

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

**REPLY BRIEF
OF
THE PEOPLE OF THE STATE OF ILLINOIS**

The People of the State of Illinois

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. ARGUMENT..... 6

 A. Section 7-204 Requires the Commission to Impose Conditions on a Merger When Necessary to Protect Customers..... 6

 B. Having Failed to Conduct Adequate Due Diligence, the JA Have Not Proven That the Merger Will Not Diminish the Utility’s Ability “to Provide Adequate, Reliable, Efficient, Safe, and 10

 C. The JA’s Failure to Have a Transition Plan for the AMRP in Place Casts Doubt on the Merger’s Compliance with Section 7-204(b)(1) of the Act, Especially in Light of the Commission’s March 11, 2015 Data Requests..... 15

 1. The Joint Applicants Admit that They Have Not Developed a Transition Plan for the Troubled AMRP..... 15

 2. The Commission Found in the 2011 Nicor Merger Case that AGL/Nicor’s Extensive “Integration Planning Process” Was Integral to the Commission’s Conclusion that the Joint Applicants in That Case Satisfied the Obligations of Section 7-204(b)(1). 20

 3. The Joint Applicants’ Lack of a Transition Plan for Assuming Control of the Troubled Main Replacement Program is Especially Concerning Given the Tremendous Cost of the Program..... 22

 4. The Joint Applicants’ Explanation for not Developing a Transition for the AMRP Cannot Be Sustained..... 23

 D. The JA’s and Staff’s Claims that the Proposed Transaction Satisfies Section 7-204(b)(7) Do Not Account for the Adverse Rate Impacts for Peoples Gas’s Customers Caused by the Joint Applicants’ Failure to Meaningfully Prepare to Assume Control of the Problem-Plagued AMRP..... 26

 E. The Merger Conditions Proposed By Staff and the Joint Applicants Are Insufficient To Protect the Public Interest and Would Not Satisfy the Section 7-204(b)(1) and (b)(7) Requirements 28

 1. Requiring a 2030 AMRP Completion Date Will Not Ensure Safety and Will Lead to Rate Shock..... 29

 2. Staff’s concurrence with the JA-proposed process for implementing Liberty Audit recommendations actually weakens existing Peoples Gas Liberty Audit obligations, and accordingly does not protect the public interest..... 36

 F. AG witness Coppola’s and City Witness Cheaks’ Proposed AMRP Conditions *Would* Protect the Public Interest..... 39

G. The Joint Applicants’ Opposition to the AG/City/CUB Proposed AMRP Conditions Is Based On Faulty Legal and Factual Analysis, And Should Be Rejected.....	44
1. The JA’s flawed interpretation of Section 7-204(f) would render nearly any condition irrelevant.....	45
2. Mr. Coppola’s proposed reporting requirements are not duplicative or redundant of existing PGL filings.....	47
3. The JA’s criticism of Mr. Coppola’s proposed disallowance of excessive street degradation fees should be rejected.....	48
H. The AG-Proposed Conditions Related to Employee Numbers and Overstated ICE Expenses Are Designed to Diminish the Merger’s Impact on Customer Service and Rates.	50
1. AG Witness Effron’s condition tied to ensuring reliable utility service consistent with the most recent employee number information forecasted in the 2014 PGL/NS rate case should be adopted.....	50
2. AG Witness Effron’s condition tied to ensuring that ICE-related expenses are properly reflected in Gas Company customer rates should be adopted.	52
I. The City/CUB Five-Year Rate Freeze Proposal and the AG-Proposed Revenue Neutral Customer Charge Reduction Proposal Should Be Adopted As Conditions of Any Merger Approval.	55
III. CONCLUSION	58

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The People of the State of Illinois, 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 Reply Brief in the above-captioned proceeding.

I. INTRODUCTION

In their Initial Brief (“IB”), the Joint Applicants (“JA”) present a legal analysis that asks this Commission to ignore that portion of Section 7-204 of the Public Utilities Act (“the Act”) that ensures that the public interest of Peoples Gas ratepayers in safe, affordable, efficient, reliable utility service is protected. It does so by arguing that the series of conditions tied to the

deeply-troubled Peoples Gas (“PGL”¹ or “Peoples Gas”) Accelerated Main Replacement Program (“AMRP”) that the Attorney General (“AG” or “the People”), the City of Chicago (“City”) and the Citizens Utility Board (“CUB”) insist be attached to any Commission merger approval are “unrelated to Wisconsin Energy or the proposed Reorganization.” JA IB at 33. Staff, on the other hand, appears to have essentially abrogated its once fervent insistence that Peoples Gas fix the AMRP in accordance with independent auditor Liberty Consulting Group’s recommendations, by agreeing to a watered-down audit recommendation implementation process that promises to delay essential fixes to the AMRP, remedies for which customers can ill afford to wait.

Five years ago, this Commission addressed the risks of Peoples Gas’s AMRP head-on. The Commission’s Staff declared AMRP to be a “massive project of significant public interest” and resolved that “accelerated system improvement has become for the Commission a matter of the public interest more so than just a Company proposal.” Order, ICC Docket Nos. 12-0511/0512 (cons.), June 18, 2013 (“2012 Rate Case Order”) at 49 (citing Order, ICC Docket Nos. 09-0166/0167 (cons.), January 21, 2010 (“2009 Rate Case Order”) at 194). After several years of operation, Staff concluded in 2012 that the management risks of AMRP had become too unbearable, and it urged the Commission to open an official audit investigation of AMRP because, as the Commission found, the “AMRP has accomplished little and has been mismanaged” and because Peoples Gas “has given the Commission no reason to believe that it can complete the AMRP in 20 years,” submitted no evidence of what the total cost of the AMRP would be, provided insufficient details to move the project forward, and prepared no budget.

¹ PGL and North Shore Gas Company (“NS” or “North Shore”) are jointly known as the Gas Companies.

Order, ICC Nos. 12-0511/0512 at 46-48. The Commission agreed and ordered a two-phase audit of AMRP. *Id.* at 61.

The concerns that triggered the AMRP audit must be the foundation of the Commission's approval of the Joint Applicants' merger proposal. The first criterion acquiring companies must meet in order to fulfill Section 7-204 of the Public Utilities Act is that "the proposed reorganization 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). The Joint Applicants would have the Commission believe that if the management problems that have plagued the AMRP are merely maintained, then that is all that is legally required of them, and the Commission is obliged to bless the merger.

For a troubled infrastructure project of the magnitude of the AMRP, for which management and cost control crises continue to threaten the interests of both the utility and its ratepayers, the Act's merger approval requirements demand more than maintenance of the *status quo*. Permitting the current level of mismanagement to continue will diminish Peoples Gas's ability to provide adequate, reliable, efficient, safe and least-cost utility service. WEC's failure to develop a post-merger transition plan, Peoples' continued poor coordination efforts with the City of Chicago's Department of Transportation ("CDOT"), and the project's inadequate cost controls, if allowed to continue – as the proposed reorganization suggests they will – can only degrade Peoples Gas's utility service and public safety, contrary to the mandate of Section 7-204.

Yet now that a merger is on the horizon, the Staff has inexplicably concluded that WEC, a company that is as ill-prepared to manage the AMRP as Peoples Gas was when the Commission-ordered audit conducted by The Liberty Consulting Group ("Liberty") began, is capable of taking over the project. The terms that Staff has proposed be imposed on the Joint

Applicants as conditions for merger approval are wholly inadequate to address the very serious problems Staff identified just a few years ago as warranting a multi-phase investigation, and which remain unaddressed. For example, despite Staff's outrage that Peoples had not developed an adequate long-term plan for AMRP, Staff has not proposed any merger conditions requiring that WEC develop a transition plan for the AMRP prior to merger closing. This position is particularly troubling as it flies in the face of Staff's complaint in this proceeding that "[t]he JAs have never provided any definitive plans for how they will operate the Gas Companies going forward, or what if any staffing level reductions they identified. In fact, JAs provided insufficient information to form a conclusion regarding any longer-term effect of the proposed reorganization." Staff IB at 16.

The problems afflicting the AMRP cannot be resolved without imposing conditions more stringent conditions than the proposals Staff has put forward. Despite the misgivings Staff has expressed, none of Staff's proposed merger conditions are designed to hold the JA accountable for the progress of the program. Nor do any of the terms address the most critical safety aspect of the program, prioritizing the replacement of infrastructure deemed the most vulnerable under PGL's Main Ranking Index ("MRI") system. Instead, Staff's conditions place the onus for improving AMRP management on the Commission's auditors, allowing Peoples Gas to ignore any audit recommendations which the utility determines are not cost effective, practical or reasonable to implement "from the standpoint of stakeholders and Peoples Gas customers". ICC IB, Appendix A at 52-53. Such latitude could permit Peoples to undermine important safety recommendations if Peoples believed their implementation conflicted with those of its stockholders.

The merger conditions proposed by the Attorney General’s witnesses, in contrast, address the safety aspect of pipeline replacement as a priority, and unlike Staff’s proposed conditions, help ensure that rates remain least-cost. Among those minimum conditions is one mandating a detailed AMRP work plan and reporting schedule, requiring Peoples to identify the MRI ranking of each pipeline segment targeted for replacement for the upcoming year, as well as the MRI ranking of those segments still in need of replacement, as well as the cost to complete. The Attorney General’s conditions also unequivocally endorse the Commission’s decision to audit the AMRP by requiring the Joint Applicants to commit unconditionally to implement all recommendations resulting from both the Interim and Final Liberty audit reports. AG IB, Appendix C at 1.

On top of these disturbing management trends, ratepayers have endured five rate increases since 2008. Utility service for Peoples and North Shore ratepayers has become less affordable every year even while utility operations have deteriorated. Ratepayers deserve some relief from having to endure this downward drift. The Attorney General’s list of merger conditions includes a minimal level of ratepayer relief, by requiring the utilities to reduce the percentage of monopoly revenues collected through the customer charge and to freeze base rates for five years from the merger closing. Given the bad bargain they have received in exchange for ever-increasing utility bills, this condition would bring customers at least one positive return for their money.

The Joint Applicants have not demonstrated that they consider their proposal to acquire Peoples Gas and North Shore Gas to be anything other than what they have maintained throughout these proceedings – a mere securities transaction. Their planned merger may “look good on paper,” but it does not offer Peoples and North Shore’s captive utility customers any

hope that their utility service will avoid the trend away from the reliable, efficient, safe and affordable service to which they are entitled.

II. ARGUMENT

A. Section 7-204 Requires the Commission to Impose Conditions on a Merger When Necessary to Protect Customers.

In their Brief, the Joint Applicants argue that they have successfully narrowed the issues “to only areas in which intervenors the AG and City/CUB are asking the Commission to impose additional conditions on its approval of the Reorganization in order to ‘improve’ service quality, particularly with respect to the AMRP...”. JA IB at 8. They argue that the Commission should reject the additional conditions sought by the AG and City/CUB “because they are not related to any of the findings required under Section 7-204.” JA IB at 31. These statements are troubling for several reasons.

First, the argument betrays a fundamental misunderstanding of the requirements of Section 7-204, and the Commission’s obligations under the entire statute. Section 7-204(b) outlines the minimum service, safety and rate impact requirements that the Commission must conclude have been satisfied before approving a merger. 220 ILCS 5/7-204(b)(1)-(7). But in addition to Section 7-204(b), Section 7-204(f) creates a further obligation on the Commission to protect the public interest – not one that must be tied to the subsection 7-204(b) requirements.

In ascertaining the legislature's intent, courts begin by examining the language of the statute, reading the statute as a whole, and construing it so that no word or phrase is rendered meaningless or superfluous. *Kraft, Inc. v. Edgar*, 138 Ill.2d 178, 189, 149 Ill.Dec. 286, 561 N.E.2d 656 (1990); *Wal-Mart Stores, Inc. v. Industrial Comm'n*, 324 Ill.App.3d 961, 965, 258

Ill.Dec. 17, 755 N.E.2d 98 (2001). Illinois courts cannot view words or phrases in isolation but, rather, must consider them in light of other relevant provisions of the statute. *In re E.B.*, 2008 WL 4943447 Ill., 2008. These statutory interpretation precepts point to rejection of the JA's proposed statutory analysis.

While it is true that Section 7-204(f) conditions, in effect, can be used to help ensure that the Section 7-204(b)(1)-(7) requirements are, in fact, satisfied post-merger, Section 7-204(f) also provides the Commission with an obligation to impose conditions that it believes are necessary and appropriate to protect the public interest. Adoption of the JA's cramped interpretation of Section 7-204 would render this subsection meaningless.

Prior Commission orders related to proposed utility mergers support the AG argument on this point. One example of the Commission's application of a condition designed to improve service quality can be found in the Commission's 1999 order approving the merger between Ameritech, Inc. and SBC Communications, Inc., the acquiring, Texas-based corporation. In that decision, the Commission imposed a condition that it specifically noted was necessary to *improve Ameritech's existing service quality found to be deficient by the Commission* – not unlike the clear evidence of mismanagement by Peoples Gas of the AMRP, and the requested AG/CUB/City conditions designed to set the AMRP operation on a better operational course.

The Commission ruled:

Ameritech Illinois' repeated failure to meet the OOS>24 service standard, however, suggests that the existing service quality mechanism in the Alternative Regulation Plan does not provide an adequate incentive for the company to comply with the standard.

[...] The Commission finds that imposing a condition that relates to Ameritech Illinois' avoided cost of meeting its service quality obligations should eliminate the company's current cost incentive not to meet the OOS>24 standard. Accordingly, and

pursuant to its authority under § 7-204(f), the Commission requires the Joint Applicants to demonstrate to the Commission, within six (6) months after obtaining all necessary regulatory approvals and closing the merger, that Ameritech Illinois is in compliance with the OOS>24 service standard. The Joint Applicants shall demonstrate compliance in the same manner currently used by the Commission and Ameritech Illinois to measure the company's compliance with the OOS>24 service standard. If, after notice and hearing, the Commission determines that the Joint Applicants have not demonstrated that Ameritech Illinois is in compliance with the OOS>24 service standard during the last month of the six month period, the Commission shall assess a \$15 million penalty fine (\$30 million X 50%), separate and apart from any annual rate reduction resulting from the service quality component of the company's Alternative Regulation Plan... [...]

The condition the Commission imposes here is designed to ensure that the Joint Applicants focus on the OOS>24 problem and devote the necessary resources to meeting the standard. The Commission has attempted to craft a condition that equates Ameritech Illinois' estimated costs of complying with the OOS>24 standard with the company's costs in avoiding it. The Commission believes that the condition is fair, protects Ameritech Illinois and its customers from risks resulting from the merger, and provides the necessary incentive to comply with the OOS>24 standard. (cites omitted)

In re SBC Communications, Inc. 1999WL 1331303 (ICC Docket No. 98-0555, September 23, 1999) (emphasis added). This merger condition is but one example of the function of Section 7-204(f) in providing the Commission with the authority to premise merger approval on the conditions it believes are necessary to protect the public interest, including conditions that would create *improvements in existing service*. It also aligns with the AG/City/CUB contentions that should the Commission approve the merger, additional conditions are needed to improve the existing deficient management of the PGL AMRP. In other words, even if the JA had satisfied the requirements of Section 7-204(b) designed to ensure that the quality, reliability and cost of utility service is not negatively impacted, the Commission has an obligation to attach any

additional conditions that “in its judgment, are necessary to protect the interests of the public utility and its customers.” 220 ILCS 5/7-204(f). The imposition of commitments that will help protect customer interests – interests that WEC has made clear are not its priority – is unquestionably appropriate and consistent with the Commission’s obligations under the Act.

Second, the evidence unequivocally shows that WEC is not prepared to step into the shoes – albeit defective – of Peoples Gas and its parent company, Integrys Energy Group, Inc. (“Integrys”) to ensure a seamless transition overseeing the management and operation of the AMRP. As discussed in the AG Initial Brief and further below, WEC admits it has no transition plan to assume control over the multi-billion construction project – one characterized by ICC Staff as *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.*² That admission alone is evidence that WEC has not performed the necessary due diligence and preparatory work to assume control over the AMRP in a way that will not add to the already significant delay, costly inefficiencies, imprudence and mismanagement that would diminish the utility’s ability “to provide adequate, reliable, efficient, safe and least-cost public utility service,” in violation of Section 7-204 of the Public Utilities Act (“the Act”). 220 ILCS 5/7-204(b)(1).

Finally, the troubling omission of any transition plans points to a need for specific merger conditions related to the AMRP should the Commission reject the AG’s conclusion that the merger does not satisfy the service quality, reliability and rate impact dictates of Section 7-204(b). In the Commission’s December 7, 2011 order in the recent Nicor/AGL Resources merger, as discussed in more detail in part C of this Reply Brief, the Commission specifically

² Staff Ex. 2.0 at 22:563-576 (emphasis added).

pointed to the existence of transition meetings between the acquired and acquiring companies as evidence that Section 7-204(b)(1) would be satisfied:

Beyond their evidence of prior and ongoing operating experience, and of specific pledges in support of future operations, the JA point to the ongoing process of integrating the merging entities, as described above. The fact that the JA are conducting this process with a significant commitment of personnel is itself evidence that service quality will be maintained after reorganization. *Indeed, it is, conceptually, exactly what needs to occur to achieve a smooth integration of the merging entities.*

AGL Resources Inc., Nicor Inc. and Northern Illinois Gas Co. d/b/a Nicor Gas Company – Application for Approval of a Reorganization Pursuant to Section 7-204 of the Act, Order of December 7, 2011 (“Nicor Merger Order”) at 13 (emphasis added). Such transition or integration meetings, unfortunately, have not occurred in this instance. The record evidence shows that additional conditions are needed to protect the public interest, even if the Commission concludes that Section 7-204(b) provisions have been satisfied, notwithstanding the substantial evidence to the contrary.

B. Having Failed to Conduct Adequate Due Diligence, the JA Have Not Proven That the Merger Will Not Diminish the Utility’s Ability “to Provide Adequate, Reliable, Efficient, Safe, and Least-Cost Public Utility Service.”³

It is undisputed that the Joint Applicants have the burden of satisfying the statutory criteria of Section 7-204 of the Act before the Commission can approve any proposed merger.

220 ILCS 5/7-204. As Staff aptly noted in its Initial Brief,

Where a statute does not specifically place any burden of proof, courts have uniformly imposed on administrative agencies the common-law rule that the party seeking relief has the burden of proof. *Scott v. Dept. of Commerce and Community Affairs*, 84 Ill. 2d 42, 53; 416 N.E.2d 1082, 1088; 1981 Ill. Lexis 229 at 14; 48 Ill. Dec. 560 (1981).

³ 220 ILCS 5/7-204(b)(1).

Staff IB at 3-4. The record evidence is clear that the Joint Applicants failed in presenting the necessary evidence to satisfy that statutory standard. The Commission’s analysis of the evidence must begin with the Joint Applicants’ admission that they failed utterly to prove that they are ready and able to step into the shoes of PGL/Integrysts to manage the day-to-day operations of Peoples Gas, and in particular to seamlessly oversee the operation and management of the PGL AMRP.

The JA admit that “Wisconsin Energy’s pre-merger due diligence did not include investigation into the specifics of the Gas Companies’ ‘on-the-ground’ operations, such as detailed work plans for the AMRP.” JA Brief at 12, citing Leverett Reb., JA Ex. 6.0, 14:385-387; Reed Reb., JA Ex. 8.0, 13:259-268; AG Cross Ex. 3 (JA response to data request AG 4.01). As it turns out, that was an understatement of the JA’s level of interest in assessing the day-to-day operations of Peoples Gas, and in particular its immense, \$4.6 billion infrastructure project, the AMRP. Section 7-204(b)(1) requires that the Commission examine WEC’s ability to ensure that the proposed merger would not diminish PGL’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service. Whether WEC is able to immediately step into the role of current PGL/Integrysts management – particularly the management team currently overseeing the AMRP – is a critical question for that assessment.

The answer to that query is that WEC is *not* ready to take the helm of the sinking ship that is the PGL AMRP. As documented in the AG Initial Brief, WEC witnesses betrayed a lack of any understanding of the fundamentals of the AMRP project – “on the ground” or otherwise. As noted at pages 24-25 of the AG Initial Brief, the JA 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 PGL uses 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 completion date 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).

Staff's Brief fails to even mention this lack of due diligence, notwithstanding the fact that their own witness Eric Lounsberry was deeply troubled by this lack of investigation of the critical operations of the PGL AMRP:

[T]he 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. [...]

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 23:566-24:570 (emphasis added). Clearly, the Joint Applicants' disinterest in examining the commitment involved in assuming responsibility for the PGL AMRP should lead the Commission to conclude that WEC is not prepared to make such a commitment without customers bearing the costs of the steep learning curve.

Unfortunately, as noted in the AG Initial Brief, Mr. Lounsberry later testified that he was satisfied that WEC had performed adequate due diligence, with little explanation except to note that the JA's must now be aware of the AMRP problems in light of intervenor testimony detailing the rampant mismanagement of the AMRP and the JA's commitment to implement a heavily qualified Liberty audit finding and implementation process. Staff Ex. 9.0 at 27:655-662. This change in position is startling, given the importance of the AMRP to PGL customer service and rate levels, and the Companies' stated view that the AMRP is unrelated to merger approval. Staff seems to suggest that it is appropriate for due diligence to be conducted during the middle of a merger proceeding, *after* the decision to acquire a utility has been made.

As Mr. Coppola aptly testified, the AMRP is not a small operational program to be dealt with in post-merger due diligence. Astounded by the JA's response to AMRP concerns and its clear lack of due diligence in reviewing the obligations and problems of the AMRP, Mr. Coppola stated:

The AMRP is fundamental to the future earning power, reliability and safety of the Peoples Gas delivery system. It is not only material to the entities being acquired, it is essential to the success of the acquisition. The facts (1) that the Commission ordered an audit of the AMRP and (2) that completing the program by 2030 requires investing more than \$4 billion in capital expenditures should have triggered a need to perform some significant due diligence. By any reasonable standard, a \$4 billion capital program is material in this merger transaction. For the Joint Applicants not to have done a reasonable amount of due diligence of the program in the pre-merger phase raises grave concerns about Wisconsin Energy's understanding of the current state of the AMRP and its priorities and commitments to complete the AMRP in a way that will not harm customers if the merger is approved.

AG Ex. 4.0 at 17-18:333-344. City/CUB witness Cheaks similarly found the JA's level of due diligence lacking, to say the least. Noting that it "fails to give the ICC confidence that AMRP

will be properly managed and the interests of PGL’s ratepayers protected.” City/CUB Ex. 3.0 at 46:891-901.

Finally, it is undisputed fact that PGL has (1) the dubious distinction of having the highest rates in the state, (2) a problem-plagued AMRP, (3) an ongoing independent audit of the AMRP, and (4) a newly opened ICC docket investigating troubling whistle-blower allegations of fraud and mismanagement related to the AMRP (ICC Docket No. 15-0186). Yet, it appears that the Joint Applicants are either stunningly oblivious to these facts or, worse yet, disinterested in improving PGL operations as a condition of merger approval, as perhaps best highlighted in this statement from the JA’s Brief, citing testimony from lead JA WEC witness Allen Leverett:

From the perspective of Peoples Gas’ and North Shore’s customers, the Reorganization will be seamless, as they will continue to receive high-quality, adequate, safe, and reliable gas service at the same cost as they did before the Reorganization. JA Ex. 1.0 (Leverett Direct) at 16:350-353; Leverett Reb., JA Ex. 6.0, 9:265-268.

JA IB at 4. If the Joint Applicants view the current state of operational affairs at PGL to be “high quality,” least-cost, or in any way worth retaining, then PGL/NS ratepayers are in for a bumpy, expensive ride. The Commission should reject that invitation.

C. The JA’s Failure to Have a Transition Plan for the AMRP in Place Casts Doubt on the Merger’s Compliance with Section 7-204(b)(1) of the Act, Especially in Light of the Commission’s March 11, 2015 Data Requests.

1. The Joint Applicants Admit that They Have Not Developed a Transition Plan for the Troubled AMRP.

In their Initial Brief, JA allege that they are “ready, willing, and able to implement the AMRP consistent with Liberty’s ultimate recommendations in its final report expected to be issued in mid-2015, in accordance with the procedures set forth in the conditions agreed to with

Staff in this proceeding.” JA IB at 13, 14. The primary basis for their claim is the assertion that WEC “has a wealth of experience successfully managing, implementing, and completing large capital infrastructure projects on time, at or under budget, and in compliance with applicable laws and regulations.” JA IB at 3. The record evidence shows otherwise.

On March 11, 2015, the Commission issued a set of data requests to the Joint Applicants. The Commissioners’ data requests sought information about one subject – Peoples Gas’s trouble-ridden AMRP. In particular, the data responses asked for transition plans the JA have in place “to ensure a seamless changeover that avoids any diminishment of the *utility’s ability to provide adequate, reliable, efficient, safe, and least-cost public utility service* both leading up to and after closing the proposed reorganization.”⁴ Notice of Commissioners’ Data Request at 2-3 (emphasis added). At a minimum, the Commission’s data requests imply that the ICC believes that the presence of transition plans is important to the determinations it must make under Section 7-204(b)(1) of the Act.

In their responses to the Commissioners’ Requests, the JA admitted that they have “no formal transition plan at this time.” JA’s Responses to Commissioners’ Data Requests at 2 (“JA’s Responses”). Rather than providing the information requested by the Commission, the Joint Applicants, as City/CUB witness William Cheaks, Jr. aptly put it, “describe[d] aspirational initiatives, not concrete commitments, and their compliance is not readily measurable or enforceable.” City/CUB Ex. 11.0 at 2. Mr. Cheaks added that the Joint Applicants’ responses “do not provide any plans or commitments to correct the specific deficiencies in AMRP.” *Id.* at 1-2. In an apparent effort to excuse their lack of a transition plan, the JA highlighted a customer

⁴ The highlighted portion of the quote from the Commissioners’ Data Requests is taken directly from Section 7-204(b)(1) of the Act.

outreach program that WEC has initiated in Wisconsin that they say could be made part of the AMRP. JA's Responses at 7. AG witness Coppola noted that talking about a customer communication while the main replacement program has been – and continues to be – in a state of distress “is akin to rearranging the deck chairs on the Titanic while the ship is sinking.” AG Ex. 7.0 at 5.

The Joint Applicants' seeming indifference to the state – and perhaps the fate – of the AMRP may come from their myopic interpretation of the scope of this case. From the beginning, the JA have asserted that this case is a simple stock transaction, nothing more, nothing less. *See, e.g.* JA Ex. 6.0 at 9:261-265, 13:356-358. In their Initial Brief, the Joint Applicants persist in their narrow interpretation of the scope of the case. To the Joint Applicants, the ongoing travails and the future of the AMRP are not relevant to this proceeding. *See, e.g.*, JA IB at 2, 33, 33-34. The JA's defiant attitude is startling in the face of not only the Commission's post-hearing data requests regarding the AMRP, but also the significance of the AMRP for PGL's operations and customers.

The Commission's interest in whether the JA have transition plans for the AMRP in place may stem from the fact that during the evidentiary phase of the case the Joint Applicants asserted that “the problems [Staff witness Lounsberry] alleges with the Peoples Gas AMRP are not the result of and are in no way related to Wisconsin Energy's acquisition of Integrys' stock.” JA Ex. 6.0 at 13:356-358. The Commission's interest may have been further piqued when The Liberty Consulting Group (“Liberty”) issued its unscheduled Interim Audit Report (“Interim Report”) describing the current status of the AMRP as part of its engagement pursuant to the Commission's Order in Docket Nos. 12-0511/0512 (cons.). The Liberty auditors found a program beset with serious problems, including:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] at S-5.

- [REDACTED]

[REDACTED] *Id.* at S-5-S-6.

As serious as these problems are, perhaps the impetus for the Commissioners' Data Requests and their focus on whether the Joint Applicants have a transition plan for the AMRP emerged from other statements in the Interim Audit. In particular, the Liberty auditors found:

- Its [REDACTED]

[REDACTED] *Id.* at 1-2 (emphasis added).

- [REDACTED]

[REDACTED]
Id. at 2 (emphasis added).

- [REDACTED]
Id.

- [REDACTED]
Id. (emphasis added).

- Liberty added that its [REDACTED]
Id. at 1-2.

Whatever the impetus for the Commission’s concern regarding whether the JA have a transition plan for the AMRP, it is well-placed. As the above quotes from the Interim Report make clear, [REDACTED]

[REDACTED] The JA’s failure to have a transition plan in place to, as the Commission said, “ensure a seamless changeover” if the transaction is approved raises serious doubts whether the 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).

2. The Commission Found in the 2011 Nicor Merger Case that AGL/Nicor’s Extensive “Integration Planning Process” Was Integral to the Commission’s Conclusion that the Joint Applicants in That Case Satisfied the Obligations of Section 7-204(b)(1).

In the last major energy merger case decided by the Commission, the ICC stressed the importance of the transition plans that the Illinois utility and its proposed purchaser had in place so that no “diminishment of the utility’s ability to provide adequate, reliable, efficient, safe, and least-cost public utility service” would occur as a result of the acquisition. In that case, Georgia-based AGL Resources Inc. (“AGL”) proposed to purchase Nicor Inc., the parent company of Northern Illinois Gas Company (“Nicor”). *AGL Resources Inc., Nicor Inc. and Northern Illinois Gas Company d/b/a Nicor Gas Company, Application for Approval of a Reorganization Pursuant to Section 7-204 of the Illinois Public Utilities Act*, ICC Docket No. 11-0046, Final Order of December 7, 2011 at 4 (“*Nicor Merger Order*”).

In explaining why the merger in that case would not “diminish the utility’s ability to provide adequate, reliable, efficient, safe, and least-cost public utility service,” the Commission stressed the significance of the integration planning process the joint applicants in that case conducted:

That exception concerns the integration planning process the JA have conducted since the Reorganization was announced. Specifically, JA explain, several hundred employees of AGL, NI and NG have worked since January 2011 on understanding and meshing the “processes, structures and practices” of the merging entities. JA state that these integration planning endeavors “assess the current state for each and every area of the two companies.” The JA further assert that their work on final operating plans will continue “until the Reorganization is closed.” ... JA underscore that approximately 3500 pages of documentation generated by JA’s integration planners were submitted to Staff and presented during the evidentiary hearings in this case.

Id. at 11-12 (citations omitted). The Commission added:

Beyond their evidence of prior and ongoing operating experience, and of specific pledges in support of future operations, the JA point to the ongoing process of integrating the merging entities, as described above. The fact that the JA are conducting this process

with a significant commitment of personnel is itself evidence that service quality will be maintained after reorganization. Indeed, it is, conceptually, exactly what needs to occur to achieve a smooth integration of the merging entities.

Id. at 13.

The Joint Applicants' evidence in this case is the antithesis of AGL/Nicor's presentation.

Unlike AGL/Nicor,:

- There is no evidence that the Joint Applicants have conducted “an integration planning process” since the proposed merger was announced.
- There is no evidence that the Joint Applicants have made an effort to mesh the “processes, structures and practices” of the merging entities.
- There is no evidence that the Joint Applicants endeavored to “assess the current state for each and every area of the two companies.”
- There is no evidence that the Joint Applicants have committed significant personnel and effort to ensure that “service quality will be maintained” after the reorganization.

Besides the lack of transition plans, there is another important distinction between the record in this case and the record in the AGL/Nicor merger. In the earlier case, the Commission found that “[a]fter [the] merger, staffing levels will be maintained, generally by the same people in place now.” *Id.* at 13-14. In response to the Commissioners' Data Requests in this case, the JA were unable to identify 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. The Joint Applicants were also unable to describe the process for evaluating whether PGL and Integrys employees currently overseeing the AMRP will be retained or replaced. *Id.* at 2-3; Tr. at 214.

3. The Joint Applicants' Lack of a Transition Plan for Assuming Control of the Troubled Main Replacement Program is Especially Concerning Given the Tremendous Cost of the Program.

The enormous cost implications of the AMRP cannot be denied. The AMRP has had – and will continue to have – severe adverse consequences on Peoples Gas’s customers’ bills. The project’s estimated lifetime 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 that went into 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. Peoples Gas has stated that the AMRP was the main driver for its need for increased rates in each of its last three rate increase requests. AG Ex. 4.0 at 17:324-326. Mr. Coppola projected that the main replacement program alone, putting aside the effect of other rate drivers, 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.

Peoples Gas’s dysfunctional operation of the AMRP, the Liberty auditors’ conclusions that [REDACTED], and the JA’s admitted lack of a transition plan for assuming control of the AMRP is almost a certain recipe for even greater cost escalations. Under these circumstances, the Commission should conclude that the Joint Applicants have failed to ensure that that the proposed transaction “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).

4. The Joint Applicants’ Explanation for not Developing a Transition for the AMRP Cannot Be Sustained.

Neither in their Initial Brief responses to the Commissioners' Data Requests nor in their Initial Brief do Joint Applicants offer an explanation for not preparing a transition plan for the AMRP. The only possible explanation offered during the evidentiary phase of the proceeding was the Joint Applicants' assertion that they could not "be making decisions about the operation of Peoples Gas' AMRP or otherwise be actively involved in the management of Integrys' and Peoples Gas' operations" prior to the closure of the proposed transaction lest they be accused of violating federal anti-trust statutes. JA Ex. 12.0 at 7:137-149. The JA's explanation is fraught with problems and cannot be sustained.

First, the Sherman Antitrust Act, 15 U.S.C. § 1 *et seq.*, prohibits independent firms from sharing competitively sensitive information in order to facilitate anti-competitive behavior in restraint of trade. That is not the case here. There is no dispute that WEC and Integrys do not compete against each other. In his Direct testimony, JA witness Leverett testified that "Wisconsin Energy believes the proposed Transaction raises no significant issues regarding either horizontal or vertical market power in any appropriately defined market." JA Ex. 1.0 at 25:544-546. Thus, contrary to Joint Applicants' allegations, there can be no possibility of antitrust violations – under either the Sherman Act (15 U.S.C. § 1 *et seq.*) or the Clayton Act – that could excuse their failure to develop a transition plan for the problem-riddled AMRP.

The pre-merger restrictions on the sharing of information contained in the Sherman Act and the Hart-Scott-Rodino provisions of the Clayton Act (15 U.S.C. § 18(a)) do not apply to the proposed merger with Integrys in a way that would preclude Joint Applicants from developing a transition plan for assuming management of the program if the proposed transaction were approved. There is no evidence that sharing information on AMRP would expose WEC or Integrys to claims actionable under the federal "gun-jumping" prohibitions contained in those

laws, since Wisconsin Energy does not compete with Integrys in the distribution or delivery of natural gas. Nor would developing a transition plan for assuming control of the AMRP qualify as a Hart-Scott-Rodino violation in the absence of any attempt by WEC to exercise control over Integrys (particularly prior to expiration of the mandatory waiting period) or in the absence of Integrys transferring any “beneficial ownership” in Integrys to WEC.

Second, by raising the specter of federal antitrust laws, the Joint Applicants have created a straw man argument that has no merit. Developing a transition plan for the AMRP does not compel the involvement of WEC in the current control, management, decision-making, or business activities of Peoples Gas or Integrys, activities that are proscribed by the antitrust laws. Nor would responsible due diligence operate to restrain trade in any way. Examining the AMRP sufficiently enough to prepare a transition plan for the project does not expose WEC to antitrust violations of any kind.

Finally, as discussed above, AGL and Nicor engaged in extensive pre-merger-closing discussions beginning in January, 2011, the time at which that merger was announced –11 months before the Commission issued its order approving the merger. Nicor Merger Order at 11. AGL and Nicor stated that “several hundred employees” of the merging companies worked “on understanding and meshing the ‘processes, structures, and practices’ of the merging entities.” *Id.* (citation omitted). Those companies added that their “integration planning endeavors ‘assess the current state for each and every area of the two companies.’” *Id.* (citation omitted).

The People are not aware of any allegations that AGL’s and Nicor’s pre-merger-completion activities to coordinate and mesh the merging entities may have violated any federal anti-trust laws. The Joint Applicants’ failure to develop a transition plan for the AMRP in this case cannot be squared with the extensive efforts AGL and Nicor made to merge their companies

in the earlier case. Simply put, federal anti-trust laws provide no excuse for JA's failure to develop a transition plan for assuming control of the AMRP.

* * * * *

In sum, by failing to develop a transition plan for assuming management of the troubled AMRP, the Joint Applicants have not met their burden to show that the proposed transaction "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).

D. The JA's and Staff's Claims that the Proposed Transaction Satisfies Section 7-204(b)(7) Do Not Account for the Adverse Rate Impacts for Peoples Gas's Customers Caused by the Joint Applicants' Failure to Meaningfully Prepare to Assume Control of the Problem-Plagued AMRP.

In their respective Initial Briefs, Staff and the JA assert that the proposed transaction meets Section 7-204(b)(7)'s requirement that the Commission find that any proposed reorganization "is not likely to result in any adverse rate impacts on retail customers." Staff IB at 35-37; JA IB at 26-29; 220 ILCS 5/7-204(b)(7). Staff's Section 7-204(b)(7) analysis focuses solely on the impact the proposed merger would have on Peoples Gas's and North Shore's respective costs of capital. The Joint Applicants mention the potential impacts on the utilities' respective costs of capital as well as their agreement to not seek recovery of (1) any portion of the acquisition associated with the transaction and (2) the "transaction costs" incurred to accomplish the merger. Absent from both Staff's and the JA's arguments is any mention of the flawed AMRP and the impact it will have on rates if the transaction were approved. As much as the Joint Applicants may prefer to ignore the rate impacts of the AMRP, the Commission must account for adverse rate impacts the troubled program is likely to have on Peoples Gas's customers' bills if the proposed merger is approved.

The record in the case shows that the AMRP has had - and almost certainly continues to have - serious rate impacts for customers. 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.

While these rate impacts may occur even absent the proposed merger, the JA's failure to engage meaningfully – if at all – regarding AMRP raises serious questions whether the transaction would exacerbate the already significant adverse rate impacts the main replacement program will have on customers' bills. As discussed above, the Liberty auditors concluded that

[REDACTED]

[REDACTED]. AG Ex. 6.1 at 1, 2. Moreover, the Joint Applicants have not developed a transition plan to ensure that they will be able to seamlessly step in to manage the massive capital improvement program.

The Commission is rightly concerned about the presence (or lack thereof) of a transition plan for the AMRP. The primary focus of the Commissioners' Data Requests was whether the JA have transition plans in place "to ensure a seamless changeover that avoids any diminishment

of the utility's ability to provide adequate, reliable, efficient, safe, and *least-cost public utility service* both leading up to and after closing the proposed reorganization." Notice of Commissioners' Data Request at 2-3 (emphasis added). Given the Joint Applicants' passive approach to assuming control of the AMRP as well as its failure to develop a transition plan for the AMRP, the record does not support a finding that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers." 220 ILCS 5/7-204(b)(7).

E. The Merger Conditions Proposed By Staff and the Joint Applicants Are Insufficient To Protect the Public Interest and Would Not Satisfy the Section 7-204(b)(1) and (b)(7) Requirements.

As noted earlier in this Brief, the Commission's obligations under Section 7-204(f) to determine whether merger conditions are needed to protect the public interest are not optional. Ensuring that the public interest is protected is an obligation separate and apart from the Commission's duty under Section 7-204(b) to ensure that approval of 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).

Staff's Initial Brief lists several proposed conditions related to the operation of the PGL AMRP that it says will ensure the JA's satisfaction of Section 7-204(b)(1) of the Act. One of those commitments – not yet agreed to by the Joint Applicants – is that the AMRP be completed by 2030, with the completion date *not* conditioned on "appropriate cost recovery" (through rate cases and Rider QIP surcharges). Staff IB at 8. It should be rejected by the Commission, as discussed below.

1. Requiring a 2030 AMRP Completion Date Will Not Ensure Safety and Will Lead to Rate Shock.
 - a. Completing the AMRP by 2030 Will Drive up Costs and Raise Residential Rates.

As noted in the AG Initial Brief at 32-37, Staff's insistence that the Joint Applicants commit to complete the AMRP by the year 2030 (Staff IB at 8), and the related proposal by the JA themselves to commit to complete the AMRP by 2030, conditioned on "appropriate cost recovery" (JA IB at 13-14), will virtually ensure that PGL's rates will continue to increase at the alarming rate that persists currently – and will continue to do so without any guarantee that the 2030 date will ensure the safety and integrity of the PGL distribution system.

Indeed, in the four years since the Commission approved the AMRP in 2010, Peoples Gas has filed three base rate cases and received approval for increases in rates of \$57.8 million⁵, \$59.8 million⁶, and \$71.1 million.⁷ 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 AMRP⁸, due largely to the gross mismanagement of the project that has been meticulously documented by AG and City/CUB witnesses in this case and the Liberty Interim Audit Report. Those facts are only made worse by the JA's admission that no transition plan exists for WEC to assume management of the AMRP operation.

⁵ ICC Docket No. 11-0280/0281, Order of January 10, 2012 at 237.

⁶ ICC Docket No. 12-0511/12-0512, Order on Rehearing of December 18, 2013 at 21.

⁷ ICC Docket No. 14-0224/0225, Order of January 28, 2015.

⁸ 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.")

The JA state that with their proposed commitment to complete the project by 2030, PGL would simply “continue the AMRP on the same basis as it currently does.” JA IB at 13. However, this commitment suffers from a false premise: as AG witness Coppola showed, PGL’s current construction pace is decidedly *not* on course to complete the AMRP by 2030. AG Ex. 2.0 at 13-14:282-287; AG IB at 32. It was, in part, PGL’s poor track record over its first two years of AMRP activity in 2011 and 2012 that led the Commission to order the Liberty audit in its 2012 Rate Case order.⁹ Thus, as the People showed in their Initial Brief at 32-34, if this reorganization is approved and if it entails a re-commitment to the 2030 completion timeline, accelerating the pace of the project over that of the *status quo* would lead to severe rate impacts for residential customers, violating the reorganization approval standard of Section 7-204(b)(7).

Staff’s insistence that the Joint Applicants complete the AMRP by 2030 without requiring an immediate reassessment of AMRP work processes, creation of cost controls, and creation of a long-term, *manageable* AMRP work plan (to mention but a few recommendations that the Liberty auditors said must be completed *now* rather than at the completion of the audit process) amounts to a head-in-the-sand approach to regulation that will leave PGL ratepayers struggling with rate shock, even as the program proceeds without a plan to prioritize safety concerns. As mentioned earlier, AG witness 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” under a 2030 completion date, all else equal. AG Ex. 2.0 at 7:159-161. Yet Staff never assessed the rate impacts associated with staying what has proven

⁹ The Commission’s 2012 Rate Case Order based its decision to order the AMRP audit on the “reasons detailed in Staff witness Buxton’s rebuttal testimony . . . immediately above”; the summary of Mr. Buxton’s testimony immediately above in the order’s Analysis and Conclusion section included his point that, as of the time of that 2012 Rate Case, the AMRP was behind schedule. Order, Docket Nos. 12-0511/0512 (cons.), June 18, 2013, at 61.

to be an unsustainable course over the next 15 years. Staff witness Lounsberry admitted under cross-examination that his recommendation 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.¹⁰ Tr. at 566-567; AG IB at 35.

Staff witness Stoller, whose testimony Staff cites as support for a 2030 AMRP completion date (Staff IB at 8) 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 anyone in the ICC Staff has conducted any independent analysis of the appropriate completion date for the AMRP. Tr. at 516. Indeed, no witness in this case has attempted to show that, even under the limited criteria offered by PGL witness Salvatore Marano in the 2009 Rate Case (discussed below), 2030 is still a manageable or appropriate completion date. Without any such analysis, Commission cannot find that the JA have met their burden to show that the proposed 2030 completion condition would not diminish least-cost service under Section 7-204(b)(1) or have adverse residential rate impacts under Section 7-204(b)(7).

b. Safety and Public Interest Considerations Do Not Support the Proposed 2030 Completion Condition.

¹⁰ 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. 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 569-570.

If Mr. Lounsberry's proposed 2030 completion date condition were rooted in a documented safety and reliability analysis, the People would not question Staff's recommendation. But the evidence is clear that neither safety nor reliability are linked to the proposed 2030 completion timeline. As noted in the AG Initial Brief at 41, 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. Marano, who provided economic *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.^{11,12} In light of these facts surrounding the Commission's establishment of the 2030 date in 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.

Additionally, in this proceeding, AG witness Coppola recommended scaling the pace and scope of AMRP activity to a level that, *inter alia*, targets high-priority and high-risk segments (AG Ex. 4.0 at 35:678-679), in light of evidence that PGL has not been historically tracking the risk level (known as the Main Rank Index) of each of its mains replaced (AG Ex. 4.0 at 9:138-

¹¹ The cited pages represent pages 49-57 of PGL Ex. SDM-1.0 Rev. from Docket No. 09-0167.

¹² 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.

10:162, 22:431-441). This merger condition proposed by the People (AG IB at 60) would address safety needs far more effectively than blithely instructing PGL to accelerate its AMRP to a timeline determined without any reference to safety considerations.

Moreover, as a legal matter, Staff's argument that the 2030 completion timeline is still an enforceable obligation under the 2009 Rate Case Order is flawed. Staff's Initial Brief mischaracterizes the Commission's 2009 Rate Case Order by suggesting that

The 2009 Rate Cases order determined that completion of AMRP by 2030 was necessary and in the public interest. (Staff Ex. 9.0, 11.) Having made that determination, the Commission required that Peoples Gas complete the AMRP by the year 2030. *Id.* Only then did the Order authorize Rider ICR to allow Peoples Gas a means to obtain recovery of its AMRP costs versus Peoples Gas needing to seek recovery via periodic rate cases.

Staff then states that “[n]othing in the 2009 Rate Cases order states or even suggests that AMRP’s 2030 end date was dependent upon rider cost recovery.” Staff IB at 10. To support this interpretation of the 2009 Rate Case Order, Staff quotes (Staff IB at 9-10) portions of the 2009 Rate Case order that mandated an accelerated main replacement program to be completed by 2030. However, the excerpt from page 196 of the order that set out the 2030 completion date followed the following passage¹³ (not quoted in Staff's Initial Brief) from page 194 of the same order: “Staff’s persistent claim that Rider ICR is not needed, falls away.” In fact, Rider ICR was struck down by the Appellate Court in 2011. Tr. at 507-508; AG IB at 42. The 2009 Rate Case Order makes clear that completing the AMRP by 2030 was tied to its grant of rider recovery.

Staff's Initial Brief claims that not requiring the JA to complete the AMRP by 2030 will result in “a diminution in Peoples Gas providing adequate, reliable, efficient safe and least-cost

¹³ The People quoted this excerpt at page 42 of their Initial Brief.

public utility service” and result in “serious safety implications.” Staff IB at 8, citing the testimony of Staff witness Stoller and Staff witness Lounsberry. But Mr. Stoller later admitted in cross-examination that his support for a 2030 completion date was nuanced and based on the expectation of further Commission review when he first supported the completion date in the 2009 rate case. 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 2030.¹⁴ 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. He also admitted in his rebuttal testimony in this proceeding that he could not quantify any alleged risk associated with

¹⁴ “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.

extending the end date for the AMRP. Staff Ex. 8.0 at 8:139-140. At any rate, because PGL is not now currently on a path toward a 2030 completion date, simply continuing the current pace quo would not mean an “extension” of the timeline.

And, as noted in the AG Initial Brief at pages 43-44, 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. He admitted in the 2009 hearing that no evidence in that 2009 Rate Case supported the notion that the AMRP must be completed by 2030. AG Cross Exhibit 15 at 15; Tr. at 515. 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. 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.

Simply put, the evidence in this case does not support Commission adoption of Staff’s recommended JA commitment that merger approval be conditioned on a strict 2030 completion date. Mr. Stoller’s statements under cross-examination and re-direct examination in the 2009 Rate Case, as well as his cross-examination in this case, do not provide sturdy ground for a finding that a blind 2030 completion date is imperative. Likewise, Mr. Lounsberry’s similar admission that his support for a 2030 completion date is not rooted in any safety or rate impact analysis supports a conclusion that adoption of this condition will not protect the public interest, and only lead to rate shock for PGL’s customers. Instead, the merger – if it is approved – should be conditioned on Mr. Coppola’s proposal to scale the AMRP to a level of cast iron/ductile iron replacement and related infrastructure upgrades that is manageable; targets high priority, high

risk segments first; is cost-effective; and minimizes the impact on customer rates. AG Ex. 4.0 at 35:676-679; AG IB at 60.

2. Staff's concurrence with the JA-proposed process for implementing Liberty Audit recommendations actually weakens existing Peoples Gas Liberty Audit obligations, and accordingly does not protect the public interest.

Both the Staff and JA Briefs cite to their concurrence on a Liberty audit recommendation implementation process (Staff IB, Appendix A, nos. 1 and 2)¹⁵ as evidence that the public interest will be protected and that the requirements of Section 7-204(b)(1) are met. Staff IB at 46; JA Brief at 14-15. But these commitments neither ensure that the adequacy, reliability, efficiency, safety, and least-cost requirements of Section 7-204(b)(1) will be met, nor ensure that the public interest will be protected pursuant to Section 7-204(f).

¹⁵ Those agreed-to, proposed commitments are as follows:

- *Implementation of the recommendations contained in the final investigation report by Liberty on AMRP*

With respect to each recommendation contained in the final report of the investigation of Peoples Gas' AMRP completed at the direction of the Commission in its June 18, 2013 Order in Docket No. 12-0512 under the authority granted in Section 8-102 of the Act (220 ILCS 5/8-102), Peoples Gas shall evaluate the recommendation and implement it if the recommendation is possible to implement, practical and reasonable from the standpoint of stakeholders and Peoples Gas customers, and cost effective. Implementing a recommendation means taking action per a recommendation. If Peoples Gas determines that a recommendation is not possible, practical, and reasonable, including that the recommendation would not be cost-effective or would require imprudent expenditures, Peoples Gas shall provide an explanation of Peoples Gas' determination with all necessary documentation and studies to demonstrate to the satisfaction of the Commission Staff that strict implementation of the recommendation is not possible, practical, or reasonable, along with an alternative plan to accomplish the goals of the recommendation as fully as is possible, practical, and reasonable. In the event that Peoples Gas and Commission Staff cannot reach agreement as to whether a recommendation should be implemented and/or how it should be implemented, Peoples Gas may file a petition to obtain the Commission's determination as to whether and/or how the recommendation is to be implemented. (JAs Ex. 15.1 REV #9.)

- PGL's cooperation with Staff and its consultants in the verification of the implementation of the recommendations from the final investigation report by Liberty on AMRP Peoples Gas will cooperate fully with the Commission's Staff and consultants as they work to verify that Peoples Gas has implemented the recommendations in the final report on the Peoples Gas' AMRP investigation to the extent it is determined they should be implemented pursuant to Condition #__, above. Cooperation means to provide requested personnel who are reasonably involved in, connected to, and/or relevant to the AMRP and/or the Liberty audit for interviews in a timely manner in which the personnel interviewed shall provide, to the best of their ability, accurate and complete non-privileged information in response to questions asked, to answer written questions in a reasonable time with accurate and complete non-privileged information, and to make all non-privileged information, equipment, work sites, work forces and facilities available for inspection upon reasonable request. (JAs Ex. 15.1 REV #10.)

First, as noted in the AG Initial Brief at page 57, WEC's commitment to implement final Liberty audit recommendations are already required for Peoples Gas under the Commission's 2012 Rate Case Order. Again, 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.

2012 Rate Case Order 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.*

2012 Rate Case Order 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 subject to any conditions, as the JA's commitment numbers 9 through 11 represent.

When these facts were pointed out to JA witness Leverett, he expressed ignorance of those existing PGL obligations related to the audit process. Tr. at 146-147. Moreover, he indicated that he did not know how long the proposed process will take in terms of PGL reviewing the Liberty audit report recommendations and deciding whether each will be accepted or modified. Tr. at 151.

In addition, the Joint Applicants (and Staff's acceptance of the commitment) does not include implementation of the Liberty Interim Audit Report recommendations. This is troubling

because on cross-examination, JA witness Giesler (the Integrys employee with management responsibilities over significant portions of the AMRP) testified that there is a process in place to develop 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.

Moreover, AG witness Coppola testified that the process outlined in these conditions repeats almost verbatim what Mr. Leverett proposed in his Rebuttal Testimony. AG Ex. 6.0 (Coppola Supplemental Rebuttal) at 7-8:143-158. This process, which remains unchanged since the Joint Applicants’ Rebuttal Testimony, gives WEC considerable and inappropriate leverage and *de facto* preliminary veto power on implementation of Liberty recommendations. Mr. Coppola noted that basically, only an appeal to the Commission can override WEC’s objections. This would be a lengthy and cumbersome process that could waste time better used to implement useful and important recommendations WEC may unilaterally decide are distasteful. *Id.*

Mr. Coppola further noted that the Commission decided to retain Liberty to audit and make recommendations to improve the administration and planning of the AMRP because it had lost confidence in the ability of Peoples Gas to effectively and timely implement the program. The fact is, Liberty brings considerable knowledge and experience on how to establish and improve a large and critical construction program like the AMRP. He noted that to give *de facto* veto power to WEC or to any of the other Joint Applicants undermines the goal of making timely, significant and structural changes to an AMRP program that is in a state of chaos. *Id.*

Even the JA’s commitment to implement the final audit recommendations is heavily conditioned. As AG witness Coppola noted, the Supplemental Rebuttal Testimony filed by

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 or 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 the 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.

The bottom line is the Staff/JA agreement on these AMRP-related commitments does nothing to ensure safe, reliable, least cost service or protect the public interest. These so-called conditions in reality amount to a diminution of existing, Commission-ordered audit requirements for Peoples Gas. Thus, Staff's and the JA's assertion that the Section 7-204(b)(1) will be satisfied with this merger condition in place amounts to little more than window dressing on a highly defective AMRP process.

F. AG witness Coppola's and City Witness Cheaks' Proposed AMRP Conditions *Would* Protect the Public Interest.

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 (which were undisputed by other parties), the

absence of rate impact analyses from other parties, the lack of a 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 must provide more protection of ratepayer interests than Staff's cursory, tunnel-vision analysis of the AMRP in this docket.

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.

As the testimony of AG witness Coppola and City witness Cheaks make clear, Peoples Gas has been unable to maintain a pace that would allow them to complete the AMRP by 2030. That fact is unrebutted. The random selection of that date will *not* ensure the integrity and safety of the PGL distribution system. Even the Company’s current pace (which if retained would not necessarily achieve the 2030 timeline) 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 of the AG Initial Brief) 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 in order to ensure safe, reliable utility service at the least cost, as Section 7-204(b)(1) requires.

With that in mind, the AG’s and the City’s proposed AMRP merger conditions would help ensure the protection of the public interest, should the Commission deem approval of the proposed merger appropriate. *Indeed, it should be noted that only the AG-proposed conditions seek to ensure that PGL’s AMRP be focused on ensuring that the most vulnerable mains be replaced first.* Staff’s condition that the project be completed by 2030 and that audit recommendations be implemented – something Peoples is already required to do under the Commission’s 12-0511/12-0512 rate order – will lead to rate shock and, ironically, not ensure that the prioritization of main replacements is tied to the vulnerability and leak frequency data that are encompassed in PGL’s Main Ranking Index (“MRI”). The necessary AMRP conditions that should be adopted by the Commission are:

- 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. 15-0186), 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 are in the public interest, and 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 contributing to least cost utility service in accordance with Sections 7-204(b)(1) and (b)(7).

G. The Joint Applicants' Opposition to the AG/City/CUB Proposed AMRP Conditions Is Based On Faulty Legal and Factual Analysis, And Should Be Rejected.

It should be noted that Staff did not specifically object to any of these proposed conditions in its Brief. The JA, on the other hand, consistent with their flawed interpretation of Section 7-204, characterize these common-sense conditions as "unrelated to Wisconsin Energy or the proposed Reorganization." JA IB at 33. The JA further claim that none of these conditions "addresses or seeks to protect Peoples Gas or its customers from an identified adverse

impact or diminishment of service that would be caused by the Reorganization” and continue to insist that this proceeding “is not the proper forum for investigating, evaluating and implementing fixes to PGL existing operations, including the AMRP.” *Id.* at 34.

1. The JA’s flawed interpretation of Section 7-204(f) would render nearly any condition irrelevant.

The Joint Applicants, as noted earlier in this Brief in the discussion of the relevant statutory standards, are simply wrong. Section 7-204(f) is a separate requirement that the Commission is obligated to address, in addition to the “would not diminish” requirements of Section 7-204(b)(1), and the adverse rate impact test of Section 7-204(b)(7). The JA’s claim that the intent of Section 7-204 “is to sustain the utility’s service quality status quo”¹⁶ is not the correct statutory standard to apply here. To do so would render Section 7-204(f) meaningless, contrary to established rules of statutory interpretation highlighted earlier in this Brief.

In support of their argument, the JA repeatedly cite to the 2011 Nicor Merger order as support for their claim that only the *status quo* need be maintained in order for merger approval to be granted. JA IB at 33. This argument fails on its face. While the cited order references the *status quo* as a relevant standard under a Section 7-204 analysis, the Order also conspicuously notes that no evidence was presented that Nicor’s existing “*status quo*” utility service was in any way deficient. Nicor Merger Order at 13. (“No one contends here that NG’s service quality is presently sub-standard or vulnerable to slippage for any reason unrelated to merger.”) That certainly is not the case here. The critical contested issue in this docket has been an evaluation of whether the JA have the ability to seamlessly *improve* the severely troubled AMRP operations, consistent with *all* of the Liberty audit team’s recommendations.

¹⁶ JA IB at 9.

Unlike the Nicor Merger docket, in which the Commission specifically found that the *status quo* Nicor utility service was not deficient, the instant docket is replete with record evidence that PGL operations related to the AMRP are terribly compromised, and have resulted in significant cost overruns that continue to be passed onto ratepayers, both through the new Rider QIP and in their frequent base rate increase filings. Nearly two years ago, the Commission was so concerned about the state of the PGL AMRP that it ordered the now-ongoing Liberty audit in an attempt to identify and correct the myriad of deficiencies, including an utter lack of budgetary cost controls and overall AMRP plan, in the operation of multi-billion-dollar infrastructure project. In this docket, the Commission has been presented with the almost-completely-unrebutted evidence from Mr. Coppola and Mr. Cheaks that detail the problems and cost overruns that plague the AMRP project. To not address these issues and proactively ensure that any new owner of Peoples Gas's utility operations will not only implement all Liberty audit recommendations but commit to improve performance through adherence to the conditions recommended by Mr. Coppola and Mr. Cheaks amounts to a failure to protect the public interest, as the Commission is obligated to do under Section 7-204(f) of the Act.

Moreover, implementation of conditions that are not necessarily tied to Section 7-204(b) but are designed to ensure that the public interest is served is common practice in ICC merger orders. *See, e.g., In re SBC Communications, Inc.* 1999WL 1331303 (ICC Docket No. 98-0555, September 23, 1999); Nicor/AGL Resources Merger, ICC Docket No. 11-0046, Order of December 7, 2011, Appendix A. The Joint Applicants' invitation to the Commission to ignore its duty under Section 7-204(f) and adopt WEC's flawed interpretation of this subsection is an invitation to potential appellate reversal, and leaves ratepayers assuming all of the risk of merger approval. That entreaty should be rejected.

The Joint Applicants attempt one other argument to dissuade Commission adoption of significant and meaningful merger conditions related to the AMRP. Amazingly, they argue that because Liberty’s interim findings “are preliminary and subject to change...it may be that the particular conditions proposed by the AG and City/CUB now could conflict and/or interfere with the final recommendations that Liberty will make in its final report.” JA IB at 34. To be blunt, that is little more than rhetoric. The AG-proposed AMRP conditions simply require that the Joint Applicants adhere to the process that the Liberty auditors state in the Interim Audit Report has already begun. *See, e.g.*, AG Ex. 6.1 at S-4. The point is that WEC must *not* be permitted to slow or in any way halt the progress that Liberty auditors indicate is occurring now at Peoples. In addition, the Liberty auditors themselves specifically stated that their Interim Report observations about [REDACTED]

[REDACTED] *Id.* at S-1. That language makes clear that implementation of Interim Audit recommendations will not *in any way* disrupt the final audit recommendation implementation process – a process that has no specific timetable, according to the record evidence.

2. Mr. Coppola’s proposed reporting requirements are not duplicative or redundant of existing PGL filings.

Finally, the Joint Applicants suggest that the conditions advocated by Mr. Coppola and Mr. Cheaks are “either redundant of existing AMRP requirements, or would add little value to the massive amounts of information” that Peoples Gas currently supplies to the Commission and the City of Chicago. That argument misses the mark. As AG witness Coppola noted, the “massive amounts of information” that JA witness Schott identified consist exclusively of historic information about AMRP expenditures, which has limited value. AG Ex. 4.0 at 9:126-

131. The point the JA miss is that the additional information requested by Mr. Coppola is designed to ensure accountability and proof of performance. He noted that the requested information is designed to reveal explanations, both quantitative and qualitative, for AMRP performance shortfalls and progress. *Id.* at 9:132-135. Most importantly, Mr. Coppola noted that the Company must provide “clear evidence” that designated high-risk mains have been replaced. *Id.* at 9:136-138. The record evidence shows that currently, PGL “does not maintain gas main segment data in a manner that could be used to provide a list of historical main rank index (MRI) values.” *Id.* at 9:138-150. In addition, the evidence shows that PGL does not track the cost of main replacement by segment. *Id.* at 9:154-156. Mr. Coppola found that statement incredible. In addition, discovery elicited from Peoples Gas revealed no information that allows the parties and Staff to understand whether meaningful progress is being made towards removing pipe segments that have high MRI rankings. *Id.* at 10-13:167-232.

Thus there is no “duplication of effort” in adopting the recommendations of Mr. Coppola and Mr. Cheaks to ensure that progress on the AMRP can be effectively monitored. This astounding opposition to any proposals to correct and monitor AMRP activity is consistent with the continued deflection by the Joint Applicants of Intervenor proposed conditions designed to ensure the public interest.

3. The JA’s criticism of Mr. Coppola’s proposed disallowance of excessive street degradation fees should be rejected.

The JA further opine that AG witness Coppola’s proposed condition that requires PGL to exclude from base rates and Rider QIP surcharges any “excessive street degradation fees found to be unreasonable and imprudently incurred” is “unrelated to the proposed Reorganization or any impact that the merger may have on the Gas Companies or their customers.” JA IB at 36.

This criticism echoes the JA's flawed interpretation of Section 7-204(f) of the Act, a subsection that specifically permits the Commission to attach conditions to any merger approval that it deems are in the public interest. As noted, above, the JA's interpretation would essentially render subsection 7-204(f) meaningless, and thus should be rejected.

Moreover, the record evidence supports the need for such a prohibition. City/CUB witness Cheaks testified that these are not a normal level of fees – PGL incurred \$12.6 million since 2012 – and expressed his frustration that the company continues to perform AMRP work in moratorium streets. City/CUB Ex. 3.0 at 24-25:490-501. The Companies admit they have included the fees in customer rates. AG Ex. 4.0 at 16:298-306. It is clear from Mr. Cheaks' testimony, which notes that PGL fails to adhere to its own MRI in the selection of main replacement locations, that he is frustrated with the Companies' refusal to attempt to minimize moratorium street work, which totaled more than 2,700 separate incidences of street degradation fees being assessed from 2012-2014. *Id.* The evidence supports a Commission conclusion that that behavior is *not* reasonable, and should be the subject of a condition of merger approval that prohibits recovery in customer rates of these fees. One suspects that the Joint Applicants would not tolerate that behavior if shareholders were responsible for the fees. Adoption of this condition would incite better behavior on PGL's and the acquiring company's part and help ensure least-cost utility service.

In sum, the above-listed merger conditions proposed by AG witness Coppola and City of Chicago/CUB witness Cheaks should be adopted by the Commission in order to protect the public interest, pursuant to Section 7-204(f) of the Act.

H. The AG-Proposed Conditions Related to Employee Numbers and Overstated ICE Expenses Are Designed to Diminish the Merger’s Impact on Customer Service and Rates.

1. AG Witness Effron’s condition tied to ensuring reliable utility service consistent with the most recent employee number information forecasted in the 2014 PGL/NS rate case should be adopted.

Both Staff and the JA challenge AG witness David Effron’s proposals to ensure that PGL and NS customer rates, service, and reliability are not further negatively impacted by the proposed merger. His refund proposals are predicated on fully capturing savings that have come to light in this case by proposing rate changes to reflect the benefit that the Joint Applicants would experience post-merger. Specifically, Mr. Effron’s proposals would permit the adjustment of rates going forward to reflect employee number and Integrys Customer Experience (“ICE”) expenses that are inconsistent with PGL/NS forecasts of these expenses that were included in rates set pursuant to the Commission’s order in the recent PGL/NS rate case, Docket Nos. 14-0224/0225 (cons.), in January of this year.

For its part, Staff argues in its Brief that it, like Mr. Effron, is troubled by the fact that the number of employees that the JA have committed they will retain after the close of any reorganization is significantly lower than the level of employees the Gas Companies forecasted and the Commission approved in the just-completed 2014 PGL/NS rate case. Staff points out the same flaws in the JA’s commitment to retain a total of 1,953 employees for PGL, NS and Integrys Business Support two years post-merger that the People identified in their Initial Brief: (1) the commitment, while based on assumed Full-Time Equivalent (“FTE”) numbers for each Gas Company and Integrys Business Support, is made in the aggregate, not by company; (2) there is no description of how this commitment breaks down between administrative support and

front line operational employees; (3) the 1,953 FTE commitment breaks down to 1,294 FTEs for Peoples Gas and 166 FTEs for North Shore; and (4) in the recently completed PGL/NS rate case, Docket Nos. 14-0224/0225 (cons.), Peoples Gas and North Shore forecasted 1,356 and 178 FTEs, respectively, for the 2015 test year, which presumably represent the level of FTEs needed to provide adequate, reliable, efficient, safe, and least-cost service in 2015 and 2016. Staff IB at 11-16. Staff seeks to require the JA to retain the number of employees that are currently represented in rates, i.e. the numbers forecasted for the 2015 test year in Docket No. 14-0224/-0225. Staff Ex. 9.0 at 21:520-522.

In response to that request, the JA proposed an alternative commitment to retain this higher number of employees for at least two years after the close of the requested reorganization. The Commission should implement that condition should it approve the merger. That being said, if numbers drop below that level, 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 merger 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.

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, contrary to the JA's claim that to do so would constitute unlawful retroactive ratemaking. JA IB at 40-41. Again, Section 7-204(f) of the Act provides the Commission with the ability to impose conditions on a merger approval that it believes are necessary to protect the public interest. Stating one thing in a rate case (that the Company will need X number of employees, which will be reflected in customer rates) and then agreeing to maintain a lower number of employees as an alleged benefit of the proposed merger is hardly a win for ratepayers, and arguably diminishes the safety, reliability and least cost nature of utility service, as prohibited under Section 7-204(b)(1) of the Act. It represents an effort to ensure that the number of employees 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) is actually reflected in customer rates. It should be adopted by the Commission, along with the JA's alternative FTE commitment.

2. AG Witness Effron's condition tied to ensuring that ICE-related expenses are properly reflected in Gas Company customer rates should be adopted.

Staff argues in its Brief that AG witness Effron's proposal that any merger approval be conditioned on the JA's agreement to reflect an additional benefit to PGL/NS customers in rates based on new information in the record in this docket demonstrating that the Gas Companies will

be experiencing significant savings post-merger related to the ICE project¹⁷ would constitute an unlawful rider. Staff IB at 43. The JA, on the other hand, characterized the proposal as unlawful retroactive ratemaking. JA IB at 41.

Both interpretations of the proposal are incorrect. First, Mr. Effron's proposed condition is offered as an attempt to ensure that new information about the ICE project provided by the JA in this merger proceeding is reflected in customer rate going *forward*, not, as the JA suggest, to cure some past rate infraction. In no way does it seek any kind of retroactive adjustment of rates. It would not be implemented pursuant to any refund provision of the Act, but rather as a condition of the merger pursuant to Section 7-204(f) of the Act.

Second, the Commission has specifically rejected the argument that rate adjustment proposals in the context of merger proceedings trigger single-issue and retroactive ratemaking concerns under Article IX principles. The Commission has stated:

The fundamental requirement for a rate is that it must be just and reasonable, and a proposed rate change must also be just and reasonable. A rate must also be non-discriminatory, and, as discussed above, it cannot, per Section 9-230, reflect capital costs associated with non-regulated affiliates. Accordingly, a merger proposal that would likely render a rate unjust, unreasonable, discriminatory or infused with prohibited capital cost is adversely impacting that rate within the meaning of subsection 7-204(b)(7), irrespective of whether the rate will increase. Moreover, a merger proceeding involves a change of ownership, not ratemaking. Indeed, if ratemaking were allowed, the Commission would have to do the very thing the JA have decried throughout this

¹⁷ The ICE project will unify Cfirst, which is the customer information system that Peoples Gas and North Shore currently use, 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)).

proceeding - set rates without a full assessment of costs and revenues in a test year.

Third, the prohibition against single-issue ratemaking is not, as JA claim, violated by focusing, in a reorganization proceeding, on fewer than all of the cost elements that the Commission considers when setting rates. Again, this is not a ratemaking case - a distinction the General Assembly certainly understood when it established different schemes for, respectively, reviewing merger requests and setting rates.

Nicor/AGL Resources Merger Order (Docket No. 11-0046) at 29-30. In that case, the Commission rejected claims by AGL/Nicor that the “adverse rate impacts” prohibited by the statute cannot occur unless the “totality” of a merger, rather than a limited number of cost elements, will likely affect the utility’s retail rates. *Id.* at 29. The Commission stated, “Absolutely nothing in the subsection states or implies that only the ‘totality’ of a proposed merger can have the precluded adverse impact. Subsection (b)(7) bars ‘any’ likely adverse rate impact, of whatever cause associated with reorganization. Indeed, the Commission cannot perceive what would constitute the ‘totality’ of merger, why the legislature would not protect retail customers from adverse rate impacts resulting from less than a ‘totality,’ or why resources should be expended debating or implementing a ‘totality’ standard.” *Id.*

In the instant case, the evidence makes clear that unless action is taken under Section 7-204(f), ratepayers will be adversely impacted by rates that reflect all of the costs but none of the savings associated with the ICE project. Moreover, contrary to Staff’s unlawful rider argument, the proposal by Mr. Effron is not intended to be a permanent rider mechanism. Rather it is intended to provide the benefit that the Joint Applicants’ discovery responses indicate will occur in 2015 and beyond. If the Commission is uncomfortable in recognizing this benefit through a rider refund mechanism, it should calculate the value of the ICE-related benefit for the period of any rate freeze and provide a one-time refund to PGL/NS customers at the close of the merger.

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 “hard benefits” commence with the in-service date of the ICE project, as the Joint Applicants assert will occur, the Gas Companies will be recovering \$19.2 million¹⁸ annually in non-existent expenses when the ICE project goes into service. AG Ex. 1.0 (Effron Direct) at 18-19:409-414. 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 100% of the benefits of the ICE project would be retained for shareholders. *Id.* at 19:414-420.

For all of these reasons, and as discussed above in the AG Initial 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).

I. The City/CUB Five-Year Rate Freeze Proposal and the AG-Proposed Revenue Neutral Customer Charge Reduction Proposal Should Be Adopted As Conditions of Any Merger Approval.

In response to the City/CUB proposed five-year rate freeze merger commitment proposal, the JA again argue that this proceeding “is not to create benefits or other enhancements in a utility’s service quality before approving a reorganization” [sic]. JA IB at 44. In the JA’s view of the case, if the Commission concludes that the required findings under subsection (b) of the statute that the proposed merger “will at least maintain the utility’s status quo and not diminish or adversely impact the utility’s service quality or rates” the merger must be approved. *Id.*

Again, as noted repeatedly above, this interpretation of the Commission’s obligations under Section 7-204 of the Act is simply wrong, and would render subsection (f) of the statute

¹⁸



meaningless. That viewpoint runs counter to well-established rules of statutory interpretation.

The JA also argue that the proposal does not take into account the 5.5% annual cap included in Rider QIP or that City of Chicago regulations “have led to dramatic increases in the costs of performing operational work” that will not be recovered in either the Rider or the 2014 rate case, citing JA witness Leverett’s Rebuttal testimony. JA IB at 45. These arguments, too, should be rejected. A review of the cited testimony that proffers these arguments (JA Ex. 6.0 at 34) includes no specific discussion of dollar amounts tied to either the Rider QIP claim or the amount of extraordinary expenses incurred as a result of the new City regulations. Moreover, given Mr. Leverett’s astounding lack of knowledge about either the AMRP or Rider QIP revealed in cross-examination, these arguments ring hollow. *See, e.g.*, Tr. at 146-237.

In addition, the Joint Applicants suggest that rather than committing to a rate freeze, net savings will occur over time, citing the testimony of JA witness Mr. Reed. JA IB at 45. But Mr. Reed’s claimed savings were so vague as to be meaningless, and his comparison of savings that occurred in other mergers proved to be irrelevant to the instant proceeding. *See* AG Initial Brief at 49-50; Tr. at 343-345.

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 Gas Companies’ revenue recovery mechanisms, as noted by City/CUB witness Gorman. *See* City/CUB Ex. 4.0 at 10. In addition, since the initiation of this docket, the Illinois Supreme Court affirmed the Commission’s approval of the permanent decoupling mechanism known as Rider VBA, 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”). As City/CUB witness Gorman testified, without protective actions by the Commission, 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. His conclusion that “a longer term base rate freeze period will provide customers some assurance of benefits from the reorganization” is supported by the record. City/CUB Ex. 4.0 at 10:230-232.

Likewise, the AG proposal to put in place a revenue-neutral reduction in the PGL/NS residential heating customer charge would provide ratepayers some assurance of benefits from the merger going forward. *See* AG Initial Brief at 65-67. The Supreme Court Decoupling Opinion earlier this year provided added value to WEC shareholders, as noted above, because it effectively settled any uncertainty as to whether the Gas Companies would be permitted to retain their decoupling riders going forward. Again, 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. It, too, should be adopted by the Commission as a condition to any merger approval.

III. CONCLUSION

Wherefore, for the reasons explained in the AG Initial and Reply Briefs, 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 of the AG Initial Brief.

Respectfully submitted,

PEOPLE OF THE STATE OF ILLINOIS
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