STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	)	
	)	
The Peoples Gas Light	)	
and Coke Company	)	
Petition to Review Affiliate Interactions with	)	Docket Nos. 12-0273
Peoples Energy Home Services, Pursuant	)	and 13-0612 (cons.)
to January 10, 2012 Rate Order	)	
	)	
Illinois Commerce Commission	)	
On Its Own Motion	)	
-vs-	)	
North Shore Gas Company	)	
The Peoples Gas Light and Coke Company	)	
Investigation into interactions with affiliates.	)	

INITIAL BRIEF OF NORTH SHORE GAS COMPANY
AND THE PEOPLES GAS LIGHT AND COKE COMPANY

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Pursuant to Section 200.800 of the Illinois Commerce Commission's ("Commission") Rules of Practice (83 Illinois Administrative Code § 200.800) and the schedule established by the Administrative Law Judge (Notice of Administrative Law Judge's Ruling and Notice of Schedule, dated March 26, 2015), North Shore Gas Company ("North Shore") and The Peoples Gas Light and Coke Company ("Peoples Gas") (together, the "Gas Companies") file their Initial Brief in this consolidated proceeding.

I. INTRODUCTION

The Commission, in its January 10, 2012 Order in the Gas Companies' 2012 test year rate cases, directed the Gas Companies "to file a petition and testimony demonstrating that the Utilities' affiliate interactions are in compliance with the STA and the Master AIA. Additionally, the petition and testimony must address any jurisdictional issues with the Master AIA agreement pending in Wisconsin. Finally this petition and testimony must provide full cost justification for the repair rates charged to ratepayers as well."[1] On April 9, 2012, the Gas Companies filed the petition, with the testimony of two witnesses, which initiated Docket No. 12-0273.

On November 6, 2013, the Commission issued an Order initiating an investigation into North Shore's and Peoples Gas' interactions with affiliated interests. That matter is Docket No. 13-0612. In that Order, the Commission consolidated the investigation with Docket No. 12-0273.

[1] *North Shore Gas Company et al*., ICC Docket Nos. 11-0280/11-0281 (Order, Jan. 10, 2012) (*2012 Rate Case*) at 98; Kallas Direct Testimony ("Dir. Test."), NS-PGL Exhibit ("Ex.") 7.0 at 3. As described in more detail in Section II of this Initial Brief, the "STA" is the "Services and Transfers Agreement" that the Commission approved in Docket No. 06-0540, and the "Master AIA" is the affiliated interest agreement that the Commission approved in Docket No. 10-0408. The STA is no longer in effect.

The consolidated proceeding was treated as an investigation. As such, Commission Staff filed the last round of testimony and bears the burden of proof in this matter.

Summary: The Gas Companies disagree with many of the characterizations of their affiliate interactions and many of the conclusions that Staff witness David Sackett drew in this matter.[2] North Shore and Peoples Gas acknowledged that some errors occurred. Considering the large number of inter-company services and transactions, some errors are inevitable. However, the record includes no evidence of pervasive errors or intentional actions to give preferences to any affiliated company. The several audits, internal and external, of activity under the agreements have not disclosed systemic problems. Kallas Supplemental Direct Testimony ("Supp. Dir. Test."), NS-PGL Ex. 1.0 at 4.

Given that much of the testimony involved companies and agreements that no longer exist, services that are no longer provided, and a relative paucity of transactions with alleged deficiencies, the Gas Companies focused on resolving contested matters that affect existing agreements, companies and services. To that end, they accepted many proposed restrictions on how the Gas Companies may interact with their affiliated interests and added safeguards such as asset transfer requirements and more detailed audit requirements. Those restrictions would be contractually set forth in a rider to the Master AIA. The rider would apply only to North Shore's and Peoples Gas' interactions with their affiliated interests and would otherwise have no effect on any other Integrys Energy Group, Inc. ("Integrys") company. The Gas Companies' proposed rider is

[2] Sackett Dir. Test., ICC Staff Ex. 1.0 Rev.; Sackett Rebuttal Testimony ("Reb. Test."), ICC Staff Ex. 2.0; Sackett Surrebuttal Testimony ("Sur. Test."), ICC Staff Ex. 3.0.

Attachment A to this Initial Brief. The Gas Companies respectfully request that the Commission accept this rider as a resolution of the matters at issue in this consolidated proceeding.

II. OVERVIEW

North Shore and Peoples Gas are each public utilities under the Public Utilities Act (the "Act"). 220 ILCS 5/1-101 *et seq*. Kallas Dir. Test., NS-PGL Ex. 7.0 at 3-4. Each is a wholly-owned subsidiary of Peoples Energy, LLC ("PELLC"), which is a wholly-owned subsidiary of Integrys. Integrys Business Support, LLC ("IBS") is also a wholly-owned subsidiary of Integrys and is a centralized service company that provides inter-company services to all the companies in the Integrys system, including North Shore and Peoples Gas. Kallas Supp. Dir. Test., NS-PGL Ex. 1.0 at 3; Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 7. At the close of the record in this matter[3], North Shore and Peoples Gas provide services to and receive services from their affiliated interests under two Commission-approved affiliated interest agreements.[4] One of those agreements governs IBS' services to its regulated utility affiliates, including North Shore and Peoples Gas. The Commission approved this agreement in Docket No. 07-0361, and the Gas Companies often refer to it as the "IBS Reg AIA." Only IBS is a service provider under the IBS Reg AIA.[5] Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 2-3. The other agreement, which took effect January 1, 2014, governs provision of services by

[3] The Gas Companies include this qualification because affiliated interest agreements are before the Commission in Docket No. 14-0496, a proceeding under Section 7-204 of the Act for approval of a Reorganization under which Wisconsin Energy Corporation would acquire Integrys.

[4] Other affiliated interest agreements for more narrow purposes are in effect. For example, Integrys has a tax allocation agreement that the Commission approved in Docket No. 07-0458 and North Shore and Peoples Gas have a storage service agreement that the Commission approved in Docket No. 12-0381. Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 3. This case and this Initial Brief focus on the broader services agreements.

[5] IBS provides services to non-utility affiliates under an agreement (the "IBS Non-Reg AIA") that is similar, but not identical, to the IBS Reg AIA. Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 2.

any Integrys entity (excluding IBS[6]) to any other Integrys entity (including IBS). The Commission approved this agreement in Docket No. 10-0408, and Staff witness Mr. Sackett referred to it as the "Master AIA." (The Gas Companies sometimes refer to it as the "Non-IBS AIA," as it is the agreement under which companies other than IBS are service providers.) Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 2-3.

Docket No. 12-0273: In Docket No. 12-0273, the Gas Companies included with their Petition the direct testimony of Linda Kallas (NS-PGL Ex. 7.0) and Jerard Julian (NS-PGL Ex. 8.0). The matters in the *2012 Rate Case* that led to the filing concerned Peoples Energy Home Services ("PEHS"), particularly PEHS' offering of a service called the "Pipeline Protection Program" ("PPP"), which Mr. Julian described. North Shore and Peoples Gas provided inter-company services to PEHS to support the PPP. IBS also provided some support services. PEHS ceased PPP services on September 30, 2012, and PEHS was dissolved as a corporation in 2012. Julian Supp. Dir. Test., NS-PGL Ex. 5.0 at 2; Kallas Supp. Dir. Test., NS-PGL Ex. 1.0 at 2.

Docket Nos. 12-0273 / 13-0612: In the consolidated proceeding, the Gas Companies offered the supplemental direct and rebuttal testimonies of Ms. Kallas (NS-PGL Exs. 1.0 and 6.0); and the supplemental direct testimony of Alana Renier (NS-PGL Ex. 2.0); Tracy Kupsh (NS-PGL Ex. 3.0); Christine Gregor (NS-PGL Ex. 4.0); and Mr. Julian (NS-PGL Ex. 5.0). All the witnesses are employed by IBS.

Ms. Kallas, the Gas Companies' Vice President and Controller, provided an overview of the Gas Companies' various affiliated interests during the time period addressed in Commission Staff testimony, explaining that many of these companies no

[6] IBS is not a service provider under the Master AIA because it provides services only under the IBS Reg AIA and the IBS Non-Reg AIA.

longer exist; described the various affiliated interest agreements in effect during this period, explaining that some have been replaced; responded to certain specific allegations by Commission Staff witness Mr. Sackett; and, using a proposal by Mr. Sackett as a starting point, sponsored a "rider" that would modify the Master AIA as it applies to North Shore and Peoples Gas.

Ms. Renier, Supervisor - Corporate Budgets, Cash Flows and Reporting, addressed services provided under the affiliated interest agreements under which companies in Integrys' holding company system, including North Shore and Peoples Gas, provide services to other companies, including to IBS, in the Integrys system.

Ms. Kupsh, Director Operations Accounting for Integrys Business Support, LLC, described services that IBS provides under the affiliated interest agreements to companies in Integrys' holding company system, including North Shore and Peoples Gas.

Ms. Gregor, Director Operations Accounting for Peoples Gas and North Shore, responded to Staff witness Mr. Sackett's direct testimony as it pertains to various allegations about charges and allocations involving non-utility affiliates.

Mr. Julian, Manager of Billing in Customer Relations, addressed PEHS' PPP and repair services that the Gas Companies provided and continue to provide to customers.

Integrys Affiliated Interest Agreements: Section 7-101 of the Act defines "affiliated interests" and requires prior Commission approval of a broad range of contracts and arrangements. 220 ILCS 5/7-101. As described below, the Gas Companies have received prior Commission approval for several affiliated interest service agreements, of which two are relevant to this matter. One of the stated

purposes in opening the investigation was to consider if changes to agreements would be appropriate.[7] Only the following two agreements need to be considered in that context, namely:

1. The **IBS Reg AIA**. This agreement has been in effect since January 1, 2008. Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 2.

2. The **Master AIA**. This agreement has been in effect since January 1, 2014. As described below, it replaced three agreements. Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 2-3.

The *2012 Rate Case* Order and the testimony in this case reference other agreements. For informational purposes, the agreements that are no longer in effect or to which North Shore and Peoples Gas are not parties, and, thus, are irrelevant to any consideration of revising an agreement, are:

1. **Services and Transfers Agreement ("STA")**. This agreement is no longer in effect. On January 1, 2014, the Master AIA replaced it. Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 3. The STA was an agreement among PELLC and its subsidiaries under which the parties provided services to and received services from other parties. Among other things, Peoples Gas and North Shore provided services to PEHS under the STA. The Commission approved the STA in Docket No. 06-0540, which was the Section 7-204 proceeding in which it approved the reorganization by which PELLC (then Peoples Energy Corporation) became part of Integrys (formerly, WPS Resources Corporation). In Docket No. 07-0492, the Commission approved an amendment to the STA. In Docket No. 10-0588, the Commission approved the

[7] Illinois Commerce Commission *vs*. North Shore Gas Company *et al*., Investigation into interactions with affiliates, ICC Docket No. 13-0612 (Order, Nov. 6, 2013) at 1.

transfer of the STA from Peoples Energy Corporation to PELLC. Kallas Dir. Test., NS-PGL Ex. 7.0 at 6. As Mr. Sackett stated, the STA replaced an affiliated interest service agreement approved in Docket No. 55071. Sackett Dir. Test., ICC Staff Ex. 1.0 Rev. at 14.

2. **Affiliated Interest Agreement ("Regulated Agreement")**. This agreement is no longer in effect, but the Gas Companies were parties to it. The Master AIA replaced it, effective January 1, 2014. Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 3. PEHS and other non-utility companies, were not parties to it and could not have provided and received services under it. This was an agreement that existed as a service agreement for WPS Resources Corporation and its state-regulated utility affiliates prior to its acquisition of Peoples Energy Corporation. North Shore and Peoples Gas were added as parties, and, for this reason, the Commission reviewed and approved the addition of North Shore and Peoples Gas to this agreement in Docket No. 06-0540. Kallas Dir. Test., NS-PGL Ex. 7.0 at 7.

3. **First Amended Master Affiliated Interest Agreement ("Non-Regulated Agreement")**. This agreement is no longer in effect, and the Gas Companies were never parties to it. The Master AIA replaced it, effective January 1, 2014. Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 3. PEHS could have provided and received services under this agreement, but that was unlikely to occur. This was an agreement that existed as a service agreement for WPS Resources Corporation and certain of its non-utility affiliates prior to its acquisition of Peoples Energy Corporation. Wisconsin Public Service Corporation, a public utility in Wisconsin and Michigan, was also a party to it. North Shore and Peoples Gas were not parties,

and, for this reason, the Commission did not review or approve this agreement. Kallas Dir. Test., NS-PGL Ex. 7.0 at 6.

4. **The Master Non-Regulated Affiliated Interest Agreement ("IBS Non-Reg AIA")**. Like the IBS Reg AIA, this agreement took effect January 1, 2008. This is the agreement under which IBS provides services to Integrys' non-utility subsidiaries. IBS provided services to PEHS under this agreement. North Shore and Peoples Gas are not and never were parties, and, for this reason, the Commission did not review or approve this agreement. Kallas Dir. Test., NS-PGL Ex. 7.0 at 7; Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 2.

Gas Companies' Affiliated Interests: The Staff testimony discusses several companies' interactions with the Gas Companies[8], but some of these companies no longer exist and others have no interaction with North Shore or Peoples Gas.[9] Kallas Supp. Dir. Test., NS-PGL Ex. 1.0 at 2.

PEHS was a wholly-owned subsidiary of PELLC that was formed to engage in the business of selling HVAC products and services. It was dissolved in 2012. *Id.*

enovate, LLC was a partially-owned subsidiary of PELLC that was formed to engage in non-utility, wholesale energy transactions. enovate, LLC was dissolved in 2003. *Id.*

[8] For example, PEHS (Sackett Dir. Test., ICC Staff Ex. 1.0 Rev., p. 15); enovate, LLC (*Id.*, p. 17); Integrys Transportation Fuels, LLC ("ITF") (*Id.*, p. 43); Trillium USA Company, Trillium USA, LLC, Pinnacle CNG Company, and Pinnacle CNG Systems, LLC (*Id.*, p. 43); and PNGV Corp. (*Id.*, pp. 17, 69)

[9] When describing companies as wholly- or partially-owned subsidiaries of PELLC, this means the company's parent is or was PELLC, but it could be or have been a second tier subsidiary. Also, references to PELLC include its predecessor, Peoples Energy Corporation. Kallas Supp. Dir. Test., NS-PGL Ex. 1.0 at 3.

Peoples NGV Corporation ("PNGV") was a wholly-owned subsidiary of PELLC that was formed to promote the use of compressed natural gas vehicles in the Chicago area. It was dissolved in 2007. *Id.* at 3.

Integrys acquired Trillium USA Company, Trillium USA, LLC, Pinnacle CNG Company, and Pinnacle CNG Systems, LLC, which became subsidiaries of ITF, in September 2011. Integrys formed ITF as the parent of these companies. These companies, themselves or through subsidiaries or through ventures with other companies, engage in the transportation fueling business, particularly compressed natural gas products and services. *Id.*

III. ARGUMENT

A. Gas Companies' Interactions with Affiliates

IBS Agreements: At this Commission's and the Public Service Commission of Wisconsin's urging[10], Integrys' intercompany services are dominated by a shared service company model. IBS is a centralized service company or a shared services company. This model puts most of the activity in a company that has specific processes and focus relative to billing other companies. It reduced the services that the Gas Companies provide to any non-regulated company. Kallas Supp. Dir. Test., NS-PGL Ex. 1.0 at 4.

IBS began providing services on January 1, 2008. Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 2. To put IBS costs and billings in perspective, the following charts show total IBS billing and IBS billings to the parties.

[10] *WPS Resources Corporation et al*., ICC Docket No. 06-0540 (Order, Feb. 7, 2007), Condition of Approval 10; *Investigation on the Commission's Own Motion into the Merger, Combination, Reorganization of WPS Resources Corporation and Peoples Energy Corporation,* PSCW Docket No. 9405-YI-100 (Final Dec., Feb. 16, 2007) at 14, 21.

TOTAL IBS MANAGED CROSS CHARGES TO UTILITY AFFILIATES' INCOME STATEMENTS (AMOUNTS IN DOLLARS)							
Year	TOTAL IBS (utility and non-utility)	MERC	MGU	PGL	NSG	WPSC	UPPCo
2008	409,358,729	20,071,198	17,176,223	152,689,875	26,584,596	139,965,960	15,922,008
2009	454,337,556	21,878,498	18,313,944	174,155,845	28,243,481	146,934,688	17,829,729
2010	438,929,318	23,614,180	19,151,560	167,252,566	30,769,386	148,553,554	16,112,253
2011	440,524,282	25,202,766	20,554,178	171,169,431	28,335,004	148,835,842	16,835,158
2012	449,094,794	25,669,492	20,634,166	173,039,762	28,734,344	148,853,872	15,504,221

TOTAL IBS MANAGED CROSS CHARGES TO NON-UTILITY AFFILIATES' INCOME STATEMENTS (AMOUNTS IN DOLLARS)						
Year	TOTAL IBS (utility and non-utility)	TEGE	ITF	TEG	WRPCo	ALL OTHERS
2008	409,358,729	30,653,018	0	3,018,785	1,384,851	1,892,216
2009	454,337,556	40,130,179	0	4,651,904	1,314,687	884,600
2010	438,929,318	26,789,808	0	3,873,839	1,069,868	1,742,303
2011	440,524,282	22,583,991	0	4,410,765	1,134,393	1,462,755
2012	449,094,794	24,511,783	6,452,397	3,972,024	1,107,838	614,894

Id. at 9.[11]

IBS allocates to affiliates all costs that it incurs. The IBS agreements detail the determination of the IBS costs of services. First, costs are directly charged whenever appropriate and practicable. Second, where direct charging is not appropriate and practical, costs are allocated using cost causation principles that link costs related to a specific type of service to the customers receiving such service. Finally, all other cost allocations are broad based with a generalized cost basis proxy. *Id.* at 3.

IBS has processes to systematically track and charge affiliates for its services. Integrys uses payroll reporting and PeopleSoft systems to calculate and bill for intercompany services. Employees who work on projects and tasks for affiliates charge

[11] MERC is Minnesota Energy Resources Corporation; MGU is Michigan Gas Utilities Corporation; PGL is Peoples Gas; NSG is North Shore; UPPCo is Upper Peninsula Power Company, which Integrys sold in August 2014; TEGE is Integrys Energy Services, Inc., the retail marketing portion of which Integrys sold in November 2014; TEG is Integrys; and WRPCo is Wisconsin River Power Company. The category "all others" includes several non-utility affiliates that are not identified separately.

their time in the time reporting system. Overhead rates are applied to labor costs to account for payroll taxes, benefits, and a facilities loader. Materials and supplies, invoices, and other expenses are also charged to appropriate accounting strings at the responsible affiliate. At the end of each month's close, accounting personnel for each company review intercompany receivables generated in the accounting system and run an automated process to create a billing to each affiliate with charges each month. These bills are reviewed to the ledger and are sent to appropriate management at the affiliate company for review and approval. *Id.* at 3-4.

An IBS Cost Accounting Committee ("ICAC") is in place. The ICAC meets monthly to ensure consistency in the accounting and the related allocations and direct billing process. The ICAC includes an ICAC Steering Team and three advisory ICAC sub-teams, namely the ICAC Allocations team, ICAC Accounting team, and ICAC Reporting team. Each of these ICAC teams includes at least one IBS budget coordinator. IBS has budget coordinators for each functional area to assist in budgeting and forecasting, analyzing monthly variances, and analyzing cross charge budget to actual variances as a detective control. These budget coordinators are subject matter experts confirming through their monthly review and analysis that the budget to actual variances are sound. *Id.* at 4-5.

Master AIA (Non-IBS AIA): Processes under the Master AIA (*i.e.*, the Non-IBS AIA) are substantially similar to the IBS processes. Integrys uses its payroll reporting and PeopleSoft systems to calculate and bill for intercompany services. Employees charge their time in the time reporting system; overhead rates are applied to labor costs; materials and supplies, invoices, and other expenses are also charged to appropriate

accounting strings. At the end of each month's close, accounting personnel for each company review intercompany receivables generated in the accounting system. These bills are reviewed to the ledger and are sent to appropriate management at the affiliate company for review and approval. These processes to produce intercompany billings are generally unchanged from the time that Peoples Gas and North Shore began using Integrys-wide systems post-merger, which occurred in 2008. The processes to collect the charges are generally the same, whether the service recipient is a non-utility company or a utility company. Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 4.

The Master AIA and its administration include several controls that can help to address concerns about accurate billing (*e.g.*, Staff's allegations that the Gas Companies did not properly bill PEHS (*see, e.g.*, Sackett Dir. Test., ICC Staff Ex. 1.0 Rev. at 37-39)). First, the Master AIA provides that "[a]ll Services provided by any Regulated Party to any Non-Regulated Party shall be priced at the greater of cost or fair market value." This provision will be analyzed with a new Cost of Services Study every three years. The Master AIA includes an annual internal audit to review cost or market pricing of transactions under the Master AIA as well as accuracy of invoices issued under the Master AIA. Finally, each month, parties with intercompany accounts receivable balances produce a billing to each affiliate. This billing is reviewed by management at the billed affiliate prior to being paid. While these controls may not identify every instance of billing errors, they are measures that require regular, comprehensive oversight of compliance with the agreement. *Id*. at 5.

1. Pinnacle / Integrys Transportation Fuels

Pinnacle: The transaction with Pinnacle CNG Systems, LLC ("Pinnacle") that is a focus of this case was limited to construction of a compressed natural gas ("CNG") station for Peoples Gas. Construction of the station was completed in 2012. The agreement governing this transaction pre-dated the affiliation of Pinnacle with Peoples Gas.[12] While execution of the agreement was close in time to Integrys' acquisition of Pinnacle and performance occurred after the acquisition, the transaction properly proceeded under the agreement described below and not under an affiliated interest agreement. This transaction did not fall under, and raises no issues under, Section 7-101 of the Act. Moreover, utility customers were not adversely affected by this transaction.

The CNG station and timing associated with it were driven by a Department of Energy grant associated with the project. Prior to issuing a request for proposal ("RFP"), Peoples Gas had been negotiating agreements with another entity. The parties were unable to enter into the requisite agreements by a February 7, 2011 deadline. After resolving matters stemming from the failed negotiations, including those related to the grant, this ultimately led to IBS' RFP issuance to seek another entity to support the project and allow Peoples Gas to use the grant money. Sackett Dir. Test., ICC Staff Ex. 1.0 Rev., Attach. J and K. Specifically, prior to Integrys' acquisition of Pinnacle and other CNG entities, IBS conducted an RFP process to solicit bids for the construction of a CNG station for Peoples Gas. The RFP process began in early June

[12] None of the criteria for defining affiliated interests were met until Integrys acquired Pinnacle, which indisputably occurred after the construction agreement was negotiated and signed. Pinnacle and Peoples Gas were not in a common chain of ownership at the time they entered into the construction agreement. No evidence shows that Pinnacle, acting alone or in concert with any other entity, exercised any influence, much less substantial influence, over the policies and actions of the utility, Peoples Gas. 220 ILCS 5/7-101(2)(ii).

2011. Negotiations ensued with an exclusivity period extending through July 31, 2011, which the parties extended through August 31, 2011. *Id*., Attach. AB. The negotiations resulted in a construction agreement between Peoples Gas and Pinnacle that they executed in August 2011. As described above, Pinnacle, in September 2011, became and remains an affiliated interest of Peoples Gas. The RFP and the construction agreement negotiations and execution pre-dated Pinnacle becoming an affiliated interest of Peoples Gas under Section 7-101 of the Act. The construction agreement, therefore, and not an affiliated interest agreement, governed services, billing, and payment. Construction was completed in April 2012, and that concluded work under what Staff witness Mr. Sackett called the Pinnacle Agreement. There have been no payments under that agreement since August 2012. Gregor Supp. Dir. Test., NS-PGL Ex. 4.0 at 12.

In a 2013 test year rate case[13], Peoples Gas proposed to include the CNG station in its rate base, but it withdrew that proposal. Specifically, Peoples Gas proposed to include $858,000 in rate base. That amount was based on the actual costs of the project through December 2011. Staff witness Mr. Sackett claimed the amount was imprudent. Sackett Dir. Test., ICC Staff Ex. 1.0 Rev. at 48.[14] In any event, as Peoples Gas withdrew its proposal to include the cost of the CNG station in rate base, the costs to construct that station are not in Peoples Gas' rates, nor did the Commission make any findings about the prudence of the costs. *2013 Rate Case* Order at 9. This station is not in rate base even though Peoples Gas uses this station to fuel its natural

[13] *North Shore Gas Company et al*., ICC Docket Nos. 12-0511/12-0512 (Order, June 18, 2013) (*2013 Rate Case*).

[14] Note that the rate base that the Commission approved in the *2013 Rate Case* was $1,470,201,000. Gregor Supp. Dir. Test., NS-PGL Ex. 4.0 at 6. The CNG proposal, which was based on actual costs incurred when the record in the case was open, thus amounted to less than 0.06% of Peoples Gas' rate base.

gas fleet vehicles, which are used and useful to provide utility service to serve utility customers. Gregor Supp. Dir. Test., NS-PGL Ex. 4.0 at 5-6.

Only a limited number of services and cost allocations involving the Gas Companies and the CNG companies occur. Peoples Gas does not currently provide any significant, ongoing service to the CNG companies but charges the CNG companies, including Pinnacle, for *ad hoc* services. As examples, "*ad hoc*" services may include Pinnacle using a part from a Peoples Gas warehouse or receiving reimbursement for a third party invoice or share of a third party invoice that is attributable to the CNG companies. Warehousing is a type of service that a Regulated Party, like Peoples Gas, may provide to and receive from a Non-Regulated Party, like Pinnacle, under the Master AIA. Third party invoice payments, called "convenience payments," are a type of transaction that may occur between any parties to the Master AIA. Convenience payments are not services but are an efficient and practical way for the Integrys companies to pay for goods and services from outside vendors and appropriately assign cost responsibility to companies purchasing goods or taking service from the third parties. If a vendor provides service to two or more parties in the Integrys family and sends one detailed invoice for such services, the accounts payable system will generate payment for the invoice from one company's cash and create an intercompany receivable on the paying entity's books for the portion that relates to the other Integrys company(ies). The other Integrys company(ies) will then reimburse the paying company through the intercompany billing process for its (their) share of the third party invoice. Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 6. For example, if Peoples Gas buys 100 widgets that it and five other Integrys companies will use, Peoples Gas

will pay the vendor's invoice (rather than requiring the vendor to issue six invoices) and an appropriate share of the invoice will be allocated to the other five companies.

Integrys Transportation Fuels ("ITF"): ITF is the parent company of Pinnacle and other entities in the CNG business. Integrys formed ITF as a company when it acquired Pinnacle and those other entities. Peoples Gas currently takes services from ITF, and, unlike the Pinnacle Agreement that was negotiated and entered into with a non-affiliate, it does so under the Master AIA and, before that, under the STA. The interactions between Peoples Gas and ITF, which has always been an affiliated interest of Peoples Gas, are proper under Section 7-101 of the Act. Customers are not harmed by and, in fact, benefit from these interactions.

ITF provides operation and maintenance services for the CNG station that Pinnacle constructed. Maintenance services are a type of service that a Regulated Party may provide to and receive from a Non-Regulated Party under the Master AIA. *Id*. at 6-7. It makes sense for Peoples Gas to contract out for this service because the CNG facility has specific technology that requires expertise Peoples Gas employees do not possess. As the billing for this service from ITF is at cost with no mark-up, it is doubtful another company could provide the service at a similar cost and with the required expertise. The service is thus beneficial and cost-effective for Peoples Gas and its customers. Kallas Supp. Dir. Test., NS-PGL Ex. 1.0 at 7-8.

The record includes a sample intercompany billing from ITF to Peoples Gas. NS-PGL Ex. 2.1. Information on the sample includes a summary of charges by type of cost, hours charged by employee, detail on invoices and expense accounts that are being charged to the affiliate, detail on inventory items being charged to the affiliate, and detail

on other journal entries generating intercompany charges. Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 7. The services are provided to Peoples Gas at cost. However, the services will be subject to a pricing review to ensure that lower of cost or market pricing is used for services by a Non-Regulated Party to a Regulated Party when the first Cost of Services Study is completed by May 1, 2015. *Id*.

North Shore does not provide or receive any ongoing services from ITF or its subsidiaries at this time. However, the two companies could have intercompany charges for items such as shared third party invoices or transition services should an employee transfer situation occur. *Id*. IBS services to ITF are insignificant; for example, in 2012, the services amounted to only about 1.44% of IBS' total billing. Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 9.

2. PNGV Corp.

As stated above, PNGV was dissolved in 2007. Kallas Supp. Dir. Test., NS-PGL Ex. 1.0 at 3. This pre-dates IBS and the Master AIA. Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 2; Renier Supp. Dir. Test., NS-PGL Ex. 2.0 at 3. The record concerning PNGV is too sparse to draw any meaningful conclusions about affiliate transactions with PNGV. Staff raised questions about PNGV that pertain largely to activity in the 1990s and involved a CNG facility[15]. With the limited information available from this period, Peoples Gas was able to determine that billing may have been incorrect under the affiliated interest agreement in effect at that time, which priced services at "reasonable cost." During the 1990s, Peoples Gas billed PNGV for labor and a return on the asset; however, Peoples Gas was not billing for the depreciation on the asset during the time it was in service. Gregor Supp. Dir. Test., NS-PGL Ex. 4.0 at 6.

[15] This is not the CNG station discussed above in connection with Peoples Gas, Pinnacle and ITF.

The CNG station was constructed from December 1995 - June 1996. Sackett Dir. Test., ICC Staff Ex. 1.0 Rev. at 77. In response to Staff inquires, Peoples Gas reviewed its records to try to determine if Peoples Gas included the station in its rate base. Peoples Gas filed its Docket No. 95-0032 rate case on December 16, 1994, which was about one year prior to construction of the station. Rates in Docket No. 95-0032 were based on a forecasted 1996 test year. Inclusion would have been appropriate given that the facility went into service in the test year, and Peoples Gas had natural gas fleet vehicles that it fueled at the station and that it used to serve utility customers. Thus, the station would have been used and useful in serving utility customers. However, the only records available to review were the actual schedules filed in the case. Gas Companies witness Ms. Gregor reviewed B schedules and Schedule F-4, but there was no specific mention of a CNG station. Peoples Gas cannot conclude from the absence of references to the CNG station that it was not in rates, but, similarly, cannot assume that Peoples Gas proposed or the Commission approved inclusion in rates. In addition, while Schedule C-13 (affiliate billing) of the filing shows an amount billed to PNGV from Peoples Gas for the test year, Peoples Gas could not determine if it was for billings related to the CNG station. Gregor Supp. Dir. Test., NS-PGL Ex. 4.0 at 7.

The insubstantial evidence about PNGV supports no conclusions about affiliate transactions. At worst, Peoples Gas not billing for depreciation may have been inconsistent with the affiliate agreement in effect at the time. There is no evidence that customers were adversely affected by interactions between Peoples Gas and PNGV. The record supports no adverse findings concerning affiliate transactions between

Peoples Gas and PNGV. The affiliate agreement that governed the transactions has not been in effect since 2007, and the cost standard in that agreement ("reasonable cost") is not the standard in any existing agreement. Consequently, nothing about PNGV provides a basis for altering any existing affiliated interest agreements.

3. PEHS

PEHS, the affiliate that prompted the initiation of Docket No. 12-0273, is no longer in existence. The service, PPP, that PEHS offered with support from North Shore, Peoples Gas and IBS, is not offered by the Gas Companies or any of their affiliated interests.

The PPP was a service that customers could purchase to mitigate the cost and inconvenience that may arise from necessary repairs to gas piping for which the customer is responsible. The Gas Companies are responsible only for their meters, regulators, piping and related company-owned equipment. Piping after gas is metered, *e.g.*, from the meter to the customer's appliances, is customer-owned and is the customer's responsibility. For a monthly fee, PEHS was responsible for certain repairs to that customer-owned piping. No customer had to contract with PEHS or anyone else. A customer may choose to deal with any necessary repairs when the need arises. For example, if a customer requests, the Gas Companies provide this service in some cases but have no obligation to do so. The customer may contract with others for the service. Kallas Dir. Test., NS-PGL Ex. 7.0 at 4-5.

Key differences exist between a customer who chose to purchase PPP service and a customer who chose to ask the utility or another vendor to repair problems with customer-owned piping on a case-by-case basis. For customers who did not purchase

PPP, the Gas Companies provided non-utility repairs to customer piping and equipment, subject to resource availability. If the Gas Companies provided a repair service that a non-PPP customer requested, the customer paid the Gas Companies only for the repair (labor, time, materials, *etc*.). If the customer did not request or the utility did not provide a repair service, the customer paid the utility nothing. Unlike a PPP customer, the customer was not paying for a right to demand the service and paid only for services it received. A PPP customer paid a fixed monthly fee that allowed it to demand service. Julian Dir. Test., NS-PGL Ex. 8.0 at 3-5; NS-PGL Ex. 8.1; Julian Supp. Dir. Test., NS-PGL Ex. 5.0 at 2-4.

PEHS supported the PPP service through arrangements with its affiliated companies. The Gas Companies provided repair services. IBS provided minimal support in the form of soliciting customers requesting a service turn-on and including the PPP charge on utility bills. Kallas Dir. Test., NS-PGL Ex. 7.0 at 5.

Staff witness Mr. Sackett is correct that IBS did not go back and charge PEHS for actual solicitation services for 2008-2010 but did correct 2011-2012. The approximate amount that IBS should have billed PEHS for solicitation services for 2008-2010 is $60,000 in total. However, due to the timing of the Gas Companies' rate cases and the assumptions in those cases, there was no impact on customers. Gregor Supp. Dir. Test., NS-PGL Ex. 4.0 at 3-4.

The record supports no adverse findings concerning the Gas Companies' interactions with PEHS. Nothing about PEHS and the PPP provides a basis for changing the agreements. The Gas Companies did agree that they and IBS would not provide customer information to affiliates, other than information they provide to alternative gas suppliers on a non-discriminatory basis. Julian Supp. Dir. Test., NS-PGL Ex. 4.0 at 5.

That is, if the Gas Companies had an affiliated interest that is an alternative gas supplier, that affiliate could receive the same sorts of information that the Gas Companies provide non-affiliated alternative gas suppliers.

B. Changes to Gas Companies Affiliated Interest Agreement

In its Order initiating Docket No. 13-0612, the Commission, quoting the Staff report that it appended to the Order, stated the case should consider "any changes necessary to existing and pending Commission-approved affiliated interest agreements to ensure that these agreements are in the public interest."[16] In his direct testimony, Staff witness Mr. Sackett proposed a rider to the Master AIA. Gas Companies witness Ms. Kallas, in supplemental direct testimony, responded with proposed changes to the rider. The proposed rider underwent additional proposed changes, by both Staff and the Gas Companies, in later rounds of testimony and data requests and responses. Attached to this Initial Brief is the Gas Companies' proposed rider.

The Gas Companies will not describe the various iterations of the rider and their comments and concerns on those versions. Instead, this Initial Brief will address only what they understand to be the final Staff proposal, as set forth in ICC Staff Ex. 3.0 and ICC Staff Cross Ex. 4.0. The Gas Companies believe only one provision remains open, namely the definition of "incidental services."[17] ICC Staff Cross Ex. 3.0.

The rider would, for the Gas Companies, replace Appendix C of the Master AIA. It would have no effect on Appendix C as it applies to other Integrys companies, other than to the extent those other companies interact with the Gas Companies. For example, the rider would have no effect on services, if any, that Wisconsin Public

[16] Illinois Commerce Commission *vs*. North Shore Gas Company *et al*., Investigation into interactions with affiliates, ICC Docket No. 13-0612 (Order, Nov. 6, 2013) at 1.

[17] If the Gas Companies correctly understand how Staff intends ICC Staff Cross Ex. 4.0 to be incorporated in the rider, then no issues pertinent to the expanded audit requirements exist.

Service Corporation ("WPSC") may provide to Michigan Gas Utilities Corporation ("MGU"). Neither WPSC or MGU is an Illinois public utility and the transactions at issue do not involve an Illinois public utility (*i.e*., they do not involve North Shore or Peoples Gas). Similarly, the rider would have no effect on services, if any, that WPSC or MGU provides to or receives from ITF or Pinnacle. Kallas Reb. Test., NS-PGL Ex. 6.0 at 3.

Appendix C, as the Commission approved it in Docket No. 10-0408, is a two-page document that describes the services that parties may provide to and receive from each other. It identifies the services in various categories (*e.g*., "major" and "incidental" and services that a "Regulated Party" may provide to another "Regulated Party" or that a "Non-Regulated Party" may provide to or receive from a "Regulated Party" and other such combinations of service providers and service recipients). The rider that would, for the Gas Companies, replace Appendix C is a ten-page document that retains much of the basic structure of the approved appendix but defines the services in much greater detail and adds restrictions on services that are not present in the approved appendix. It also includes additional distinctions among parties (*e.g*., a category of "Non-Utility Affiliates" is defined); restrictions on asset transfers that apply to land and any asset with an original cost exceeding $100,000; and more substantial audit requirements.

As stated above, the definition of "incidental services" is at issue. The Gas Companies propose the following:

> "Incidental Services" shall mean Services identified as such in this Rider to Appendix C and for which the Parties expect that, in the normal course of business and under normal operating conditions, they shall provide infrequently or, if provided on a regular or day-to-day basis, <u>shall represent an insignificant amount in relation to the Receiving Party's total operations and maintenance expense</u>.

ICC Staff Cross Ex. 3.0 (emphasis added).

This would be in place of the following Staff proposal:

> "Incidental Services" shall mean Services identified as such in this Rider to Appendix C and for which the Parties expect that, in the normal course of business and under normal operating conditions, they shall provide infrequently or, if provided on a regular or day-to-day basis, shall be less than 10% of the dollar amount of intercompany services provided by the Providing Party.

Sackett Sur. Test., ICC Staff Ex. 3.0, Attach A (emphasis added).

The underscored words highlight the issue. In general, North Shore and Peoples Gas understood the "major" and "incidental" distinction to separate services into those provided regularly or routinely and representing a significant part of a receiving company's activity *versus* those provided infrequently (and, thus, insignificant) or, if provided more regularly, still representing an insignificant amount of activity. In evaluating the ITF activity when those services began, Peoples Gas regarded them as incidental or insignificant as it had contemplated this agreement functioning. The ITF services to Peoples Gas were expected to be, and in fact were and are, a small part of Peoples Gas' operation and maintenance expense. For the providing party, ITF, the services are a small part of its business, *i.e*., they are insignificant when measured against total revenue. North Shore and Peoples Gas believe that the "Incidental Services" definition can be better-worded to implement that general framework more clearly. However, applying a specific percentage, as Staff proposed, is problematic because it is necessarily an after-the-fact test and not conducive to ongoing monitoring of the day-to-day implementation of the agreement.[18] ICC Staff Cross Ex. 3.0.

[18] In response to a data request, the Gas Companies defined "insignificant" in percentage terms, but as 10% of a providing party's operating costs, which is much different than the Staff proposal for the rider. Sackett Sur. Test., ICC Staff Ex. 3.0, Attach. B, page 20 of 25 (response to Staff data request DAS 35.04(f)).

Their further concern with the Staff discussion and proposal is that it would lead to incongruous results. *Id.* For example, assume a Non-Regulated Party provided $2 million dollars of a service to Peoples Gas and that affiliate also provided over $20 million in services to the rest of the Integrys companies; under the Staff's proposed definition, the service to Peoples Gas would meet the "Incidental Services" test. Assume that another Non-Regulated Party provided $4,000 in services to Peoples Gas but Peoples Gas was the only affiliate it served; this service would not meet the "Incidental Services" test because it was 100% of the intercompany services. This is so even if $4,000 is trivial measured against Peoples Gas' operation and maintenance expense or against the providing party's revenue. While the examples may be extreme, the result seems odd because it can result in relatively small dollar amount failing a test of insignificance while a much larger dollar amount passes the test. *Id.* The Staff proposal also disregards how a providing party or a receiving party may view "significance," because it ignores the company's activity as a whole, *i.e*., it does not take into account the party's total operation and maintenance expense or its total revenues. The Gas Companies' proposal avoids that result.

IV. CONCLUSION

This proceeding was an exhaustive investigation of the Gas Companies' interactions with their affiliated interests, current and dissolved, under several affiliated interest agreements, current and superseded. The review included events dating to the 1990s to the present. Of the hundreds of millions of dollars[19] and hundreds of

[19] For example, IBS alone has annual cross charges of about $450 million. Kupsh Supp. Dir. Test., NS-PGL Ex. 3.0 at 9.

thousands of transactions[20] at issue under these agreements and among the various companies, the issues amounted to alleged errors involving two affiliates that no longer exist, a contract with a non-affiliate that concluded approximately three years ago, and a handful of transactions, including some dating to the 1990s for which data are limited.

The Gas Companies do not oppose the adoption of a rider to one of their current affiliated interest agreements (the "Master AIA" approved in Docket No. 10-0408) to restrict their activities with affiliated interests and impose additional requirements on asset transfers and annual audits. The rider attached to this Initial Brief as Attachment A is, with one exception, consistent with what the Gas Companies believe is acceptable to the Staff.

[20] For example, in 2013, there were over 536,000 transactions between companies. Sackett Sur. Test., ICC Staff Ex. 3.0, Attach. B, page 23 of 25 (response to Staff data request DAS 35.05(b)).

The Gas Companies respectfully request that the Commission adopt the attached rider as a resolution of all matters at issue in this consolidated proceeding.

Respectfully submitted,
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