

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

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

December 23, 2014

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North Shore Gas Company (“North Shore”) and The Peoples Gas Light and Coke Company (“Peoples Gas”) (together, the “Utilities”), under applicable law and the December 5, 2014, Administrative Law Judges’ (“ALJs”) Proposed Order (“Proposed Order”), submit this Reply Brief on Exceptions.

I. INTRODUCTION

The Proposed Order, on a majority of subjects, makes findings and recommendations that are consistent with the evidence and applicable law. Staff and intervenors, in the aggregate, propose *substantive* Exceptions (changed outcomes) to the Proposed Order on: (1) six revenue requirement subjects, (2) two cost of service study subjects, and (3) three rate design subjects (some of these subjects have multiple aspects.) Only one of those Exceptions has merit: Staff’s Exception related to Peoples Gas’ Accelerated Main Replacement Program (“AMRP”) costs and the related costs of removal is headed in the right direction, although the destination that should be reached on that subject is use of the updated, middle ground presented in the Utilities’ Brief on Exceptions (“BOE”) (at 3-4, 9, 10-17 and Attachment 1). *See* Section IV.C.1.a of this Reply Brief on Exceptions (“RBOE”).

The other Staff and intervenor *substantive* Exceptions on the above subjects are not supported by the evidence or the law. Their revenue requirement-related Exceptions would result in rates that do not allow the Utilities the opportunity to recover proper costs of service. *See* Sections III and IV of this RBOE. Their cost of service study and rate design-related Exceptions would distort cost recovery and are contrary to Commission policy regarding gas utility rates. *See* Sections VIII and IX of this RBOE.

Staff also proposes an Exception on a potential legal issue regarding a potential future Peoples Gas project. The Proposed Order correctly declines to address that premature topic. *See* Section IV.B.1.c.6 of this RBOE.

Staff also proposes some non-substantive and technical Exceptions. The Utilities support or do not oppose those items. They appear in various Sections of this RBOE.

Finally, CCI¹ presents an Exception regarding its six proposals relating to Wisconsin Energy Corporation's ("WEC") proposed acquisition of Integrys Energy Group, Inc. ("Integrys"), the ultimate parent company of the Utilities. CCI claims that its proposals somehow belong in the instant rate cases, rather than in the Commission's reorganization approval proceeding (ICC Docket No. 14-0496). CCI's claim is not true, as even CCI's own discussion proves over and over. In any event, CCI's proposals are wrong in every possible way. They are untimely, unsupported, contrary to the evidence, and unlawful. The Proposed Order rightly rejected CCI's proposals, and the Commission's final Order, if anything, should state additional grounds for rejecting them. *See* Section III.C of this RBOE.

¹ CCI = City of Chicago, Citizens Utility Board, and Illinois Industrial Energy Consumers (also "City-CUB-IIEC").

The Commission should approve the Proposed Order with the corrections and updates proposed in the Utilities' Brief on Exceptions, plus certain Staff Exceptions, as discussed below.

III. REVENUE REQUIREMENT

C. Proposed Reorganization

CCI'S EXCEPTION

The Proposed Order (at 22), based on the evidence and the law, correctly rejects CCI's attempt to bring into these cases six proposals that belong, if anywhere, in the WEC-Integrus transaction approval Docket, ICC Docket No. 14-0496. Moreover, the "Commission Analysis and Conclusion" section on this subject should include additional language that CCI's six proposals were untimely, were not supported or addressed by any witness nor otherwise based on the evidence, are contrary to the evidence, and cannot properly or fairly be considered in these Dockets. NS-PGL BOE at 10; *see also* NS-PGL Reply Brief ("RB") at 16-19.

CCI nonetheless presents as an Exception its request that its six² proposals should be adopted. CCI BOE at 1, 2-9. CCI's Exception lacks any merit and its adoption would violate every applicable principle for delineating which issues belong in the reorganization approval Docket and for how the instant rate cases should and must be decided.

Section 7-204 of the Act, 220 ILCS 5/7-204, is the provision 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

² CCI's Brief on Exceptions (at 2-3) expressly refers to the six proposals that it made (for the first time) in its Initial Brief ("IB") (at 6-7). CCI's Brief on Exceptions then lists the proposals but leaves out one of them. *See* CCI BOE at 2-3. The Utilities infer that that omission is a mistake.

dockets, and to do so would cause duplicative litigation and could result in inconsistent outcomes. Moreover, while CCI refers to the testimony of Staff witness Ms. Dianna Hathhorn in a manner that implies that her testimony somehow supports consideration of CCI's proposals here (*see* CCI BOE at 6), she did not contend that any reorganization-related requirements could or should be imposed in the instant cases; rather, the opposite is true. *See* Hathhorn Rebuttal ("Reb."), Staff Exhibit ("Ex.") 6.0, 23:468 – 25:517 and Attachment B. Furthermore, CCI points to no deficiency in Sections 9-202 and 9-250 of the Act, 220 ILCS 5/9-202, 9-250, regarding interim rate relief and rate investigations, respectively, which Staff witness Ms. Hathhorn cited as measures that were available in the event they were needed, and which CCI itself previously has cited. *See* CCI IB at 7. CCI's proposals belong, if anywhere, in the reorganization approval Docket, for the reasons noted above as well as other reasons discussed in prior briefing. NS-PGL RB at 16-19.

CCI claims that its proposals nonetheless somehow belong in the instant rate cases, and not in the reorganization approval Docket. *See* CCI BOE at 3-4, *et seq.* However, even CCI's own briefing effectively disproves its claim, time and again.

- CCI's Brief on Exceptions (at 1) describes its six proposals as "measures to protect ratepayers from reorganization-related changes...." That description only confirms the facts that CCI's proposals are based on the proposed reorganization, and, thus, that they belong, if anywhere, in the reorganization approval Docket.
- The fact that CCI's proposals are based on the proposed reorganization also is confirmed by examining the six individual proposals. All six of them are premised on the Commission (and the other applicable governmental authorities)

approving the reorganization and the transaction then closing. *See* CCI IB at 6-7; CCI BOE at 2-3, *et seq.*

- CCI uses contorted logic and language in an effort to escape the Proposed Order’s ineluctable conclusions about the proper Docket for CCI’s proposals. CCI says that its proposals are not conditions on the reorganization, but rather are requirements to be imposed if the reorganization is approved and the transaction closes. *See* CCI BOE at 3-5. That is nothing more or less than imposing conditions on the reorganization. Conditions that require action after the reorganization closes are not conditions on the rate case because they are triggered only by the reorganization’s closing.
- Similarly, CCI says that it is not proposing any required commitments regarding “concrete savings” potentially resulting from the reorganization. CCI BOE at 4. That characterization is not relevant to the question of where the issues belong. In any event, five of CCI’s six proposals relate directly to asserted potential changes in costs due to the reorganization, and the other, CCI’s arbitrary proposal to impose restrictions on dividends based on the reorganization, is based indirectly on potential changes in costs. *See* CCI IB at 6-7; CCI BOE at 2-3, *et seq.*

Moreover, CCI’s six proposals lack any basis in the evidence. CCI did not make any of those proposals until its Initial Brief. No other party made these or any similar 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.

CCI throws in a misleading, unsupported, and irrelevant characterization of the Utilities’ position and of the evidentiary record. CCI refers to “the utilities[’] fiction that the Commission

decision on the Companies' reorganization will have no effect on the test year costs used to set rates in this case." CCI BOE at 4. Use of the word "fiction" is rather bold coming from a party that submitted no evidence on the subject and that made its proposals for the first time in its Initial Brief. Furthermore, the test year in these rate cases is 2015, and Staff and the Utilities presented evidence that the proposed reorganization, if it is approved and closed, will not lead to any net cost reductions in 2015. Staff IB at 4-7; NS-PGL IB at 13-16; NS-PGL RB at 4, 13-16. Indeed, as indicated below, net cost savings would not be expected for years. The AG presented only conjecture on this point, both Staff and the Utilities refuted that conjecture, and the Proposed Order correctly rejected that conjecture. See Sections V.C.1.a, V.C.1.b, V.C.3.a.v, V.C.3.a.v.a, and V.C.3.a.v.b of this RBOE. See also NS-PGL IB at 13-16; NS-PGL RB at 4, 13-16. Not only that, but CCI's innuendo only once again shows that its proposals belong, if anywhere, in the reorganization approval Docket, because CCI here once again confirms that its proposals are based on what the Commission orders in that Docket.

Thus, to entertain and approve CCI's list of proposals in the instant cases: (1) not only would contravene Section 7-204; but (2) 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) 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 rights of the Utilities that would be violated. WEC and four of the six other Joint 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, at least one party has intervened and other parties might intervene in that Docket that are not parties here, and so their due process rights could be violated as well. Furthermore, CCI's irresponsible proposal that the Commission limit post-reorganization dividends, which has no factual or legal basis, would be an additional due process violation in its own right by directly infringing on the rights and interests of investors with no notice or opportunity to be heard.

In addition, CCI's proposals lack merit even on their face. Several of CCI's proposals involve adding new cost and revenue and other information tracking and reporting requirements, but CCI does not explain why the reorganization approval 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 approval Docket and/or under Sections 9-202 and 9-250 of the Act. Moreover, the Utilities have a legal right to determine if and 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, as a possible condition of approval, in the reorganization approval Docket, that the Commission could address such a proposal, although, again, the Commission also may proceed under Sections 9-202 and 9-250 when warranted to investigate and change rates. There is nothing in the record even remotely close to supporting CCI's proposal to limit post-reorganization dividends or the possible effects on the Utilities' cost of capital.

CCI's assertion, that "the Companies have avowed a near-total lack of knowledge about potential changes to the test year costs of service resulting from the reorganization, while

presenting test year costs as an appropriate, representative basis for future rates” (CCI BOE at 6), is misleading and incorrect, in multiple respects. CCI cites portions of the rebuttal and surrebuttal of Utilities witness Mr. Dennis Derricks. His rebuttal, however, was filed before the reorganization application was filed. CCI cites only a few lines from the summary portion of his surrebuttal, while conveniently ignoring the remainder of his surrebuttal on this point, including his pointing to the evidence submitted by Staff witness Ms. Hathhorn and his pointing to data request responses of the AG’s witness showing that the AG’s conjecture about cost reductions lacks any valid basis. *See Derricks Surrebuttal (“Sur.”)*, NS-PGL Ex. 33.0, 5:100 – 8:158.

CCI’s assertion that its proposals “were based on the full record” (CCI BOE at 5) is untrue and absurd. CCI states that, in the Circuit Court, a party may amend its request for relief in order to conform to the evidence, citing 735 ILCS 5/2-616(c), but CCI’s six proposals never were discussed directly or even indirectly in evidence, and CCI’s attempt to claim that the actual evidence somehow provides a sufficient basis for these bolts from the blue (*see* CCI BOE at 5-6) lacks any substance or credibility. Legally, the Utilities were not required to anticipate and put in evidence opposing CCI’s proposals; rather, CCI had the burden of going forward with evidence supporting its proposals. *See* NS-PGL RB at 9-10 and fn. 16. Furthermore, CCI’s argument is based not on the facts in evidence regarding the Utilities’ test year costs, but rather, if on anything at all, is based on the AG witness’ unsupported conjecture that, if the reorganization is approved and closed, then changed conditions might occur that warrant changes in the Utilities’ rates. *See id.* As noted earlier, the AG witness’ own data request responses showed that his conjecture was just that, lacked support, and was not reasonable. *Derricks Sur.*, NS-PGL Ex. 33.0, 6:115 – 8:158; NS-PGL Ex. 33.1. In addition, the evidence from Staff as well as the Utilities is to the contrary, as referenced above. *Id.* Staff witness Ms. Hathhorn did note

the possibility of net cost savings sometime in the future, but she concluded that it was reasonable that net costs savings are not expected in the test year. Hathhorn Reb., Staff Ex. 6.0, 24:496 – 25:517 (also referencing Sections 9-202 and 9-250) and Attachment B. In addition, Ms. Hathhorn pointed out that the proposed reorganization, if approved, would cause certain costs to be incurred in 2015. Hathhorn Reb., Staff Ex. 6.0, 24:486-490. Furthermore, it is unlawful for the Commission to base a decision on speculation, which is all that the AG’s witness provided. *See, e.g., Ameropan Oil Corp. v. Illinois Commerce Comm’n*, 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.”). Not only that, but that CCI argument is yet one more illustration that its proposals are based on the proposed reorganization, and therefore that they belong, if anywhere, in the reorganization approval Docket, not here. CCI here indicates that it is only by virtue of the Commission’s approving the reorganization that any of its asserted potential concerns could become a concern. *See* CCI BOE at 7. On top of that, CCI goes on to assert that it would be reasonable to include most of CCI’s proposals “as reorganization conditions”. *Id.*

Finally, CCI’s speculation about cost decreases fails to take into account that Peoples Gas is experiencing a significant increase in paving costs that is not reflected in its proposed revenue requirement. Derricks Sur., NS-PGL Ex. 33.0, 7:150 – 8:158; Lazzaro Sur., NS-PGL Ex. 38.0, 8:159-163; NS-PGL Ex. 38.2 (regarding Peoples Gas’ paving costs, showing they are almost \$8 million over the forecast for the first eight months of 2014).

CCI's Exception has no merit. CCI's proposed Exceptions language (*see* CCI BOE at 8-9) adds nothing to CCI's claims and simply repeats points that are unsupported and incorrect and are contrary to law, as discussed above and in the Utilities Reply Brief (at 16-19). CCI's Exception must be rejected.

IV. RATE BASE

B. Potentially Uncontested Issues (All subjects relate to NS and PGL unless otherwise noted)

1. Gross Utility Plant

c. 2015 Forecasted Capital Additions

vi. LNG Truck Loading Facility (PGL)

The Proposed Order (at 26) correctly finds that, in light of the fact that Peoples Gas had withdrawn its proposal to develop an LNG Truck Loading Facility, it would be premature to require Peoples Gas to seek approval pursuant to Section 7-102 of the Act, 220 ILCS 5/7-102, prior to initiating the construction of a LNG Truck Loading Facility or prior to entering into contracts to sell LNG by means of the LNG Truck Loading Facility. Staff takes Exception to this conclusion. Staff BOE at 3-5. The Exception is not warranted.

The Proposed Order's finding is correct, as a ruling on the potential application of Section 7-102 at this time would be premature. In the instant proceeding, it is undisputed there is no LNG Truck Loading Facility proposed for the Commission's consideration. NS-PGL IB at 22-23; Staff RB at 8; Proposed Order at 26. Peoples Gas is not seeking cost recovery for this project in this proceeding, a fact which Staff admits. NS-PGL RB at 21; Staff IB at 8-9. Furthermore, it is clear that the Commission is unable, at this time, to determine whether and at what point in the future Peoples Gas may propose the construction of a LNG Truck Loading

Facility. NS-PGL RB at 21. Thus, the Commission cannot determine if this hypothetical project would require Commission approval. *Id.* at 22.

Notably, Staff admits that there is insufficient evidence in these Dockets to evaluate whether such a facility would be “essentially and directly connected with or a proper and necessary department or division of the business of such public utility.” Staff IB at 11; Staff RB at 8. (*See* 220 ILCS 5/7-102(A)(g).) Thus, not only is this hypothetical project not before the Commission at this time, the Commission cannot and should not make a broad decision that any future LNG Truck Loading Facility or contract to sell LNG from a facility is implicated by Section 7-102 and requires Commission approval. Staff’s Exception lacks merit and is needless. The Proposed Order’s conclusion is correct, and Staff’s Exception should be rejected.

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

1. Plant

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

STAFF’S EXCEPTION

The Proposed Order (at 37): (1) recommends approval of the AG’s proposed adjustments to Peoples Gas’ 2014 AMRP additions and to the associated costs of removal, subject to Staff’s corrections of the AG’s figures; and (2) finds that Peoples Gas ultimately will recover its actual 2014 prudent costs of AMRP additions and the associated costs of removal through Rider QIP – Qualifying Infrastructure Plant (“Rider QIP”). The Proposed Order’s recommendation is incorrect. NS-PGL BOE at 10-18. In any event, however, the Commission should adopt the updated figures discussed in the Utilities’ Brief on Exceptions, which are based on (1) data put into the record by Staff pursuant to the Administrative Law Judges’ ruling granting a Staff

motion, *i.e.*, data through November 2014; plus (2) as to December 2014, use of Peoples Gas' rebuttal's estimate for December 2014. *Id.*³

Staff previously has supported the AG's proposed adjustments, subject to Staff's corrections, but Staff's Brief on Exceptions recognizes that the updated data added to the record in accordance with the ALJs' ruling on Staff's motion shows that Peoples Gas' 2014 AMRP additions and the associated costs of removal will exceed the levels proposed by the AG. *See* Staff BOE at 7-8. Staff's discussion references data through October 2014 (*see id.*), and does not reflect the additional November 2014 data that Staff filed on December 16, 2014. As indicated above, the Utilities' Brief on Exceptions' updates do reflect the data for November 2014.

Staff's Brief on Exceptions takes the position that the updated data may be considered by the Commission in deciding this issue. *See* Staff BOE at 8 (proposed language). Staff does not take Exception to the Proposed Order's recommendation, but Staff also provides proposed language in the event that the Commission concludes that the Utilities' position (*i.e.*, their position as of rebuttal and as of their Initial Brief and their Reply Brief), rather than the AG's position, is reasonable. *Id.*

While the Utilities' prior position was reasonable, unlike the AG's position, the Utilities now have proposed updated, middle ground figures. Those updates should be adopted. If the

³ As discussed in the Utilities' Brief on Exceptions, the updated data also include the 2014 costs of one other qualifying infrastructure plant ("QIP") project, the Calumet system upgrade project, and the Utilities' proposed updates would reduce the amounts in rate base from Peoples Gas' prior figures not only for the 2014 AMRP costs and associated costs of removal but also the Calumet system upgrade project. The Utilities' proposed updates would reduce net plant in rate base by \$46,181,000 (more specifically, \$46,180,669), of which \$40,278,000 (more specifically, \$40,278,070) is for the 2014 AMRP costs and associated costs of removal, and \$5,903,000 (more specifically, \$5,902,599) is for the Calumet system upgrade project. These figures can be derived from the data in the record and also can be derived from the work paper that the Utilities served with their BOE.

Commission were to adopt the Utilities' prior position, however, then Staff's proposed language for that scenario would be suitable.

The Utilities further note that Staff's Brief on Exceptions also provides figures that could be used in the Findings and Ordering Paragraphs of the final Order, if the Commission were to adopt the Utilities' prior position. The Commission should use the updated figures in the Utilities' proposed Exceptions language accompanying their Brief on Exceptions, if the Commission were to approve the Utilities' proposed updates. If the Commission were to adopt the Utilities' prior position, however, then Staff's figures for that scenario are correct.

3. Retirement Benefits, Net

STAFF'S EXCEPTION

The Proposed Order (at 51) recommends exclusion of Peoples Gas' pension asset of \$17,350,000 and North Shore's pension liability of \$(8,000) from rate base, while also reducing rate base by the Utilities' other post-employment benefits ("OPEB") liabilities. The Utilities (1) have demonstrated that the Proposed Order's recommendation is incorrect with regards to its exclusion of the Peoples Gas pension asset; although (2) they also have stated, in the alternative, that the Proposed Order is correct that, if the Peoples Gas pension asset is not included in rate base, then North Shore's pension liability also should not be included, which is exactly how the Commission ruled in the Utilities' 2007⁴ and 2009⁵ rate cases, the two most recent cases in which, as here, Peoples Gas had a pension asset and North Shore had a pension liability.

⁴ ICC Docket Nos. 07-0241, 07-0242 (Order Feb. 5, 2008) (Order on Rehearing and Amendatory Order July 30, 2008) ("*Peoples Gas 2007*").

⁵ ICC Docket Nos. 09-0166/09-0167 Cons. (Order Jan. 21, 2010) (Order on Rehearing June 2, 2010) ("*Peoples Gas 2009*"), *aff'd in part and rev'd in part*, *People ex rel. Madigan v. Illinois Commerce Comm'n*, 2011 IL App (1st) 100654 (Sept. 30, 2011) ("*Peoples Gas 2009 Appeal*"), *appeal denied*, 963 N.E.2d 246 (Ill. 2012).

NS-PGL BOE at 22-27; *Peoples Gas 2009* Order at 36-37 (also discussing that the Commission had made the same rulings in *Peoples Gas 2007*). The AG's witness here also agrees that, if the Peoples Gas pension asset is excluded, then the North Shore pension liability also should be excluded. Effron Direct ("Dir."), AG Ex. 1.0, 13:286-293.

Even though Staff strongly relies on the prior Commission Orders in opposing inclusion of the Peoples Gas pension asset in rate base, Staff now submits an Exception that disagrees with the prior Orders' exclusion of the North Shore pension liability from rate base. See Staff BOE at 10-13. Staff's same position expressly was rejected in the *Peoples Gas 2007* and *Peoples Gas 2009* Orders and it should be rejected again. NS-PGL IB at 43; NS-PGL RB at 37. Staff does not present any new facts that were not present in *Peoples Gas 2007* or *Peoples Gas 2009*, nor does Staff claim to do so.

Staff bases its position on the fact that, in *Peoples Gas 2007* and *Peoples Gas 2009*, and also in *Peoples Gas 2011*⁶ and *Peoples Gas 2012*⁷ where both of the Utilities had a pension asset, the Commission included the Utilities' OPEB liabilities in rate base. See Staff BOE at 10-13. However, as Staff's own arguments necessarily reflect, in *Peoples Gas 2007* and *Peoples Gas 2009*, the Commission also included the OPEB liabilities in rate base while at the same time excluding the North Shore pension liability as well as the Peoples Gas pension asset, which is exactly what the Proposed Order does here.

Staff argues that the rationale for including the OPEB liabilities also ought to apply to North Shore's pension liability, on the grounds that the pension liability is a source of cost-free

⁶ *North Shore Gas Co., et al.*, ICC Docket Nos. 11-0280/11-0281 Cons. (Order Jan. 10, 2012) ("*Peoples Gas 2011*").

⁷ *North Shore Gas Co., et al.*, ICC Docket Nos. 12-0511/12-0512 Cons. (Order June 18, 2013; Order on Rehearing Dec. 18, 2013) ("*Peoples Gas 2012*").

capital supplied by customers, but Staff made that same argument in *Peoples Gas 2009* and the Commission rejected it as a grounds for including the North Shore pension liability. See *Peoples Gas 2009* Order at 36. The Commission stated:

The question then becomes whether Staff or the AG has treated North Shore's pension liability appropriately. Staff's entire argument and testimony, upon which the Commission is meant to overturn its prior decision, is that the "North Shore pension liability represents the amount of expense that has been recovered in rates and not yet contributed to the pension plan by the Company. Therefore, it represents a cost-free source of capital to the Company and must be a reduction of rate base." Staff Initial Brief at 37 and Staff Ex. 16.0 at 14. This is not a sufficient basis for adopting a different methodology here.

Consistent with our decision in the Utilities' last rate case, the Commission finds that it is appropriate to treat Peoples Gas' pension asset and North Shore's pension liability consistently, i.e., the AG has appropriately excluded both from the rate base calculation. Staff has not provided sufficient evidence or argument for a different conclusion here.

Peoples Gas 2009 Order at 36. Again, Staff does not cite any changes since the Commission rejected the same Staff proposal in the 2007 and 2009 cases.⁸

The inclusion of the OPEB liabilities in the 2011 and 2012 cases is not a new fact. The same thing was done in the 2007 and 2009 cases, as noted above. In *Peoples Gas 2007*, the Commission analyzed Peoples Gas' pension asset and North Shore's pension liability and the OPEB liabilities, and ultimately excluded the pension asset and liability from rate base while including the OPEB liabilities. *Peoples Gas 2007* Order at 36. Similarly, in *Peoples Gas 2009*, the Commission specifically determined that "it is appropriate to treat Peoples Gas' pension asset and North Shore's pension liability consistently" and exclude both (*Peoples Gas 2009* Order

⁸ Also, while Staff claims that the North Shore pension liability is a source of cost-free capital, the reasons the Utilities have given for inclusion of the Peoples Gas pension asset effectively refute that claim, in any event. See NS-PGL BOE at 22-27.

at 36), while at the same time including the OPEB liabilities in rate base (*see id.*). Staff's Exception should be rejected.

V. OPERATING EXPENSES

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

1. Test Year Employee Levels

a. Peoples Gas

Please note that the discussion here also covers North Shore.

The Proposed Order (at 62, 66) correctly approves each of the Utilities' forecasted 2015 full time equivalent ("FTE") employee levels. The Proposed Order agrees with the Utilities, and Staff, finding that the Utilities "offered detailed evidence regarding its current and planned hiring practices, and identified specific positions that are due to be filled." Proposed Order at 62, 66. As a result, the Proposed Order properly concludes that the AG and CCI's proposed adjustments to the Utilities' forecasted FTE employee levels are unwarranted. However, in their Briefs on Exceptions the AG and CCI continue to argue, supported by no reasonable evidence, for a downward adjustment to each of the Utilities' 2015 FTE levels. Their Exceptions lack merit and should be rejected.

THE AG'S EXCEPTION

The AG recommends that the Commission delete in its entirety, the Proposed Order's "Commission Analysis and Conclusion" sections on the Utilities' 2015 FTE levels that were correctly arrived at after considering the evidence. *See* AG BOE at 8. The AG recommends that the Commission adopt AG witness Mr. David Effron's proposals for downward adjustments to the Utilities' 2015 FTE levels. *Id.* at 8-9.

The Commission should adopt the Proposed Order's rejection of the AG's position. The AG presents nothing new here when arguing that its proposed adjustments are proper, and continues to try to direct the Commission's focus to data that, from the months of July 2013 through July 2014, the Utilities' actual FTE levels were below the authorized levels, while failing to refute the Utilities' evidence about why the 2015 levels will be higher. *See* AG BOE at 4-5. As a result, according to the AG, the Commission should conclude that in 2015, the Utilities' FTE levels will be below authorized levels. The AG's proposed adjustments improperly ignore the ample evidence provided by the Utilities to support their 2015 forecasted FTE levels. NS-PGL IB at 68-72.

Peoples Gas has provided ample evidence to justify its increased 2015 test year employee levels. The Peoples Gas 2015 FTE forecast reflects an increased need for employees to address stricter standards of compliance with pipeline safety rules as well as increased work on the AMRP. Lazzaro Dir., PGL Ex. 8.0 2nd REV., 24:512-515, 25:534-540. For example, Peoples Gas noted that a number of positions related to pipeline safety compliance and AMRP work have been recently filled. *Id.* at 25:542. Additional detail regarding these positions, including identification of the pool of workers from which the positions are filled, was provided in the Utilities' rebuttal. Lazzaro Reb., NS-PGL Ex. 23.0 2nd REV., 9:194 – 10:201. In addition, Peoples Gas in rebuttal identified 33 positions for which interviews were being conducted. *Id.* at 10:203-208. In surrebuttal, the Utilities noted that approximately 20 Peoples Gas positions will be filled by Utility Workers who graduated from the Power for America training program at Dawson Technical Institute in Chicago in September 2014. Lazzaro Sur., NS-PGL Ex. 38.0, 7:128-135. These Utility Workers participate in a six-week long internship through Peoples Gas, wherein the workers are assigned to a district shop and are evaluated by management staff,

supervisors, and peers. Transcript (“Tr.”) at 110:21-111:15. Peoples Gas seeks to hire those individuals who successfully complete the internship program as full-time utility workers. Tr. at 111:8-9. Additionally, phone interviews have already been completed for the remaining 13 positions, and in-person interviews are being scheduled. Lazzaro Reb., NS-PGL Ex. 23.0 2nd REV., 10:202-209; NS-PGL Ex. 23.2. The AG’s Brief on Exceptions makes it clear that the AG continues to misunderstand how the Dawson Technical Institute training program operates. *See* AG BOE at 6. As a result, the AG unduly criticizes Peoples Gas for being careful and not providing what would amount to a premature update on hiring out of the Dawson Technical Institute at the time of the evidentiary hearing. Further, as stated in the Utilities’ Reply Brief (at 46) regarding the Dawson Technical Institute, Peoples Gas’ projection of hiring practices is based on actual experiences that create a well-founded expectation that the members of the internship will be hired for permanent employment.

During the evidentiary hearings held on September 23, 2014, the AG entered certain cross-exhibits into the record reflecting Peoples Gas’ actual employee levels as of December 2013 and July 2014. Tr. at 106:15-109:3; AG Cross Ex. 10, pp. 4, 11. In doing so, the AG noted that the actual total FTE employee count as of December 2013 was 1,299.5, while the actual total FTE employee count as of July 2014 was 1,314.6. *Id.* Although the AG correctly identified the actual employee levels for Peoples Gas in July 2014, the AG’s adjustment does not take into account Peoples Gas’ planned hiring activities.

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

The AG also relies heavily on its unsupported predicted attrition rates for the Utilities as support for its adjustment. *See* AG BOE at 6. The AG's argument, however, again disregards an essential factor. Peoples Gas is increasing its employee levels to cover the operational needs of AMRP projects (and also has increased them for pipeline safety compliance work). Lazzaro Dir., PGL Ex. 8.0 2nd REV., 23:503-25:545.

The North Shore 2015 FTE forecast also is well-supported. North Shore is actively in the process of filling 13 open positions, including four internal company construction inspector positions. Kinzle Tr. at 55:22 – 56:3.

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

Regarding North Shore, the AG's focus on attrition is unsupported and ignores the fact that North Shore has been forced to supplement its workforce and operate at levels below its budgeted headcount through reliance on overtime and contractors. NS-PGL IB at 72; NS-PGL RB at 48-49.

Finally, the AG unjustifiably relies on, and makes unsupported assumptions regarding, a discovery response provided in the separate WEC-Integritys transaction docket, ICC Docket No. 14-0496. *See* AG BOE at 7. During the evidentiary hearing, the AG introduced a discovery response related to certain proposed FTE commitments proposed in 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 positions at Peoples Gas and North

Shore within that minimum. Tr. at 117:6-10; AG Cross Ex. 11. This information does not support the AG's proposed adjustments to headcount levels, whether at Peoples Gas or North Shore. As an initial matter, as the Utilities have emphasized, the WEC-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. Derricks Reb., NS-PGL Ex. 17.0, 10:165-166; Tr. at 117:11-17. As such, the proposed commitment is subject to the proposed transaction, which has not yet been approved. In addition, the proposed commitment identifies a minimum number of FTE positions, but the response itself makes clear that the proposed commitment is for 1,953 FTEs in Illinois, and not for the breakdown shown among Peoples Gas, North Shore, and their affiliate Integritys Business Support, LLC ("IBS"). See AG Cross Ex. 11. 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 and North Shore from maintaining the forecasted FTE levels. Moreover, the public announcements and data request responses do not indicate that employment levels would be decreased, although potential reductions may occur due to natural attrition. Derricks, Tr. 38:7-12. The discovery response does not support the AG's position.

The AG has not provided any relevant and convincing evidence to rebut the Utilities' prudent and reasonable 2015 forecasted employee levels. The Utilities' proposed forecasted 2015 test year employee levels are fully supported by Staff, are recommended by the Proposed Order, and should be adopted by the Commission.

CCI'S EXCEPTION

CCI also submits an Exception to the Proposed Order's conclusions regarding the Utilities' forecasted 2015 FTE levels. CCI BOE at 14. CCI adds no relevant and convincing

facts. CCI offered direct testimony on this subject but did not respond to the Utilities on this subject in rebuttal. CCI, like the AG, emphasizes historical data while failing to acknowledge key factors that differentiate the Utilities' historical performance from its 2015 forecasted FTE levels. *See* CCI BOE at 10. Not surprisingly, CCI's claims suffer from the same flaws as those of the AG, discussed above. The Commission should reject CCI's Exception and adopt the Utilities' proposed forecasted 2015 test year employee levels.

b. North Shore

See the above discussion under the Peoples Gas heading.

3. Other Administrative & General

a. Integrys Business Support Costs

v. ICE Project

(a) Return on Assets and Depreciation

The evidence shows that the Utilities' proposed revenue requirements accurately and properly reflect the forecasted 2015 "cross-charges" (direct charges and allocations) to them from their affiliated service company, IBS, subject to the updates the Utilities provided in rebuttal testimony, and that the cross-charges are consistent with the Commission-approved Master Regulated Affiliated Interest Agreement. NS-PGL IB at 77.

A portion of the forecasted 2015 cross-charges to the Utilities from IBS are for the Integrys Customer Experience ("ICE") project, a project which IBS is conducting on behalf of the Integrys utilities, including Peoples Gas and North Shore. The ICE project will go into service fully in 2015, and it will unify the Utilities' customer information systems with those of other Integrys companies, providing significant benefits to customers, including, among other

things, improved and enhanced billing, collections, call center and service-related offerings. *E.g.*, Kupsh Dir., PGL Ex. 13.0, 9:205 – 10:215.

The Proposed Order correctly agrees with the Utilities and Staff that the evidence shows that the forecasted 2015 cross-charges from IBS for the Utilities' portions of the ICE's project's return on assets and depreciation costs and its non-labor costs should be approved and that the AG's proposed adjustments to those costs should not be adopted. Proposed Order at 86, 89.

STAFF'S (TECHNICAL) EXCEPTION

Staff proposes a technical Exception to add a reference to its position regarding the ICE project. Staff BOE at 16. The Utilities do not oppose that technical Exception.

THE AG'S EXCEPTION

The Proposed Order correctly agrees with the Utilities and Staff that the Utilities' forecasted expenses for the ICE project return on assets and depreciation costs and non-labor costs should be approved and that the AG's proposed adjustments should not be adopted, as noted above. Proposed Order at 86, 89. The AG presents an Exception and argues at length for its proposed adjustments, *see* AG BOE at 1-2, 9-20, but the AG's Brief on Exceptions says nothing new on this subject and, much more importantly, it says nothing that shows its adjustments to have any merit. They have none.

The AG states that its witness Mr. Effron presented an "essentially unchallenged analysis" of how much was spent on the ICE project as of the summer of 2014, and that analysis is the primary basis of its proposed adjustments. *See* AG BOE at 10-11, *et seq.* That is illustrative of a common problem in the AG's analyses of operating expenses. The AG focuses on selected historical data and then argues that it somehow calls into question carefully prepared forecasts of future expenses, without actually addressing the drivers of the differences between

historical and future costs. The evidence supporting the 2015 forecasts of ICE costs, however, is sound and persuasive, as discussed below, and the AG has failed to demonstrate that it is flawed. The AG now claims that Mr. Effron found flaws in the forecasted 2015 costs, but the claimed flaws actually once more are based on his review of the 2014 costs, not on any actual claimed flaw in the forecasts. *See* AG BOE at 12-15. The AG also makes arguments about the burden of proof (*see id.* at 15-16) and information provided in discovery in ICC Docket No. 14-0496 (*see* AG BOE at 11-12, 16-17), but none of those arguments has merit.

The forecasted 2015 ICE project costs were determined as part of a careful, well-established forecasting process. To begin with, Utilities witness Ms. Christine Gregor, in her direct testimony filed on February 26, 2014, 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 Fall 2013. These processes resulted in 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). Gregor Dir., PGL Ex. 5.0 REV., 5:97 – 9:194; PGL Ex. 5.1 REV.; Gregor Dir., NS Ex. 5.0, 5:97 – 9:194; NS Ex. 5.1 REV. Although not required by the Commission's rules, 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. Gregor Dir., PGL Ex. 5.0 REV., 11:243 – 16:357; Gregor Dir., NS Ex. 5.0, 11:243 – 15:333.

The Utilities witness Ms. Tracy Kupsh, in her direct testimony, filed on that same date, discussed the IBS budgeting and forecasting process, which parallels that 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. Kupsh Dir., PGL Ex. 13.0, 6:127 – 8:165, 8:177 - 10:215; Kupsh Dir., NS Ex. 13.0, 6:127 – 8:165, 8:177 - 9:205.

As the Utilities explained in their Initial Brief, AG witness Mr. Effron nonetheless proposed to reduce the portion of forecasted 2015 ICE project depreciation and capital investment costs cross-charged to the Utilities using simple math, based on his 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, his proposal (1) arbitrarily rejects the forecasted expenditures and plant in service activity; (2) disregards the fact that IBS only bills the Utilities for assets that are in service; and (3) disregards the fact that, while work on the ICE 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 2014 data from which Mr. Effron extrapolates completely unrepresentative of 2015 costs. *E.g.*, Kupsh Reb., NS-PGL Ex. 27.0, 6:121-127; Kupsh Sur., NS-PGL Ex. 41.0, 5:96-102.

The AG's emphasis on 2014 costs without ever addressing those undisputed facts about why 2014 costs are unrepresentative of 2015 costs (*see* AG BOE at 2, 10-11, 12-13) shows the lack of merit of the AG's position. The AG's BOE does nothing to remedy any of the fatal flaws of Mr. Effron's proposal.

Staff also rejected 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; Hathhorn Reb., Staff Ex. 6.0, 22:453 – 25:517.

Moreover, 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 the absence of any 2015 savings 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, will continue spending through 2015, that the project as a whole will go into service in 2015, and that savings are not expected to occur until 2016. Hathhorn Tr. at 148:17 – 149:16, 151:13 – 152:19; *See also* Staff Cross Ex. 2. *See also* Kupsh Tr. at 88:11 - 89:11; AG Cross Ex. 7.

The AG criticizes the Proposed Order on the theory that it reversed the burden of proof. AG BOE at 15. The criticism is not true. The Proposed Order was persuaded by the Utilities’ and Staff’s evidence. The Proposed Order was not persuaded by the AG’s evidence. That does not somehow translate into reversing the burden of proof. Moreover, the AG again ignores the law placing the burden of going forward with the evidence on parties opposing the utility’s proposals, if the utility has made a *prima facie* case, as the Utilities did here; and also ignores the law that utilities are not required to anticipate and disprove the proposals that other parties might make. NS-PGL RB at 9-10 and fn. 16.

The AG also makes a number of claims related to AG-selected discovery provided in ICC Docket No. 14-0496 (see AG BOE at 11-12, 16-17), but those claims lack any merit.

The existing evidentiary record and a data request response (“DRR”) (AG 3.05) from ICC Docket No. 14-0496 do not provide any basis for questioning the 2015 forecasted ICE project costs, nor for adopting AG witness Mr. Efron’s proposed adjustments.

At the evidentiary hearing in this proceeding, on September 23rd, the AG showed Utilities witness Ms. Kupsh AG Cross Ex. 8. 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. Counsel for the Utilities explained that Utilities witness Ms. Lisa Gast, as to whom cross-examination had been waived, was the affiant for DRR DLH 35.01. Tr. at 90:17 - 92:20.

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 under Section 7-204(a)(7) of the Act, 220 ILCS 5/7-204(a)(7), that, in brief, the reorganization applicants provide a five year forecast showing the utility's capital requirements. Reorganization DRR AG 2.13 was focused on a single item (an assumption) in JA Ex. 4.1. Reorganization DRR 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.

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. 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 reorganization case DRR AG 3.05 itself showed a 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.

Thus, reorganization DRR AG 3.05 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 rate case data have been provided by the Utilities to address the forecasted 2015 test year. Reorganization DRR AG 3.05 necessarily will be inconsistent, because the two sets of information were prepared at different points in time. DRR AG 3.05 is no basis for approval of the AG’s proposed adjustments to the ICE project costs.

The AG complains that the Proposed Order did not “comment on, much less critically assess” the AG’s claim that the discovery from ICC Docket No. 14-0496 supported the notion that there would be cost savings in 2015 (*see* AG BOE at 15), but the Proposed Order’s recommendation is based on assessing the evidence from the Utilities, Staff, and the AG. Proposed Order at 86. At most, if anything, the Proposed Order could be supplemented by adding as the penultimate sentence: “Moreover, in any event, the AG’s claims based on discovery from that Docket do not provide a reasonable grounds for rejecting the more recent forecasts of ICE project costs.”

The AG also irresponsibly complains that the Proposed Order “invites mischief” by supposedly saying that it is not relevant that a party submitted contrary information in another case. See AG BOE at 17. The Proposed Order said no such thing. The information from the other Docket is older and as explained above it does not call into question the 2015 forecasts.

The AG also complains that Proposed Order states in part: “The Commission notes as well that issues and speculation related to ICC Docket No. 14-0496 have no bearing here.” AG BOE at 16-17. The AG seeks to spin that statement as if it meant that the AG ignored some of the evidence here. That is not the case. The Utilities understand that sentence of the Proposed Order to mean that issues that belong in ICC Docket No. 14-0496, such as speculation that the ICE project might be cancelled if the reorganization were to be approved, do indeed belong in that Docket.

Finally, the AG’s speculation about the ICE project costs and savings fails to take into account that Peoples Gas is experiencing a significant increase in paving costs that is not reflected in its proposed revenue requirement. Derricks Sur., NS-PGL Ex. 33.0, 7:150 – 8:158; Lazzaro Sur., NS-PGL Ex. 38.0, 8:159-163; NS-PGL Ex. 38.2 (regarding Peoples Gas’ paving costs, showing they are almost \$8 million over the forecast for the first eight months of 2014).

The AG’s proposed language (AG BOE at 17-20) lacks support and merit for the reasons reflected above. The AG’s Exception must be rejected.

(b) Non-Labor

See the preceding subsection of this Reply Brief on Exceptions.

b. Advertising Expenses

The Proposed Order (at 75-76) correctly approves the Utilities’ proposed advertising expenses, concluding that the evidence shows that these expenditures are charitable in nature and therefore recoverable under Section 9-227 of the Act, 220 ILCS 5/9-227. Despite that correct conclusion, Staff and CCI submit Exceptions.

STAFF'S EXCEPTION

Staff's Brief on Exceptions initially alleges that the Proposed Order "does not provide a rationale for allowing these advertising expenses to be recoverable as charitable contributions." Staff BOE at 17. What Staff really is arguing, however, is that because the Utilities' accounting classified the costs in question as advertising expenses, that means they cannot or should not be treated as charitable contributions, and that the Proposed Order's conclusion on this issue somehow "would result in the Commission relieving the Companies of their burden of proof, which it should not, and assume that these advertising expenses are recoverable as charitable contributions." Staff BOE at 17.

Staff's claims are baseless. The Utilities cannot be relieved of a burden that they have already met. The Proposed Order correctly determined that the Utilities met the burden of proving that their advertising expenses were charitable in nature. As the Utilities have previously explained and have shown through their evidence, the "advertising expenditures" in question are not of a promotional, good will 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), and/or are recoverable as expenditures supporting the Utilities' customer communications and education about its energy efficiency, billing and energy assistance programs under Section 9-225(3) of the Act (220 ILCS 5/9-225(3)). NS-PGL IB at 81-82; NS-PGL RB at 66. Section 9-227 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 allows for recovery of certain advertising expenditures to the extent those advertising expenditures address utility energy efficiency, payment, assistance, safety and related programs. The detailed evidence shows that the Utilities' "advertising expenses" at issue

are charitable in nature as they go to sponsorships of charitable events. NS-PGL IB at 82; NS-PGL RB at 66.

Staff's fundamental argument is that the Utilities did not take steps to record their charitable contributions correctly. *See* Staff BOE at 17. While the Utilities do not agree with Staff that they did not take steps to record their contributions correctly, as discussed further below, the Utilities state that even if they were somehow recorded incorrectly this would not be fatal to recovery. As previously determined by the Commission in *Peoples Gas 2012*, it is the nature of the expenditure, in these cases charitable expenditures, that is the determinative factor for rate recovery. *Peoples Gas 2012* Order at 164. The Commission could not have been any clearer in *Peoples Gas 2012* when it stated 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 (emphasis added).

In *Peoples Gas 2012* the Commission directed the Utilities to

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

Peoples Gas 2012 Order at 164.

The Utilities took the Commission's directive seriously and in response: (1) greatly expanded the screening process for charitable sponsorships to help ensure that the expenditure had the greatest beneficial effect on the community and (2) expanded the description surrounding each of these expenditures to clearly indicate to whom the expenditure was being made and the charitable purpose of the expenditure. NS-PGL IB. at 84-86; NS-PGL RB at 68.

Staff also states that just because an expense is a charitable contribution does not mean that it is recoverable. Staff BOE at 17. The Utilities have submitted sufficient evidence

demonstrating that these expenses are recoverable, as discussed above. Section 9-227 does not allow the Commission to disallow charitable expenses by rule. For the Commission suddenly to adopt a new position that, even if a charitable expense has been supported by evidence, it will not be allowed, with no grounds for disallowance, would be contrary to the Commission's past Orders and to Section 9-227. Such a ruling also would be contrary to the law placing the burden of going forward with the evidence on parties opposing the utility's proposals, if the utility has made a *prima facie* case, as the Utilities did here; and also would be contrary to the law that utilities are not required to anticipate and disprove the proposals that other parties might make. NS-PGL RB at 9-10 and fn. 16.

The Proposed Order correctly concluded that the Utilities' advertising expenses are recoverable. Staff's Exception should be rejected.

CCI'S EXCEPTION

While CCI did not submit evidence on this subject, CCI supports Staff's position and submitted an Exception to the Proposed Order's conclusion that the Utilities' advertising expenses are recoverable. CCI BOE at 15-16. CCI's Brief on Exceptions argues that the Utilities' position is "oops", but in reality it is CCI's position that is a false "gotcha". *See id.*

CCI's claim fundamentally is the same claim that Staff made about the accounting for the expenses in question. That claim has been shown to lack any merit, as discussed above. CCI also seems to complain that the Proposed Order included very specific factual findings, see CCI BOE at 16, but that is no reason to reject its well-founded recommendation that the expenses should not be disallowed.

The Proposed Order correctly concluded that the Utilities' advertising expenses are recoverable. CCI's Exception, like Staff's Exception, should be rejected.

c. Institutional Events

The Proposed Order (at 97-98) correctly approves the Utilities’ proposed institutional events expenses, concluding that the evidence shows that these expenditures are charitable in nature and therefore recoverable under Sections 9-227 and 9-225 of the Act. Despite that correct conclusion, Staff and CCI submit Exceptions.

STAFF’S EXCEPTION

Staff makes the same “accounting” argument that it advanced to support its Exception regarding advertising expenses, which lacks any merit, as discussed in the preceding section of this RBOE. *See* Staff BOE at 18-19. Staff’s Exception must be rejected.

CCI’S EXCEPTION

CCI mischaracterizes the costs at issue as if they were food and drink expenses for events celebrating the Utilities’ executives and employees. *See* CCI BOE at 17. The Commission should base its decision on the actual facts, not hyperbole drafted as if it were fodder for a press release. The actual facts are as found by the Proposed Order, *i.e.*, that the costs at issue are charitable and/or support programs that benefit customers. *E.g.*, NS-PGL IB at 88; Moy Reb., NS-PGL Ex. 21.0, 8:175 – 10:200; NS-PGL Exs. 21.5N, 21.5P. These costs should be approved just as the Commission approved similar institutional events costs in *Peoples Gas 2012* (Order at 169). CCI’s Exception must be rejected.

VI. RATE OF RETURN

A. Overview

Staff proposes certain corrections regarding Staff-proposed figures. Staff BOE at 20. The Utilities do not oppose the correction of Staff’s figures as such, although, of course, the Utilities continue to advocate their proposed figures.

E. Cost of Common Equity

Staff proposes certain corrections to the discussion of Staff's position. Staff BOE at 21-22. The Utilities do not oppose the correction of the discussion of Staff's position, although, of course, the Utilities continue to advocate their own positions.

F. Weighted Average Cost of Capital

1. Peoples Gas

Staff proposes certain corrections of figures. Staff BOE at 22. The Utilities advocate their proposed rate of return for Peoples Gas and the components thereof, but, the Utilities agree that if the Commission were to adopt the Proposed Order's recommendations, then the figures should be corrected.

2. North Shore

Staff here, too, proposes certain corrections of figures. Staff BOE at 22. The Utilities advocate their proposed rate of return for North Shore and the components thereof, but, the Utilities agree that if the Commission were to adopt the Proposed Order's recommendations, then the figures should be corrected.

VIII. COST OF SERVICE

B. Embedded Cost of Service Study

1. Allocation of Demand-Classified Transmission and Distribution Costs

IIEC excepted to the Proposed Order's recommended adoption of the average and peak ("A&P") methodology to allocated demand-classified transmission and distribution ("T&D") costs (Proposed Order at 159), rather than IIEC's recommended coincident peak allocator ("CP"). IIEC argued that the CP allocator better reflects cost causation and how the utility designs the distribution system. IIEC BOE at 2-10.

The Utilities agree with the Proposed Order’s statement that “both the CP and the A&P method are acceptable ways to allocate demand-classified T&D costs.” Proposed Order at 159. However, in *Peoples Gas 2007*, the Commission rejected the CP allocator for demand-classified T&D costs after considering arguments from the Utilities and others supporting that allocator. The Commission concluded that the Utilities had not “overcome the Commission-established and long-standing tradition of A&P methodology for allocating distribution costs.” *Peoples Gas 2007* Order at 199; *also see* Hoffman Malueg Reb., NS-PGL Ex. 28.0, 4:69-74. Subsequent to that case, to limit the scope of contested issues, the Utilities have used the A&P allocator. Hoffman Malueg Reb., NS-PGL Ex. 28.0, 3:63-64. Also, the National Association of Regulatory Utility Commissioners’ (“NARUC”) has recognized that the A&P demand allocation method is an accepted demand allocator for natural gas distribution utilities and that this method “tempers the apportionment of costs between the high and low load factor customers.” Hoffman Malueg Reb., NS-PGL Ex. 28.0, 4:74-79.

The Utilities disagree with IIEC’s dismissal of the NARUC statement by describing “tempers” as a euphemism for cost shifting. IIEC BOE at 4, 6. In this context, the Utilities construe “tempers” as synonymous with “moderates,” and the A&P method does moderate the apportionment of costs between low and high load factor customers. The Utilities also note that IIEC’s reliance on NARUC for the proposition that peak day demand is the determinative factor, *i.e.*, how the system is designed (IIEC BOE at 8-9) may be misplaced because the quoted language states that “apportionment must be based on the fashion in which the utility’s system, facilities and personnel operate to provide the service.” IIEC BOE at 9 (emphasis added). In other words, NARUC does not look solely to how the system is designed but also how the utility

operates the system. Moreover, as the Utilities explained, peak demand is the primary, but not the only, factor in system design. Hoffman Malueg Reb., NS-PGL Ex. 28.0, 5:91-96.

For these reasons, the Utilities did not except to the Proposed Order's recommended use of the A&P allocator for demand-classified T&D costs. NS-PGL IB at 118-119; NS-PGL RB at 92-93.

The Commission should reject IIEC's exception.

2. Allocation of Small Diameter Main Service Costs

IIEC excepted to the Proposed Order's recommended rejection (Proposed Order at 163) of IIEC's proposals related to delineating small diameter mains in the embedded cost of service studies ("ECOS studies"). IIEC states that only three out of 180 Service Classification ("S.C.") No. 4, Large Volume Demand Service, customers take service directly from small diameter (less than four inches⁹) main. From that fact and citing cost causation principles, IIEC argues that either small diameter main costs should be allocated to all service classes except S.C. No. 4 or only the small diameter main costs to serve the three customers should be allocated to S.C. No. 4. IIEC BOE at 13-18.

IIEC explains neither the relevance of four-inch main as a dividing point, nor why three out of 180 customers is a small enough number in the class to warrant special treatment for these costs. The special treatment that IIEC seeks is that the Utilities allocate no small diameter main costs or selectively allocate only certain main costs to S.C. No. 4, contrary to the class-based nature of the ECOS studies. All of the Utilities' customers take service from all the various sized

⁹ IIEC's argument is based on mains smaller than four inches. The Utilities note that "small diameter" is not synonymous with mains smaller than four inches; for example, the Utilities' systems include two-inch main. NS-PGL Ex. 28.1.

mains in the system. NS-PGL Ex. 28.2. The Utilities' ECOS studies allocate costs to the customer classes (like S.C. No. 4), 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. Hoffman Malueg Reb., NS-PGL Ex. 28.0, 10:208-213. The ECOS studies are not intended to extract for or allocate specific costs to individual customers. *Id.* at 10:214-216. Making a single, selective exception to the class-based nature of the ECOS studies may be feasible, but it is not feasible to make exceptions for other or all particular costs that may fit IIEC's theory. *Id.* at 11:222-226.

IIEC's proposal to allocate no small diameter main costs to S.C. No. 4 is clearly wrong and incompatible with the cost causation principles that IIEC claims support its argument, as even IIEC does not dispute that some S.C. No. 4 customers receive service directly from small diameter mains. IIEC's alternative entails allocating small diameter main costs based on examining each customer in the class to single out those taking service from small diameter mains, ascertaining those main costs, and allocating only those main costs to S.C. No. 4. That alternative is not only contrary to the class-based nature of the ECOS studies, but it is patently unfair to make an exception for S.C. No. 4 customers by examining each customer in the class and not similarly examining other classes and other size mains or like facilities. *Id.*; *also see* NS-PGL IB at 119-121; NS-PGL RB at 93-96.

The Commission should reject IIEC's exception.

IX. RATE DESIGN

B. General Rate Design

1. Allocation of Rate Increase

IIEC excepted to the Proposed Order's recommended rejection (Proposed Order at 169-170) of IIEC's proposed "across-the-board" method of allocating the rate increase. IIEC BOE at 20-22. The Utilities excepted to the description of their position and also proposed a clarification to the Commission Analysis and Conclusion section. NS-PGL BOE at 53-54.

First, IIEC clarified that, if its proposed changes to the ECOS studies are adopted, it would not oppose the Utilities revising their ECOS studies and then using the studies to allocate the rate increases. IIEC BOE at 21. The Utilities oppose IIEC's proposed changes to the ECOS studies, but they agree with IIEC that, if the Commission adopts one or both changes, they should revise their ECOS studies and use the ECOS studies, not the across-the-board method, to allocate the rate increases. NS-PGL RB at 99.

IIEC alternatively argues that, if the Commission does not want to move to cost-based rates with the revised ECOS studies, then it recommends the across-the-board method, and it disagrees with the Proposed Order's reasons for rejecting that recommendation. IIEC BOE at 22. The Utilities oppose the across-the-board allocation proposal. A simplistic across-the-board allocation has nothing to do with cost causation or the ECOS studies. As stated above, should the Commission require any changes to the Utilities' ECOS studies, the Utilities recommend that the Commission also require using ECOS studies to design rates based on the approved rate design, as IIEC has stated is its primary proposal.

The Ameren "across-the-board" proposal cited by IIEC is not applicable in this case. *See, Central Illinois Light Company d/b/a AmerenCILCO et al.*, ICC Docket Nos. 07-0585 *et al.* (Order, Sept. 24, 2008) ("*AmerenCILCO*"). The Commission concluded that:

Given that the rate design resulting from Docket No. 07-0165 has only been in effect since January 1, 2008, the Commission is 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. In order to mitigate the impact of the rate increase approved in this proceeding and avoid renewed rate shock, the Commission believes that it is more appropriate at this time to, generally, increase rates on an across-the-board basis. The Commission 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. That said, for purposes of this proceeding and based on this record the Commission concludes that adoption of an across-the-board increase is the most prudent and reasonable methodology that will serve to ease rate impacts occurring due to the continued transition from the end of the rate freeze.

AmerenCILCO at 280. The rate freeze and resulting rate increases were a situation unique to electric utilities and the *AmerenCILCO* decision is rooted in that time period and the electric utility restructuring law. NS-PGL IB at 121-122; NS-PGL RB at 98-101.

More pertinent is *Peoples Gas 2009* in which the Commission rejected a Staff proposal to apply across-the-board increases in favor of the Utilities using their ECOS studies to determine rates based on the final revenue requirement. In the 2009 Rate Cases, Staff generally agreed with the Utilities' rate design and ECOS studies, mainly disagreeing with the treatment of Account 904, uncollectible accounts expense. Staff proposed an across-the-board allocation, rather than using the ECOS studies, to determine rates based on the final revenue requirement. The Commission rejected that flawed approach, finding that "the Utilities proposed a reliable means of allocating the revenue increases approved by this Order." *Peoples Gas 2009* Order at 203-204.

The Commission should reject IIEC's exceptions. The Commission should adopt the Utilities' Exception Nos. 15 and 16.

2. Fixed Cost Recovery

The AG and the Environmental Law and Policy Center (“ELPC”) excepted to the Proposed Order’s discussion of fixed cost recovery (Proposed Order at 187-190). AG BOE at 22-38; ELPC BOE at 2-5. Staff and IIEC also proposed some wording changes to this section. Staff BOE at 23-24; IIEC BOE at 24-29. The Utilities also excepted to this section. NS-PGL BOE at 55-57. The AG’s arguments focus on its complaint that the Proposed Order does not move far enough away from a straight fixed variable (“SFV”) rate design (AG BOE at 22-26); its belief that the Utilities face no risk of recovery (*Id.* at 23-26); its position that energy efficiency principles support AG/ELPC witness Mr. Rubin’s rate design (*Id.* at 27-30); and its belief that the rate designs result in S.C. No. 1, Small Residential Service, low use customers subsidizing high use customers (*Id.* at 30-37). The AG also states that the Proposed Order appears to have mistakenly based rates on the Utilities’ revenue requirement. ELPC argues that the rate design sends the wrong price signals and cost causers should pay their fair share. ELPC BOE at 2-5. Staff’s proposals are a clarification and language addressing approval of its proposed rate designs. Staff BOE at 23-24. IIEC states its proposals are to clarify language. IIEC BOE at 24-29.

THE AG’S AND ELPC’S EXCEPTIONS

First, the discussion of SFV is misleading, in that it uses the term inaccurately, and irrelevant. NS-PGL RB at 102-103; NS-PGL BOE at 55-56. The Utilities do not have and are not proposing SFV rate designs. Egelhoff Reb., NS-PGL Ex. 29.0 REV, 4:74-85.

Second, it is incongruous for the AG to address the risk of recovery when the AG opposes, and has appealed to the Illinois Supreme Court the Commission’s authority to approve, revenue decoupling. Nonetheless, as the Utilities explained, their rate designs assume that their

decoupling mechanisms, Rider VBA, remain in effect. For that reason, they have proposed only gradual movement to recovering fixed costs in fixed charges. Egelhoff Dir., NS Ex. 15.0, 13:260-271; PGL Ex. 15.0 REV, 13:260-271; NS-PGL IB at 125; NS-PGL RB at 101.

Third, the Illinois General Assembly, through Section 8-104 of the Act, has prescribed how large gas utilities support energy efficiency. The Utilities have Commission-approved energy efficiency programs in effect. *See* ICC Docket No. 13-0550. Section 8-104 does not include supporting energy efficiency through flawed rate designs that send false price signals about fixed costs and variable costs. Moreover, even under SFV and to a much greater degree under the Utilities' proposed rate designs, a substantial amount of a typical S.C. No. 1 heating customer's bill is derived from variable charges. NS-PGL RB at 97. The notion that moving more fixed cost recovery into variable charges somehow represents rates based on cost causation principles is incorrect. Recovery of fixed costs belongs in fixed charges. Both customer-classified and demand-classified costs are clearly fixed (*i.e.*, do not vary with customer usage). Placing fixed cost recovery in variable charges incorrectly signals to customers that lower use causes the utility to incur lower fixed costs. NS-PGL IB at 123-127; NS-PGL RB at 96-98, 101-110.

Fourth, the Utilities' proposed rate designs do not result in low use customers subsidizing high use customers. This claim rests on the incorrect position that demand costs are not fixed costs. NS-PGL RB at 108-110.

Finally, the Utilities agree that the final rates in this proceeding should be derived from the approved revenue requirements, the approved rate designs, and the Utilities' ECOS studies. NS-PGL RB at 99.

STAFF'S AND IIEC'S EXCEPTIONS

The Utilities do not support Staff's S.C. No. 1 and S.C. No. 2, General Service, rate designs. NS-PGL IB at 123-131; NS-PGL RB at 101-112; NS-PGL BOE at 55-57. However, if the Commission adopts those rate designs, the Utilities do not oppose Staff's exceptions.

The Utilities take no position on IIEC's proposed changes.

The Commission should adopt the Utilities' Exception No. 17.

C. Service Classification Rate Design

2. Contested Issues – North Shore and Peoples Gas

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

The AG and Staff excepted to the Proposed Order's S.C. No. 1, Non-Heating, conclusions (Proposed Order at 195-196). The Utilities also excepted to the Proposed Order's adoption of Staff's rate design for S.C. No. 1, Non-Heating. NS-PGL BOE at 58-59. The AG's proposals are based on its exceptions to Section IX.B.2, Fixed Cost Recovery. AG BOE at 20-43. Staff proposed language to describe what it believes to be the alignment of its rate design with the ECOS studies. Staff BOE at 24-25.

Like the AG, the Utilities principally addressed their exceptions in Section IX.B.2. In this RBOE, the Utilities add only that the AG's proposal is even more flawed than the Staff's proposal that the Proposed Order recommended. The AG argued for an even lower amount of fixed cost recovery in fixed charges and represented a greater departure from cost-based rates. For these same reasons, the Utilities oppose Staff's exceptions, which incorrectly claim that the Staff's rate design is more closely aligned with costs.

The Commission should adopt the Utilities' Exception No. 18.

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

The AG, ELPC and Staff excepted to the Proposed Order's S.C. No. 1, Heating, conclusions (Proposed Order at 209). The Utilities also excepted to the Proposed Order's adoption of Staff's rate design for S.C. No. 1, Heating. NS-PGL BOE at 59-60. The AG's proposals and ELPC's proposals are based on each of their exceptions to Section IX.B.2, Fixed Cost Recovery. AG BOE at 20-43; ELPC BOE at 2-7. Staff proposed deleting specific rates from the Commission Analysis and Conclusion. Staff BOE at 25-26.

Like the AG and ELPC, the Utilities principally addressed their exceptions in Section IX.B.2. In this RBOE, the Utilities add only that the AG's and ELPC's proposals are even more flawed than the Staff's rate design proposal that the Proposed Order recommended. The AG and ELPC each argued for an even lower amount of fixed cost recovery in fixed charges and represented a greater departure from cost-based rates.

If the Commission does not adopt the Utilities' Exception No. 19, the Utilities do not oppose Staff's exception.

The Commission should adopt the Utilities' Exception No. 19.

c. Service Classification No. 2, General Service

Like the Utilities (NS-PGL BOE at 60-61), Staff proposed language to revise the Proposed Order's incorrect description of Staff's proposal and Commission Analysis and Conclusions language that describes S.C. No. 2. Staff BOE at 26-31.

The Utilities do not oppose Staff's description of Staff's position.

The Utilities oppose Staff's S.C. No. 2 rate design and, thus, oppose Staff's exceptions to the Commission Analysis and Conclusion section. NS-PGL IB at 123-127, 130-131; NS-PGL RB at 101-110, 112; NS-PGL BOE at 55-57, 61.

The Commission should adopt the Utilities' Exception Nos. 20 and 22.

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

Staff and intervenors did not oppose the Proposed Order's recommendation that the Utilities include in their rate case customer communications information emphasizing to S.C. No. 1 customers the significance of the "heating" and "non-heating" designations and encouraging customers to call with questions or concerns or to request an inspection and that the Utilities report to Staff the number of inquiries generated by the communication and the number of resulting inspections and reclassifications. Proposed Order at 216. However, Staff proposed that, in lieu of the Utilities reporting to Staff, they include the information in their direct testimony in their next rate cases. Staff BOE at 32.

The Utilities do not oppose Staff's exception but continue to support their exceptions, which describe the information that they anticipate being able to gather. NS-PGL BOE at 61-62.

The Commission should adopt the Utilities' Exception No. 23.

X. OTHER TECHNICAL EXCEPTIONS

Staff proposes to correct an inconsistent / incomplete presentation of the approved revenue requirement for North Shore and a typographical error in a figure in the discussion of charitable contributions. Staff BOE at 33-34.

The Utilities presented a similar technical Exception regarding the North Shore revenue requirement. NS-PGL BOE at 7-8. The Utilities agree with Staff that the North Shore revenue requirement figure should be stated completely and consistently, without waiving the Utilities' substantive Exceptions.

The Utilities agree with Staff's typographical error correction.

XI. CONCLUSION

Therefore, North Shore Gas Company and The Peoples Gas Light and Coke Company, for all reasons set forth in this Reply Brief on Exceptions, in their Brief on Exceptions and in the separate Exceptions language document filed in conjunction with that brief, and in their prior Initial Brief, Reply Brief, and their November 7, 2014, Proposed Language for Draft Order, respectfully request that the Commission enter findings and make conclusions on all uncontested and contested issues consistent with the Utilities' positions taken in testimony and/or stated herein regarding the evidence in the record and the applicable law.

Dated: December 23, 2014

Respectfully submitted,

By: 
Counsel for North Shore Gas Company
and The Peoples Gas Light and Coke
Company

John P. Ratnaswamy
John E. Rooney
Maris J. Jager
ROONEY RIPPPIE & RATNASWAMY LLP
350 W. Hubbard St., Suite 600
Chicago, Illinois 60654
(312) 447-2800
john.ratnaswamy@r3law.com
john.rooney@r3law.com
maris.jager@r3law.com

M. Gavin McCarty
Mary Klyasheff
Koby A. Bailey
INTEGRYS ENERGY GROUP, INC.
200 East Randolph Street
Chicago, Illinois 60601
(312) 240-4470
mgmccarty@integrysgroup.com
mpklyasheff@integrysgroup.com
kabailey@integrysgroup.com

Theodore T. Eidukas
FOLEY & LARDNER LLP
321 N. Clark St., Suite 2800
Chicago, Illinois 60654
(312) 832-4500
teidukas@foley.com

Counsel for North Shore Gas Company and The
Peoples Gas Light and Coke Company