (NS)

The AG proposes to adjust legal express cross-charged to North Shore, essentially on the grounds that this cost has been flat, and Staff agrees. The AG's proposal should be rejected, however, because the North Shore legal budget was developed based not only on historical legal expenses but also expected future requirements and demands for services. Kupsh Reb., NS-PGL Ex. 27.0, 6:112-120; Kupsh Sur., NS-PGL Ex. 41.0, 4:80-87. The AG's proposal should not be adopted.

v. ICE Project

The AG proposes adjustments to the portion of Integrys Customer Experience project costs that is cross-charged to the Utilities. The ICE project, which will go into service fully in 2015, will unify the Utilities' customer information systems with those of other Integrys companies, providing significant benefits to customers, including, among other things, improved and enhanced billing, collections, call center and service-related offerings. *E.g.,* Kupsh Dir., PGL Ex. 13.0, 9:205 – 10:215. The AG's proposed adjustments are arbitrary and unreasonable and should be rejected.

(a) Return on Assets and Depreciation

AG witness Mr. Effron proposes to reduce the portion of forecasted 2015 ICE project depreciation and capital investment costs cross-charged to the Utilities using simple math, extrapolating from costs from certain months at the beginning of 2014 and then multiplying by them to reach an annualized figure which he uses to estimate 2015 costs. His proposal arbitrarily ignores the forecasted expenditures and plant in service activity, including the facts that IBS only bills the Utilities for assets that are in service, and that while work on the project began in 2012 only a small portion of the ICE project was in service in the months of 2014 on which his proposal is based, making the data from which Mr. Effron extrapolates completely unrepresentative of 2015 costs. *E.g.*, Kupsh Reb., NS-PGL Ex. 27.0, 6:121-127; Kupsh Sur., NS-PGL Ex. 41.0, 5:96-102. Staff also rejects Mr. Effron's proposed adjustments, noting the expected service date of the full ICE project and the lack of factual support for Mr. Effron's proposal. Hathhorn Reb., Staff Ex. 6.0, 22:453 – 25:517. The AG's proposed adjustments have no merit.

At the evidentiary hearing, the AG cross-examined Staff witness Ms. Hathhorn about the fact that the Utilities' 2015 forecasts do not reflect any cost savings resulting from the ICE project, but the evidence shows that to be correct. Ms. Hathhorn pointed out that the Utilities have been expending money on their portions of the ICE project from 2012 to now and will continue spending through 2015, that the project as a whole will go into service in 2015, and that savings are not expected to occur until 2016. Hathhorn Tr. at 148:17 – 149:16, 151:13 – 152:19; *see also* Staff Cross Ex. 2.

The Utilities also note in Mr. Effron's rebuttal, he added raw speculation to the implied effect that, if the WEC-Integrys transaction proposal is approved, then the ICE project might be cancelled. Any such issue belongs in ICC Docket No. 14-0496, not here. In any event, Mr. Effron cited no relevant facts and his speculation does not make sense. The ICE project work already is well along. For example, the project is approximately 90% complete with respect to coding and some system tests have started. Derricks, Tr. at 41:14 – 42:4. The project is expected to be in service fully in 2015, as noted above. The WEC-Integrys transaction, if approved, is expected to close in Summer 2015. Derrick Sur., NS-PGL Ex. 33.0, 6:132 – 7:134. *See also* Section III.C of this Initial Brief. The AG's proposed adjustments should be rejected.

(b) <u>Non-Labor</u>

AG witness Mr. Effron makes a similar proposal relating to the portion of forecasted 2015 "non-labor" costs cross-charged to the Utilities in relation to the ICE project.[46] His proposal here suffers from the same flaws and lack of a factual foundation as his first two ICE-related adjustments, discussed above, and Staff agrees that this AG proposal also lacks merit. Kupsh Reb., NS-PGL Ex. 27.0, 7:135-149; Hathhorn Reb., Staff Ex. 6.0, 22:453 - 25:517; Kupsh Sur., NS-PGL Ex. 41.0, 5:96 – 6:111. The AG's proposed adjustment should be rejected.

b. <u>Advertising Expenses</u>

Staff witness Mr. Kahle in his direct testimony proposed to disallow $80,000 of the Utilities' "advertising expenses" recorded as Account 909 Informational and Institutional Advertising expenses for expenditures that support events and sponsorships of community events. Kahle Dir., Staff Ex. 2.0, Scheds. 2.02N, 2.02P. The Utilities' rebuttal accepted $25,000[47] of the proposed adjustments. However, as to the remaining Staff proposed disallowance of $4,000[48] for North Shore and $51,000[49] for Peoples Gas, the Utilities have demonstrated that the proposed disallowance of expenditures should be rejected.

Staff witness Mr. Kahle wrongly considers these expenditures to support the community to be "of a promotional, goodwill or institutional nature" under Section 9-225 of the Act and,

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[46] As used here, "non-labor" expenses essentially means payments made on behalf of the Utilities and other Integrys companies, with the applicable portion of those expenses being cross-charged to the Utilities. *See* Kupsh Dir., PGL Ex. 13.0, 4:78-91.

[47] Moy Reb., NS-PGL Ex. 21.0, Ex.21.2N and Ex.21.2P.

[48] Kahle Reb. Staff Ex.7.0, Ex. 7.01 N.

[49] Kahle Reb. Staff Ex.7.0, Ex. 7.01 P.

therefore, not recoverable. Kahle Dir., Staff Ex. 2.0, 6:126-130. Contrary to Staff's assertions, the Utilities' "advertising expenditures" are not of a promotional, goodwill or institutional nature, but instead are recoverable expenses that are charitable in nature under Section 9-227 of the Act, 220 ILCS 5/9-227 or recoverable as expenditures supporting the promotion of the Utilities' energy efficiency and energy assistance programs under Section 9-225 of the Act, 220 ILCS 5/9-225.[50]

Section 9-227 of the Act provides for recovery as an operating expense of donations "for the public welfare or for charitable, scientific, religious, or educational purposes, provided that such donations are reasonable in amount." Section 9-225 of the Act addresses advertising expenditures and identifies several categories that "shall be considered operating expenses for gas or electric utilities." 220 ILCS 5/9-225(3). The expenditures that Staff seeks to disallow support the sponsorship of charitable events including: the Chicago Children's Choir, the Chicago Public Library Foundation, the Children First Fund, Friends of Holstein Park, the Hispanic Heritage Organization, the Museum of Science and Industry, Red Moon Theater, Children of Purpose, Preservation Foundation of Lake County, the University Center of Lake County, and the Waukegan Public Library and other similar events.[51] The funding of those charitable events supports a range of cultural and educational activities for charitable organizations within Chicago and Cook and Lake Counties.[52] Further, for most of the sponsorships of those charitable events, the Utilities use their presence at the events to provide

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[50] Moy Reb., NS-PGL Ex. 21.0, Ex.21.4N and Ex.21.4P.
[51] *Id.*
[52] *Id.*

information about the Utilities' energy efficiency and energy assistance programs.[53] Clearly, "promotion" of utility energy efficiency and energy assistance programs is not "promotional advertising" for which recovery is prohibited, but is a form of permissible and recoverable advertising under Section 9-225(3)(a), (e) and (i) of the Act, 220 ILCS 5/9-225(3)(a), (e) and (i). Further, support of charitable events is recoverable under Section 9-227 of the Act, 220 ILCS 5/9-227. Thus, the expenditures that Staff's testimony proposed to disallow, other than the amounts accepted by the Utilities' rebuttal and surrebuttal, are expenditures that are recoverable under Sections 9-225 and 9-227.

Staff's contention that these expenditures should not be recoverable lacks merit. First, the theory that Section 9-225 requires or warrants disallowance of costs that put the Utilities "in a philanthropic light" is not supported by the language or past interpretations of Section 9-225. Moreover, that theory essentially would read Section 9-225 to mean that if the Utilities spend money on a good purpose that benefits customers or communities, unless the Utilities do it anonymously, then the costs should be unrecoverable. Thus, the Staff theory is both unreasonable and counter-productive. Further, the Staff theory reads Section 9-225 in a manner that is inconsistent with the express allowance of charitable contributions costs recovery under Section 9-227 of the Act, 220 ILCS 5/9-227. The Commission previously rejected the Staff's argument that an expenditure that puts the Utilities' name in a "philanthropic light" should not be recoverable *Peoples Gas 2012*, p. 164. Instead, the Commission rightly determined that the nature of the expenditure, in these cases charitable expenditures, is the determinative factor for

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[53] *Id.*

rate recovery. *Id.* The Utilities have shown that many of the expenses in question are allowable under Section 9-227, as discussed above.

Even in light of the Utilities demonstrating that above sponsorships are not simply "of a promotional, goodwill or institutional nature" as they support charitable institutions and events and, in many cases, also serve as a means of promoting the Utilities' energy efficiency and energy assistance programs, Staff in its direct and rebuttal testimony insists that those expenditures are still not recoverable as the expenditures are improperly classified as advertising expenditures.[54] Staff indicates the Utilities failed to follow the directions of the Commission in the final Order in *Peoples Gas 2012*, p. 164. Staff points to the Commission's direction in *Peoples Gas 2012* (at 164), where the Commission directs the Utilities to:

> …be more careful in distinguishing sponsorship and institutional expenditures that are allowable for charitable purposes and those that are allowable advertising expenses.

Staff claims the Commission's direction to the Utilities "…appears to have gone unheeded." Kahle Dir. Staff Ex. 2.0, 10:212. That is simply untrue.

The Utilities' expenditures are recorded, for accounting purposes, in Account 909 – Informational and Institutional Advertising expenses. Moy Reb., NS-PGL Ex. 21.0, 7:143-146. Following the direction of the Commission from *Peoples Gas 2012*, the Utilities have expanded their screening, categorization and detail descriptions of informational and institutional advertising expenditures. *Peoples Gas 2012* Order at 164.

First, the Utilities have created a more detailed review process for requests for the Utilities' participation in a charitable, sponsorship or institutional event, to better insure that such

[54] Kahle Dir. Staff Ex. 2.0, 7:135-155; Kahle Reb. Staff Ex. 7.0, 5:96-108.

expenditure is for a rate-recoverable purpose. Moy Dir., NS Ex. 6.0, 17:368-380; Moy Dir., PGL Ex. 6.0, 19: 405-421. The Utilities first determine if a particular request goes to a rate recoverable-purpose such as an educational, safety, environmental, charitable, human and health services, or community development. *Id.* If the Utilities determine that: (1) such expenditure would fulfill a strategic purpose, whether for the charitable institution, the community and/or customers, (2) such expenditure will further build the Utilities' relationship with that charity, the community, and/or customers, (3) the requestor has a strong reputation, including the strength of its management and board, (4) there is a need for a contribution/spending, and (5) such expenditure will be impactful in achieving the charity's, community's, or customers' needs, then the expenditure has met the necessary screening criteria for potential funding. *Id.* The Utilities also review the funding request to determine: (1) if there are multiple funding sources; (2) does the Utilities' participation enhance the possibility of other entities funding the educational, safety, environmental, charitable, human and health services, or community development need; (3) is the funding request realistic for the goal; and (4) what is the Utilities', its employees', and their retirees' involvement with the requestor and goal. *Id.*

Once the decision has been made to fund the request for sponsorship, the expenditures are classified into one of two categories: (a) sponsorships or expenditures where information and education related to safety, energy efficiency, energy assistance, and/or billing and payment options are communicated to customers and the community; and (b) sponsorships or expenditures where community services are enhanced and benefited for charitable purpose. Moy Dir., NS Ex. 6.0, 17:368-380; Moy Dir., PGL Ex. 6.0, 18: 381-390.

Last, the Utilities provide expanded descriptions of the expenditure/sponsorship funding, the organization that is being supported, the nature of the expenditure and cause or program being promoted or advanced, *see e.g.* Moy Reb., NS-PGL Ex. 21.0, Ex. 21.4N and 21.4P. The changes in expanding the description are a direct result of *Peoples Gas 2012*, where, these expanded descriptions serve to distinguish recoverable from non-recoverable expenditures.

As indicated in the Utilities' rebuttal, the Utilities expect additional guidance for the classification of expenditures related to charitable spending pending the outcome of the ongoing rulemaking concerning the rate case treatment of charitable contributions in ICC Docket No. 12-0457. Moy Reb., NS-PGL Ex. 21.0, 7:132-136. The Commission ruled in *Peoples Gas 2012* that:

> …the Commission believes the nature of the expense is more important and declines to adopt Staff's position that these expenses can not be considered as charitable contributions because the Utilities initially recorded them as advertising expenses.

Peoples Gas 2012 Order at 164.

The Utilities have expanded their screening, categorization and description of the nature of these "advertising expenses" in the instant proceeding to describe how these expenditures are not simply for placing the Utilities in a positive light through its philanthropic efforts. The Utilities' expenditures, as indicated above, support local charitable organizations and provide a forum for the Utilities' energy efficiency and energy assistance programs. Staff's proposed adjustments should and must be rejected. They lack any sound factual basis, are contrary to the evidence, and are contrary to Sections 9-225 and 9-227.

c. <u>Institutional Events</u>

Staff proposes to disallow $203,000 of Peoples Gas' sponsorship of institutional events and $10,000 of North Shore's sponsorship of institutional events, on the theory that the costs are for promotional, goodwill advertising, and thus are barred from recovery under Section 9-225 of the Act. Kahle Reb., Staff Ex. 7.0, Scheds. 7.02 N and 7.02 P.

The Utilities have shown that these expenditures: (1) support local charities, (2) serve as a means for the charities to raise contributions, (3) allow for dialogue between the charities and the Utilities so they can better serve the community, and (4) foster cross-collaboration between the Utilities and the community so the Utilities can better serve their customers. Moy Reb., NS-PGL Ex. 21.0, 8:175 – 10:208; NS-PGL Exs. 21.5N, 21.5P. For example, Staff proposes to disallow the cost Peoples Gas' institutional event support of "The Chicago Police Memorial Foundation", a charitable organization providing support to families of fallen or critically injured Chicago Police Officers. Moy Reb., NS-PGL Ex. 21.0, 9:180-185. Other examples of proposed disallowances include supporting institutional events for other organizations meeting the Section 9-227 criteria, such as the Adler Planetarium, the Chicago Children's Choir, the Chicago Public Library Foundation, Connections for Abused Women and their Children, Chicago Sinfonietta and the Chicago Urban League.[55] *Id.* at 9:186 - 10:199.

Similar to the Utilities' expanded description of the "advertising expenditures" in Section V.C.3.b. above, each of the institutional events where recovery is sought has a description of the nature of the event, the charitable institution holding the event, and a description of the purpose of the expenditures.[56] Further, the same screening criteria as discussed in Section V.C.3.b. above are used to assess making the expenditure, Staff makes a blanket dismissal of the expenditures labeled "institutional events" indicating they are simply promoting goodwill, where in reality, supporting these institutional events help support those charitable organizations' public missions. Moy. Sur. NS-PGL Ex. 36.0:126-129. The claim that the

[55] An expanded description of each charitable organization's institutional event is within Moy Reb., NS-PGL Ex. 21.0, Ex. 21.5N and 21.5P.

[56] *Id.*

Utilities have not shown the sponsorships are not promotional is incorrect, and for it to be correct would have to stretch the meaning of the term promotional beyond the language and reasonable fair interpretation of Section 9-225, as discussed in Section V.C.3.b, above.

Further, Staff's claim as to "misclassification" of these institutional expenditures as a means of disallowing the costs should be rejected. Kahle Reb., Staff Ex. 7.0, 9:196-203. Similar to the discussion in Section V.C.3.b, the nature of the expenditure should determine its recoverability, not the accounting classification. These institutional events: 1) support local charities, (2) serve as a means for the charities to raise contributions, (3) allow for dialogue between the charities and the Utilities so they can better serve the community, and (4) foster cross-collaboration between the Utilities and the community so the Utilities can better serve their customers. Moy Reb., NS-PGL Ex. 21.0, 8:175 – 10:208; Exs. 21.5N, 21.5P. Notably, this same set of issues regarding institutional expenditures was addressed in *Peoples Gas 2012* and the Commission rejected similar Staff challenges. Moy Sur., NS-PGL Ex. 36.0, 6:131-7:134. The Commission ruled in *Peoples Gas 2012* as to institutional expenditures that:

> The Utilities have provided sufficient evidence to show that these contributions were made to support fundraising events for local charities and communities in the Utilities' service territory and not primarily to promote the Utilities or foster goodwill towards the Utilities.

Peoples Gas 2012 Order at 169.

As in *Peoples Gas 2012*, the Utilities have made the necessary showings. Staff's adjustments should and must be rejected. The evidence shows that the costs in question are recoverable.

d. <u>Charitable Contributions</u>

Staff proposes to disallow $28,000 of Peoples Gas' charitable contributions and $10,000 of North Shore's charitable contributions. Kahle Reb., Staff Ex. 7.0, Scheds. 7.03 N and 7.03 P.

Staff proposes to disallow those charitable contributions as those contributions are either to: (1) organizations outside of the Utilities' service territory or (2) universities and colleges outside of the State of Illinois. Kahle Dir., Staff Ex. 2.0, 14:312-15:316. Staff indicates that, for a charitable expenditure to be recovered by a utility in accordance with Section 9-227, the expenditures must be directed to charitable organizations within a utility service territory or providing some type of education benefit within a utility service territory. *Id.* at 15:326-332.

Section 9-227 of the Act, 220 ILCS 5/9-227, expressly allows recovery of donations made by a public utility for "…the public welfare or for charitable scientific, religious, or education purposes…" as the amounts are reasonable (the reasonableness of the amounts is uncontested here). Further, Section 9-227 limits the power of the Commission to establish rules disallowing charitable contributions, stating in part:

> In determining the reasonableness of such donations, the Commission may not establish, by rule, a presumption that any particular portion of an otherwise reasonable amount may not be considered as an operating expense. The Commission shall be prohibited from disallowing by rule, as an operating expense, any portion of a reasonable donation for public welfare or charitable purposes.

Nonetheless Staff seeks to maintain the requirement (in substance, a rule) disallowing charitable contributions outside a utility's service territory. In *Peoples Gas 2012*, the Commission ruled that:

> The Commission notes that a utility is not precluded from recovering expenses for charitable contributions simply because the organization receiving the donation is outside the utility's service territory. However, the utility must show that the donation will provide a benefit to customers in its service territory to recover these expenses.

Peoples Gas 2012 Order at 167.

The Commission also ruled in *Peoples Gas 2012* that charitable expenditures to colleges and universities outside of the State of Illinois were not recoverable. *Id*. at 167. The Utilities disagree with the Commission's ruling in *Peoples Gas 2012*, noting that Section 9-227 does not include such a restriction. The Utilities respectfully request that the Commission reconsider its approach to these contributions in light of the statutory requirements applicable to recovery of charitable contributions as an operating expense. Statutorily, restrictions on the recoverability of charitable contributions under Section 9-227 are based on: (1) the recipient of the charitable contribution - entities that provide contributions to public welfare, or scientific, religious or educational purpose and (2) the donations are a reasonable amount. The contributions at issue meet these criteria.

Moreover, Section 9-227 provides that:

> … the Commission may not establish, by a rule, a presumption that any particular portion of an otherwise reasonable about may not be considered as an operating expense.

The Utilities submitted an overall level of charitable contributions in its initial rate filing as a reasonable operating expense for the 2015 future test year. Moy Dir., PGL Ex. 6.0, 14:291 - 15:314; Moy Dir., NS Ex. 6.0, 14:292-312. No party has challenged the overall level of charitable contributions. Notably many of these out-of-service territory contributions are related to utility employee matching gifts where the Utilities, match, dollar-for-dollar, up to a certain level gifts to charitable institutions. The particular occurrences of employee contributions may vary over time, but the overall expected total level of contributions, as indicated in each Utility's Schedule C-7 filing is reasonable for the future test year of 2015. Moy PGL Ex. 6.1, Sched. C-7; Moy NS Ex. 6.1, Sched. C-7.

Staff's position is contrary to Section 9-227 both in terms of its provisions regarding what is recoverable and in terms of its provisions limiting disallowance by rule. *See* Kahle Dir., Staff Ex. 2.0, 15:326-332. The charitable organizations where Staff is seeking a disallowance of expenditures are all entities that provide contributions to public welfare, or scientific, religious or educational purpose. Kahle Reb., Staff Ex. 7.0, Scheds. 7.03 N and 7.03 P. The charitable organizations include, for example, food banks and a wide range of educational institutions. *Id.* As these organizations contribute to the public welfare, or scientific, religious or educational purpose and the specific level of expenditures are not argued as unreasonable, these expenditures should be recoverable. The Staff position proposes a ruling that would be unlawful, but, even if it could be lawful, the evidence here supports recovery. The Staff adjustment should be rejected.

e. <u>Social and Service Club Membership Dues</u>

Staff proposes to disallow $44,000 of Peoples Gas' social and service club membership dues and $17,000 of North Shore's social and service club membership dues. Kahle Reb., Staff Ex. 7.0, Scheds. 7.04 N and 7.04 P. Staff proposes to disallow those social and service club membership dues arguing that these are a promotional and goodwill practice and not necessary in providing utility service. Kahle Reb., Staff Ex. 7.0, 11:242-245. Alternatively, certain portions of these dues are indicated by Staff to be lobbying expenses, and therefore not recoverable. Kahle Dir. Staff Ex. 2.0, 16:347-355. Staff is incorrect that the expenses are not appropriate and support utility service to customers.

Overall, the Utilities' expenditures on social and service clubs provide benefits to customers in an indirect way to work with various external stakeholders within their service territories. The membership in these social and service clubs allow the Utilities to interact with other business and governmental entities to develop contacts, exchange ideas, coordinate current projects and plan future projects. Moy Sur., NS-PGL Ex. 36.0, 7:152-8:157. The Utilities provide, maintain and continue to develop vital infrastructure within their service territories. Moy Reb., NS-PGL Ex. 21.0, 11:226-227. The Utilities' activities and the activities of other businesses and governmental entities within the Utilities' service territories require coordination and cooperation between the various stakeholders. If the Utilities can better coordinate and cooperate with other stakeholders in there service territories, improved and more cost-effective service can be delivered to customers.

Staff's argument that Utilities' expenditures for social and service clubs memberships provide no ratepayer benefit should be rejected.

4. <u>**Amortization Period for Rate Cases Expense**</u>

Staff's rebuttal testimony proposes one very minor adjustment based on the proposed WEC-TEG transaction, *i.e.*, to change the amortization period for rate cases expenses from two years to two and one-half years based on the premise that the Commission, if it approves the transaction, may approve a condition proposed by the joint applicants regarding when the Utilities' next new rates may go into effect. Staff's proposal is too speculative to adopt, because it assumes approval of the transaction and of that specific condition, as well as approval by the applicable out of state regulatory authorities. Moy Sur., NS-PGL Ex. 36.0, 9:189 – 10:202. *See also* Section III.C of this Initial Brief.

5. <u>**Peer Group Analyses**</u>

In support of AG witness Mr. Effron's proposed adjustments to O&M and A&G expenses, AG witness Dr. Dismukes presented what he claimed are "peer" group analysis of the Utilities' O&M and A&G expenses. Dr. Dismukes did not himself propose any adjustments. His analyses are incomplete and they are not a reliable basis of support for any of Mr. Effron's O&M and A&G expense adjustments, for numerous reasons.

First, as indicated above, Dr. Dismukes did not propose any adjustments, and ostensibly his testimony is presented in support of Mr. Effron's proposed adjustments to O&M and A&G expenses, but neither Dr. Dismukes nor Mr. Effron tied the "peer" group analysis to any of

Mr. Effron's specific proposed adjustments. Derricks Reb., NS-PGL Ex. 17.0, 10:174-182, 13:230-249; Derricks Sur., NS-PGL Ex. 33.0, 8:160-169, 8:176-178.

Second, when Mr. Effron's specific adjustments to O&M and A&G expenses are considered, it is clear that they rely on specific points about the Utilities, *i.e.*, their test year employee levels, increases in medical benefits expenses, and the challenged IBS cost items. *See* Sections V.C.1, V.C.2, and V.C.3.a of this Initial Brief. Dr. Dismukes' testimony simply does not bear on those items in any direct or meaningful way.

Third, Dr. Dismukes' analyses expressly are limited to O&M and A&G expenses. Thus, they do not take into account overall costs of service, because they do not include any of the categories of customer expense or the return of and on plant and other capital investments. He presented no comparison of overall costs of service of the Utilities versus other utilities.

Fourth, his analyses look at data from 2004 to 2013, but the test year in the current cases is 2015. Moreover, he never addresses the fact that the Commission reviewed the Utilities' costs of services in their 2007, 2009, 2011, and 2012 rate cases.

Fifth, he failed to show to any reasonable degree that the "peers" are peers of the Utilities for cost comparison purposes in the current cases. He did not show, among other things, that they have comparable service territories (including whether they have comparable customer bases over time), comparable systems (such as the prevalence of inside or outside metering), or comparable state and local regulations under which they operate. Derricks Reb., NS-PGL Ex. 17.0, 11:203 – 12:218; Derricks Sur., NS-PGL Ex. 33.0, 8:178 - 9:190; NS-PGL Cross Ex. 1. Many of the "peers" are combined gas and electric utilities (which could result in common cost being reduced), none is an essentially all urban utility like Peoples Gas, and he did not examine the state and local regulations under which the "peers" operate. Derricks Reb., NS-PGL

Ex. 17.0, 11:203 – 12:218; Derricks Sur., NS-PGL Ex. 33.0, 8:178 – 9:190. Regulations matter, as has been discussed with respect to restoration expenses, for example. *E.g.*, Derricks Sur., NS-PGL Ex. 33.0, 8:186-190. He also did not show that they have comparable accounting policies such as for when expenses are capitalized or accounting for service company expenses. *E.g.*, *id*. at 9:186-188. He also did not look at whether any of the "peers" had a rate freeze or other rate increase prohibition in place during the period he studied. NS-PGL Cross Ex. 2.

Sixth, a significant part of his analyses is based on costs per volume of gas delivered, but he did not explain how that is a relevant or meaningful criterion, and he apparently has not normalized that delivery data. Derricks Sur., NS-PGL Ex. 33.0, 8:172-176, 9:190-192.

Finally, he did not identify any specific expense of either utility that he claims is imprudent, inefficient, or excessive. Derricks Reb., NS-PGL Ex. 17.0, 12:219 - 13:229; Derricks Sur., NS-PGL Ex. 33.0, 9:192-194.

"What Dr. Dismukes has provided is data, but not an analysis that can be used as support for Mr. Effron's proposed revenue requirement adjustments." Derricks Sur. NS-PGL Ex. 33.0, 9:196-198.

VI. RATE OF RETURN

A. Overview

The Utilities seek modest increases to their authorized overall rates of return on capital. Peoples Gas seeks an increase from 6.67% to 7.21%, North Shore from 6.72% to 6.89%. Gast Sur., NS-PGL Ex. 34.0, 4:85. By contrast, Staff proposes reductions in the Utilities' overall rates of return to 6.23% for North Shore and 6.59% for Peoples Gas. Freetly Reb., Staff Ex. 8.0, Sched. 8.01.[57]

The Utilities' proposed increases are consistent with the clear weight of the evidence that their costs of capital will be higher in 2015 than they currently are, not to mention what they were when the Utilities' rates were last set in 2013. Uncontested evidence uniformly points to increased costs of capital in the test year, including rising interest rates,[58] improvement in leading economic indicators including stock prices,[59] higher earnings growth[60] and higher authorized and actual returns on common equity for natural gas utilities.[61]

B. Capital Structure

The following 2015 capital structures are uncontested. NS-PGL Exs. 18.1N & 18.1P; Staff Ex. 8.01.

	North Shore	**Peoples Gas**
Common Equity	50.48%	50.33%
Long-Term Debt	38.94%	46.51%
Short-Term Debt	10.58%	3.16%

The Utilities' proposed capital structures are similar to their currently authorized ones. *Peoples Gas 2012* Order at 182. According to Staff, these structures "reasonably balance the cost advantage of tax deductible interest expense that comes from employing debt as a source of

[57] CCI did not dispute the Utilities' debt cost forecasts, but submitted evidence as to their cost of common equity. It is not known if CCI has a position on the Utilities' overall rates of return.

[58] Moul Dir., PGL Ex. 3.0, p. 28 table, 32:672 – 676; PGL Ex. 3.12; Moul Reb., NS-PGL Ex. 19.0, p. 12 table.

[59] Moul Dir., PGL Ex. 3.0, 20:422 – 21:430.

[60] Moul Reb., NS-PGL Ex. 19.0, 10:183-184.

[61] Moul Reb., NS-PGL Ex. 19.0, 2:41 – 46 & p. 5 table; Gorman Reb., CCI Ex. 2.0, p. 5 table.

capital against the financial strength needed to raise capital under most capital market conditions that comes from employing common equity as a source of capital." Freetly Dir., Staff Ex. 3.0, 3:61 – 4:65; Freetly Reb., Staff Ex. 8.0, 2:20-33 (accepting Utilities' revised capital structures).

C. Cost of Short-Term Debt

Based on forecasts published by *Moody's*, updated in rebuttal testimony, the Utilities estimate their 2015 costs of short-term debt to be 1.06% for North Shore and 1.19% for Peoples Gas. Gast Reb., NS-PGL Ex. 18.0, p. 4 table; NS-PGL Exs. 18.2N & 18.2P. Staff proposes lower short-term debt costs – 0.74% for North Shore and 0.91% for Peoples Gas – based on the actual yields of commercial paper on June 12, 2014. Freetly Reb., Staff Ex. 8.0, 2:34 – 3:47.

The credit rating agency interest rate forecasts the Utilities relied on to estimate their costs in 2015 are verifiable and unbiased. These types of forecasts are "used by investors to formulate their expectations for the future." Moul Sur., NS-PGL Ex. 35.0, 2:43-44. Such forecasts are an eminently reasonable basis to predict the Utilities' costs in the future.

By contrast, Staff's reliance on historical "spot day" measurements to forecast capital costs in a future test year is arbitrary and unreliable and should be rejected. As Staff itself recognized, relying on historical data "will necessarily be arbitrary" because the analyst must choose the historical timeframe for the data. Freetly Dir., Staff Ex. 3.0, 28:508-510. Basing a forecast on historical data will produce the "correct" result only by chance. *Id*. at 28:510-511, 518-519. Recognizing that spot data "is exposed to inefficiencies from a number of sources" on any given day, the Commission has asked to be informed of "the conditions or financial climate of the spot day and whether any of these might cause material market inefficiencies." *Peoples Gas 2009* Order at 125-126. Staff did not attempt to make this showing with respect to its spot day interest rate measurements in this case.

Instead, Staff argued that "current" interest rates are better predictors of future interest rates than published forecasts like *Moody's*. Freetly Dir., Staff Ex. 3.0, 4:78-79. Staff also claimed that it is impossible to forecast interest rates because such forecasts are too often "inaccurate." Freetly Reb., Staff Ex. 8.0, 4:63-69. Staff's position is a fallacy because the accuracy of forecasts can be determined only with hindsight. Moul Sur., NS-PGL Ex. 35.0, 2:42-43. A forecast represents the best estimate by the forecaster with the information then available. The fact that intervening events cause future rates to differ from a forecast does not render the forecast inaccurate when it was made.

Pointing to a few recent instances where the forecasts "overstated" the actual yields that occurred, Staff posited the truism that "no one can predict with certainty when interest rates will begin to rise, the rate which they will rise, how long they will rise before falling again, the rate at which they will fall, or even whether they will rise before they fall further." Freetly Reb., Staff Ex. 8.0, 4:70 – 5:77 & 6:91-94. This is a truism because nothing that depends on future events can be forecasted "with certainty" because no one can know "with certainty" what future conditions will be. This doesn't mean, however, that forecasts are not accurate based on the information available when they are made.

The cited source of Staff's "random walk" theory does not support Staff's contention that "the current return [is] the best estimate going forward." *See* Freetly Reb., Staff Ex. 8.0, 4:69-70. The cited portion of Dr. Malkiel's work presents his thesis that "[t]he past history of stock prices cannot be used to predict the future in any meaningful way." Burton G. Malkiel, *A Random Walk Down Wall Street* at 146 (4th Ed. 1985) (emphasis added). It says nothing about an analyst forecasting stock prices (or interest rates) based on existing and expected conditions.

All that Staff's "random walk" theory proves is that on any given day, it is impossible to know whether intervening events will cause a forecast to be wrong on the high side or the low side or by how much. If a forecast's performance in hindsight is truly random, as Staff claims, then there is no reason to believe that today's forecasts are either too low or too high. What is important is the forecast's credibility and objectivity.

Staff did not challenge the credibility or objectivity of the *Moody's* short-term debt forecasts on which the Utilities relied. Gast Dir., PGL Ex. 20, 9:166-177.[62] Staff instead points to variance in the forecasts of 10-year Treasury yields for the fourth quarter of this year as evidence that interest rate forecasting is not reliable. Freetly Reb., Staff Ex. 8.0, 5:78 – 6:90. Staff's evidence does not prove its conclusion. Rather, the variation is a product of Staff's arbitrary selection of forecasts, namely "the most easily obtainable sources Staff was able to access in the limited time available." *Id.* at 5 n.4. The fact that two of the four forecasts Staff selected were significantly different than the other two suggests that more inquiry was required to determine the reliability of the outliers. Had it engaged in that inquiry, Staff could have determined whether the *Forecasts.org* and *EconomicOutlookgroup.com* forecasts (2.28% and 3.50%, respectively) were reliable when made, as compared to the *Freddi Mac* and *Survey of Professional Forecasters* ("*Survey*") forecasts (2.60% and 2.80%, respectively).

Finally, Staff's objection to the use of interest rate forecasts for debt costs in a future test year is inconsistent with Staff's reliance on forecasts in its cost of equity analyses, including (1)

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[62] Consistent with the Utilities' view that their rates should be based on the most current information available, they updated their short term debt rate forecast on rebuttal, resulting in a 27-basis-point <u>reduction</u>. Gast Reb., NS-PGL Ex. 18.0, 3:61-65. The fact that the forecasts moved downward between February and August is not evidence of forecast inaccuracy, as Staff claims, but rather reflects the passage of time and changing events.

the "expected" quarterly dividends of the proxy group of delivery utilities used in its Discounted Cash Flow ("DCF") model (Freetly Dir., Staff Ex. 3.0, 10:200 – 11:210 & Sched. 3.04); (2) gross domestic product ("GDP") inflation and GDP growth forecasts from the Energy Information Administration ("EIA"), *Global Insight* and the *Survey* (*id*. at 16:301-313) used in its Capital Asset Pricing Model ("CAPM"); and (3) analysts' forecasts of growth in earnings per share (*id*. at 9:173-179). Forecasts from credible and objective sources are reliable for the purpose of establishing a utility's cost of capital in a future test year.

For these reasons, the record strongly supports basing the Utilities' short-term debt costs on *Moody's* forecasts instead of a short-term debt rate selected by Staff on a single date several months ago.

D. <u>**Cost of Long-Term Debt**</u>

A utility's forecasted cost of long-term debt is comprised of two components, the "embedded" cost of pre-existing debt issuances and the forecasted cost of issuances expected to occur during the test year (if any). Including the forecasted costs of its planned issuances in 2015, Peoples Gas' original forecasted cost of long-term debt was 4.72%. PGL Ex. 2.3. North Shore's 2015 long-term debt cost forecast is 4.13%, and is based entirely on existing issuances as North Shore plans no new issuances in 2015. NS Ex. 2.3. Staff accepted the 4.13% cost for North Shore, but proposed a 4.36% cost for Peoples Gas based on the June 11, 2014 spot day yield on A-rated bonds. Freetly Dir., Staff Ex. 3.0, 6:112 – 7:141.

Due to the actual pricing of certain debt and newer forecasts, Peoples Gas' proposed long-term debt cost fell from 4.72% on direct (PGL Ex. 2.3) to 4.32% on rebuttal (NS-PGL Ex. 34.2P). The late August price of Peoples Gas' Series BBB, 4.21%, was lower than both the

Utility's forecasted price of 4.72% and Ms. Freetly's 4.66% based on the June 11, 2014 actual rate. Gast Sur., NS-PGL Ex. 34.0, 3:61-64.

In response to this updated information, Staff adopted an inconsistent approach. While Ms. Freetly agreed that the actual pricing of issuances should be used as it became known, she applied the 3.90% cost Peoples Gas obtained on its Series VV municipal bond remarketing in July to the Series WW municipal bond remarketing Peoples Gas does not expect to make until August 2015. She used the actual cost of Peoples Gas' Series VV remarketing as the forecasted cost for its Series WW remarketing instead of adjusting "current" municipal bond yields from *Vanguard* "for the difference in years to maturity on the proposed new issuances," as she did in her direct testimony. *Compare* Freetly Reb., Staff Ex. 8.0, 7:107-117 *with* Freetly Dir., Staff Ex. 3.0, 6:117 – 7:122.

This inconsistent mixing of methods avoided any changes to Staff's initial position based on June 11, 2014, actual interest rates. *See* Freetly Reb., Staff Ex. 8.0, 7:125-126. Absent a sufficient rationale for the change, which has not been presented here, the Commission should insist on consistency of method in the highly complex area of corporate finance, which is the subject of many theories and data sources. Indeed, forecasting the cost of debt is itself "highly dependent on analyst judgment as to the inputs, and therefore subject to manipulation." *Peoples Gas 2009* at 123. For these reasons, the Utilities urge the Commission to adopt their proposed long-term debt forecasts, even though the result will be a slightly <u>lower</u> cost for Peoples Gas (4.32% instead of 4.36%).

E. <u>Cost of Common Equity</u>

The Commission "is charged by the legislature with setting rates which are '<u>just and reasonable</u>' not only to the ratepayers but [also] to the utility and stockholders." *BPI II*, 146 Ill.

2d at 208-209 (emphasis in original). Ratesetting by the Commission "involves a balancing of the investor and consumer interests." *Citizens Utility Board, et al. v. Illinois Commerce Comm'n,* 276 Ill. App. 3d 730, 736, 658 N.E.2d 1194 (1994) (*quoting Illinois Bell Tel. Co. v. Illinois Commerce Comm'n,* 414 Ill. 275, 287, 111 N.E. 2d 329 (1953)).

The Utilities are entitled to fair and reasonable returns on their investment, returns that are "reasonably sufficient to assure confidence in the financial soundness of the utility and adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of the State of West Virginia,* 262 U.S. 679, 693 (1923). The returns authorized by this Commission "should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944). This Commission "fully embraces the principles set forth" in *Bluefield* and *Hope*. *Consumers Ill. Water Co.,* ICC Docket No. 03-0403 (Order April 13, 2004), at 41.

The Commission has recognized that its decisions directly affect the Utilities' credit ratings and the capital costs that they pass on to their customers:

> We are cognizant that the Commission's ratemaking decisions are increasingly important to the Utilities' ability to maintain investment grade credit ratings and reasonable capital costs. Indeed the quality and direction of regulation, in particular the ability to recover costs and earn a reasonable return, are among the most important considerations when a credit rating agency assesses utility credit quality and assigns credit ratings. . . . [S]tate commissions play a critical and relevant role in defining the market for utility capital, and we understand that this Commission's decisions play a larger role in setting the Utilities' actual capital costs. <u>The bottom line impact of setting a rate of return too low, unless warranted, could have a deleterious [effect] on a utility's ability to</u>

deliver quality service as well as higher credit costs that will make their way to each ratepayer[']s bill.

Peoples Gas 2011 Order at 137 (emphasis added). Accordingly, "[a]llowing a utility the opportunity to recovery fully its costs of service, including its costs of capital, is in the long-term interests of customers, because this is necessary in order for the utility to be able to provide adequate, safe, and reliable service over time at the least long term cost." *Id*. at 5.

1. **The Context**

Traditionally, the Commission has established the utility's authorized return on equity by employing financial models designed to estimate a firm's market cost of equity. In recent cases, however, the Commission has recognized that the financial models have theoretical limitations and are "highly dependent on analyst judgment as to the inputs, and therefore are susceptible to manipulation. Although these models provide the best information of what we need for the purposes at hand, their limitations require that we also consult general financial market information to ensure that the model results presented us are reasonable rates of return on equity based on the models that we deem appropriate for our consideration." *Peoples Gas 2009* Order at 123. More recently, the Commission reiterated that it will consider current market conditions and trends, including the returns recently authorized for other utilities, in addition to the financial model results, "provided the data are verifiable and unbiased." *Peoples Gas 2012* Order at 205. Such general market data "provide relevant comparative information" for the Commission's assessment of the parties' cost of equity evidence. *Id*.

Earlier this year, the Federal Energy Regulatory Commission ("FERC") reached similar conclusions, rejecting the "mechanical application" of the DCF model and expanded its "zone of reasonableness" inquiry to include results from the Risk Premium, CAPM and Expected Earnings approaches as well as "record evidence of state commission-approved ROEs." *Martha*

Coakley, Mass. Attorney Gen., Docket No. EL11-66-001, 147 FERC ¶ 61,234 (2014), at PP 142-148. FERC, like this Commission, "has repeatedly held that it does not establish utilities' ROE based on state commission ROEs ... because those ROEs 'are established at different times in different jurisdictions which use different policies, standards, and methodologies in setting rates.'" *Id*. at P 148. FERC confirmed this position, but considered other authorized returns as "an indicator" that an upward adjustment of the ROE was required in the case before it. *Id*. Consideration of other returns is necessary to ensure that investments in the utilities under review were not put at a competitive disadvantage in the capital market. *Id*. at P 150.

The "verifiable and unbiased" evidence of general market conditions and trends in this case uniformly lead to the conclusion that the Utilities' cost of equity will be higher in 2015 than it was in 2013, when the Commission last set the Utilities' rates. Stellar stock market performance and increasing strength in the leading economic indicators point to an improving economy. Moul Dir., PGL Ex. 3.0, 20:422 – 21:430. Treasury and utility bond yields are projected to rise due to the Federal Reserve's tapering of its quantitative easing program to support the economy in response to the 2008 financial crisis. *Id*. at 28:586-597, 31:654 – 32:678; Moul Reb., NS-PGL Ex. 19.0, 11:202 – 12:209.

Consistent with these leading economic indicators, forecasted returns for the Delivery Group are projected to average <u>10.50%</u>, which is substantially higher than the Utilities' current authorized return of 9.28%. Moul Reb., NS-PGL Ex. 19.0, 4:74 – 5:78. This forecasted growth in returns is consistent with the increase in the average authorized returns for natural gas utilities from 9.68% in 2013 to 9.71% in the first half of 2014. *Id*. at 3:45-46. Indeed, the average return in the second quarter of 2014 was 9.84%. Gorman Reb., CCI Ex. 2.0, p. 5 table.

Staff urges the Commission to ignore authorized returns of other utilities, arguing that unless all of the "crucial factors that influenced the allowed returns" are known, "any evaluation of the return recommendations in this proceeding via comparison to the returns authorized for other natural gas utilities is useless because there is no basis on which to assess comparability." Freetly Reb., Staff Ex. 8.0, 8:131-144 (emphases added). Staff's objection is contrary to this Commission's and now FERC's pronouncements that other authorized returns should be considered as "indicators" to ensure that the return set in an individual case meets constitutional standards. Moreover, the Utilities' evidence of other returns accounted for Staff's "crucial factors" by being restricted to 2013 and 2014 and therefore captured "market fundamentals that are closely aligned with the present." Moul Sur., NS-PGL Ex. 35.0, 4:77-79. The evidence was based on a large sample, which encompassed the diversity of risk characteristics and minimizes the effect of any given factor. *Id*. at 4:79-85. Neither Staff nor CCI disputed that the Utilities' risk characteristics are reasonably similar to natural gas distribution companies generally. And credit ratings among utilities are "tightly clustered" and do not represent a likely source of variation in authorized returns. The same is true for flotation costs, as few commissions adjust for them. *Id*. at 4:89 – 5:103.

For all of these reasons, the Commission should continue its practice of considering general market conditions and trends, including recent authorized returns for other utilities, in its assessment of the parties' positions on the Utilities' authorized return and the evidence underlying those positions. Doing so does not mean, as Staff and CCI claim, that the Commission would be basing its ROE decisions on such data.

2. Overview of the Parties' Positions

Three parties propose returns in this case. Consistent with current market conditions and trends, the Utilities propose an increase in their authorized return on equity from 9.28% to 10.25%. Gast Dir., PGL Ex. 2.0, 7:143-144. By contrast, Staff and CCI advocate reductions in the Utilities' return by 28 and 13 basis points, respectively. Staff Ex. 8.01; Gorman Dir., CCI Ex. 1.0, 33:737. A reduction of the Utilities' authorized returns at this time, when all leading economic indicators point to an improving economy, interest rates are expected to rise, and increasing costs of equity for natural gas utilities are increasing would send a strong signal to the financial markets that the Commission is not supportive of the Utilities' financial strength. Moul Reb., NS-PGL Ex. 19.0 Rev., 3:51 – 4:71.

3. The Utilities' Proposed ROE Is Based on Consistent Methodologies and the Same Types of Market Data on Which Investors and Analysts Rely

The Utilities' ROE witness, Paul Moul, is an independent financial and regulatory consultant with over 35 years' experience analyzing utility cost of equity. PGL Ex. 3.1. He supported the Utilities' requested authorized returns in each of their last four rate cases and in each one the Commission relied in part on Mr. Moul's models in setting the Utilities' authorized return on equity. *Peoples Gas 2012* Order at 208 (relying on Mr. Moul's DCF and CAPM models); *Peoples Gas 2011* Order at 140 (relying on Mr. Moul's ROE recommendation); *Peoples 2009* Order at 126 (relying on Mr. Moul's DCF model); *Peoples Gas 2007* Order at 100 (relying on Mr. Moul's DCF and CAPM models)

In this case, Mr. Moul used the same methodologies to estimate the Utilities' cost of equity as he did in those prior cases. Because the Utilities' stock is not publicly traded, he calculated their cost of equity using three market-based mathematical models based on a proxy group of publicly-traded gas and electric distribution utilities (the "Delivery Group"):[63] the DCF model, the CAPM and the Risk Premium ("RP") model. Mr. Moul developed inputs to the models based on his independent evaluation of the types of historical, current and forecasted information that is readily available to and routinely relied upon by investors and financial analysts. Mr. Moul presented the following calculations of the Utilities' market cost of equity:

Model	Cost
DCF	9.71%
RP	11.50%
CAPM	9.62%
Average	10.25%

Moul Dir., PGL Ex. 3.0, 6:101-106.

For the reasons discussed in the following sections, the Commission should adopt Mr. Moul's recommended ROE of 10.25% and reject Staff's and CCI's proposals to decrease the Utilities' ROE because those proposals are products of unsound applications of the models and inappropriate inputs.

4. CCI's ROE Analysis Is Based On An Improper Proxy Group

Staff accepted the Utilities' Delivery Group for the purpose of running its cost of equity models. Freetly Dir., Staff Ex. 3.0, 9:165 & 18:337. On that score, at least, the Utilities' and Staff's model results can be compared on an "apples to apples basis." CCI, however, used a different proxy group comprised of all but two of the Delivery Group companies. One company

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[63] The inclusion of electric utilities that have divested most if not all of their generation assets and operate primarily if not exclusively as distribution companies, is reasonable because they have risk profiles that are generally similar to natural gas distribution companies. Moul Dir., PGL Ex. 3.0, 5:83-92.

was properly excluded because it became an acquisition target in the time between the Utilities' and CCI's analyses. CCI also excluded Laclede Group because it is pursuing an acquisition of another company. CCI did not justify this exclusion, pointing only to the fact that a credit rating agency had placed the company on watch for potential downgrade. Gorman Reb., CCI Ex. 2.0, 9:168 – 10:187. Mr. Gorman did not provide any evidence that Laclede Group's proposed acquisition impacted the company's fundamentals. Moul Reb., NS-PGL Ex. 19.0, 18:338-343.

The weight of the evidence favors the use of the Delivery Group to estimate the Utilities' cost of equity. CCI's reliance on a different proxy group was not justified and therefore its analyses are not comparable to those of the Utilities or Staff. Accordingly, the Commission should disregard CCI's analyses.

5. The Staff and CCI DCF Model Results Are Too Low to be Credible

a. Staff's 8.71% DCF Result is the Product of Biased Inputs

i. Staff Did Not Adopt Mr. Moul's Dividend Yield

In response to Mr. Moul's renewed criticism of Staff's continued reliance of spot day stock prices to develop its DCF dividend yield, Staff chose not to defend its practice. Instead, "in order to reduce issues in this proceeding," Staff stated that would "adopt" Mr. Moul's "6-month average dividend yield of 3.89%." Freetly Reb., Staff Ex. 8.0, 11:196-197. Staff thus implied that it was conceding to the dividend yield that Mr. Moul used in his DCF model, but this was not the case. Mr. Moul actually used a dividend yield of 4.00% "to reflect the prospective nature of the dividend payments." Moul Dir., PGL Ex. 3.0, 16:316-322; *see* PGL Ex. 3.6. Staff did not explain, much less justify, why it did not adopt the dividend yield Mr. Moul actually used. In any event, Staff's "concession" did not reduce issues in this proceeding because Staff did not concede to Mr. Moul's position.

ii. Staff Double Counted the Forecasted Reduction in Natural Gas Utility <u>Dividend Yields to Reduce its DCF Result</u>

The Commission has been troubled in the past by Staff's departures from established methodologies that result in lower costs of equity through the models. For example, in the Utilities' 2009 rate cases, the Commission rejected Staff's DCF result because Staff had departed from its constant-growth version of the model without justification. *Peoples Gas 2009* Order at 124-125. In this case, Staff has once again departed from past practice without explanation and the result of that departure is a lower DCF result.

In past cases, Staff has relied on security analyst forecasts of earnings per share ("EPS") to estimate the DCF growth component. Moul Sur., NS-PGL Ex. 35.0, 5:108-113. In this case, Staff averaged *Value Line* EPS forecasts with *Value Line* forecasts of dividends per share ("DPS"), book value per share, cash flow per share, and percent retained to common equity. Then, Staff averaged this average "*Value Line*" forecast with EPS forecasts from four other published sources. Moul Reb., NS-PGL Ex. 19.0, 8:133-137. This mixing and averaging of growth forecasts resulted in a Staff DCF growth rate of 4.77%. Freetly Dir., Staff Ex. 3.0, 9:166.

By contrast, Mr. Moul considered both historical and forecasted growth data and did not simply average selected values. Because "[e]arnings per share growth is the primary determinant of investors' expectations regarding their total returns in the stock market," Mr. Moul focused on EPS growth forecasts. With these forecasts ranging from 4.70% to 5.58%, Mr. Moul selected a DCF growth component of 5.25% to reflect improving business conditions. Moul Dir., PGL Ex. 3.0, 19:394 – 21:430.

On rebuttal, Staff agreed to narrow the *Value Line* forecasts it averaged to obtain the DCF growth component. However, Staff retained the *Value Line* DPS forecast so as not to ignore "the slowing in growth of dividends that is necessary to achieve an increase in the earnings retention rate." Freetly Reb., ICC Staff Ex. 8.0, 12:228 – 13:231. Thus, Staff's approach remained inconsistent with its past reliance on EPS forecasts. Plus, Staff introduced a double counting issue into its DCF model because the forecasted dividend yield for the Delivery Group is already included in the DCF model. Had Staff limited its averaging to the EPS forecasts, its DCF growth rate would have been <u>5.11%</u> instead of 3.89%. Moul Reb., NS-PGL Ex. 19.0, 8:140-147.

iii. If the Commission Considers Staff's DCF Result, it Should be Corrected for the <u>Appropriate Dividend Yield and Growth Rate</u>

Staff's DCF result of 8.71% is the product of biased dividend yield and growth rates and simply too low to be credible. If these biased parameters are replaced with more reasonable ones, as discussed above, Staff's DCF result is <u>9.11%</u> (4.00% plus 5.11%).

b. CCI's DCF Average of 9.00% Is Based on <u>Inappropriate Methodology and Inputs</u>

i. CCI Did Not Support its Use of a <u>Non-constant Form of the DCF Model</u>

In addition to two versions of the constant growth form of the DCF model, CCI presented a non-constant growth version. In the Utilities' 2010 test year rate cases, the Commission rejected Staff's reliance on a non-constant growth form of the DCF model, noting that the constant growth model "has been favored by the Commission for years." *Peoples Gas 2009* Order at 124. The Commission found that Staff had not justified its departure from prior practice:

> In contrast to the constant growth version of the DCF model, which assumes one, steady rate of future dividend growth, Staff's non-constant growth model assumes multiple stages of growth on the theory that, given the large difference between the near-term growth rates for the Gas Group and the expected long-term growth of the overall economy, the continuous sustainability of the near-term growth rates for the Gas Group is unlikely. Staff, however was unable to demonstrate the unsustainability of the analyst growth rates it relied on which

> we must assume took into account indicators of below average growth associated with the Gas Group, including earnings retention rates and risk/return.

Id. In addition, the Commission rejected "Staff's position that the non-constant growth form of the model must be used any time it can be claimed that analyst growth rates are not sustainable. Rather we will require a more robust showing that application of the constant model is appropriate." *Id*. at 125.

CCI did not attempt to make this "more robust showing" for its non-constant growth model. To the contrary, Mr. Gorman testified that his constant growth model "is a reasonable reflection of rational investment expectations over the next three to five years." Gorman Dir., CCI Ex. 1.0, 21:487-488. He included a non-constant form of the model simply to reflect an "outlook of changing growth expectations." *Id*. at 21:492.

For this reason alone, the Commission should disregard CCI's non-constant growth DCF model. If another reason was needed, the result of this model – 8.65% -- is far too low to be credible, even by CCI's own evidence of 2014 year-to-date gas utility ROEs, which <u>average</u> over 100 basis points higher. Gorman Reb., CCI Ex. 2.0, p. 5 table.

ii. Many of CCI's DCF Results Are <u>Far Too Low to be Credible</u>

The Commission has in the past rejected DCF results that are "anomalous." *Peoples Gas 2007* Order at 92. Many of Mr. Gorman's constant growth DCF rates for Delivery Group companies are so anomalous that they undercut the credibility of his DCF results:

Company		DCF
AGL Resources		6.59%
Consolidated Edison		7.86%
New Jersey Resources		7.26%
Northwest Natural Gas		7.96%
Piedmont Natural Gas		7.60%
Southwest Gas		5.76%

Moul Reb., NS-PGL Ex. 19.0, 18 table.

"It is a fundamental tenet of finance that the cost of equity must be higher than the cost of debt by a meaningful margin to compensate for the higher risk associated with common equity investment." Moul Reb., NS-PGL Ex. 19.0, 18:351 – 19:353. The six-month average yield on Baa-rated public utility bonds is 4.98%. *Id*. at 19:354-355. Even under Mr. Gorman's 30-year historical average equity risk premium of 3.80% (which is much lower than the more recent premiums in excess of 5.00%), his DCF results for 6 of the Delivery Group companies are far below the minimum expected cost of equity of 8.78%, much less the average 2014 authorized gas utility ROE of 9.71%. CCI Ex. 2.3.

6. <u>Staff's CAPM Model is Fundamentally Flawed</u>

The Commission should reject Staff's CAPM result of 9.27% for two reasons. First, it is based on historical spot day interest rates as of October 31, 2013, which have no relation to what interest rates are likely to be in 2015. Second, Staff's unique "beta" measurement of systematic risk is biased because it uniformly results in lower CAPM results.

a. Staff's Use of Historical Spot Day Interest Rates <u>to Predict a Future Cost of Equity is Arbitrary</u>

According to Staff, an interest rate, stock price or other datum from a single day in the recent past is a better predictor of what that data point will be in the future than the forecasts made by governmental and commercial analysts on which investors and analysts routinely rely.

In this case, Staff did not defend its reliance on single day spot stock prices in its DCF model "in order to reduce issues in this proceeding." Freetly Reb., ICC Staff Ex. 8.0, 11:194-197. But Staff maintained its position that single day spot interest rates were superior to forecasts in its CAPM model. Id. at 13:245 – 14:259.

As discussed above, it is undeniably true that few if any forecasts are exactly right <u>in hindsight</u>. Staff provided no evidence that information from a single day in the past provides a more accurate prediction than forecasts do <u>when they are made</u>. Logic and common sense dictate otherwise. All that a given day's interest rate reflects is the cost of a certain type of debt capital on that day. It says nothing about what that cost of capital will be in the future.

Again, under the Commission's prior decisions the question is whether the data in question are "verifiable and unbiased." *Peoples Gas 2012* Order at 205. Here, Staff rejected interest rate forecasts published by *Blue Chip* in favor of historical spot day rates. The credibility and objectiveness of the *Blue Chip* forecasts is undisputable:

> Blue Chip does not actually make forecasts of interest rates itself. Rather, Blue Chip conducts a monthly survey of noted economists from academic institutions, banking, brokerage, business consulting, financial institutions, investment advisory firms, and rating agencies. Presently, there are forty-eight (48) contributors to the Blue Chip survey. Blue Chip takes the results of its monthly surveys and publishes the consensus of these individual forecasts. The major attributes of Blue Chip are its independence, the influence it has on investors' expectations of future interest rates, and the objectivity of the survey that encompasses the wide range of viewpoints obtained from a broad sample of renowned economists.

Moul Sur., NS-PGL Ex. 35.0, 3:48-56. Staff did not challenge these attributes of the *Blue Chip* forecasts, which were also used in CCI's CAPM model. Gorman Dir., CCI Ex. 1.0, 29:639-643. The use of such "verifiable and unbiased" data in determining the Utilities' cost of equity is entirely appropriate and superior to relying solely on historical spot day data to establish that cost in a future test year.

For this reason alone, the Commission should reject Staff's CAPM model. Alternatively, it should be adjusted to incorporate either Mr. Moul's *Blue Chip*-based risk-free rate of 4.25% or Mr. Gorman's rate of 4.30%. Moul Dir., PGL Ex. 3.0, 32:672 – 33:680; Gorman Dir., CCI Ex. 1.0, 29:643.

b. <u>Staff's Betas Are Biased Downward</u>

As the Utilities have noted in prior cases, Staff is not content to rely on the "betas" – the theoretical measurement of the systematic risk of the Delivery Group – published by well-recognized sources like *Value Line*. In addition to the *Value Line* betas, Staff in this case used betas published by *Zacks*. Freetly Dir., NS-PGL Ex. 3.0, 18:338. Staff also averaged in a "regression beta" of its own creation. *Id*. There is no need for this additional beta measurement and it is not a data point on which any investor relies. By contrast, *Value Line* betas are routinely relied on by investors and thus used in the actual pricing of stocks by the market. Moul Reb., NS-PGL Ex. 19.0, 13:227-231. Accordingly, both the Utilities and CCI relied on *Value Line* betas alone. Gorman Dir., CCI Ex. 1.12.

Of more concern is the fact that the Staff betas are routinely lower than the published betas. Moul Sur., NS-PGL Ex. 35.0, p. 7 table. Thus, the only purpose served by Staff's lower beta is to reduce its CAPM result. In this case, had Staff relied solely on the published betas, its CAPM result would have been 9.71% instead of 9.27%. Moul Reb., NS-PGL Ex. 19.0, 13:234-235. If Staff had based its CAPM on the *Value Line* betas as the Utilities and CCI did, the result would have been 9.82%. *Id*. at 13:242. Thus, even if there was some value in using multiple beta models (Freetly Reb., ICC Staff Ex. 8.0, 14:264 – 15:291), Staff's "multiple source" approach is invalid because of its downward bias.

c. If the Commission Considers Staff's DCF Result, it Should be <u>Corrected for the Appropriate Risk Free Rate and Beta</u>

Staff's CAPM result of 9.27% is the product of its biased dividend yield and growth rate. If the Utilities' parameters are used, Staff's CAPM result is <u>9.89%</u> (((12.43% - 4.25%) x .69) + 4.25%). If CCI's parameters are used, the Staff CAPM result is <u>10.40%</u> (((12.43% - 4.30%) x .75) + 4.30%).

F. <u>Weighted Average Cost of Capital</u>

1. <u>Peoples Gas</u>

The Commission should include in Peoples Gas' 2015 rates an overall ROR of 7.21% comprised of a capital structure of 50.33% equity, 46.51% long-term debt and 3.16% short-term debt, a cost of long-term debt of 4.32%, a cost of short-term debt of 1.19% and a cost of equity of 10.25%. NS-PGL Ex. 34.1P.

2. <u>North Shore</u>

The Commission should include in North Shore's 2015 rates an overall ROR of 6.89% comprised of a capital structure of 50.48% equity, 38.94% long-term debt and 10.58% short-term debt, a cost of long-term debt of 4.13%, a cost of short-term debt of 1.06% and a cost of equity of 10.25%. NS-PGL Ex. 18.1N.

VII. <u>OPERATIONS</u>

A. <u>AMRP Main Ranking Index and AG Proposed Leak Metric(s)</u>

In replacing cast iron and ductile iron mains, Peoples Gas utilizes criteria according to its Main Ranking Index (MRI), which guides it in making appropriate decisions about targeting which mains to replace. Lazzaro Dir., PGL Ex. 8.0 2nd REV, 11:228-230. Utilities witness Mr. Lazzaro explained that:

> The MRI system was developed in 1995 and instituted in 1996 to identify and prioritize gas main segments as candidates for replacement. A segment is defined as a unique unit of pipe identified by parameters such as installation year, operating pressure, pipe diameter, pipe material, and in-street and square mile boundaries. Because segment lengths vary from one foot to one mile, the MRI normalizes segment lengths greater than one city block to one city block for evaluation purposes. Each individual segment is evaluated based on its maintenance history. Criteria taken into account include breaks, cracks at taps, pipe wall thickness based on pipe coupons, visual observation, incidence of leak and other repairs. Each of these criteria is assigned a multiplication factor based on "Break Equivalents" which is then multiplied by the number of occurrences to calculate a numerical value for each criterion.
>
> The sum of the aforementioned numerical values is then multiplied by a factor based on pipe material, operating pressure, diameter, street type and pavement cover. The result of this calculation is that a value is assigned to each segment, *i.e.*, the MRI. The MRI value is rounded to the nearest quarter point, and sorted in descending order in order to identify those segments with the highest incidence of MRI points per block.
>
> All segments that have accumulated an MRI rating greater than 6.0 are placed on an expedited schedule to be retired. This is also true for high priority locations with an MRI rating greater than 5.0. Segments with an MRI value greater than 3.0 are viewed as possible replacement candidates when performing work on adjacent segments and when evaluating the extent of public improvement projects under consideration.
>
> Three criteria are used to determine the pipe to be replaced in any given year. First, the MRI rating is considered, as it highlights the most problematic segments of pipe in terms of their maintenance histories. Second, Peoples Gas' selections for replacement are coordinated with areas where the City or other governmental bodies are conducting public improvement work. This coordination with public improvement projects reduces the likelihood that Peoples Gas will need to disturb recently completed municipal infrastructure improvements in the future. Finally, replacement miles are determined from capital projects for the year, with consideration given to contiguous areas with highly ranked mains which allows for more cost effective replacement in concentrated areas.

Id. at 11:233 – 12:263. He also described the processes for management oversight of the AMRP and coordinating with the City of Chicago. *Id*. at 12:264 – 14:298.

AG witness Dr. Dismukes suggested that one or more additional metrics related to leaks be adopted for the AMRP, but his proposals were vague and ill-conceived (not an accurate measure of the effectiveness of the AMRP), unnecessary given the current leak control measures in place, and, if adopted, could be counter-productive. Lazzaro Reb., NS-PGL Ex. 23.0 2nd Rev., 2:37-40, 6:119 - 9:179; Lazzaro Sur., NS-PGL Ex. 38.0, 3:45-47, 5:96 – 6:123; Lazzaro, Tr. at 130:5-16.

Utilities witness Mr. Lazzaro, in his rebuttal testimony, explained in detail why Dr. Dismukes' (vague) original proposal, of new metrics related to corrosion related leaks, was poorly designed and unnecessary, and why the MRI is what should continue to be used. Lazzaro Reb., NS-PGL Ex. 23.0 2nd Rev., 2:37-40, 6:119 - 9:179.

Utilities witness Mr. Lazzaro, in his surrebuttal testimony, explained in detail why Dr. Dismukes' (vague) rebuttal proposal, of new metrics related to a broader range of leaks, also was poorly designed and unnecessary, and why the MRI is what should continue to be used. Lazzaro Sur., NS-PGL Ex. 38.0, 5:96 – 6:123.

Adding new metrics, as AG witness Dr. Dismukes proposed, simply is a bad idea. As Utilities witness Mr. Lazzaro explained:

> Q I mean, let's put it simply: Why don't you want to add those metrics as metrics for the program?
>
> A Well, we have currently in place procedures that grade and monitor the leaks that we have in our system, the ICC safety staff is aware of these pipeline safety staff is aware of these procedures and they audit the process annually, and opposed to any metrics that would take away the resources whether they're staff or dollars to focus on something that I don't think would help us with our replacement, considering we have the Main Replacement Program already.

Tr. at 130:5-16. The AG's vague proposals on this subject are ill-advised and should not be adopted.

B. Pipeline Safety-Related Training

The Utilities and Staff agree to include a finding and ordering paragraph that specifies, for Peoples Gas, the test year amounts of certain pipeline-safety related training. This paragraph shall read:

> (x) The test year amounts of test year pipelines safety-related training for Peoples Gas are: $11,355 for Corrosion-NACE Levels 1 and 2 Certification; $80,500 for Parts 191 and 192 Training; $0 for Construction Inspection; $6,300 for all other pipeline safety-related training, totally $98,135.

Lazzaro Reb., NS-PGL Ex. 23.0 2nd REV., 11:229-234; Hathhorn Dir., Staff Ex. 1.0, 28:618-626.

VIII. COST OF SERVICE

A. Overview

Only the Utilities prepared embedded cost of service studies ("ECOSSs") to develop and implement their rate design proposals. Hoffman Malueg Dir., NS Ex. 14.0, NS Exs. 14.1-14.8; PGL Ex. 14.0, PGL Exs. 14.1-14.8. With few exceptions, the Utilities' ECOSSs are substantially identical to those presented, and approved by the Commission, in the Utilities' recent rate cases. *Id*. They slightly modified how they allocated Uncollectible Expense (Hoffman Malueg Dir., NS Ex. 14.0, 17:369-18:384; PGL Ex. 14.0, 18:398-19:413) and the Miscellaneous Revenues in Account 495 (Hoffman Malueg Dir., NS Ex. 14.0, 21:469-22:493; PGL Ex. 14.0, 22:498-23:522).

IIEC presented exhibits with two adjustments to the Utilities' ECOSSs (Alderson Dir., IIEC Ex. 2.0, IIEC Ex. 2.1), but IIEC did not present exhibits or ECOSSs with its unconventional "across-the-board" revenue increase allocation proposal (Collins Dir., IIEC Ex. 1.0, 24:532 - 25:538). Staff had no objections to the Utilities' ECOSSs and concluded they were "acceptable guidance tools for determining rates in this case." Johnson Dir., Staff Ex. 4.0, 14:297-303.

For the reasons in Section VIII.B of this Initial Brief, *infra*, the Commission should reject IIEC's proposed adjustments to the Utilities' ECOSSs and approve the Utilities' ECOSSs to determine rates based on the approved revenue requirements and rate designs.

B. <u>Embedded Cost of Service Study</u>

1. <u>Allocation of Demand-Classified Transmission Distribution Costs</u>

The Utilities proposed to allocate demand-classified transmission and distribution ("T&D") costs using an average and peak ("A&P") methodology. Hoffman Malueg Dir., NS Ex. 14.0, 11:227-230; PGL Ex. 14.0, 11:231-234. A&P is an accepted approach to T&D cost allocation, and it is consistent with the Commission's orders in the Utilities' five most recent rate cases.[64] IIEC proposed a coincident peak ("CP") allocator for T&D costs. Collins Dir., IIEC Ex. 1.0, 24:522-527. Staff opposed IIEC's proposal and supported the A&P methodology. Johnson Reb., Staff Ex. 9.0, 25:519-32:690. AG/ELPC opposed IIEC's proposal. Rubin Reb., AG/ELPC Ex. 9.0, 12:245-255.

IIEC is correct that the Utilities have supported a CP allocator for T&D investment in past cases.[65] Collins Dir., IIEC Ex. 1.0, 18:373-384. However, in *Peoples Gas 2007*, the Commission rejected that approach after considering arguments from the Utilities and others

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[64] Hoffman Malueg Reb., NS-PGL Ex. 28.0, 4:74-79; *Re North Shore Gas Company*, ICC Docket No. 95-0031, 1995 WL 17200629 (Ill.C.C. Nov 8, 1995) ("*North Shore 1995*"); *Re Peoples Gas Light and Coke Company*, ICC Docket No. 95-0032, 1995 WL 17200632 (Ill.C.C. Nov 8, 1995) ("*Peoples Gas 1995*"); *Peoples Gas 2007* Order at 199; *Peoples Gas 2009* (issue uncontested); *Peoples Gas 2011* (issue uncontested); *Peoples Gas 2012* (issue uncontested).

[65] Of the five cases recent noted above, the Utilities proposed, and the Commission rejected, a CP allocator for T&D investment in *North Shore 1995*, *Peoples Gas 1995* and *Peoples Gas 2007*.

supporting a CP allocator. The Commission concluded that the Utilities had not "overcome the Commission-established and long-standing tradition of A&P methodology for allocating distribution costs." *Peoples Gas 2007* Order at 199; *also see* Hoffman Malueg Reb., NS-PGL Ex. 28.0, 4:69-74. Subsequent to that case, to limit the scope of contested issues, the Utilities have used the A&P allocator. Hoffman Malueg Reb., NS-PGL Ex. 28.0, 3:63-64. Moreover, the A&P allocator is recognized as an acceptable methodology for demand-classified costs. For example, the National Association of Regulatory Utility Commissioners ("NARUC") states at pages 27-28 of its Gas Distribution Rate Design Manual (June 1989) that the A&P demand allocation method is a commonly used demand allocator for natural gas distribution utilities and that this method "tempers the apportionment of costs between the high and low load factor customers." Hoffman Malueg Reb., NS-PGL Ex. 28.0, 4:74-79.

The Commission should approve the A&P allocator for demand-classified T&D costs. It is an accepted approach for gas utilities, and it is consistent with several years of Commission orders in the Utilities' rate cases.

2. Allocation of Small Diameter Main Service Costs

The Utilities do not delineate between small and large diameter distribution mains in their ECOSSs, nor is it appropriate to do so. Hoffman Malueg Reb., NS-PGL Ex. 28.0, 9:179-181. IIEC proposed that the ECOSSs allocate the costs of mains smaller than four inches to all classes except Service Classification ("S.C.") No. 4, Large Volume Demand Service, because IIEC witness Mr. Collins states that all but three S.C. No. 4 customers do not use mains smaller than four inches in receiving service. Collins Dir., IIEC Ex. 1.0, 20:446-21:451. IIEC alternatively proposed that only the specific smaller than four-inch main costs used to serve these three customers be directly assigned to S.C. No. 4. Collins Reb., IIEC Ex. 3.0, 13:272-275.

All of the Utilities' customers take service from all the various sized mains in the system. Specifically, except for Peoples Gas' negotiated contract rates (S.C. Nos. 5, Contract Service for Electric Generation, and 7, Contract Service to Prevent Bypass)[66], all service classifications take service directly from mains smaller than four inches and from mains that are four inches and larger. NS-PGL Ex. 28.2. Moreover, the Utilities operate their systems in an integrated manner, which enhances system reliability for all customers. Lazzaro Reb., NS-PGL Ex. 23.0 REV., 11:240-12:244; Kinzle Reb., NS-PGL Ex. 31.0, 4:82-86. The Utilities' ECOSSs have a class-based structure. That is, the Utilities allocate costs to the customer classes and not individual customers or *ad hoc* groups within the classes. For the Utilities, the customer classes are the service classifications and rate groups within the service classifications for which the Utilities design rates. The classes are S.C. No. 1, Small Residential Service (Non-Heating, Heating, Total); S.C. No. 2, General Service (Meter Class 1, Meter Class 2, Meter Class 3, Total); S.C. No. 4; and S.C. No. 8, Compressed Natural Gas Service (Peoples Gas only). Hoffman Malueg Dir., NS Ex. 14.0, 9:186-10:209; PGL Ex. 14.0, 9:189-10:213.

The Utilities' ECOSSs classify distribution mains as demand-related and allocate them to the service classifications based on the A&P method and not on customer counts. The number of customers taking service from various main sizes is irrelevant. Hoffman Malueg Reb., NS-PGL Ex. 28.0, 10:208-213. More importantly, the ECOSSs show cost allocations to customer classes, as a whole, and not at an individual customer level. The ECOSSs are not intended to extract for or allocate specific costs to individual customers. *Id*. at 10:214-216. Delineating mains by size

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[66] The contract service rates are not part of the ECOSSs because this case does not affect their rates. Hoffman Malueg Dir., NS Ex. 14.0, 35:801-804; PGL Ex. 14.0, 35:832-36:836.

within the ECOSS would be inconsistent with this approach, no matter how implemented. Allocating to S.C. No. 4 only the costs of the mains serving the three customers taking service directly from smaller diameter main is a selective exception to the class-based nature of the ECOSSs, and it is not feasible to begin making exceptions for particular costs. Likewise, it is not feasible for the S.C. No. 4 customers taking service directly from smaller diameter mains to receive a different cost of service than the other S.C. No. 4 customers. *Id*. at 11:217-226.

The Commission should reject IIEC's proposal, which is incompatible with a class-based cost of service study.

IX. RATE DESIGN

A. Overview

The Utilities' proposed rate designs were intended to and would accomplish the following six major objectives: (1) recover the revenue requirement, (2) better align rates and revenues with underlying costs, (3) send proper price signals, (4) provide more equity between and within rate classes, (5) reflect gradualism considering test year revenue requirements, and (6) address the S.C. No. 2 distribution block structure and sizes. Egelhoff Dir., NS Ex. 15.0, 6:115 - 119; PGL Ex. 15.0 REV., 6:116-120.

B. General Rate Design

1. Allocation of Rate Increase

The Utilities used their ECOSSs to allocate revenue requirements and develop rates. As in prior cases, the Utilities set cost-based rates for each service classification. Egelhoff Dir., NS Ex. 15.0, 7:140-141, 10:195-205; PGL Ex. 15.0 REV., 7:141-142; 10:194-205. Their ECOSSs and the descriptions of their rate designs, including the supporting exhibits, are detailed and specific enough that it would be straightforward to derive rates from the revenue requirements the Commission approves. Egelhoff Dir., NS Ex. 15.0, 7:132-8:160; PGL Ex. 15.0 REV., 7:133 - 8:161. IIEC, despite arguing for two changes to the ECOSSs, proposed an "across-the-board" increase (Collins Dir., IIEC Ex. 1.0, 24:532-533) that ignores the ECOSSs (the Utilities' and IIEC's proposed changes to the Utilities'). IIEC variously described this as "a uniform increase to all rate classes" (Collins Reb., IIEC Ex. 3.0, 18:383) or a "uniform increase to all rate components within all non-gas rate charges" (*id*. at 18:383-384). The Commission should reject IIEC's proposal as poorly defined and inconsistent with using ECOSSs to set each service classification at cost. Indeed, under IIEC's proposal, the ECOSSs have no purpose.

IIEC proposed two changes to the ECOSSs, which it illustrated in an exhibit. IIEC Ex. 2.1. It neither prepared ECOSSs reflecting its unconventional "across-the-board" allocation, nor developed rates or a comprehensive rate design that would result from its proposal. IIEC's across-the-board revenue allocation does not have merit from an ECOSS perspective. Allocating the same revenue deficiency percentage to each service classification completely ignores the results of the Utilities' ECOSSs, which show cost causation by service classification, and also completely ignores IIEC's own proposed changes to the Utilities' ECOSSs. If IIEC intended for the Utilities to perform the across-the-board revenue allocation in the ECOSSs, it did not provide any support for performing such an adjustment, which affects cost classifications in the ECOSSs, which, in turn, affects rate design. Hoffman Malueg Reb., NS-PGL Ex. 28.0, 12:241-255.

IIEC cited only an Ameren case (ICC Docket No. 07-0585) as support for its proposal. Notably, in *Peoples Gas 2009*, the Commission considered and rejected a Staff proposal based on applying across-the-board increases. *Peoples Gas 2009* Order at 203-204. As with that Staff proposal, the IIEC proposal is ill-defined and incomplete (*see, e.g.*, IIEC Cross Ex. 1.0) and should be rejected.

2. **Fixed Cost Recovery**

The principal rate design issue in this case is the type of charge -- fixed or variable[67] -- through which the Utilities should recover non-storage demand-classified distribution costs. Thus, the predicate question is whether these costs are fixed or variable. Demand-classified costs are clearly fixed costs. The Commission concluded in the Utilities' 2009 rate cases that "[w]e find compelling Ms. Grace's explanation that demand costs (also known as capacity costs) are fixed costs and not volumetrically based." *Peoples Gas 2009* Order at 225. NARUC stated on pages 49-50 of its Gas Distribution Rate Design Manual (June 1989) (emphasis added):

> The most controversial issue is deciding where capacity [demand] costs belong in the rate. Because they are fixed costs, it is sometimes argued that they should be part of the customer charge. On the other hand, it can be argued that … those common fixed costs should be recovered evenly from all units of commodity sold. It is even occasionally proposed that these costs be spread between customer and commodity [distribution] charges.

Egelhoff Reb., NS-PGL Ex. 29.0 REV., 8:172-9:182.

Demand costs include items like storage, land, structures and improvements, mains, compressor station equipment and measuring and regulating equipment. The costs of investment in these items do not vary with customer usage or even if the customer's demand day requirements change. Egelhoff Sur., NS-PGL Ex. 43.0 REV., 4:73-76. When North Shore or Peoples Gas installs a main to serve a residential customer, the cost of that main, included in setting the revenue requirement that will underlie rates in this 2015 test year case, will not change from day-to-day or year-to-year simply because the customer uses more or less gas on the peak day or any other day. *Id*. at 5:102-6:112. Unlike, for example, the quantity of gas that

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[67] Variable charges are also called volumetric charges.

the Utilities purchase to serve customers, including what they buy on a peak day[68], the "quantity" (and cost) of main serving customers or the "quantity" (and cost) of land supporting the Utilities' service does not vary with customer usage. The amount included in base rates for these items is the same whether a customer consumes 0 therms or 100 therms and, in the test year, will not change even if the customer class' peak day usage increases or decreases. *Id*.

When a customer reduces its usage in response to the false price signal represented by placing fixed costs in variable charges, the utility under-recovers the fixed costs in its approved revenue requirement. The customer's conservation has not reduced those costs.[69] As the Commission recognized in a Nicor Gas case, "[t]he portion of fixed costs that are currently recovered through a volumetric charge are in fact fixed costs, and thus cannot be conserved. Moving a greater percentage of fixed cost recovery to fixed charges rather than volumetric charges provides a more stable revenue stream and sends a better price signal to the consumer." *In re Northern Illinois Gas Company d/b/a Nicor Gas Company*, ICC Docket No. 08-0363 (Order Mar. 25, 2009), at 91.

As NARUC explained, while demand costs are fixed costs, the way to recover the costs can be, and in this case is, contested. Staff (for S.C. Nos. 1 and 2) and AG/ELPC (for S.C. No. 1) have proposed moving all or, relative to current rates, a greater percentage of demand costs to volumetric charges. The Utilities have generally included some demand costs in a fixed

[68] It is variable costs, like gas, that allow customers to reduce their bills through reducing gas usage. Under the Utilities' rate design proposals, customers have ample incentives and opportunity to reduce their gas bills by reducing usage. Egelhoff Sur., NS-PGL Ex. 43.0 REV., 6:118-133.

[69] Staff and AG/ELPC each mentioned incentives to conserve in the context of fixed cost recovery in variable charges. These witnesses argue, in part, that their proposed rate designs, compared with the Utilities' proposals, encourage customers, and send better price signals, to conserve gas. *See*, *e.g.*, Johnson Dir., Staff Ex. 4.0, 20:475-478; Johnson Reb., Staff Ex. 9.0, 8:148-158; Rubin Dir., AG/ELPC Ex. 3.0, 3:68-70, 20:425-427.

charge (the customer charge for S.C. Nos. 1 and 2 and the demand charge for S.C. No. 4) and some in a volumetric charge (the distribution charge for S.C. Nos. 1, 2 and 8). Consistent with the objective of gradualism and assuming the continuation of Rider VBA, Volume Balancing Adjustment (Egelhoff Dir., NS Ex. 15.0, 13:263-266; PGL Ex. 15.0 REV., 13:263-266), the Utilities would continue to recover some demand costs in variable charges. The Staff and intervenor proposals are flawed because recovering fixed costs through a variable distribution charge sends an incorrect price signal to customers that the more gas they use the more it costs the Utilities to provide them delivery service. Similarly, placing fixed cost recovery in variable distribution charges incorrectly signals that lower usage reduces the Utilities' costs to provide delivery service. Egelhoff Reb., NS-PGL Ex. 29.0 REV., 3:63-4:67.

The Utilities generally proposed to increase fixed cost recovery through fixed charges, but, in the interests of gradualism, did not propose to recover all fixed costs through fixed charges.[70] These proposals are aligned with both long-standing and recent Commission policy for gas utilities. In *Peoples Gas 1995*, the Commission urged Peoples Gas to increase the customer charge in future rate proceedings to move it closer to cost. In *Peoples Gas 2007* (Order at 249-250) and *Peoples Gas 2009* (Order at 225-226), the Commission found it appropriate that rates reflect a greater recovery of fixed costs in customer charges. In *Peoples Gas 2011*, the Commission again endorsed increased fixed cost recovery by stating:

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[70] The term "straight fixed variable" or "SFV" rate design appears throughout the record. It became a distraction as the Utilities do not currently have SFV rate design in effect, nor are they or any party proposing it. Egelhoff Reb., NS-PGL Ex. 29.0 REV., 4:76-85. An SFV rate design recovers all fixed costs related to gas distribution service (*i.e.*, costs that do not vary with customer usage) through fixed charges and recovers costs that vary with customer usage through volumetric charges. Egelhoff Dir., NS Ex. 15.0, 15:301-304; PGL Ex. 15.0 REV., 14:300-303.

> While the Commission supports increased recovery of fixed costs through fixed charges, it prefers, at this time, decoupling rather than a switch to an SFV rate design. For these reasons the Commission is convinced that there has been a compelling and sufficient showing that a permanent Rider VBA is reasonable and justified.

Peoples Gas 2011 Order at 164. Last, in *Peoples Gas 2012* (Order at 237-238), issued in June 2013, the Commission reiterated its "policy of increasing fixed cost recovery through fixed charges on a gradual basis." Egelhoff Dir., NS Ex. 15.0, 13:275-14:293; PGL Ex. 15.0 REV., 13:275-14:292.

Staff cites recent Commission decisions as support for reducing fixed cost recovery in fixed charges. Johnson Dir., Staff Ex. 4.0, 16:348-19:443. The Commission decisions in those cases are inapposite, primarily because they apply to rate designs for electric utilities with rates set under the Energy Infrastructure Modernization Act ("EIMA") (Commonwealth Edison Company and Ameren Illinois Company d/b/a Ameren Illinois). EIMA rates, sometimes called "formula rates" or "performance-based rates" are quite different than what apply to gas utilities like North Shore and Peoples Gas. As the Commission described it:

> The performance-based rate provides for recovery of a utility's actual, prudently incurred and reasonable costs of electric delivery services, except for those costs that the utility continues to recover through automatic adjustment clause tariffs. The performance-based rate also reflects the utility's actual capital structure for the applicable year (excluding goodwill) and includes a cost of equity, the calculation of which is addressed in Section 16-108.5. The performance-based rate is intended to operate in a standardized and transparent manner and be updated annually to reflect (i) historical data from the most recently filed Federal Energy Regulatory Commission ("FERC") Form 1, plus projected plant additions and correspondingly updated depreciation reserve and depreciation expense for the year of filing, (ii) a reconciliation of the revenue requirement reflected in rates for each year, with what the revenue requirement would have been had the actual cost information for the year been available at the filing date, and (iii) any adjustments, including adjustments to reflect an earned rate of return on common equity outside the statutory range, required by Section 16-108.5(c).

Ameren Illinois Company d/b/a Ameren Illinois, ICC Docket 12-0001 (Order Sept. 19, 2012), at 4.

For the Utilities, the Commission determines costs in the rate case and establishes an approved revenue requirement. Rider VBA, which Staff also cites in support of its proposals (Johnson Dir., Staff Ex. 4.0, 19:448-453) does not provide for the recovery of any costs outside of the approved revenue requirement, nor does it allow adjustments based on actual costs being more or less than the approved revenue requirement. Under EIMA, the reconciliation is far more than a simple true-up of amounts billed to customers to an approved revenue requirement. EIMA looks at all actual non-fuel costs in its reconciliation. With some limits, the EIMA process takes into account higher or lower costs. Egelhoff Reb. NS-PGL Ex. 29.0 REV., 6:112-124. Movement away from fixed cost recovery in fixed charges thus has much less of an effect on the electric utilities' ability, under EIMA, to recover its revenue requirement.

The Commission's analysis of the rate design proposals should start with these basic precepts. Demand-classified distribution costs are fixed costs. Fixed costs should be recovered in fixed charges, but it is reasonable for movement to that point to be gradual. For S.C. Nos. 1 and 2, customer charges are the fixed charges where fixed costs belong.

C. Service Classification Rate Design

1. Uncontested Issues

a. Service Classification No. 8, Compressed Natural Gas Service

Peoples Gas proposed to continue to set S.C. No. 8 at cost. Egelhoff Dir., PGL Ex. 15.0 REV., 10:204-205. The monthly customer charge would increase and the per therm distribution charge would decrease. *Id.*, 19:407-409. Staff did not object to the proposal. Johnson Dir., Staff Ex. 4.0, 63:1374-1375. The Commission should approve Peoples Gas' S.C. No. 8 rate design.

b. S.C. No. 5 Contract Service for Electric Generation and S.C. No. 7 Contract Service to Prevent Bypass

The Utilities proposed no changes to S.C. Nos. 5 and 7, and they exclude these classes from consideration because the revenues from these customers are based on negotiated rates rather than the ECOSSs. Egelhoff Dir., NS Ex. 15.0, 8:163-9:171, 19:404; PGL Ex. 15.0 REV., 8:164-9:170; 19:413. Staff did not object. Johnson Dir., Staff Ex. 4.0, 63:1386-1389. The Commission should approve no changes to these service classifications.

2. Contested Issues – North Shore and Peoples Gas

a. Service Classification No. 1, Small Residential Service, Non-Heating

Consistent with the rate design objectives and principles applicable to fixed cost recovery (*see* Section IX.B.2, *supra*), the Utilities each proposed to continue to set S.C. No. 1 NH[71] at cost. Egelhoff Dir., NS Ex. 15.0, 10:197-198; PGL Ex. 15.0 REV., 10:196-197. North Shore and Peoples Gas each proposed to recover 90% of non-storage related fixed costs through the customer charge with all remaining non-storage costs being recovered through a flat distribution charge. Each would continue to recover storage-related costs under Rider SSC, Storage Service Charge. Egelhoff Dir., NS Ex. 15.0, 11:225-234; PGL Ex. 15.0 REV., 11:225-234. Staff did not oppose the proposals as long as the customer charges recovered no more than customer costs. Johnson Dir., Staff Ex. 4.0, 27:621-632, 45:1009-46:1020. AG/ELPC recommended that the

[71] S.C. No. 1 NH is not a distinct service classification. S.C. No. 1 includes separate rates for "heating" and "non-heating" customers. "Heating" customers use and "non-heating" customers do not use gas as their principal source of space heating. The Utilities sometimes refer to the "heating" customers with the designation "HTG" and the "non-heating" customers with the designation "NH." Egelhoff Dir., NS Ex. 15.0, 3 n. 1; PGL Ex. 15.0 REV., 3 n. 1.

Utilities move towards recovering only 75% of fixed costs in the customer charge. Rubin Dir., AG/ELPC Ex. 3.0, 22:470-471, 29:579-580.

The Commission should approve the Utilities' S.C. No. 1 NH rate design. The proposals are consistent with the Commission policy of gradually increasing fixed cost recovery in fixed charges. To retreat from this gradual movement, as AG/ELPC and potentially Staff proposed, exacerbates the extent to which a customer's bill does not reflect the costs it causes the Utilities to incur, *i.e.*, customer usage would drive fixed cost recovery but usage does not drive the Utilities' incurrence of those fixed costs. IIEC's flawed across-the-board increase should be rejected for the reasons stated in Section IX.B.1, *supra.*

b. Service Classification No. 1, Small Residential Service, Heating

Consistent with the rate design objectives and principles applicable to fixed cost recovery (*see* Section IX.B.2, *supra*), the Utilities each proposed to continue to set S.C. No. 1 HTG at cost. Egelhoff Dir., NS Ex. 15.0, 10:197-198; PGL Ex. 15.0 REV., 10:196-197. North Shore proposed to recover 80% and Peoples Gas proposed to recovery 75% of non-storage related fixed costs through the customer charge with all remaining non-storage costs being recovered through a flat distribution charge. Each would continue to recover storage-related costs under Rider SSC. Egelhoff Dir., NS Ex. 15.0, 12:237-246; PGL Ex. 15.0 REV., 12:237-246. Staff proposed that the customer charge recover only customer costs. Johnson Dir., Staff Ex. 4.0, 30:685-688, 48:1072-1075. AG/ELPC recommended that the Utilities move towards recovering only 50% of fixed costs in the customer charge. Rubin Dir., AG/ELPC Ex. 3.0, 22:470-471, 29:579-580.

The Commission should approve the Utilities' S.C. No. 1 HTG rate design. The proposals are consistent with the Commission policy of gradually increasing fixed cost recovery in fixed charges. To retreat, as Staff and AG/ELPC would do, from this gradual movement exacerbates the extent to which a customer's bill does not reflect the costs it causes the Utilities to incur, *i.e.*, customer usage would drive fixed cost recovery but usage does not drive the Utilities' incurrence of those fixed costs. IIEC's flawed across-the-board increase should be rejected for the reasons stated in Section IX.B.1, *supra.*

c. **<u>Service Classification No. 2, General Service</u>**

Consistent with the rate design objectives and principles applicable to fixed cost recovery (*see* Section IX.B.2, *supra*), the Utilities each proposed to continue to set S.C. No. 2 at cost. Egelhoff Dir., NS Ex. 15.0, 10:201-202; PGL Ex. 15.0 REV., 10:200-201. The Utilities each proposed to maintain three meter classes. Using the ECOSSs, each proposed to increase the monthly customer charges for each meter class and to recover 100% of customer-related costs and a portion of the non-storage related demand costs through the customer charge for all meter classes. In *Peoples Gas 2012* (Order at 218), the Commission ordered the Utilities to examine the number of blocks of their current declining three-block distribution charge. They did so and proposed a declining two-block distribution charge that combined the front and middle blocks, with the existing third block becoming the second block. The Utilities would each continue to recover storage-related costs under Rider SSC. Egelhoff Dir., NS Ex. 15.0, 16:341-18:382; PGL Ex. 15.0 REV., 16:343-18:384.

For North Shore, the customer charge would recover 60% of non-storage demand related costs for Meter Class 1 and Meter Class 2. In the interest of gradualism, only 45% of non-storage related demand costs would be recovered through the Meter Class 3 customer charge. North Shore proposed to recover 75% and 80% of all remaining non-storage related fixed costs through the front and end distribution blocks, respectively. Egelhoff Dir., NS Ex. 15.0, 16:344 - 17:360.

For Peoples Gas, the customer charge would recover 45% of non-storage demand related costs for Meter Class 1 and 50% for Meter Class 2. In the interest of gradualism, only 15% of non-storage related demand costs would be recovered through the Meter Class 3 customer charge. Peoples Gas proposed to recover 80% and 20% of all remaining non-storage related fixed costs through the front and end distribution blocks, respectively. Egelhoff Dir., PGL Ex. 15.0 REV., 16:346-17:362.

Staff did not oppose combining the first and second distribution blocks. Staff recommended movement towards recovering only customer costs in customer charges, but its specific recommendations in this case are a reduction in, but not elimination of, recovery of non-storage demand costs in customer charges. Johnson Dir., Staff Ex. 4.0, 35:804-36:835, 53:1189 – 55:1229.

The Commission should approve the Utilities' S.C. No. 2 rate design. The Utilities addressed the Commission's directive that they examine their distribution blocks and proposed a reasonable alternative, which is unopposed. The Utilities' other proposals are fully consistent with their rate design objectives, including fixed cost recovery in fixed charges, tempered with gradualism. IIEC's flawed across-the-board increase should be rejected for the reasons stated in Section IX.B.1, *supra.*

d. <u>Service Classification No. 4, Large Volume Demand Service</u>

Consistent with the rate design objectives and principles applicable to fixed cost recovery, the Utilities each proposed to continue to set S.C. No. 4 at cost. Egelhoff Dir., NS Ex. 15.0, 10:205; PGL Ex. 15.0 REV., 10:203. Each proposed to set the monthly customer charge at cost. For North Shore, the demand charge would recover 70% of non-storage related demand costs and the distribution charge would recover all remaining non-storage related demand costs. For Peoples Gas, the demand charge would continue to recover 55% of non-storage related demand costs and the distribution charge would recover all remaining non-storage related demand costs. For each, storage related costs would be recovered under Rider SSC. Egelhoff Dir., NS Ex. 15.0, 19:396-400; PGL Ex. 15.0 REV., 19:398-403. Staff did not oppose the proposals as long as the customer charges recovered no more than customer costs. Johnson Dir., Staff Ex. 4.0, 43:953-966, 61:1340-62:1353.

The Commission should approve the Utilities' rate design proposals. They show reasonable movement towards greater fixed cost recovery in fixed charges. IIEC's testimony concerning S.C. No. 4 is addressed in Sections VIII.B.2 and IX.B.1, *supra*, and its proposed ECOSS changes that are focused on S.C. No. 4 and the flawed across-the-board increase should be rejected.

3. Classification of SC No. 1 Residential Heating and Non-Heating Customers

AG/ELPC questioned the accuracy of customers classified as S.C. No. 1 NH and S.C. No. 1 HTG. Rubin Dir., AG/ELPC Ex. 3.0, 6:129-14:292. Staff asked the Utilities to estimate the time and costs of studying the classifications. Johnson Reb., Staff Ex. 9.0, 21:443-22:451.

In response to AG/ELPC, the Utilities showed that the AG/ELPC analysis was flawed because it focused on usage as the basis for determining if a customer uses gas for space heating, and the Utilities' approach of classifying customers based on their gas appliances is more accurate. As AG/ELPC agreed (Rubin Reb., AG/ELPC Ex. 9.0, 11:222-223), there may be good explanations for why a customer's usage may vary from an expected level (Robinson Reb., NS-PGL Ex. 32.0, 4:75-7:134). This is why the Utilities focus on the customer's appliances and not usage to determine if the customer is an S.C. No. 1 NH or HTG customer. *Id*. at 3:50-54, 6:107-108. The Utilities explained that they have long-standing processes, pre-dating the introduction of S.C. No. 1 non-heating and heating rates, to identify the customer's appliances. These processes include inquiries when an applicant or customer interacts with a customer service representative and a physical inspection of the premises. *Id*. at 7:136-8:170. A sample that the Utilities reviewed showed that, overwhelmingly and to the extent they had definitive data, customers were correctly classified. While it is certainly possible that some customers are misclassified, it is not likely that 100% accuracy, 100% of the time is achievable, even if the Utilities conducted the suggested study. Robinson Sur., NS-PGL Ex. 46.0, 5:96-100.

In response to Staff, the Utilities, in the limited time available, were unable to develop a sound cost estimate, but they explained that the large number of accounts that could require intensive manual review or physical inspections of the premises, or both, suggests that the costs of an in-depth study would almost certainly be millions of dollars and a large commitment of personnel and time. The Utilities further explained that, given the processes already in place and the large number of customers that are already subject to review on an annual basis as part of the application process, a study is not needed. *Id*., 2:37-4:88.

The Commission should reject proposals that the Utilities conduct what is almost certainly a costly and time-consuming study to address flawed allegations of customer misclassification.

D. <u>Other Rate Design Issues</u>

1. <u>Terms and Conditions of Service</u>

a. <u>Service Activation</u>

The Utilities proposed changes to some of their Service Activation Charges, which recover a portion of the costs related to initiating gas service at a premises. The two types of service activations are (1) a succession turn-on (gas is on and only a meter reading is taken) and (2) a straight turn-on (gas is off and the Utilities turn on the gas and relight appliances).

North Shore showed that its costs are $23.74 for a succession turn-on, $64.07 for a straight turn-on, and $16.55 to light an additional appliance over four. North Shore proposed no change to its succession turn-on charge, $50.00 for a straight turn-on, and $12.00 for relighting each appliance over four. Egelhoff Dir., NS Ex. 15.0, 20:423-21:439; NS Ex. 15.8. Peoples Gas showed that its costs are $25.89 for a succession turn-on, $63.42 for a straight turn-on, and $17.23 to light an additional appliance over four. Peoples Gas proposed $23.00 for a succession turn-on, $38.00 for a straight turn-on, and $13.00 for relighting each appliance over four. Egelhoff Dir., PGL Ex. 15.0 REV., 20:433-21:448; PGL Ex. 15.8 REV. Staff did not object to the proposals. Johnson Dir., Staff Ex. 4.0, 66:1440-1443.

The Commission should approve the Utilities' proposed Service Activation Charges, which are based on a cost study and show appropriate and gradual movement towards full cost recovery.

b. <u>Service Reconnection Charges</u>

The Utilities proposed changes to some of their Service Reconnection Charges, which they assess customers whose gas has been turned off (*e.g.*, disconnections for non-payment or at the customer's request). Each customer receives a waiver of one reconnection charge each year for reconnection at the meter, except where the customer voluntarily disconnects and then requests reconnection within twelve months. The charges are for reconnections that: (1) require a meter turn-on, (2) require setting a new meter, and (3) involve excavating at the main.

North Shore showed that its costs are $90.72 for a reconnection at the meter, $200.46 for a reconnection when the meter has to be reset, and $1,638.63 for a reconnection at the main.

North Shore proposed no change for reconnection at the meter, $180.00 when the meter has to be reset, $500.00 when service has to be reconnected at the main, and $12.00 to relight each appliance over four (*see* Section IX.D.1.a, *supra*). Egelhoff Dir., NS Ex. 15.0, 21:441-22:462; NS Ex. 15.8. Peoples Gas showed that its costs are $102.23 for a reconnection at the meter, $321.94 for a reconnection when the meter has to be reset, and $1,338.72 for a reconnection at the main. Peoples Gas proposed $94.00 for reconnection at the meter, $188.00 when the meter has to be reset, $500.00 when service has to be reconnected at the main, and $13.00 to relight each appliance over four (*see* Section IX.D.1.a, *supra*). Egelhoff Dir., PGL Ex. 15.0 REV., 21:450-22:471; PGL Ex. 15.8 REV. Staff did not object to the proposals. Johnson Dir., Staff Ex. 4.0, 68:1488-1491.

The Commission should approve the Utilities' proposed Service Reconnection Charges, which are based on a cost study and show appropriate and gradual movement towards full cost recovery.

c. <u>Second Pulse Data Capability Charge</u>

A customer with certain metering devices may choose to have the Utilities enable second pulse capability. Based on cost studies, the Utilities proposed to decrease the Second Pulse Data Capability charge from $14.00 to $10.25 (North Shore) and to $10.60 (Peoples Gas). Egelhoff Dir., NS Ex. 15.0, 22:464-469; NS Ex. 15.12; PGL Ex. 15.0 REV., 22:473-478; PGL Ex. 15.12. The Utilities agreed with Staff's proposal (Johnson Dir., Staff Ex. 4.0, 69:1510-1517) to update the charges using the rate of return that the Commission approves. Egelhoff Reb., NS-PGL Ex. 29.0 REV., 24:519-520. The Commission should approve the Utilities' proposed Second Pulse Data Capability Charges, which are based on cost studies, subject to updating the charges for the Commission-approved rate of return.

2. Riders

a. Rider 5, Gas Service Pipe

The Utilities proposed clarifying language concerning installation and cost responsibility for service pipe and an editorial change to Rider 5, Gas Service Pipe. In particular, the Utilities proposed that the pipe installation will meet certain location requirements when practicable and, if it is not practicable and if the reason is not a customer's request or other circumstance for which the customer bears cost responsibility, then the full installation is at the company's expense. Egelhoff Dir., NS Ex. 15.0, 26:558-27:574; PGL Ex. 15.0 REV., 26:566-27:582. The Commission should approve the proposed Rider 5 clarifications, which are unopposed.

b. Rider SSC, Storage Service Pipe

North Shore and Peoples Gas each proposed to revise the Rider SSC Storage Banking Charge, which applies to transportation customers, and the Storage Service Charge, which applies to sales customers, to reflect the requested revenue requirements. Egelhoff Dir., NS Ex. 15.0, 22:473-476; PGL Ex. 15.0 REV., 22:482-23:485. The Commission should approve updating the Rider SSC charges, which are unopposed.

c. Rider QIP, Qualifying Infrastructure Plant

Peoples Gas agreed with Staff's proposal to include language in the final order identifying specific QIP dollar amounts that will be needed to make certain Rider QIP calculations. Egelhoff Sur., NS-PGL Ex. 43.0 REV., 13:268-269.

Peoples Gas also agreed with a Staff proposal to revise Rider QIP to add a process to adjust the Rider QIP Surcharge Percentage ("S%") if its 2014 actual QIP amounts do not equal the 2014 QIP amounts approved in the Commission order. NS-PGL Ex. 29.1. With the proposed changes, Peoples Gas would adjust the S% after new base rates go into effect if its actual 2014 QIP amounts do not equal the 2014 QIP dollar amounts included in rate base as approved in the Commission order. This adjustment could be a negative or positive value, if the actual 2014 QIP amounts are less than or greater than the QIP-related amounts approved in rate base. Thus, customers are protected if the QIP amount in rate base is overstated. Alternatively, if actual 2014 QIP amounts are higher than the QIP amounts approved in rate base, the S% in 2015 would include this 2014 variance in addition to the new QIP placed in service in and after 2015. Egelhoff Reb., NS-PGL Ex. 29.0 REV., 25:528-549; *also see* Egelhoff Sur., NS-PGL Ex. 43.0 REV., 15:324-16:343.

The Commission should approve the Rider QIP changes and include appropriate language in the final order to indicate the amount of 2014 QIP approved in base rates in this proceeding to support the related calculations and recovery under the rider.[72]

d. <u>Rider UEA, Uncollectible Expense Adjustment – Gas Costs</u>

The Utilities proposed revising Rider UEA-GC to reflect the proposed Uncollectible Factors arising from data in this case and Rider UEA to reflect the updated uncollectible amount to be recovered in base rates. Egelhoff Dir., NS Ex. 15.0, 25:538-26:546; NS Ex. 15.11; PGL Ex. 15.0 REV., 25:546-26:554; PGL Ex. 15.11. The Commission should approve the necessary updates to Riders UEA and UEA-GC.

e. <u>Rider VBA Volume Balancing Adjustment, Percentage of Fixed Costs</u>

The Utilities' proposed revenue increase and rate design would result in new distribution rates and related distribution revenues ("Rate Case Revenues" or "RCR") for Rider VBA. The

[72] *Also see* Section IV.A.C.1.a, *supra*, which, *inter alia*, addresses the flawed suggestion that Rider QIP will fix an incorrect adjustment of 2014 AMRP costs.

Utilities, consistent with the evidence in this case and as was true in *Peoples Gas 2011* (Order at 238) and *Peoples Gas 2012* (Order at 282), proposed the Rider VBA Percentage of Fixed Costs ("PFC") be set at 100%. Egelhoff Dir., NS Ex. 15.0, 12:247-13:257, 18:383-389; PGL Ex. 15.0 REV., 12:247-257, 18:385-391. The Commission should direct the Utilities to file updated RCRs and to set the PFC at 100%.

f. Transportation Riders

i. Transportation Administrative Charges

Based on cost studies, North Shore proposed to increase the Administrative Charge for Riders FST, Full Standby Transportation Service, and SST, Subscription Storage Transportation Service, from $5.74 to $6.14 per account and the Pooling Charge for Rider P, Pooling Service, from $1.97 to $2.98 per account. Egelhoff Dir., NS Ex. 15.0, 23:484-492; NS Ex. 15.9. Peoples Gas proposed to decrease the Riders FST and SST Administrative Charge from $7.78 to $5.82 per account and the Rider P Pooling Charge from $5.39 to $4.18 per account. Egelhoff Dir., PGL Ex. 15.0 REV., 23:493-500; PGL Ex. 15.9. The Commission should approve the transportation administrative charges, which are based on a cost study and unopposed.

ii. Rider SBO Credit

Rider SBO, Supplier Bill Option Service, allows suppliers providing service to Rider CFY customers to render their own bills to the customers for their services and the Utilities' delivery service. The Utilities provide a credit to suppliers to compensate them for the Utilities' avoided billing cost. The Utilities proposed to increase the credit from 46 to 47 cents per bill per month. Egelhoff Dir., NS Ex. 15.0, 23:495-500; NS Ex. 15.10; PGL Ex. 15.0 REV., 23:503-24:508; PGL Ex. 15.10. The Commission should approve the revised Rider SBO credit, which is based on a cost study and unopposed.

iii. Purchase of Receivables

The Utilities observed that Ameren filed for approval of a small volume transportation program, and its proposal includes language to allow utility consolidated billing/purchase of receivables. The Utilities plan to review Ameren's filing and monitor the Commission proceeding. Based on what the Commission determines for Ameren, they plan to develop and file, in 2015 for 2016 implementation, a purchase of receivables tariff. Egelhoff Dir., NS Ex. 15.0, 24:501-513; PGL Ex. 15.0 REV., 24:509-521. The Commission has not yet issued an Order in the Ameren case, ICC Docket No. 14-0097.

3. Service Classifications

a. S.C. Nos. 1 and 2 Terms of Service

The Utilities proposed clarifications in the S.C. Nos. 1 and 2 "Terms of Service" language to distinguish more clearly service discontinuance under the Commission's rules (*e.g.*, due to non-payment) from service discontinuance at the customer's request (*e.g.*, when a customer moves). In the former case, the Commission's rules specifically govern the process and the latter case is largely a matter of the Utilities implementing the customer's request. Egelhoff Dir., NS Ex. 15.0, 26:552-556; PGL Ex. 15.0 REV., 26:560-564. The Commission should approve the proposed S.C. Nos. 1 and 2 clarifications.

4. Other

The Utilities have no additional rate design matters to address.

X. CONCLUSION

Therefore, North Shore Gas Company and The Peoples Gas Light and Coke Company, for all reasons set forth above, appearing of record, or to be reflected in their Reply Brief to be filed by November 5, 2014, and their draft proposed Administrative Law Judges' Proposed

Order to be filed by November 7, 2014, respectfully request that the Commission enter findings and make conclusions on all uncontested and contested issues consistent with the Utilities' positions taken in testimony and/or stated herein regarding the evidence in the record and the applicable law.

Dated: October 21, 2014

Respectfully submitted,

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