

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	14-0224
Proposed General Increase	:	
In Rates For Gas Service	:	
	:	
	:	
The Peoples Gas Light and Coke Company	:	14-0225
	:	
Proposed General Increase	:	Cons.
In Rates For Gas Service	:	

NORTH SHORE GAS COMPANY’S AND THE PEOPLES GAS LIGHT AND COKE COMPANY’S PROPOSED LANGUAGE FOR DRAFT ORDER

[PLEASE NOTE: Due to timing, this document does not reflect other parties’ Reply Briefs. The Utilities do not waive any position regarding same.]

By the Commission:

I. Introduction

A. Procedural History

On February 26, 2014, North Shore Gas Company (“North Shore” or “NS”) filed with the Illinois Commerce Commission (“Commission”), pursuant to Section 9-201 of the Public Utilities Act (the “Act”) (220 ILCS 5/9-201), the following revised tariff sheets: ILL. C.C. No. 17, Title Sheet and ILL. C.C. No. 17, Sheet Nos. 6-10, 18, 27, 42, 58, 66, 77, 89, 114, 124, 135.1. This tariff filing embodied a proposed general increase in gas service rates, revisions to the service classifications, riders and terms and conditions of service. The tariff filing was accompanied by direct testimony, other exhibits, and other materials required under Parts 285 and 286 of Title 83 of the Illinois Administrative Code (the “Code”), 83 Ill. Adm. Code Parts 285 and 286.

On February 26, 2014, The Peoples Gas Light and Coke Company (“Peoples Gas” or “PGL”) filed with the Commission, pursuant to Section 9-201 of the Act, the following revised tariff sheets: ILL. CC. No. 28, Title Sheet and ILL. C. C. No. 28, Sheet Nos. 5-9, 16, 19, 28, 42, 59, 68, 78, 95, 120, 140, 151.1. This tariff filing embodied a proposed general increase in gas service rates and revisions of other terms and conditions of service. The tariff filing was accompanied by direct testimony, other exhibits, and other materials required under Parts 285 and 286 of the Code.

Notices of the proposed tariff changes reflected in these rate filings were posted in North Shore's and Peoples Gas' (the "Utilities" or "Companies") business offices and published in secular newspapers of general circulation in the Utilities' respective service areas, as evidenced by publishers' certificates, in accordance with the requirements of Section 9-201(a) of the Act and the provisions of 83 Ill. Adm. Code Part 255.

The Commission issued a Suspension Order for North Shore's tariff filing on March 19, 2014, which suspended the tariffs to and including July 25, 2014, and further initiated Docket 14-0224. On July 9, 2014, the Commission issued a Resuspension Order that suspended these tariffs to, and including, January 25, 2015.

The Commission issued a Suspension Order for Peoples Gas' tariff filing on March 19, 2014, which suspended the tariffs to and including July 25, 2014, and initiated Docket 14-0225. On July 9, 2014, the Commission issued a Resuspension Order that suspended these tariffs to, and including, January 25, 2015.

On April 1, 2014, North Shore and Peoples Gas each filed motions for protective orders in their respective Dockets, pursuant to Section 4-404 of the Act and 83 Ill. Adm. Code §§200.190 and 200.430.

On April 14, 2014, the Administrative Law Judges ("ALJs") held an initial status hearing and, received the oral motion of Commission Staff ("Staff") to consolidate these cases and also orally approved a case schedule and data request response time schedule.

On April 15, 2014, the Attorney General of the State of Illinois (the "Attorney General" or "AG") filed a response to North Shore Gas Company's and The Peoples Gas Light and Coke Company's motions for a protective order.

On May 7, 2014, North Shore and Peoples Gas (collectively, the "Utilities") each filed a motion for entry of case management plan and schedule, pursuant to Section 10-101.1 of the Act and 83 Ill. Adm. Code §§ 200.190, 200.370, and 200.500.

On August 8, 2014, Staff filed a motion to strike portions of the rebuttal testimony of the Utilities' witness Ms. Christine M. Hans and NS-PGL Ex. 26.3 in its entirety.

On August 20, 2014, the Utilities filed a response to Staff's motion to strike portions of the rebuttal testimony of Ms. Christine M. Hans and NS-PGL Ex. 26.3.

On August 27, 2014, Staff filed a reply in support of its motion to strike portions of the rebuttal testimony of Ms. Christine M. Hans and NS-PGL Ex. 26.3.

On September 2, 2014, the ALJs denied Staff's motion to strike portions of the rebuttal testimony of Ms. Christine M. Hans and NS-PGL Ex. 26.3.

On September 4, 2014, Staff filed a motion for leave to file instant the rebuttal testimony of Daniel G. Kahle, Dianna Hathhorn, and Janis Freetly.

On September 10, 2014, the ALJs granted Staff's motion for leave to file instanter.

On September 15, 2014, the Attorney General filed a motion to strike certain testimony of Utilities' witness Ms. Debra Egelhoff.

On September 17, 2014, the Utilities filed a response to the Attorney General's motion to strike certain testimony of Utilities' witness Ms. Debra Egelhoff.

On September 19, 2014, the Administrative Law Judges granted in part and denied in part the Attorney General's motion to strike certain testimony of Utilities' witness Ms. Debra Egelhoff.

On October 17, 2014, Staff filed a motion for administrative notice of Peoples Gas' Rider QIP information Sheet No. 9 and its supporting schedules and future Rider QIP informational Sheet Filing Nos. 10, 11, and 12 and their supporting schedules.

On October 27, 2014, the Utilities filed a motion to correct the transcript of September 22-23, 2014 hearings.

On October 29, 2014, the Utilities filed a response to Staff's motion for administrative notice relating to Rider QIP information sheets and supporting schedules.

On October 29, 2014, the AG filed a motion to correct the transcript of September 22-23, 2014 hearings.

On October 29, 2014, the AG filed a Motion to re-open the record of the People of the State of Illinois and admit into evidence a data request response from ICC Docket No. 14-0496. On October 30, 2014, the AG filed a revised version of that motion.

On October 31, 2014, the Utilities filed a response to the AG's October 30th motion.

On November 3, 2014, Staff filed a reply in support of its motion for administrative notice.

On November 3, 2014, the AG filed a reply in support of its October 30th motion.

On _____, 2014, the Administrative Law Judges [rulings on Utilities' and the AG's transcript correction motions].

On November 5, 2014, the Administrative Law Judges granted Staff's motion for administrative notice with certain additional rulings.

On November 5, 2014, the Administrative Law Judges granted the AG's October 30th motion.

Rulings on motions are discussed further below.

Petitions to Intervene

Petitions to Intervene were filed or appearances were entered on behalf of the AG; the Citizens Utility Board (“CUB”); the Retail Energy Supply Association (“RESA”), Merchandise Mart, the University of Illinois, Abbot Laboratories, Inc., and AbbVie, Inc., and Ford Motor Company (collectively the “IIEC”), the Environmental Law and Policy Center (“ELPC”), (collectively, the AG and ELPC are “AG-ELPC”) and the City of Chicago (the “City”), (collectively, the City, CUB and IIEC are “City-CUB-IIEC” or “CCI”).

The Evidentiary Hearing

The evidentiary hearing was held September 22, 2014 through September 23, 2014, at the offices of the Commission in Chicago, Illinois. At the evidentiary hearings, the Utilities, Staff, and certain Intervenors entered appearances and presented testimony. The following witnesses testified on behalf of the Utilities: Dennis M. Derricks, Assistant Vice President, Regulatory Affairs, Integrys Business Support, LLC, North Shore and Peoples Gas (NS Exhibit (“Ex.”) 1.0 , PGL Ex. 1.0, NS-PGL 17.0, NS-PGL Ex 33.0); Lisa J. Gast, Manager, Financial Planning and Analysis, Integrys Business Support, LLC (NS Ex. 2.0, PGL Ex. 2.0, NS-PGL Ex. 18.0, NS-PGL Ex. 34.0); Paul R. Moul, Managing Consultant, P. Moul & Associates (NS Ex. 3.0, PGL Ex. 3.0, NS-PGL Ex 19.0, NS-PGL Ex. 35.0); Kevin R. Kuse, Senior Load Forecaster, Integrys Business Support, LLC (NS Ex. 4.0, PGL Ex. 4.0); Christine M. Gregor, Director, Operations Accounting, North Shore and Peoples Gas, Integrys Business Support, LLC (NS Ex. 5.0, PGL Ex. 5.0 REV, NS-PGL Ex. 20.0); Sharon Moy, Rate Case Consultant, Regulatory Affairs, Integrys Business Support, LLC (NS Ex. 6.0, PGL Ex. 6.0, NS-PGL Ex. 21.0, NS-PGL Ex. 36.0); John Hengtgen, Consultant, Hengtgen Consulting, LLC (NS Ex. 7.0, PGL Ex. 7.0, NS-PGL Ex. 22.0 REV, NS-PGL Ex. 37.0); Mark Kinzle, General Manager, District Field Operations, North Shore Gas Company (NS Ex. 8.0, NS-PGL Ex. 31.0, NS-PGL Ex. 45.0); David Lazzaro, General Manager, District Field Operations, The Peoples Gas Light and Coke Company (PGL Ex. 8.0 2nd REV, NS-PGL Ex. 23.0 2nd REV, NS-PGL Ex. 38.0); John J. Spanos, Senior Vice President, Valuation and Rate Division, Gannett Fleming, Inc. (NS Ex. 9.0, PGL Ex. 9.0); Noreen E. Cleary, Assistant Vice President, Total Compensation, Integrys Energy Group, Inc. (NS Ex. 10.0, PGL Ex. 10.0, NS-PGL Ex. 24.0); John P. Stabile, Tax Director, Integrys Business Support, LLC (NS Ex. 11.0, PGL Ex. 11.0, NS-PGL Ex. 25.0 REV, NS-PGL Ex. 39.0); Christine M. Hans, Manager, Benefits Accounting, Integrys Business Support, LLC (NS Ex. 12.0, PGL Ex. 12.0, NS-PGL Ex. 26.0, NS-PGL Ex. 40.0); Tracy L. Kupsh, Director, Operations Accounting IBS, Integrys Business Support, LLC (NS Ex. 13.0, PGL Ex. 13.0, NS-PGL Ex. 27.0, NS-PGL Ex. 41.0); Joylyn C. Hoffman Malueg, Rate Case Consultant – Regulatory Affairs, Integrys Business Support, LLC (NS Ex. 14.0, PGL Ex. 14.0, NS-PGL Ex. 28.0, NS-PGL Ex. 42.0); Debra E. Egelhoff, Manager, Gas Regulatory Policy, Integrys Business Support, LLC (NS Ex. 15.0, PGL Ex. 15.0 REV, NS-PGL Ex. 29.0 REV, NS-PGL Ex. 43.0 REV); Thomas L. Puracchio, Manager, Gas Storage, Integrys Business Support, LLC (NS Ex. 16.0, PGL Ex. 16.0, NS-PGL Ex. 30.0, NS-PGL Ex. 44.0); James G. Robinson, General Manager – Customer Relations, Integrys Business Support, LLC (NS-PGL Ex. 32.0, NS-PGL Ex. 46.0).

The following witnesses testified on behalf of Staff: Dianna Hathhorn, Accountant, Accounting Department, Financial Analysis Division, Illinois Commerce Commission (Staff Ex. 1.0, Staff Ex. 6.0), Daniel Kahle, Accountant, Accounting Department Financial Analysis Division, Illinois Commerce Commission (Staff Ex. 2.0, Staff Ex. 7.0); Janis Freetly, Senior Financial Analyst, Finance Department, Financial Analysis Division, Illinois Commerce Commission (Staff Ex. 3.0, Staff Ex. 8.0); William R. Johnson, Economic Analyst, Rates Department, Financial Analysis Division, Illinois Commerce Commission (Staff Ex. 4.0, Staff Ex. 9.0), Brett Seagle, Gas Engineer, Energy Engineering Program, Safety and Reliability Division, Illinois Commerce Commission (Staff Ex. 5.0, Staff Ex. 10.0).

The AG's witnesses were: David J. Effron, Consultant (AG Ex. 1.0, AG Ex. 7.0); David E. Dismukes, PH.D., Consulting Economist, Acadian Consulting Group (AG Ex. 2.0 Corrected ("C"), AG Ex. 8.0); Roger D. Colton, Principal, Fisher Sheehan & Colton, Public Finance and General Economics (AG Ex. 4.0C, AG Ex. 10.0); Sarah Pickett, Administrative Assistant, Center for the Advancement of Science Education, Museum of Science and Industry (AG Ex. 5.0); Nathaniel Doromal, a software engineer in the finance industry (AG Ex. 6.0).

AG-ELPC's witness was: Scott J. Rubin, Consultant (AG/ELPC Ex. 3.0, AG/ELPC Ex. 9.0).

IIEC's witnesses were: Brian C. Collins, Consultant and Associate, Brubaker & Associates, Inc. (IIEC Ex. 1.0, IIEC Ex. 3.0); Amanda M. Alderson, Consultant, Brubaker & Associates, Inc. (IIEC Ex. 2.0).

City-CUB-IIEC's witness was: Michael P. Gorman, Consultant and Managing Principal, Brubaker & Associates, Inc. (City-CUB-IIEC Jt. Ex. 1.0, City-CUB-IIEC Jt. Ex. 2.0).

The above references to testimony are intended to include the attachments thereto, whether given separate exhibit numbers or not.

All parties were given the opportunity to cross-examine witnesses. On _____, 2014, the ALJs marked the record "Heard and Taken".

Rulings on Motions

A status hearing was held April 14, 2014, where Staff made a motion to consolidate these Dockets, as noted above.

On April 14, 2014, after considering all of the parties' arguments, the ALJs entered a Protective Order for these dockets.

On April 14, 2014, the ALJs issued a notice of schedule.

On August 11, 2014, the ALJs granted Staff's motion to consolidate these dockets.

On September 2, 2014, the ALJs denied Staff's motion to strike portions of the rebuttal testimony of Ms. Christine M. Hans and NS-PGL Ex. 26.3.

On September 10, 2014, the ALJs issued a notice of ALJ's ruling granting Staff's motion for leave to file instanter the rebuttal testimony of Daniel G. Kahle, Dianna Hathhorn, and Janis Freetly.

On September 19, 2014, the ALJs issued a notice of ALJ's ruling granting in part and denying in part the AG's motion to strike certain testimony of Utilities' witness Ms. Debra Egelhoff.

On _____, 2014, the Administrative Law Judges [rulings on Utilities' and the AG's transcript correction motions].

On November 5, 2014, the Administrative Law Judges granted Staff's motion for administrative notice, with certain additional rulings.

On November 5, 2014, the Administrative Law Judges granted the AG's October 30th motion.

Post-Hearing Briefs

On October 21, 2014, the Utilities, Staff, the AG, City-CUB, City-CUB-IIEC, ELPC, and IIEC, each filed Initial Briefs ("Init. Br." or "IB").

On November 6, 2014, the Utilities, _____, and _____ each filed Reply Briefs ("Rep. Br." or "RB").

On November 7, 2014, per direction of the ALJs, the Utilities submitted a draft Proposed Order and _____ submitted draft position statements.

On December 5, 2014, the ALJs issued their Proposed Order.

On December 16, 2014, Briefs on Exceptions ("BOE") were filed by _____.

On December 23, 2014, Reply Briefs on Exceptions ("RBOE") were filed by _____.

This Order considers all of the positions and arguments set out in the exceptions briefs and reply briefs on exceptions listed above.

* * *

B. Nature of Operations

1. North Shore

North Shore is engaged in the business of distributing and selling natural gas at retail to approximately 160,000 residential, commercial, and industrial customers in

Cook and Lake Counties, Illinois. This service territory covers an area of about 275 square miles. The company owns approximately 2,271 miles of gas. The company owns approximately 2,271 miles of gas distribution mains and approximately 96 miles of transmission lines. North Shore employed approximately 166 people at the time these cases were filed. North Shore is a wholly owned indirect subsidiary of Integrys Energy Group, Inc. (“Integrys”). NS Ex. 1.0 at 3.

2. Peoples Gas

Peoples Gas is engaged in the business of transporting, purchasing, storing, distributing and selling natural gas at retail to approximately 829,000 residential, commercial, and industrial customers within the City of Chicago. This service territory covers about 237 square miles. The company owns approximately 4,169 miles of gas distribution mains and approximately 419 miles of transmission lines. Peoples Gas also owns a gas storage field, Manlove Field. Peoples Gas employed approximately 1,296 people at the time these cases were filed, nearly all within the City of Chicago. Peoples Gas is a wholly owned indirect subsidiary of Integrys. PGL Ex. 1.0 at 4.

II. TEST YEAR (Uncontested)

The Utilities proposed calendar year 2015, the twelve months ending December 31, 2015, as the test year. NS Ex. 6.0 at 5; PGL Ex. 6.0 at 5. The Utilities submitted evidence that the forecasted 2015 test year data were based on careful analyses and appropriate adjustments. NS Ex. 5.0 at 4-5; NS Ex. 6.0 at 5; PGL Ex. 5.0 REV at 4-5; PGL Ex. 6.0 at 5. The proposed test year is reasonable (NS Ex. 6.0 at 2; PGL Ex. 6.0 at 2), is uncontested, and is approved.

III. REVENUE REQUIREMENT

As stated in this Commission’s Order in the Utilities’ 2012 rate cases, a utility is legally entitled to rates that allow it the opportunity to recover its cost 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). See Docket Nos. 12-0511/12-0512 (cons.) (final Order June 18, 2013) at 6-7 (“*Peoples Gas 2012*”) (citing case law, Section 9-201 of the Act, and past Commission Orders, including the Order in the Utilities’ 2011 rate cases, Docket Nos. 11-0280/11-0281 (cons.) (final Order Jan. 10, 2012) (“*Peoples Gas 2011*”). This principle is in the long term interest of customers and investors alike. “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 2012* Order at 7; *accord Peoples Gas 2011* Order at 5.

The AG in briefing on general standards makes the same points and cites to the same case law as it did in *Peoples Gas 2012*. Neither the AG nor any other party argues, however, that any case law or other authority allows the Commission to set rates that do not allow a utility the opportunity to recover fully its cost of service

(revenue requirement). The Utilities accurately note that case law does not support such a result.

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

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

Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 327 Ill. App. 3d 768, 776, 762 N.E.2d 1172, 1173-1174 (3d Dist. 2002).¹

The Utilities state that their witness, Ms. Gregor, explained in detail the well-established processes used to establish the forecasts and budgets of each of the Utilities, and discussed that, in compliance with the Commission's rules (83 Ill. Adm. Code § 285.7010), an independent CPA, Deloitte & Touche LLP, examined the financial forecast and the related notes and assumptions, and confirmed the Utilities' compliance with the standards established by the American Institute of Certified Public Accountants. PGL Ex. 5.0 REV at 4-9; NS Ex. 5.0 at 4-9.

The Utilities contend that their direct testimony collectively provided extensive, detailed evidence supporting every component of their forecasted costs of service, and their rebuttal and surrebuttal testimony provided further support. See, e.g., the discussion in Sections IV.A, V.A, and VI of the Utilities' Initial and Reply Briefs.

In addition, the Utilities state that their direct testimony addressed, in detail, as to each utility, their major capital projects since *Peoples Gas 2012* (in compliance with the Commission's rules, 83 Ill. Adm. Code §§ 285.1600, 286.20(a)(2)) and all significant changes in operating expenses since 2012 (on the Utilities' own initiative). NS-PGL IB at 9-11 fn. 8 and 9; NS-PGL RB at 9, fn. 15.

The Utilities state that thus they presented far more than a *prima facie* case of their costs. They contend that they provided extensive, compelling evidence of their costs, and of why those costs have changed. The Utilities argue that the adjustments

¹ In addition, the utility does not bear the burden of proof on all the issues that conceivably are relevant to the reasonableness of its rates, nor is it required in its direct case to anticipate and disprove the objections that opposing parties might make. *City of Chicago*, 133 Ill. App. 3d at 442, 478 N.E.2d at 1375.

proposed by Staff and intervenors, in contrast, lack merit, and they should not be adopted for the reasons identified above and in Sections I, III.A., III.B, III.C, IV.A., IV.C, V.A., V.C, and VI of the Utilities' Initial and Reply Briefs.

Finally, the Utilities contend that the AG also, at times, through broad brush claims, purports to challenge the Utilities' overall costs of service, e.g., AG IB Corr. at 1, but that challenge is not supported by, and instead is contrary to, the facts in evidence, for the reasons discussed in the Utilities' Initial and Reply Briefs.

Staff and intervenors, in contrast, contend that their respective specific proposed adjustments should be adopted. Staff opposes a number of the adjustments proposed by intervenors and supports some others. In some instances, such as the subject of the Utilities' rates of return on common equity, Staff and intervenors make different proposals on the same subject.

The Commission addresses the contested revenue requirement issues in the later, applicable sections of this Order.

A. North Shore

North Shore's final proposed base rate revenue requirement (as revised in its rebuttal testimony) is \$88,181,000, or \$89,778,000 if costs recovered as Other Revenues (\$1,597,000) are included, and North Shore states that its proposed revenue requirement is just and reasonable based on the testimony and other exhibits in evidence. *E.g.*, NS-PGL Ex. 21.0 at 3; NS-PGL Ex. 36.0 at 3, fn. 1; NS-PGL Ex. 21.1N, lines 1, 5, 10, and 11, col. [G].

At each of the direct and rebuttal testimony stages, North Shore presented pie charts and additional information 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 the rates approved in the Utilities' 2012 rate cases. NS-PGL IB at 10.

B. Peoples Gas

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

At each of the direct and rebuttal testimony stages, Peoples Gas presented pie charts and additional information 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 the rates approved in the Utilities' 2012 rate cases. The Peoples Gas rebuttal information was not significantly changed by the surrebuttal revenue requirement reduction. NS-PGL IB at 12.

C. Proposed Reorganization

North Shore and Peoples Gas

The Utilities note that the proposed acquisition by Wisconsin Energy Corporation (“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. NS-PGL IB at 13.

The Utilities and Staff agree that no adjustment to the Utilities’ revenue requirements is warranted by the reorganization, provided that Staff proposes one very minor change to one amortization period, as discussed in Section V.C.4 of this Order. The Utilities emphasize that 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, and Staff agrees, with that minor exception. However, the Utilities add that the AG is trying to use the proposed reorganization as secondary support for some of its proposed adjustments; and that CCI, which presented no evidence on this subject, for the first time in its Initial Brief, made proposals relating to the proposed reorganization, but those proposals relate to the reorganization as such and are not proposed adjustments to the Utilities’ revenue requirements. NS-PGL IB at 15-16; NS-PGL RB at 13-16.

AG witness David Efron noted the June 23, 2014, announcement of the proposed WEC-Integrys transaction, which referred in part to anticipated “operational and financial benefits”. AG Ex. 1.0 at 4-5. Mr. Efron 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 incorporate those expected operational and financial benefits into the determination of their test-year revenue requirements.” *Id.* at 5.

Again, while no adjustments have been proposed based on the proposed transaction, the Utilities state that the evidence would not support any adjustment, in any event. In rebuttal testimony, the Utilities 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.

NS-PGL Ex. 17.0 at 10.

The Utilities point out that Staff agrees that no revenue requirement adjustments should be made based on the proposed reorganization (subject to the minor amortization item noted earlier). In rebuttal testimony, Staff discussed materials 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. Staff Ex. 6.0 at 23-25 and Attachment B. Staff witness Dianna Hathhorn 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- 25 (emphasis added in Answer).

The Utilities note that Ms. Hathhorn added that, under some circumstances, if savings² 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 (under 220 ILCS 5/9-202), and that the Commission could condition its approval of the reorganization on a sharing of savings or other conditions (under 220 ILCS 5/7-204). Staff Ex. 6.0 at 25. The Utilities argue that 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

² The Utilities note that they 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, and the Utilities state that 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.

ILCS 5/9-202) and conditions upon approvals of a reorganization (220 ILCS 5/7-204). NS-PGL IB at 15; NS-PGL RB at 17-18.

The Utilities note that Staff also has pointed out that the Utilities are not proposing to include in their costs of service in these cases the acquisition premium or costs incurred to approve the reorganization, even though such costs would be incurred in 2015, the test year, if the reorganization is approved. Staff IB at 5. In addition, the Utilities note that Staff explained that the Act contains not only provisions for conditions upon approvals of a reorganization (Section 7-204), but also provisions regarding interim rate orders (Section 9-202) and requests for investigations of rates (Section 9-250), which could address the hypothetical situation of net costs savings occurring after the reorganization closes. Staff IB at 4-7.

The Utilities point out that AG witness Mr. Effron, in his rebuttal, speculated that the proposed reorganization might lead to cost savings, but that he neither proposed, nor presented facts supporting, any adjustment to the Utilities' revenue requirements based on the proposed reorganization, except that, in relation to his proposed adjustments to Integrys Customer Experience ("ICE") project costs, he speculated that the proposed reorganization, if approved, might lead to cancellation of the ICE project. See AG Ex. 7.0 at 22-25; NS-PGL IB at 7; NS-PGL RB at 14. In addition, the Utilities note that Mr. Effron offered conjecture that the proposed reorganization might lead to lower overall costs, and that the AG in briefing added the argument that the reorganization might also indirectly support his proposed adjustments to the Utilities' employee levels. NS-PGL IB at 15-16; NS-PGL RB at 14. The Utilities argue that the AG's speculation lacks any valid factual basis, and that any such issues belong in the other Docket. NS-PGL IB at 16; NS-PGL RB at 14.

The Utilities state that their witness Mr. Derricks, in his surrebuttal (1) discussed Ms. Hathhorn's rebuttal testimony, largely agreeing with it; (2) pointed out that Mr. Effron's rebuttal testimony's speculation is 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. NS-PGL Ex. 33.0 at 5-8; NS-PGL Ex. 33.1. See *also* NS-PGL Cross Ex. 3 (additional data request responses of Mr. Effron); NS-PGL Ex. 38.0 at 8; 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 Utilities state that, for example, Mr. Effron admitted that he did not review any information from past transactions regarding the amount of time that elapses between when a transaction closes and when a net decrease in expenses, if any, first occurred. NS-PGL Ex. 33.0, 6:129 – 7:149 (citing and quoting data request responses of Mr. Effron).

The Utilities state that Mr. Effron's failure to examine when net savings occur after a transaction (if they do) is even more problematic than the above may suggest, because he also did not take into account Staff's point that the Utilities are not proposing to include in their costs of service in these cases the acquisition premium or other costs to be incurred to approve the reorganization, even though such costs would be incurred in 2015, the test year, if the reorganization is approved. Staff IB at 5. Such costs, if considered and applied here, would increase, not decrease, the Utilities' test year costs. The Utilities are not proposing to include any such costs, which would not be appropriate in the current cases, but they do note that it is well established that costs incurred to achieve savings may be recovered through rates. NS-PGL IB at 15, fn. 12.

Thus, the Utilities summarize that Mr. Effron speculated about net savings, while not analyzing any information regarding when they might occur, and while ignoring the costs that will be incurred to achieve those savings, which costs would include significant costs in 2015.

The Utilities contend that speculation is not a lawful basis for a Commission decision. See, e.g., *Ameropan Oil Corp. v. ICC*, 298 Ill. App. 3d 341, 348, 698 N.E.2d 582, 587 (1st Dist. 1998) ("speculation has no place in the ICC's decision"); *Allied Delivery System. Inc. v. Illinois Commerce Comm'n*, 93 Ill. App. 3d 656, 667, 417 N.E.2d 777, 785 (1st Dist. 1981) ("The speculation indulged in by the Commission is clearly an unsatisfactory and unacceptable basis for its decision.").

The Utilities also contend that the AG's position is inconsistent. The AG has previously, and successfully, opposed the Utilities' use of an end of year rate base in future test year rate cases, rejecting the Utilities' argument that an end of year rate base would better reflect higher levels of investment as the rates being set remain in effect after the test year, on the grounds that other cost factors may increase or decrease after the test year. See, e.g., *Peoples Gas 2012 Order* at 26. However, the Utilities note that in the instant proceeding, the AG conjectures about post-reorganization net cost savings that may or may not occur, and that would not be expected to occur in 2015, while ignoring all other factors influencing the Utilities' costs of service, such as the costs of the reorganization itself, costs to achieve savings, and increased paving costs, the third of which is an already occurring known fact that is not reflected in Peoples Gas' revenue requirement. NS-PGL RB at 15-16.

The Utilities note that CCI presented no evidence on this subject and yet, CCI, in its Initial Brief (at 5), claimed that the Commission lacks sufficient information about whether the rates set in the current cases will remain appropriate under the changed conditions that may prevail after the reorganization closes in summer 2015, assuming approval of the reorganization. CCI does not oppose use of the 2015 test year. *Id.* However, CCI now proposes that the Commission in the current cases, not in the reorganization docket, impose a list of cost and revenue tracking, reporting, and filing requirements and even dividend limitations. *Id.* at 6-7.

The Utilities contend that CCI's proposals have no factual basis in the evidence, and to adopt them would be unlawful, for multiple reasons. To begin with, CCI purports

to support its proposal to impose reorganization related requirements in the instant cases, rather than in the reorganization approval Docket, based on arguments that have no basis in fact or law. NS-PGL RB at 16.

The Utilities contend that those assertions come out of left field and are baseless and incorrect. Section 7-204 is exactly the provision of the Act that governs the conditions that may be imposed upon approval of the proposed reorganization, and ICC Docket No. 14-0496 is the sole Docket in which the Commission is considering and can and must consider such issues. Section 7-204 does not permit such issues to be litigated in multiple dockets, and to do so would cause duplicative litigation and could result in inconsistent outcomes. Moreover, Staff witness Ms. Hathhorn did not contend that any reorganization related requirements could or should be imposed in the instant cases. The opposite is true. Furthermore, CCI points to no deficiency in Sections 9-202 and 9-250, which Staff has cited, and in fact CCI itself cites. CCI IB at 7. CCI's assertion that the record in ICC Docket No. 14-0496 "is not certain to contain sufficient evidence" has no foundation. Discovery is occurring in that Docket, as has been referenced here. See, e.g., AG Cross Ex. 11. Moreover, Staff and intervenor testimony in that Docket is not even due until November 20, 2014 (and, on certain issues, not until November 26, 2014). CCI does not even attempt to claim that, much less explain why, it could not make the same proposals in the reorganization Docket. There is no factual or legal basis for imposing any reorganization related requirements in the instant cases. NS-PGL RB at 16-17.

The Utilities further contend that, in addition, and perhaps even more importantly, CCI's specific list of proposed requirements itself lacks any basis in the evidence. CCI did not make any of those proposals until CCI's Initial Brief. No other party made any such proposals. No witness supported CCI's proposals, and no witness had the chance to oppose them. There was no discovery or cross examination regarding CCI's proposals. NS-PGL RB at 17.

The Utilities contend that, thus, to approve CCI's list of proposals in the instant cases: (1) not only would contravene Section 7 204; but (2) it would be contrary to the Commission's basic duty to decide these cases based on the evidence in the record and the applicable law, 220 ILCS 5/10-103; 220 ILCS 5/10-201(e)(iv)(A); and (3) it also would be contrary to due process, due to the lack of affording the Utilities notice and a fair opportunity to be heard regarding CCI's proposals, see, e.g., *Quantum Pipeline Co. v. Illinois Commerce Comm'n*, 204 Ill. App. 3d 310, 709 N.E.2d 950 (3d Dist. 1999). The due process violation would be even worse than the above discussion indicates, because it is not only the Utilities' rights that would be violated. Wisconsin Energy Corporation and four of the six other applicants in ICC Docket No. 14-0496 are not parties to the instant cases. Their due process rights will be violated if requirements are imposed here based on the proposed reorganization. Moreover, other parties might intervene in that Docket that are not parties here, and, if so, their due process rights will be violated as well. NS-PGL RB at 17-18.

Finally, the Utilities contend that CCI's proposals lack merit even on their face. Several of the proposals involve cost and revenue and other information tracking and

reporting, but CCI does not discuss any of the Utilities' existing obligations, such as their duty to file an annual ICC Form 21, and, again, CCI does not explain why the reorganization Docket could not handle any valid concerns on this subject. CCI goes even farther, urging the Commission to order the Utilities to file new rate cases by a date certain or defined in relation to the reorganization. Here, too, CCI does not explain why any concerns could not be handled in the reorganization Docket and/or under Sections 9-202 and 9-250. Moreover, the Utilities have a legal right to determine when they will file rate cases, *Lowden v. Illinois Commerce Comm'n*, 376 Ill. 225, 231, 33 N.E.2d 430, 434 (1941), so it is only under Section 7-204 in the reorganization Docket, as a possible condition of approval, that the Commission could address such a proposal, although, again, the Commission also would have Sections 9-202 and 9-250 available as measures to investigate and change rates. CCI goes still farther, by urging the Commission to limit post-reorganization dividends, which is a breathtakingly irresponsible proposal with no factual or legal basis, and which would be an additional due process violation in its own right by directly affecting the rights of investors with no notice or opportunity to be heard. CCI's proposals must be rejected. NS-PGL RB at 18-19.

The test year in this case is 2015. The Utilities contend that there is nothing in the record that supports any suggestion that the proposed reorganization might lead to net savings in 2015. The evidence is to the contrary. Moreover, any such issue belongs in the reorganization Docket. NS-PGL IB at 13; NS-PGL RB at 19.

The Utilities argue that 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. The AG's conjectures and CCI's proposals must be rejected. NS-PGL IB at 13; NS-PGL RB at 19.

Other Parties

[Insert]

Commission Analysis and Conclusions

It is undisputed that the proposed acquisition by WEC of Integrys is pending before the Commission in ICC Docket No. 14-0496. That docket is not a part of the instant proceedings, and based on the record the proposed reorganization cannot be relied upon as the justification or basis for any revenue requirement adjustments or other proposals in this case. Although the parties to this docket appear to be in general agreement as to the former point, and have not proposed any adjustments based upon the proposed reorganization, apart from the Staff item discussed in Section V.C.4 of this Order, the Commission wishes to emphasize that these proceedings are distinct and separate.

The AG alludes to possible "operational and financial benefits" that may inure to the Utilities following an approval of the reorganization, and requests that the Utilities

identify and quantify the same in the instant proceeding. These benefits and their timing, particularly the timing of net cost savings, if any, are unknown, unquantifiable, and it would be premature to account for them in the instant rate case dockets. As Staff and the Utilities noted, the reorganization is not guaranteed – it is subject to approval by the Commission, and the conditions and timing of such an approval are unknown at this time. There has been no evidence presented in the current record related to these supposed benefits, and no such evidence can exist at this time; any evidence related to benefits that would arise out of the reorganization would be mere speculation. Further, Staff points to additional costs that will be incurred in 2015 if the reorganization is approved, and the Utilities point to the principle of recovery of costs incurred to achieve savings. As a result, the Commission finds that the proposed reorganization, pending in ICC Docket No. 14-0496, is not a part of the instant cases, cannot be the basis of any adjustment, and that all issues related to the reorganization must and will be addressed in ICC Docket No. 14-0496.

That finding and ruling applies to CCI's proposals as well. CCI's proposals have no basis in the record in these Dockets, and no party or affected non-party was given the opportunity to address them in evidence or cross-examine CCI's witness (who did not address this subject, in any event). To approve CCI's proposals here would not be supported by the evidence and would be contrary to law.

IV. RATE BASE

A. Overview/Summary/Totals

1. North Shore

North Shore's rebuttal testimony presented an average rate base³ 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. NS-PGL Ex. 22.0 REV. at 3; NS-PGL Ex. 22.1N, line 15, col. [F].

2. Peoples Gas

Peoples Gas' surrebuttal testimony presented an average rate base 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. NS-PGL Ex. 37.0 at 2; NS-PGL Ex. 37.1P, line 15, col. [F].

North Shore and Peoples Gas state that their rate bases are supported by extensive, detailed evidence, including the testimony of Mr. Hengtgen (overall rate base and the underlying calculations and supporting various components of rate base); Christine Gregor (the test year forecast, including the Capital Budget); Noreen Cleary

³ The Utilities used 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. NS Ex. 7.0 at 4-5; PGL Ex. 7.0 at 4-5.

(capitalized incentive compensation costs); Christine Hans (updating the pension and other post-employment benefits (“OPEB”) liability figures and the pension asset); Thomas Puracchio (certain capital projects); as to North Shore in particular, Mark Kinzle (key components of Gross Utility Plant and certain capital projects); and, as to Peoples Gas in particular, David Lazzaro (key components of Gross Utility Plant and certain capital projects). NS-PGL IB at 17-18.

The rate base issues are discussed below, in the applicable subsections of this Section IV.

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

1. Gross Utility Plant

a. 2013 Plant Balances

The Utilities’ direct cases 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, 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 recommended that the Utilities develop a forecasted rate base reflecting the 2013 actual data. CCI Ex. 1.0 at 51-52. Mr. Gorman did not address North Shore’s actual 2013 plant balances, which exceeded its forecasted 2013 balances. NS-PGL Ex. 22.0 REV. at 12. 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.* Mr. Gorman did not further address this issue in rebuttal testimony. See CCI Ex. 2.0. No witness or party contested the updated 2013 figures. Therefore, the Commission approves the Utilities’ updated 2013 plant balances.

b. 2014 Plant Balances (Other than PGL AMRP Additions and associated items addressed in Section III.C.1.a)

The Utilities provided 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). CCI Ex. 1.0 at 51-52; AG Ex. 1.0 at 5-11. In rebuttal testimony, the Utilities updated their forecasted 2014 plant balances. NS-PGL Ex. 22.0 REV. at 13; NS-PGL Exs. 22.4P, 22.5P, 22.8N and 22.8P. Mr. Gorman did not further address this issue in rebuttal testimony. See 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. Hathorn

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. CCI's Initial Brief (at 8) confirmed that it was not proposing any adjustment to 2014 plant balances. 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 is uncontested, discussed in Section IV.B.1.c.vii, below). Therefore, the Commission approves the Utilities' updated 2014 plant balances.

c. 2015 Forecasted Capital Additions

i. In General

The Utilities provided forecasts for 2015 plant balances to be included in rate base. See NS Ex. 7.1 REV.; PGL Ex. 7.1 REV.⁴ The forecasted 2015 plant additions (as revised in rebuttal, where applicable) are uncontested. Therefore, the Commission approves the Utilities' forecasts for 2015 plant balances.

The Utilities noted that, pursuant to 83 Ill. Adm. Code § 285.6100, Peoples Gas 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. PGL Ex. 8.0 2nd REV. at 9. 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.* These projects, discussed below, are uncontested as to 2015.

The Utilities further noted that pursuant to 83 Ill. Adm. 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. NS Ex. 8.0 at 9. North Shore identified three major capital projects: (1) Wildwood/Gages Lake, (2) Grayslake Gate Station, and (3) Casing Remediation Program. *Id.* These projects, as discussed below, are uncontested as to 2015.

2014 AMRP costs are discussed in Section IV.C.1.a of this Order. The other major capital projects are discussed below, including both 2014 and 2015 costs.

ii. Calumet System Upgrade (PGL)

Peoples Gas has reduced its Calumet System Upgrade costs to reflect the updated cost of work that will be completed in 2014, reducing 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

⁴ 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.

for as construction work in progress at December 31, 2014. NS-PGL Ex. 23.0 2nd REV. at 5. These costs are not contested. Therefore, the Commission approves the costs associated with Peoples Gas' Calumet System Upgrade project.

iii. Casing Remediation (PGL)

Peoples Gas forecasted capital additions in 2014 and 2015 of \$10 million for the casing remediation program. PGL Ex. 8.0 2nd REV. at 20; PGL Ex. 8.1 REV line 3, col. (D). These costs are not contested. Therefore, the Commission approves the costs associated with Peoples Gas' Casing Remediation project.

iv. Gathering System Pipe Replacement Project (PGL)

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. Peoples Gas noted that these projects exceeded the major capital project threshold of \$4,262,000. PGL Ex. 16.0 at 10. Peoples Gas forecasted capital costs of \$5,525,000 for the 2014 Gathering System Pipe Replacement Project, to be expended during calendar year 2014 and capital costs of \$6,000,000 for the 2015 Gathering System Pipe Replacement Project, to be expended during calendar year 2015. *Id.* at 11, 13. These costs are uncontested. Therefore, the Commission approves the costs associated with Peoples Gas' 2014 and 2015 Gathering System Pipe Replacement Project.

v. LNG Control System Upgrade (PGL)

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. PGL Ex. 16.0 at 13-15. This item was not contested. Therefore, the Commission approves the costs associated with Peoples Gas' LNG Control System Upgrade Project.

vi. LNG Truck Loading Facility (PGL)

Peoples Gas has withdrawn its proposal to develop an LNG Truck Loading Facility to be added to rate base in the 2015 test year. NS-PGL Ex. 30.0 at 2. This issue is not contested. Therefore, the Commission approves the withdrawal of the LNG Truck Loading Facility project.

Staff requests the Commission to rule in this docket 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. Staff Ex. 10.0 at 5; Staff IB at 11. The Utilities argue that such a ruling would be premature, as there is no LNG Truck Loading Facility proposed for consideration in front of the Commission. NS-PGL IB at 22-23; NS-PGL RB at 21-22. The Commission agrees that, at this time, such a ruling by the Commission is

premature. Not only is there no project before the Commission for its consideration at this time, there is insufficient evidence in this docket to make such a determination.

vii. Reclassification of Costs to Plant in Service (PGL)

Peoples Gas 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, and updated its adjustment accordingly to reflect the reduction to O&M expense offset by derivative depreciation expense and income taxes on Plant in Service. NS-PGL Ex. 36.0 at 10. See also NS-PGL Ex. 37.0 at 7; NS-PGL Exs. 37.1P, 37.3P. This adjustment is uncontested. Therefore, the Commission approves Peoples Gas' coordinated adjustment to rate base and O&M expenses.

viii. Wildwood/Gages Lake (NS)

North Shore forecasted capital additions for its Wildwood/Gages Lake project of \$2,400,000 for 2014 and 2015. NS Ex. 8.0 at 10; NS Ex. 8.1, line 1, col. (D). These costs were not contested. Therefore, the Commission approves the costs associated with North Shore's Wildwood/Gages Lake project.

ix. Grayslake Gate Station (NS)

North Shore forecasted capital additions for its Grayslake Gate Station project of \$6,525,000 for 2014 and 2015. NS Ex. 8.0 at 11; NS Ex. 8.1, line 2, col. (D). These costs were not contested. Therefore, the Commission approves the costs associated with North Shore's Grayslake Gate Station project.

x. Casing Remediation (NS)

North Shore forecasted capital additions for its Casing Remediation project of \$6,250,000 for 2014 and 2015. NS Ex. 8.0 at 12; NS Ex. 8.1, line 3, col. (D). These costs were not contested. Therefore, the Commission approves the costs associated with North Shore's Casing Remediation project.

xi. Locker Room (NS)

North Shore withdrew the Locker Room project from this rate case. NS-PGL Ex. 31.0 at 2-3; Staff Ex. 5.0 at 17-22. The calculation of the resulting plant reductions as presented in North Shore's rebuttal testimony is uncontested. NS-PGL Ex. 22.0 REV. at 11; Staff Ex. 6.0 at 4. Therefore, the Commission approves North Shore's plant reductions for this project.

d. Original Cost Determinations as to Plant Balances as of December 31, 2012

The Utilities and Staff 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. NS Ex. 7.0 at 14; PGL Ex. 7.0 at 17; Staff Ex. 1.0 at 29; NS-PGL Ex. 22.0 REV. at 5. They

agreed that the following language 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.

The Commission approves that language, which appears in the Findings and Ordering Paragraphs, below.

2. Accumulated Provisions for Depreciation and Amortization (Including new depreciation rates and including derivative impacts other than in Section III.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. NS-PGL Ex. 22.0 REV. at 14-15; NS-PGL Ex. 22.1N, line 2, col. (F); NS-PGL Ex. 37.0 at 7-8; 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 below. Therefore, the Commission approves the balances for accumulated depreciation and amortization, subject to derivative impacts.

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. The Utilities further note that this reflects the Commission's past direction that the Utilities prepare a new study every five years. NS Ex. 9.0; NS Ex. 9.1; PGL Ex. 9.0; PGL Ex. 9.1. The new rates are uncontested. Therefore, the Commission approves the new depreciation rates provided by the Utilities.

3. Cash Working Capital (Other than Section III.C.2)

The Utilities explain that cash working capital ("CWC") is the amount of funds required to finance the day-to-day operations of a utility. E.g., PGL Ex. 7.0 at 18. The Utilities note that 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. The Utilities further note that the CWC figure is independently calculated for the test year, so it is not an average. NS-PGL IB at 25.

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). The Utilities and Staff agree on the calculation of CWC, subject to the item in the next paragraph of this Order, and agree that the final balances of CWC will be established using the applicable final inputs

ultimately approved in this proceeding. NS-PGL Ex, 22.0 REV. at 5; Staff Ex. 1.0 at 9-10.

This subject is uncontested with the exception of the “expense lead” for OPEB expenses, discussed in Section IV.C.2.a below, and derivative impacts on the inputs to the CWC calculation, if any, of contested operating expense adjustments. NS-PGL IB at 25-26. Therefore, the Commission approves the final CWC calculations presented by the Utilities, subject to the determination of the OPEB expense lead issue and the derivative impacts, if any, of rulings on contested issues that affect the final inputs to the CWC calculations.

4. Materials and Supplies, Net of Accounts Payable

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. NS Ex. 7.0 at 10-11; NS Ex. 7.1 REV., Sched. B-8.1; PGL Ex. 7.0 at 12-13; PGL Ex. 7.1 REV., Sched. B-8.1. This subject is uncontested. Therefore, the Commission approves the Utilities’ 13-month average balances of Materials and Supplies, net of accounts payable.

5. Gas in Storage

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. NS Ex. 7.0 at 11-12; NS Ex. 7.1 REV., Sched. B-1.1; PGL Ex. 7.0 at 13-14; PGL Ex. 7.1 REV., Sched. B-1.1. This subject is uncontested. Therefore, the Commission approves the Utilities’ 13-month average balances of Gas in Storage.

6. Budget Plan Balances

The Utilities note that 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. NS Ex. 7.0 at 12; NS Ex. 7.1 REV., Sched. B-14; PGL Ex. 7.0 at 14; 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. NS-PGL Ex. 21.0 at 4-5; Staff Ex. 1.0 at 24. This subject is uncontested. Therefore, the Commission approves the Utilities’ Budget Plan Balances and the use of the interest rate of 0% to be paid on customer deposits.

7. Accumulated Deferred Income Taxes

The Utilities note that inclusion of Plant in Service in rate base 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 below. Therefore, the Commission approves the final ADIT balances as presented by the Utilities.

a. Incentive Compensation

The Utilities have agreed to remove, from rate base, the ADIT related to the capitalized incentive compensation costs previously disallowed by the Commission. Staff Ex. 2.0 at 25-26, Schedules 2.10N, 2.10P; NS-PGL Ex. 22.0 REV at 5, NS-PGL Exs. 22.10N, 22.10P. This is not contested. Therefore, the Commission approves removal from rate base of the ADIT related to the capitalized incentive compensation costs previously disallowed by the Commission.

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. NS-PGL Ex. 25.0 REV. at 4; NS-PGL Ex. 39.0 at 2. These items are not included in the Utilities’ rate bases. This subject is uncontested and is approved by the Commission.

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

The Utilities note, and the Commission agrees, that 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 below.

8. Customer Deposits

The Utilities note that 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. NS Ex. 7.0 at 12-13; NS Ex. 7.1 REV., Schedule B-13; PGL Ex. 7.0 at 15; PGL Ex. 7.1 REV., Schedule 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. NS-PGL Ex. 21.0 at 4-5; Staff Ex. 1.0 at 23. This subject is uncontested. Therefore, the Commission approves the Utilities’ Customer Deposit balances and the use of the interest rate of 0% to be paid on customer deposits.

9. Customer Advances for Construction

The Utilities note that 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. NS Ex. 7.0 at 13; NS Ex. 7.1 REV., Sched. B-1.3; PGL Ex. 7.0 at 15; PGL Ex. 7.1 REV., Sched. B-1.3. This subject is uncontested. Therefore, the Commission approves the Utilities' Customer Advances for Construction credit balances.

10. Reserve for Injuries and Damages

The Utilities note that 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. NS Ex. 7.0 at 13; 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. PGL Ex. 7.0 at 15; PGL Ex. 7.1 REV., Sched. B-1.4.

This subject is uncontested. Therefore, the Commission approves the credit balances for 2014 and 2015 for North Shore and for Peoples Gas.

11. Other

There are no 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 Cost of Removal (Including derivative impacts on Accumulated Depreciation and Accumulated Deferred Income Taxes) (PGL)

Peoples Gas

Peoples Gas argues that its 2014 AMRP costs and the associated costs of removal, as presented in its rebuttal testimony, should be adopted. As support for this argument, Peoples Gas provided the Commission with relevant background information.

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%. PGL Ex. 8.0 2nd Rev. at 9-10. 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.

Peoples Gas later determined, however, that acceleration of the program would be beneficial, and the Commission agreed. PGL Ex. 8.0 2nd Rev. at 10. 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),⁵ Peoples Gas moved forward with the AMRP. PGL Ex. 8.0 2nd Rev. at 10. In 2013, Section 9-220.3 of the Act, 220 ILCS 5/9-220.3, was enacted to allow rider recovery of qualifying infrastructure plant, which includes (but is not limited to) accelerated main replacement costs.

Peoples Gas explains that 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. PGL Ex. 8.0 2nd Rev. at 11. According to Peoples Gas,

⁵ *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 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.* Peoples Gas uses a Main Ranking Index (“MRI”) to decide which mains to replace. *E.g., Id.* at 11-12. The MRI is discussed in more detail in Section VII.A below. The Utilities state that AMRP is coordinated with the City of Chicago and has extensive management oversight. PGL Ex. 8.0 2nd Rev. at 12-14.

Peoples Gas notes that their primary witness related to the AMRP, David Lazzaro, is a General Manager of District Field Operations for Peoples Gas, is a highly experienced engineer, and is responsible for all gas distribution utility field operations in the Peoples Gas Central District, including customer service, distribution system maintenance, and construction. PGL Ex. 8.0 2nd Rev. at 1, 3-4.

The AG’s Proposals. Peoples Gas notes that the AG, in 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). AG Ex. 1.0 at 7-9; AG Ex. 1.2, p. 3. According to Peoples Gas, this proposal was based on simply extrapolating from data on actual costs from January through May 2014. AG Ex. 1.0 at 7.

Peoples Gas explains that Mr. Efron’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. AG Ex. 1.0 at 1-2. Peoples Gas states that Mr. Efron is not an engineer and he does not appear to have any experience managing a utility capital project or any other infrastructure project.

Peoples Gas argues that Mr. Efron’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. NS-PGL Ex. 23.0 2nd Rev. at 3-6. According to Peoples Gas, Mr. Efron’s proposal also included errors in calculating the derivative impacts (the accumulated depreciation, ADIT, and depreciation expense impacts) associated with his recommended reductions. NS-PGL Ex. 22.0 REV at 11-12.

Peoples Gas notes that, 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. NS-PGL Ex. 23.0 2nd Rev. at 3-6. Peoples Gas contends that these are the only reliable numbers in the

evidentiary record for these costs. In addition, Peoples Gas notes that CCI accepts the Utilities' figures, as presented in rebuttal testimony, for the 2014 plant balances. See CCI IB at 8; NS-PGL RB at 26, fn. 20.

Peoples Gas notes that although Mr. Effron's rebuttal testimony significantly reduced his recommended adjustments, he continued to propose 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). AG Ex. 7.0 at 3-4; AG Ex. 7.2, p. 3. This proposal is based on simply extrapolating from data on actual costs from January through July 2014. AG Ex. 7.0 at 3-4. Peoples Gas points out that as a result, the AG's rebuttal proposal does not cure the fundamental flaws of the earlier simplistic extrapolation, although the addition of two months of data to his extrapolation reduced the size of his recommended adjustment. NS-PGL Ex. 38.0 at 2-5. Further, the Utilities' witness noted 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 4-5; 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). Peoples Gas also states that, setting aside the merits of the primary proposed adjustments, the derivative adjustments Mr. Effron calculated in rebuttal were less inaccurate than those in his direct testimony proposal, but they still were incorrect. NS-PGL Ex. 37.0 at 5-7; NS-PGL Ex. 37.5P. Staff agrees with the Utilities' corrections to the AG's calculations of the derivative impacts. Staff IB at 13-14.

Peoples Gas notes that while the AG's briefing (like its cross-examination at the evidentiary hearing) focuses on confirming the correctness of figures for actual capital expenditures on AMRP for January through August 2014, the capital expenditure "actuals" do not support the AG's proposals. Peoples Gas emphasizes that the numbers it presented in rebuttal testimony take into account the delays due to weather, the contract plans to reduce some of those delays, and the construction cycle. In addition, Peoples Gas notes that while the AG's rebuttal proposal is based on capital expenditures through July 2014, the AG's Initial Brief shows that in August 2014, actual AMRP capital expenditures were \$38,465,000, which is \$6,349,000 above the budgeted figure for that month, \$32,116,000. AG IB Corr. at 17. However, as the Utilities emphasize, even though August was more than \$6 million above the budget for that month, the AG made no modification to reduce its proposed adjustments. Peoples Gas contends that the August data is consistent with Peoples Gas' rebuttal figures, not the AG's proposal. NS-PGL RB at 29. Peoples Gas further states that the AG's arguments also effectively ignore the contractors' plans to make up in part for the delays earlier in the year, and disregard the Utilities witness' testimony regarding opportunities that developed after the revised budget was prepared. *Id.*

Peoples Gas notes that the AG's Initial Brief (at 18) asserts that:

The high spending in August 2014 can be understood because summer is the “peak” season for construction (NS-PGL Ex. 23.0 (2nd REV) at 4), but summer is now over, and we should not expect that actual spending in the final four months of 2014 will equal budgeted capital expenditure. In light of the Company’s poor track record of actually spending up to its budget on the AMRP program, the Commission should not give weight to the Company’s optimistic projections for the remaining months of 2014.

However, Peoples Gas points out that Mr. Efron’s rebuttal proposal takes no account of the August data or the construction cycle, as discussed above, and that the AG’s assertion that “we should not expect that actual spending in the final four months of 2014 will equal budgeted capital expenditure” is supported by no citation to any evidence, again ignores the August 2014 data, and provides no valid basis for rejecting Mr. Lazzaro’s testimony regarding expected spending in the remainder of 2014. Peoples Gas further contends that the AG’s reliance on the budget is selective, as it places no weight on the total budget figure, and only focuses on the variances in the first seven months of the year. NS-PGL RB at 29.

In addition, Peoples Gas notes that the AG argues that according to Utilities witness Mr. Lazzaro’s testimony, the expected AMRP expenditures for the last four months of the year are \$25 million to \$30 million per month, which are contrary to the revised budget’s figures for those months. AG IB at 18-19. However, Peoples Gas emphasizes that the AG’s argument again ignores the fact that August 2014 expenditures were more than \$6 million over the revised budget, ignores the contractors’ plans to make up in part for the delays earlier in the year, and disregards Mr. Lazzaro’s testimony regarding opportunities that developed after the revised budget was prepared. Further, Peoples Gas notes that the AG complains (AG IB Corr. at 18-19) that when the Utilities’ witness Mr. Lazzaro testified about the opportunities that developed after the revised budget was proposed, he did not explain them in more depth. In response, Peoples Gas emphasizes that this was cross-examination, and the AG did not ask Mr. Lazzaro to do so. Rather, the AG stopped its cross-examination of Mr. Lazzaro at that exact point. See Lazzaro Tr. at 131:19 – 132:12.

Peoples Gas contends that the AG’s proposal to adjust costs of removal associated with AMRP based on January through July 2014 actual costs lacks merit for the same reasons as the proposal to reduce AMRP costs, with one exception. Peoples Gas explains that here, inconsistently, the AG points to the fact that August 2014 data also was under the revised budget, and Peoples Gas argues that the AG cannot have it both ways. The AG cannot claim that the August removal costs being almost \$1 million under the budget supports its proposal, while the August AMRP costs being over \$6 million over the budget somehow is irrelevant and does not undercut its proposal. NS-PGL RB at 29-30.

In addition, 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. Peoples Gas argues that the evidence supports the

Utilities' rebuttal figures and negates the AG's proposal and the Staff witness' speculation.

Peoples Gas notes that 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. Staff Ex. 6.0 at 17-18. In addition, Peoples Gas notes that Staff provided no testimony that addressed the merits of any version of the AG proposal, apart from Staff's speculation that Peoples Gas' rebuttal's reduced figures did not appear attainable. *Id.*

Peoples Gas notes that Staff's support of the AG's proposal, as discussed in briefing, is based primarily on figures for QIP additions (which includes both AMRP additions and the uncontested revised costs of the Calumet project), less retirements. See Staff IB at 14-15.⁶ Peoples Gas notes, however, that Mr. Effron's rebuttal proposals are based on his analysis of capital expenditures (not additions), and do not factor in retirements, as reflected in the discussion above.⁷

Peoples Gas notes that Staff's discussion, by focusing on additions and not expenditures, fails to take into account the large amount of 2014 AMRP expenditures that already have been incurred but have not yet been recorded as additions. See, e.g., NS-PGL Ex. 38.1.

Peoples Gas notes that on October 17, 2014, Staff filed a motion that the Commission take administrative notice of an existing filing relating to September QIP additions and related data and certain future filings relating to QIP additions and related data. The Utilities filed a response on October 29, 2014, in which, in brief, they did not object to Staff's motion but they expressed concerns with how the information might be used by the Commission and regarding its selectivity (providing update information regarding one area of costs but no others, such as paving costs, which are increasing, see NS-PGL RB at 31). Staff filed a reply on November 3, 2014, that, in brief, accepted the Utilities' caveats about use of the information and did not discuss the subject of selectivity. On November 5th, the Administrative law Judges granted Staff's motion, and incorporated certain caveats. The Utilities state that the data in the attachment to Staff's motion does not support the AG's proposal. *Id.*

Finally, Peoples Gas argues that Staff's assertion that the Utilities are using their concern about the cap in Rider QIP as a reason to include an excessive amount of 2014 AMRP and associated removal costs in rate base is incorrect. Peoples Gas contends that the AG and Staff are using Rider QIP as a failsafe to argue that the Commission should not worry about excessive rate base reductions here because the rider will fix them. Peoples Gas emphasizes that the Utilities are not arguing that anything about the

⁶ As to the Calumet project, see Section IV.B.1.c.ii of this Order.

⁷ Peoples Gas states that there is nothing inherently wrong with an analysis that includes retirements, but notes that an apples to apples comparison to the AG's rebuttal proposal can be made only by starting with the same cost category (AMRP, not QIP), looking at the same kind of costs (expenditures, not additions), and excluding retirements, unless data simultaneously are provided to quantify the effects of the differences, which Staff's discussion does not provide.

rider means that the Commission should approve any rate base figure that the evidence shows to be too high, but that the Utilities are arguing that the facts in evidence show that their rebuttal figures are the only reliable figures. NS-PGL RB at 32.

Peoples Gas argues that there is only one reasonable set of figures for 2014 AMRP additions and the associated costs of removal, which are reflected in the Utilities' rebuttal testimony. Peoples Gas contends that the reduced 2014 AMRP costs figures (including the removal costs), as reflected in rebuttal testimony, should be adopted.

Rider QIP. Peoples Gas notes that 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.*, AG Ex. 1.0 at 8-9. According to Peoples Gas, the Staff witness appeared to accept that reasoning. Staff Ex. 6.0 at 19.

Peoples Gas argues that this reasoning is a highly problematic over-simplification. According to Peoples Gas, 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. Efron speculated they will be, then the amount of QIP investment that Peoples Gas can make and recover under Rider QIP while staying within the annual average revenue cap in 2015 (and in all subsequent years until new base rates are set and in effect) will be reduced. NS-PGL Ex. 43.0 REV. at 15-16. As a result, that could potentially adversely impact future QIP projects, mainly the AMRP, unless Peoples Gas was to file another rate case. *Id.* at 16; see also NS-PGL Ex. 29.0 REV at 26.⁸

Peoples Gas argues that the reduced figures for 2014 AMRP additions and the associated costs of removal, as presented in rebuttal testimony, should be approved. According to Peoples Gas, 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.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission has acknowledged the importance of the Peoples Gas AMRP project, has prioritized the acceleration of the program, and notes the varied and essential benefits for customers that have and will arise out of this project. Pursuant to 220 ILCS 5/9-220.3, Peoples Gas is entitled to allowed rider recovery of qualifying infrastructure plant, including accelerated main replacement costs, but the 2014 costs at issue will become part of rate base here, and no longer recovered under the rider.

The AG's proposed reductions to the forecasted 2014 AMRP additions and associated costs of removal are unreasonable. The AG's proposal ignores the practical

⁸ Also see Section IX.D.2.c below regarding Rider QIP.

implications discussed in evidence of the unusually cold weather earlier in the year and the resulting construction delays, contractors' plans to make up for some but not all of those delays, and the annual construction cycle, is simplistic, and is unsupported by detailed analyses. In contrast, Peoples Gas provided evidence from an experienced engineer supporting the reduced costs presented in its rebuttal of the original forecasted 2014 AMRP additions and associated costs of removal, taking into account the various factors discussed above. In addition, the AG's assumption that Peoples Gas' Rider QIP will correct for any errors associated with the AG's calculations disregards the impacts that such an adjustment could have on future QIP projects, including the AMRP.

Therefore, the AG's proposal is rejected, and the Commission adopts the forecasted costs for Peoples Gas' 2014 AMRP additions and associated costs of removal, as presented in the Utilities' rebuttal testimony. The Commission in future cases will continue to perform its duty of assessing the evidence regarding the prudence and reasonableness of main replacement costs.

2. Cash Working Capital

a. Pension/OPEB lead

North Shore and Peoples Gas

The Utilities explain that CWC essentially is the amount of funds (positive or negative) required to finance the day-to-day operations of a utility, and that the CWC requirement is included in each of the Utilities' rate bases for ratemaking purposes. NS Ex. 7.0 at 15; PGL Ex. 7.0 at 18-19. To determine the CWC requirement, a lead-lag study 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. NS Ex. 7.0 at 15; PGL Ex. 7.0 at 19. The Utilities further explain that 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. NS Ex. 7.0 at 16; PGL Ex. 7.0 at 19. The Utilities state that, 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. NS Ex. 7.0 at 16; PGL Ex. 7.0 at 19. As discussed in Section IV.B.3 above, 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.

The Utilities state that, 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. NS Ex. 7.0 at 27; PGL Ex. 7.0 at 31.

The Utilities note that the use of a lead-lag study to calculate the Utilities' CWC requirement is not contested. However, Staff contests the Utilities' OPEB expense lead, arguing 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. Staff Ex. 1.0 at 9-10. 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.

The Utilities argue that 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 assert that their OPEB leads are based upon the most recent calendar year data that were available at the time the lead-lag studies were conducted, and that 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. NS-PGL Ex. 37.0 at 3-4.

The Utilities argue that 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. The Utilities note that Staff admits that the OPEB trust payments did not have specific due dates. Staff Ex. 1.0 at 9. According to the Utilities, 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. 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. NS-PGL Ex. 22.0 REV. at 8. The Utilities argue that 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, and that Staff's adjustment should be rejected.

The Utilities further note that Staff's position is inconsistent with its position taken in *Peoples Gas 2012*, during which Staff argued that the OPEB lead should be set at the intercompany billing lead. *Peoples Gas 2012* Order at 80; NS-PGL Ex. 22.0 REV at 6-7. In the instant proceeding, the Utilities note, 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. Hathorn. This adjustment results in lead changes from negative to positive, resulting in a decreased CWC. NS-PGL Ex. 22.0 REV. at 7-8. The Utilities argue that Staff has offered no valid justification for this inconsistency.

Further, the Utilities argue that Staff bases its adjustment on an inapposite and irrelevant Commission Order in an unrelated docket. The Utilities explain that Ms. Hathorn 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.” Staff Ex. 1.0 at 10-11. According to the Utilities, 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. The Utilities emphasize that, 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, and argue that Staff’s reliance on ICC Docket No. 13-0192 as support for its adjustment is misplaced and should be rejected.

The Utilities further point out that the lead-lag studies are based on data that consists of hundreds of thousands of cash transactions, and, moreover, that 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. NS-PGL Ex. 37.0 at 4.

The Utilities contend that 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 (NS-PGL Ex. 22.0 REV at 6, 10), although the Utilities recognize that the Commission did not adopt their view that the lead should be zero days in *Peoples Gas 2012*.

Finally, the Utilities argue that 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., PGL Ex. 12.0 at 11-13. According to the Utilities, 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, which is unfair and unreasonable.

The Utilities note that, in its Initial Brief, CCI expressed support for Staff’s position but that this was based wholly on the arguments propounded by Staff. NS-PGL RB at 33.

Therefore, the Utilities conclude that Staff’s proposal, as supported by CCI, should be rejected and that the Utilities’ CWC figures should be approved.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Utilities properly based the OPEB expense lead on the actual cash payments that were made for OPEB during January of calendar year 2012. The timing of these payments is reasonable, and is approved. The Utilities are not required to make such payments on or before a specific date, and, despite Staff's protestations, historical practice demonstrates that the Utilities have appropriately made payments in the beginning of the year in two out of the last three full calendar years. Staff has provided no evidence to demonstrate that the Utilities should be required to act otherwise. Moreover, Staff's reliance on the Commission's Order in Docket No. 13-0192 is misplaced. In that docket, the utility was required by law to make certain payments by statute and municipal ordinance. No such requirement exists here. Last, the Commission agrees with the Utilities that customers benefit from the Utilities' actual payment date in the form of reduced OPEB expenses that resulted from the January 2012 date being included in the calculation of operating expenses with 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.

3. Retirement Benefits, Net

North Shore and Peoples Gas

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.⁹ 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. Also, 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.

⁹ 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.

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, line 11, col. (G); NS-PGL Ex. 22.9P, line 11, col. (G).

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. The Utilities note that Staff advances that same position in the instant cases, while the AG simply proposes to apply the prior Commission decisions. *E.g.*, Staff Ex. 1.0 at 14; Staff Ex. 6.0 at 10; AG Ex. 1.0 at 12-13.

The Utilities argue that the Commission should reconsider approving inclusion of the pension asset(s) in rate base for several reasons. First, 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). Second, 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. NS Ex. 12.0 at 14; PGL Ex. 12.0 at 14.

Third, the rates on which customers' bills are based reflect the accrual of pension expense. NS Ex. 12.0 at 14-15; PGL Ex. 12.0 at 14-15. The Utilities note that although Staff claims that customers paid for the pension asset (Staff IB at 20-21, 26-27) (and the AG does so implicitly by citing past Orders to that effect), Staff does not explain how customers supposedly pay for the pension asset, as discussed further below, and, specifically, does not refute the fact that the bills customers pay are based on the accrual of pension expense. The Utilities assert that a pension asset exists when cumulative funding exceeds the cumulative amount of recognized pension expense. NS Ex. 12.0 at 15; PGL Ex. 12.0 at 15. The Utilities contend that customers did not pay for the excess by which cumulative pension funding exceeds cumulative recognized pension expense, which means that they did not pay for the pension asset. In addition, the Utilities contend that the rates upon which customers' bills are based reflect the accrual of pension expense. NS-PGL RB at 34. The Utilities note that Staff simply argues that pension assets are created with funds supplied by customers, and that the Utilities have not provided evidence to distinguish this case from prior Commission rulings, yet fails to provide any new evidence to support its claims.

Fourth, 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 shareholders' equity, to the extent it is not paid out in dividends. NS Ex. 12.0 at 15; PGL Ex. 12.0 at 15; NS-PGL Ex. 26.0 at 9. Further, the Utilities note that Staff admitted that the pension asset is funded by normal operating revenues. NS-PGL RB at 35-36. The Utilities emphasize that the evidence demonstrates that funds from normal operations include repayment of the utility's cost of capital, so the utility's use of that

repayment for pension funding does not mean that the funding is not capital of the utility. NS Ex. 12.0 at 15; PGL Ex. 12.0 at 15; NS-PGL Ex. 26.0 at 9. In addition, the Utilities contend that Staff's reasoning is inconsistent. When the subject at hand is whether incentive compensation costs should be recovered, and the metric is net income, Staff contends, and the Commission has agreed, that the metric is "shareholder-oriented". See, e.g., Staff Ex. 2.0 at 23, quoting *Peoples Gas 2011 Order* at 54. Yet, here, where it has been shown that the prepayment of pension expense is a reduction to net income and retained earnings, Staff contends that the funds in question are customer-supplied. NS-PGL RB at 36.

Fifth, cumulative pension contributions have exceeded cumulative recognized Generally Accepted Accounting Principles ("GAAP") pension expense. NS Ex. 12.0 at 15; NS Ex. 12.3; PGL Ex. 12.0 at 15-16; PGL Ex. 12.3. The Utilities note that Staff has not disputed this point. NS-PGL RB at 36.

The Utilities note that in the instant proceeding, Staff has only offered a limited response to the Utilities' point regarding the normal operating revenues of a utility, 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. Staff Ex. 6.0 at 12. However, the Utilities argue, Staff continues to fail to provide a sound reason those particular points are incorrect or do not support the inclusion of the pension assets in rate base. Thus, the Utilities contend that the Commission has sufficient grounds for reconsidering this issue and note that, 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).

The Utilities note that the AG's Initial Brief did not respond to or dispute any of the Utilities' points in detail; instead, the AG asserted that the adjustments made by its witness were in accordance with the Commission's previous findings in the past relevant dockets. See AG IB Corr. at 22-23. In addition, the Utilities note that although CCI did not address this issue in testimony, CCI argues that the Commission should adopt the proposal to "properly account for pension assets, which are ratepayer funded." CCI IB at 9. CCI simply refers to the past Commission decisions on this topic, and adopts the propositions of Staff and the AG. See CCI IB at 9-10.

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, line 11, col. (G); NS-PGL Ex. 22.9P, line 11, col. (G); NS-PGL Ex. 26.0 at 10.

Finally, while Staff espouses adherence to the prior Orders as to exclusion of Peoples Gas' pension asset from rate base, Staff's rebuttal (Staff Ex. 6.0 at 11) inconsistently argues for subtracting the North Shore pension liability, even though that same Staff proposal was rejected in the prior 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, and Staff has not provided any change in circumstances or any basis for a different outcome here. NS-PGL Ex. 40.0 at 7. 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. AG Ex. 1.0 at 13.

Accordingly, the Commission (1) should approve the inclusion of Peoples Gas' pension asset and North Shore's pension liability in rate base, or, alternatively (2) should exclude the Peoples Gas pension asset and the North Shore pension liability, the latter being as ordered in *Peoples Gas 2007* and *Peoples Gas 2009* when one utility had a pension asset and the other had a 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 (NS-PGL Ex. 26.0 at 3; NS-PGL Ex. 40.0 at 6), although the Utilities acknowledge that the Commission rejected that contention in past rate cases.

Other Parties

[Insert]

Commission Analysis and Conclusions

[ALTERNATIVE ONE, IF INCLUSION OF PEOPLES GAS' ASSET IS APPROVED:] The Commission finds that Peoples Gas' pension asset of \$17,350,000 should be included in rate base, as should North Shore's pension liability of \$(8,000). The Commission must decide the instant cases based on their record, just as it decided the prior cases based on their records. The prior findings that customers funded the pension assets cannot be made based on the evidence here, in particular the evidence that prepaid pension expense effectively is funded out of retained earnings.

[ALTERNATIVE TWO, IF PEOPLES GAS' ASSET IS EXCLUDED:] The Commission finds that Peoples Gas' pension asset of \$17,350,000 should not be included in rate base for the reasons stated in its past Orders and that North Shore's pension liability of \$(8,000) should be excluded as well as it was in the 2007 and 2009 rate cases. Staff has not shown any reason for a different outcome.

[IN ALTERNATIVE TWO, IF THE OPEB LIABILITIES ALSO WERE TO BE EXCLUDED:] In addition, the Commission has reconsidered the facts and concludes that, to be consistent, the OPEB liabilities should be removed from rate base.

V. OPERATING EXPENSES

A. Overview/Summary/Totals

1 and 2. North Shore and Peoples Gas

North Shore and Peoples Gas

North Shore states that its final properly calculated base rate operating expenses (per its rebuttal testimony) are \$74,635,000, including income taxes and reflecting the Staff and intervenor adjustments that it adopted or accepted in whole or in part in order to narrow the issues and certain updates. *E.g.*, NS-PGL Ex. 21.1N, line 33, col. [G]. Peoples Gas states that its final properly calculated base rate operating expenses (per its rebuttal testimony as slightly revised in surrebuttal) are \$570,562,000, including income taxes and reflecting the Staff and intervenor adjustments that it adopted or accepted in whole or in part in order to narrow the issues and certain updates. *E.g.*, NS-PGL Ex. 36.1P, line 32, col. [G].

The Utilities state their operating expenses are supported by extensive, detailed evidence, including the testimony of seven witnesses on the following topics: (1) the test year, the overall revenue requirement, operating expenses, operating income, rate case expenses, and the Gross Revenue Conversion Factor, and underlying calculations and support of numerous components of operating income and expenses; (2) the test year forecast and associated “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; (3) employee headcounts and Sched. C-4 account variances; (4) incentive compensation program expenses and non-union base wage increases; (5) net operating loss and deferred income taxes; (6) employee benefits operating expenses, including savings and investment plans, pensions, OPEB, group insurance, and Integrys Business Support, LLC (“IBS”) billed benefits. NS-PGL IB at 44-45.

The operating expenses issues are discussed below, in the applicable subsections of this Section V.

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

1. Other Revenues

In rebuttal and surrebuttal testimony, the Utilities updated the proposed other revenues figures. NS-PGL Ex. 21.1N, line 10, col. [G]; NS-PGL Ex. 36.1P, line 9, col. [G]. These figures are not contested. Therefore, the Commission approves the Utilities’ updated figures for these revenue amounts, subject to any derivative impacts, if any.

2. Resolved Items

a. Incentive Compensation

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, in brief, 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 have three different incentive compensation plans: (i) an Executive Incentive Compensation Plan; (ii) an Omnibus Incentive Compensation Plan, consisting of various stock plans; and (iii) a Non-Executive Incentive Compensation Plan. The Utilities submitted evidence of the benefits provided to customers by their incentive compensation plans, in particular metrics contained within their Non-Executive Incentive Compensation Plan and the operational metrics contained within their Executive Incentive Compensation Plan. NS Ex. 10.0 at 9, 15-22; PGL Ex. 10.0 at 9, 15-22. No party has opposed the recovery of the costs related to the Utilities’ Non-Executive Incentive Compensation Plans. This issue is not in dispute. Therefore, the Commission approves the recovery of the Utilities’ expenses for their Non-Executive Incentive Compensation Plans.

Only for the purposes of narrowing the issues in this proceeding and without waiving any rights to contest such amounts in future proceedings, the Utilities do not object to an adjustment removing their Omnibus Incentive Compensation Plan expenses from the test year operating expenses, consistent with the recommendations made by Staff, the AG, and CCI. Staff Ex. 2.0 at 20-25; NS-PGL Ex. 24.0 at 8-9; AG Ex. 1.0 at 26; CCI Ex. 1.0 at 58. This issue is not in dispute. Therefore, the Commission approves an adjustment removing the costs of the Omnibus Incentive Compensation Plan expenses (\$1,455,000 for Peoples Gas and \$245,000 for North Shore) from the Utilities’ test year operating expenses.

With respect to the Executive Incentive Compensation Plan, only for the purposes of narrowing the issues in this proceeding and without waiving any rights to contest such amounts in future proceedings, both the Utilities and CCI have agreed not to contest proposed disallowances to portions of the Utilities’ Executive Incentive Compensation Plan expenses as calculated by Staff. See Staff Ex. 2.0, 20-25; NS-PGL Ex. 24.0 at 3-5; CCI IB at 10-11. This disallowance is consistent with the adjustment proposed by the AG. See AG Ex. 1.0 at 26. This issue is not in dispute. Therefore, the

Commission approves an adjustment removing \$4,216,000 for Peoples Gas' and \$655,000 for North Shore's Executive Incentive Compensation Plan operating expenses.

b. Executive Perquisites

Only for the purposes of narrowing the issues in this proceeding and without waiving any rights to contest such amounts in future proceedings, the Utilities do not object to an adjustment removing 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. NS-PGL Ex. 24.0 at 9-10; NS-PGL Ex. 21.0 at 13-14; Staff Ex. 7.0 at 2. This is not contested. Therefore, the Commission approves an adjustment removing these amounts from the Utilities' respective operating expenses.

c. Interest

i. Budget Payment Plan

In rebuttal testimony, the Utilities accepted Staff's adjustments of interest expense on budget payment plans based on the December 18, 2013, Commission ruling setting the 2014 rate of interest to be paid at 0%. Staff Ex. 1.0 at 24; NS-PGL Ex. 21.0 at 4-5. This subject is uncontested. Therefore, the Commission approves Staff's adjustments.

ii. Customer Deposits

In rebuttal testimony, the Utilities accepted Staff's 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%. Staff Ex. 1.0 at 24; NS-PGL Ex. 21.0 at 4-5. This subject is uncontested. Therefore, the Commission approves Staff's adjustments.

iii. Synchronization

In rebuttal testimony, the Utilities accepted Staff's adjustments to interest synchronization. Staff Ex. 1.0 at 6; NS-PGL Ex. 21.0 at 4-5. This subject is uncontested. Therefore, the Commission approves Staff's adjustments.

d. Lobbying

In rebuttal testimony, the Utilities accepted Staff's adjustments to disallow certain inadvertently included lobbying-related expenses. Staff Ex. 2.0 at 16-17; NS-PGL Ex. 21.0 at 4-5. This subject is uncontested. Therefore, the Commission approves Staff's adjustments.

e. Fines and Penalties (PGL)

In rebuttal testimony, the Utilities accepted Staff's adjustments to remove fines and penalties expenses. Staff Ex. 2.0 at 26-27; NS-PGL Ex. 21.0 at 4-5. This subject is uncontested. Therefore, the Commission approves Staff's adjustments.

f. Plastic Pipefitting Remediation Project (PGL)

In rebuttal testimony, the Utilities accepted Staff's adjustment to disallow inadvertently included costs associated with the Plastic Pipefitting Remediation Project. Staff Ex. 5.0 at 4-6; NS-PGL Ex. 21.0 at 4-5. This subject is uncontested. Therefore, the Commission approves Staff's adjustments.

3. Other Production (PGL)

The Utilities' proposed Other Production expense for Peoples Gas is not contested. NS-PGL Ex. 36.1P, line 14, col. [G]. This subject is uncontested. Therefore, the Commission approves the Utilities' Other Production expense.

4. Storage (PGL)

The Utilities' proposed Storage expense for Peoples Gas is not contested. NS-PGL Ex. 36.1P, line 15, col. [G]. This subject is uncontested. Therefore, the Commission approves the Utilities' Storage expense.

5. Transmission

The Utilities' proposed Transmission expense is not contested. NS-PGL Ex. 21.1N, line 17, col. [G]; NS-PGL Ex. 36.1P, line 16, col. [G]. This subject is uncontested. Therefore, the Commission approves the Utilities' Transmission expense.

6. Distribution

The Utilities' proposed Distribution expense is not contested. NS-PGL Ex. 21.1N, line 18, col. [G]; NS-PGL Ex. 36.1P, line 17, col. [G]. For Peoples Gas, this includes the three-year amortization recovery of costs associated with the Section 8-102 of the Act two-phase AMRP investigation as ordered in *Peoples Gas 2012*. PGL Ex. 6.0 at 17; PGL Ex. 6.1 Sched. C-2.16. This subject is uncontested. Therefore, the Commission approves the Utilities' Distribution expense.

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). PGL Ex. 5.0 Rev. at 16-17; NS Ex. 5.0 at 15-16; NS-PGL Ex. 20.0 at 2; NS-PGL Exs. 20.1P and Ex. 20.1N. The Utilities' proposals are not contested. 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. Staff Ex. 7.0 at 3. Therefore, the Commission approves the Utilities' Customer Accounts – Uncollectible expense.

8. Customer Accounts – Other than Uncollectibles

The Utilities' proposed Customer Accounts – Other than Uncollectible expense is not contested. NS-PGL Ex. 21.1N, line 20, col. [G]; NS-PGL Ex. 36.1P, line 19, col. [G]. Therefore, the Commission approves the Utilities' Customer Accounts – Other than Uncollectible expense.

9. Customer Services and Information

The Utilities' proposed Customer Services and Informational Services expense is not contested. NS-PGL Ex. 21.1N, line 21, col. [G]; NS-PGL Ex. 36.1P, line 20, col. [G]. Therefore, the Commission approves the Utilities' Customer Services and Informational Services expense.

10. Administrative & General (Other than items in Section V.C.3)

The Utilities' proposed Administrative and General ("A&G") expenses are not contested with the exception of items addressed in Section V.C.3 of this Order. PGL Ex. 5.0 Rev., at 15-16; PGL Ex. 5.1 REV., Sched. C-4; NS Ex. 5.0 at 15; NS Ex. 5.1 REV., Sched. C-4. Therefore, the Commission approves the Utilities' A&G expenses.

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

The Utilities' proposed Depreciation expenses are not contested except for the impacts of the 2014 AMRP costs discussed in Section IV.C.1.a of this Order. NS-PGL Exs. 36.1P, 36.2P; NS-PGL Ex. 21.1N. Therefore, the Commission approves the Utilities' Depreciation Expense (including derivative impacts other than in Section IV.C.1a of this Order).

12. Amortization Expense (Including derivative impacts)

The Utilities' proposed Amortization Expense is not contested. NS-PGL Ex. 21.1N, line 26, col [G]; NS-PGL Ex. 36.1P, line 25, col. [G]. Therefore, the Commission approves the Utilities' Amortization Expense (including derivative impacts).

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

North Shore and Peoples Gas

Rate Case Expense in Current Rate Case

North Shore and Peoples Gas take the position that the evidentiary record contains substantial evidence demonstrating that their revised proposed rate case expenses for this rate case – \$1.947 million for North Shore and \$2.945 million for Peoples Gas – are just and reasonable. NS-PGL Ex. 21.0 at 14-15; NS-PGL Exs. 21.3N, 21.3P; NS-PGL Ex. 36.0 at 13; NS-PGL Exs. 36.4N and 36.4P; Staff Ex. 7.0 at 16 and Schedules 7.06N, 7.06P. The Utilities assert that 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. The Utilities further rely on the fact that 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. Staff Ex. 2.0 at 4; Staff Ex. 7.0 at 13-16; Staff Ex. 8.0 at 20-21. The Utilities further request that these rate case expenses be amortized over two years for ratemaking purposes.¹⁰

The Utilities state that it is well-established law 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 and 561 (1971) (“rate-case expense is ordinarily properly and fairly allowed as 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”¹¹ – 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”).

¹⁰ 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 will be addressed below in Section V.C.4.

¹¹ 220 ILCS 5/9-201(c); *Business and Prof’al People for the Public Interest v. Illinois Commerce Comm’n*, 146 Ill. 2d 175, 208, 585 N.E.2d 1032, 1045 (1991).

The Utilities' position is that Section 9-229 of the Act did not change this standard, as 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.¹² 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 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.¹³ *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), at 14.

The Utilities further state that 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 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

¹² 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."

¹³ "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).

(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. *Id.* at ¶¶ 90-96.

The Utilities state that the evidentiary record in this rate case 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. NS Ex. 6.0 at 19-21; PGL Ex. 6.0 at 20-22.

The Utilities state that 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 Sharon Moy 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. NS Ex. 6.0 at 21; PGL Ex. 6.0 at 22. 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. NS-PGL Ex. 36.0 at 11.

Specifically for each law firm and consultant, the Utilities provided voluminous record evidence containing 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, which the Utilities summarized as follows:

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. NS-PGL Ex. 21.0 at 18-19. 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; 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 NS-PGL Ex. 21.0 at 19-20; NS-PGL Ex. 36.0 at 13-14; NS-PGL Exs. 21.7, 21.8, 36.5, 36.6, 36.7 and 36.8.

In addition, the Utilities rely on the testimony of Staff witness Mr. Kahle 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. Staff Ex. 7.0 at 15-16.

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. NS-PGL Ex. 21.0 at 21; NS-PGL Ex. 36.0 at 15. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services and qualifications of Stafflogix. NS-PGL Ex. 21.0 at 21; 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. NS-PGL Ex. 21.0 at 21-22; NS-PGL Ex. 36.0 at 15; NS-PGL Exs. 21.10 and 36.9.

Centric Consulting (“Centric”)

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. NS-PGL Ex. 21.0 at 22; 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. NS-PGL Ex. 21.0 at 22-23; NS-PGL Ex. 36.0 at 15-16; 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. NS-PGL Ex. 21.0 at 23; NS-PGL Ex. 36.0 at 16. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services and qualifications of Hengtgen Consulting, LLC. NS-PGL Ex. 21.0 at 23; 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. NS-PGL Ex. 21.0 at 23-24; NS-PGL Ex. 36.0 at 16-17; 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. NS-PGL Ex. 21.0 at 24-25; NS-PGL Ex. 36.0 at 17. 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. NS-PGL Ex. 21.0 at 25; 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. NS-PGL Ex. 21.0 at 25; NS-PGL Ex. 36.0 at 17; NS-PGL Exs. 21.16 and 36.13.

Deloitte & Touche ("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. NS-PGL Ex. 21.0 at 26; NS-PGL Ex. 36.0 at 18. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services, and qualifications of Deloitte. NS-PGL Ex. 21.0 at 26; 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. NS-PGL Ex. 21.0 at 26; NS-PGL Ex. 36.0 at 18; 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. NS-PGL Ex. 21.0 at 26; NS-PGL Ex. 36.0 at 18. 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 26-27; 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. NS-PGL Ex. 21.0 at 27; NS-PGL Ex. 36.0 at 18; 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. John 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. NS-PGL Ex.21.0 at 27; NS-PGL Ex. 36.0 at 19. 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. NS Ex. 9.0 at 7; PGL Ex. 9.0 at 8. The Utilities introduced evidence into the record regarding the terms of engagement, particular fees, services, and qualifications of Gannett Fleming, Inc. NS-PGL Ex. 21.0 at 27-28; 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. NS-PGL Ex. 21.0 at 28; NS-PGL Ex. 36.0 at 19; NS-PGL Exs. 21.22 and 36.15.

Towers Watson

The record evidence shows that 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. NS-PGL Ex. 21.0 at 28; NS-PGL Ex. 36.0 at 19. 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. NS-PGL Ex. 21.0 at 28-29; NS-PGL Ex. 36.0 at 19; 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. NS-PGL Ex. 21.0 at 29; NS-PGL Ex. 36.0 at 20. 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. NS-PGL Ex. 21.0 at 29; NS-PGL Ex. 36.0 at 203; NS-PGL Exs. 21.24, 36.16 and 36.17.

Unrecovered Rate Case Expense Approved in Prior Rate Cases

The Utilities state that 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, lines 19, 23-24, col [H] and 36.4P, lines 19, 23-24, col [H]. NS Ex. 6.0 at 15; PGL Ex. 6.0 at 15. The Utilities note that no party has submitted testimony concerning or otherwise opposed the recovery of these expenses. The Utilities state that Commission thus should approve the recovery of \$521,000 for North Shore and \$786,000 for Peoples Gas over the same two-year amortization period sought for rate case expenses from the current proceedings.¹⁴

¹⁴ 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

Rehearing and Appeal Costs From Prior Rate Cases

The Utilities assert that, 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*, 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). 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. 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 describing what was done during that time, and the hourly rate charged. NS-PGL Ex. 21.0 at 30; NS-PGL Ex. 21.25. Moreover, the Utilities note that in the appeals from the 2012 rate cases, the Utilities are only defending the appeals. NS-PGL Ex. 21.0 at 30.

No party has submitted testimony concerning or otherwise opposed the recovery of these rehearing and/or appeal expenses. The Utilities state that as concluded by the Commission in *Peoples Gas 2011 Order* (at 85-86), 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 of \$118,000 for North Shore and \$180,000 for Peoples Gas in the same two-year amortization period sought for rate case expenses from the current proceedings. NS-PGL Exs. 36.4N, line 22 col [H] and 36.4P, line 22 col [H].

The Utilities conclude that for these reasons, the Commission should make a determination pursuant to Section 9-229 of the Act, 220 ILCS 5/9-229, that the \$1.947 million and \$2.945 million in rate case expenses requested by North Shore and Peoples Gas, respectively, in these dockets are just and reasonable and allow their recovery (as well as recovery of the unamortized amounts of rate case expenses remaining, and rehearing and appeal costs, from previous rate cases) over a two-year amortization period.

Other Parties

[Insert]

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.

Commission Analysis and Conclusions

“The costs incurred by a utility to prepare and present a rate case are properly recoverable as an ordinary and reasonable cost of doing business.” *Illinois-American Water*, 2011 IL App (1st) 101776 at ¶ 13 (citations omitted). The guiding standard for the Commission in setting any rates for a public utility – that the rates be “just and reasonable” – 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”).

As stated by the Utilities, Section 9-229 of the Act did not change this standard. Section 9-229 provides:

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.

220 ILCS 5/9-229. The appellate court in *Illinois-American Water* held that Section 9-229 requires the Commission to “‘expressly address’ the basis for its findings” – i.e., include “explanation or discussion” – as to 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. Based on the guidance provided by the court in *Illinois-American Water*, as confirmed by the *ComEd* decision, 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 19; *In re Charmar Water Co., et al.*, ICC Docket Nos. 11-0561 – 11-0566 (consol.) (Order on Rehearing Nov. 28, 2012), at 14.

The Commission here has thoroughly examined the voluminous record evidence supporting the rate case expenses for which North Shore and Peoples Gas have requested recovery in this rate case. The Commission finds that for each of the attorneys and technical experts for which recovery of rate case expense is sought, the Utilities provided detailed information concerning the nature and scope of their engagement, their hourly rates, what services they performed in support of the rate case, why those services were necessary, and what their actual expenses have been or will be incurred. Detailed invoices were provided that identified who was performing the

work, what work or tasks were performed, when and for how long, and the fees and costs associated with that work. Further, the record evidence demonstrates that the rates negotiated with the attorneys and experts were reasonable in light of their experience working on rate cases generally and for the Utilities specifically, the market rate for such services, discounts and other cost protections such as “not-to-exceed” provisions provided, and the necessity and level of difficulty of the work to be performed. The record evidence also established that the Utilities review the invoices and have other safeguards in place to ensure that there is no “double-counting” for the costs of work performed by IBS personnel and that the time spent performing work by outside counsel and experts is reasonable and not duplicative. Moreover, while not determinative of the issue, the Commission notes that no party opposed recovery of the final revised amounts of rate case expenses sought by the Utilities, and that Staff testified it had reviewed the record evidence and found the amounts requested to be just and reasonable based on the facts and circumstances of this rate case.

Additionally, the Commission finds that the evidence in the record supports the conclusion that the amounts of rate case expenses not actually shown to have been expended by the time of the hearing are reasonably likely to be expended by the end of the rate case.

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.

Further, the Commission approves the recovery of \$521,000 for North Shore and \$786,000 for Peoples Gas for their approved but unrecovered prior rate case expenses from their 2009 and 2011 rate case rehearings and their 2012 rate cases, as well as \$118,000 for North Shore and \$180,000 for Peoples Gas for their appeal costs from their 2012 rate cases, to be amortized over the same two-year period as the rate case expenses from the current proceedings.

The total rate case costs are detailed in NS-PGL Exs. 36.4N and 36.4P.

14. Taxes Other Than Income Taxes (Including derivative impacts)

The Utilities’ revised proposed Taxes Other Than Income expense is not contested. NS-PGL Ex. 21.1N, line 27, col [G]; NS-PGL Ex. 36.1P, line 26, col. [G]. Therefore, the Commission approves the Utilities’ Taxes Other Than Income expense.

15. Income Taxes (Including derivative impacts)

In rebuttal (North Shore) and surrebuttal (Peoples Gas) testimony, the Utilities’ revised the proposed Income Taxes expense. These expenses are uncontested except

for derivative impacts of contested items. NS-PGL Ex. 21.1N, lines 29-30, col [G]; NS-PGL Ex. 36.1P, lines 28-29, col. [G]. Therefore, the Commission approves the Utilities' Income Taxes expenses.

16. Reclassification of Costs to Plant in Service (PGL)

The Utilities acknowledged in response to a Staff data request that they inadvertently omitted in Peoples Gas' rebuttal revenue requirement an adjustment to reclassify certain costs from O&M expense to Plant in Service. NS-PGL Ex. 36.3P. In surrebuttal testimony, the Utilities' corrected this omission to show the reduction to O&M expense offset by derivative depreciation expense and income taxes on Plant in Service. NS-PGL Ex. 36.0 at 10. This corrected Reclassification of Costs to Plant in Service is not contested. Therefore, the Commission approves the Utilities' Reclassification of Costs to Plant in Service.

17. Gross Revenue Conversion Factor

The Utilities' Gross Revenue Conversion Factors ("GRCFs") are not contested. PGL Ex. 6.0 at 23; NS Ex. 6.0 at 22. Therefore, the Commission approves the Utilities' GRCFs.

18. Other

As ordered by the *Peoples Gas 2012* Order on Rehearing, 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.*, NS-PGL Ex. 36.0 at 21-22. As indicated in Section IV.B.7.(b) of this Order, 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 accept Staff's adjustments to Invested Capital Tax ("ICT"), and thus there are no contested issues concerning the calculation of ICT. Staff Ex. 2.0 at 26; Staff Ex. 7.0 at 13; Staff IB at 32; NS-PGL RB at 44. Therefore, the Commission approves the final invested capital tax figures (including derivative impacts) based on the revenue requirement findings in the final Order.

There are no other issues related to operating expenses that are required to be discussed here.

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

1. Test Year Employee Levels

a. Peoples Gas

Peoples Gas

Peoples Gas argues that its forecasted 2015 test year employee level should be approved. Peoples Gas notes that 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." AG Ex. 1.0 at 15; AG Ex. 7.0 at 10. The AG proposes a reduction to Peoples Gas' 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. AG Ex. 7.0 at 10; Sched. DJE PGL C-1. Peoples Gas argues that the AG's adjustment is unsupported and should be rejected.

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. PGL Ex. 8.0 2nd REV. at 23. 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 24-25. Although the AG's witness Mr. Effron admitted that he does not "dispute that Peoples Gas will [b]e hiring new employees from time to time," he argued that the AG's significant adjustment is justified by the supposition that "other employees will be simultaneously retiring or leaving for other reasons." AG Ex. 7.0 at 10.

Peoples Gas contends that it 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. PGL Ex. 8.0 2nd REV. at 25. Additional detail regarding these positions, including identification of the pool of workers from which the positions are filled, was provided in the Utilities' rebuttal testimony. NS-PGL Ex. 23.0 2nd REV. at 9-10. In addition, Peoples Gas identified thirty-three positions for which interviews were currently being conducted. *Id.* at 10. In surrebuttal testimony, 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. NS-PGL Ex. 38.0 at 7. Peoples Gas states that it has created a well-founded expectation that members of the Power for America training program will be hired for permanent employment. Peoples Gas states that the AG allegations that Peoples Gas failed to indicate that students in the program "had actually already started" (AG IB Corr. at 27) are unfounded and demonstrate a misunderstanding of the Dawson Technical Institute training program. Peoples Gas explains that graduating students are hired for a six-week internship program through the company with the *goal* of full time employment

following the conclusion of the internship. See NS-PGL IB at 69-70. Peoples Gas states that the AG's criticism is misplaced because Peoples Gas rightfully did not want to provide a premature update at the time of the hearings. Peoples Gas argues that 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 the Utilities' witness 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. Lazzaro 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 Utilities emphasize that 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. NS-PGL Ex. 38.0 at 7; 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-Integritys 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-Integritys 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 discovery response was additionally relied upon by CCI in its Initial Brief. CCI IB at 12, citing AG Cross Ex. 11. The Utilities argue that this information does not support the AG's nor CCI's proposed adjustments to headcount levels. As an initial matter, as the Utilities have emphasized, the WEC-Integritys 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. NS-PGL Ex. 17.0 at 9-10; 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 Utilities emphasize that this point was acknowledged by the AG. AG IB Corr. at 31. The information from the WEC-Integritys 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. at 38:7-12. The Utilities argue that the Commission should reject this discovery response as not probative as to the proceeding at hand.

Although CCI did not address this issue in the rebuttal testimony of its witness, Mr. Gorman, CCI's Initial Brief reiterates the position expressed by the CCI witness in direct testimony. CCI IB at 11-13. Like the AG, CCI relies upon Peoples Gas' historical employee levels, arguing that Peoples Gas' employee levels be reduced to match the Company's May 2014 actual levels. *Id.* at 12. In addition, CCI also wholly disregards the evidence related to Peoples Gas' current and planned hiring practices.

Finally, Peoples Gas notes that 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. Staff Ex. 7.0 at 18; Kahle Tr. at 160:7 – 161:9, 168:11 – 169:5.

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

Other Parties

[Insert]

Commission Analysis and Conclusions

The adjustments to Peoples Gas' forecasted 2015 FTE employee levels, as made by the AG and CCI, are rejected. The Utilities and Staff agree that the adjustments are not warranted. Peoples Gas has offered detailed evidence regarding its current and planned hiring practices, and has identified specific positions that are due to be filled. Moreover, certain capital additions (including Peoples Gas' AMRP project, as discussed above) creates a need for a supplemented workforce. Peoples Gas' forecasted 2015 employee levels are approved.

b. North Shore

North Shore

North Shore contends that its forecasted 2015 test year employee level should be approved. North Shore notes that 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." AG Ex. 1.0 at 15. The AG proposes 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; Sched. DJE NS C-1. North Shore argues that 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. NS-PGL Ex. 31.0 at 3. 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. 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. NS-PGL Ex. 45.0 at 2-3.

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 2013 and July 2014. Tr. at 52:21-53:5; AG Cross Ex. 1, pp. 2, 5.¹⁵ 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, North Shore argues that these numbers do not take into account North Shore's expressed planned hiring goals for 2014. North Shore emphasizes that, 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.

As noted above, during the evidentiary hearings in this proceeding, the AG also introduced a discovery response related to certain proposed FTE commitments proposed in the WEC-Integrus transaction docket, ICC Docket No. 14-0496. Tr. at 114:7-115:7; AG Cross Ex. 11. As discussed with respect to Peoples Gas, this discovery response identifies a proposed commitment that is subject to approval of the WEC-Integrus proposed transaction. See NS-PGL Ex. 17.0 at 10; Tr. at 117:11-17. Moreover, the AG acknowledged that the proposed commitment as stated in the discovery response identifies a commitment for 1,953 FTEs in Illinois, not for the breakdown among Peoples Gas, North Shore, and IBS. AG IB Corr. at 31. The AG further admits that the North Shore commitment is for a minimum of 166 FTEs, which equals the number of employees forecasted by the AG. *Id.* However, North Shore argues that the AG attempts to explain this fact away by arguing that "the company-based employee figures...must be based on some carefully calculated expectation for

¹⁵ 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.

the test year.” *Id.* North Shore asserts that the AG introduced this data request, as issued in a separate docket by a witness that is not participating in the instant proceeding, and then attempts to explain away the numbers by assuming that there is some unknown, unidentified calculation that assumes that North Shore will not hire nor maintain additional employees to meet its forecasted 2015 test year FTE employee count. North Shore argues that the AG does not, and cannot, provide any evidence to rebut North Shore’s prudent and reasonable 2015 forecasted employee levels, and that the Commission should reject the AG’s adjustment.

Although CCI did not address this issue in the rebuttal testimony of its witness, Mr. Gorman, CCI’s Initial Brief reiterates the position expressed by the CCI witness in direct testimony. CCI IB at 13-14. The Utilities state that, like the AG, CCI relies upon North Shore’s historical employee levels, and wholly disregards the evidence related to North Shore’s current and planned hiring practices. NS-PGL RB at 50.

Finally, North Shore notes that 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. Staff Ex. 7.0 at 18.

Therefore, North Shore concludes that the Commission should reject the adjustments proposed by the AG and CCI, and should adopt North Shore’s test year employee level.

Other Parties

[Insert]

Commission Analysis and Conclusions

The adjustments to North Shore’s forecasted 2015 FTE employee levels, as made by the AG and CCI, are rejected. The Utilities and Staff agree that the adjustments are not warranted. North Shore has offered detailed evidence regarding its current and planned hiring practices, and has identified specific positions that are due to be filled. North Shore’s forecasted 2015 employee levels are approved.

2. Medical Benefits

a. Peoples Gas

Peoples Gas

The Utilities state that the AG fails to provide any credible basis for its attempt to reject the Utilities’ medical benefits costs which are properly based on an independent actuarial report. See AG IB Corr. at 32-36, 45-46. Throughout the record, the Utilities have provided evidence explaining how the Utilities’ figures are based on an independent actuary report, and detailing the supporting calculations that were supplied to Staff and intervenors. NS-PGL IB at 74. Independent actuarial reports have regularly been relied upon by the Commission in numerous rate cases, for many years.

Id. at 75-76. The Utilities note that, ironically, even AG witness Mr. Effron himself argued 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. Mr. Effron was successful in that case and the Commission there found arguments against use of the study “too speculative” (*id.* at *179), just as it should do so here.

While Mr. Effron argued against rejection of an actuarial study in Illinois Power Co., in the current cases he and the AG have flipped the script, arguing that the independent actuary report that was used to provide the foundation of the Utilities’ forecasts is not enough. AG IB Corr. at 32-36, 45-46. However, Mr. Effron has provided no credible evidence that explains why the independent actuary’s figures should not be relied upon by the Commission and has not articulated any way in which the actuarial report is flawed. This is critical, because the Utilities are not claiming that an actuarial report can never be rejected, but rather that sufficient grounds must be presented before rejecting a traditionally accepted report that has been supported in the evidence. NS-PGL IB at 77.

Mr. Effron’s position rests on nothing more than his personal opinion that based on the rate of medical cost increases from 2012 to 2013, the independent actuary’s estimate of how much medical benefits costs will increase by 2015 must be unreasonable. See AG IB Corr. at 33-34. The Utilities argue that this is not a valid basis for rejecting the independent actuary report and reducing medical benefits costs, and merely speculation. See NS-PGL IB at 74-75.

The Utilities maintain there is no credible or relevant evidence supporting Mr. Effron’s opinion, and the AG points to no independent evidence suggesting a lower rate of medical benefits costs increases. The AG has not presented any valid reason to reject the independent actuary’s figures, which are based on trend information, properly reflects changes in numbers of employees, and are consistently and correctly calculated.

Staff also opposes the AG’s proposed medical benefits adjustments as lacking in merit. Additionally, Staff shares nearly identical sentiments with the Utilities when stating in its Initial Brief that “The Commission should reject AG witness Effron’s proposed adjustment to reduce the amount of projected direct medical benefit costs and medical benefits allocated from IBS based on applying an inflation factor to historical costs.” Staff IB at 33. Further, Staff notes that Mr. Effron’s analysis is lacking and unjustifiably ignores the independent actuary study. *Id.*

The Utilities note that the AG had the opportunity to cross-examine Staff witness Mr. Kahle regarding the reasonableness of the Utilities’ proposed medical benefits figures that were based on the independent actuary’s figures. However, the AG’s 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.

Finally, the Utilities' Initial Brief provides a more in depth discussion supporting the reasonableness of their proposed medical benefits costs and the IBS medical benefits costs cross charged to them. NS-PGL IB at 73-77. The Utilities' Initial Brief also more thoroughly explains why AG witness Mr. Effron's proposed adjustments to the Utilities figures are arbitrary and should be rejected. *Id.*

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that the Utilities have provided extensive evidence supporting approval of the Utilities' medical benefits costs. The AG's primary argument would require the Commission to ignore the data provided by an independent actuary report. Without evidence of an error in the report, the Commission cannot disregard the report's conclusions. As noted by the Utilities, the Commission has a long history of relying on actuarial reports during rate cases. Absent a proven flaw in an actuarial report, the Commission will not ignore such a report. The AG has provided no other evidence supporting rejection of the Utilities proposal, and has provided no evidence supporting its own proposal. Therefore, the Commission rejects the AG's proposal and adopts the Utilities' proposed medical benefits expense.

b. North Shore

North Shore

The Utilities state that the AG's arguments as to North Shore's medical benefits costs (AG IB Corr. at 35-36) parallel the AG's arguments as to Peoples Gas medical benefits costs, lack any valid basis, and should be rejected for the same reasons. NS-PGL IB at 77; NS-PGL RB at 53. See Section V.C.2.a of this Order.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission rejects the AG's proposal and adopts the Utilities' proposed medical benefits expense as to North Shore for the same reasons discussed above as to Peoples Gas.

3. Other Administrative & General

a. Integrys Business Support Costs

North Shore and Peoples Gas

The Utilities state that they have provided sufficient and detailed evidence through testimony and supporting exhibits that support the costs and expenses attributable to IBS. See PGL Ex. 5.0 REV at 16, 18; PGL Ex. 13.0 (entire); NS Ex. 5.0 at 14-15, 17; NS Ex. 13.0 (entire). As such, the Utilities contend that their revenue requirements, subject to the updates provided in rebuttal testimony, accurately and properly reflect the forecasted 2015 cross-charges to them from their affiliated business services company, IBS. The Utilities state that the cross-charges are consistent with the Commission-approved Master Regulated Affiliated Interest Agreement. NS-PGL IB at 77.

The Utilities note that the AG discusses figures regarding the overall increases in IBS costs cross-charged to the Utilities, but the AG does not claim that the overall figures themselves warrant any adjustments. See AG IB Corr. at 37. Rather, the AG has proposed only adjustments to specific IBS cost items. Additionally, the Utilities note that Staff opposes nearly all of the AG's proposed adjustments. The AG's proposed adjustments are discussed in the following subsections of this Order.

i. Labor

North Shore and Peoples Gas

The Utilities state that their cost figures reflect properly forecasted IBS labor costs cross-charges. NS-PGL IB at 78; NS-PGL RB at 54. The Utilities note that the AG advocates its witness Mr. Efron's proposals to reduce the level of these costs, AG IB Corr. at 37-45. However, the Utilities state that the proposals are inconsistent and without merit. While the issue to be addressed should be whether the forecasted level of IBS labor costs to be cross-charged in 2015 is reasonable, the AG proceeded as if the true issue was determination of the level of costs or the IBS headcount as of some point in 2014. NS-PGL IB at 78; NS-PGL RB at 54.

The Utilities state that Mr. Efron's proposals were based on his analysis of data from 2012, 2013, and the first four months of 2014, but he used one method for Peoples Gas (his figure is based on the 2013 expense level with a wage increase level based on two years of the average wage increase level from 2012 to 2015) and a different one for North Shore (his figure is based on the 2013 expense level with a wage increase level based on one year of the average wage increase level from 2012 to 2015), and he did not take into account any other factors that impacted labor's costs between 2013 and 2015. NS-PGL Ex. 27.0 at 3.

In particular, the Utilities contend that Mr. Efron's direct testimony proposal ignored the three primary reasons that these labor costs were forecasted to increase:

(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. NS-PGL Ex. 27.0 at 3-4; NS-PGL Exs. 27.1P and 27.1N.

The Utilities note that Mr. Effron's rebuttal proposal did not correct for any of the above flaws in his direct testimony proposal. In fact, during rebuttal, the only change made by Effron was to correct for his using incorrect allocation percentages, and to calculate the Peoples Gas figure by escalating 2013 costs based on the rate of increase in the first six months of 2014. AG IB Corr. at 40; NS-PGL Ex. 40.0 at 2-3.

The Utilities note that the AG points to the percentage increases in cross-charged labor costs from 2012 to 2013, but the AG does not show how that is relevant. See AG IB Corr. at 37-38. The issue is 2015.

The Utilities also note that the AG also argues that Mr. Effron's proposal is reasonable as to North Shore on the grounds that the actual labor expense in the first four or six months of 2014 was lower than in the same period of 2013, and that it is reasonable as to Peoples Gas on the grounds that, while the actual labor expense in the first four months of 2014 was higher than in the same period of 2013, the rate of increase in those four months was less than was forecasted. AG IB Corr. at 37-39. Again, the Utilities note that the issue is 2015.

The Utilities state that the AG's repeated reliance in cross-examination and later in briefing on data extrapolated from specific and limited periods from 2012, 2013 and 2014 simply serves to confirm certain mathematical calculations that reflect the increase in costs between specific years. Kupsh Tr. at 76:13 – 82:2; AG IB Corr. at 37-39. The Utilities note that the AG entered several cross-exhibits into the record, purportedly in support of the AG's claim that "the forecasted test year amounts of labor expense charged by IBS to North Shore and Peoples Gas is excessive and unjustified." AG IB Corr. at 37; *see also* AG Cross Exs. 2-4. However, the Utilities contend that these cross-exhibits simply reflect cost information, and nothing more. The Utilities explain that this financial information is not relevant to the forecasted 2015 costs, and does not provide any support for the AG's inconsistent and meritless proposals. NS-PGL RB at 55-56.

Finally, and most importantly, the Utilities state that neither of the AG's arguments takes into account the three points noted above from the rebuttal of Utilities' witness Ms. Kupsh regarding why the 2015 costs are forecasted to be higher. The AG's response to this subject is circular. Additionally, the AG admits that Mr. Effron's proposals did not "explicitly" address those three points, but claims that his looking at data from 2012, 2013, and the beginning of 2014 somehow implicitly took them into account. See AG IB Corr. at 39-40. That argument assumes, without any identified factual basis, that that data fully reflects those three factors.

Staff opposes the AG's proposals and recommends that they not be adopted. Staff IB at 33-34; Staff Ex. 7.0 at 18-19. The AG attempts to weaken Staff's testimony, but all the AG demonstrates is that Staff witness Mr. Kahle, in concluding that the 2015

forecasted level is reasonable, did not perform an “independent analysis” of whether the three factors cited by Ms. Kupsh already have resulted in increases, and did not assess whether the costs have been increasing in the recent past. AG IB Corr. at 40.

The Utilities contend that, as a result of the AG’s deficiencies in evidence and lack of meritorious proposals, the Utilities’ well-supported figures should be adopted, as both the Utilities and Staff contend.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that the Utilities have provided sufficient, detailed evidence in support of their forecasted IBS labor costs cross charges. The Commission further finds that the AG’s proposals are both inconsistent and unsupported by the evidence. The AG analysis does not take into account various factors that impacted the increase in labor costs between 2013 and 2015 such as the following: (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. Additionally, the AG’s analysis often focuses on irrelevant information. Therefore, the Commission rejects the AG’s proposals.

ii. Benefits

North Shore and Peoples Gas

The Utilities state that the AG’s proposed adjustments to medical benefits cross-charged by IBS in all but one respect parallel the AG’s arguments as to Peoples Gas’ and North Shore’s medical benefits costs, lack any valid basis, and should be rejected for the same reasons. See Section V.C.2.a of the Utilities’ Initial Brief, Reply Brief, and, as to the Utilities’ positions, this Order.

The Utilities state that the new item that is added here by the AG is that Mr. Efron originally included a component in his proposed adjustments relating to the percentage of IBS medical benefits costs cross-charged to the Utilities. See AG IB Corr. at 46-48. However, after the Utilities pointed out that Mr. Efron had not used the right percentages, he corrected his adjustments as to this aspect in his rebuttal. NS-PGL Ex. 41.0 at 3. The final paragraph of the AG’s Initial Brief’s discussion seems to suggest this aspect still is contested, but that it not the case.

The Utilities contend that their figures should be adopted, and Staff agrees.

Other Parties

[Insert]

Commission Analysis and Conclusion

For the same reasons discussed in the Commission Analysis and Conclusion section in Section V.C.2.a of this Order, the Commission finds that the AG's proposed adjustments to medical benefits expense, including medical benefits cross-charged by IBS, lack merit and should be rejected.

iii. Postage

North Shore and Peoples Gas

The Utilities state that the AG's proposed adjustments to the Utilities' forecasted cross charged postage expense are incorrect and should be rejected. NS-PGL IB at 78-79; NS-PGL RB at 57-58. 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 Integrys Customer Experience project. NS-PGL IB at 78-79. Staff also opposes the AG's postage adjustments. Staff IB at 34.

The Utilities state that the AG calls the forecasted 2015 level of this expense "unexplained", but this is nothing more than the AG seeking to define away the expected increases in postage rates and volume of mail as explanations. See AG IB Corr. at 48. In fact, the AG admits that those two factors could increase the expense level, although the AG unpersuasively claims that the Utilities did not sufficiently explain how they will result in the forecasted levels. *Id.* at 49.

The Utilities state that the AG seeks to diminish the fact that Staff witness Mr. Kahle agrees with the Utilities' figures and opposes the AG's proposed adjustments, by pointing to the fact that he did not do an "independent analysis" of the likelihood of the volume increases (AG IB Corr. at 49-50), but that does not alter the fact that Mr. Kahle's review led him to conclude that the Utilities' figures should be approved. Additionally, Mr. Kahle's rebuttal testimony made clear that he had reviewed the Utilities' support for the increases. Staff Ex. 7.0 at 20.

The Utilities contend that the AG cannot ignore the effect of the expected increases in postage rates and the increase in the volume of mail on the Utilities' forecasted cross charged postage expense. As a result, the Utilities' figures should be adopted, as both the Utilities and Staff contend.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission approves the Utilities' forecasted cross charged postage expense. The Commission agrees with the Utilities and Staff that the effect of the expected increase in postage rates and the increase in the volume of mail on the

Utilities' forecast cannot be ignored. The AG has provided no evidence supporting its proposed adjustments to the Utilities' forecasts.

iv. Legal (NS)

North Shore

The Utilities state that the North Shore legal budget was developed through consultation of the business team and the legal department, based not only on historical legal expenses but also expected future requirements and demands for services. NS-GL IB at 79; NS-PGL Ex. 27.0 at 6.

The Utilities contend that the AG's proposed adjustment should not be adopted. The AG proposes to adjust the forecasted legal expenses cross-charged to North Shore, essentially on the grounds that this cost has been flat and that the Utilities did not provide sufficient data to support the forecast, and Staff agrees. AG IB Corr. at 50-51; Staff IB at 35. However, that places no weight on how the forecast of this item was developed.

The North Shore figure should be approved.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that Utilities have provided sufficient evidence justifying their forecasted legal expenses cross-charged to North Shore. The AG's proposal does not consider the method in which North Shore's legal budget is developed or fluctuations in future requirements and demands for services. Therefore, the Commission rejects the AG's proposal.

v. ICE Project

The Integrys Customer Experience ("ICE") project is scheduled to go into service fully in 2015. This project will unify the Utilities' customer information systems with those of other Integrys companies, providing significant benefits to customers, including, among other things, the following: improved efficiency, productivity, and standardization of internal delivery; and improved and enhanced billing, collections, call center and service related offerings. *E.g.*, PGL Ex. 13.0 at 9-10.

(a) Return on Assets and Depreciation

North Shore and Peoples Gas

The Utilities state that they provided evidence supporting the portions of the forecasted ICE project costs allocated to the Utilities. NS-PGL IB at 79-81; NS-PGL RB

at 58-61. The Utilities emphasize that the forecasted 2015 ICE project costs were determined as part of a careful, well-established forecasting process. The Utilities note that in direct testimony, Utilities' witness Ms. Gregor described the Utilities' established budgeting and forecasting processes, and overviewed the careful steps through which the 2015 forecasts were prepared, starting from the foundations of the approved 2014 budget that was prepared in the Fall of 2013. PGL Ex. 5.0 REV. at 5-9; PGL Ex. 5.1; NS Ex. 5.0 at 5-9; NS Ex. 5.1. The Utilities further stated that these processes resulted in the forecasted 2015 financial statements that an independent CPA, Deloitte & Touche LLP, confirmed were prepared in accordance with the applicable accounting rules (in accordance with 83 Ill. Adm. Code § 285.7010). *Id.* The Utilities note that Ms. Gregor also discussed all significant variances in operating expenses from 2012 to forecasted 2015, noting, among other things, that the second largest factor in the increase in the category of Customer Accounts expense was the combination of increased call center costs and costs of the ICE project. PGL Ex. 5.0 REV. at 11-16; NS Ex. 5.0 at 11-15.

The Utilities also note that in direct testimony, Utilities' witness Ms. Kupsh discussed the IBS budgeting and forecasting process, which parallels those of the Utilities, and variances in the IBS costs cross-charged to the Utilities from 2012 to forecasted 2015, noting that the third largest factor was the ICE project. PGL Ex. 13.0 at 6-9; NS Ex. 13.0 at 6-9.

The Utilities note that 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. NS-PGL IB at 79. However, the Utilities state that his proposal (1) arbitrarily ignores the forecasted expenditures and plant in service activity, (2) also ignores the fact that IBS only bills the Utilities for assets that are in service, and (3) the fact 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.*, NS-PGL Ex. 27.0 at 6; NS-PGL Ex. 41.0 at 5.

Staff also rejects Mr. Effron's proposed adjustments, noting the expected in service date of the full ICE project and the lack of factual support for Mr. Effron's proposal. Staff IB at 35; Staff Ex. 6.0 at 22-25. 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 – 149:6, 151:13 – 152:19; see also Staff Cross Ex. 2.

The Utilities contend that the AG essentially just wishes away the above facts. AG IB Corr. at 51-53. The AG points to data from the first four months and the first six months of 2014, without even considering the above facts, including, among others, the

fact that only a small portion of the ICE project was in service in those months, meaning that the costs then do not reflect the costs when the project is in service in 2015. The AG notes that Mr. Effron claimed that his looking at the data from the first six months of 2014 somehow implicitly incorporated the above facts (AG IB Corr. at 52), but that is nonsense on its face. First half of 2014 data does not take into account that the costs are charged to the Utilities only to the extent the project is in service.

The Utilities' Initial Brief also noted that in Mr. Effron's rebuttal, he added raw speculation to the implied effect that, if the WEC-Integritys transaction proposal is approved, then the ICE project might be cancelled. Any such issue belongs in ICC Docket No. 14-0496, not here. See Section III.C of this Order.

In any event, Mr. Effron cited no relevant facts to support his speculation, and it does not make sense. The ICE project work already is well along, even though only a small portion of the project is in service. 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. *E.g.*, PGL Ex. 13.0 at 9-10. The WEC-Integritys transaction, if approved, is expected to close in Summer 2015. NS-PGL Ex. 33.0 at 6-7. The Utilities contend that Mr. Effron's conjecture lacks logic and is not a proper basis for a Commission decision. See *also* Section III.C of this Order; NS-PGL RB at 4, fn. 5.

The Utilities note that, on October 30, 2014, the AG filed a "Motion to Admit New Information", which sought to add to the evidentiary record a copy of the Utilities' data request response ("DRR") AG 3.05 from the reorganization case, ICC Docket No. 14-0496. The Utilities state that the Motion offered panoply of assertions and innuendo relating to the ICE project costs issue. The Utilities note that they filed their objections to the Motion on October 31st, as per the schedule ordered by the ALJs and that the AG filed a reply on November 3rd that contained addition assertions and innuendo. The Motion was granted on November 5th.

The Utilities incorporate their objections to the Motion, including their objections under Ill. R. Ev. 401 and 403. In their Reply Brief, the Utilities stated that they believe it is not fair or proper to expect them to anticipate and address in briefing what the AG may claim in its Reply Brief based on reorganization case DRR AG 3.05. NS-PGL RB at 61. The Utilities further state that the Commission must base its decision on the evidence in the record and in accordance with the applicable law, including due process principles, but the Utilities have not had notice and an opportunity to submit evidence responding to what the AG's Reply Brief will claim in relation to that DRR.

The Utilities contend that the existing evidentiary record and DRR AG 3.05 itself in context show that whatever the AG may claim based on the DRR, it does not provide any basis for questioning the 2015 forecasted ICE project costs, nor for adopting AG witness Mr. Effron's proposed adjustments. The Utilities note that the AG already argued for a scenario in which the ICE project goes ahead as scheduled but costs less than forecasted, and alternatively for a scenario in which the project is cancelled, as previously discussed. The Utilities contend that the AG now, in an apparent effort to

exhaust all options, appears to plan to argue for a scenario based on older, non-updated information reflected in DRR AG. 3.05.

The Utilities assert that at the evidentiary hearing on September 23rd, the AG showed Utilities witness Ms. Kupsh AG Cross Ex. 8. Kupsh Tr. at 90:17 – 92:20. AG Cross Ex. 8 consists of: (1) the Utilities' data request response to Staff data request DLH 35.01 in the instant rate cases and (2) the Joint Applicants' response to AG data request 2.13 in ICC Docket No. 14-0496. Data request DLH 35.01 asks about DRR AG 2.13. The Utilities further note that at this time, counsel for the Utilities explained that Utilities witness Lisa Gast, as to whom cross-examination had been waived, was the affiant for DRR DLH 35.01. Tr. at 90:17 - 92:20.¹⁶

The Utilities note that as can be seen in AG Cross Ex. 8, reorganization DRR AG 2.13 related to an exhibit the Joint Applicants filed in the reorganization Docket (JA Ex. 4.1). That exhibit was offered to meet the requirement of Section 7-204(a)(7) of the Public Utilities Act that, in brief, the reorganization applicants provide a five year forecast showing the utility's capital requirements. The Utilities explain that data request AG 2.13 is focused on a single item (an assumption) in JA Ex. 4.1. Reorganization data request AG 3.05 is a follow-up to data request AG 2.13, and data request AG 3.05 also relates to that same item in JA Ex. 4.1.

The Utilities contend that AG Cross Ex. 8 (in DRR DLH 35.01) explains, however, that the information in JA Ex. 4.1 that is referenced in reorganization DRR AG 2.13 was derived from the Utilities' 2013 Long Term Financial plans prepared in Spring 2013, and that the assumptions used in those plans were based on budget data from Summer and Fall 2012. Further, the Utilities assert that AG Cross Ex. 8 (in DRR DLH 35.01) also explains that, since then, an updated forecast was developed, and that the 2015 test year data used by the Utilities in these rate cases reflects the updated forecast, which includes the forecasted costs (and the absence of savings) in 2015. *See also* Kupsh Tr. at 92:2-11.

The Utilities emphasize that the AG considered asking that Ms. Gast be called for cross-examination on this subject (Tr. 93:2-21), but the AG ultimately agreed with the Utilities that the AG would move AG Cross Ex. 8 into evidence and not call Ms. Gast as a witness (Tr. 141:9 – 142:14).

The Utilities state that the AG's October 30th Motion brought up assertions about possible savings in 2015 due to the ICE project. The Utilities' October 31st response explained, among other things, that reorganization case DRR AG 3.05 itself showed a

¹⁶ The Utilities contend that although the AG's November 3rd reply asserted that this was the first time this information was provided, the Utilities served all discovery response affidavits at about 4:44 p.m. on September 22nd.

Further, the Utilities contend that the AG's November 3rd reply also offered the innuendo that it is "inexplicab[le]" that the Utilities' internal witness on finance issues, Ms. Lisa Gast, would be the affiant in support of a data request response relating to an assumption in the Utilities' 2013 long range financial forecast relating to the ICE project. Because reorganization case DRR AG 2.13 related to an assumption in the 2013 long range financial forecast, Ms. Gast was the appropriate affiant.

forecast of no savings in 2015. DRR AG 3.05 did refer to costs that would not be incurred in 2015 if the ICE project continued, but the Utilities' forecasts reflect that the ICE project is continuing, and thus they include no such avoided costs. More specifically, the attachment to reorganization Docket DRR AG 3.05 (on page 1) is dated September 17, 2012. The attachment (on page 2, *et seq.*) refers to "Hard O&M Benefits" and "Avoided" costs, but it shows no "Hard O&M Benefits" until 2016. The attachment shows "Avoided" Costs beginning in 2013, but "Avoided" costs are not savings; rather, they are costs that IBS has not incurred but which it would incur if it did not implement the ICE project, as noted above. The Utilities note that the AG's November 3rd reply did not make any further assertions about possible savings.

Thus, the Utilities state that the AG's Reply Brief presumably is going to argue from reorganization case DRR AG 3.05, which followed up on information that AG Cross Ex. 8 already has explained is based on budget data from Summer and Fall 2012 and thus does not reflect the later information reflected in the Utilities' 2015 rate case forecasts. The Utilities assert that the rate case data have been provided by the Utilities to address the forecasted 2015 test year. Reorganization case DRR AG 3.05 necessarily will be inconsistent, because the two sets of information were prepared at different points in time. Thus, the Utilities contend that DRR AG 3.05 is no basis for approval of the AG's proposed adjustments to the ICE project costs.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that the AG's proposal lacks factual and evidentiary support and does not consider the following key facts identified by the Utilities: (1) the forecasted expenditures and plant in service activity, (2) the fact that IBS only bills the Utilities for assets that are in service, and (3) the fact 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 puts forth completely unrepresentative of 2015 costs. The Commission notes that Staff also rejects the AG's proposal due to its lack of factual support. The Commission notes that the AG here again has introduced speculation regarding the WEC-Integritys transaction into another issue in this docket. Issues and speculation related to ICC Docket No. 14-0496 belong in that docket. Furthermore, the conjecture that the ICE project might be cancelled has no factual basis and is unreasonable given the facts. Therefore, the Commission rejects the AG's proposal.

(b) Non-Labor

The Utilities state that the evidence supports their forecasted 2015 "non-labor" costs cross-charged to the Utilities in relation to the ICE project. However, AG witness Mr. Effron attempts to reduce the Utilities' forecasted costs. AG IB Corr. at 53-55. The Utilities point out that that Mr. Effron's proposal is based on looking at costs from only

the first four or six months of 2014, yet he somehow assumes they are fully representative of the 2015 costs. See AG IB Corr. at 52-53.

The Utilities state that Mr. Efron's proposal, therefore, suffers from the same flaws – wishing away of the relevant facts and lack of a factual foundation – as his first two ICE-related adjustments, discussed above. NS-PGL RB at 65. Staff and the Utilities agree that the AG's proposal lacks merit. NS-PGL Ex. 27.0 at 7; Staff Ex. 6.0 at 22-25; NS-PGL Ex. 41.0 at 5-6; NS-PGL IB at 80; Staff IB at 35-36; NS-PGL RB at 65.

The Utilities also again note that AG witness Mr. Efron suggested that the proposed WEC TEG transaction somehow means that there is a chance the ICE project will be cancelled (AG IB Corr. at 54-55), but, as discussed in the preceding section of this Order, this is merely a conjecture that lacks any sound basis. Section III.C of this Order. The AG's proposed adjustments should be rejected.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that the AG's proposals lack factual support. As pointed out by the Utilities, the AG's proposal is based on looking at costs from only the first four or six months of 2014, yet somehow assumes they are fully representative of the 2015 costs. This is clearly not the case. The Commission notes that Staff also agrees with the Utilities that the AG's proposal lacks merit. Also, as observed in the preceding subsection of this Order, the AG continues to introduce speculation regarding the WEC-Integritys transaction into another issue in this docket. However, issues related to ICC Docket No. 14-0496 belong in that docket. Speculation of what may or may not occur in another docket has no bearing on this docket. Furthermore, the speculation that the ICE project will be cancelled has no basis other than speculation. Therefore, the Commission does not adopt the AG's proposal.

b. Advertising Expenses

North Shore and Peoples Gas

The Utilities note that in rebuttal, they accepted a total of \$25,000 of Staff's proposed downward adjustment to advertising expenses for North Shore Gas and Peoples Gas, but rejected Staff's proposed adjustments removing \$4,000 of expenses for North Shore and \$51,000 of expenses for Peoples Gas because those remaining challenged expenditures were recoverable under Section 9-225 and were also recoverable as charitable expenditures under Section 9-227. NS-PGL IB at 82. The Utilities note that although CCI did not submit evidence on this issue, it supports Staff's position. CCI IB at 15-16.

The Utilities note that Staff's (and CCI's) primary contention is that these expenditures proposed for removal are "of a promotional, goodwill or institutional nature" under Section 9-225 of the Act and, therefore, not recoverable. Staff IB at 37; CCI IB at 14-15. The basis for Staff's and CCI's argument that these "advertising expenditures" are not properly recoverable is that the Utilities classified them, for accounting purposes, under the Utilities' Account 909 – Informational and Institutional Advertising. As those "advertising expenditures" are classified in Account 909, Staff and CCI derive the notion that these expenditures are simply used to put the Utilities' name in a philanthropic light.

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 Utilities explain that 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. NS-PGL Ex. 21.0; NS-PGL Ex. 21.4N; NS-PGL Ex. 21.4P. The Utilities contend that the funding of those charitable events supports a range of cultural and educational activities for charitable organizations within Chicago and Cook and Lake Counties. NS-PGL IB at 82. Further, the Utilities note that for most of the sponsorships of those charitable events, the Utilities use their presence at the events to provide information about the Utilities' energy efficiency and energy assistance programs. NS-PGL Ex. 21.0 at 7. As a result, the Utilities contend that "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, the Utilities note that support of charitable events is recoverable under Section 9-227 of the Act, 220 ILCS 5/9-227. Thus, the Utilities contend, 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.

The Utilities contend that 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 are 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). The Utilities presented detailed descriptions of the "advertising expenditures" demonstrating the charitable purpose and nature of the expenditure. NS-PGL Ex. 21.0, Ex.21.2N and Ex. 21.2P.

Further, the Utilities assert that Staff's contention that these expenditures should not be recoverable lacks merit, as Staff's 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. The Utilities contend that such a 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. As a result, the Utilities argue, the Staff theory is both unreasonable and counter-productive. Further, the Utilities contend that 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 Utilities note that the Commission previously rejected the Staff's argument that an expenditure for a charitable purpose under Section 9-227 that puts the Utilities' name in a "philanthropic light" should not be recoverable. *Peoples Gas 2012 Order* at 164. The Utilities contend that the Commission rightly determined that the nature of the expenditure is the determinative factor for rate recovery. *Id.* Further, Utilities contend that the particular accounting entry of these expenditures under Account 909 - Informational and Institutional Advertising also is not determinative of recovery. 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 also noted that, in following the Commission's direction in *Peoples Gas 2012*, the Utilities significantly changed their processes for distinguishing expenditures that were charitable in nature from other expenditures. The Commission in *Peoples Gas 2012* said that the Commission

...believes the Utilities must be more careful in distinguishing sponsorship and institutional expenditures that are allowable for charitable purposes and those that are allowable advertising expenses.

Peoples Gas 2012 Order at 164.

The Utilities note that Staff argues that the Utilities' were not "more careful" in distinguishing the nature of expenditures, contrary to the direction of the Commission in *Peoples Gas 2012*. Staff IB 37-38. However, the Utilities state that the Utilities greatly expanded the process for screening and categorization of charitable, sponsorship and institutional expenditures and developed more detail descriptions of the informational and institutional "advertising expenditures" made under Account 909.

The Utilities indicate the following changes to their process to distinguish these "advertising expenditures." 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 expenditure is for a rate-recoverable purpose. NS Ex. 6.0 at 17; PGL Ex. 6.0 at 19. The Utilities explain that they 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.*

The Utilities state that, once the decision has been made to fund the request for sponsorship and spending, 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. NS Ex. 6.0 at 17; PGL Ex. 6.0 at 18. Last, the Utilities provide expanded descriptions of the expenditure/charitable funding, the organization that is being supported, the nature of the expenditure and cause or program being promoted or advanced, see e.g. NS-PGL Ex. 21.0, Ex. 21.4N and 21.4P. The Utilities explain that these changes are a direct result of *Peoples Gas 2012* and serve to distinguish recoverable, charitable expenditures from non-recoverable expenditures under Account 909.

The Utilities note that they 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. NS-PGL Ex. 21.0 at 7. 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 cannot be considered as charitable contributions because the Utilities initially recorded them as advertising expenses.

Peoples Gas 2012 Order at 164.

The Utilities note that Staff argues that the expenditures should not be recoverable as "...Staff (and the other parties) would not have the opportunity to adequately and timely review the expenditures for compliance with Section 9-227." Staff IB at 38. The Utilities strongly assert that this contention is nonsense, and that

Staff has had no issue contending that the “advertising expenditures” should not be recoverable. See Staff Ex. 7.0, Scheds. 7.01N and 7.01P. The Utilities state that the “advertising expenditures” that Staff seeks to disallow were brought to the attention of all of the parties in the Utilities’ direct testimony. See NS Ex. 6.0 at 17; PGL Ex. 6.0 at 18. Further, the Utilities assert that full and expanded descriptions of the expenditures were provided in discovery and included in the Utilities’ rebuttal exhibits. See NS-PGL Ex. 21.0 at 7; NS-PGL Exs. 21.4N and 21.4P. The Utilities contend that they have identified the recoverable nature of the “advertising expenses” early in this docket and have modified and highlighted their processes and procedures as to those expenditures in response to *Peoples Gas 2012*. NS-PGL IB at 84-86.

The Utilities contend that, contrary to Staff’s position, the Utilities have clearly identified the particular “advertising expenditures” recorded under Account 909 as charitable nature or otherwise permissible for recovery and have described 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. Further, the Utilities state that they have followed the Commission’s direction in *Peoples Gas 2012* and have modified their processes for distinguishing the various Account 909 expenditures to clearly reflect the charitable nature of the expenditures in contention. As the rulemaking on charitable expenditures in ICC Docket No. 12-0457 is not completed, the Utilities note that they will further modify their processes, as directed, on completion of that rulemaking. As a result, the Utilities contend that 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.

Other Parties

[Insert]

Commission Analysis and Conclusion

Staff and CCI seek to disallow the Utilities’ “advertising expenditures” that go to charitable purpose: (1) in the case of North Shore Gas: the American Legion, Children of Purpose and the University Center of Lake County and (2) in the case of Peoples Gas: the Museum of Science and Industry, the Red Moon Theater, the Hispanic Heritage Organization and others. The Commission finds that the Utilities have established that these expenditures and the organizations are charitable in nature and therefore recoverable under Section 9-227. Further, the Commission finds that the Utilities have responded to the Commission’s directions in *Peoples Gas 2012* and that the Utilities have taken the necessary steps to better classify and distinguish these types of charitable expenditures from nonrecoverable “advertising expenses.” The Commission notes that the rulemaking on charitable expenditures in ICC Docket No. 12-0457 should provide further guidance in the classification and distinguishing of

expenditures. Therefore, the Commission approves the Utilities' Advertising Expenses of \$4,000 for North Shore and \$51,000 for Peoples Gas.

c. Institutional Events

North Shore and Peoples Gas

The Utilities note that 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. Staff Ex. 7.0, Schedules 7.02 N and 7.02 P. The Utilities note that although CCI did not submit evidence on this issue, it supports Staff's position. CCI IB at 15-16.

The Utilities contend that they have demonstrated that their expenditures for 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. NS-PGL Ex. 21.0 at 8-10; NS-PGL Exs. 21.5N, 21.5P. The Utilities note that charitable expenditures are recoverable under Section 9-227.

The Utilities contend that, contrary to Staff's argument that these institutional expenditures are recorded as institutional events and are therefore, promotional in nature and not recoverable, these institutional event expenditures support the charitable organizations' public missions and are therefore recoverable. The Utilities indicate that these expenditures support institutional events of the Chicago Police Memorial Foundation, the Adler Planetarium, the Chicago Children's Choir, the Chicago Public Library Foundation, Connections for Abused Women and their Children, Chicago Sinfonietta, the Chicago Urban League and along with other charitable institutions' events. NS-PGL Ex. 21.0 at 9.

The Utilities explain that 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. Further, the Utilities assert that the same screening criteria as discussed with regards to Advertising Expenses are used to assess making the expenditure. The Utilities contend that 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. NS-PGL Ex. 36.0 at 6. The Utilities contend that the claim that the Utilities have not shown the sponsorships are not promotional is incorrect, and, moreover, for the claim to be correct, the meaning of the term promotional would have to be stretched beyond the language and the reasonable and fair interpretation of Section 9-225, as discussed above in Section V.C.3.b of this Order.

The Utilities note that Staff and CCI argue that these expenditures should not be recoverable because Staff and CCI assert that these institutional expenditures put the Utilities' names in a "philanthropic light" or improve the image of the Utilities. Staff IB at 39; CCI IB at 15. The Utilities note that they agree that *if* the institutional expenditures were solely for promotional or goodwill advertising within Section 9-225(2), then the expenditures should not be recovered. However, the Utilities emphasize, the Commission previously has rejected the "philanthropic light" argument, which seeks to redefine funds spent on charitable purposes.

Further, the Utilities contend that Staff's claim as to "misclassification" of these institutional expenditures as a means of disallowing the costs should be rejected. Staff Ex. 7.0 at 9. The Utilities assert that, similar to the contested Advertising Expenses, the nature of the expenditure should determine its recoverability, not the accounting classification. The Utilities explain that 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 that the Utilities can better serve their customers. NS-PGL Ex. 21.0 at 8-10; Exs. 21.5N, 21.5P. The Utilities emphasize that this same set of issues regarding institutional expenditures was addressed in *Peoples Gas 2012* and the Commission rejected similar Staff challenges, ruling 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.

The Utilities contend that an institutional event expenditure that goes to a charitable purpose, such as fundraising for a charitable institution or community group is recoverable. Further, the Utilities contend that merely because an expenditure is classified as spending for an institutional event does not lead to its disallowance. *Peoples Gas 2012* Order at 169. The Utilities assert that the actual nature of the expenditure, in this case as presented by the Utilities for support of charitable institutions and community groups within each Utility service territory, determines the recoverability.

To support the Utilities position, the Utilities note that, similar to changes in descriptions and processes as to "advertising expenditures" under Account 909, the Utilities have: (1) expanded the descriptions of the nature of the institutional event, (2) specifically identified the charitable institution holding the event and (3) have provided expanded descriptions of the purpose of the institutional event spending. NS-PGL Ex. 21.5N, Ex. 21.5P.

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

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission rejects Staff's proposed disallowance of \$203,000 of Peoples Gas' institutional event spending and \$10,000 of North Shore's institutional event spending and finds that those institutional event expenditures made by the Utilities are recoverable. The Utilities have presented sufficient evidence identifying those institutional events' spending as contributions made to support local charities and community groups and not primarily to promote the Utilities and enhance its goodwill in the community. The Commission concludes these institutional event expenditures are not barred under Section 9-225 and are recoverable under Section 9-225 and 9-227. Therefore, the Commission approves the Utilities' Institutional Events expenditures of \$203,000 for Peoples Gas and \$10,000 for North Shore.

d. Charitable Contributions

North Shore and Peoples Gas

The Utilities note that Staff proposes to disallow \$28,000 of Peoples Gas' charitable contributions and \$10,000 of North Shore's charitable contributions. Staff Ex. 7.0, Scheds. 7.03 N and 7.03 P; Staff IB at 40. The Utilities state that 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. Staff Ex. 2.0 at 14-15. Further, the Utilities note that The Utilities note that Staff proposes to disallow \$28,000 of Peoples Gas' charitable contributions and \$10,000 of North Shore's charitable contributions. Staff Ex. 7.0, Scheds. 7.03 N and 7.03 P. The Utilities state that 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. Staff Ex. 2.0 at 14-15. Further, the Utilities note that 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. The Utilities note that, in support of their argument, Staff and CCI cite the Commission's decision in *Peoples Gas 2012* that held that a utility must show a charitable donation benefit customers in its service territory in order to recover those expenses. *Peoples Gas 2012* Order at 167. The Utilities note that although CCI did not submit evidence on this issue, it supports Staff's position. CCI IB at 16.

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, the Utilities assert that Staff seeks to maintain the requirement (in substance, a rule) disallowing charitable contributions outside a utility's service territory. The Utilities state that 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.

Further, the Utilities state that the Commission also ruled in *Peoples Gas 2012* that charitable expenditures to colleges and universities outside of the State of Illinois were not recoverable. *Peoples Gas 2012* Order 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) whether the donations are a reasonable amount. The contributions at issue meet these criteria.

Further, the Utilities note that the overall reasonableness of the amounts of the charitable contributions is uncontested. NS-PGL IB at 89. Section 9-227 provides that:

...the Commission may not establish, by a rule, a presumption that any particular portion of an otherwise reasonable amount 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. PGL Ex. 6.0 at 14-15; NS Ex. 6.0 at 14.

The Utilities note that many of the out-of-service territory contributions that are challenged by Staff are related to utility employee matching gifts where the Utilities, match, dollar-for-dollar, up to a certain level gifts to charitable institutions. Many of these contributions are individually small charitable contributions that are in communities where the Utilities' employees live or coincide with the educational institution that an employee attended. Further, the Utilities assert that strengthening the overall network of charitable institutions in northern Illinois and surrounding areas is beneficial to the Utilities' service territory in general. In addition, the Utilities contend that out-of-state universities and college do provide graduates that work for the Utilities. The Utilities note that CCI argues that charitable contributions are discretionary utility spending and not necessary for the provision of safe and reliable utility service. CCI IB at 16. Further, CCI contends that charitable contributions "force" utility customers to support organizations that an individual customer may not otherwise support. *Id.* The Utilities contend that CCI's argument should be disregarded, as CCI's two conditions as to the "necessity" of the expenditure or the "forcing" of customer expenditure are not elements of the statutory requirement for rate recovery of a charitable expenditure and instead amount to an attempt to overrule the statute. The Utilities state that the statutory requirement for recoverability of utility charitable expenditures is indicated in Section 9-227 is:

...whether a rate or other charge or classification is sufficient, donations made by a public utility for the public welfare or for charitable scientific, religious or educational purposes, provided that such donations are reasonable in amount.

220 ILCS 5/9-227.

The Utilities contend that Staff and CCI ignore that Section 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, the Utilities emphasize that Section 9-227 limits the power of the Commission to establish rules disallowing charitable contributions.

The Utilities contend that although particular occurrences of employee contributions may vary over time, the overall expected total level of contributions, as indicated in each Utility's C-7 filing is reasonable for the future test year of 2015. PGL Ex. 6.1, Sched. C-7; NS Ex. 6.1, Sched. C-7.

The Utilities contend that the statutory standard for recovery of expenditures under Section 9-227 is clear, and notes that no party has argued that the particular expenditures do not go to a charitable purpose. Further, the Utilities note that no party has argued that the overall amount of charitable expenditures is unreasonable. The Utilities contend that 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 Staff Ex. 2.0 at 15. The Utilities assert that 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. Staff Ex. 7.0, Schedules 7.03 N and 7.03 P. The Utilities note that these charitable organizations include, for example, food banks and a wide range of educational institutions. *Id.* The Utilities contend that 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 Utilities argue that the Staff position proposes a ruling that would be unlawful and should be rejected. Further, the Utilities assert that even if Staff's position could be lawful, the evidence here supports recovery.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that Staff's proposed disallowance of \$28,000 of Peoples Gas' charitable contributions and \$10,000 of North Shore's charitable contributions is contrary to the evidence and contrary to Section 9-227 of the Act, and is rejected. Section 9-227 allows for recovery of utility expenditures for "donations made by a public utility for the public welfare or for charitable scientific, religious, or educational purposes, provided that such donations are reasonable in amount." The Commission finds that no party has provided any evidence that the charitable expenditures in dispute are not of a charitable nature and the overall amount of donations is unreasonable. The Commission also notes that charitable contributions made by the Utilities related to matching the Utilities employees' charitable giving generally benefits Northern Illinois and the surrounding area and is beneficial to the Utilities' service territories in general. Last, the Commission notes that out-of-state colleges and universities do provide education to some of the Utilities' employees, indirectly providing benefits to the Utilities' service territories. Therefore, the charitable contributions made by the Utilities related to matching the Utilities' employee gifts to out-of-state universities and colleges should be recovered. As such, Staff's proposed reduction in test year expenses for charitable contributions is rejected.

e. Social and Service Club Membership Dues

North Shore and Peoples Gas

The Utilities note that 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. Staff Ex. 7.0, Schedules 7.04 N and 7.04 P. Further, the Utilities note that although CCI did not submit evidence on this issue, it supports Staff's position. CCI IB at 17-18. The Utilities state that Staff proposes to disallow those social and service club membership dues by arguing that these are a promotional and goodwill practice and not necessary in providing utility service. Staff Ex. 7.0 at 11. The Utilities note that Staff references Peoples Gas' direct coordination with the City of Chicago Aldermanic offices and the City's Department of Water Management in its ongoing

AMRP project as a reason the “indirect” contacts and related expenditures for social and service clubs should not be included in the test year. Staff IB. at 17-18. In addition, the Utilities state that Staff asserts that certain portions of these dues are lobbying expenses, and therefore not recoverable. Staff Ex. 2.0 at 16. The Utilities contend that Staff is incorrect that the expenses are not appropriate and support utility service to customers.

The Utilities contend that their expenditures on social and service clubs provide benefits to customers in an indirect way by allowing the Utilities to work with various external stakeholders within their service territories. The Utilities assert that 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. NS-PGL Ex. 36.0 at 7-8. Further, the Utilities contend that these memberships provide important interactions with other business and governmental entities within the Utilities’ service territories. The Utilities assert that they provide, maintain and continue to develop vital infrastructure within their service territories. NS-PGL Ex. 21.0 at 11.

In addition, the Utilities note that while the City of Chicago Aldermanic offices and the City’s Department of Water Management are key stakeholders where Peoples Gas has direct, routine and beneficial interactions, there are more stakeholders than just those groups. The Utilities explain that the social and service club memberships expose the Utilities to a wider group of parties with wider interests from across the Utilities’ service territories, and that social and service club memberships can provide opportunities for broader interactions that allow for better coordination, identification of issues, and can help improve the Utilities’ service to its customers.

The Utilities note that Staff and CCI argue that certain of these social and service club membership expenditures are not necessary for utility service. *E.g.*, Staff IB at 17. The Utilities disagree with this as a ground for disallowance. The Utilities contend that these expenditures for social and service club memberships enhance the ability of the Utilities’ personnel to interact with stakeholders in the Utilities’ service territories and help identify challenges, risks, and opportunities to improve the Utilities’ services to its customers. The Utilities further note that Staff also argues that certain of these expenditures are unnecessary, as the Utilities already have direct contacts with stakeholders in the Utilities’ service territories. Staff IB at 17-18. The Utilities contend that although they have direct contacts with a variety of stakeholders in the Utilities’ service territories, the advantage that the social and service club memberships bring is the ability to interact with a wider group of business and governmental entities.

The Utilities contend that Staff’s argument that the Utilities’ expenditures for social and service clubs memberships provide no customer benefit should be rejected.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that Staff's proposed disallowance of \$44,000 of Peoples Gas' social and service club membership dues and \$17,000 of North Shore's social and service club membership dues is contrary to the evidence and is rejected. The Commission finds that these expenditures allow for indirect interactions with stakeholders – both governmental and business – within the Utilities' service territories, promoting the exchange of ideas and facilitating current and future projects of the Utilities. The Commission finds that these expenditures are beneficial to customers and are appropriately recoverable. Therefore, the Commission approves the Utilities' Social and Service Club Membership Dues of \$44,000 for Peoples Gas and \$17,000 for North Shore.

4. Amortization Period for Rate Cases Expense

North Shore and Peoples Gas

The Utilities note that Staff proposes to change the amortization period for rate case expenses from two years to two and one-half years, based on the premise that the Commission, if it approves the proposed WEC-Integritys transaction in ICC Docket No. 14-0496, may approve a condition proposed there by the joint applicants regarding when the Utilities' next new rates may go into effect. Staff IB at 41-42.

The Utilities state that Staff's proposal is too speculative to adopt, because it assumes approval in that Docket of both the proposed reorganization and that specific proposed condition, as well as approval of the transaction by the applicable out of state regulatory authorities. NS-PGL Ex. 36.0 at 9-10. See also Section III.C of the Utilities' Initial and Reply Briefs and this Order.

The Utilities' contend that their proposal to amortize rate case expenses over two years should be adopted. The two year amortization period is based on what the Utilities have experienced in their most recent rate cases. NS Ex. 6.0 at 13 and PGL Ex. 6.0 at 13. Furthermore, the two year period is the same period approved in the Utilities' 2012 rate cases. *Peoples Gas 2012 Order* at 170, 175.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that Staff's proposal is too speculative to adopt. The Commission is reluctant to reverse previous practice regarding the amortization period based on the possible outcome of ICC Docket No. 14-0496, which is unknown at this time. As the Utilities point out, the current two-year amortization period for rate case expense is based on what the Utilities have experienced in their most recent rate case. In fact, the two-year rate case amortization period was just approved in the Utilities' last

rate case in 2012. The Commission sees no reason to reverse its decision from 2012 based upon speculation. Therefore, the Commission rejects Staff's proposal.

5. Peer Group Analyses

North Shore and Peoples Gas

The Utilities state that, ostensibly 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. NS-PGL IB at 92-94.

The Utilities state that the AG's Initial Brief relies to a great extent on Dr. Dismukes' analyses in attempts to refute some (but not all) of the flaws that the Utilities have pointed out that make the analyses not probative or even relevant as support for Mr. Effron's proposed O&M and A&G adjustments. AG IB Corr. at 55-62, 69-70.

The Utilities state, 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. NS-PGL Ex. 17.0 at 10, 13; NS-PGL Ex. 33.0 at 8.

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 the Utilities' Initial and Reply Briefs and this Order. Dr. Dismukes' testimony simply does not address those items in any direct or meaningful way.

The AG (IB Corr. at 69-70) acknowledges that Dr. Dismukes did not propose any specific adjustments, but claims that his analyses nonetheless support Mr. Effron's proposed O&M and A&G expenses adjustments. The AG, like Dr. Dismukes, makes no attempt to explain how the analyses tie to any of those specific adjustments. For example, the AG does not explain how assertions that the Utilities' costs are high compared to their "peers" somehow supports the hypothesis that the Utilities will have fewer employees in 2015 than they have forecasted, or that the independent actuary overestimated the increases in medical benefits costs in 2015.

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. The AG's Initial Brief does not and cannot deny that point.

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. The AG does not and cannot deny that point.

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. NS-PGL Ex. 17.0 at 11-12.; NS-PGL Ex. 33.0 at 8-9; 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. NS-PGL Ex. 17.0 at 11-12; NS-PGL Ex. 33.0 at 8-9. Regulations matter, as has been discussed with respect to restoration expenses, for example. *E.g.*, NS-PGL Ex. 33.0 at 8. 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. 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.

The Utilities note that the AG attempts to defend the contention that the "peer" utilities are in fact "peers", however the AG's arguments fail. AG IB Corr. at 59-62. Additionally, the AG claims that Mr. Derricks was throwing as many objections against the wall as he could (AG IB Corr. at 60), but it was Dr. Dismukes who should be expected to show that the "peer" utilities are in fact peers, and the AG fails to refute Mr. Derricks' criticisms. For example, the AG (IB at 60) claims that Mr. Derricks did not show that it matters that Peoples Gas has an all urban service territory unlike all of the "peers" nor how state and local regulations might drive up operating expenses. That is not correct. As Mr. Derricks pointed out, regulations matter, as has been discussed with respect to the City of Chicago's regulations and restoration expenses. The Utilities note that in the instant cases, the Utilities' direct testimony supported a forecasted \$16,780,000 increase as of 2015 in Peoples Gas' distribution expenses compared to the 2012 level due primarily to changes in Chicago Department of Transportation Regulations that went into effect in the second half of 2012 or 2013, and further changes that became effective in 2014. PGL Ex. 5.0 REV. at 14; PGL Ex. 8.0 2nd REV. at 23. This increase is uncontested. Additionally, in surrebuttal the Utilities pointed out that paving costs (which reflect regulatory requirements) are running nearly \$8 million over the forecast as of August 2014, an increase that was not reflected in Peoples Gas' proposed revenue requirement. NS-PGL Ex. 33.0 at 9; NS-PGL Ex. 38.0 at 8; NS-PGL Ex. 38.2. In the Utilities' 2007 rate cases, the Commission approved (with modifications) updated rebuttal amounts for Peoples Gas' resurfacing costs in the City of Chicago. *Peoples Gas 2007 Order* at 40. With respect to whether the peers have similar accounting policies, or gas distribution systems, the AG tries to reverse the burden of proof, by claiming that the Utilities have to disprove that the "peers" are comparable to the Utilities, rather than Dr. Dismukes having to show they are

comparable in the first place. See AG IB Corr. at 60-61. The AG's argument seems to be: "Close enough".

Sixth, a significant part of Dr. Dismukes' 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. NS-PGL Ex. 33.0 at 8-9. The AG's Initial Brief suggests that looking at costs per volume is a standard method (AG IB Corr. at 56), but the AG does not deny that Dr. Dismukes apparently did not normalize the delivery data.

Finally, the Utilities contend that Dr. Dismukes did not identify any specific expense of either utility that he claims is imprudent, inefficient, or excessive. NS-PGL Ex. 17.0 at 12-13; NS-PGL Ex. 33.0 at 9. The AG's Initial Brief does not and cannot deny that point.

The Utilities quote Mr. Derricks: "What Dr. Dismukes has provided is data, but not an analysis that can be used as support for Mr. Efron's proposed revenue requirement adjustments." NS-PGL Ex. 33.0 at 9. The AG questions Mr. Derrick's qualifications as a statistician, and notes that he has not published papers or taught courses on peer group analysis, and that the development of the Utilities' operational budgets is not his responsibility area. See AG IB Corr. at 60, fn. 19. However, Mr. Derricks has an engineering degree, an MBA, and 23 years of experience working for utilities. PGL Ex. 1.0 at 3. He is not an academic, so his not publishing papers or teaching courses is not an indictment. The AG does not explain how his not being one of the employees tasked with developing operational budgets undercuts his criticisms, and, as the discussion above shows, the AG has been unable to refute those criticisms.

Finally, the AG discusses at great length the individual complaints of two Peoples Gas customers. See AG IB Corr. at 63-69. The treatment of each and every customer matters, but the AG never shows that discussing the circumstances of two customers bears in any meaningful way on the issues in these rate cases. The AG's discussion appears to serve no purpose other than to vilify Peoples Gas. Neither customer has filed a complaint with the Commission.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that the Peer Group analyses conducted by Dr. Dismukes do not provide reliable support Mr. Efron's O&M and A&G expense adjustments. The evidence proffered by the Utilities, including points about omissions and deficiencies in the analyses that support this finding is persuasive. First, Dr. Dismukes' analyses are not tied to any of Mr. Efron's specific proposed adjustments, and they do not bear on his specific proposals. Furthermore, the analyses are limited to O&M and A&G expenses and do not take into account overall costs of service. The analyses look at

data from 2004 to 2013, but the test year here is 2015. Also, as noted by the Utilities, the Commission has reviewed the Utilities' costs of services in each of their four previous rate cases dating back to 2007. There are significant questions about whether the "peers" identified in the analyses are actually peers of the Utilities for various reasons identified by the Utilities. The data based on volumes delivered does not appear to be a meaningful criterion and, in any event, apparently has not been normalized. Finally, Dr. Dismukes did not identify any specific expense of the Utilities that is imprudent, inefficient, or excessive. For these reasons, the analyses conducted by Dr. Dismukes do not provide independent support for the O&M and A&G expense adjustments proposed by AG witness Mr. Effron. The Commission also agrees with the Utilities that the testimony by two individual Peoples Gas customers does not provide a basis for any proposed adjustments.

VII. RATE OF RETURN

A. Overview

Each of the Utilities propose modest increases in their overall rates of return on rate base. Peoples Gas proposes an increase from 6.67% to 7.21% based on a capital structure comprised of 50.33% common equity at a cost (a rate of return on common equity or "ROE") of 10.25%, 46.51% long-term debt at a cost of 4.32%, and 3.16% short-term debt at a cost of 1.19%. North Shore proposes an increase from 6.72% to 6.89% based on a capital structure comprised of 50.48% common equity at a ROE of 10.25%, 38.94% long-term debt at a cost of 4.13%, and 10.58% short-term debt at a cost of 1.06%. NS-PGL IB at 94-95.

Only Staff and CCI have addressed directly the Utilities' cost of capital. The Utilities' capital structures are not disputed. The Utilities and Staff are in agreement on North Shore's long-term debt costs. The Utilities and Staff disagree, however, on the Utilities' short-term debt costs and Peoples Gas' long-term debt costs. Staff proposes substantially lower rates of return on rate base, 6.54% for Peoples Gas and 6.23% for North Shore, by virtue of its proposal to reduce the Utilities' ROE from 9.28% to 9.00%. CCI proposes a slightly smaller reduction in the Utilities' ROE – from 9.28% to 9.15%. (CCI did not address short-term or long-term debt costs in its briefs.) NS-PGL IB at 105.

The legal standards governing a public utility's entitlement to a fair and reasonable return on its investment are well established and familiar. The Commission summarized these standards in one of the Utilities' recent rate cases thus:

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 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.' The authorized return on equity 'should be commensurate with returns on investments in other enterprises having corresponding risks. That return, however, should be sufficient to assure

confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.'

Peoples Gas 2009 Order at 89-90 (citations omitted). *Accord Peoples Gas 2012 Order* at 181-182.

B. Capital Structure

1. North Shore and 2. Peoples Gas (Uncontested)

North Shore and Peoples Gas

As shown in their respective cost of capital schedules, the Utilities and Staff agree on the following capital structures. NS-PGL Exs. 18.1N & 18.1P; Staff Ex. 8.01. No party disputed these structures.

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

According to the Utilities, these 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 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.” Staff Ex. 3.0 at 3-4; Staff Ex. 8.0 at 2.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that the undisputed capital structures agreed to by the Utilities and Staff are reasonable and consistent with the Act, and therefore approves them.

C. Cost of Short-Term Debt

1. North Shore and 2. Peoples Gas (Combined Discussion)

The Utilities estimate their 2015 costs of short-term debt to be 1.06% for North Shore and 1.19% for Peoples Gas based on forecasts published by the credit rating agency *Moody's*. NS-PGL Ex. 18.0 at 4 (table); NS-PGL Exs. 18.2N & 18.2P. The Utilities argue that the credit rating agency interest rate forecasts the Utilities relied on to estimate their costs in 2015 are verifiable and unbiased, and that these types of forecasts are “used by investors to formulate their expectations for the future.” NS-PGL Ex. 35.0 at 2. The Utilities state that such forecasts are an eminently reasonable basis to predict their costs in the future. NS-PGL IB at 96.

The Utilities argue that Staff’s proposed short-term debt costs should be rejected because they are based on historical “spot day” measurements to forecast capital costs in a future test year, which is arbitrary and unreliable. *Id.* The Utilities point out that Staff itself recognized that relying on historical data “will necessarily be arbitrary” because the analyst must choose the historical timeframe for the data. See Staff Ex. 3.0 at 28. Basing a forecast on historical data will produce the “correct” result only by chance. *Id.* at 28. 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.

The Utilities dispute Staff’s positions that “current” interest rates are better predictors of future interest rates than published forecasts like *Moody's*, and that it is impossible to forecast interest rates because such forecasts are too often “inaccurate.” See Staff Ex. 3.0 at 4; Staff Ex. 8.0 at 4. The Utilities argue that the fallacy of Staff’s position is that the accuracy of forecasts can be determined only with hindsight. 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. The Utilities explain that nothing that depends on future events can be forecasted “with certainty” because no one can know “with certainty” what the future events will be, but this does not mean that forecasts are not accurate based on the information available when they are made. NS-PGL IB at 97.

The Utilities argue further that all 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. *Id.* at 98.

The Utilities point out that Staff did not challenge the credibility or objectivity of the *Moody's* short-term debt forecasts on which the Utilities relied. PGL Ex. 20.0 at 9.¹⁷ 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. Staff Ex. 8.0 at 5-6. The Utilities state that 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, the Utilities argue that Staff could have determined whether the *Forecasts.org* and *EconomicOutlookgroup.com* forecasts (2.28% and 3.50%, respectively) were reliable, as compared to the *Freddie Mac* and *Survey of Professional Forecasters* ("Survey") forecasts (2.60% and 2.80%, respectively). NS-PGL IB at 98.

Finally, the Utilities argue that Staff's objection to the use of interest rate forecasts for debt costs in a future test year is flatly inconsistent with Staff's reliance on forecasts in its cost of equity analyses, including (1) the "expected" quarterly dividends of the proxy group of delivery utilities used in its DCF model (Staff Ex. 3.0 at 10-11 & Sched. 3.04); and (2) gross domestic product ("GDP") inflation and GDP growth forecasts from the Energy Information Administration ("EIA"), *Global Insight* and the *Survey* (*id.* at 16) used in its CAPM model. Forecasts from credible and objective sources are reliable for the purpose of establishing a utility's cost of capital in a future test year. NS-PGL IB at 98-99.

The Utilities thus maintain that 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 data several months ago.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that short-term debt costs proposed by the Utilities represent a more accurate forecast of what those costs will be in the 2015 test year than Staff's estimates based on current rates. No evidence was introduced challenging the credibility and objectivity of the forecasts published by *Moody's*. Staff further failed to make the showings the Commission stated in *Peoples Gas 2009* would be necessary when relying upon spot data. Moreover, use of interest rate forecasts for debt costs in a

¹⁷ 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 reduction. NS-PGL Ex. 18.0 at 3. The Utilities argue that the fact the forecasts moved downward between February and August is not evidence of forecast inaccuracy, as Staff claims, but rather the passage of time and changing events.

future test year is consistent with the use of forecasted information in other aspects of how a utility's cost of capital is analyzed. Although few forecasts are precisely correct in hindsight, forecasts published by unbiased sources and widely relied upon in the financial markets provide the best evidence of what certain types of capital will cost in a future test year.

D. Cost of Long-Term Debt

1. North Shore (Uncontested)

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). 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. The Utilities and Staff agree on a long-term debt cost of 4.13% for North Shore. Staff Ex. 3.0 at 6-7; NS-PGL Ex. 2.0 at 7.

2. Peoples Gas

Including the forecasted costs of its planned issuances in 2015, Peoples Gas originally forecasted its cost of long-term debt to be 4.72%. PGL Ex. 2.3. Due to the actual pricing of certain debt and newer forecasts, however, Peoples Gas' proposed long-term debt cost fell from 4.72% (PGL Ex. 2.3) on direct to 4.32% (NS-PGL Ex. 34.2P) on rebuttal. The late August price of Peoples Gas' Series BBB, 4.21% was lower than both the Utility's forecasted price of 4.72% and Staff's 4.66% based on the June 11, 2014 actual rate. NS-PGL Ex. 34.0 at 3.

Staff proposed a 4.36% cost for Peoples Gas' long-term debt based on the June 11, 2014 spot day yield on A-rated bonds. Staff Ex. 3.0 at 6-7. The Utilities argue that Staff's approach is inconsistent and arbitrary. NS-PGL IB at 100. While Staff agreed that the actual pricing of issuances should be used as it became known, Staff 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. Staff 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 Staff did on direct. *Compare* Staff Ex. 8.0 at 7 *with* Staff Ex. 3.0 at 6-7.

The Utilities note that this inconsistent mixing of methods avoided any changes to Staff's initial position based on June 11, 2014, actual interest rates. NS-PGL IB at 100; see Staff Ex. 8.0 at 7. The Utilities argue that 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 Order* 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 lower cost for Peoples Gas (4.32% instead of 4.36%).

[Insert]

Other Parties

[Insert]

Commission Analysis and Conclusions

With respect to North Shore, the Commission finds that the undisputed cost of long-term debt agreed to by the Utilities and Staff is reasonable and consistent with the Act, and therefore approves it.

With respect to Peoples Gas, the Commission agrees with the Utilities that a consistent approach should be taken to setting their capital costs, and thus approves the Utilities' proposed long-term debt cost of 4.32% for Peoples Gas as the more accurate forecast of these costs.

E. Cost of Common Equity

1. Peoples Gas and 2. North Shore (Combined Discussion)

a. Overview

Utilities' Overall Position.

The Commission "is charged by the legislature with setting rates which are 'just and reasonable' 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 III. Water Co.*, Order at 41, Docket 03-0403 (April 13, 2004).

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. 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 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.

Understood properly, the courts' admonishment that the Commission balance customer and investor interests in ratemaking does not mean, as the AG argues, that the Commission can consider adjustments to a utility's ROE in order to reduce rates paid by low income customers. AG IB at 6-7. The Utilities argue that supportive ROE decisions are in the interest of both customers and shareholders by maintaining the Utilities' financial strength and their access to capital at reasonable cost. The Commission, however, has many ways to address customer impact, such as its policies on energy efficiency and customer matters such as bill payment NS-PGL RB 82.

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. PGL Ex. 3.0 at 20-21. Treasury and utility bond yields are projected to rise due to the Federal Reserve’s tapering of its program to support the economy in response to the 2008 financial crisis. *Id.* at 28, 31-32; NS-PGL Ex. 19.0 at 11-12.

Consistent with these leading economic indicators, forecasted returns for the Delivery Group are projected to average 10.50%, which is substantially higher than the Utilities’ current authorized return of 9.28%. NS-PGL Ex. 19.0 at 4-5. This forecasted growth is consistent with growth 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. Indeed, the average return in the second quarter of 2014 was 9.84%. CCI Ex. 2.0 at 5 (table).

The Utilities find Staff’s continued objections to the consideration of ROEs authorized for other utilities “grossly exaggerated” for at least three reasons. First, Staff’s position 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. Second, the Utilities’ evidence of other returns was restricted to 2013 and 2014 and therefore captured “market fundamentals that are closely aligned with the present.” NS-PGL Ex. 35.0 at 4. The Utilities’ evidence was also based on a large sample, which encompassed the diversity of risk characteristics and minimizes the effect of any given factor. *Id.* Neither Staff nor CCI disputed that the Utilities’ risk characteristics are reasonably similar to natural gas distribution companies generally. Third, 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 4-5.

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. NS-PGL IB at 102-104.

Moreover, the Utilities explain that Staff’s own contextual information in the form of various calculations of a cost of equity for the U.S. market “as a whole” should be rejected. NS-PGL RB at 82-83. Staff claims that a 9.0% ROE for the Utilities is “representative of the return investors can earn on other investments of comparable risk because the overall U.S. market cost of equity is anywhere from 8.80% to 9.52%. Staff IB at 57-58. Staff fails, however, to explain how the Commission is to use this measurement to determine the return on investments of risk comparable to the Utilities, other than the unsupported claim that the “market as a whole” is riskier than gas distribution utilities. *Id.* at 58.

Moreover, Staff did not explain how these published measurements of the “market” cost of equity deviated so dramatically from Staff’s own calculation of the “expected rate of return on the market” for purposes of its CAPM model. NS-PGL RB at 83. Based on a DCF analysis on the firms in the S&P 500 Index, Staff calculated that cost to be 12.43%. Staff Ex. 3.0 at 17. By comparison, the Utilities calculated the total return on the market of U.S. equities to be 10.90%. PGL Ex. 3.0 at 33.

The Utilities argue (NS-PGL RB at 83) that the most direct calculation of investments of risk comparable to the Utilities is Mr. Moul’s Comparable Earnings model, which estimates “the returns realized by non-regulated firms with comparable risks to a public utility.” PGL Ex. 3.0 at 35. Using six categories of comparability of risk to the Delivery Group and reviewing both historical and forecasted returns for non-utility companies, Mr. Moul calculated a 10.30% ROE for investments of comparable risk to the Utilities, which is very close to his recommendation based on his other models. *Id.* at 37.

The Utilities conclude that all of these considerations support an increase of the Utilities’ ROE to 10.25%.

Staff’s Overall Position

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CCI’s Overall Position

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b. Proxy Group Analysis

North Shore and Peoples Gas

Because the Utilities' stock is not publicly traded, their cost of equity must be estimated using mathematical models applied to a proxy group of publicly-traded companies with investment risk similar to that of the Utilities. NS Ex. 3.0 at 4. Mr. Moul based his 10.25% ROE recommendation using three market-based mathematical models based on a proxy group of publicly-traded gas and electric distribution utilities (the "Delivery Group"):¹⁸ the Discounted Cash Flow ("DCF") model, the Capital Asset Pricing Model ("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:

<u>Model</u>	<u>Cost</u>
DCF	9.71%
RP	11.50%
<u>CAPM</u>	<u>9.62%</u>
Average	10.25%

PGL Ex. 3.0 at 6.

Staff accepted the Utilities' Delivery Group for the purpose of running its cost of equity models. Staff Ex. 3.0 at 9, 18. CCI, however, used a different proxy group comprised of all but two of the Delivery Group companies. One company 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. See CCI Ex. 2.0 at 9-10. CCI did not provide any evidence that Laclede Group's proposed acquisition impacted the company's fundamentals. NS-PGL Ex. 19.0 at 18.

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.

Staff

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¹⁸ 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. PGL Ex. 3.0 at 5.

CCI

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c. DCF

North Shore and Peoples Gas

The DCF model expresses the value of an asset as the present value of future expected cash flows discounted at the appropriate risk-adjusted rate of return, which for common stock is the dividend yield plus future price growth. NS Ex. 3.0 at 14. Mr. Moul used a six-month average dividend yield for the Delivery Group, adjusted by three generally accepted methods to reflect investors' expected cash flows, and averaging the three adjusted values. *Id.* at 15-16. For the investor-expected growth rate, Mr. Moul evaluated an array of historical and forecast growth data from sources that are publicly available to, and relied upon by, investors and analysts. *Id.* at 17-18. He focused on forecasts of earnings per share growth because empirical evidence supports it and because they are most relevant to investors' total return expectations. *Id.* at 18-20. He selected 5.25% to reflect improving business conditions. *Id.* at 20. Mr. Moul then applied a financial leverage adjustment to his DCF results because they are based on market prices of the Gas Group's stock, which imply a capital structure with more equity and less financial risk, but are applied to utility book values, which imply a capital structure with less equity and more financial risk. *Id.* at 22-25.

The Utilities argue that Staff's and CCI's DCF model results are too low to be credible, and are the result of inappropriate or biased inputs, as well as unsupported methodologies.

Staff's Failure to Adopt Mr. Moul's Dividend Yield is Unsupported

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%." Staff Ex. 8.0 at 11. 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." PGL Ex. 3.0 at 16; see PGL Ex. 3.6. The Utilities state that Staff did not explain, much less justify, why it did not "adopt" Mr. Moul's actual dividend yield. NS-PGL IB at 107.

Staff Makes Unsupported Departures From Its Prior DCF Methodologies Resulting in Reduced Results

The Utilities note that 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. The Utilities argue that in this case, Staff has once again departed from past practice without sufficient explanation and the result is a lower DCF result.

In prior cases, including the Utilities' last four rate cases, Staff has based its DCF growth component on security analyst forecasts of earnings per share ("EPS") growth for the proxy group. *Peoples Gas 2012 Order* at 198 (*Zacks* and *Reuters*); *Peoples Gas 2011 Order* at 126 (*Zacks*); *Peoples Gas 2009 Order* at 104 (*Zacks*); *Peoples Gas 2007 Order* at 78 (*Zacks*, *Yahoo* and *Reuters*). In this respect, Staff's approach has been consistent with that of the Utilities, though they have not necessarily agreed upon which forecasts to use in a given case.

In this case, however, Staff calculated its DCF growth rate differently. First, Staff did not rely on *Zacks* and/or *Reuters* EPS growth forecasts as it did in the past. Instead, it relied on the group of four published EPS growth forecasts identified by Mr. Moul, which included *Zacks* but not *Reuters*. Instead of averaging the *Value Line* EPS growth forecast with the other EPS growth forecasts, however, Staff first averaged that forecast with *Value Line* growth forecasts for several other parameters in order to arrive at an average *Value Line* growth forecast. Staff Ex. 3.0 at 9. This average *Value Line* growth forecast of 4.47% was over 100 basis points lower than the *Value Line* EPS growth forecast of 5.58%. See PGL Ex. 3.8. Staff then averaged its average *Value Line* growth forecast with the EPS growth forecasts from *I/B/E/S First Call* (4.87%), *Zacks* (5.10%) and *Morningstar* (4.70%) to arrive at its DCF growth rate of 4.77%. Had Staff simply averaged the four EPS growth forecasts, its DCF growth rate would have been 5.06%. PGL Ex. 3.0 at 19.

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 the EPS growth forecasts ranging from 4.70% to 5.58%, Mr. Moul selected a DCF growth component of 5.25% to reflect improving business conditions. PGL Ex. 3.0 at 19-21.

Staff did not claim that the *Value Line* EPS growth forecast was biased, inaccurate or otherwise faulty. In fact, when Mr. Moul objected to the mishmash nature of Staff's DCF growth component, Staff witness Ms. Freetly agreed to exclude the *Value Line* growth forecasts for book value per share, cash flow per share and percent retained to common equity. Staff Ex. 8.0 12. She insisted, however, on blending the *Value Line* EPS growth forecast with the *Value Line* growth forecast for dividends per share ("DPS"). *Id.* at 12. By averaging the much lower DPS rate (3.92%) with the EPS rate (5.58%), Staff reduced the *Value Line* component to 4.75% and its DCF growth rate from 5.06% to 4.82%. *Id.* at 13:237.

Staff claims, without citation to the record, that it has used forecasted DPS growth rates in the DCF model "when available from Staff's growth rate sources." Staff

IB at 51. Yet Staff can identify only one instance from over 23 years ago. *Id.*, citing Order, Docket No. 90-0169 (Mar. 8, 1991).

Staff also claims that it “usually relies on growth rates from *Zacks* and *Reuters* for the DCF model, which do not provide projected growth in dividends per share; they only publish growth in earnings per share.” *Id.* If this is true, then it must also be true that Staff does not use DPS growth forecasts for the growth component of the DCF model.

Additionally, the Utilities argue that 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 5.11% instead of 3.89%. NS-PGL Ex. 19.0 at 8. Coincidentally, had Staff followed its longstanding practice and relied on the *Zacks* EPS growth forecast (a *Reuters* forecast is not in the record), its DCF growth rate would have been 5.10%. *Id.*

Mr. Moul's Leverage Adjustment is Methodologically Sound

Consistent with his past analyses presented to this Commission, Mr. Moul has included a “leverage” adjustment in his DCF and CAPM models. PGL Ex. 3.0 at 21-26, 30-31. The Utilities acknowledge that the Commission has not accepted this adjustment, but the Utilities continue to urge its consideration because its underlying logic is unassailable.

The leverage adjustment is necessary to correct the measurement error that occurs when a market cost of equity that is based on the market value capital structure of the Delivery Group is applied to the Utilities’ book value capital structure. The market cost of equity assumes a capital structure with more equity, about 60%, and less risk than the Utilities’ book value capital structures, which include about 50% equity. PGL Ex. 3.9. If the Delivery Group’s market cost of equity is 10.25% as estimated by Mr. Moul, then the Utilities would have to recover 10.25% times the market value of their equity to earn their market-based return. But because of the regulatory practice of applying the market-based cost of equity to the utility’s book-value capital structure, the Utilities by definition cannot earn their market-based return. Moul Dir., PGL Ex. 3.0 at 22.

The leverage adjustment makes the Utilities’ market cost of equity applicable to their book value capital structures by accounting for the lower equity ratios and higher risk in those structures. In this case, the DCF return of 9.25% must be adjusted upward by 46 basis points to allow the Utilities to earn their market cost of equity applied to their market value capital structures. *Id.* at 25- 26. Likewise, the CAPM beta must be adjusted upward from 0.69 to 0.75. *Id.* at 30-31.

Staff and CCI raise a number of familiar but unfounded objections to the leverage adjustment. First, Staff and CCI argue that utilities are allowed to earn a return only on the amount actually invested in providing utility service and the leverage adjustment would provide a return on amounts that are not invested in the Utilities, contrary to

Illinois law. Staff IB at 62-63; CCI IB 24-25. The Utilities claim that this is pure sophistry. The Utilities are not trying to earn on dollars that they have not invested; rather, they are trying to earn the full cost of equity that is associated with their book value investment. NS-PGL RB at 87.

Second, Staff speculates that correcting the leverage mismatch between market returns and book value capital structures would result in a “never ending upward spiral” in utility market values and authorized ROEs. Staff IB at 62-63. The Utilities argue that there is no basis for Staff’s assertion that the “investor required return” is exactly the product of the authorized return and the book value of the utility’s equity. If that was true, “then a stock price would always equal the firm’s book value.” NS-PGL Ex. 35.0 at 7. Of course, this is not true, as demonstrated by the prevalence of natural gas utility stocks trading at multiples of book value; the average multiple over the last 56 years is 1.72. *Id.* at 7-8. Clearly, authorized natural gas utility ROEs are not routinely set at Staff’s notion of the “investor required return,” and the result has not been a “never ending upward spiral” of market values and ROEs. NS-PGL RB at 87.

Third, Staff argues that a firm can have only one level of “intrinsic” risk. Staff IB at 66-67. The Utilities do not disagree. However, the Utilities state it is undeniable that if the market priced the Utilities’ equity assuming their book value capital structures, the cost would be higher than it is when the market assumes their market value capital structures. NS-PGL Ex. 19.0 at 15. A firm’s financial risk as perceived by the market changes when the firm’s capital structure changes. *Id.* at 16. The market will perceive more financial risk with an equity ratio of 50% than with an equity ratio of 60%. *Id.* at 17.

CCI Failed to Support Its Use of a Non-Constant Form of the DCF Model

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.

The Utilities argue that CCI did not attempt to make this “more robust showing” required by the Commission 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.” CCI Ex. 1.0 at 21. He included a non-constant form of the model simply to reflect an “outlook of changing growth expectations.” *Id.* at 21.

The Utilities argue that for this reason alone, the Commission should disregard CCI’s non-constant growth DCF model. NS-PGL IB at 109-110. 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 average over 100 basis points higher. See CCI Ex. 2.0 at 5 (table).

Many Of CCI’s DCF Results Are Far Too Low To Be Credible

The Commission has in the past rejected DCF results that are “anomalous.” *Peoples Gas 2007 Order* at 92. Many of CCI’s constant growth DCF rates for Delivery Group companies are so anomalous that they undercut the credibility of his DCF results. See NS-PGL Ex. 19.0 at 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.” NS-PGL Ex. 19.0 at 18-19. The six-month average yield on Baa-rated public utility bonds is 4.98%. *Id.* at 19. 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. The Utilities thus argue that these results should be disregarded.

Staff

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d. CAPM

North Shore and Peoples Gas

The CAPM determines an expected rate of return on a security by adding to the “risk-free” rate of return a risk premium that is proportional to the non-diversifiable, or systematic, risk of the security. This model requires three inputs: (1) the risk-free rate of return, (2) a “beta” that measures systematic risk, and (3) the market risk premium. For the risk-free rate of return, Mr. Moul used historical and forecast yields on 20-year Treasury bonds and selected a mid-point of 4.25% based on current forecasts and recent trends. NS Ex. 3.0 at 30-31. For the beta measurement of systematic risk, he used the average *Value Line* beta for the Gas Group, adjusted using the Hamada formula to reflect the application of this market-based measurement to the utility’s book value capital structure used in ratemaking. NS Ex. 3.0 at 29-30. Mr. Moul developed his market premium of by averaging forecast data from *Value Line* and the S&P 500 Composite and historical data from Ibbotson Associates, all of which are sources routinely used by investors, analysts and academics. NS Ex. 3.0 at 31-32.

The Utilities argue that 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. NS-PGL IB at 111-113.

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. The Utilities note that it is undeniably true that few if any forecasts are exactly right in hindsight. Staff provided no evidence that information from a single day in the past provides a more accurate prediction than forecasts do when they are made. 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. The Utilities conclude that it says nothing about what that cost of capital will be in the future. *Id.* at 112.

Again, the Utilities argue that 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 Utilities posit that 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.

NS-PGL Ex. 35.0 at 3. Staff did not challenge these attributes of the *Blue Chip* forecasts, which were also used in CCI's CAPM model. See CCI Ex. 1.0 at 29. 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. NS-PGL IB at 112.

For this reason alone, the Utilities conclude, 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%. PGL Ex. 3.0 at 32-33; CCI Ex. 1.0 at 29.

Furthermore, 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* but adjusted them downward because "[s]ome empirical tests of the CAPM suggest that the linear relationship between risk, as measured by the raw beta, and return is flatter than the CAPM predicts." Staff Ex. 3.0 at 20. Staff also averaged in a "regression beta" of its own creation. The Utilities argue that 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. NS-PGL Ex. 19.0 at 13. Accordingly, both the Utilities and CCI relied on *Value Line* betas alone. CCI Ex. 1.12.

The Utilities state that of more concern is the fact that the Staff betas are routinely lower than the published betas. NS-PGL Ex. 35.0 at 7 (table). Thus, the only purpose served by Staff's lower beta, according to the Utilities, is to reduce Staff's 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%. NS-PGL Ex. 19.0 at 13. 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. Thus, even if there was some value in using multiple beta models (see Staff Ex. 8.0 at 14-15), Staff's "multiple source" approach is invalid because of its downward bias.

Staff

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e. Risk Premium

North Shore and Peoples Gas

The Risk Premium model measures the cost of equity by determining the degree to which equity has more risk than corporate debt, and adding that “equity risk premium” to the interest rate on long-term public debt. NS Ex. 3.0 at 25. Mr. Moul estimated a 5.25% prospective yield on A-rated utility bonds based on historical and forecasted yields. NS Ex. 3.0 at 26. Mr. Moul determined an equity risk premium of 6.25% by analyzing results for S&P Public Utilities and then adjusting those results based upon the results of his fundamental risk analysis in comparing the results for the S&P Public Utilities to the Gas Group. NS Ex. 3.0 at 26-28. Mr. Moul’s risk premium analysis thus provided a cost of equity of 11.50%. NS Ex. 3.0 at 25.

Staff contends that the Risk Premium model is unreliable because the true mean of the market risk premium is unobservable and the result is influenced by the choice of historical period. The Utilities respond that it is not necessary to establish the true mean because the risk premium approach is designed to align the risk premium with the level of forecasted interest rates. The risk premium rises as interest rates decline and the risk premium falls as interest rates increase. Mr. Moul’s risk premium analysis is dynamic and does not rest upon a single risk premium that might be represented by the “true mean.” NS-PGL Ex. 35 at 6. Second, Mr. Moul did not arbitrarily select any particular period to measure the risk premium with historical data. Rather, he used all available and reliable data in order to avoid the introduction of a particular bias into the results. *Id.*

Staff

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f. Commission Analysis and Conclusions

(i) The Context

Traditionally, the Commission has established rates of return on common equity for utilities by employing mathematical models designed to quantify the likely cost of attracting capital investment during the time rates are expected to be in effect. In virtually all cases, we have relied on the DCF and CAPM models. The Utilities urge the Commission also to consider in this case Mr. Moul’s Risk Premium model, as well as

relevant general market information, including a large sample of recent ROEs approved by this Commission and others, for context in our evaluation of the parties' various ROE proposals.

While we adhere to the position that the Commission does not base utility returns on those approved for other utilities, in Illinois or elsewhere, we do agree that we have an obligation to consider how our decisions will be perceived by the financial markets and what impact those perceptions might have on the Utilities, and thus, ultimately their customers. To this end, the Commission should take notice, through verifiable and well regarded sources, of general market conditions and trends because this information affects directly the decisions that investors make in the market. This information is relevant to our ROE decisions because we determine what investors demand and that requires consideration of the full array of information that investors consider when they effectively set the real cost of capital for a utility. See *Illinois Bell Tel. Co.*, ICC Docket Nos. 92-0448, 93-0239 (Cons.) (Order Oct. 11, 1994), p. 103. Furthermore, the Commission takes notice that this approach is consistent with that recently taken by the FERC in addressing a similar issue. *Martha Coakley, Mass. Attorney Gen.*, Docket No. EL11-66-001, 147 FERC ¶ 61,234 (2014), at PP 142-148.

Staff's and CCI's objections to our consideration of such evidence are not well founded. Our consideration of large samples of recent authorized ROEs of utilities in the same business as the Utilities answers their concern about comparability. Indeed, Staff itself routinely asks us to consider data averages with the assurance that using a sample mitigates measurement error. Moreover, investors routinely rely on trend analysis and forecasting provided by governmental and commercial analysts. In deciding a utility's market cost of equity, we cannot pretend that such information regularly used by the market does not exist.

It is also important that we are apprised of current market conditions because our decisions affect at least in part the capital costs that the market sets for the Utilities, in particular through the credit rating agencies' evaluation of regulation quality and direction. As we opined in one of the Utilities' previous rate cases:

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. 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 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. Thus, we would be remiss if we ignored altogether, as Staff and CCI urge, the potential market reactions to our cost of capital decisions.

Based on the record before us, we find that the average of recent ROEs authorized for natural gas utilities is 10.50%. NS-PGL IB at 102-103. We also note that stellar stock market performance and increasing strength in the leading economic indicators point to an improving economy. PGL Ex. 3.0 at 20-21. Treasury and utility bond yields also 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, 31-32; NS-PGL Ex. 19.0 at 11-12. These general market data provide relevant comparative information as we assess the parties' various ROE provisions. They do not, however, replace our analysis of the Utilities' specific cost of equity using the traditional tools at our disposal, to which we now turn.

(ii) The DCF Model

In reviewing the results from the DCF model as performed by the Utilities and Staff, the Commission remains concerned that Staff continues to modify its DCF methodology without explanation. When the results of such modifications are consistently lower ROE estimates, the Commission must consider whether the modifications are motivated by bias. Indeed, we have previously recognized the limits of the mathematical models, including the fact that they are "highly dependent on analyst judgment as to the inputs, and therefore are susceptible to manipulation." *Peoples Gas 2009 Order* at 123.

We find no basis for Staff's blending published EPS growth forecasts with other forecasts for the DCF growth component or its reliance on a purely historical dividend yield rate, and therefore reject Staff's DCF model for further consideration. Likewise, we find that CCI's use of a non-constant growth model, improper proxy group, and anomalous results render its DCF results too unreliable to use in estimating the Utilities' ROEs.

Although we acknowledge that analysts might disagree as to different variants and ways in which a model might be constructed, we deem Mr. Moul's DCF methodology to be reasoned and sound. Consistent with the Utilities' compromise position, we will consider the Utilities' DCF result for the Delivery Group only.

Turning to Mr. Moul's financial leverage adjustment to his DCF result, we find that it is based on the well-accepted, if not irrefutable, economic theory that there is a direct relationship between a firm's risk and the amount of debt in its capital structure. Currently, there is no dispute that the Delivery Group's average market value capital structure has more equity (and therefore less risk) than its average book value capital structure. In order to make a market cost of equity relevant and applicable to the utility's book value capital structure, an adjustment is required. Otherwise, if the market value cost of equity is applied to the utility's book value capital structure (and all other things are held equal), the utility will not recover its total cost of capital and will not earn its authorized return. NS-PGL RB at 87-88.

Using well-accepted formulas, Mr. Moul calculated the Delivery Group's ROEs with an average book value equity ratio and with a market value equity ratio, and determined the ROE of the Delivery Group with a book value equity ratio to be 46 basis points higher than its ROE with a market value equity ratio.

Absent any competing calculation of this adjustment, we find that a 46 basis point upward adjustment to the Utilities' DCF-based cost of equity is necessary to apply that cost of equity to the Utilities' book value capital structures.

(iii) The CAPM Model

We find that the Utilities' CAPM analyses present an appropriate basis to determine ROE. Mr. Moul's consideration of historical information in conjunction with current and forecast data is a reasonable approach for this financial model. Consistent with the Utilities' compromise position, we will consider the Utilities' CAPM result for the Delivery Group only, without adjustment for size.

In light of the undisputed evidence in the record that Staff's beta methodology typically generates lower betas than those published and relied upon by investors, we find that Staff's CAPM is biased and will not consider it.

(iv) Risk Premium Analysis

We find that Mr. Moul's use of A-rated utility bonds and his development of an equity risk premium based on an analysis of historical data and current market conditions constitute a methodologically sound basis for estimating the Utilities' cost of equity. Thus, the Commission concludes that it is appropriate to include the results from this model in its determination of the Utilities' ROEs.

(v) Conclusions

Based on the foregoing discussion, the calculation of ROE will be affected by the following conclusions: (1) the leverage-adjusted DCF analysis performed by the Utilities for the Delivery Group will be included in this calculation; (2) the leverage-adjusted CAPM analysis of the Utilities for the Delivery Group will be included in this calculation; and (3) the Utilities Risk Premium analysis for the Delivery Group will be included in this calculation. Based on its review of the record, and consistent with the conclusions above, the Commission finds that an average of the Utilities' DCF, CAPM and Risk Premium models forms an appropriate basis to determine ROE, which results in an ROE of 10.25% for each Utility.

F. Weighted Average Cost of Capital

1. Peoples Gas

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for Peoples Gas of 7.21%, calculated as follows:

Peoples Gas Cost of Capital Summary			
Cost of Capital	Percent of Total	Percent Cost	Weighted Cost
Long Term Debt	46.51%	4.32%	2.01%
Common Equity	50.33%	10.25%	5.16%
Short Term Debt	3.16%	1.19%	0.04
Total Capital			7.21%

2. North Shore

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for North Shore of 6.89%, calculated as follows:

North Shore Cost of Capital Summary			
Cost of Capital	Percent of Total	Percent Cost	Weighted Cost
Long Term Debt	38.94%	4.13%	1.61%
Common Equity	50.48%	10.25%	5.17%
Short Term Debt	10.58%	1.06%	0.11%
Total Capital			6.89%

VIII. OPERATIONS

A. AMRP Main Ranking Index and AG Proposed Leak Metric(s)

Peoples Gas

Peoples Gas states that the evidence establishes that (1) Peoples Gas prudently uses its Main Ranking Index (“MRI”) to make decisions about which mains to replace; (2) the “peer group” analyses presented by AG witness Dr. Dismukes relating to replacement trends and leak trends are flawed; and (3) in any event, Dr. Dismukes’ vague proposals to add one or more “performance metrics” related to leaks as conditions of recovery of costs of efforts to reduce leaks are not only unnecessary, but they could be counter-productive by diverting resources away from their best use. NS-PGL IB at 114-116; NS-PGL RB at 89-90.

Peoples Gas states that, as explained by the Peoples Gas witness, David Lazzaro, an experienced engineer, in replacing cast iron and ductile iron mains, Peoples Gas utilizes criteria according to its MRI, which guides it in making appropriate decisions about targeting which mains to replace. PGL Ex. 8.0 2nd REV. at 11. He discussed in detail the development and use of the MRI. *Id.* at 11-12. He also described the processes for management oversight of the AMRP and coordinating with the City of Chicago. *Id.* at 12-14.

Peoples Gas states that 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. NS-PGL Ex. 23.0 2nd REV. at 2, 6-9; NS-PGL Ex. 38.0 at 3, 5-6; Tr. at 130. 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. NS-PGL Ex. 23.0 2nd Rev. at 2, 6-9. 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. NS-PGL Ex. 38.0 at 5-6.

Peoples Gas states that 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 acknowledges that it has no objection in principle to Peoples Gas using the MRI. AG IB Corr. at 75. The AG and its witness failed to identify anything in the MRI to which they object.

Peoples Gas contends that the AG's arguments in its briefs are devoted mostly to defending Dr. Dismukes' analyses, but provide essentially no factual support for his or the AG's vague proposals. The evidence does not provide any credible basis for rejecting the testimony of the Utilities' witness on this subject, Mr. Lazzaro, an experienced engineer, in favor of that of Dr. Dismukes, an economist, regarding whether new metrics should be adopted. It is not even clear what was Dr. Dismukes' proposal, or what is the AG's proposal. They refer to cost recovery-related proposals adopted in three cases in New Jersey, but do not appear to advocate those same exact proposals here, do not show that circumstances are similar here, and provide no evidence that those proposals would be suitable, or cost-effective, as to Peoples Gas. NS-PGL RB at 90-91.

Peoples Gas concludes that the AG's vague proposals on this subject are ill-advised and should not be adopted.

Other Parties

[Insert]

Commission Analysis and Conclusion

The record does not support imposing any additional metrics on Peoples Gas' main replacement program, whether for operational purposes or as conditions of recovery of costs of leak reduction efforts. Peoples Gas provided evidence from an experienced engineer supporting the continued use of its Main Ranking Index, and that adding metrics could cause resources to be diverted from their best use. The proposals for new metrics are too vague, and too lacking in evidence that their adoption would be useful and cost-effective, for the Commission to impose them. The Commission in future cases will continue to perform its duty of assessing the evidence regarding the prudence and reasonableness of main replacement and other leak reduction effort costs.

B. Pipeline Safety-Related Training

The Utilities and Staff agree that this Order should include a Findings and Ordering Paragraphs paragraph that specifies, for Peoples Gas, the test year amounts of certain pipeline-safety related training. The agreed language is as follows:

(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 49 CFR Parts 191 and 192 Training; \$0 for Construction Inspection; \$6,300 for all other pipeline safety-related training, totaling \$98,135.

NS-PGL Ex. 23.0 2nd REV. at 11; Staff Ex. 1.0 at 28. The agreed language is proper and it is incorporated in the Findings and Ordering Paragraphs section of this Order.

VIII. COST OF SERVICE

A. Overview

North Shore and Peoples Gas

The Utilities prepared embedded cost of service studies (“ECOSSs”) to develop and implement their rate design proposals. 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 (NS Ex. 14.0 at 17-18; PGL Ex. 14.0 at 18-19) and the Miscellaneous Revenues in Account 495 (NS Ex. 14.0 at 21-22; PGL Ex. 14.0 at 22-23).

Other Parties

[Insert]

Commission Analysis and Conclusions

Only IIEC contested the sufficiency of the Utilities’ ECOSSs to develop rates in this proceeding. IIEC proposed two changes to the Utilities’ ECOSSs but did not otherwise present ECOSSs for the Commission’s consideration. For the reasons stated in Section VIII.B, *infra*, the Commission does not accept IIEC’s proposed changes to the Utilities’ ECOSSs. The Utilities’ ECOSSs are complete, they systematically functionalize, classify and allocate costs, and they comport with the cost causation principles for preparing such studies that the Commission has approved in many other rate cases. The Commission finds that the Utilities’ ECOSSs are sufficient and reasonable for developing rate designs in this proceeding.

B. Embedded Cost of Service Study

1. Allocation of Demand-Classified Transmission and Distribution Costs

North Shore and Peoples Gas

The Utilities proposed to allocate demand-classified transmission and distribution (“T&D”) costs using an average and peak (“A&P”) methodology. NS Ex. 14.0 at 11; PGL Ex. 14.0 at 11. A&P is an accepted approach to such T&D cost allocation, and it is consistent with the Commission’s orders in the Utilities’ five most recent rate cases.¹⁹ IIEC proposed a coincident peak (“CP”) allocator for demand-classified T&D costs. IIEC Ex. 1.0 at 24. Staff opposed IIEC’s proposal and supported the A&P methodology. Staff Ex. 9.0 at 25-32. AG/ELPC opposed IIEC’s proposal. AG/ELPC Ex. 9.0 at 12.

The Utilities noted that IIEC is correct that they have supported a CP allocator for demand-classified T&D investment in past cases.²⁰ IIEC Ex. 1.0 at 18. However, the Utilities explained that, in *Peoples Gas 2007*, the Commission rejected that approach after considering arguments from the Utilities and others 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 NS-PGL Ex. 28.0 at 4. Subsequent to that case, to limit the scope of contested issues, the Utilities have used the A&P allocator. NS-PGL Ex. 28.0 at 3. The Utilities further explained that 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.” NS-PGL Ex. 28.0 at 4.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission agrees that both the CP and the A&P method are acceptable ways to allocate demand-classified T&D costs. However, as Staff and the Utilities explained, the Commission, for many years, has approved use of the A&P method for Illinois gas

¹⁹ NS-PGL Ex. 28.0, 4; *Re North Shore Gas Company*, 1995 WL 17200629 (Ill.C.C. Nov. 8, 1995) (Docket No. 95-0031) (“*North Shore 1995*”); *Re Peoples Gas Light and Coke Company*, 1995 WL 17200632 (Ill.C.C. Nov 8, 1995) (Docket No. 95-0032) (“*Peoples Gas 1995*”); *Peoples Gas 2007* Order at 199; *Peoples Gas 2009* (issue uncontested); *Peoples Gas 2011* (issue uncontested); *Peoples Gas 2012* (issue uncontested).

²⁰ Of the five recent cases 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*.

utilities in general and for North Shore and Peoples Gas in particular. IIEC has not shown that the CP method is preferable in this case. The Commission therefore finds that the Utilities' use of the A&P method for demand-classified T&D costs is reasonable and is approved.

2. Allocation of Small Diameter Main Service Costs

North Shore and Peoples Gas

The Utilities do not delineate between small and large diameter distribution mains in their ECOSs, nor is it appropriate to do so. NS-PGL Ex. 28.0 at 9. The Utilities explained, and it is undisputed, that 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)²¹, 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 stated that they operate their systems in an integrated manner, which enhances system reliability for all customers. NS-PGL Ex. 23.0 REV. at 11-12; NS-PGL Ex. 31.0 at 4. The Utilities explained that their ECOSs 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. NS Ex. 14.0 at 9-10; PGL Ex. 14.0 at 9-10.

The Utilities showed that IIEC's proposal to consider moving the three customers taking service directly from smaller diameter mains to another service class is flawed because these customers do not qualify for S.C. No. 2, which is available only to customers using a monthly average of 41,000 therms or less. None of the three customers are eligible for S.C. No. 2 and all are properly on S.C. No. 4. NS-PGL Ex. 43.0 REV. at 3.

The Utilities witness Ms. Hoffman Malueg explained that selectively allocating only certain main costs to S.C. No. 4 is incompatible with the class-based nature of the ECOSs. The Utilities' ECOSs allocate costs to the customer classes (S.C. No. 4 is such a class), based on class characteristics and not based on individual customer characteristics or *ad hoc* group characteristics within the classes. The number of customers taking service from various main sizes in a given class is irrelevant. NS Ex. 14.0 at 9-10; PGL Ex. 14.0 at 9-10; NS-PGL Ex. 28.0, 10. Ms. Hoffman Malueg explained that the ECOSs are not intended to extract for or allocate specific costs to individual customers. NS-PGL Ex. 28.0 at 10.

Finally, the Utilities expressed concerns about the feasibility of IIEC's proposal. The Utilities do not allocate distribution mains to customer classes within their ECOSs

²¹ The contract service rates are not part of the ECOSs because these cases do not affect their rates. NS Ex. 14.0 at 35; PGL Ex. 14.0 at 35-36.

based on customer counts. The fact that there are only three S.C. No. 4 customers out of 180 (total within both Utilities) taking service directly from a main smaller than four inches has no relevance in the ECOSs. NS-PGL Ex. 28.0 at 10. IIEC apparently seeks only to look at customer counts as relevant for S.C. No. 4 for certain mains, but, if customer counts are appropriate for S.C. No. 4 and for certain size mains, does fairness dictate that customer counts become a factor for all size mains and other facilities, for all service classifications? The Utilities stated that making a single, selective exception to the class-based nature of the ECOSs may be feasible, but it is not feasible to begin making exceptions for all particular costs that may fit IIEC's theory. *Id.* at 11. The Utilities described various scenarios to illustrate its selective nature and the lack of support for whether this proposed exception makes any more sense than other potentially similar exceptions.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission agrees that selective exceptions to the class-based nature of the ECOSs are not appropriate in this instance. It is significant that customers in all the service classes (except for certain Peoples Gas negotiated rate customers) take service from all the different sized mains on the Utilities' systems. IIEC did not demonstrate why it makes sense to allocate certain main costs to S.C. No. 4 based on the number of customers taking service from certain sized mains but not to consider similar customer-level analyses for other types of facilities or for other service classes. The Commission therefore finds that the Utilities' decisions not to make delineations in their ECOSs based on main diameter are reasonable.

IX. RATE DESIGN

A. Overview

The Utilities' witness Ms. Egelhoff testified that the 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 regarding the costs recovered through the rates, (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. NS Ex. 15.0 at 6; PGL Ex. 15.0 REV. at 6.

Other Parties

[Insert]

B. General Rate Design

1. Allocation of Rate Increase

The Utilities used their ECOSs to allocate revenue requirements and develop rates. As in prior cases, the Utilities set cost-based rates for each service classification. NS Ex. 15.0 at 7, 10; PGL Ex. 15.0 REV. at 7, 10. The Utilities stated that their ECOSs and the descriptions of their rate designs are detailed and specific enough that it would be straightforward to derive rates from the revenue requirements the Commission approves. NS Ex. 15.0 at 7; PGL Ex. 15.0 REV. at 7. IIEC proposed an “across-the-board” increase (IIEC Ex. 1.0 at 24), *i.e.*, each service classification should receive the same percentage of the revenue deficiency as the overall system deficiency, regardless of what the ECOSs shows. IIEC IB at 22. The Utilities witnesses Ms. Hoffman Malueg and Ms. Egelhoff opposed IIEC’s proposal for several reasons discussed in the next paragraph. NS-PGL IB at 121-122.

First, the premise for IIEC’s allocation proposal is its two proposed changes to the Utilities’ ECOSs. The Commission should reject both proposals. Second, while IIEC proposed two specific changes to the Utilities’ ECOSs, it did not present complete ECOSs for the record. Third, despite IIEC’s citing the importance of cost causation in the ECOSs, the Utilities stated that it is incongruous for IIEC to ignore the ECOSs to design rates. The Utilities contend that, if the Commission agrees with IIEC that the Utilities’ ECOSs are flawed, then the solution is to remedy those flaws and then use the resulting ECOSs to design rates. Finally, the Utilities argued that the Ameren case cited by IIEC does not support its proposal. In *Central Illinois Light Company d/b/a AmerenCILCO, et al.*, ICC Docket Nos. 07-0585 *et al.* (Order Sept. 24, 2008) (“*AmerenCILCO*”), the Commission approved an across-the-board increase because of the unique circumstances of the electric utility’s transition from a legislatively mandated rate freeze. The Commission stated that it was “reluctant to return to full cost based rates after less than one year. The rate shock that would result from returning to full cost based rates would likely lead to another redesign docket.” The Commission further stated that it “certainly does not mean to suggest by this decision that cost based rates have fallen out of favor. Indeed, cost based rates, as we affirmed in our recent decision in Docket No. 07-0566, continue to be the Commission’s preferred rate design methodology.” *AmerenCILCO* at 280. The Utilities stated that a more pertinent decision is *Peoples Gas 2009* in which the Commission considered and rejected a Staff proposal based on applying across-the-board increases. *Peoples Gas 2009* Order at 203-204.

The Utilities concluded that the Commission should reject IIEC’s across-the-board allocation proposal and, instead, direct the Utilities to re-run their ECOSs and adjust the rate design based on the Commission’s order. The Utilities recommend this approach even if the Commission adopts one or both of IIEC’s proposed changes to the Utilities’ ECOSs.

Other Parties

[Insert]

Commission Analysis and Conclusions

For the reasons stated in Section VIII, *supra*, the Commission rejects both of IIEC's proposed changes to the ECOSs. Thus, IIEC's proposed across-the-board rate increase allocation is moot as the proposal appeared predicated on the changes to the ECOSs. Accordingly, the Utilities should re-run their ECOSs and, using those ECOSs, develop cost-based rates consistent with this Order. The facts and circumstances underlying our decision in *AmerenCILCO* are not present and an across-the-board allocation is not appropriate in this case.

2. Fixed Cost Recovery

North Shore and Peoples Gas

The Utilities stated that the principal rate design issue in this case is the type of charge -- fixed or variable (sometimes called volumetric) -- through which they should recover non-storage demand-classified distribution costs. The Utilities contend that their proposals strike an appropriate balance between recovering all fixed costs in fixed charges, which is driven by the fact that fixed costs do not vary with gas use, and moving gradually to such a rate design, recognizing that the Utilities' Rider VBA, Volume Balancing Adjustment, addresses the inevitable over- and under-recovery that results from recovering fixed costs in variable charges. NS-PGL IB at 123-127.

Staff and intervenors advocate placing more fixed cost recovery in variable charges as a "traditional" rate design, cite recent electric utility orders as support for moving more fixed cost recovery to variable charges, argue that their rate designs promote energy efficiency, cite certain of the Utilities' riders as a reason to have less fixed cost recovery in fixed charges, and claim that the Utilities' rates result in low use Service Classification ("S.C.") No. 1, Small Residential Service, customers subsidizing high use S.C. No. 1 customers. The Utilities addressed these several allegations. *Id.*

a. Straight Fixed Variable ("SFV") Rate Design

The Utilities noted that Staff and intervenors refer to "SFV" rate design repeatedly. The Utilities explained that straight fixed variable ("SFV") is merely a term describing a rate design under which all fixed costs are recovered in fixed charges. NS Ex. 15.0 at 13; PGL Ex. 15.0 REV. at 13. Contrary to at least one intervenor's claims (City/CUB IB at 7), the Utilities have not proposed an SFV rate design, nor are their current rates based on an SFV rate design. NS-PGL Ex. 29.0 REV. at 4. The Utilities witness Ms. Egelhoff did state that, absent the Utilities' decoupling mechanism (Rider VBA), which is under Illinois Supreme Court review, SFV is the appropriate rate design. NS Ex. 15.0 at 13; PGL Ex. 15.0 REV. at 13. An SFV rate design is not before the Commission in this case.

b. Demand Costs Are Fixed Costs

The Utilities explained that demand-classified costs (e.g., storage, land, structures and improvements, mains, compressor station equipment and measuring and regulating equipment) are fixed costs. The costs of this type of investment do not vary with customer usage or even if the customer's demand day requirements change. NS-PGL Ex. 43.0 REV. at 4. 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 5-6. The Utilities contrasted the demand costs with, for example, the quantity of gas that the Utilities purchase to serve customers, which does vary with usage. For demand costs, the amount included in base rates in the test year is the same whether a customer consumes 0 therms or 100 therms and will not change even if the customer class' peak day usage increases or decreases. *Id.* The Utilities acknowledged that the way to recover demand costs is often contested, but, citing an authoritative NARUC source, the costs are clearly fixed. NS-PGL Ex. 29.0 REV. at 8. The Utilities also explained that the example of the demand of different size homes does not support Staff's and intervenors' arguments. There is no support for their premise that the cost of the main is different because a customer's home is 1,000 square feet and another customer's home is 4,000 square feet. The costs incurred to serve a community containing either size home would be comparable. In the example given and considering not just a single home but a community with like-sized homes, the same size main and services would be used to supply each community. The Utilities' explained that the size of the service and the cost to install would be the same for both size homes. NS-PGL Ex. 38.0 at 8; NS-PGL Ex. 45.0 at 4.

The Utilities posited that the question is, in the absence of a demand charge, whether to recover these fixed costs in a customer charge, a distribution charge, or both. (The Utilities noted that a demand charge would be a way to recover demand costs. However, Staff, confusingly, refers to "distribution\demand charges." Staff IB at 95, 100. They are not the same. NS-PGL Ex. 29.0 REV. at 14.) The Utilities' rate design, in this and prior cases, generally recovers the demand costs in both fixed and variable charges, with gradual movement towards placing recovery of these fixed costs in fixed charges. See, e.g., NS Ex. 15.0 at 11, 16; PGL Ex. 15.0 REV. at 11, 16. The problem with Staff and intervenor proposals to place all S.C. No. 1 demand costs in variable charges is that it necessarily presumes that usage affects demand costs. (Staff also makes proposals for other service classifications that stem from the same arguments.) It is correct that system peak day usage drives the size of demand-related infrastructure (NS-PGL Ex. 29.0 REV. at 7), but it is false that day-to-day usage causes any change to these costs. Under the Staff and intervenor proposals, when a customer uses more gas -- on a peak or other day -- he pays more towards demand costs, and when he uses less gas, he pays less towards demand costs. Yet, the same main or regulator is still in base rates and still supporting service to that customer. *Id.* at 7-8. For these reasons, for a rate class that does not include a demand charge, a fixed charge, like the customer charge, is a much better cost causal rate design than a variable charge, like the distribution charge.

c. Energy Efficiency

Utilities witness Ms. Egelhoff stated that one of the Utilities' rate design objectives is to send proper price signals regarding the costs that are the subject of the rates being set in these cases. They achieve this by proposing to move more fixed cost recovery into fixed charges. The price signal conveyed to customers is the cost to serve them, *i.e.*, how much gas the customer uses does not affect the cost to deliver gas to that customer. The Utilities contrast this accurate price signal with the erroneous price signals that the Staff and intervenor proposals would send, namely that the more gas customers use the more it costs the Utilities to provide them delivery service. Stated differently, Staff and intervenor proposals falsely tell customers that lower usage reduces the Utilities' costs to provide delivery service. NS-PGL Ex. 29.0 REV. at 3-4. The Utilities contend that the purpose of rate design is not to manipulate customer behavior but, *inter alia*, to recover the revenue requirement and better align rates and revenues with underlying costs. NS Ex. 15.0 at 6; PGL Ex. 15.0 REV. at 6.

Ms. Egelhoff explained that energy efficiency is addressed through other means. The Utilities' energy efficiency programs, under Section 8-104 of the Act and that the Commission most recently approved in ICC Docket No. 13-0550 and before that in ICC Docket No. 10-0564, are designed to achieve statutorily-required energy efficiency goals, through customer participation in the approved programs. Ms. Egelhoff stated that the Commission approved a budget and the Utilities recover the costs of their programs under their Rider EOA, Energy Efficiency and On-Bill Financing Adjustment. The Illinois General Assembly and the Commission intend that costs related to conservation and energy efficiency measures occur within the context of the Utilities' approved Section 8-104 plans and not through rate design that sends incorrect price signals. NS-PGL Ex. 29.0 REV. at 10. Through the Section 8-104 programs and providing for volumetric cost recovery under Rider EOA, the Commission provided a clear signal as to how the Utilities are to implement and recover costs for their energy efficiency programs. The Utilities' gas distribution service to residential customers in single family homes and multi-family buildings is entirely driven by fixed costs. The mere presence of the customer for a particular account drives the nature of the cost of the utility service (*e.g.*, the meter and main) to that premises. NS-PGL Ex. 29.0 REV. at 11.

The Utilities also showed that customers have ample incentives to reduce gas use. Under their proposals, a large portion of a typical S.C. No. 1 heating customer's annual bill before taxes would be derived from variable charges such as supply and distribution (approximately 60% for Peoples Gas and 70% for North Shore). *Id.* at 9. Also, under any rate design, gas costs remain one of the largest portions of an average residential heating customer's annual bill, with the cost of gas constituting approximately 40% for Peoples Gas and 55% for North Shore. NS-PGL Ex. 29.0 REV. at 9-10. The Utilities cited the Commission's conclusions 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, at 91 (Order Mar. 25, 2009).

d. Rider Mechanisms

The Utilities acknowledged that the various riders that Staff and intervenors cited provide stability for customers and the Utilities. For example, Rider VBA is a rate design mechanism designed to prevent over- or under-recovery of the Utilities’ Commission-approved revenue requirement. *Peoples Gas 2011 Order* at 163. Rider UEA, Uncollectible Expense Adjustment, is designed to provide recovery (not over- or under-) of the Utilities’ uncollectible amount (bad debt). 220 ILCS 5/19-145. Rider SSC, Storage Service Charge, does the same for base rate storage costs and was needed to support unbundling that the Commission required for certain transportation programs. *Peoples Gas 2011 Order* at 229. However, these mechanisms do not support rates that are not founded on sound cost causation principles. They are not (contrary to Staff’s analogy (Staff IB at 100)) comparable to the Energy Infrastructure Modernization Act (“EIMA”). Rider VBA, for example, 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. NS-PGL Ex. 29.0 REV. at 6. 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 than it does on gas utilities.

e. Low Use/High Use Customers

The AG argues that the Utilities’ rate design proposals would create intra-class subsidies (with low use customers subsidizing high use customers) and are unfair to low income customers. AG IB at 83-84, 92-97. The Utilities contend that the AG arguments fail for two fundamental reasons. NS-PGL RB at 108-110.

First, the cross-subsidization argument is premised on not recognizing that demand costs are fixed costs. Indeed, the Staff and intervenor proposals could result in high use customers subsidizing low use customers. NS-PGL Ex. 43.0 REV. at 9.

Second, the AG equates low use customers with low income customers and their arguments are predicated on taking general data about the city, county, state or other region and applying it to the Utilities’ customer bases to categorize customers as low income. Neither the Utilities nor the AG have income information about the Utilities’ customers. The AG witness used general data to draw conclusions, and tried to explain away utility data that were contrary to his theory. The Utilities only have Low Income Home Energy Assistance Program (“LIHEAP”) and Percentage of Income Payment Program (“PIPP”) customer-specific data to identify North Shore’s and Peoples Gas’ low income customers. The data Peoples Gas provided AG witness Mr. Colton show that an average Peoples Gas low income (*i.e.*, LIHEAP and PIPP) S.C. No. 1 heating

customer uses more (not less) gas than the typical such customer (1,258.60 therms versus 1,066.62 therms). NS-PGL Ex. 29.0 REV. at 22, 24. The AG witness tried to dismiss these data by saying they were a function of what he considers the Utilities' inappropriate definition of low income customers. AG Ex. 4.0C at 11; AG Ex. 10.0 at 9-10. The AG's witness ignored the customer-specific data Peoples Gas provided, which contradicted his theory that low income customers are low use customers, and instead claimed the data were flawed because they did not use his definition of low income. NS-PGL Ex. 43.0 REV. at 11.

The Utilities responded to the Commission's concerns about distinguishing low use and high use residential customers by proposing S.C. No. 1 non-heating (sometimes identified by "NH") and heating (sometimes identified by "HTG"), which the Commission approved. S.C. No. 1 NH rates accurately reflect the lower costs of serving these lower use customers who place less demand on the system. The Utilities do not have service classifications based on customer's income, nor do they agree that subsidizing low use customers on the premise that it may be beneficial to low income and elderly customers is a sound rate design. However, low income customers' needs are addressed through targeted assistance programs that are available irrespective of a customer's usage levels. Even low income customers with higher than average use may be eligible for assistance. The Utilities also offer energy efficiency programs and on-bill financing programs to all customers, encouraging them to adopt energy efficiency measures and practices. NS-PGL Ex. 29.0 REV. at 23.

The Utilities' S.C. No. 1 rate design takes low use and high use customers into account through the heating and non-heating rate design. The fact that the bill impacts, in percentage terms, are higher for low use customers than for high use customers is not evidence of inappropriate intra-class subsidies, but rather is evidence of simple mathematics: the percentage effect of an increase in the fixed customer charge will be greater for a low use customer, compared with a high use customer, because the increase is applied to a smaller bill.

Other Parties

[Insert]

Commission Analysis and Conclusions

An SFV rate design is not at issue in this docket, and the Commission makes no findings about whether and under what circumstances an SFV rate design may be appropriate.

For gas utilities, it continues to be appropriate to move gradually to recovering fixed costs in fixed charges. Demand classified costs are fixed costs. These costs are associated with customer usage in the sense that it is the peak day usage that drives the size of demand-related infrastructure like mains, but demand costs do not vary with customer usage. Unlike commodity costs, like the cost of gas, which will fluctuate from day-to-day based on how much gas the utility must acquire to serve its customers'

requirements each day, demand costs (like mains and land) do not fluctuate based on usage. Instead, demand costs included in base rates set in this case are not subject to change because customers' usage changes; the cost of a main is not more or less when a customer's usage increases or decreases.

The Commission supports energy efficiency. Section 8-104 of the Act is the means through which the Utilities promote energy efficiency for their customers, and the Commission and stakeholders have significant oversight and involvement in those programs. Both through the availability of Section 8-104 programs, on-bill financing, and the large amount of the customer's bill that is based on variable charges, customers have strong incentives and opportunities to enjoy reduced energy costs from reduced usage. It is not necessary to depart from cost-based rates to provide additional incentives, nor does it make sense to promote conservation through inaccurate price signals.

Finally, the Commission does not find that the evidence shows inappropriate S.C. No. 1 intra-class subsidies. The Commission ordered the Utilities to address the low use/high use rate design issues it saw in S.C. No. 1 and the Utilities responded by splitting S.C. No. 1 into heating and non-heating classes. We found, in *Peoples Gas 2012*, that this addressed our concerns. The fact that a low use customer will experience a higher percentage impact than a high use customer does not mean that a subsidy exists. Because the Utilities' base rate costs are all fixed and ought to be recovered in fixed charges, it is to be expected that any rate increase will produce, in percentage terms, a bigger effect on low use customers if such a rate design is in place. These low use customers have fewer therms to spread fixed costs over and the resulting impact is bigger.

The Commission will apply these findings to its analysis of the specific rate design proposals for each of the Utilities' service classifications.

C. Service Classification Rate Design

1. Uncontested Issues

a. Service Classification No. 8, Compressed Natural Gas Service (PGL)

North Shore and Peoples Gas

Peoples Gas proposed to set S.C. No. 8, Compressed Natural Gas Service, at cost. PGL Ex. 15.0 REV. at 10. North Shore does not have a comparable service classification.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that Peoples Gas' rate design for its compressed natural gas service classification is appropriate and reasonable. It is proper to set this service classification at cost. The proposal is uncontested. The Commission approves Peoples Gas' proposed S.C. No. 8 rate design.

- b. Service Classification No. 5 Contract Service for Electric Generation and Service Classification No. 7 Contract Service to Prevent Bypass**

North Shore and Peoples Gas

North Shore and Peoples Gas 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 ECOSs. NS Ex. 15.0 at 8-9, 19; PGL Ex. 15.0 REV. at 8-9, 19.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that the Utilities' proposals not to revise these service classifications are appropriate and reasonable. The proposals are uncontested. The Commission approves no changes to S.C. Nos. 5 and 7.

2. Contested Issues – North Shore and Peoples Gas

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

North Shore and Peoples Gas

The Utilities stated that, consistent with the rate design objectives and principles applicable to fixed cost recovery, they each proposed to continue to set S.C. No. 1 NH at cost. NS Ex. 15.0 at 10; PGL Ex. 15.0 REV. at 10. 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. NS Ex. 15.0 at 11; PGL Ex. 15.0 REV. at 11. The Utilities contend that their proposals are consistent with the Commission policy for gas utilities 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. The Utilities also stated that the IIEC's flawed across-the-board increase should be rejected.

Other Parties

[Insert]

Commission Analysis and Conclusions

The issue for the S.C. No. 1 non-heating rate design is how much, if any, demand costs should be recovered in the customer charge. As we concluded in Section IX.B.2 of this Order, demand costs are fixed costs. For that reason, it is appropriate to recover these costs in fixed charges, but gradual movement to full cost recovery in fixed charges is appropriate. The Utilities' proposals are consistent with this basic principle. The Commission also finds that the continued use of a flat distribution charge to recover all remaining non-storage costs is appropriate as well as continued recovery of storage-related costs under Rider SSC.

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

North Shore and Peoples Gas

The Utilities stated that, consistent with the rate design objectives and principles applicable to fixed cost recovery, they each proposed to continue to set S.C. No. 1 HTG at cost. NS Ex. 15.0 at 10; PGL Ex. 15.0 REV. at 10. 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. NS Ex. 15.0 at 12; PGL Ex. 15.0 REV. at 12. The Utilities contend that their proposals are consistent with the Commission policy for gas utilities of gradually increasing fixed cost recovery in fixed charges. To retreat from this gradual movement, as AG/ELPC and 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.

Other Parties

[Insert]

Commission Analysis and Conclusions

The issue for the S.C. No. 1 heating rate design, as with the non-heating class, is how much, if any, demand costs should be recovered in the customer charge. As we concluded in Section IX.B.2 of this Order, demand costs are fixed costs. For that

reason, it is appropriate to recover these costs in fixed charges, but gradual movement to full cost recovery in fixed charges is appropriate. The Utilities' proposals are consistent with this basic principle. The Commission also finds that the continued use of a flat distribution charge to recover all remaining non-storage costs is appropriate as well as continued recovery of storage-related costs under Rider SSC.

c. Service Classification No. 2, General Service

The Utilities stated that, consistent with the rate design objectives and principles applicable to fixed cost recovery, they each proposed to continue to set S.C. No. 2 at cost. NS Ex. 15.0 at 10; PGL Ex. 15.0 REV. at 10. The Utilities each proposed to maintain three meter classes. Using the ECOSs, 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. The Utilities stated that 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. NS Ex. 15.0 at 16-18; PGL Ex. 15.0 REV. at 16-18.

For North Shore, Utilities witness Ms. Egelhoff stated that 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 25% of all remaining non-storage related fixed costs through the front and end distribution blocks, respectively. NS Ex. 15.0 at 16-17.

For Peoples Gas, Ms. Egelhoff stated that 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. PGL Ex. 15.0 REV. at 16-17.

Other Parties

[Insert]

Commission Analysis and Conclusions

The main issue for S.C. No. 2, as with S.C. No. 1, is how much, if any, demand costs should be recovered in the customer charge. As we concluded in Section IX.B.2 of this Order, demand costs are fixed costs. For that reason, it is appropriate to recover these costs in fixed charges, but gradual movement to full cost recovery in fixed charges is appropriate. The Utilities' proposals are consistent with this basic principle.

The uncontested proposal to combine the first and second distribution blocks is a reasonable response to our directive in *Peoples Gas 2012* to review the block structure. The Commission also finds that continued recovery of storage-related costs under Rider SSC is appropriate.

**d. Service Classification No. 4,
Large Volume Demand Service**

The Utilities stated that, consistent with the rate design objectives and principles applicable to fixed cost recovery, they each proposed to continue to set S.C. No. 4 at cost. NS Ex. 15.0 at 10; PGL Ex. 15.0 REV. at 10. Each proposed to set the monthly customer charge at cost. For North Shore, Utilities witness Ms. Egelhoff stated that 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, Ms. Egelhoff stated that 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. NS Ex. 15.0 at 19; PGL Ex. 15.0 REV. at 19.

Other Parties

[Insert]

Commission Analysis and Conclusions

The main issue for S.C. No. 4, as with S.C. Nos. 1 and 2, is how much, if any, demand costs should be recovered in fixed charges. As we concluded in Section IX.B.2 of this Order, demand costs are fixed costs. For that reason, it is appropriate to recover these costs in fixed charges, but gradual movement to full cost recovery in fixed charges is appropriate. The Utilities' proposals are consistent with this basic principle. The Commission also finds that continued recovery of storage-related costs under Rider SSC is appropriate.

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

North Shore and Peoples Gas

In response to AG/ELPC's claims that a large number of North Shore and Peoples Gas S.C. No. 1 customers appeared to be misclassified between heating and non-heating, 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 Utilities witness Mr. Robinson showed, there are often good explanations for why a customer's usage may vary from an expected level. NS-PGL Ex. 32.0 at 4-7. 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, 6. 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 7-8. A sample of data on which the AG witness relied 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 study that Staff suggested. NS-PGL Ex. 46.0 at 5.

In response to Staff, the Utilities stated that, in the limited time available, they were unable to develop a sound cost estimate for a study of classifications, 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 existing processes and the large number of customers already subject to review on an annual basis as part of the application process, a study is not needed. *Id.* at 2-4.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission agrees with the AG that correct S.C. No. 1 customer classification is essential to ensure that customers pay the correct rates. However, it is not apparent that misclassifications are a significant problem. The AG/ELPC witness identified a potentially large number of errors based on reviewing customer usage, but the Utilities showed that the AG/ELPC approach tended to generate "false positives" because usage is not the key to assessing if a customer is heating or non-heating. The Commission recognizes that the AG is not proposing that the Utilities assign customers to the heating or non-heating rate based solely on usage, but the AG did rely on usage data as the basis for claiming a significant problem existed. That usage-based analysis is flawed. Moreover, the Utilities showed that they have thorough and effective processes for assigning customers to the correct rate. For that reason, the Commission concludes that an exhaustive review or audit of S.C. No. 1 customer classifications is not warranted.

D. Other Rate Design Issues

1. Terms and Conditions of Service

a. Service Activation

North Shore and Peoples Gas

Based on a cost study, 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. 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. NS Ex. 15.0 at 20-21; NS Ex. 15.8. 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. PGL Ex. 15.0 REV. at 20-21; PGL Ex. 15.8 REV.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that the Utilities' proposed Service Activation Charges are appropriate and reasonable. The proposals show appropriate movement towards cost. The proposals are uncontested. The Commission approves the Utilities' proposed Service Activation Charges.

b. Service Reconnection Charges

Based on a cost study, 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. 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. NS Ex. 15.0 at 21-22; NS Ex. 15.8. 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. PGL Ex. 15.0 REV. at 21-22; PGL Ex. 15.8 REV.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that the Utilities' proposed Service Reconnection Charges are appropriate and reasonable. The proposals show appropriate movement towards cost. The proposals are uncontested. The Commission approves the Utilities' proposed Service Reconnection Charges.

c. Second Pulse Data Capability Charge

North Shore and Peoples Gas

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). NS Ex. 15.0 at 22; NS Ex. 15.12; PGL Ex. 15.0 REV. at 22; PGL Ex. 15.12. The Utilities agreed with Staff's proposal to update the charges using the rate of return that the Commission approves. NS-PGL Ex. 29.0 REV. at 24.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission approves the Utilities' uncontested Second Pulse Data Capability Charges, which are based on cost studies, subject to Staff's proposal to update the charges for the Commission-approved rate of return.

2. Riders

a. Rider 5, Gas Service Pipe

North Shore and Peoples Gas

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. NS Ex. 15.0 at 26-27; PGL Ex. 15.0 REV. at 26-27.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that the proposed clarifications are reasonable. The Commission approves the uncontested proposal.

b. Rider SSC, Storage Service Charge

North Shore and Peoples Gas

The Utilities 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. NS Ex. 15.0 at 22; PGL Ex. 15.0 REV. at 22-23.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that it is appropriate to update the Rider SSC charges based on the Order in this proceeding.

c. Rider QIP, Qualifying Infrastructure Plant (PGL)

North Shore and Peoples Gas

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. NS-PGL Ex. 43.0 REV. at 13.

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. 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. NS-PGL Ex. 29.0 REV. at 25; *also see* NS-PGL Ex. 43.0 REV. at 15-16.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission agrees that it is necessary for the smooth functioning of Rider QIP to include language in the Order that defines specific QIP dollar amounts. The Commission also agrees that the proposed and uncontested tariff changes are needed to effectuate the calculation of the Rider QIP surcharge following a rate case. The Staff and Peoples Gas proposals in these regards are appropriate to achieve these goals and the Commission approves them.

d. Rider UEA, Uncollectible Expense Adjustment, and Rider UEA-GC, Uncollectible Expense Adjustment – Gas Costs

North Shore and Peoples Gas

The Utilities each 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 based on the final revenue requirements determined by the Commission in these cases. NS Ex. 15.0 at 25-26; NS Ex. 15.11; PGL Ex. 15.0 REV. at 25-26; PGL Ex. 15.11.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that it is appropriate to update 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 based on the uncollectible amount approved in the final Order.

e. Rider VBA, Volume Balancing Adjustment, Percentage of Fixed Costs

North Shore and Peoples Gas

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 Utilities proposed the Rider VBA Percentage of Fixed Costs ("PFC") be set at 100%. NS Ex. 15.0 at 12-13, 18; PGL Ex. 15.0 REV. at 12-13, 18.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission agrees that it is necessary under Rider VBA for the Utilities to file RCRs and it directs the Utilities to do so. The Commission also finds that the PFC should be set at 100%. The Utilities' proposals are uncontested and approved.

f. Transportation Riders

i. Transportation Administrative Charges

North Shore and Peoples Gas

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. NS Ex. 15.0 at 23; 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. PGL Ex. 15.0 REV. at 23; PGL Ex. 15.9.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that the Utilities' proposed Administrative and Pooling Charges are appropriate and reasonable. The proposals are based on an uncontested cost study. The Commission approves the Utilities' proposed Administrative and Pooling Charges.

ii. Rider SBO Credit

North Shore and Peoples Gas

The Utilities' 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. Based on a cost study, the Utilities proposed to increase the credit from 46 to 47 cents per bill per month. NS Ex. 15.0 at 23; NS Ex. 15.10; PGL Ex. 15.0 REV. at 23-24; PGL Ex. 15.10.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission finds that the proposed Rider SBO credit is reasonable and based on an uncontested cost study. The Commission approves the proposed Rider SBO credit.

iii. Purchase of Receivables

North Shore and Peoples Gas

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 witness Ms. Egelhoff stated that 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. NS Ex. 15.0 at 24; PGL Ex. 15.0 REV. at 24. The Utilities noted that the Commission has not yet issued an Order in the Ameren case, ICC Docket No. 14-0097.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission notes that neither Staff nor intervenors commented on the Utilities' proposal. The Commission takes no position on the proposal but will review the merits of any proposed tariff when it is filed.

3. Service Classifications

a. Service Classification Nos. 1 and 2 Terms of Service

North Shore and Peoples Gas

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). NS Ex. 15.0 at 26; PGL Ex. 15.0 REV. at 26.

Other Parties

[Insert]

Commission Analysis and Conclusions

The Commission approves the Utilities' proposed clarifications to S.C. Nos. 1 and 2. These uncontested proposals are reasonable.

4. Other

X. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Peoples Gas is an Illinois corporation engaged in the transportation, purchase, storage, distribution and sale of natural gas to the public in Illinois and is a public utility as defined in Section 3-105 of the Act;
- (2) North Shore is an Illinois corporation engaged in the transportation, purchase, storage, distribution and sale of natural gas to the public in Illinois and is a public utility as defined in Section 3-105 of the Act;
- (3) the Commission has jurisdiction over the parties and the subject matter herein;
- (4) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record, and are hereby adopted as findings of fact and conclusions of law; the Appendices attached hereto provide supporting calculations;
- (5) the test year for the determination of the rates herein found to be just and reasonable should be the 12 months ending December 31, 2015; such test year is appropriate for purposes of this proceeding;
- (6) 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 Ex. 1.0, are unconditionally approved as the original costs of plant;
- (7) for the test year ending December 31, 2015, and for the purposes of this proceeding, Peoples Gas' original cost rate base with adjustments is \$1,759,289,000;
- (8) for the test year ending December 31, 2015, and for the purposes of this proceeding, North Shore's original cost rate base with adjustments is \$219,786,000;
- (9) a just and reasonable return which Peoples Gas should be allowed to earn on its net original cost rate base is 7.21%; this rate of return incorporates a return on common equity of 10.25% and costs of long-term debt of 4.32% and short-term debt of 1.19%, with a just and reasonable capital structure of 50.33% common equity, 46.51% long-term debt and 3.16% short-term debt;
- (10) a just and reasonable return which North Shore should be allowed to earn on its net original cost rate base is 6.89%; this rate of return incorporates a return on common equity of 10.25% and costs of long-term debt of 4.13%

and short-term debt of 1.06%, with a just and reasonable capital structure of 50.48% common equity, 38.94% long-term debt and 10.58% short-term debt;

- (11) Peoples Gas' rate of return set forth in Finding (9) results in approved base rate net operating income of \$126,845,000;
- (12) North Shore's rate of return set forth in Finding (10) results in approved base rate net operating income of \$15,143,000;
- (13) pursuant to Section 9-229 of the Act, the Commission has specifically assessed the amounts expended by North Shore and Peoples Gas to compensate attorneys and experts to prepare and litigate this general rate case filing and finds those amounts as adjusted to be just and reasonable, with the Commission's more detailed supporting findings on this subject set forth in Sections V.B.13 and V.C.4 of this Order;
- (14) Peoples Gas' rates, which are presently in effect, are insufficient to generate the operating income necessary to permit Peoples Gas the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;
- (15) North Shore's rates, which are presently in effect, are insufficient to generate the operating income necessary to permit North Shore the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;
- (16) the specific rates proposed by Peoples Gas in its initial filing do not reflect various determinations made in this Order regarding revenue requirement, cost of service allocations, and rate design; Peoples Gas' proposed rates should be permanently canceled and annulled consistent with the findings herein;
- (17) the specific rates proposed by North Shore in its initial filing do not reflect various determinations made in this Order regarding revenue requirement, cost of service allocations, and rate design; North Shore's proposed rates should be permanently canceled and annulled consistent with the findings herein;
- (18) Peoples Gas should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of \$680,801,000, in addition to \$16,606,000 of other revenues, which represents a total base rate increase of \$100,541,000 or 16.84% in base rate revenues; such revenues will provide Peoples Gas with an opportunity to earn the rate of return set forth in Finding (9) above; based on the record in this proceeding, this return is just and reasonable;

- (19) North Shore should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of \$88,181,000, in addition to \$1,597,000 of other revenues, which represents a base rate increase of \$6,524,000 or 7.84% in base rate revenues; such revenues will provide North Shore with an opportunity to earn the rate of return set forth in Finding (10) above; based on the record in this proceeding, this return is just and reasonable;
- (20) it is further ordered that the uncollectible expense included in base rates for People Gas is \$14,215,000 and for North Shore is \$513,000, which excludes amounts recoverable under Rider UEA-GC;
- (21) 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 49 CFR Parts 191 and 192 Training; \$0 for Construction Inspection; \$6,300 for all other pipeline safety-related training, totaling \$98,135;
- (22) the determinations regarding cost of service and rate design contained in the prefatory portion of this Order are reasonable for purposes of this proceeding; the tariffs filed by North Shore and Peoples Gas should incorporate the rates and rate designs set forth and referred to herein, including revisions to their Schedule of Rates for Gas Service;
- (23) the percentage of fixed costs for purposes of computations under Rider VBA shall be 100% for each of North Shore and Peoples Gas and North Shore and Peoples Gas shall file revised Rate Case Revenues for Rider VBA;
- (24) Peoples Gas shall reflect in its Rider QIP Surcharge Percentage following the date of this Order the variance from the 2014 QIP amounts included in base rates to its actual 2014 QIP amounts, which may be an increase or decrease to the amount to be recovered through the Rider QIP Surcharge Percentage. The 2014 QIP amounts included in base rates are comprised of \$173,237,532, less a negative amount of \$58,686,380 for accumulated depreciation and less a positive amount of \$16,463,375 for accumulated deferred income taxes, and \$2,620,588 for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired;
- (25) as required in this Order, under the discussion of Rider SSC, Storage Service Charge, North Shore and Peoples Gas shall file Rider SSC charges (Storage Banking Charge and Storage Service Charge) consistent with the approved revenue requirements;

- (26) new tariff sheets authorized to be filed by this Order should reflect an effective date consistent with the requirements of Section 9-201(b) as amended; and
- (27) North Shore and Peoples Gas' updated depreciation rates are uncontested and they are approved.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets presently in effect of The Peoples Gas Light and Coke Company and North Shore Gas Company that are the subject of this proceeding are hereby permanently canceled and annulled, effective at such time as the new tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the proposed tariffs seeking a general rate increase, filed by The Peoples Gas Light and Coke Company and North Shore Gas Company on February 26, 2014, are permanently canceled and annulled.

IT IS FURTHER ORDERED 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 Ex. 1.0, are unconditionally approved as the original costs of plant.

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company and North Shore Gas Company are authorized to file new tariff sheets with supporting workpapers in accordance with Findings (18) and (19) of this Order, applicable to service furnished on and after the effective date of said tariff sheets, which date shall be no later than four business days after said sheets are filed.

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company and North Shore Gas Company shall revise their Schedule of Rates for Gas Service in accordance with Finding 22 of this Order.

IT IS FURTHER ORDERED that the Peoples Gas Light and Coke Company and North Shore Gas Company shall file revised Rider VBA Rate Case Revenue amounts and set the percentage of fixed costs for purposes of computations under Rider VBA at 100%.

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company shall reflect in its Rider QIP Surcharge Percentage following the date of this Order the variance from the 2014 QIP amounts included in base rates to its actual 2014 QIP amounts, which may be an increase or decrease to the amount to be recovered through the Rider QIP Surcharge Percentage. The 2014 QIP amounts included in base rates are comprised of \$173,237,532, less a negative amount of \$58,686,380 for accumulated depreciation and less a positive amount of \$16,463,375 for accumulated deferred income taxes, and \$2,620,588 for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired.

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company and North Shore Gas Company shall file Rider SSC charges (Storage Banking Charge and Storage Service Charge) consistent with the approved revenue requirements.

IT IS FURTHER ORDERED that the Utilities' updated depreciation rates are approved.

IT IS FURTHER ORDERED that any motions, petitions, objections, and other matters in this proceeding which remain unresolved are disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this ____ day of January, 2015.

(SIGNED) DOUGLAS P. SCOTT

CHAIRMAN