STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	)	
Proposed General Increase in	)	Docket No. 14-0224
Rates for Gas Service	)	
	)	
THE PEOPLES GAS LIGHT AND COKE COMPANY	)	
Proposed general increase in	)	Docket No. 14-0225
Rates for Gas Service	)	

REPLY BRIEF ON EXCEPTIONS OF THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois

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The People of the State of Illinois ("AG" or "the People"), by and through Lisa Madigan, Attorney General of the State of Illinois, pursuant to Part 200.830 of the Illinois Commerce Commission's ("the Commission" or "ICC") rules, 83 Ill. Adm. Code § 200.830, in accordance with the schedule established in this docket, hereby file their Reply Brief on Exceptions to the Briefs on Exceptions ("BOE") filed (i) by the ICC Staff, (ii) by the Illinois Industrial Energy Consumers ("IIEC"), and (iii) jointly by North Shore Gas Company ("North Shore" or "North Shore Gas" or "NS") and The Peoples Gas Light and Coke Company ("Peoples" or "Peoples Gas" or "PGL") (NS and PGL are referred to collectively as the "Utilities" or the "Companies").

The People's Reply Brief on Exceptions addresses four issues: (1) the proper adjustment for PGL's 2014 level of Accelerated Main Replacement Program ("AMRP") cost; (2) Retirement Benefits, Net; (3) IIEC's proposed modifications to the Companies' embedded cost of service studies ("ECOSS"); and (4) Fixed Cost Recovery and Residential Rate Design. As discussed below, the Commission should enter an Order in this proceeding consistent with the arguments presented in this Brief, as well as in the People's Brief on Exceptions, filed on December 16, 2014.

The People's lack of comment on other issues in the Proposed Order ("PO"), or on Briefs on Exceptions filed by other parties, should not be interpreted as support of, or opposition to, those other issues or other Briefs on Exceptions.

I. The Commission Should Adopt the "Middle Ground" Proposal On 2014 AMRP Costs Offered By Peoples Gas In Its Brief on Exceptions.

In their Initial Brief[1] at 16-21, the People advocated an adjustment to PGL's inflated projection of AMRP plant additions for 2014 to be included in the test-year rate base for this proceeding. Following the recommendations of AG witness Effron (AG Ex. 7.0 at 2-6), the People proposed that forecasted AMRP additions should be based on the annualized actual data for AMRP additions from January through July of this year. The Proposed Order at page 37 adopted the People's position.

Since the filing of Mr. Effron's rebuttal testimony and the filing of initial and reply briefs, however, actual AMRP cost data for August through November 2014 has now become part of the record. *See* NS-PGL Ex. 38.1; Staff Group Cross Ex. 1; Staff Exs. 11.0, 12.0, 13.0. In light of that data, PGL proposed at pages 15-16 of the Utilities' Brief on Exceptions a "middle ground" or compromise proposal that would reduce net plant in rate base by $46,181,000 compared to PGL's Initial Brief proposal. This compromise proposal is not unreasonable, as it constructs an estimate for calendar year 2014 based on actual evidence of plant additions for the

[1] References in this Reply Brief on Exceptions to the People's "Initial Brief" shall refer to the People's Corrected Initial Brief, filed October 24, 2014.

first eleven months of 2014. PGL's "middle ground" proposal is quantified in detail in Attachment 1 to the Companies' BOE.

The People ***agree to and support*** PGL's compromise proposal for the reasons discussed above. Thus, the People agree to and support Exception No. 5 filed by PGL with its Brief on Exceptions. With regard to PGL's Exception No. 6, the People do not object to the first two proposed modified paragraphs and the last two proposed modified paragraphs. However, the third paragraph of PGL's Exception No. 6 (beginning "The AG's proposed reductions…") is inappropriate and unnecessary – as the Proposed Order agreed – and the People request that the Commission ignore that proposed paragraph in drafting its final Order. While the AG's proposed AMRP plant addition forecast for 2014 presented in its Initial Brief may have been somewhat lower than what the later-realized data through November 2014 foretells, PGL's Initial Brief request on this issue was significantly *higher*[2] than what the actual data through November 2014 implies. The record evidence shows, too, that the AG forecast was closer[3] than PGL's forecast to the actual numbers that are likely to be incurred during 2014. As PGL said in the Companies' BOE, a rate base reduction of $46,181,000 is a "middle ground" proposal between the AG and PGL positions. If, as recommended by the Utilities' Exception No. 6, the Commission were to outline the reasons why the People's Initial Brief position was too low, it could and should symmetrically also outline the reasons why PGL's Initial Brief position on this issue was too high. However, there is no reason to make the effort to explain why both parties did not make a perfect forecast in their Initial Briefs before data through November was

[2] *See* Staff Ex. 13.0 at 31 (rate base addition of $158.3 million through November implying annualized amount of $172.7 million, significantly under PGL's Initial Brief position of $215.4 million, shown in NS-PGL Ex. 22.14P REV at 1).

[3] The People's Initial Brief and Reply Brief forecast of $141.1 million addition to rate base (*see* NS-PGL Ex. 37.5P at 3) is slightly closer to the annualized amount of $172.7 million discussed in footnote 2 than is PGL's Initial Brief forecast of $215.4 million.

available. Instead, the Commission should adopt the following language in place of the proposed third paragraph of PGL's Exception No. 6:

> The "middle ground" proposal for a forecast of 2014 AMRP costs offered by PGL in the Utilities' Brief on Exceptions is based on the actual data on net plant additions for January through November of 2014 entered into the evidentiary record. The AG indicates that it supports this middle ground proposal. The proposal appears to be based on a reasonable methodology of annualizing actual January-November 2014 data.

In Staff's Brief on Exceptions, the People do not object to the *first* proposed modification to the Proposed Order contained on page 8. However, the People reject the dichotomy suggested by Staff's BOE at 8, suggesting that the Commission must choose between either the People's Initial Brief position or PGL's Initial Brief position. Indeed, between the two, the actual Rider QIP data in the record supports adoption of the People's forecast of 2014 investment over the Company's inflated number. That being said, the "middle ground" position suggested by PGL in the Companies' BOE is based on actual experience in 2014 and is not unreasonable.

Finally, the People reject the proposed modification to the Findings and Ordering Paragraphs section of the PO contained in Staff's BOE at 9, as the figures in those modifications, reflecting PGL's Initial Brief position, have now been superseded by PGL's BOE compromise position, quantified in Attachment 1 to the Companies' BOE. In sum, consistent with the actual AMRP investment data in the record, the Commission should adopt the Companies' "middle ground" proposal for 2014 AMRP costs.

II. The Commission Should Hew To Its Previous Decisions And Exclude Pension Asset From Rate Base While Deducting Accrued OPEB Liability.

In their Brief on Exceptions, the Utilities concede – as they must – that in their last four rate cases, the Commission has ruled that their respective pension asset should not be included in rate base. NS-PGL BOE at 22-23. The Utilities also concede that the Illinois Appellate Court affirmed the Commission's decision on this point in the appeal of their 2009 rate cases. *People ex rel Madigan v. Illinois Commerce Commission ("People v. ICC")*, Nos. 1-10-0654, 1-10-0655, 1-10-0936, 1-10-179, and 1-10-1846 and 1-10-1852 (cons.), Appellate Court (First District-Fifth Division) September 30, 2011, par. 64-71. Despite being repeatedly rebuked on this issue, and having presented no new evidence or compelling arguments, the Companies ask that the Commission reverse course and reject its past decisions. The Utilities' position should be rejected, and the Commission, as it did in their last four rate cases, should exclude the Companies' pension asset from rate base.

The basis for the Commission's conclusions excluding the pension asset from rate base is that the pension asset was created with ratepayer funds. *See, e.g.*, *In re North Shore and Peoples Gas*, ICC Docket Nos. 07-0241/07-0241 (cons.), Order at 36 (Feb 5, 2008) ("we note that the underlying rationale for these adjustments is that such funds are supplied by ratepayers and not by shareholders such that shareholders are not entitled to earn a return on these funds"); *see also*, *In re North Shore and Peoples Gas*, ICC Docket Nos. 09-0166/09-0167 (cons.), Order at 36 (Jan. 21, 2010) ("The Utilities have given us no reason to overturn our decision from their last rate case. … The Commission finds no support in the record to allow for the inclusion of Peoples Gas' pension asset in rate base which in turn would allow shareholders to earn a return on ratepayer supplied funds.").

In the appeal of the 2009 rate case, the Utilities argued that there was no evidence that ratepayers funded the pension asset. *People v. ICC*, par. 60. The Appellate Court rejected the Utilities' argument, finding that "the Commission's decision with regard to the pension asset deduction is not clearly against the manifest weight of the evidence. Accordingly, we see no reason to disturb the Commission's findings." *People v. ICC*, par. 71.

In their BOE, the Utilities list five points that purportedly constitute new evidence or arguments that would justify the Commission taking the drastic step of reversing its repeated decisions that the pension asset should be excluded from rate base. NS-PGL BOE at 23-24. The Companies then contradict themselves, admitting that they made similar arguments in prior rate cases, but that Staff and intervenors did not address these points, and that the Commission did not specifically reject the arguments. Apparently, the Companies believe that because these arguments were not specifically rejected in the past, they count as new arguments here.

The assertion that the Commission did not address these contentions in past cases is of no moment. By generally rejecting the Utilities' arguments, the Commission impliedly rejected their specific arguments. Moreover, as Staff pointed out in its Initial Brief, the Commission is not obliged to address specifically every argument raised by parties. Staff BOE at 19, *citing*, United Cities Gas Co. v. Illinois Commerce Commission, 47 Ill.2d 498, 501 (1970) ("[i]t is true that the Commission's order did not make a finding on each of the issues in controversy. We have held, however, that it is not necessary to make a particular finding as to each evidentiary fact or claim.").

Further, Illinois courts have held that a Commission decision is "entitled to less deference when it drastically departs from past practice." *Business and Prof'l People for the Pub. Interest et al. v. Ill. Comm. Comm'n*, 136 Ill. 2d 192, 228 (1989). In these cases, the Utilities provide no new arguments or new evidence that warrant the Commission departing from its previous decisions. Rather, they submit warmed-over assertions that they concede were made – and at least impliedly rejected – in past rate cases. Such scant reasoning is no basis for overturning the Commission's repeated decisions excluding the pension asset from rate base.

The Commission should come to the same conclusion here. It should reject the Utilities' contention that the pension asset be included in rate base.

Finally, the Commission should reject the Utilities' "Alternative Two" portion of their Exception No. 8 that would add the following sentence to the Commission Analysis and Conclusion section of the Proposed Order: "However, notwithstanding rulings in the prior cases, the Commission finds based on the evidence here that the OPEB liabilities also should be excluded from rate base, to be consistent." As the People showed in their Initial Brief at 22-23, in the Companies' three most recent rate cases, the Commission deducted accrued OPEB liability from rate base. AG Ex. 1.0 at 13. For similar reasons as discussed above, the Commission should not depart from its recent decisions on this issue.

III. IIEC's Arguments In Support of Revising the Companies' Cost Studies Should Be Rejected.

IIEC argues in its Brief on Exceptions that the Average and Peak ("A&P") cost allocation methodology used by the Companies in their embedded cost of service studies ("ECOSS") inaccurately allocated demand costs across the transmission and distribution systems across customer classes. IIEC BOE at 2-10. They revive their arguments, repeatedly rejected by the Commission, that the Companies' ECOSS should be modified to instead reflect the Coincident Peak ("CP") method of allocating costs, which it argues best reflects cost causation on the Companies' systems.

IIEC's arguments should be rejected. As AG witness Scott Rubin noted in his Rebuttal testimony, the Commission has not used the A&P method of allocating costs since at least 2007, and IIEC witness Collins does not present any new arguments or a compelling reason to change this well-established allocation method. AG Ex. 9.0 at 12; *see* AG Reply Brief at 39-42. As NS/PGL witness Hoffman-Malueg stated, the Commission has repeated rejected IIEC's request require the Companies to use the A&P methodology. NS/PGL Ex. 28.0 at 4. In addition, she pointed out that the National Association of Regulatory Utility Commissioners ("NARUC") in its Gas Distribution Rate Design Manual ("Gas Manual"), June 1989, states at pages 27-28 that the Average and Peak 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." *Id.*

IIEC emphasizes in its BOE that "[a]verage demand is *NOT* and was not a factor in the design of these systems." IIEC BOE at 7. Ms. Hoffman-Malueg, however, responded to that assertion in testimony. She noted that while IIEC witness Mr. Collins continually remarks that the Utilities' T&D system is designed to meet peak day demand, the Utilities repeatedly stated in data responses to the IIEC that peak day demand, while being the primary factor, *is not the only factor that is taken into consideration when designing the system.* As Ms. Hoffman-Malueg noted, "[t]he Average and Peak demand allocation method is a reasonable method that provides 'compromise' and 'tempers' cost apportionment (NARUC, Gas Manual, June 1989)." NS/PGL Ex. 28.0 at 4. Mr. Collins, in response to NS-PGL data request IIEC 2.08, agrees that the NARUC manual is an authoritative source. *Id.* at 5.

The Proposed Order correctly agreed and finds that the Utilities' use of the Transmission and Distribution ("T&D") method of allocating cost responsibility is both reasonable and supported by the record. PO at 159. That conclusion should be adopted in the Commission's final order.

IIEC also argues that the A&P demand allocator double-counts the average component of demand. IIEC BOE at 6. IIEC is wrong on this point. As Ms. Hoffman-Malueg explained:

> Coincident Peak demand can generally be described as either a customer's or customer classes' demand at the time of system peak. Average Demand is calculated by simply taking a customer's, or customer classes', annual usage and dividing it by the 365 days in a year to arrive at an average daily usage, or sometimes referred to as Average Demand. These are two different mathematical calculations and terminologies, and Mr. Collins' agrees with this fact. Yet, simply because average demand values are smaller than coincident peak demand values should not imply that the Average and Peak demand allocation method should be discredited because it is "double-counting". The theory that an Average and Peak demand allocation method is premised upon is this: demand costs are attributable to both average use as well as peak demand. To align with this theory, the Average and Peak demand allocation method mathematically combines average usage and peak demand to appropriately allocate capacity costs based upon that cost causation theory. Furthermore, the Average and Peak demand allocation method also mathematically weights the portion of the allocator that is to be based upon average demand by the system load factor, further aligning the theory that it is premised upon. Mr. Collins confirms the accuracy of this calculation, as he has portrayed the formula on page 6 of his direct testimony as part of his Diagram 1 (depicted in IIEC's Brief at page 9).

NS/PGL Ex. 28.0 at 6.

Ms. Hoffman-Malueg also took issue with IIEC witness Collins' testimony that the A&P allocation methodology fails to reflect cost causation. *See, e.g,* NS/PGL Ex. 28.0 at 5-8. In particular, she rejected Mr. Collins' proposal to delineate distribution main investment and costs within the ECOSSs between small mains (*i.e.*, pipe diameters smaller than 4 inches), and large mains (*i.e.*, pipe diameters 4 inches and greater) and that S.C. No. 4 be removed from the allocation of small distribution mains based upon the premise that there are a small number of S.C. No. 4 customers taking service directly from small distribution mains. She noted that all service classifications portrayed in the Utilities' ECOSSs receive service directly from all sizes of distribution mains, and that the only purpose of delineating between small and large distribution mains within the Utilities' ECOSSs would be to segregate costs such that they can be allocated to the service classifications differently. However, because all of the Utilities' service classifications are served from all sizes of distribution mains, there is no reason to delineate distribution mains within the ECOSSs. *Id.* at 9-10. She noted that the Utilities' witnesses Mr. David Lazzaro and Mr. Mark Kinzle within their rebuttal testimonies (NS/PGL Exs. 23.0 and 31.0, respectively) explain that the Utilities' distribution systems are an integrated network of various main sizes, and that simply because a customer is directly served by a large distribution main does not preclude the fact that a small distribution main is useful in providing service to such customer.

AG/ELPC witness Mr. Rubin agreed with this analysis. AG Ex. 9.0 at 12. IIEC witness Collins was the only witness who recommended any changes in the study. As discussed above and as accepted in the Proposed Order, his changes are not appropriate, as they are neither supported by the facts nor consistent with the Commission's standard practice.

Moreover, as Mr. Rubin pointed out, even if one of IIEC witness Collins' recommendations were properly supported, that does not render the study itself to be flawed. *Id.* at 13. Another IIEC witness (Ms. Alderson in IIEC Exhibit 2.0) had no trouble using the Companies' cost models to produce new results using Mr. Collins's assumptions. Thus, there is no basis for concluding that the Companies' cost-of-service studies are "flawed" or unable to be modified to produce reliable results.

For all of these reasons, IIEC's arguments to revise the Proposed Order to alter the Companies' allocation of costs in the ECOSS should be rejected.

IV. The Proposed Order's Rate Design Conclusions Are Consistent With Cost Causation, Illinois Public Policy, and the Record In This Proceeding.

The Companies' Brief on Exceptions lobbies for a final order that would ignore the Commission's most recent rate design decisions and revive its previous embrace of (1) Straight Fixed Variable ("SFV") pricing and (2) the theory that all of a delivery service company's costs are fixed. NS/PGL BOE at 55-60. As discussed below, the Proposed Order correctly rejects the NS/PGL arguments in support of SFV-type pricing designs, consistent with the Commission's recent orders in the Commonwealth Edison Company and Ameren Illinois Company rate design dockets.[4] While the People believe the Proposed Order fell short in selecting a rate design that (1) truly reflects the Companies' lack of risk of revenue requirement recovery; (2) ends inequitable cross-subsidization of high users of natural gas by low users; and (3) promotes energy efficiency and conservation goals[5], its conclusions in the Fixed Cost Recovery section are, for the most part, consistent with the evidence in the record. The Companies offer no new evidence to support the now-repudiated argument that a continued march toward SFV pricing through ever-increasing customer charges is equitable, consistent with cost-causation principles, or furthers the General Assembly's stated public policy goals favoring efficiency and conservation. The Companies' arguments should be rejected.

A. The Companies' Goal of Guaranteeing Revenue Recovery Through Rate Design Mirrors SFV Pricing – A Proposal That Is Neither Supported By The Record Nor Recent Commission Decisions.

The Companies complain in their BOE that the Proposed Order has mischaracterized its proposed rate design by referring to it as SFV pricing. NS/PGL BOE at 55-56, 58. The Company writes, "The Utilities are not proposing SFV rate design for any service classification"

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[4] *See* ICC Docket No. 13-0387, Order of December 18, 2013, at 75.

[5] *See* AG BOE at 20-39, which argues that the Proposed Order's adoption of Staff witness William Johnson's proposed rate design should be rejected in favor of AG/ELPC witness Scott Rubin's rate design.

and that calling the NS/PGL rate design SFV "misrepresents the Utilities' proposals and makes it easier to dismiss them as out-of-step with Commission policy." *Id.* at 55.

The Commission should reject the Utilities' hollow protests. Whatever name the Utilities want to append to their rate design proposal, the result is the same – promoting their desire to move the rate design ball closer and closer to their 100% SFV pricing goal – either through a full SFV rate design or an ever-increasing customer charge, coupled with Rider VBA. NS Ex. 15.0 at 9, 12-13; PGL Ex. 15.0 at 9, 12-13. NS/PGL witness Debra Egelhoff makes clear that the only regulatory policy standing between full SFV rate proposals and ever-increasing customer charges is the Commission's approval of permanent Rider VBA decoupling:

> …decoupling addresses the over- and under-recovery that inevitably results from including fixed cost recovery in variable charges. If the (Illinois Supreme) Court held that the Commission lacked authority to approve Rider VBA, then a straight fixed variable ("SFV") rate design is the appropriate way to address that over-/under-recovery situation. If the Court issued an adverse ruling while the record in this case is open, North Shore would propose an SFV rate design.

NS Ex. 15.0 at 12-13; PGL Ex. 15.0 at 12-13. Ms. Egelhoff's testimony shows that the Proposed Order's characterization of the Companies' Residential rate proposals as SFV correctly reflects the fact that ever-increasing customer charges and claims that all costs are fixed are tantamount to SFV pricing.

The Companies further argue that recent Commission NS/PGL rate case orders have embraced the Companies' rate design proposals to move residential rate design closer and closer to SFV pricing. *Id.* at 13. But, the Illinois Supreme Court has made clear that the concept of public regulation requires that the Commission have power to deal freely with each situation that comes before it, regardless of how it may have dealt with a similar or even the same situation in a previous proceeding. *Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill. 2d

509, 513, 116 N.E.2d 394 (1953). "A record containing new evidence or argument that implicates past decision compels reconsideration on the new record and may require a different result." *Commonwealth Edison Company v. Ill. Comm. Comm'n et al.*, 405 Ill.App.3d 389, 408 (2d Dist. 2010). While past Commission orders – including NS/PGL orders – have responded to utility company claims that revenue stabilization is needed through ever-increasing customer charges[6], the Commission over the last year has begun to re-think that policy, and for good reason. In the recent ComEd rate design proceeding, for example, the Commission rolled back the amount of revenues recovered through the customer charge for ComEd from 50% to 38%, noting in particular that because there is little risk of non-recovery of costs for ComEd because of its adoption of formula rates, a lower percentage of revenues recovered through the customer charge was justified.[7] The Commission adopted a similar reduction of revenues recovered through the customer charge in the recent Ameren electric rate design docket, rolling back the percentage of revenues recovered in the customer charge from 44.8% to 36%.[8]

The Companies dispute the notion that the Commission's recent decisions impacting electric service rate design should apply to them because decoupling mechanisms reconcile to the approved revenue requirement and not to actual costs, as formula ratemaking does. NS/PGL BOE at 57. This argument, however, misses the mark. First, the rates set in this case will be based on a future test year, which means that *projected* plant investment as well as operating expenses will be reflected in customer rates – not simply historic costs. That serves the Companies' cost and revenue recovery goals well. Second, the Commission has no obligation in either rate of return or formula rate ratemaking to ensure that rates guarantee -- either through the

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[6] *See*, e.g. ICC Docket No. 07-0241/0242, Order of February 5, 2008 at 250; ICC Docket Nos. 09-0166/0167, Order of January 21, 2012 at 218; ICC Docket No. 11-0280/81, Order of January 10, 2012 at 188.

[7] *See* ICC Docket No. 13-0387, Order of December 18, 2013 at 75.

[8] ICC Docket No. 13-0476, Order on Rehearing at 42.

revenue requirement or the rate design – that costs *going forward* are recovered in rates. The U.S. Supreme Court has made clear that "regulation does not insure that the business shall produce net revenues." *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591, 603 (1941). In the landmark case of *Bluefield Waterworks Improvement Co. v. Public Service Comm'n of West Virginia,* 262 U.S. 279 (1923), the U.S. Supreme Court established that a utility's rates should reflect the opportunity – not a guarantee – to earn a return on its used and useful property when a commission sets rates. *Bluefield,* 262 U.S. at 692-693.

In the case of NS/PGL, the Commission is obliged to set rates that reflect the reasonable and prudent test-year levels of expenses and investment – no more, no less. These Companies, unlike any utility in the state, are ensured that the revenue requirement set in the final order will be recovered, through both the rate design and Rider VBA. In addition, the Companies also enjoy the benefits of ensured recovery between rate cases of its future investment of and on all infrastructure that meet the definitions supplied in Section 9-220.3(b) of the Act through Rider QIP. The Companies simply have no demonstrated need for ever-increasing customer charges. If the Companies decide that the rates produced by the design established in this order are not recovering their costs, NS and PGL are free to file a rate case at any time under Section 9-201 of the Act.

In short, the record in this case supports the Proposed Order's rejection of SFV pricing. Staff and Intervenors presented compelling testimony, cited in the Proposed Order, that rejects the Companies' assertions that 100% of their costs are fixed. *See, e.g.,* Staff Ex. 9.0 at 4; AG/ELPC Ex. 9.0 at 2-8. Moreover, both Staff witness Johnson and AG/ELPC witness Rubin highlighted the Companies' complete lack of risk of recovery of the revenue requirement set in this case, which supports lower customer charges. *See* Staff Ex. 4.0 at 16-24; AG/ELPC Ex. 3.0

at 18-20; AG BOE at 22-27. The Proposed Order correctly acknowledged this retreat from SFV pricing and the essentially risk-free environment Peoples Gas and North Shore Gas enjoy:

> The Companies' revenue recovery is virtually guaranteed through the existence of Rider VBA, which acts as a decoupling mechanism for S.C. Nos. 1 and 2 and reduces the Companies' financial risk of under-recovery of revenues. In addition to Rider VBA, PGL has also implemented Rider QIP, which allows PGL to recover a return of and on the Company's investment in qualifying plant, further mitigating any concern about the Companies' revenue stability. The Companies also enjoy recovery of storage costs through Rider SSC. Further, PGL is essentially guaranteed a designated level of revenues for uncollectible accounts through Rider UEA, which provides monthly adjustments to customers' bills for over or under collection of PGL's actual uncollectible expenses.

PO at 188-189. The evidence in this record, too, makes clear that low users of natural gas are punished by absorbing a greater percentage of rate increases than their high usage counterparts when customer charges are increased. *See* AG/ELPC Ex 3.3, 3.4. Recovering an ever-increasing amount of revenues through fixed customer charges, as SFV pricing requires, is inequitable and violates principles of cost causation. The Proposed Order correctly made clear that the Commission's recent retreat from the march toward SFV pricing is reasonable and appropriate for both Peoples Gas and North Shore.

B. SFV Pricing Is Not Supported By The Companies' Own Cost Studies And Is Contradictory To Public Policy Goals Favoring Efficiency And Conservation.

NS/PGL also argue that trying to affect energy efficiency goals through distribution service pricing is both unneeded and ignores the Companies' view that all costs are fixed. NS/PGL BOE at 56, 58-59. The Company asserts, "If a gas main costs $1,000, it will cost $1,000 whether 0 therms of gas flow through the main or one million therms of gas flow through that same main. Energy conservation does not reduce the cost of the main." NS/PGL BOE at 56.

This argument, however, was refuted by the testimony of AG/ELPC witness Rubin, who testified that investment in a gas distribution system is designed to serve the anticipated peak demands and energy requirements of all customers, thereby supporting a rate design that sends price signals to higher users of natural gas:

> When we talk about the principle of cost causation, we're actually talking about a fair way to allocate shared costs among customer classes and customers.
>
> For example, when a gas main is installed in the street, it is very unlikely that one customer "caused" that main to be sized and installed, because the main is designed to serve dozens (and sometimes hundreds) of customers. It is the collective peak demands and energy needs of customers that "caused" the main to be installed, and -- as Ms. Egelhoff notes -- a change in one customer's usage will not "cause" the main to be made larger or smaller.
>
> That obvious statement, however, misses the point. When we allocate costs among customer classes in a cost-of-service study, we recognize the shared nature of these common costs. We allocate those costs to each customer class in a way that we find to be fair to all customers. For example, as NS-PGL witness Hoffman Malueg discusses in her rebuttal testimony (NS-PGL Exhibit 28.0), there are good reasons for allocating the cost of distribution mains based on the average and peak approach which recognizes that mains serve both peak demands and annual energy usage. That is, the allocation of a shared cost (or facility) uses energy usage and/or peak demand to have each customer class pay its fair share of jointly used facilities.
>
> That same principle needs to apply when rates are designed. It makes no sense to say that the cost of serving residential customers is based, in part, on demand and energy usage; but then to design rates that ignore demand and energy usage (as SFV rates would do).

AG/ELPC Ex. 9.0 at 2-3. Mr. Rubin explained that if the costs of mains are collected based on a customer's energy consumption or demands, then the customer whose consumption doubled would pay most (or ideally all) of the cost increase, which is exactly what happens under a traditional rate design that collects demand-related costs either through a demand charge (when demand metering is in place) or through an energy charge (when demand-metering is not feasible).

Staff witness Johnson likewise noted that different customers place different demands on the delivery service system, and that "[w]hile both (SFV and non-SFV) cost recovery methods are not exact, recovering demand costs through the distribution charge takes into consideration that customers do place different costs on the system." Staff Ex. 9.0 at 12. The Proposed Order agreed and correctly rejected the notion that all costs are fixed, and the Commission should uphold that finding here. PO at 187-190.

The Companies next refute the Proposed Order's rejection of the SFV pricing design by arguing that a substantial portion of customer costs are already variable, which enables customers to engage in conservation and efficiency. NS/PGL BOE at 56. But this reference to variable charges includes the cost of natural gas supply. This case is setting and designing rates for delivery service – not supply charges. Most importantly, all delivery service costs are *not* fixed, as the Proposed Order correctly noted. There are significant demand-related costs that have been identified in the Companies' own cost studies. AG Ex. 3.0 at 15, citing PGL Ex. 14.2, p. 1 lines 8, 14, 38 and 42, col. D; AG/ELPC Ex. 3.0 at 27, citing NS Ex. 14.2, p. 1, lines 8, 14, 38 and 42, col. D. Those costs, *at a minimum*, must be reflected in variable charges in order to send customers the correct price signal.

The Companies assert, too, that the Companies address energy efficiency policy goals in the programs mandated under Section 8-104 of the Public Utilities Act – not in the pricing of utility distribution service. NS/PGL BOE at 56. But the Commission has rejected that notion, both in the recent ComEd and Ameren rate design orders discussed above and in statements to the General Assembly, which highlighted the importance of creating a rate design that gives customers more control over their natural gas bills. *See* AG/ELPC Ex. 3.0 at 21, citing ICC's "Report to the General Assembly Concerning Coordination Between Gas and Electric Utilities' Energy Efficiency Programs and Spending Limits for Gas Utilities' Energy Efficiency Programs" at 24.

In sum, the ALJs' rejection in the "Fixed Cost Recovery" section of the Proposed Order of the Companies' assertions that (1) all delivery service costs are fixed; (2) ever-increasing customer charges are necessary to ensure cost recovery; and (3) the pursuit of policy goals of encouraging efficiency are unrelated to delivery service pricing, is supported by the record, and consistent with recent rate design decisions and public policy goals favoring efficiency and conservation.

The Commission should retain those findings but, as recommended in the AG Brief on Exceptions at 39-43, adopt the rate design proposals of AG/ELPC witness Scott Rubin, whose rate design actually reflects these conclusions in customer rates, as opposed to Staff witness Johnson's rate design (adopted in the PO), which effectively leaves SFV-style pricing in place.

V. CONCLUSION

WHEREFORE, the People of the State of Illinois respectfully request that the Commission enter a final order consistent with the recommendations in this Reply Brief on Exceptions, as well as in their Initial Brief, Reply Brief, and Brief on Exceptions.

Respectfully submitted,

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