

STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION

Wisconsin Energy Corporation, Integrys )  
Energy Group, Inc., Peoples Energy, LLC, )  
The Peoples Gas Light and Coke Company, )  
North Shore Gas Company, ATC Management )  
Inc., and American Transmission Company LLC )

Application pursuant to Section 7-204 of )  
the Public Utilities Act for authority to )  
engage in a Reorganization, to enter into an )  
agreement with affiliated interests pursuant )  
to Section 7-101, and for such other )  
approvals as may be required under the )  
Public Utilities Act to effectuate the )  
Reorganization. )

Docket No. 14-0496

**INITIAL BRIEF  
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 (“the People” or “AG”), by Lisa Madigan, Attorney General of the State of Illinois, pursuant to Part 200.800 of the Illinois Commerce Commission’s (“the Commission” or “ICC”) Rules of Practice, 83 Ill. Admin. Code §200.800, hereby file their Initial Brief in the above-captioned proceeding involving the petition filed by Wisconsin Energy Corporation (“WEC”), Integrys Energy Group, Inc. (“Integrys”), Peoples Energy, LLC, the Peoples Gas Light & Coke Company (“Peoples Gas,” “PGL,” or “the Company”), North Shore Gas Company (“North Shore” or “NS”) (PGL and NS, collectively “the Gas Companies”), ATC Management Inc., and American Transmission Company LLC (“ATC”) (collectively “Joint Applicants” or “JA”), seeking approval of the Commission for a “reorganization” of the Gas Companies and ATC, under Section 7-204 of the Public Utilities Act (“the Act”).

## **I. INTRODUCTION AND STATEMENT OF THE CASE**

While the thought of having new corporate owners assume responsibility for Peoples Gas’s troubled accelerated main replacement program (“AMRP”) might appear attractive in theory, given the problems that have been documented with PGL’s AMRP in the record to date and in the January 2015 Liberty report, as well as the Commission’s initiation of an investigation into claims of unlawful and fraudulent activity in PGL’s operation of the AMRP<sup>1</sup>, a handover of the reins to a visionless WEC is not in ratepayers’ interest. Throughout the case – from their submittal of pre-filed testimony, through cross-examination of the JA witnesses and their most recent submittal of responses to specific post-hearing Commission data requests seeking information about post-merger transition plans – the petitioners have demonstrated both a stunning ignorance of and disinterest in the Gas Companies’ operations. The missing transition plan and the JA’s empty promise to finish the AMRP by 2030, subject to “appropriate cost recovery,” spells trouble for Peoples Gas’s rate-case-weary ratepayers. The record evidence supports rejection of the Joint Applicants’ assertion that the merger would not diminish the utility’s ability “to provide adequate, reliable, efficient, safe, and least-cost public utility service” (220 ILCS 5/7-204(b)(1)) and that the proposed transaction “is not likely to result in any adverse rate impacts on retail customers.” 220 ILCS 5/7-204(b)(7).

### **A. The Governing Statute**

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<sup>1</sup> See ICC Docket No. 15-0186 – Investigation into Anonymous letter alleging misconduct and improprieties related to The Peoples Gas Light and Coke Company’s accelerated main replacement program.

Section 7-204(b) of the Public Utilities Act (the “Act”) provides that no reorganization shall take place without prior Commission approval. 220 ILCS 5/7-204(b). Before approving any proposed reorganization, the Commission must find that:

- (1) the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service;
- (2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;
- (3) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes;
- (4) the proposed reorganization will not significantly impair the utility’s ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
- (5) the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;
- (6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;
- (7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

220 ILCS 5/7-204(b). In addition, Section 7-204(c) provides that the Commission “shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.” 220 ILCS 5/7-204(c). The burden of proof is on the JA to demonstrate that these provisions have been satisfied.

Finally, and of particular importance to Peoples Gas and North Shore ratepayers, subsection (f) provides that “[i]n approving any proposed reorganization pursuant to this Section the Commission may impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers.” 220 ILCS 5/7-204(f).

**B. The Transaction**

On August 6, 2014, the Joint Applicants filed their petition for reorganization with the Commission. As stated therein, the JA seek approval of an agreement by WEC to acquire 100% of the outstanding common stock of Integrys to create a new holding company – WEC Energy Group, Inc. (“WEC Energy Group”) – that would wholly own Peoples Energy LLC and the Gas Companies, as well as a majority interest in ATC. Petition at 1. The transaction, if approved, would create WEC Energy Group, Inc., a corporation that would serve more than four million customers across four states, Illinois, Minnesota, Wisconsin and Michigan. JA Ex. 1.0 (Leverett Direct) at 11:222-231. Peoples Gas and North Shore’s share of the new corporation’s net income would comprise 15% of the total. Tr. at 145. Similarly, the combined Peoples Gas/North Shore assets would constitute about 15% of the total WEC asset base. Tr. at 145-146.

The structure that would exist after the reorganization is a multi-layered one that puts the Gas Companies’ new parent in Wisconsin, not Illinois. The existing Integrys would merge with a subsidiary that Wisconsin Energy would create, and Integrys would be the surviving company in that merger. Integrys would then merge into a second as-yet-unnamed subsidiary created by Wisconsin Energy, with the second subsidiary surviving after that merger as a subsidiary of WEC Energy Group. This second subsidiary would stand in the shoes of the current Integrys, and have all of the Integrys utility and non-utility subsidiaries under it. JA Ex. 1.0 at 12:248-255.

**C. The Current Record Does Not Support Approval of the Merger.**

By their own admission, the JA did not identify any benefits that would accrue to ratepayers. From WEC’s perspective, the driving force behind the proposed merger appears to

be the significant revenue streams enabled by the infrastructure cost recovery rider known as Rider QIP, which permits PGL a return of and on its AMRP investments between rate cases. Coupled with an assortment of other rider revenue recovery mechanisms, including a decoupling rider, the Gas Companies are an attractive takeover target.

WEC has hesitated at every turn to explain how it would transition into its new role as owner of the Gas Companies, especially Peoples Gas with its problem plagued main replacement program. WEC's unwillingness is particularly troubling because *the* critical issue that must be addressed by the Commission is whether the putative new owners have the ability to step in and effectively right the sinking ship that is the PGL AMRP. More specifically, *the Commission must determine if the Joint Applicants have presented sufficient evidence that they can immediately step into the shoes of PGL and Integrys and not impede or otherwise negatively affect needed corrections to the management of the AMRP.* An inability to demonstrate that they are capable to do that points to a diminishment in the utility's ability "to provide adequate, reliable, efficient, safe, and least-cost public utility service" (220 ILCS 5/7-204(b)(1)) and an inability to ensure that the proposed transaction "is not likely to result in any adverse rate impacts on retail customers." 220 ILCS 7-204(b)(7).

The Joint Applicants' minimalist view of what they must demonstrate to win Commission approval of their proposed merger is inconsistent with the Commission's obligation to ensure safe, reliable, least cost utility service, and to impose the conditions necessary to protect both Peoples Gas and its customers. 220 ILCS 5/7-204(b),(f). From the perspective of the Joint Applicants, the proposed merger is a simple, high level stock transaction, as the testimony of the JA's lead witness, Wisconsin Energy Corporation President Allen Leverett, makes clear. When asked whether the protection of the interests of the utilities and their

customers in a reorganization should require a commitment to improve identified deficiencies in a utility's operations (particularly one as troubled as Peoples Gas's AMRP), the Joint Applicants stated:

that 'protection of the interests' of utilities and their customers means preventing harm, diminishment or other adverse effects from occurring to those interests, and in this context, 'protection' thus does not mean requiring that the position of those parties be improved. *In this context, therefore, 'improvement of deficiencies' would be above and beyond what is required for the protection of interests.*

AG Ex. 5.1 at 1 (emphasis added). (AG Ex. 5.1 is attached hereto as Appendix A.) Even more surprising, in Rebuttal testimony, WEC's President dismissed concerns about the future operations of the troubled AMRP as "unrelated to the proposed Reorganization." JA Ex. 6.0 at 9:272.

What is the Commission to make of these statements as it analyzes the requested merger? Clearly, the operations of Peoples Gas – in particular, its multi-billion dollar main replacement program – and the impact of the merger on customer rates are *not* the focus of the Joint Applicants. Their position is that they need only prove that they will not make the problem-plagued and ineptly-run AMRP worse in order to meet Section 7-204's dictates. This is confirmed in their list of commitments to the Commission, should the merger be approved (JA Ex. 15.1 REV) – a list that amounts to little more than business as usual for Peoples Gas and its customers, and a disconcerting promise to retain the existing timeline for the trouble-plagued AMRP.

Indeed, the question as to how WEC would transition into its role as the new owners of Peoples Gas and, in particular, as overseers of the troubled AMRP, emerged as the central contested issue in this case. The record is replete with evidence submitted by AG witness

Sebastian Coppola, City of Chicago/Citizens Utility Board (“City/CUB”) witness William Cheaks, Jr., and Staff witness Harry Stoller, who attached the Interim Audit Report (the “Interim Report”) prepared by the Commission-selected auditors, The Liberty Consulting Group (“Liberty”) to his Rebuttal testimony, of the troubled state of the AMRP. As is detailed in Part II of this Brief, the witnesses detail mismanagement, lack of cost controls and skyrocketing costs that have, unfortunately, been borne by Peoples Gas ratepayers since the program began in 2010. Concerns about how the new corporate owners would address these serious operational problems are directly relevant to the Commission’s review of the proposed merger.

It is important to note that none of the meticulously documented operational deficiencies of the existing AMRP included in Mr. Coppola’s and Mr. Cheaks’s testimony is new information. Indeed, the Commission in its rate order in ICC Docket Nos. 12-0511/0512 (cons.) (the “2012 Rate Case”) ordered that “a two-phase investigation of the AMRP [be conducted] under Section 8-102 of the Act ending in a public document report.” ICC Docket Nos. 12-0511/0512 (cons.), North Shore Gas Co., Peoples Gas Light & Coke Co. – *Proposed Increase in Rates*, Order of June 18, 2013 at 61 (“2012 Rate Case Order”). PGL, in fact, conducted its own internal PricewaterhouseCoopers (“PWC”) audit.<sup>2</sup> JA Ex. 10.0 (Giesler Rebuttal) at 4:70-76, JA Ex. 10.1. Yet, as discussed in more detail below, the Joint Applicants’ due diligence review omitted any review of this internal audit, the details behind the Commission’s 2012 Rate Case Order, and any inquiry into the resulting Liberty Consulting Group audit.

As it turned out, the Liberty auditors chose to issue an unprecedented Interim Audit Report in January, 2015 that, as Mr. Stoller noted, detailed significant troubling operational and

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<sup>2</sup> In fact, in its 2014 audit attached to Mr. Giesler’s Rebuttal testimony, PWC stated that had “assessed the status and progress of the AMRP two previous times.” JA Ex. 10.1 at 3.

managerial problems in PGL. (“At this point, my reading of the attached Liberty Interim Audit Report indicates that there are, in Liberty’s opinion, several problems with the way Peoples Gas has conducted AMRP.” Staff Ex. 8.0 (Stoller Rebuttal) at 9-10:171-174.) Mr. Stoller further noted, and the Interim Report – attached to this Brief as Appendix B – verifies, that the auditors made several findings about the AMRP and initial recommendations about how those problems can and/or should be resolved. *Id.*; *See* Appendix A (AG Ex. 6.1) at S-1. As AG witness Coppola noted, the auditors made it abundantly clear that [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] AG Ex. 6.0 (Coppola Supplemental Rebuttal) at 13:271-276; Appendix B at S-1. Importantly, the auditors also found that [REDACTED]

[REDACTED]

[REDACTED] AG Ex. 5.0 (Coppola Supplemental) at 14; Appendix A (AG Ex. 6.1) at S-1, 2, 10.

Despite the abundance of evidence of PGL AMRP mismanagement, both before and after the release of the Liberty Interim Report, the Joint Applicants throughout this case revealed a surprising lack of knowledge and apparent disinterest in the AMRP, along with a stunning evidentiary oversight: the lack of a plan that informs the Commission as to how they as new owners would transition into the role of overseers of the AMRP. JA witness Leverett perhaps best summarized the Joint Applicants’ view of the proposed merger and their disinterest in the systemic operational troubles that plague Peoples Gas:

*Other than [the] change in corporate ownership, the proposed Reorganization will leave The Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore Gas Company (“North Shore”) (together, the “Gas Companies”) essentially unchanged, with local headquarters, facilities, and management remaining in Chicago and Waukegan, respectively. From the perspective of the Gas Companies’ customers, this change in ownership will be seamless, with no diminishment in Peoples Gas’ and North Shore’s ability to deliver high-quality, adequate, reliable, efficient, safe, and least-cost gas service.*

JA Ex. 6.0 at 8-9:256-268 (emphasis added). The JA’s assertion in their Rebuttal testimony that the proposed reorganization is a mere stock transaction, that Peoples Gas customers enjoy “efficient” and “least-cost” gas service currently, and that PGL operations will remain “essentially unchanged” should give the Commission significant pause in assessing the proposed reorganization. The fact is, there is nothing “least cost” or “efficient” about current PGL operations. Its customers pay the highest rates in the State, have felt the financial sting of five rate increases in the last seven years, and are currently paying monthly surcharges for an infrastructure program so troubled that the Commission ordered an independent audit two years ago and, more recently, an investigation into allegations of unlawful activity and gross mismanagement of the AMRP.<sup>3</sup> Clearly, given these facts, the JA’s initial promise to leave PGL operations “essentially unchanged” is reason enough to reject the merger.

Indeed, any discussion of how it might operate Peoples Gas post-merger has only been extracted from the Joint Applicants as a result of ALJ rulings or post-hearing, Commission-issued data requests: first, in January, when the ALJ directed the JA to provide testimony (after the release of the Liberty Interim Report) detailing “(1) whether the Joint Applicants are aware of the scope and scale of the potential obligations under AMRP; and (2) whether Joint

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<sup>3</sup> ICC Docket No. 15-0186, Corrected Initiating Order of March 11, 2015.

Applicants are ready, willing and able to implement the AMRP consistent with additional remedies as recommended by the Liberty audit”<sup>4</sup>, and then after the close of hearings, when the Commission issued data requests to the Companies that sought information related to the existence of any AMRP transition plans. Commissioners’ Data Request to Joint Applicants of March 12, 2015. In fact, the Joint Applicants admit they have no transition plan,<sup>5</sup> but vaguely promise to implement (subject to several conditions) the final recommendations of Liberty auditors when the final report is released this Spring, something Peoples Gas was already required to do as part of the Commission’s 2012 Rate Case Order.<sup>6</sup> JA Ex. 15.1 REV. The Joint Applicants stated during cross-examination that their commitment does *not* include implementation of Liberty’s Interim Report recommendations. Tr. at 148. In the People’s view, these statements do not constitute sufficient evidence for the Commission to conclude that PGL service, reliability, safety and customer rates will not be negatively impacted by the merger.

Moreover, when asked by the Commission in its post-hearing data request to describe their transition plans, the JA admitted they had no such plans and, instead, pointed to a customer communication program WEC uses in Wisconsin. JA’s Responses to Commissioner’s Data Requests at 7. AG witness Coppola commented “that highlighting customer communication efforts in the face of the foundering AMRP is akin to rearranging the deck chairs on the Titanic while the ship is sinking.” AG Ex 7.0 at 5.

The JA’s commitments and their impact on customer rates are made worse by the Joint Applicants’ commitment that PGL will complete the AMRP by 2030, “assuming it receives and continues to receive appropriate cost recovery.” JA Ex. 15.1 REV.. The un rebutted evidence in

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<sup>4</sup> ALJ Ruling of January 14, 2015.

<sup>5</sup> JA Response to ICC-issued data requests, filed on March 18, 2015.

<sup>6</sup> Order, Docket Nos. 12-0511/0512 (cons.), June 18, 2013, at 61.

the record demonstrates that PGL has never been able to maintain a main replacement pace that would bring about a 2030 completion date, and that PGL's apparent attempts to maintain that pace have resulted in huge cost overruns – a doubling in the price of the AMRP from PGL's initial estimate in 2009 – and millions of dollars in City of Chicago fines, penalties, and street degradation fees for its lack of coordination with the City and failure to adhere to dates of scheduled permit-authorized work. AG Ex. 2.0 at 30-31:598-614; City/CUB Ex. 3.0 at 21-31. The fact that the Joint Applicants made this 2030 completion date commitment without (1) the existence of an overall AMRP plan, (2) reviewing PGL-conducted internal audits of the AMRP, (3) conducting adequate due diligence on the scope and financial obligation of such a commitment<sup>7</sup> (detailed in part II of the Brief, *infra*), and (4) any clear understanding of how that commitment would impact customer rates, makes clear that the Commission cannot conclude that the proposed reorganization as presented by the JA will not lead to higher customer rates – something Section 7-204(b)(7) requires for merger approval. In fact, as detailed later in this Brief, AG witness Coppola's analysis of the current AMRP and the adoption of a 2030 completion date shows that Peoples Gas residential customers' base rates will double within 10 years under a 2030 date, all else equal. AG Ex. 2.0 at 24-29:491-585.

The Joint Applicants' request for merger approval amounts to a request that the Commission gamble with Peoples Gas ratepayers' interest in safe, reliable, and least cost utility service. In particular, it is an invitation to simply assume that a corporate entity with no transition plan for assuming the ownership of Peoples Gas and its troubled AMRP will not interrupt any positive remedial activity at Peoples Gas now apparently being begun at the direction of the Liberty auditors. A prospective new owner that clearly had no idea of what the

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<sup>7</sup> Tr. at 177; *see also*, Tr. at 84-85, 177, 122-130, 152-157, 180-183, 281, 317.

AMRP entails - both financially and operationally - at the start of this case has not presented substantial evidence through the close of this record that it is capable and should be trusted to take over the reins of Peoples Gas and its AMRP. Unless and until the Companies agree to the conditions presented in part III of this Brief, the requested reorganization should be rejected. Given the pending investigation of the PGL AMRP in Docket No. 15-0186, the Commission should also consider rejecting the current petition and invite the Joint Applicants to refile their reorganization request when that investigation is complete.

**II. The Merger Should Be Rejected Because The Joint Applicants Have Failed to Prove That “The Proposed Reorganization Will Not Diminish The Utility's Ability To Provide Adequate, Reliable, Efficient, Safe And Least-Cost Public Utility Service” Under Section 7-204(b)(1) Of The Act.**

**A. The Joint Applicants Failed To Demonstrate That PGL Rates And Utility Service Will Not Be Negatively Impacted By A Transition from Integrys to WEC Ownership.**

1. From Its Inception, The AMRP Has Been Riddled With Problems.

As discussed in Section I, the AMRP has been beset by poor management since the Commission approved the program in Peoples Gas’s 2009 Rate Case. The first indication of the extent of the problems with Peoples Gas’s project management was identified in the utility’s 2012 rate case. In its Final Order in that case, the Commission found that the AMRP was besieged with troubles, stating:

Part of the problem with the AMRP is the lack of detail. Staff examined Peoples’ submissions to Staff DR ENG 2.12, which asked for a detailed explanation of its five-year plan for the AMRP, including all costs. They found: “There is no discussion of costs in the White Paper. There is no discussion of resource requirements or project management. The response to Staff DR ENG 2.12 states that the AMRP budget for 2013 is \$220.75 million, but does not explain how Peoples arrived at that number and Attachment 01, the White Paper, does not address the issue

either.” *Id.* at 19. Additionally, Peoples also stated that they “have not determined the funding level past the year 2013”. *Id.* Attachment 20.02.

2012 Rate Case Order at 61. The Commission was so concerned about the poor state of the program, it ordered “a two-phase investigation of the AMRP [be conducted] under Section 8-102 of the Act (220 ILCS 5/8-102) ending in a public document report.” *Id.* Liberty’s AMRP audit (and the Interim Report filed in January, 2015) are the result of the Commission’s 2012 Rate Case Order.

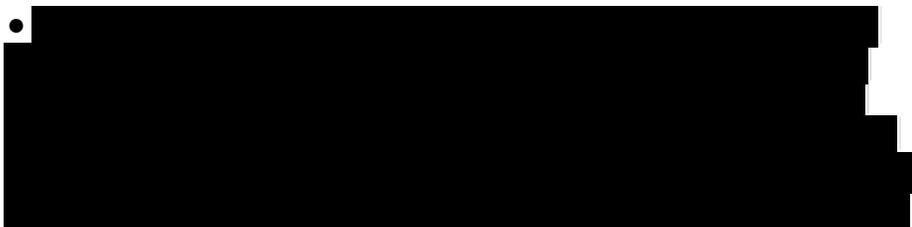
In the instant case, AG witness Coppola and City/CUB witness Cheaks described an AMRP program that has not improved since the Commission’s findings in its 2012 Rate Case Order. Among other problems, Mr. Coppola testified that a 2012 internal review of Peoples Gas’s AMRP project management conducted by PWC “identified several deficiencies and 23 areas where improvements needed to be made.” AG Ex. 2.0 at 16-17:341-342. Mr. Coppola pointed out that “as of October 2014, two years later, none of these improvements have been completed.” *Id.* at 17:342-343. Mr. Coppola added that Peoples Gas and Integrys admit that they “have not formally defined a future state operating model or project delivery strategy in conjunction with the Rider QIP, or developed associated processes and controls.” *Id.* at 17:350-353; AG Ex. 2.2. Mr. Coppola concluded that

The scale of the AMRP seems to have overwhelmed the utility’s resources. It has not proved itself capable of managing an accelerated main replacement program that is more than double in scope from what PGL was managing historically. The demands on the City of Chicago to respond to the increased activity of the AMRP also have taxed the resources of the City. The result has been huge cost overruns, delays in completing projects, and, in my view, a state of mass confusion and uncertainty as to whether or not the critical objectives of increasing safety, system reliability, operating cost reductions, and financial benefits to customers have actually been, or are likely to be accomplished.

AG Ex. 2.0 at 20:410-418.

In his testimony, City/CUB witness William Cheaks, Jr. identified some of the same issues with the AMRP raised by Mr. Coppola. For instance, Mr. Cheaks testified that although the 2012 PWC audit identified numerous serious deficiencies with the AMRP, Peoples Gas “did not implement these measures, if at all, until August of 2014.” City/CUB Ex. 3.0 at 6:102-103. Mr. Cheaks also added that Peoples Gas’s coordination efforts with the City’s Department of Transportation (“CDOT”) have been “poor,” a problem the utility has acknowledged. *Id.* at 20:399-401. Mr. Cheaks testified that the utility’s construction management in Chicago’s public way has also been “poor.” *Id.* at 21:420-425. Examples of Peoples Gas’s poor performance cited by Mr. Cheaks include doing work without necessary permits, shutting down a portion of a street without City permission, deviating from designs submitted for CDOT approval, submitting unrealistic construction schedules, applying for permits that were not needed, and applying for permits to do work at locations where the utility had recently finished projects. *Id.* at 23-26:461-510. Due to its apparent inability to comply with City ordinances and regulations, from 2011 through 2014, Peoples Gas has been charged with 67% more violations than the next three highest offenders combined. *Id.* at 30:561-569.

Liberty’s Interim Report also found major deficiencies with Peoples Gas’s AMRP management. Among the significant conclusions by Liberty are:

-   
AG Ex. 6.1 at S-2.

• [REDACTED]

[REDACTED] *Id.*

• [REDACTED] *Id.* at S-3.  
• [REDACTED]

[REDACTED]

[REDACTED] *Id.* at S-4.

• [REDACTED]

[REDACTED]

[REDACTED] *Id.* at S-5.

• [REDACTED]

[REDACTED]

[REDACTED] *Id.*

• [REDACTED]

[REDACTED]

[REDACTED] *Id.* at S-5.

• [REDACTED]

[REDACTED]

[REDACTED]

*Id.* at 5-6.

In short, the record is replete with uncontradicted evidence that the AMRP has been and continues to be a poorly managed program.

2. The Record is Clear that the Joint Applicants Failed to Conduct Due Diligence Regarding the AMRP.

It is clear that WEC began the process of proposing to purchase Integrys and Peoples Gas and North Shore, there was already evidence that the AMRP was a program plagued with problems. The Commission had given its stinging assessment of the program’s management in its 2012 Rate Case Order. 2012 Rate Case Order at 61. It was also known that as part of its Order in that case, the Commission had ordered a two-part audit of the AMRP. *Id.* Finally, it was known that Liberty, the Commission’s selected auditor, had started the first phase of its assessment of the troubled AMRP. All of these things were known – or should have been known – as WEC began its due diligence examination of Integrys and its subsidiary gas companies.

The concept of “due diligence” refers to the investigation that is initiated when one company is contemplating acquiring or merging with another company. Staff Ex. 2.0 at 18. One aspect of an acquiring company’s due diligence review involves assessing the financial health of the target company. As Staff witness Eric Lounsberry testified, an acquiring company performs such an investigation of the target company “to ensure the target is healthy and worth the asking price.” *Id.* According to Mr. Lounsberry, “a thorough due diligence review would look into all

aspects of a company, including financial records, personnel, legal and regulatory issues, physical assets, and operational procedures and costs.” *Id.* at 18-19:452-454

From the Commission’s perspective in this docket, assessing the quality and depth of the acquiring company’s due diligence review is directly relevant to its evaluation of claims by WEC that the reorganization will not adversely affect the utility’s ability to perform its duties under the Act. 220 ILCS 5/7-204(b). As Staff witness Lounsberry noted:

A due diligence audit provides a rare opportunity for the Commission to review an outside party’s assessment of a utility’s system. The absence of a detailed due diligence report on the Gas Companies infrastructure, especially AMRP, reflects a failure by WE to conduct a complete analysis of Integrys. It also limits Staff’s analysis and the information that the Commission has when evaluating the benefits of the merger.

Staff Ex. 2.0 at 22:518-522.

Whether WEC engaged in an adequate due diligence process has implications for not only shareholders, but utility customers, whose interest the Commission is charged with protecting. 220 ILCS 5/7-204(b)(1)-(7),(f). As Mr. Lounsberry noted, WEC’s claims that the resulting combined company “will strengthen the WEC Energy Group’s operating companies, including the Gas Companies (PGL and NS), by integrating best practices in distribution operations, larger capital project management, gas supply, system reliability, and customer service” must be scrutinized by the Commission in light of evidence of whether the JA actually understood the capital investment commitments and problems of the companies they seek to acquire. Staff Ex. 2.0 at 19. Most importantly, for purposes of the evaluation required of the Commission under Section 7-204 of the Act, WEC’s claim that PGL and NS service will not be negatively impacted by the proposed merger transition from Integrys to WEC ownership must be tested in light of evidence of what WEC understood about the operations of Peoples Gas and

North Shore Gas when it made those commitments. Likewise, the JA's claim that "the Reorganization will result in a larger, more diversified, financially strong energy company that, over time, may generate benefits from its increased scale of operations<sup>8</sup>" must be examined through the lens of how well WEC understood the day-to-day operations and infrastructure commitments of Peoples Gas.

That said, the record evidence in this case reinforce reveals a troubling lack of due diligence by WEC related to the PGL AMRP, both in terms of a basic understanding of the AMRP as an ongoing infrastructure project within the City of Chicago as well as the past and ongoing problems identified by the Commission and the utility's internal auditors in the operation of the program. At least initially in this case, the Commission Staff identified the lack of due diligence as a troubling deficiency in the JA's evidentiary presentation. Staff Ex. 2.0 at 22-24: 534-582. Mr. Lounsberry concluded, "the Joint Applicants conducted no review to determine the level of effort and expenditure it would take on their part to make any of this happen, assuming they can make any of these changes happen at all." *Id.* Indeed, Mr. Lounsberry characterized the Joint Applicants' due diligence review process as "only ...a high level review of Integrys without any detailed review of operating practices of the Gas Companies or of AMRP." *Id.* JA witness Leverett confirmed this conclusion during cross-examination when he stated, "WEC didn't do a specific examination of the AMRP" as part of its due diligence analysis. Tr. at 177.

Importantly, Staff witness Eric Lounsberry's Direct testimony concluded that the Joint Applicants had not met their burden of satisfying Section 7-204(b)(1) of the Act. Staff Ex. 2.0 at 23:561-563. He stated:

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<sup>8</sup> JA Ex. 1.0 at 15:315-317.

The Joint Applicants claim the proposed reorganization will strengthen the WEC Energy Group's operating companies, including the Gas Companies, by integrating best practices in distribution operations, larger capital project management, gas supply, system reliability, and customer service. However, the Joint Applicants conducted no review to determine the level of effort and expenditure it would take on their part to make any of this happen, assuming they can make any of these changes happen at all. This is especially true of larger capital project management, which is what AMRP clearly requires. Therefore, I conclude that Joint Applicants' claims are broad, unsubstantiated generalizations.

*In my opinion, the AMRP is the most risky capital project undertaken by a utility in Illinois since Commonwealth Edison Company and Illinois Power Company began constructing their nuclear powered generation plants, each of which ultimately cost billions of dollars each to complete. It is very clearly not, as WE has described it above, part of Peoples' Gas "day-to-day" operations.*

Staff Ex. 2.0 at 22:563-576 (emphasis added).

In his criticism of WEC's due diligence process, Mr. Lounsberry further noted that WEC's review of the PGL AMRP consisted of public Integrys investor presentations, the Rider QIP (Qualified Infrastructure Program) filing with the ICC and the Section 9-220.3 statute that authorizes gas utilities to file a QIP rider request. *Id.* at 22. He concluded that none of the JA's responses to data requests indicated that WEC had conducted a thorough due diligence review of the Gas Companies' operating practices or any specific review of PGL's AMRP. *Id.* Importantly, he noted that in his view, "the primary focus of WE's review of AMRP was whether Peoples Gas is allowed to recover AMRP costs through its QIP Rider without the need to file for a rate increase under Section 9-201." *Id.* In addition, the record makes clear that the Joint Applicants at no time requested or reviewed a detailed work plan of the AMRP (to the extent that it existed) as part of their due diligence review. *See* Staff Ex. 2.0 at 23, AG Cross Ex. 3.

AG witness Sebastian Coppola, who performed a detailed assessment of the PGL AMRP and concluded, among other findings, that project costs have doubled since originally approved by the Commission in 2010 due to rampant mismanagement, and that the project lacked an overall plan and any sort of cost controls<sup>9</sup>, likewise concluded that WEC failed to conduct due diligence in its bid to acquire Integrys and, in particular, Peoples Gas. He testified, “there is no evidence that the Joint Applicants have performed the due diligence necessary to understand the infrastructure investment rate involved in achieving that deadline, the impact on customer rates, and whether the current AMRP is, in fact, prioritizing the most vulnerable main for replacement.” AG Ex. 2.0 at 30-31:604-608.

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<sup>9</sup> Mr. Coppola, as discussed further in part II.B below, states that it is likely that over the 20-year life of the program, the total cost of the AMRP will exceed \$4.6 billion, as opposed to the \$2.2 billion Peoples Gas projected it would cost in 2009. AG Ex. 2.0 at 20. He also concludes that, within the next 10 years, the AMRP will about double the portion of residential customers’ gas bills related to base rates if the Joint Applicants are permitted to install infrastructure at the level of costs currently projected under a 2030 timeline. *Id.* at 28. He concluded that PGL practices have contributed to “huge cost overruns, delays in completing projects, and, in my view, a state of mass confusion and uncertainty as to whether or not the critical objectives of increasing safety, system reliability, operating cost reductions, and financial benefits to customers have actually been, or are likely to be accomplished.” *Id.* at 20.

The Joint Applicants responded by arguing that concern about AMRP and other “on the ground” operations before a reorganization is approved “is not customary.” JA Ex. 8.0 (Reed Rebuttal) at 13:260-263. JA witness Reed made clear that in the eyes of WEC, Peoples Gas and its troubled AMRP are but a small cog in the big wheel that is a newly reorganized Wisconsin Energy Corporation:

When viewed in the context of the larger transaction, those amounts equal about \$300 million per year in capital expenditures on AMRP measured against a total capital program of 1.5 billion, so they're about 20 percent of the annual capital budget. And they're also measured for relevance of whether they're material. They're measured against the entire asset base of the company, which is \$17 billion. That's about 1.75 percent per year for the capital expenditures on the AMRP as compared to the aggregate enterprise value or asset value of the combined company.

Tr. at 426. JA witness Leverett went so far as to characterize the AG and City/CUB testimony that discussed the AMRP and concerns about future operations under WEC ownership as issues “that are unrelated to the proposed Reorganization.” JA Ex. 6.0 at 9:272. The problem with these assumptions, however, is that Peoples Gas ratepayers and, indeed, the Commission, *do care* and *are interested* in the AMRP capital expenditure plans of a WEC-owned Peoples Gas. For example, as noted above, in PGL’s 2012 rate case, the Commission ordered that an independent audit of the troubled AMRP be conducted in order to identify and remedy integral operational flaws, including the lack of an overall plan for the project, budget or cost controls.<sup>10</sup> From the ratepayers’ perspective, the AMRP has been the primary driver in Peoples Gas’s constant rate increase requests. In the four years since PGL initiated the AMRP, Peoples Gas has filed three base rate cases and received approval for increases in rates of \$57.8 million, \$59.8 million, and

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<sup>10</sup> ICC Docket Nos. 12-0511/0512 (cons.), North Shore Gas Company and Peoples Gas Light & Coke Company– Proposed General Increase in Rates, Order of June 18, 2013 at 61.

\$71.1 million.<sup>11</sup> By far, the largest driver of these actual and proposed rate increases has been the actual and forecasted capital investment and expenses tied to the Company's AMRP.<sup>12</sup>

When pressed in cross-examination, WEC's justification for its minimalist view of due diligence requirements falls apart. In fact, Mr. Leverett admitted during cross-examination that information regarding capital expenditure budgets for WEC's utility companies are (and should be) a concern for both WEC and its investors. Tr. at 177. He admitted that understanding the projected capital expenditure spending of a utility WEC is acquiring *is*, in fact, important to WEC. Tr. at 178. He further agreed that PGL's AMRP *directly* impacts PGL's level of capital expenditures. *Id.* As for JA witness Reed, he admitted that he did not participate in WEC's due diligence review (Tr. at 372), but conceded that a multiple billion dollar capital expenditure program is significant for PGL and the combined company. Tr. at 429.

Mr. Lounsberry, however, inexplicably went on to testify in Rebuttal testimony that he was somehow satisfied that the Joint Applicants now understand the breadth of the infrastructure and operational challenges the AMRP presents to the acquiring company – apparently based on the JA's review of Intervenor and Staff testimony. Staff Ex. 9.0 at 27:653-658. He added that the JA's commitment to "various conditions," including those related to implementation of the Liberty Audit, assuaged him of his early concerns about the quality of the JA's due diligence.

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<sup>11</sup> ICC Docket No. 11-0280/0281, Order of January 10, 2012 at 237; ICC Docket Nos. 12-0511/12-0512 (cons.), Order on Rehearing of December 18, 2013 at 21; ICC Docket Nos. 14-0224/0225 (cons.), Second Amendatory Order of February 11, 2015 at 4.

<sup>12</sup> ICC Docket No. 11-0281, PGL Ex. 1.0 at 10-11; ICC Docket No. 12-0281, PGL Ex. 1.0 at 3. ("The largest cause of the increase is Peoples Gas' capital investments to improve the reliability of its gas distribution system and the quality of its services. The largest capital investments currently being made by Peoples Gas are for main replacement, in particular the replacement of cast iron and ductile iron gas main in the City of Chicago."); ICC Docket No. 14-0225, PGL Ex. 1.0 at 5. ("The costs that Peoples Gas incurs in order to serve its customers have increased significantly in recent years, due primarily to main replacement and other increased plant investment costs, and increased operating expenses, such as increased costs of pipeline safety and other compliance work.")

Yet, even JA witness Leverett admitted on cross-examination that due diligence typically requires examining an acquired company's infrastructure commitments *before* an acquisition agreement is signed. Tr. at 192-193. That did not take place here.

Indeed, Mr. Lounsberry's initial criticism of the JA's due diligence process was the more accurate assessment. This is perhaps best revealed in the Company's own pre-filed testimony and subsequent revelations during cross-examination. For example, despite the evidence presented about the dismal state of the PGL-run AMRP, lead JA witness Leverett proclaimed in Rebuttal testimony that "the proposed Reorganization will leave Peoples Gas (and North Shore) essentially unchanged...." JA Ex. 7.0 at 9:262-264. Moreover, clearly oblivious or indifferent to the endemic problems in Peoples Gas AMRP management and cost control processes, and in no mood to assure the Commission that it intended to ensure any corrective actions relative to the Liberty audit, the JAs intended to convince this Commission to focus instead on its suggested narrow reading of the statute. Leverett testified thus: "While I am not an attorney, it seems that the provisions of Section 7-204 focus on ensuring that a reorganization will not 'diminish' a utility's ability to perform its duties under the Act and provide service to its customers, 'significantly impair' its ability to raise capital and maintain a reasonable capital structure, or cause 'adverse rate impacts.'" *Id.* at 11:316-318.

Even by the end of the case, cross-examination of the JA witnesses revealed a stunning lack of knowledge about the AMRP, again indicative of the lack of adequate due diligence in researching and understanding the operations of Peoples Gas, an inadequate commitment to ensure best practices in the operation of the AMRP, and an inability to ensure a smooth transition that will not negatively impact Peoples Gas's quality of service, reliability, safety and customer rates, as discussed in part II.B below. Lead JA witness Leverett, who also filed the principal

testimony alleging that Joint Applicants were “ready, willing and able” to implement Liberty audit recommendations, and who specifically responded to criticisms of the quality of the due diligence review of PGL by WEC, admitted that WEC:

- Was not aware that PGL lacked any overall plan for the AMRP (Tr. at 187); *see also* ICC Ex. 8.0 Attachment A (Confidential Liberty Interim Report) at 9  

- Performed no analysis of whether PGL had in place formal written guidelines or procedures related to the AMRP (Tr. at 196);
- Could not name who is in charge of the AMRP at Peoples;
- Had no knowledge of the number of miles of main that PGL has replaced to date or has remaining to replace (Tr. at 220);
- Had no understanding of the main ranking index used to prioritize main replacement from a safety and reliability perspective (Tr. at 237);
- Performed no review of PGL’s internal PricewaterhouseCoopers audits, which identified operational deficiencies and needed remedial action in the AMRP (Tr. at 182-183);
- Had no communication with Integrys employee and JA witness David Giesler, who is responsible for project planning, execution, control, and close out for the AMRP, and was the JA witness from Peoples Gas responding to Intervenor criticisms of the PGL AMRP (JA Ex. 1.0 at 1:9-10);
- Did not include the JA witness, Andrew Hesselbach in WEC’s due diligence review of Integrys/Peoples Gas, even though Mr. Hesselbach sponsored testimony in response to the ALJ’s January 14, 2015 directive to file testimony indicating “whether the JA are aware of the scope and scale of the potential obligations under AMRP”; and “whether the JA are ready, willing and able to implement the AMRP consistent with additional remedies as recommended by the Liberty audit”) (Tr. at 183);
- Performed no analysis of whether the Staff-requested 2030 AMRP completion date was even feasible (Tr. at 221), despite including it as a Joint Applicant commitment in Rebuttal testimony;

- Had no idea how long an assessment of the feasibility of achieving a 2030 would take (Tr. at 222);
- Had no opinion as to whether the AMRP is currently on track to achieve a 2030 completion date (Tr. at 222).

In fact, Joint Applicants did not even acknowledge that systemic, critical problems existed in PGL's operation of the AMRP until January 29, 2015, and only following the ALJ's ruling that the Joint Applicants should file supplemental rebuttal and surrebuttal testimony addressing: "(1) whether the Joint Applicants are aware of the scope and scale of the potential obligations under AMRP; and (2) whether Joint Applicants are ready, willing and able to implement the AMRP consistent with additional remedies as recommended by the Liberty audit." *See, gen'ly*, JA Ex. 12.0 (Leverett Supplemental Rebuttal), 13.0 (Hesselbach Supplemental Rebuttal) and 14.0 (Leverett Supplemental Reply). As discussed in part II.B below, that testimony and the cross-examination of JA witnesses Leverett and Hesselbach regarding that alleged state of readiness to step into the shoes of Peoples Gas and Integrys in overseeing the AMRP and implementation of Liberty audit recommendations revealed a startling lack of readiness to do just that, and clear disinterest in the PGL remedial activity that Mr. Giesler testified is now occurring. Tr. at 263.

This lack of due diligence must inform the Commission's evaluation of the Joint Applicants' commitments, detailed in JA Ex. 15.1 REV, and their claims that they are "ready, willing and able" to implement the final audit recommendations related to PGL's AMRP, due to be released sometime this Spring. More importantly, as discussed further below, it points to an inability to demonstrate that the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service, a burden of proof that is required under Section 7-204(b)(1) of the Act, as discussed further below.

**B. The JA did not prove that they are “ready, willing, and able to implement the AMRP consistent with additional remedies as recommended by the Liberty audit.”**

Despite the JA’s best efforts to marginalize, if not ignore altogether, the significance of the AMRP in this proceeding, its emergence as the central issue for evaluating whether the merger should be approved under Section 7-204 of the Act cannot be denied. In the rebuttal testimony phase of this case, Staff witness Harold Stoller attached to his Rebuttal testimony an Interim Report issued by Liberty, the independent auditors the Commission selected to conduct the two-phase audit it ordered in the Gas Companies’ 2012 Rate Cases. In response to an AG/City Motion to Extend the Schedule in this case to incorporate the results of Liberty’s Interim Report and the JA’s response to the report, the Administrative Law Judge issued a ruling requiring the JA (and other parties) to submit supplemental testimony addressing:

(1) whether the Joint Applicants are aware of the scope and scale of the potential obligations under AMRP; and (2) whether Joint Applicants are ready, willing and able to implement the AMRP consistent with additional remedies as recommended by the Liberty audit.

ALJ Ruling, January 14, 2015. The JA’s supplemental testimony, as well the other evidence of record, demonstrates that the JA have not shown that they are “ready, willing, and able to implement the AMRP consistent with the additional remedies as recommended by the Liberty audit.” In fact, as noted throughout this Brief, the JA have shown a startling lack of concern about a multi-billion infrastructure program that has been beset with poor management from its inception and has resulted in substantial cost overruns that threaten to double a typical customer’s base rates by 2024. AG Ex. 2.0 at 15:300-306. The JA’s apparent indifference to remedying the AMRP’s many problems has manifested in many ways.

First, and perhaps most important, the JA have no transition plan for assuming ownership of Peoples Gas and oversight of the very troubled AMRP. This was made clear in the Joint Applicants' Responses to the March 11, 2015 Commissioner Data Requests ("JA's Responses"), wherein they admitted that no transition plan has been developed. JA's Responses at 2-3. The Commissioners' question on this point sought this information "to ensure a seamless changeover that avoids any diminishment of the utility's ability to provide adequate, reliable, efficient, safe, and least-cost public service both leading up to and after closing the proposed reorganization, if approved." Notice of Commissioners' Data Request at 2. As noted by Mr. Coppola in the AG's response to the JA's Responses, in lieu of describing a firm transition plan that would "ensure a seamless changeover" in management of the AMRP, the JA "provided a list of general management principles not specific to the AMRP." AG Ex. 7.0 at 2. Mr. Coppola also noted that in lieu of identifying a transition plan, the JA discussed a customer communication plan WEC has implemented in Wisconsin. As noted in the Introduction, Mr. Coppola responded that while improving customer communication is "admirable," the JA's discussion of customer communication programs is "akin to rearranging the deck chairs on the Titanic while the ship is sinking." *Id.* at 5. The JA's lack of a transition plan, as well as their non-responsive answer to the Commissioners' question, should provide little comfort to the Commission that they are capable of ensuring a "seamless changeover" in management of the AMRP.<sup>13</sup>

Second, the JA have not identified the person or persons who would be responsible for overseeing the AMRP if the transaction is approved. *See, e.g.*, JA's Responses at 3. Each JA

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<sup>13</sup> It is worth noting that in Docket No. 11-0046, the Nicor Inc.-AGL Resources, Inc. merger case, the joint applicants there testified that an integration planning process had begun in January 2011 (Tr. at 382-383), around the same time the proposed transaction was filed for Commission approval (January 18, 2011). Here, WEC has made no effort to integrate planning to improve AMRP performance with Integrity and/or Peoples Gas almost eight months since this case was filed.

witness – whether a WEC or Integrys employee – who was asked about this important issue testified that he did not know who would manage the program. *See* Tr. at 84, 256, 314. JA witnesses James Schott, David Giesler (an Integrys Senior Project Manager with management responsibility over certain aspects of the AMRP), and Andrew Hesselbach each testified that they did not know who would manage the AMRP if the transaction were approved. *Id.*

Third, the JA have not described the process for evaluating whether PGL and Integrys employees currently overseeing the AMRP will be retained or replaced. Tr. at 214; JA’s Responses at 2-3. Like their question regarding the existence of a transition plan, the Commissioners’ Data Requests asked for information on this point “to ensure a seamless changeover that avoids any diminishment of the utility’s ability to provide adequate, reliable, efficient, safe, and least-cost public service both leading up to and after closing the proposed reorganization, if approved.” Mr. Coppola noted in his response to the JA’s Responses that:

It would have been helpful to hear that a core of current personnel would be retained at least during a multi-month period to help with the transition of responsibilities in order to maintain continuity of work. It also would have been informative if the JA had defined a time frame to evaluate the current staff and management assigned to the AMRP so that the Commissioners and other parties could have garnered some confidence that some real and timely transition plan would emerge soon.

AG Ex. 7.0 at 2. However, the JA provided no such information, and the Commission and the parties are left to wonder when, if ever, the JA will have a transition plan in place to take over the AMRP.

Fourth, in its Interim Report, the Liberty auditors explained that they were issuing

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] AG Ex. 6.1 at S-1. The auditors went on to say that [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] *Id.* at 1.

On cross-examination, Mr. Giesler (the Integrys employee with management responsibilities over significant portions of the AMRP) testified that he was part of the process that is developing plans to implement the [REDACTED]

[REDACTED]

[REDACTED] Tr. at 273. WEC apparently was not interested in learning about that remedial activity. Mr. Hesselbach testified that he had not held a single conversation with anyone at Peoples Gas or Integrys regarding the plans Peoples Gas is developing to implement the [REDACTED]

[REDACTED] discussed in the Interim Report. Tr. at 317. He added that he was not aware of WEC having input into the implementation plans. Tr. at 318. In fact, Mr. Hesselbach stated that WEC could not agree that it would follow the initiatives Peoples Gas has begun to develop, saying doing so would be “imprudent.” Tr. at 320-321.

Fifth, [REDACTED]

[REDACTED] Liberty stated that one of the primary reasons it decided to issue its unscheduled Interim Report was [REDACTED]

[REDACTED] AG Ex.

6.1 at S-1. Liberty added that its [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] *Id.* at 1-2. Thus, there is evidence that not only have the JA not proved that they are “ready, willing, and able” to take over management of the AMRP, but, soon after this case was filed, [REDACTED]

[REDACTED]

Sixth, as noted in earlier in this Brief, Mr. Leverett and Mr. Hesselbach each submitted supplemental testimony in response to the ALJ’s Ruling that the JA demonstrate that they are “ready, willing, and able to implement the AMRP consistent with the additional remedies as recommended by the Liberty audit.” ALJ Ruling of January 14, 2015. Mr. Leverett admitted that WEC did not request a specific work plan as part of its due diligence review. Tr. at 175-176; AG Cross Ex. 3. He testified that he had not read the entire Liberty Interim Report, choosing to only read the Executive Summary. Tr. at 193-194. In fact, other than reading the Executive Summary, Mr. Leverett’s knowledge of the Liberty Interim Report was based on two conversations he had with Mr. Kleczynski, Peoples Gas’s President, and Mr. Morrow regarding the utility’s plans to respond to the Liberty audit findings. Tr. at 204, 206-208. One of those conversations occurred in February 2015 (Tr. at 204), subsequent to the filing date for the supplemental and supplemental rebuttal testimony that was intended by the ALJ to document that the JA were “ready, willing and able” to assume ownership of the AMRP. Thus, it could not have informed Mr. Leverett’s assertion in his supplemental testimony that WEC is “ready, willing, and able” to take on the management of the AMRP. Although Mr. Hesselbach appeared

to have greater awareness of the Liberty Interim Report, he has not worked on natural gas projects since the mid-1990s, focusing on electric generation projects since that time. Tr. at 315.

Moreover, although Integrys and Peoples Gas are two of the Joint Applicants seeking merger approval, those two entities did not submit supplemental testimony as to whether they are “ready, willing, and able to implement the AMRP consistent with the additional remedies as recommended by the Liberty audit.” The lack of any testimony from Peoples Gas is remarkable, particularly because, as AG witness Coppola testified, “Peoples Gas (1) is the company that is implementing the AMRP now, and (2) will continue to be implementing it post-merger, should the proposed acquisition be approved.” AG Ex. 6.0 at 5:79-81.

Thus, in response to the ALJ’s January 14, 2015 ruling, the JA chose to file the testimony of one witness who had little specific knowledge of the Interim Report and the AMRP and a second witness who has not worked on a gas infrastructure project in 20 years. The Joint Applicants also chose not to file any testimony from a witness or witnesses from the two entities that have knowledge of the AMRP (PGL and Integrys) and the apparently existing PGL plans to implement the changes recommended by the Liberty auditors. Other than the JA’s “trust us” approach, there is little in the record to conclude that WEC is “ready, willing, and able to implement the AMRP consistent with the additional remedies as recommended by the Liberty audit.”

In sum, the JA failed to show that the proposed merger “will not diminish the utility’s ability to provide adequate, reliable, efficient safe and least-cost public utility service.” 220 ILCS 5/7-204(b)(1).

**III. The Joint Applicants Have Failed to Prove That The Proposed Reorganization is Not Likely to Result in Adverse Rate Impacts On Retail Customers.**

**A. The JA’s Unquestioning Adherence to a Discredited and Inappropriately Paced AMRP Completion Date That the Joint Applicants Lack Capacity to Deliver Will Lead to Rate Shock.**

1. The JAs Propose to Increase the Pace of AMRP Construction Activity Far Above Trend In A Way That Will Increase Customer Rates.

The Commission originally ordered the AMRP in PGL’s 2009 rate case, Docket Nos. 09-0166/0167 (cons.) (the “2009 Rate Case”). In its Order in that proceeding, the Commission first approved the institution of an infrastructure cost recovery rider known as Rider ICR for purposes of supporting an accelerated main replacement program for PGL’s pipelines.<sup>14</sup> The Commission then approved PGL’s proposed AMRP and required completion of the program by 2030 – an end date that PGL had proposed in an effort to secure approval of the rider.<sup>15</sup>

Since the Commission first issued that order more than five years ago, Peoples Gas has fallen badly behind schedule in its AMRP; PGL’s current pace of main replacement puts it far off any putative 2030 completion date. AG witness Coppola found in his Direct testimony that, while the accelerated program approved in the 2009 Rate Case entailed<sup>16</sup> the installation of 164 miles of new coated steel and plastic pipe annually, it had installed only 103 miles in 2011, 136 miles in 2012, and 98 miles in 2013. AG Ex. 2.0 at 13-14:282-287. Mr. Coppola found that PGL’s “inability to achieve the target installation of 164 miles of new main per year called for in the current program means that it will need to install even more in coming years in order to complete the program by 2030. This is not likely to occur. The result would certainly be further cost overruns that will drive the final cost of AMRP even higher.” AG Ex. 2.0 at 30:600-604.

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<sup>14</sup> Order, Docket Nos. 09-0166/0167 (cons.) at 194.

<sup>15</sup> *Id.* at 196.

<sup>16</sup> See AG Ex. 2.0 at 12:249 (citing Docket No. 09-0167, PGL Ex. SDM-1.15).

The “further cost overruns” that Mr. Coppola alludes to are beyond the existing cost overruns that have inflated the estimated total construction cost of the AMRP from around \$2.2 billion, as projected in the 2009 Rate Case, to around \$4.6 billion in May, 2013. AG Ex. 2.0 at 19:394-399.

Additionally, the Commission’s directive to have Peoples Gas complete the AMRP by 2030 was made only in the context of approving Rider ICR, as discussed above. Rider ICR was overturned by the Appellate Court in 2011. *People ex rel. Madigan v. Illinois Commerce Comm’n*, 2011 IL App (1st) 100654 (Sep. 30, 2011), at ¶ 42. The Commission recognized that the 2030 completion date was no longer operative in its next rate order for Peoples Gas, Docket Nos. 12-0511/0512 (cons.), in which it noted (relying on Staff witness Buxton’s testimony) PGL’s lack of progress on the AMRP<sup>17</sup>, and it ordered an investigation to determine the “shortest reasonable time” in which the AMRP could be completed.<sup>18</sup> AG witness Coppola found in this proceeding that he has “seen no evidence in this case that leads me to believe that Mr. Buxton’s conclusions are no longer true. The level of construction activity that Peoples Gas has undertaken to implement the AMRP is taxing its resources and capabilities.” AG Ex. 4.0 at 31:591-593.

The record is clear that if Peoples Gas were to now follow through on a goal of completing the AMRP by 2030, the effect on residential customer rates would be large and financially burdensome for Chicago residents. Calculations by AG witness Coppola in this case show that, if a 2030 completion date for the AMRP is assumed, the incremental contribution of

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<sup>17</sup> The Commission’s Order in that proceeding expressly relied on the testimony of Staff witness Buxton, who found that “[t]here is no reason for the Commission to believe that Peoples can complete its AMRP in 20 years as it convinced the Commission it should back in 2009.” Staff Ex. 2.0 at 16:375-377; Order, Docket Nos. 12-0511/0512 (cons.), June 18, 2013, at 61 (“[f]or reasons detailed in Staff witness Buxton’s rebuttal testimony . . . this Commission adopts Staff’s proposed two-phase investigation of the AMRP”).

<sup>18</sup> Order, Docket Nos. 12-0511/0512 (cons.), June 18, 2013, at 61.

AMRP costs – including rate base effects and Rider QIP recovery – to the typical residential customer bill will reach \$529 by 2023 (up from \$10 in 2011 and \$180 today).<sup>19</sup> AG Ex. 2.0 at 28-29. For context, a typical residential customer’s annual PGL bill as of 2013 includes around \$555 related to base rates. *Id.* at 28:567-568. No JA witness refuted Mr. Coppola’s findings.

The Joint Applicants now propose to resurrect a completion date that they have proven to be unachievable: as commitment no. 5 of their list of conditions and commitments, they propose that after a hypothetical merger, PGL will commit to continue the AMRP, assuming it “receives and continues to receive appropriate cost recovery,” with a planned 2030 completion date. PGL Ex. 15.1 REV at 1. Similarly, Staff witness Lounsberry recommends that the Commission require the JA to “reaffirm Peoples Gas’ commitment from the 2009 Rate Cases to complete the AMRP by 2030” (Staff Ex. 9.0 at 15:393-395), and Staff witness Stoller argues that the AMRP completion date of 2030 originally ordered in the 2009 Rate Case Order should be ordered anew as part of the proposed merger. Staff Ex. 8.0 at 8:159.

Both Section 7-204(b)(1) and Section 7-204(b)(7) of the Act are salient in evaluating whether the Commission should order such a commitment to a 2030 completion date. Subsection (b)(1) requires that a reorganization not diminish a utility’s ability to provide (*inter alia*) least-cost service; subsection (b)(7) requires that a reorganization be not likely to result in any adverse rate impacts for retail customers. But, as Mr. Coppola’s findings discussed above show, a re-commitment to the 2030 completion date would scale the AMRP far beyond PGL’s capabilities, requiring it to expand its construction activities at a runaway pace that, if history is any guide, will lead to large cost overruns. PGL is not currently conducting the AMRP on a pace

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<sup>19</sup> Mr. Coppola’s analysis assumed a 2% annual escalation of gas costs and rate riders (excluding Rider QIP), and a 3.5% annual increase in base rates (excluding any effect of the AMRP). AG Ex. 2.0 at 28:575-29:579.

anywhere close to completing the work by 2030 and has shown no plans in this proceeding for how it might cost-effectively accelerate its pace of activity commensurate with such an ambitious goal. Thus, a merger without a reassessment of what AMRP pace is achievable would diminish the provision of least-cost service and would have adverse retail rate impacts; the Commission should not approve such a merger. As the discussion below will show, the 2030 date was originally selected somewhat arbitrarily in the 2009 Rate Case without any consideration of optimizing safety or minimizing the effect on customer rates. Importantly, Staff witness Lounsberry, who presented the 2030 date as a commitment requirement, admitted during cross-examination that neither he nor anyone at Staff had conducted an analysis of how the 2030 would impact customer rates. Tr. at 566:1-567:2. The Joint Applicants' promise to resurrect the 2030 AMRP completion date without a realistic assessment of whether that date is achievable would have clear, adverse rate impacts on PGL customers – a phenomenon Section 7-204(b)(7) prohibits for any merger applicant.

2. The Joint Applicants' Poorly-Defined Request for "Appropriate Cost Recovery" Is a Harbinger of the Rate Shock To Come Should the Commission Approve Their Proposed AMRP Completion Date.

JA witness Schott stated in his Surrebuttal testimony that "appropriate cost recovery" is "linked" to PGL's intention to complete the AMRP by 2030. AG Ex. 18.0 at 3:47-49. JA witness Mr. Leverett added the identical caveat of "appropriate cost recovery" in his Surrebuttal testimony. JA Ex. 15.0 at 9:182-184. The People sought to clarify the meaning of "appropriate cost recovery" through discovery and cross-examination to identify exactly what circumstances would cause the JA's proposed commitment to be effective. In discovery, Mr. Schott stated that,

after Rider QIP<sup>20</sup> expires after 2023 pursuant to Section 9-220.3 of the Act, appropriate cost recovery could come through rate case filings, but that “[w]hat the appropriate cost recovery is in future years remains to be seen.” AG Cross Ex. 1 at 1. Invited to clarify the precise type of rate case treatment he was referring to, Mr. Schott stated in cross-examination only that he did not feel comfortable answering a question about events nine years hence. Tr. at 98:18-99:3. Mr. Schott mentioned several factors such as “the amount of dollars to be spent, the current regulatory environment, the current financial environment, [and] the current cost projections at the time” (Tr. at 100:2-5) that would inform the definition of “appropriate” cost recovery, but declined to “speculate” as to what “appropriate” cost recovery through a Commission rate order might look like. Tr. at 100:5-8.

Putting aside the inappropriateness of saddling both Peoples Gas and its ratepayers with constant rate increases in order to achieve the unsupported 2030 deadline, as discussed further below, the Commission should not approve a merger with an ambiguous condition whose predicate has not been clearly defined. The Joint Applicants appear to be deliberately leaving the meaning of “appropriate cost recovery” unclear so that they may escape the obligation of the now-discredited 2030 completion date at a future time of their choosing if a Commission rate order is not to their liking. Moreover, the JA’s unwavering emphasis on gaining “appropriate” cost recovery for AMRP activity suggests that they value the 2030 date not because it is important to optimize public safety, but only to the extent that adding this condition to the merger can improve their profitability. Meanwhile, the extreme acceleration of construction activity within the next 5-8 years that would be required to catch up with a 2030 completion date

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<sup>20</sup> PGL’s Rider QIP, approved by the Commission in 2014 pursuant to Section 9-220.3 of the Act, permits Peoples Gas to recover a return of and on qualifying infrastructure investment, including its AMRP investments, through a monthly surcharge on customer bills. 220 ILCS 5/9-220.3.

would cause large adverse retail rate impacts, as noted above – all with an uncertain public benefit. Moreover, the JA’s poorly clarified qualifications for meeting the targeted date would make a 2030 timetable highly unpredictable. The Commission must not impose such a one-sided condition that puts great burden upon ratepayers and relieves PGL of any risk associated with the acceleration – particularly in light of the lack of any tangible, safety-related justification for that particular date and the resulting rate shock that promises to accompany efforts to meet that target.

3. Evidence Shows PGL Has Not and Cannot Keep Pace With the Proposed Completion Date, and the Commission Should Order PGL to Run the AMRP Consistent With Its Capabilities.

The evidence shows that Peoples Gas simply has been unable to manage an AMRP with a 2030 completion date, and a condition in this proceeding that requires a resumption of that goal would violate the statutory requirements of maintaining least-cost service and causing no adverse retail rate impacts. 220 ILCS 5/7-204(b)(1), (b)(7). AG witness Coppola concluded in his Direct testimony that “[t]he scale of the AMRP seems to have overwhelmed the utility’s resources.” AG Ex. 2.0 at 20:410. Moreover, after reviewing the Liberty Interim Report, Mr. Coppola concluded that the “lack of proper on-site management of the program, the hesitancy on the part of senior level management to make decisions about the organization and structural changes to the program, compounded by cost overruns and delays in completing scheduled projects, all point to an inability to complete the AMRP by 2030.” AG Ex. 5.0 (Coppola Supplemental Direct) at 15:317-321.

Mr. Coppola further testified that “[t]he Joint Applicants, particularly Wisconsin Energy, if the merger is approved, face a monumental task to get the program on the right footing, and

make up for the lost ground identified in the Interim Audit Report. Continuing to believe that 2030 is an achievable completion date is neither realistic nor advisable in achieving a cost-effective implementation, regardless of any claims the Joint Applicants might make that they will endeavor to do so.” *Id.* at 15:322-329.

Mr. Coppola also observed that holding the Joint Applicants to a 2030 completion date for the AMRP will not “achieve completing the program ‘at the lowest reasonable cost’ – one of the listed goals of the Liberty audit examination.” *Id.* Additionally, as Mr. Coppola noted in testimony, the Liberty Interim Report does not mention anywhere in its pages a goal of completing the AMRP by 2030. AG Ex. 5.0 at 15:333-16:334. The Commission-hired auditors have not thus far recommended any acceleration of the AMRP to a 2030 completion timeline, and the Commission should not second-guess the auditors by imposing such a condition.

Staff witness Stoller filed Supplemental Reply testimony solely to claim that “[i]t is irrelevant that Liberty did not mention the end date of AMRP in its Interim Report.” Staff Ex. 15.0 at 2:18-19. Mr. Stoller claimed that Liberty’s task in its ongoing audit is, *inter alia*, “to make recommendations regarding how [PGL] can get back on schedule to complete AMRP by 2030.” However, the evidence simply does not support Mr. Stoller’s claim that Liberty was hired by the Commission with a goal of moving the AMRP toward completion on that particular date. As Mr. Stoller admitted in a discovery response, the Request for Proposals (“RFP”) that initiated the audit now being conducted by Liberty provided that the audit should “help ensure that Peoples completes its AMRP in the shortest reasonable time and at the lowest reasonable cost,” but did not ask the prospective auditor to consider the constraint that the “shortest reasonable time” cannot end after 2030. AG Cross Ex. 12 at 1. Mr. Stoller also admitted in discovery (AG Cross Ex. 12 at 2) that the “shortest reasonable time” and “reasonable cost”

language from the RFP echoes recommendations made in the 2012 Rate Case by Staff witness Buxton, on which the Commission based its final directive to initiate the AMRP audit. (Order, Docket Nos. 12-0511/0512 (cons.), June 18, 2013, at 61.) Moreover, Mr. Stoller admitted that he does not deem it impossible that Liberty might conclude that the “shortest reasonable time” for completion of the AMRP is a time frame ending after 2030, and he also admitted that Liberty’s task of determining the AMRP’s likely completion date was not constrained by any condition that the likely completion date could not be after 2030. AG Cross Ex. 12 at 1, 4. He also admitted that nowhere in the RFP that initiated the audit, other than one reference to a calculation of a pipe replacement pace for a 2030 completion, is there any reference to a 2030 completion date or a 20-year timeline, or to the aforementioned pipe replacement pace calculation. AG Cross Ex. 12 at 3.

4. Neither Staff Nor the JA Conducted Any Rate Impact Analysis Related to the AMRP Completion Date.

While the Joint Applicants have stated repeatedly that they will commit to complete the AMRP by 2030 (with “appropriate cost recovery”), they have not explained how they matched that goal with the Section 7-204 statutory standards discussed above. As JA witness Mr. Schott agreed in cross-examination, an effectively managed AMRP should minimize the impact on customer rates. Tr. at 95:5-11. Indeed, Mr. Schott, Chief Financial Officer of Integrys Energy Group, stated during cross-examination that (using his example) near-term customer rates would be lower when \$100 million is prudently spent in a given year on capital expenditure, compared to capital expenditure of \$200 million. Tr. at 104:19-105:10. Moreover, he agreed generally that the annual rate of AMRP investment increases customer rates in the near term. Tr. at 105:16-106:1.

Despite this correlation, JA witness Mr. Lauber, who is Vice President and Treasurer of WEC, stated during cross-examination that WEC did not ask PGL or Integrys to calculate a rate impact associated with different AMRP completion timelines. Tr. at 462:9-14. Similarly, Mr. Leverett, President of WEC, stated that neither he nor any other JA witness has performed any recent analysis or assessment to conclude that the 2030 completion date is still feasible and achievable in a cost-effective manner for ratepayers. Tr. at 221:2-7. Additionally, as Mr. Coppola found, and as highlighted earlier in this Brief in Part II.A.2, “there is no evidence that the Joint Applicants have performed the due diligence necessary to understand the infrastructure investment rate involved in achieving that [2030] deadline [and] the impact on customer rate.” *Id.* at 30:604-606.

Similarly, Staff witness Mr. Lounsberry agreed during cross-examination that his recommendation on page 15 of his Rebuttal testimony, Staff Ex. 9.0, that the Joint Applicants should be required as a merger condition to complete the AMRP by 2030 was based solely on his reading of the 2009 Rate Case order and not on any analysis of customer rate impacts.<sup>21</sup> Tr. at 566:1-567:2. Staff witness Stoller also admitted in a discovery response that he did not consider rate impacts to PGL ratepayers associated with his recommendation to re-commit to the 2030 completion date ordered by the Commission in Docket Nos. 09-0166/0167 (cons.). AG Cross Ex. 13. Mr. Lounsberry similarly admitted in cross-examination that neither he nor any Staff witness has conducted any analysis as to whether the proposed merger could impact AMRP management in a way that could affect customer rates. He also conceded that neither he nor

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<sup>21</sup> A failure to investigate rate impacts is not the only infirmity with Mr. Lounsberry’s recommendation. Mr. Lounsberry admitted in cross-examination that the ICC Staff did not perform any safety or engineering studies to arrive at its recommendation in the 2009 Rate Case or in *this* case that a 2030 completion date was appropriate. Tr. at 569:8-18. He also admitted that Staff has not conducted any analysis or investigation to determine that 2030 is an optimal completion date in terms of management issues. Tr. at 569:19:570:2.

anyone in the ICC Staff has conducted any independent analysis of the appropriate completion date for the AMRP. Tr. at 516:17-20. Indeed, no witness in this case has attempted to show that, even under the limited criteria offered by PGL witness Marano in the 2009 Rate Case (discussed below), 2030 is still a manageable or appropriate completion date.

In light of the General Assembly's statutory mandate in Section 7-204(b)(7) of the Act to consider retail rate impacts, it is difficult to see how the Commission could approve this proposed reorganization with a 2030 AMRP completion condition when the *only* rate impact study related to the proposed condition, presented by AG witness Coppola, suggests that customer rates would roughly double, before considering any non-AMRP factors that inform the setting of rates, within the next decade if the 2030 completion date is required.

5. The Commission Did Not Choose A 2030 Completion Date In The 2009 Rate Case As A Pipeline Safety Optimization Strategy.

As JA witness Schott observed in his Surrebuttal testimony, the Commission's decision authorizing the AMRP with a 2030 targeted completion date in its 2009 Rate Case was based on the testimony of PGL witness Mr. Salvatore Marano, who provided *cost-benefit* analyses for a possible accelerated main replacement program using three possible completion dates: 2025, 2030, and 2035. From those alternatives, Mr. Marano concluded that a 2030 completion date was most feasible. JA Ex. 18.0 at 3:52-57. A careful look at the direct testimony filed by Mr. Marano in the 2009 Rate Case regarding a proposed 2030 completion date shows that he focused *only* on cost-benefit analyses and did not consider customer rate impacts, pipeline safety issues, or the Company's ability to manage an accelerated program. AG Ex. 4.0 at 30:577-579; AG

Cross Exhibit 2 at 51-59.<sup>22,23</sup> In light of the Commission’s decision calculus from the 2009 Rate Case, AG witness Coppola correctly noted in his Rebuttal testimony that there is nothing “magical or critical” about a 2030 completion date. AG Ex. 4.0 at 30:577.

While Mr. Stoller alleged in his Rebuttal testimony that “AMRP was not ordered by the Commission for reasons other than pipeline safety” (Staff Ex. 8.0 at 8:153), he later admitted in cross-examination that he was not a Commissioner at the time of the 2009 Rate Case order and agreed that he is not suggesting that he is a legal expert in the interpretation of prior ICC orders. Tr. at 500:8-501:3. In fact, as Mr. Stoller agreed during cross-examination, the Commission approved Rider ICR, which enabled PGL to collect a return of and on AMRP investment over a designated dollar amount each year between rate cases, at the same time as it ordered a 2030 completion date in the Company’s 2009 Rate Case order. Tr. at 504:12-20. Mr. Stoller also agreed (Tr. at 506:21) that the Commission’s 2009 Rate Case order expressly rejected “Staff’s persistent claim that Rider ICR is not needed.”<sup>24</sup> The Commission’s 2009 Rate Case order speaks for itself and clearly demonstrates that it approved the 2030 AMRP completion date in the context of also approving Rider ICR. As Mr. Stoller agreed, after the Illinois Appellate Court reversed the Commission’s approval of Rider ICR in September, 2011, Peoples Gas was unable to collect a return of and on AMRP investment between rate cases until the time in 2014 when Rider QIP was initiated pursuant to the new Section 9-220.3 of the Act. Tr. at 507-508.

Mr. Stoller’s Direct testimony from the 2009 Rate Case shows that the genesis of his support for a 2030 completion date was nuanced and based on the expectation of further

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<sup>22</sup> The cited pages represent pages 49-57 of PGL Ex. SDM-1.0 Rev. from Docket No. 09-0167.

<sup>23</sup> Page 51 of the cross exhibit (page 49 of the Marano testimony) at line 948 poses the question: “How was the basis for the proposed accelerated replacement period determined?” The discussion and analyses on the following eight pages focus only on purported cost savings.

<sup>24</sup> Order, Docket Nos. 09-0166/0167 (cons.), Jan. 21, 2010, at 194.

Commission review. There, Mr. Stoller recommended that (1) Peoples Gas should be ordered to conduct an in-depth study of the (then-proposed) AMRP since the program appears to be necessary for the long-term safety of PGL's system; (2) PGL should present the Commission with an AMRP implementation plan in a separate docket, with the plan to be analyzed by an independent consultant, and obtain Commission approval before commencing the AMRP; and (3) following Commission approval, PGL should be ordered to return to the Commission with updated analysis of the AMRP every three years. Tr. at 511-512. The Commission looked to Mr. Stoller's recommendations in the 2009 Rate Case in formulating its conclusion in that case that the AMRP should be concluded by 2030.<sup>25</sup> However, as Mr. Stoller admitted under cross-examination in this case, the Commission never adopted his second or third recommendation from his 2009 Rate Case testimony. Tr. at 513. It is not clear how Mr. Stoller's 2030 completion date recommendation is still tenable when the Commission never executed the second and third steps that Mr. Stoller recommended in his 2009 Rate Case testimony. It is also noteworthy that Mr. Stoller admitted in this case that he performed no analysis of the impact on customer rates at the time of the 2009 Rate Case, and he did not know if any other Staff member did. Tr. at 517:17-21.

Mr. Stoller's support for the 2030 completion date is complicated by looking to his statements in the evidentiary hearing of Docket Nos. 09-0166/0167 (cons.), where he admitted that 2030 is not a "magic bullet" and is not necessarily the year that the AMRP must be completed. AG Cross Exhibit 15 at 15; Tr. at 514:10-20. He admitted in that 2009 hearing that no evidence in that 2009 Rate Case supported the notion that the AMRP must be completed by

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<sup>25</sup> "The testimony of Mr. Stoller confirms for the Commission what it should do in terms of Rider ICR." Order, Docket Nos. 09-0166/0167, Jan. 21, 2010, at 194.

2030. AG Cross Exhibit 15 at 15; Tr. at 515:1-4. He also admitted that he did not “know if it’s 2029 or 2030 or 2031.” AG Cross Exhibit 15 at 15; Tr. at 515:17-22. Finally, he also admitted in that 2009 hearing that the issue of a particular completion date would be something that should be addressed in the future ICC proceeding that he had recommended in his Direct testimony in that case. AG Cross Exhibit 15 at 15; Tr. at 516: 3-10. If the Commission wished to rely in *this* proceeding on Mr. Stoller’s position as it determines an appropriate AMRP completion date, Mr. Stoller’s statements under cross-examination and re-direct examination in the 2009 Rate Case do not provide sturdy ground for a finding that a 2030 completion date is imperative. In short, neither Mr. Stoller nor Mr. Lounsberry were able to justify the inclusion of a 2030 AMRP completion date as a condition to the requested merger.

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As Mr. Coppola stated in his Rebuttal testimony, a 20-year program at the time of the 2009 Rate Case “seemed like a reasonable timeframe,” but “now seems unrealistic and will likely cause further program cost overruns.” AG Ex. 4.0 at 33:643-645. In light of the severe adverse rate impacts forecasted by Mr. Coppola (and undisputed by other parties), the absence of rate impact analyses from other parties, the lack of safety analysis associated with the date, PGL’s inability to date to manage the program on a 20-year timeline, and PGL’s refusal to make an unequivocal commitment to the 2030 completion date without self-serving caveats, the Commission should reject the merger as proposed by the Joint Applicants. Approving this JA commitment would, as demonstrated above, lead to rate shock for PGL’s customers, in clear violation of Section 7-204(b)(7) of the Act.

**B. The JA’s Failure to Make a Meaningful Engagement With the AMRP’s Significant Issues Will Lead to Adverse Rate Impacts for Peoples Gas’s Customers.**

Section 7-204(b)(7) requires that the Commission, before approving any merger, must determine that the proposed transaction “is not likely to result in any adverse rate impacts on retail customers.” 220 ILCS 5/7-204(b)(7). Because of their failure to engage meaningfully – if at all – regarding the fate of the AMRP, the Joint Applicants failed to make such a showing.

As described above, the AMRP has had – and will continue to have – severe adverse consequences on Peoples Gas’s customers’ bills. The project’s estimated costs have swelled from \$2.2 billion in 2009 to \$4.6 billion in May, 2013. AG Ex. 2.0 at 6:135-139. And, as pointed out by AG witness Coppola, Peoples Gas’s May, 2013 estimate did not include the cost impact of new City of Chicago regulations scheduled to go effect in January 2014 as well as other factors. *Id.* at 19-20:400-407. Thus, the \$4.6 billion price tag is likely to increase.

The staggering costs of the AMRP have translated to higher rates for customers. As noted earlier, Peoples Gas has stated that the AMRP was the main driver for its need for increased rates in each of its last two rate increase requests. AG Ex. 4.0 at 17:324-326. Mr. Coppola projected that the main replacement program will cause the average residential customer’s base rates to double from “\$555 annually to more than \$1,100 per year by 2024.” AG Ex. 2.0 at 7:159-161.

The record shows that the JA’s indifferent attitude regarding the AMRP may likely lead to even greater increases in program costs, and, therefore, rate increases, than those estimated by Mr. Coppola. The details of the Joint Applicants’ surprising lack of concern regarding the problem-plagued main replacement program are set forth above and will not be repeated in full here. However, a summary of a portion of the evidence on this point is set forth below.

- The Joint Applicants did not conduct a meaningful due diligence analysis of the AMRP.
- The Liberty auditors stated that one of the primary reasons for issuing their Interim Report was their [REDACTED] AG Ex. 6.1 at 1-2.
- As admitted in their responses to the Commissioners' March 11, 2015 Data Requests, the Joint Applicants have not developed a transition plan for the AMRP. JA's Responses at 2.
- The JA do not know who will be responsible for managing the AMRP if the merger is approved. *See, e.g., id.* at 3.
- In their March 11, 2015 Data Requests, the Commissioners asked whether any Peoples Gas or Integrys employees "with extensive AMRP management experience" would be retained. Commissioners' Data Requests at 2. The JA were unable to provide a direct response to the Commissioners' question, nor were they able to explain the process for evaluating whether PGL and Integrys employees currently overseeing the AMRP will be retained or replaced. Tr. at 214; JA's Responses at 2-3.

These are a few examples of the seeming lack of interest the JA have displayed in the AMRP. The first two questions of the Commissioners' March 11, 2015 Data Requests sought information that they believed necessary "to ensure a seamless changeover that avoids any diminishment of the utility's ability to provide adequate, reliable, efficient, safe, and least-cost public service both leading up to and after closing the proposed reorganization, if approved." Notice of Commissioners' Data Request at 2. The Joint Applicants' failure to provide meaningful, direct answers to these questions should give the Commission significant pause.

In addition to the serious questions raised regarding whether the proposed merger meets the requirement of Section 7-204(b)(7) because of the JA's lack of focus on, and plans for, the AMRP, Staff witness Michael McNally conducted an analysis of the merger's potential impact on the Companies' cost of capital. Mr. McNally testified that "[a]s a consequence of the

proposed reorganization, the Gas Companies' credit ratings have been assigned a negative rating outlook from [Standard & Poor's]." Staff Ex. 7.0 at 9:185-187. Mr. McNally explained that "[a]ll else equal, lower credit ratings would lead to higher debt costs, which in turn, would lead to higher equity costs as well, since higher debt costs increase financial risk." *Id.* at 10:217-219. And although Mr. McNally proposed certain conditions to mitigate potential increases in the utilities' capital costs, he concluded that "it is not clear that the proposed reorganization will satisfy the requirement set forth in Section 7-204(b)(7) of the Act since it does not identify an acceptable means for eliminating any adverse rate impacts of the potential declines in the Gas Companies' credit ratings on their costs of capital." *Id.* at 17:392-395.

In sum, the JA's remarkable lack of detail as to how they plan to conduct a seamless transition to managing the troubled AMRP and Mr. McNally's testimony regarding the proposed transaction's potential impact on the Companies' cost of capital demonstrate that the Joint Applicants have not proved that the proposed reorganization "is not likely to result in any adverse rate impacts for retail customers." 220 ILCS 5/7-204(b)(7). As a result, the Commission should reject the proposed transaction.

**IV. If The Commission Approves The Merger, Several Conditions Under Section 7-204(f) Should Be Attached In Order To Protect The Public Interest.**

As discussed above, the record evidence supports rejection of the Joint Applicants' assertions that the merger would not diminish the utility's ability "to provide adequate, reliable, efficient, safe, and least-cost public utility service" (220 ILCS 5/7-204(b)(1)) and that the proposed transaction "is not likely to result in any adverse rate impacts on retail customers." 220 ILCS 7-204(b)(7). In addition, the Commission cannot protect the interests of the utilities and their customers, as it is required to do under Sections 7-204(b) and (f) of the Act, if it is

investigating allegations of wrongdoing involving WEC and other members of the Joint Applicants in Docket No. 15-0186 but simultaneously moving ahead with a decision as to whether WEC should be permitted to acquire the Gas Companies in this docket.<sup>26</sup> Moving forward to approve a merger under these circumstances is contrary to the ICC's obligation to protect the interests of utility customers. 220 ILCS 5/ 7-204(b),(f). Without having completed its investigation into the alleged wrongdoing, the Commission simply cannot be assured that the transition will not prolong or exacerbate dysfunction in PGL's AMRP. Indeed, the Commission has already asserted a connection between the merger and the investigation. Docket No. 15-0186, Corrected Initiating Order at 1.

Notwithstanding these procedural and evidentiary barriers to satisfying Section 7-204 requirements, should the Commission decide to approve a WEC/Integritys merger, the record supports the addition of numerous conditions to help ensure the protection of the public interest pursuant to Section 7-204(f), which are summarized and attached as Appendix C to this Brief. As a starting point for the Commission's 7-204(f) analysis, it should be recognized that the list of commitments that the Joint Applicants have included as JA Ex. 15.1 REV as a condition of the merger are woefully insufficient to protect ratepayers and the public interest in general, as discussed below.

**A. WEC's Proposed Commitments For Merger Approval Are of Little Tangible Value and Do Not Protect the Gas Companies' Customers.**

The Joint Applicants assert that "the Reorganization is not one based upon synergies" and that if savings do occur, they "likely will not result from the Reorganization until after a 'ramp

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<sup>26</sup> In this instant proceeding, the AG, City, and CUB filed on March 24, 2015 a Motion for an Extension of the Schedule and Motion to Hold Open the Record for Additional Evidence in light of this new investigation and the receipt of new information in the JA's Responses to the Commissioners' Data Requests of March 11, 2015.

up' period of 5-10 years after the Reorganization closes." JA Ex. 2.0REV. (Lauber Revised Direct) at 12:251:260. The JA's claim that future benefits may arise from the reorganization is vague and offers no tangible value to PGL/NS customers. As described by City/CUB witness Gorman,

The Joint Applicants have not identified any quantifiable ratepayer benefits. Their testimony on claimed ratepayer benefits describes possibilities and opportunities that may or may not yield benefits, years in the future. The described benefits are not specific, quantifiable, or useful as standards the utilities must meet.

City/CUB Ex. 4.0 at 247:566-569. As discussed further below, AG witness David Effron was similarly unimpressed, testifying that the merger should not be approved absent modifications to the employee headcount and rate commitments that would ensure any JA rate commitments are truly meaningful and beneficial to customers. AG Ex. 1.0 at 4:83-85. Each of the primary JA purported benefits is discussed below.

1. The JA's promise of future net savings as a result of the reorganization is so vague and unsupported as to be worthless.

In Direct testimony in this case, JA witness Reed claimed the reorganization "is likely to generate net savings in the range of three to five percent of non-fuel O&M of the combined company after a five to ten year ramp up period relative to what non-fuel O&M for the Companies would have been absent the transaction." JA Ex. 3.0 at 34:712-715. The JA, however, conducted no specific WEC/Integritys synergy savings analysis. Cross-examination revealed that of the 15 mergers Mr. Reed cited in support for his O&M savings estimates, 14 were based on savings *estimates* made before or at the cited merger closings. Tr. at 343. In other words, 14 of the 15 cited savings examples were merely unverified estimates, with no follow-up to see if the savings were achieved. Moreover, the one utility cited in Mr. Reed's

sample that did provide an actual savings figure involved WEC's merger with a water company. Tr. at 343-344.

In the instant case, WEC is seeking a merger with a company (Integrys) that has already consolidated operations with another holding company, Peoples Energy Corporation, the former corporate parent of the Gas Companies, in 2007. That fact suggests any synergies that typically result from a merger of two holding companies will not necessarily produce any or comparable synergies when a similar holding company consolidation and reorganization has occurred within a relatively short time frame prior to the later merger. In the prior case, WPS Resource Corporation merged with Peoples Energy, as approved by the Commission in 2007, and thereby creating the Integrys holding company.<sup>27</sup> Mr. Reed admitted during cross-examination that Peoples Gas has likely already realized operational savings from the recent merger of its parent company with Wisconsin Public Service Corporation. Tr. at 344-345.

JAs further claim, generally, that the increased scale and scope of a reorganization will "create a financially stronger company with both greater financial liquidity and improved access to capital markets" (JA Ex. 3.0 28:576-577). But here again, the Joint Applicants did not describe any improved access to capital that does not already exist for the Gas Companies with their current parent, Integrys.

2. The acquisition premium commitment is standard, and nothing more than business-as-usual merger treatment.

The Joint Applicants have committed to exclude the goodwill from the determination of the Gas Companies' rates, irrespective of whether push down accounting is required or not. The balance of goodwill on the Gas Companies' balance sheet, if any, will not be included in rate

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<sup>27</sup> ICC Docket No. 06-0540, Order of February 7, 2007.

base. The JA further commit that amortization of goodwill, if any, will not be included in operating expenses. JA Ex. 1.0 at 22:471-474. In response to AG Data Request 2.02, the Joint Applicants have also represented that they will not include of any portion of the acquisition premium in common equity for revenue requirement purposes. AG Ex. 1.0 at 7:139-142. As AG witness David Effron testified, these accounting treatments are appropriate and essential requirements of any reorganization involving a utility and are standard practice in merger proceedings. The Joint Applicants' commitment in this regard is therefore of limited value, at best.. AG Ex. 1.0 at 6-7:122-142. He explained that, as a general rule, goodwill is excluded from the determination of utility revenue requirements, as purchased goodwill does not represent an investment in assets used to provide utility service. *Id.* at 7:144-153. Therefore, it is unlikely that the goodwill would be reflected in the cost of service, even absent the Joint Applicants' commitment. *Id.*

3. The JA's two-year rate freeze offer approximates PGL's current rate case filing timeline.

The Joint Applicants also touted a commitment to not seek increases in their base rates (just approved in January of this year) in ICC Docket Nos. 14-0224/0225 (cons.) "any earlier than two years after the Transaction closes." JA Ex. 1.0 at 21:454-455; JA Ex. 15.1 REV, par. 1. This commitment is heavily conditioned, as it is contingent on "the right to request that the Commission waive this base rate limitation if the financial integrity of Peoples Gas and/or North Shore is jeopardized to the extent of negatively affecting customers." *Id.* The evidence shows that this, too, has little tangible value to ratepayers..

During cross-examination, JA witness Leverett, who sponsored the JA's list of merger commitments, confirmed that a rate case could be filed by the Gas Companies 11 months prior to

the two-year anniversary of the merger closing, or as early as August of 2016. Tr. at 169. It should be noted that the Gas Companies recently received a \$71.1 million rate increase just two months ago.<sup>28</sup> Given that the Gas Companies have filed a rate case, on average, every 16.6 months since their 2007 rate case filing, this commitment does not suggest that the time period between the Companies' rate case filings would be extended significantly beyond a business-as-usual frequency.

Moreover, the JA's rate freeze commitment falls short compared to the most recent Illinois-based natural gas utility reorganization commitment, that of AGL Resources in Docket No. 11-0046, the acquiring company of Nicor Gas. There, the AGL/Nicor Joint Applicants agreed to a *three-year* rate freeze as a merger commitment, *a full year longer than* what the JA in this docket promise. ICC Docket No. 11-0046, Order of December 11, 2011, Appendix A, condition no. 21. Here again, the Joint Applicants' asserted benefits of the merger are underwhelming, at best.

4. The JA's employee retention commitment is non-specific and is of no value.

As for WEC's promises to retain at least 1,953 full-time equivalent ("FTE") employment positions "in the State of Illinois for two years after the Reorganization closes," this, too, offers little value to customers. The commitment, while based on assumed FTE numbers for each Gas Company and Integrys Business Support, is made in the aggregate, not by company. AG Ex. 1.0 at 8:164-166. Further, as Mr. Effron notes, there is no description of how this commitment breaks down between administrative support and front line operational employees. *Id.*

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<sup>28</sup> Order, Docket Nos. 14-0224/0225 (cons.), January 21, 2015; Second Amendatory Order, Docket Nos. 14-0224/0225 (cons.), February 11, 2015.

Moreover, in Direct testimony, Mr. Effron noted that in the recently completed PGL/NS rate case, Docket Nos. 14-0224/0225 (cons.), North Shore and Peoples Gas forecasted 178 and 1,356 FTEs, respectively, for the 2015 test year. *Id.* at 8:171-172. The JAs, in response to Mr. Effron's observation, asserted that these higher headcount numbers "represent the FTEs that will be needed to provide adequate, reliable, efficient, safe, and least-cost service in 2015 and 2016." JA Ex. 6.0 at 26:681-684. The JA added, however, that the 1,953 FTEs represent "a 'floor-level' of FTEs, below which the post-merger company, WEC Energy Group, will not allow its employment levels in Illinois to fall for a period of two years after the closing of the Transaction." *Id.* at 8-9:180-184.

In light of this information, Mr. Effron concluded that "[i]f, as claimed in the rate cases, the Gas Companies really expect to have 178 FTEs for North Shore and 1,356 FTEs for Peoples Gas in 2015, then the Joint Applicants' employee complement commitment in this case has little, if any substantive value, as there is little or no chance that the 'floor-levels' will ever be a factor in the Gas Companies' actual employee headcounts." *Id.* at 9:189-193. He noted that if the commitment to maintain designated employee headcounts is to have any value to customers and the Illinois communities the Gas Companies serve, "then further conditions must attach to this commitment." AG Ex. 3.0 at 3:56-65.

Thus, in order to provide any value to the WEC employee number commitment, Mr. Effron recommended that the Commission condition merger approval on the proper crediting to ratepayers of any savings due to the difference between the headcounts for the Test Year reflected in the revenue requirements presented by the Gas Companies in Docket Nos. 14-0224/14-0225 (cons.) and the Joint Applicants' employee headcount commitment in the present case. One option recommended by Mr. Effron would be to credit to customers the savings

associated with a decreased employee complement post-merger, as compared to the FTE numbers PGL and NS forecasted in the rate case – a number that is reflected in current customer rates. Mr. Effron proposed that the differential in expense associated with these conflicting numbers be returned to PGL/NS customers by means of a rider that would commence at the closing of the Transaction and would continue until the rates in the Gas Companies' next base rate case go into effect. AG Ex. 1.0 at 20:437-444. The rider would be no different than any other merger commitment; it would exist because the JA had agreed to implement it to ensure that customers were not financially harmed by the merger, consistent with Section 7-204(b)(1) and (7) of the Act.

As AG witness Effron noted, the Joint Applicants' characterization of the minimum employee headcount commitment as a benefit to customers in the present case is inconsistent with the test-year employee headcounts presented by the Gas Companies in the rate cases as being necessary to provide safe and reliable service. Mr. Effron's rider credit proposal is an effort to give some substance to the Joint Applicants' minimum employee headcount commitment, on a *forward looking* basis. While the Joint Applicants and Staff complained that the ratemaking prohibition against single-issue ratemaking is triggered by the proposal, it is in fact an effort to resolve the inconsistency that PGL and NS created by forecasting higher FTE numbers in the rate case (thereby maximizing revenues) and the JA's commitment in this docket to a lower combined FTE number post-merger – a number that the JA admit is lower than the FTE amount that “will be needed to provide adequate, reliable, efficient, safe, and least-cost service in 2015 and 2016.” JA Ex. 6.0 at 26:681-684. Importantly, it demonstrates that this JA commitment neither ensures the maintenance of existing service quality nor least cost rates. The bottom line is that if we are to believe Mr. Leverett's claim that the higher rate case forecasted

FTE numbers are needed “to provide adequate, reliable, efficient, safe, and least-cost service in 2015 and 2016,” then the JA’s commitment to retain a lower number as the FTE “floor” is of no benefit to customers, and potentially evidence of a planned degradation of service quality. AG Ex. 3.0 at 4:76-87.

As discussed later in this brief, Mr. Effron’s proposal (or a modification of that proposal that captures this revenue difference) should be adopted as a condition of any Commission merger approval, pursuant to Section 7-204(f).

5. The JA proposed no service quality improvements.

WEC appears to have made no investigation or attempt to remedy service quality issues at the Gas Companies. In fact, problems with PGL field work, customer interaction and prompt establishment of natural gas delivery service were documented as recently as PGL’s last rate case, ICC Docket Nos. 14-0224/0225 (cons.). See AG Ex. 5.0, AG Ex. 6.0, *gen’ly*. This disinterest in service quality issues as a proposed merger benefit is unrebutted, as revealed in cross-examination of JA witness Leverett:

**REQUEST NO. 2.29:** Are the Joint Applicants proposing any specific, enforceable quality of service improvements as a part of the reorganization?

**RESPONSE:** At this time, the Joint Applicants have not proposed any quality of service improvements as a part of the proposed Reorganization.

CUB Cross Ex. 1. This evidence speaks for itself. The merger will not result in any utility service benefits for PGL/NS customers.

6. The JA's commitment to implement the Liberty final report audit recommendations is heavily conditioned and omits any reference to implementation of Liberty Interim Report recommendations.

The fact that the JA have no transition plan for assuming ownership of Peoples Gas and oversight of the very troubled AMRP is made worse by the fact that the Joint Applicants' commitment to implement the Liberty audit report recommendations is limited to the *final* report – not the Interim Report as well. On cross-examination, JA witness Giesler (the Integrys employee with management responsibilities over significant portions of the AMRP) testified that there is a process that is developing plans to implement a “series of changes” that the senior management of Peoples Gas and Integrys and the Liberty auditors agree need to be implemented before the beginning of the next construction season. Tr. at 273. But the JA have not committed to continuing those ongoing, curative activities. Tr. at 148, 200-201.

Even the JA's commitment to implement the final audit recommendations is a heavily conditioned one. As AG witness Coppola noted, the Supplemental Rebuttal Testimony filed by both WEC witnesses Leverett and Hesselbach does not make a convincing case that the Joint Applicants have fully embraced the recommendations contained in the Interim Report. AG Ex. 6.0 at 2-3:29-46. Conspicuously absent from the Joint Applicants' evidentiary presentation was any testimony from the companies now operating and in charge of the AMRP – Peoples Gas and its parent company, Integrys. The absence of any testimony by Integrys and Peoples Gas addressing (i) the findings and recommendations contained in the Interim Report, and (ii) how they would ensure that their new corporate parent continues any progress made to date, leaves a significant void in this evidentiary record. This lack of commitment to ensure a smooth transition between now and the time that WEC receives a Commission decision or closes on the

Reorganization will likely have a detrimental impact on the operation, safety, and rates of Peoples Gas. AG Ex. 6.0 at 5-6:96-100.

Thus, the JA's conditioned commitment to implement only the Liberty *final* audit recommendations does not ensure that the reorganization will not diminish safety, reliability and the cost of utility service. 220 ILCS 5/7-204(b)(1), (7). In fact, WEC's commitment to implement final Liberty audit recommendations are already required for Peoples Gas under the Commission's 2012 Rate Case Order. The Commission's order made clear that Peoples Gas would be required to implement audit recommendations without condition. The Commission stated:

For reasons detailed in Staff witness Buxton's rebuttal testimony (Staff Ex. 20.0 at 23-24) and immediately above, this Commission adopts Staff's proposed two-phase investigation of the AMRP under Section 8-102 of the Act (220 ILCS 5/8-102) ending in a public document report. This Order directs Staff to conduct the tasks outlined on pages 3-8 of Staff Ex. 20.0 and directs Peoples to comply with the same.

ICC Docket Nos. 12-0511/0512 (cons.), Order of June 18, 2013 at 61. Mr. Buxton's testimony required the following of PGL:

The Commission's consulting contract should include two phases. Phase I will be the investigation. *Phase II will be a two-year verification period following the Phase I investigation and the engineering consultant who performs the investigation should work during this Phase II two-year period to verify that Peoples has implemented the recommendations from the Phase I investigation.*

ICC Docket Nos. 12-0511/0512 (cons.) at 61, citing Staff Ex. 20.0 at 3-4 (emphasis added).

Thus, PGL is already required, per Commission order, to implement audit recommendations – and not in any kind of conditioned format, as the JA's commitment numbers 9 through 11 are, as discussed above.

7. Other WEC commitments are already required of PGL pursuant to law and/or Commission order.

The JA have committed to establish a new training center within the City of Chicago, the extension of funding of technical training for future gas utility workers at Chicago's City Colleges (JA Ex. 15.1 REV, nos. 37 and 38), and to contribute \$5 million over five years to the Gas Companies' Share the Warmth Fund. While the People appreciate these commitments, the promises are insufficient in light of the risks of rate shock associated with the JA's rudderless assumption of the AMRP. WEC's other proposed merger commitments offer little or no tangible value and amount to no more than what the Gas Companies are already required to do under Commission order or statute.

In addition, filing requirements for both the JA-proposed AMRP activity and other merger-related monitoring and ratemaking activities represent standard, boiler-plate filing requirements that are necessary but unremarkable in scope. *See, e.g.*, JA Ex. 15.1 REV, commitment nos. 3, 4, 6, 7, 8, 9-13, 16, 17-25. These commitments represent business-as-usual activity that is either already happening under Integrys's leadership or is standard practice when acquisitions are approved by the Commission.

In sum, other than technical employee training funding and the Share the Warmth contributions, the JA commitments promise little, if any tangible benefits for PGL and NS customers. This was perhaps best signified in the JA's Direct testimony presentation that promised that "[c]ustomers will continue to receive high-quality, adequate, safe, and reliable gas service just as they did before the Reorganization, and...at the same cost as they would have absent the Reorganization," notwithstanding the barrage of rate increases PGL customers have experienced since 2008, along with the well-documented mismanagement of the AMRP. JA Ex.

1.0 at 16:350-353. Coupled with their failure to create a transition plan for the AMRP and blind commitment to its troubled trajectory, the Joint Applicants' "commitments" will result in a deterioration of service and rate shock, as noted earlier in this Brief, and do not protect the public interest.

**B. The AG-Proposed Conditions Will Help Ensure Protection of the Public Interest, Consistent with Section 7-204(f) of the Act.**

As noted in the Introduction of this Brief, the Commission must ensure that the interests of the Gas Companies' customers are protected. Section 7-204(f) of the Act permits the Commission to condition any merger approval to ensure that approval of the merger would not result in increased rates and diminished safety and reliability in Peoples Gas utility service. 220 ILCS 5/7-204(f).

1. The Joint Applicants should be required to commit to reassessing the completion timeline of the AMRP.

As discussed in part II.B of this Brief, the Commission must not blindly adopt the Joint Applicant's commitment to complete the AMRP by 2030 – a date that the record and this Brief make clear has no validity in terms of safety assessment or law. To do so would lead to rate shock and not ensure the safety and reliability of the PGL delivery system.

As the testimony of AG witness Coppola and City witness Cheaks testified, Peoples Gas has been unable to maintain a pace that would allow them to complete the AMRP by 2030. That fact is unrebutted. Even the Company's current pace has resulted in huge cost overruns and unrelenting rate increases since the AMRP was approved in 2010. Mr. Coppola's assessment of the rate impacts of blindly attempting to maintain an arbitrary 2030 completion date (discussed in part II.B and C above) makes clear that the Commission must require the Joint Applicants to

commit to improving the current operation of the AMRP by reassessing the scale and timeline of the program to a manageable level. In addition, the Joint Applicants must be required to commit to implementing *all* findings – both Interim and Final – of the Commission-ordered Liberty audit now being conducted. With that in mind, any approval of the merger should be conditioned on the JAs committing to the following AMRP improvements:

- i. Peoples Gas shall perform a thorough evaluation of the AMRP and scale the program to a level of cast iron/ductile iron replacement and related infrastructure upgrades that is manageable, targets high priority, high risk segments first, cost-effective, and minimizes the impact on customer rates.
- ii. Peoples Gas shall commit to a transparent process of providing annual reports to the Commission, reconciling its actual vs. forecasted AMRP investments, and provide an accounting of financial and non-financial benefits realized from the AMRP to date.
- iii. Peoples Gas will present to the Commission an annual, detailed, work plan for the remainder of the AMRP program that shows: (1) the planned infrastructure replacement segments for the upcoming 12-month period and their related cost; (2) the Main Ranking Index (“MRI”) of each planned targeted segment; (3) a list of the mains and other infrastructure that are still in need of replacement, along with their respective MRI ranking and projected cost to complete; (4) the total projected annual cost to complete the program and quantity of mains, services, meters and other infrastructure to be replaced and installed. (5) an explanation and detailed corrective action/implementation plan for improved coordination with the City of Chicago permit and public works activities; and (6) a detailed corrective action plan and status report for implementation of the approved final recommendations from the pending outside audit.
- iv. Peoples Gas shall credit customers for all construction fines and penalties paid from the beginning of 2011 to date to the City of Chicago, plus any fines and penalties incurred through the close of the merger, that were recovered in base

rates or infrastructure riders. The credits could be flowed through PGL's Rider QIP during a single month or alternatively contributed by PGL to its "Share the Warmth" fund.

- v. Going forward, Peoples Gas shareholders should bear the costs of any such City of Chicago fines and penalties associated with AMRP and other construction activity.
- vi. The Joint Applicants shall commit unconditionally to implement all audit recommendations of *both* the Interim and Final Liberty audit reports.
- vii. The Joint Applicants shall commit to fully cooperating with the Commission's investigation into allegations of misconduct and improprieties in the PGL AMRP (ICC Docket No. 15-0142), and implementing any corrective actions, including customer refunds of AMRP costs deemed imprudent by the Commission, as ordered by the Commission in that and any other docket related to review of the AMRP and PGL's Rider QIP. (AG Ex. 3.0 at 6.0 at 2-3:37-46.)
- viii. The Joint Applicants shall commit to City of Chicago witness Cheaks' proposed conditions that are designed to revamp PGL's coordination with CDOT. They include:
  - Requiring a weekly, block-by-block schedule of construction activities be given to CDOT and the ICC, provided on a five-year, annual, and monthly basis.
  - Requiring that any Field Order Authorizations or Change Orders be communicated within 24 hours to CDOT.
  - Requiring the newly formed entity to actively participate in CDOT's dotMaps website in order to better collaborate with all occupants of the Public Way.
  - Requiring that PGL improve their performance in the following categories, with financial penalties for failure to improve that cannot be recovered from PGL's ratepayers:
    - Permitted timeframe adherence (being on schedule more often)
    - Approved capital and O&M spend adherence (being on budget more often)
    - Change order spending and communication
    - Management reserve spending and budgeting
    - Time needed to close Field Order Authorizations and Change Orders

- Contractor “Hits” on City facilities (City/CUB Ex. 3.0 at 4-5.)

These conditions will help to ensure both the safety and reliability of the Peoples Gas distribution network and that the impact of the AMRP on future customer rates will be minimized, thereby ensuring least cost utility service in accordance with Sections 7-204(b)(1) and (b)(7).

2. The Joint Applicants should be ordered to freeze rates for five years.

Particularly in light of the Gas Company’s revenue stabilizing mechanisms, the JAs should be required to adopt a five-year rate freeze as a condition of the merger. As observed by City of Chicago/CUB witness Michael Gorman, Section 9-220.3 of the Act authorizes some Illinois gas utilities, including PGL, to file a tariff for a surcharge that adjusts rates and charges to provide for recovery of costs associated with QIP investments. City/CUB Ex. 4.0 at 3:73-76. PGL currently uses this rate mechanism to earn a return of and on its investment in the AMRP throughout the year and between rate case filings. The qualifying QIP capital investment is more than 70% of the total capital investments Integrys management plans over the next five years. JA Ex. 1.0 at 18. The QIP surcharge, approved on January 7, 2014, in ICC Docket No. 13-0534, allows PGL to recover a return of and on investments for: (1) the costs to install facilities to retire cost iron/ductile iron gas distribution facilities; (2) gas meter relocation costs to move meters from inside customers’ premises to outside; (3) the cost of upgrading the gas distribution system from a low pressure system to a medium pressure system, including installation of high-pressure facilities to support the upgrade; (4) the cost to replace high-pressure transmission pipelines identified as at higher risk of failure; and (5) the cost to install regulator stations to establish over-pressure protection. City/CUB Ex. 4.0 at 24:87-95.

City/CUB witness Gorman notes that this rider mechanism is a significant revenue stability mechanism for the Gas Companies that was of particular interest to WEC investors. WEC noted in a November 2014 investor presentation that the Rider QIP surcharge will provide “Immediate earnings as infrastructure investments are made (return on and of capital costs).” *Id.* at 4:104-105. PGL’s QIP rider mechanism for assured recovery of and on PGL’s increasing rate base (due to AMRP) is a major element of the utility’s premium value to the acquiring firm, WEC. *Id.*

Mr. Gorman noted that in a report on Integrys, *Value Line* stated that the existence of new regulatory mechanisms in Illinois will allow PGL to support earnings growth without filing rate increases, even as it pursues its large AMRP capital program. He noted, too, that Rider QIP was not available during the acquisition of Nicor Gas by AGL. Thus, this rider increases PGL’s revenue stability as compared to that of Nicor, and yet, as noted above, AGL agreed to freeze Nicor rates for three-years post-merger as a condition of its reorganization approval. Mr. Gorman further noted the fact that in its November 2014 presentation to investors, Integrys highlighted several innovative ratemaking mechanisms that reduce its risks, including Rider QIP, the Gas Companies’ uncollectibles rider, storage service rider, implementation of a permanent decoupling mechanism in 2012, and the existence of a rider to recover manufactured gas plant site cleaning cost. *Id.* at 5:124-129. Mr. Gorman noted that while these revenue stability mechanisms significantly reduce the JA’s revenue-recovery risk, and increase the market value of Integrys and the Gas Companies, they result in increased rate instability for customers.

Like AG witness Effron, Mr. Gorman was unimpressed with the JA’s offer of a two-year rate freeze as a merger commitment. *Id.* at 8:179-182. He recommended, and the AG supports, implementation of a five-year rate freeze should the merger be approved. There is substantial

evidence in the record that this commitment is justified given the Gas Companies' revenue stability mechanisms and the investor community's acknowledgement and recognition of the revenue recovery mechanisms. In addition, since the initiation of this docket, the Illinois Supreme Court affirmed the Commission's approval of the permanent decoupling mechanism, thereby settling any uncertainty associated with the fate of the decoupling rider and its ability to reduce revenue recovery risk for the Gas Companies. *People of the State of Illinois ex rel. Lisa Madigan vs. Illinois Commerce Commission*, 2015 IL 116005, January 23, 2015 (the "Supreme Court Decoupling Opinion"). Without protective actions by the Commission, Mr. Gorman testified, that added value could flow to the acquiring company's shareholders, rather than enhancing the utilities' ability to provide safe, reliable infrastructure and adequate, least-cost service. He concluded that with all these riders in effect, the Joint Applicants should be able to defer an increase in base rates for a longer time period, particularly given that he projects more than 70% of PGL's planned capital expenditures will be subject to recovery through Rider QIP, and that the existence of the rider should help provide sufficient funding for PGL and NS to make qualifying capital investments during the base rate freeze period. Mr. Gorman concluded that "a longer term base rate freeze period will provide customers some assurance of benefits from the reorganization." *Id.* at 10:230-232.

In addition, Mr. Gorman noted that a financial integrity provision to the rate freeze commitment is not necessary, but if included, should clarify that any rate freeze waiver for financial integrity needs must meet a high standard, and should be based on the necessity of an increase in rates, such as being necessary to maintain an investment grade bond rating outlook, and not on a "mere expectation that PGL and NS earnings may be reduced." *Id.* at City/CUB Ex. 4.0 at 10:242-243.

In sum, the Commission should adopt Mr. Gorman's five-year rate freeze commitment recommendation as a condition of merger approval.

3. The JA should be required to cap residential revenue recovery through fixed charges to 40%.

It is no secret that in addition to experiencing the financial pains of five PGL/NS rate increases over the last seven years, the Gas Companies' customers have seen their fixed monthly customer charges grow to 63% of the bill for PGL customers and 73% for NS customers. Peoples Gas and North Shore Gas customers now pay the highest fixed monthly customer charges and overall rates in Illinois, with customer charges at \$30.84 and \$23.94 for Peoples Gas and North Shore heating customers, and \$16.37 and \$15.70 for Peoples and North Shore non-heating customers, respectively.<sup>29</sup>

Including a merger condition that lowers the customer charge portion of the bill such that no more than 40% of revenues is collected through the residential heating class customer charge is in the public interest and fully justified if customers are to see value from the reorganization beyond any rate freeze commitment. Adding the customer charge cap to the merger condition list is particularly appropriate in view of facts arising since the filing of testimony in this case and the Commission's January 21, 2015 rate case Order in Docket Nos. 14-0224/0225 (cons.): specifically, the January 23, 2015 Supreme Court Decoupling Opinion, which affirmed the Commission's approval of Rider VBA (Volume Balancing Adjustment)<sup>30</sup>. Since the Supreme

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<sup>29</sup> <http://www.peoplesgasdelivery.com/company/tariffs/sc1.pdf>,  
<http://www.northshoregasdelivery.com/company/tariffs/sc1.pdf> (last accessed March 27, 2015).

<sup>30</sup> Rider VBA uncouples the Companies' revenues from their sales such that utilities that have "decoupling" riders have recovery of the full amount of their Commission-approved revenue requirement guaranteed, through an annual reconciliation process that accounts for under-recovery or over-recovery of approved revenues and authorizes customer bill surcharges or credits, respectively. The Commission first approved a pilot for Rider VBA in its 2007 rate case proceeding, Docket Nos. 07-0241/07-0242 (cons.). After the four-year pilot ended, the Commission

Court's decision now guarantees that Peoples Gas and North Shore Gas will continue to recover their entire Commission-approved revenue requirement each year, the Commission should add the customer charge reduction commitment to the list of merger conditions in light of the increased value this reduction in shareholder risk brings to WEC.

The Supreme Court's decision just two days after entry of the Commission's Final Order in Docket Nos. 14-0224/0225 (cons.) provides added value to WEC shareholders because it effectively settled any uncertainty as to whether the Gas Companies would be permitted to retain their decoupling riders going forward. A WEC commitment to lower the customer charge to a level that caps recovery of revenues through the fixed charge portion of monthly customer bills would acknowledge this reduction in risk and provide a tangible value to PGL/NS customers. Doing so, too, would provide Peoples Gas and North Shore customers more control over their natural gas bills, enabling the General Assembly's public policy goal of reducing the usage of natural gas and achieving least cost utility service, consistent with Sections 8-104 and 1-102 of the Act. In addition to providing some tangible benefit to the Gas Companies' customers, lower customer charges minimize cross-subsidies of high users by low users of natural gas, and serves the General Assembly's and the Commission's goal of encouraging energy efficiency by giving customers more control over their bills

In view of these new facts and circumstances regarding Rider VBA and the revenue protections it now offers the Joint Applicants on a permanent basis, and in light of the fact that ratepayers have seen their monthly customer charges rise by almost 200% (Peoples) and 179% (North Shore) since the inception of Rider VBA, the Commission should condition merger

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approved Rider VBA on a permanent basis in its January 10, 2012 decision in Docket Nos. 11-0280/11-0281 (cons.).

approval on a (revenue-neutral) lowering of the customer charge that would provide additional, tangible value to the Gas Companies' customers outside of any rate freeze condition, and is consistent with the public interest.

4. Any merger approval should include a dividend ring-fencing provision.

City/CUB witness Gorman testified that after any Commission-approved Integrys/Gas Companies acquisition, WEC still will need to draw sufficient cash from its subsidiaries (including PGL/NS) to pay dividends to WEC public shareholders, and to pay its debt. City/CUB Ex. 4.0 at 14:333-336. In response to City Data Request 6.01, the Joint Applicants provided the financial forecast that it also provided to credit rating agencies, which was used to assess the credit metric impact on the Joint Applicant utility companies and WEC after the merger. *Id.* at 14:340-343. In that forecast, Mr. Gorman testified, the consolidated operations are projected to produce enough cash flow to support the additional \$1.5 billion of acquisition-related debt. However, if WEC requires its utilities to pay higher dividends, "the cash flow available to utilities for making system modernization will be reduced, and that could either delay replacement of aging infrastructure, or require the utilities to rely more on external debt." *Id.* at 15:348-351. A need for more external debt could increase the financial leverage of the utilities, erode their credit standing, and harm the utilities' ratepayers, either through diminished service or higher costs of service in rates, Mr. Gorman testified. *Id.* at 15:348-359.

In order to evaluate the likelihood of increased demands on the Gas Companies to pay dividends to WEC, Mr. Gorman conducted an assessment of whether or not the projected level of dividend payments from utility companies up to WEC is able to support both public dividend payments and the acquisition debt service. He performed this analysis by comparing the

forecasted level of utility dividend payments up to WEC, with the amount of cash WEC needs to pay its public dividends and to service the \$1.5 billion of acquisition-related debt, as outlined in confidential City/CUB Exhibit 4.1. He concluded that “WEC’s planned public dividend payments from utility subsidiaries up to WEC may not be adequate both to pay the forecasted public dividend payments and to service the acquisition debt based on the 15-year amortization schedule” and that “the proposed Transaction will create some incentive for WEC to maximize the cash withdrawal from its utility subsidiaries in order to service the significant increase in debt at the parent company level, and to pay its public dividends.” *Id.* at 16: 381-384. Mr. Gorman noted that “[d]ividend payments to WEC from a utility will reduce the amount of internal funds that remain in the utility and that are available to fund utility infrastructure investments. As such, if WEC requires the utility to increase the amount of dividend payments up to WEC so it can service its own public dividends and acquisition-related debt, then the amount of internal cash available to the utilities to support their own capital investment programs will be reduced.” *Id.* at 16-17:390-395.

Mr. Gorman testified that “the amount of dividends utilities would be expected to pay up to WEC to enable the parent to meet its public dividend payments, and its other financial obligations is a factor the Commission must consider in determining whether the reorganization can be or should be approved.” *Id.* at 17:400-404. Importantly, Mr. Gorman testified that WEC’s own projections suggest an increase in the percentage of utility earnings paid out as dividends to WEC over the forecast period, compared to before the merger. *Id.* at 17:408-409. In total, WEC’s projections show that utility subsidiaries pay out 89% of utility earnings up to WEC as dividend payments and that, aside from the ratepayer funds collected through PGL’s

infrastructure rider QIP, only a reduced fraction of PGL's retained earnings or new debt (with consequences noted earlier) will be available to support PGL's AMRP. *Id.*

Mr. Gorman further noted that Standard & Poor's, Moody's and Fitch have all noted the increased financial obligation being taken on by WEC as a result of the acquisition, and recognize "that WEC's only source of cash will be its utility subsidiaries." *Id.* at 18:432.

Importantly, because the Wisconsin utility subsidiaries have regulatory insulation that limits the amount of dividends that the utilities can pay to WEC in order to satisfy this acquisition debt obligation, Mr. Gorman testified that the Wisconsin PUC's ratepayer protections and service quality in that state "will undoubtedly result in pressure to increase the amount of cash withdrawn from non-Wisconsin utilities as a result of the acquisition." *Id.* at 18: 436-438.

Indeed, the Supplemental Direct testimony of JA witness Scott Lauber indicated that WEC's debt will increase from \$817 million at year-end 2013, up to \$2.3 billion by year-end 2015. JA Ex. 5.0 at 6:107-114. He states that this level of debt will increase from 15.6% of consolidated debt at year-end 2013 up to 20.8% of consolidated debt by year-end 2015, and that the amount of acquisition debt included at the parent company level will result in parent company debt equal to approximately 31.3% of total consolidated company debt at year-end 2015. *Id.* at 6-7:120-135. Mr. Gorman noted that "[b]y any reasonable measure, the proposed financing structure will significantly increase the amount of debt at the parent company level," thereby increasing dependence on cash flows from the utilities. *Id.* at 20-21:494-496. Mr. Gorman concluded that "there is a near-certainty that this planned level of parent company debt will increase the utility companies' dividend payment obligations (as the Joint Applicants themselves forecast)" and potentially restrict the amount of internal cash flow available to the utility companies to support utility capital investments. *Id.* at 21:500-504.

While the Joint Applicants reject the need for any “ring-fence” protections to ensure that the Gas Companies are able to fund their planned capital improvements before sending money up to the corporate parent for shareholder dividend payments, City/CUB witness Gorman viewed them as essential. The People agree and support this as a necessary condition to merger approval to protect the interests of both of the Gas Companies, particularly PGL, given its AMRP commitment in the City of Chicago.

5. AG witness Effron’s proposal to reflect the Joint Applicants’ most recent forecast of Integrys Customer Experience project savings in rates should be included among merger conditions.

Merger approval should also be conditioned on the JA’s agreement to provide an additional rate benefit to PGL/NS customers based on new information in the record in this docket that demonstrates that the Gas Companies will be experiencing significant savings post-merger related to ratepayer financing of the Integrys Customer Experience (“ICE”) project.<sup>31</sup>

However, the Gas Companies have taken contradictory positions in the 2014 rate case and this proceeding as to whether savings associated with the ICE project will be realized sooner than forecasted in the rate case. In particular, the Gas Companies included \$9.2 million in expenses associated with the ICE project in their revenue requirements in Docket Nos. 14-0224/14-0225 (cons.); asserted that the ICE system would result in significant efficiencies that will produce cost reductions; and did not reflect savings associated with the project in the 2015

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<sup>31</sup> The ICE project will unify Cfirst, which is the customer information system that Peoples Gas [and North Shore] currently uses, and the various customer information systems currently in use across Integrys. It will provide significant benefits to Peoples Gas [and North Shore] and the other Integrys regulated utilities such as improved efficiency and productivity and standardization of internal delivery which will improve customer satisfaction. In addition to unifying systems, the ICE project will improve and enhance billing, collections, call center, and self-service related offerings by ensuring that these functions are staffed appropriately to continue to leverage the opportunities of a large corporation, while maintaining the high level of service of a local utility. AG Ex. 1.0 at 12:269-284 (citing Docket Nos. 14-0224/14-0225 (cons.), PGL Ex. 13.0, at 10:207-215 (bracketed text added)).

test year. But then, in discovery responses in this docket from the Joint Applicants, they provided updated information that showed ICE project [REDACTED]. AG Ex. 1.0 at 14-16:309-363. In fact, Mr. Effron testified, it is expected that ICE will produce a “net benefit (a credit to expense, i.e. pre-tax reduction in O&M),” which is “derived from forecasted system savings greater than [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] the Gas Companies’ position in the 14-0224/0225 rate case that ICE savings would not be achieved until 2016, with no reductions in the 2015 Test Year. *Id.* at 14:309-311. Response to AG Data Request PGL 11.08, Docket Nos. 14-0224/14-0225 (cons.), attached as AG Ex. 1.4. In other words, Mr. Effron testified, “based on the scenario presented by the Gas Companies in the rate cases, the in-service of the ICE project would be precisely timed so that a full year of costs (in excess of \$19 million) would be billed to the Gas Companies in the twelve-month period that just happened to coincide with the Test Year, while, conveniently, no savings whatsoever (savings that would fully offset those costs) would be experienced until one day after the end of the Test Year.” *Id.* at 14:312-318. He characterized this timeline assessment as “improbable in the extreme.” *Id.* at 14:317-318.

Mr. Effron provided actual documentary evidence that the timing of the ICE costs and savings presented in this merger proceeding differs from what the Gas Companies presented in the rate cases. He noted that in AG Data Request 2.13, the Joint Applicants were asked to explain what the statement on JA Ex. 4.1 CONFIDENTIAL, Page 4, that [REDACTED] [REDACTED] with regard to the ICE project means. The Joint Applicants responded that: “The ICE 2016 project estimated net benefits beginning in 2015. The initial O&M estimate in the forecast years was reduced by the estimated amount of net

benefit of the project. The net benefit (a credit to expense, i.e. pre-tax reduction in O&M) was derived from forecasted system savings greater than forecasted system costs.” *Id.* at 15:322-329.

AG Data Request 3.05 followed up on this response by requesting any studies and/or analyses supporting the statement that “credits indicate pre-tax reduction in O&M” with regard to the ICE project. The response to this request, attached as AG Ex. 1.5, includes an attached spreadsheet, JA AG 3.05 Attach 01CONFIDENTIAL, that was prepared in conjunction with the long-term financial forecast prepared in September 2012. This spreadsheet details the forecasted costs and benefits of the ICE project. It contains numerous inconsistencies with the version of the ICE costs and benefits presented by the Gas Companies in Docket Nos. 14-0224/14-0225 (cons.). *Id.* at 15:330-338.

The Joint Applicants asserted that the basic justification for these inconsistencies was “that the response to AG 3.05 was support for an item in Joint Applicants’ Ex. 4.1 and that data underlying Ex. 4.1 were from the long-term financial forecast. The rate case data in the Gas Companies’ Docket Nos. 14-0224/14-0225 (cons.) are to support a forecasted 2015 Test Year. The documents will necessarily be inconsistent because they were prepared at different points in time.” *Id.* at 17:366-372. But Mr. Effron noted that when the AG asked the Joint Applicants (in AG Data Request 3.06, attached as AG Ex. 1.7 to describe revisions, identify when the revisions took place, and quantify the effect of the revisions on the forecasted year-by-year costs and benefits of the ICE project, the Joint Applicants described one, and only one, change: “*Subsequent to the compilation of data underlying JA AG 3.05 Attach 01 CONFIDENTIAL, the estimated ICE implementation date for the Gas Companies has moved from the second to the third quarter of 2015.*” *Id.* at 17:382-385.

In response, Mr. Effron observed:

...if the estimated ICE implementation date for the Gas Companies was moved *back* from the second to the third quarter of 2015, it seems illogical that the billing for the ROA/depreciation on the ICE project would be moved *forward* from the beginning of 2016 to the beginning of 2015, as was assumed by the Gas Companies in the rate cases. And there is no way that moving the ICE implementation from the second to the third quarter of 2015 can even begin to explain the [REDACTED] discrepancy between the 2015 ICE O&M expense allocated to the Gas Companies in JA AG 3.05 Attach 01CONFIDENTIAL and the 2015 ICE O&M expense allocated to the Gas Companies in the rate cases.

*Id.* at 17-18:386-394. He noted that if the billings for the ICE ROA/depreciation and the “hard benefits” of the ICE project [REDACTED], as shown in JA AG 3.05 Attach 01CONFIDENTIAL, the effect on the Gas Companies’ revenue requirements would be that [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED].

Accordingly, the evidence in this case shows that if there is no adjustment to the ICE costs forecasted by the Gas Companies in those cases and the [REDACTED], as the Joint Applicants assert will occur, the Gas Companies will be recovering [REDACTED] when the ICE project goes into service.

*Id.* at 18-19:409-414. Those [REDACTED] would consist of \$10.6 million of O&M expenses associated with project readiness (which in JA AG 3.05 Attach 01CONFIDENTIAL are [REDACTED]) and \$8.6 million in ROA/depreciation that would [REDACTED]. In effect, during the term of the proposed rate freeze, the customers would be charged for all of the annual costs of the ICE

project, while [REDACTED]. *Id.* at 19:414-420.

Mr. Effron recommended that the Commission “should condition its approval of the Reorganization in the present case on the reduction to costs resulting from the in-service date of the ICE project (the cessation of the organizational readiness expenses and the ‘hard benefits’ in the form of other cost reductions) being properly credited to customers by means of a rider that would commence at the closing of the Transaction and would continue until the rates in the Gas Companies’ next base rate case go into effect.” AG Ex. 1.0 at 20:451-457.

In response to this proposal, JA witness Schott argued that by relying on information the Joint Applicants provided in JA Ex. 4.1 and in their data request responses related to the ICE project, AG witness Effron was “trying to use older information to call into question updated information.” JA Ex. 9.0, at 22:476-480. That criticism is simply untrue. The so-called “older information” that Mr. Effron relied on is the data contained in the response to JA AG 3.05 Attach 01 CONFIDENTIAL (AG Ex. 1.5 Confidential). When asked to identify the differences between the “older information” and the “updated information”, the Joint Applicants described one, and only one, change to what Mr. Schott characterizes as “older information.” Specifically, the Joint Applicants stated that: “Subsequent to the compilation of data underlying JA AG 3.05 Attach 01 CONFIDENTIAL, the estimated ICE implementation date for the Gas Companies has moved from the second to the third quarter of 2015.” *See* AG Ex. 1.7 (attached to Effron Direct).

The bottom line is that the delay in the estimated ICE implementation date by one quarter cannot possibly explain why the billing for the return on assets/depreciation on the ICE project would be [REDACTED], as was assumed by the Gas Companies in the rate cases. Nor can the change in the implementation date possibly

explain the other significant discrepancies in the treatment of ICE costs and benefits in the Gas Companies' rate cases, as described in Mr. Effron's Direct testimony.

Unless the Commission adopts Mr. Effron's proposed condition, PGL/NS customers will be paying \$19.2 million per year for ICE costs for as long as the rates established in those cases are in effect, without getting the benefit of any of [REDACTED]. The Joint Applicants have stated that they are "prepared to provide immediate benefits to customers and the Illinois communities the Gas Companies serve by making commitments that it would accept as conditions on the Commission's approval of the Reorganization." JA Ex. 1.0, at 15:331-334. Adoption of a mechanism that properly credits customers for the ICE savings is a reasonable condition for approval of the merger.

6. AG witness Effron's proposal to reflect the difference between employee numbers projections currently reflected in PGL/NS rate and the JA's "floor" employee number commitment should be adopted as a merger condition.

As noted in part IV.A.4 above, in order to provide any value to the WEC employee number commitment, Mr. Effron recommended that the Commission condition merger approval on any savings due to the difference between the headcounts for the Test Year reflected in the revenue requirements presented by the Gas Companies in Docket Nos. 14-0224/14-0225 (cons.) and the Joint Applicants' employee headcount commitment in the present case being properly credited to customers. One option recommended by Mr. Effron would be to credit to customers the savings associated with a decreased employee complement post-merger, as compared to the FTE numbers PGL and NS forecasted in the rate case – a number that is reflected in current customer rates. Mr. Effron proposed that the differential in expense associated with these conflicting numbers be returned to PGL/NS customers by means of a rider that would commence

at the closing of the Transaction and would continue until the rates in the Gas Companies' next base rate case go into effect. AG Ex. 1.0 at 20:437-444. The rider would be no different than any other merger commitment; it would exist because the JA had agreed to implement it to ensure that customers were not financially harmed by the merger, consistent with Sections 7-204(b)(1) and (7) of the Act.

As noted above, the Joint Applicants' characterization of the minimum employee headcount commitment as a benefit to customers in the present case is inconsistent with the test-year employee headcounts presented by the Gas Companies in the rate cases as being necessary to provide safe and reliable service. Mr. Effron's rider credit proposal is an effort to give some substance to the Joint Applicants' minimum employee headcount commitment, on a *forward looking* basis. The proposal would ensure the public interest by resolving the inconsistency that PGL and NS created by forecasting higher FTE numbers in the rate case (thereby maximizing revenues) and the JA's commitment in this docket to a lower combined FTE number post-merger – a number that the JA admit is lower than the FTE amount that “will be needed to provide adequate, reliable, efficient, safe, and least-cost service in 2015 and 2016.” JA Ex. 6.0 at 26:681-684. It should be adopted by the Commission as a condition of the merger.

7. The Commission should condition the merger on exclusion of all transaction costs, including any severance packages.

While the Joint Applicants state that they will not seek recovery of costs incurred to accomplish the reorganization, including transaction, change in control, financing and “legal/other professional” costs<sup>32</sup>, City/CUB witness Gorman notes that it is not clear whether all costs associated with the reorganization transaction will not be recovered from ratepayers. He

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<sup>32</sup> JA Ex. 2.0REV at 11:236-243.

recommended that the Commission condition any merger approval by specifically prohibiting recovery in rates of any executive, Board of Director or senior employee severance costs or early termination fees, i.e. severance packages. City/CUB Ex. 4.0 at 11:255-262. To be clear, Mr. Gorman explained costs incurred in order to produce savings should be permitted in rate recovery up to the level of savings created. City/CUB Ex. 8.0 (Gorman Rebuttal) at 5:94-96. He noted that if transition costs are included in a future rate case test year, then the Joint Applicants have the burden of proving that there are savings within the test year and over the life of the project that fully offset the level of transition costs. *Id.* at 6:113-116.

This condition should be attached to any Commission merger approval as well.

\* \* \* \* \*

In sum, all of the conditions described in part IV.B above are necessary to ensure the safety and reliability of the Gas Companies' utility network and the protection of PGL/NS ratepayers from adverse rate impacts associated with adoption of the proposed reorganization, and are consistent with the Commission's obligation to ensure protection of the public interest, consistent with Section 7-204(f) of the Act. They are listed in Appendix C. They should be adopted by the Commission if it decides to approve the proposed transaction.

## V. CONCLUSION

Wherefore, the People of the State of Illinois urge the Commission to reject the proposed transaction. If, however the Commission approves the merger, it should adopt the conditions included in Appendix C. In addition, the People reserve the right to modify their proposed conditions based on a review of conditions proposed by other parties in their respective Initial Briefs.

Respectfully submitted,

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