STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	)	
	)	
Proposed General Increase In Rates For Gas Service	)	
	)	Docket No. 14-0224
	)	Docket No. 14-0225
THE PEOPLES GAS LIGHT AND COKE COMPANY	)	(Consolidated)
	)	
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	)	

INITIAL BRIEF OF THE ENVIRONMENTAL LAW & POLICY CENTER

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Submitted By:

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IX. RATE DESIGN

A. Overview

The Environmental Law and Policy Center (ELPC) intervened in this case in order to address one important issue, Peoples Gas' proposal to increase its fixed monthly charge for residential heating customers by 43.1%. The Commission should reject this proposal because it sends customers the wrong price signals regarding energy efficiency and it reduces customers' benefits from efficiency. While ELPC acknowledges that the Company should recover some of its fixed costs through fixed charges, the current allocation ratio already allows the Company to recover an adequate percentage. This issue has sparked ongoing debate in Illinois, but the Commission succinctly addressed the issue in a recent 2013 report to the General Assembly that recommends shifting revenues out of the fixed charges back in the variable charges. As set forth below, the evidence in this docket supports those findings.

B. General Rate Design

2. Fixed Cost Recovery

Peoples Fails to Justify Charging $38.50 per Month for the Fixed Charge

Peoples Gas proposes increasing its fixed customer charge for residential heating customers from the current $26.91 per month to $38.50 per month – a 43% increase. AG/ELPC Ex. 3.0 at 14. To state the obvious, this means that Peoples customers would pay $38.50 per month before using a therm of gas. Moreover, according to AG/ELPC Witness Rubin's calculations, "annual bill impacts would range from bill reductions (for a few thousand very high-use customers) to increases in excess of 30% (for the more than 30,000 customers using less than 250 therms per year)." *Id.* at 21-22. Given this impact on customers, the Commission should set the bar very high in terms of what Peoples must show to justify this revenue shift.

Peoples Gas states its objective is a desire to "better align revenues with underlying costs." PGL Ex. 15.0 at 9. As the major reason for doing this Witness Egelhoff asserts, "Peoples Gas' proposed rates will provide more balance than its present rates and will send more appropriate price signals to customers about the fixed costs underlying its delivery service." *Id.* She reiterates this argument in her rebuttal, "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 services." Peoples Ex. 29.0 at 3. In essence, Ms. Egelhoff argues that Peoples wants to correct customers notion that the more gas they use, the higher the cost of service. However, she fails to justify that there is customer confusion or that this constitutes a problem that should be corrected.

Most importantly, Peoples provides no evidence that customers look at their bills and express confusion that their fixed charges do not change even when they use less gas. Peoples

easily could have submitted evidence of this alleged confusion by providing information on calls to its customer service center from customers expressing such confusion, but it did not. Peoples also could have supported its argument with a witness who has first-hand knowledge of the problem from their work directly with customers. It also did not do that. Hence, the only evidence in the record regarding "customer confusion" is from Ms. Egelhoff who describes her background and experience in one sentence, "I am manager, Gas Regulatory Policy, for Integrys Business Support." PGL Ex. 15.0 at 1. Ms. Egelhoff fails to articulate any basis that customer confusion constitutes a problem.

When asked on cross "what are the appropriate price signals the Company hoped to send," Ms. Egelhoff answered:

> A The price signals that I'm referring to here is to convey to customers the fact that if they -- how much gas they use doesn't impact the cost or how much it costs the company to deliver that gas to them. And I feel that -- or the company feels that if we put fixed cost in a variable charge, you're sending the wrong price signals. And in our proposed rate design, we moved more of the fixed cost recovery from variable charges into fixed charges.

Tr. at 138. ELPC submits that this answer is nonsensical. Similarly, when Judge Hilliard then followed up with the question, "So what signal is the company intending to convey by this rate structure," she gave an equally convoluted answer concluding, "So we feel putting costs into a fixed charge sends the appropriate signals; that if you use less, your bill goes down, that's not really what's happening to the company, if that makes sense." *Id.* at 140.

One thing clear from the record is that this is not about helping customers or changing customer behavior. Normally, one would expect the company to argue that if it sends customers the right message (price signal) then we can expect customers to change their behavior. However, Ms. Egelhoff said, "I don't expect them (customers) to change their behavior based on that message." *Id.*

Peoples argument that fixed costs should all be recovered through fixed charges because, "All of Peoples Gas' costs recovered through base rates are fixed, i.e., they do not vary with the volume of gas delivered to customers." PGL Ex. 15.0 at 9. Both AG/ELPC Witness Rubin and Staff Witness Johnson dispute this assertion. Mr. Rubin notes:

> A gas distribution system is designed to serve the anticipated peak demands and energy requirements of all customers. Very little if any of that investment is actually "caused" by a single customer. When we talk about the principle of cost causation, we're actually talking about a fair way to allocate shared costs among customer classes and customers.

AG/ELPC Ex. 9.0 at 2. He further notes that there is a question of fairness between customer classes, because if residential customers increase their usage more of the cost of a gas main should then be transferred to that customer class. *Id.* at 3-5. Thus, you want to send the correct price signal to members of that class.

Staff Witness Johnson makes a similar point to Mr. Rubin's:

> The relevant question here is not the cost of the infrastructure built to meet demand but rather who should pay for it. If demand costs are recovered through the customer charge, all customers are assumed to cost the same for the Companies to serve them. If demand costs are recovered through the distribution charge, the recovery method assumes the costs are not the same for all customers to serve them. If demand costs are recovered through the distribution charge, that assumes that customers with higher usage will have higher peak demands and be more costly to serve than small use customers. While this latter assumption may not be true in each and every case, it is more reasonable than the Companies' proposed rate design's implied assumption that all customers within a class cause the utility to incur the same amount of demand costs. Back to my previous example, a customer with a 4,000 square foot home could be expected to place greater demands on the system at the peak compared to the 1,000 square foot home. Recovering demand costs through the customer charge does not recognize this difference.

ICC Staff Ex. 9.0 at 7. The point that Mr. Johnson emphasizes is that long term, fixed costs increase when customers use more gas. Holding down usage, ultimately translates to a less

costly system. In essence, Peoples defines fixed costs in a very narrow and inaccurate way that the facts do not support.

The Commission Recently Issued a Report to the General Assembly Concluding that Rate Design Should Encourage Efficiency

The issue of rate design and the utilities desire to shift revenue into fixed monthly charges is not unique to Peoples and has been a significant issue in a number of states in recent years, including Illinois. The ICC recognized the importance of this issue and addressed it directly in a report to the General Assembly in August, 2013. ICC Report to the General Assembly Concerning Coordination Between Gas and Electric Utility Programs and Spending Limits for Gas Energy Efficiency Programs, August 30, 2013. The Report addresses the effect of decreasing natural gas prices on the gas companies' efficiency budget, which the legislature's price caps limit to 2% of rates, and whether the Legislature should increase gas efficiency budgets. The Commission reaches a conclusion that the gas companies can reach their savings targets by shifting revenue from the fixed customer charge to the volumetric charge. Report at 22. The Commission conclusion lies in direct contradiction to Peoples' proposal in this proceeding.

The Report does an excellent job of analyzing the issue Peoples poses in this proceeding. First the Report notes:

> The Commission currently allows the largest portion of gas distribution costs to be recovered through monthly per customer charges. An alternative means to recover costs is through higher volumetric (i.e., per therm) charges. Recovery through monthly customer charges provides more stability in the amount of revenue that a utility recovers and provides less variability in customer bills.

Id. This statement accurately describes the issue at hand. Then the report discusses the fact that Peoples Gas has decoupling (Rider VBA), which reduces the need for Peoples to recover such a

high percentage of its delivery costs through its fixed charges. It notes the recent Second Circuit Court of Appeals ruling upholding the legality of decoupling, emphasizing:

> The result of this ruling is that the Commission can provide a mechanism for revenue stability that lowers the monthly customer charges and increases the volumetric charges. Such a change can decrease energy use by providing a greater price signal without affecting the overall bill to an average retail customer.

Id. See also, AG/ELPC Ex. 3.0 at 20. The Report contains a footnote indicating that it will evaluate this issue in the context of utility rate cases, but nothing in this record regarding Peoples' revenues supports a different conclusion.

In terms of the proper rate design moving forward, the Commission argues that revenue should be shifted back from fixed charges to volumetric charges going forward:

> The importance of these findings is that increasing the volumetric distribution charge by even 10% (the distribution charge is approximately 40%-50% of the bill) could lead to a 0.4%-0.5% short term reduction and 0.88%-1.1% long-term reduction in gas use over what it would be with the lower volumetric price19. Since altering the volumetric charge does not affect the average cost of delivery service to retail customers (it does affect the costs to individual customers but on average a customer pays the same amount), these additional savings can be achieved without increasing the budget limitations. If prices and weather are similar to what was experienced in 2009, one should expect that increasing the volumetric distribution charge by 10% would achieve a usage reduction that is about half of the May 31, 2015 goal of 0.8%.

Id. at 24. Hence, the Report's conclusion directly contradicts Peoples request.

Oddly, Peoples Gas never mentions this ICC Report in any of its testimony. In fact, Ms. Egelhoff goes out of her way to address the issue in her Rebuttal Testimony while avoiding the Report.[1] She addresses Mr. Rubin's testimony by arguing that the Commission should not use rate design to encourage efficiency. In so doing she interprets Section 8-104(c) very narrowly.

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[1] Mr. Rubin uses the Report as a basis for his direct testimony. AG/ELPC Ex. 3.0 at 20. Hence, in the highly unlikely event that Peoples never saw the Report before this proceeding, Peoples and its Witness Ms. Egelhoff are aware of the Report and have chosen to ignore it.

She distinguishes the efficiency programs as an unrelated issue to the rate cases, and ignores the legislature's general intent to promote efficiency. Peoples Ex. 29.0 at 10. She also ignores the legislature's general directive that public utilities must furnish service that protects the public, "and as shall be in all respects adequate, efficient, just, and reasonable." 220 ILCS 5/8-10.1. Read in its totality, the Public Utilities Act stresses the value of efficiency, and Ms. Egelhoff's reading that the Commission should not consider the rate design effect on efficiency contradicts the letter and spirit of the law. The legislature's point is that it has set efficiency targets that the utility should meet for the protection of Illinois customers; it did not set the targets in a vacuum and the Commission would not have taken the position that it should use rate design to affect efficiency in the Report if it believed this contradicts the Public Utilities Act.

Peoples Demonstrates No Revenue Issues and Decoupling Guarantees its Revenues

AG/ELPC Witness Rubin asserts that the main reason that a utility would need to collect more revenue through the customer charge stems from uncertainty over cost recovery that generally stems from a decline in sales. AG/ELPC Ex. 3.0 at 17. In fact the record reflects that few if any utilities have ever had greater revenue certainty, or face less risk. Mr. Rubin explains, "Peoples has three rate mechanisms in place that essentially assure PGL that it will recover approximately the same annual level of residential revenues each year." *Id.* He notes that, "Rider VBA (decoupling) adjusts PGL's revenue collections for any changes in consumption as compared to the forecasted amount." *Id* at 18. He further notes that Rider SSC assures Peoples it will collect all of its storage related costs, and that Rider UEA guarantees Peoples will collect all of its uncollectibles. *Id.*

In addition to the revenue adjustments above, Peoples has a new revenue adjustment mechanism called Rider QIP. This adjustment, approved in Docket No. 13-0554, allows Peoples to collect an immediate return on its infrastructure investments through Rider QIP. *Id.* Combined with the revenue adjustment above, Peoples has more than enough certainty without increasing its fixed charge.

Peoples Fixed Charges Currently Exceed Reasonable Levels

Peoples has already received a number of increases to its fixed customer, as this charge has increased from $9.00 per month in 2007 to the current $26.91 per month in 2014. The following table sets out the recent history:

[2]	**North Shore current**	**North Shore proposed**	**Peoples Gas current**	**Peoples Gas proposed**
2007	$8.50	$16.00	$9.00	$19.00
2009	$13.50	$19.90	$15.50	$23.30
2011	$17.80	$24.75	$19.50	$28.21
2012	$22.00	$27.70	$22.25	$32.83
2014	$23.75	$29.55	$26.91	$38.50
% increase total	179% since 2007		199% since 2007	

Simple math indicates the Commission has allowed Peoples to increase its customer charge by 179% in only seven years, which raises questions about the tone of Peoples' testimony in terms of the need to correct a dire problem. In fact, the record indicates the opposite situation; the Commission has shifted too much revenue to the fixed monthly charge and it needs to reverse the trend.

[2] ICC Case No. 14-0224, Direct Testimony of Scott J. Rubin, AG/ELPC Exhibit 3.0 at 14, 25
ICC Case No. 12-0511, Direct Testimony of Scott J. Rubin, AG Exhibit 3.0 at 10, 15, 18, 22
ICC Case No. 11-0280, Direct Testimony of Scott J. Rubin, GCI Exhibit 3.0 at 16-17
ICC Case No. 09-0166, Direct Testimony of Scott J. Rubin, AG/CUB/City Exhibit 2.0 at 5-6
ICC Case No. 07-0241, Direct Testimony of William L. Glahn, GCI Ex. 3.0 at 18.

Under present rates, PGL's customer charges collect approximately 62% of non-storage revenues from heating customers and 81% from non-heating customers. The proposed changes would raise those percentages to approximately 75% heating and 90% non-heating. *Id*. at 15. Instead, ELPC recommends that the ICC adjust Peoples' fixed charges consistent with the recommendations made by AG/ELPC Witness Rubin.

The exact amount of the customer charge depends on whether the Commission grants Peoples a rate increase, and if so what amount it approves.[3] Mr. Rubin proposes a rate design that collects approximately 52% of non-storage revenue from HTG customers through customer charges and 73% from NH customers. *Id.* At 24. Based on this recommendation, even if the Commission grants Peoples its full proposed revenue increase, the HTG customer charge would remain at $26.91. If the Commission determines that Peoples has not met its burden regarding the rate increase, "[T]he rates should be scaled back proportionately so that the HTG customer charge would be designed to collect between 50% and 52% of non-storage revenues and the NH customer charge would be designed to collect approximately 73%-75% of non-storage revenues." *Id.* at 24-25. This recommendation is in line with the finding in the Commission's Report that a 10% shift of revenue from fixed charges to variable would send the correct price signals on efficiency.

Peoples Proposal Shift of Revenue to Fixed Costs is not Just and Reasonable

As set forth above, Peoples analysis regarding fixed costs fails to correctly analyze the true nature of Peoples' sunk costs in the delivery system. More than that though, Peoples' proposal violates fundamental fairness principles. As the U.S. Supreme Court has explained,

[3] ELPC has taken no position on Peoples' revenue requirement.

"[u]nder the statutory standard of 'just and reasonable' it is the *result reached* not the method employed which is controlling." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (*emphasis added*). The Court adds"[i]t is not theory but the impact of the rate order which counts." *Id.* at 602. As Mr. Rubin asserts, "Giving PGL's customers more control over their natural gas bills by reducing the customer charge gives customers an important incentive to reduce their energy usage." AG/ELPC Ex. 3.0 at 21. Given the legislature's desire to promote energy efficiency, the Commission should ensure that Peoples' rate design does not reduce the value of efficiency. The current customer charge of $26 per month already reduces customer benefits from efficiency and an increase to $38.50 speaks for itself.

The Illinois Commerce Commission recently ordered ComEd to *reduce* its fixed charges and increase its variable rates to better protect low-usage customers. Stating specifically, "It rebalances fixed and variable costs and more closely aligns customer's bills with the cost of service, especially for many low use customers." ICC Docket No. 13-0387, Final Order at 75, Dec. 18, 2013. The Commission should take similar action in this proceeding as well.

X. CONCLUSION

Peoples fails to demonstrate that it does not recover a sufficient share of its costs in its current fixed charges. In fact, the opposite is true. The Commission previously set fixed charges too high, and ELPC requests that the Commission shift revenue back into variable rates consistent with Mr. Rubin's proposal. This correction would better align Peoples' rates with the State of Illinois policy to promote energy efficiency, and it would protect low use customers.

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