

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

Illinois Commerce Commission	)	
On Its Own Motion	)	
	)	
vs.	)	Docket No. 03-0703
	)	
Northern Illinois Gas Company	)	
d/b/a Nicor Gas Company	)	
	)	
Reconciliation of revenues collected under	)	
gas adjustment charges with actual costs	)	
prudently incurred.	)	

**REPLY BRIEF ON EXCEPTIONS OF  
NICOR GAS COMPANY**

August 28, 2015

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In accordance with Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (“Commission”), 83 Ill. Adm. Code § 200.830, and the Administrative Law Judge’s (“ALJ”) schedule, Northern Illinois Gas Company d/b/a Nicor Gas Company (“Nicor Gas” or the “Company”) respectfully submits its Reply Brief on Exceptions to the ALJ’s Proposed Order dated July 7, 2015 (“Proposed Order” or “PO”).

**I. INTRODUCTION**

The Briefs on Exceptions of the Staff of the Commission (“Staff”) and the Citizens Utility Board (“CUB”) and the Illinois Attorney General<sup>1</sup> (“AG”) (collectively “CUB/AG”) provide no basis to modify the Proposed Order’s conclusions. Each of their briefs and proposed disallowances is premised on faulty assumptions, not facts. Specifically, they assume that the Company’s provision of Hub<sup>2</sup> services somehow can affect the Purchased Gas Adjustment

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<sup>1</sup> The AG did not submit any testimony in this proceeding, nor did it cross-examine any witness.

<sup>2</sup> The Hub is a collection of services that Nicor Gas offers to end-user, local distribution companies and other customers that permit those customers to store and transport gas and, in some instances, to borrow gas, using the Nicor Gas system. Sherwood Sur., Nicor Gas Ex. 6.0R, 7:129-131.

(“PGA”) cost of gas for Nicor Gas’ sales customers.<sup>3</sup> The facts in evidence refute these flawed assumptions. Moreover, Staff and CUB/AG compound this error assuming further that Nicor Gas did not have sufficient gas in its storage fields to serve sales customers during February and March 2003. Indeed, both the witnesses for Staff and CUB admitted that they never analyzed the *actual* amount of gas available to the Company’s sales customers during that period. Tr. 193:19-195:10 (Rearden); Tr. 222:16-223:16; Nicor Gas Ex. 7.5 at NG CUB 3.03(a); CUB/AG Brief on Exceptions (“BOE”) at 6 (“He *assumed* that the gas Nicor took out of storage and loaned to third-parties was used to displace purchases made by Nicor during February and March 2003”) (emphasis added). Had they conducted an analysis of the actual data, the facts show that Nicor Gas had more than 19 Bcf in storage gas available to sales customers at the end of March 2003. Gulick Sur., Nicor Gas Ex. 7.0R, 20:400-402, 22:431-432 and Table 3. In short, the facts in evidence refute in total the flawed assumptions that underlie Staff’s and CUB/AG’s claims.

The Proposed Order correctly determines that proper application of the law and the facts in evidence demonstrate that Nicor Gas’ PGA costs for its sales customers in 2003 were prudently incurred and reasonable. PO at 25. During 2003, Nicor Gas supplied gas to its sales customers reliably and at a reasonable cost properly calculated and recovered through Nicor Gas’ PGA rider mechanism. Nicor Gas’ management took lawful and prudent steps to make that possible, and to assure that its storage assets were protected and preserved to meet its customers’ then-current and future needs. Nicor Gas also properly accounted for its gas costs and correctly calculated the charges under its PGA rider mechanism.

Staff’s and CUB/AG’s challenges to the Proposed Order’s conclusions are inaccurate and have no basis in law or in fact. They base their challenges on assumptions and

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<sup>3</sup> It is undisputed that Nicor Gas offered Hub services in compliance with Commission and Federal Energy Regulatory Commission (“FERC”)-approved tariffs during 2003.

mischaracterizations of data, and demonstrate a fundamental misunderstanding of Nicor Gas' loans to the Hub and its PGA activity. As Nicor Gas demonstrated in its evidentiary presentation, Hub activities do not affect PGA costs to sales customers. Nicor Gas Init. Br. at 2. The sole contested issue before the Commission is whether Nicor Gas' Hub loans to third parties negatively and imprudently affected sales customers in February and March of 2003. Nicor Gas Rep. Br. at 1. As Nicor Gas demonstrated, and the Proposed Order correctly concludes, the answer to this question is no.

In sum, the Proposed Order correctly finds that the evidence in this proceeding demonstrates that "Nicor Gas did not and does not purchase gas to satisfy Hub parks or to repay Hub loans. Gas for this is secured by third parties and sales customers do not bear any commodity costs related to Hub activities." PO at 24.

With the exception of Staff's proposed Exception to edit language describing the applicable legal standards in this proceeding, each of the Exceptions that Staff and CUB/AG propose are unsupported by the law and the evidentiary record, and should be rejected. The remainder of this brief will address the respective Exceptions of Staff and CUB/AG in turn.

## **II. ARGUMENT**

### **A. Staff's Proposed Exceptions<sup>4</sup>**

#### **1. Staff's Exception Regarding the Burden of Proof (Staff BOE at 2-3)**

Staff offers an Exception to the Proposed Order's summary of the applicable legal standard set forth in Section 9-220 of the Public Utilities Act (the "Act"), 220 ILCS 5-9220(a). Staff urges the Commission to adopt a modification that clarifies that Nicor Gas has the burden of proof to establish the prudence of its gas purchases and related costs. Staff BOE at 2-3. Nicor

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<sup>4</sup> In its BOE, Staff fails to number its proposed Exceptions as provided for in the Commission's Rules of Practice. See 83 Ill. Adm. Code § 200.830. Therefore, the Company will refer to these Exceptions by reference to the page number on which each Exception appears in Staff's BOE.

Gas does not contest this Exception. In fact, the Proposed Order correctly concludes that the Company met its burden of proof, finding ample support for the prudence of the Company's gas supply costs in the record. PO at 24-25. Although Staff articulates the correct legal standard in this Exception, Staff misapplies the standard later in its BOE when arguing for the Commission to apply a non-existent burden of proof on Nicor Gas under Section 525.40 of the Commission's Rules, 83 Ill. Adm. Code § 525.40, further discussed below.

**2. Staff's Exception Regarding the FERC Tariff (Staff BOE at 3-4)**

Staff proposes to modify language in the Proposed Order's factual summary of Hub services. Staff BOE at 3-4. The evidence demonstrates that Nicor Gas' provision of Hub services in 2003 was subject to the regulation of the Commission and the Federal Energy Regulatory Commission ("FERC"), and that the Company offered these services pursuant to Commission- and FERC-approved tariffs. Nicor Gas Init. Br. at 12-14, 20-22; Nicor Gas Rep. Br. at 1, 5, 15. No party contests this fact. *See, e.g.*, Nicor Gas Init. Br. at 20-21; Nicor Gas Rep. Br. at 15; Tr. 195:12-196:21 (Rearden); Tr. 216:15-217:2 (Mierzwa). The Proposed Order correctly and succinctly addresses this fact. PO at 5.

However, Staff's proposed modifications implicitly and inappropriately criticize the FERC-approved tariff and Nicor Gas' actions taken in compliance with them. In particular, Staff asserts that the maximum rates set for the Hub services were cost-based, that there was no minimum, and that "the revenues the Company recovered depended upon market prices which may not cover Nicor Gas' costs of providing Hub services". Staff BOE at 4. Staff's proposed modifications amount to an improper collateral attack on the FERC-approved tariff.

It is well-established that "the reasonableness of rates and agreements regulated by FERC may not be collaterally attacked in state or federal courts." *Miss. Power & Light Co. v. Miss.*, 47

U.S. 354, 375 (1988). Although Staff does not explicitly challenge the terms of the FERC tariff, its proposed modifications implicitly argue that any failure by Nicor Gas to recover its cost of providing Hub services is due, at least in part, to the fact that the FERC tariff sets maximum rates for Hub services, but not minimum rates. *See* Staff BOE at 4 (“...however, the revenues the Company recovered depended upon market prices which may not cover Nicor Gas’ costs of providing Hub Services pursuant to its tariffed charges since the FERC tariff only set a maximum price but not a minimum”). This challenge is contrary to law. Staff further argues that because “the FERC tariff allowed a price of zero for the services ... Nicor could sell the service for free.” *Id.* at 3. This suggestion is completely unfounded. Staff appears to be suggesting that although Nicor Gas operated within the confines of the FERC tariff (*i.e.*, setting its rates within the limits allowed by FERC), there is a negative inference to be drawn from the fact that the tariff did not set a minimum price. Lastly, it is notable that Staff’s proposed modifications are not directed at the Proposed Order’s conclusions, or even the summary of Staff’s position, but instead target the factual background. For these reasons, the Commission should reject Staff’s proposed modifications.

### **3. Staff’s Exception Regarding its Positions (Staff BOE at 4-5)**

Staff proposes an Exception to modify the Proposed Order’s summary of Staff’s position in order to purportedly clarify that “the only Staff witness who addressed Nicor Gas’ use of Hub services was Dr. Rearden, an economist.” Staff BOE at 4-5. The evidence shows otherwise and the Commission should reject this proposed Exception.

In fact, the testimony of Staff’s own witnesses in this proceeding demonstrate that the positions of Staff economic policy witness David Rearden and Staff engineering witness Mark Maple are irreconcilable. *See* Nicor Gas Init. Br. at 18-20; Nicor Gas Rep. Br. at 4. While Staff

continues to claim that Mr. Maple did not address the Hub in testimony, Staff BOE at 4, Mr. Maple's testimony itself belies this claim. Specifically, Mr. Maple's direct testimony stated clearly and unequivocally that he "found no reason to dispute the Company's assertion that *all gas supply purchases were prudently incurred during the reconciliation period.*" Maple Dir., Staff Ex. 2.0, 3:38-40 (emphasis added); *see* Nicor Gas Init. Br. at 18; Nicor Gas. Rep. Br. at 4. Mr. Maple's testimony offers no limitation as to what he reviewed and considered when arriving at his conclusion. Moreover, Mr. Maple was the *only* Staff witness to present direct testimony on the Company's 2003 PGA costs. Clearly, Mr. Maple was addressing all costs at issue, which undermines Staff's flawed attempt to reconcile the irreconcilable testimony of Dr. Rearden. Indeed, Dr. Rearden addressed a subset of the costs that Mr. Maple found to be prudently incurred and reasonable. *See, e.g.,* Rearden Reb., Staff Ex. 2.0, 18:378-383 ("Q: Do you believe that Nicor's storage usage imprudently raised gas costs? A: Yes"). Consequently, the evidence does not support Staff's claim that Dr. Rearden was the only Staff witness to address Nicor Gas' use of the Hub services. The Commission should reject this Exception as the evidence flatly contradicts Staff's claim.

**4. Staff's Exceptions to the Commission Analysis and Conclusion (Staff BOE at 8-11, 12-14)**

Staff takes Exception to the Proposed Order's conclusions and proposes a number of modifications to the Analysis and Conclusion section. Staff BOE at 8-11, 12-14. Staff does not offer any new justifications or reasoning for its proposed Exceptions, and fails to rebut the findings of the Proposed Order that Staff's proposed adjustments were improperly based on hindsight and were unsupported by "substantive evidence that demonstrates that the Company's gas supply purchases and costs were imprudent or improper." PO at 23-24. Neither the law nor the facts support Staff's Exceptions on these other points.

The Proposed Order correctly concludes that Staff’s proposed adjustments were “based entirely on information available only after the reconciliation period in question.” PO at 23. Staff disputes this finding, arguing that “it is impossible for Dr. Rearden’s first adjustment to be based upon hindsight ... [because it] is based upon application of Section 525.40(d) of the Commission’s rules and there should be no dispute that Section 525.40(d) of the Commission’s rules was in place during 2003.” Staff BOE at 6. This argument has no merit and misapprehends the application of the prudence standard. It does not matter whether certain statutory provisions or regulations were in effect at the time of the activity in question – the fact that Staff’s proposed disallowance was calculated with information that was not available to Nicor Gas at the time the Company entered into the Hub loan agreements is demonstrably hindsight review. Staff even acknowledges that “a hindsight review is one that considers facts that were not available at the time decisions were made to determine the prudence of a decision.” Staff BOE at 6 (emphasis in original). Notably, this standard concerns whether certain facts, not legal provisions, were available at the time of the relevant decision-making. It is unrefuted that Staff’s adjustment was premised upon a comparison of then-actual Chicago city-gate gas prices during an incomplete portion of the Hub loan period to actual gas prices during the Hub re-fill period. Nicor Gas Init. Br. at 43; Nicor Gas Rep. Br. at 24; Gulick Sur., Nicor Gas Ex. 7.0R, 6:126-130. Thus, by using actual market prices – available only after Nicor Gas determined to engage in Hub loans – to calculate the “lost” value to Nicor Gas’ sales, or PGA, customers, Staff impermissibly applied hindsight review in the calculation of its adjustment. *Id.*

Staff additionally argues that its proposed disallowance was not based on hindsight review, but was instead based on the claim that Nicor Gas’ use of the Hub was imprudent because Nicor Gas “did not analyze individual transactions for whether their revenues exceeded

costs” and did not “investigate the prudence of any individual Hub transaction.” Staff Init. Br. at 13-14; Staff Rep. Br at 14-15; Staff BOE at 11. The record demonstrates that Staff’s focus on “individual transactions” is misplaced. As an initial matter, Nicor Gas witness Timothy Sherwood<sup>5</sup> testified that it was irrelevant to Nicor Gas’ gas supply activities “to do an analysis on an individual basis as to the impact on PGA sales customers when, in total, there is no impact” on the cost of serving PGA customers. Tr. 72:5-8, 97:10-15 (Sherwood); *see also* Nicor Gas Rep. Br. at 26. The evidence also demonstrates that Hub services did not affect the quantity or cost of storage inventories for PGA customers. Thus, Nicor Gas had a rational basis for its understanding that Hub services in the aggregate were essentially costless to the PGA customers and, in fact, provided a benefit. Gulick Sur., Nicor Gas Ex. 7.0R, 26:479-481; Nicor Gas Init. Br. at 36-37; Nicor Gas Rep. Br. at 26. Despite these facts, Staff continues to assert that Nicor Gas should have conducted a different analysis in order to demonstrate the value of these benefits relative to the market value of the storage. Staff BOE at 11. However, such an analysis would be dependent upon application of after-the-fact market prices, and cannot be reconciled with the Commission’s prudence standard by which Nicor Gas’ conduct must be reviewed. “In determining whether or not a judgment was prudently made, only those facts available at the time judgment was exercised can be considered.” *In re: Commonwealth Edison Company*, Docket No. 84-0395, Order at 17 (October 7, 1987). Illinois courts have affirmed the Commission’s articulation of the prudence standard. *See, e.g., Illinois Power Co. v. Illinois Commerce Comm’n*, 339 Ill. App. 3d 425, 428 (5th Dist. 2003) (“When a court considers

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<sup>5</sup> Mr. Sherwood is the current Vice President of Gas Supply Operations and has nearly 30 years of experience working for natural gas operators, including extensive operational experience in managing the gas supply operations of local distribution companies (“LDCs”), including the management of storage assets. Sherwood Sur., Nicor Gas Ex. 6.0R, 1:7-2:22, 3:52-58; Nicor Gas Ex. 6.1; Tr. 34:2-35:1 (Sherwood).

whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered.”); *see also* Nicor Gas Init. Br. at 15-16; Nicor Gas Rep. Br. at 26.

Staff also challenges the Proposed Order’s conclusion that “the record does not support Dr. Rearden’s first adjustment” because, as Staff argues, “Dr. Rearden provided narrative testimony” and Staff addressed it in briefing. Staff BOE at 6. Simply put, Staff appears to contend that its speculative arguments, unsupported by any real-world facts and, in fact, refuted by Nicor Gas’ evidence, should be sufficient to justify its adjustment. The Proposed Order correctly finds that Staff’s showing is inadequate. It is well-established that a Commission Order that is not supported by “substantial evidence” is subject to judicial reversal. 220 ILCS 5/10-201(e)(iv)(A); *Citizens Util. Bd. v. Illinois Commerce Comm’n*, 166 Ill. 2d 111, 132-133 (1995); *see* Nicor Gas Rep. Br. at 14-15. The testimony of Dr. Rearden is characterized by a lack of first-hand knowledge of the events in question, is based solely on inferences and assumptions gleaned from a handful of documents, and cannot be considered substantial evidence.

Indeed, his most important assumption, that Nicor Gas did not have sufficient gas in storage to serve sales customers’ demand in February and March 2003, was refuted in total. Dr. Rearden never conducted any analysis of the actual amount of gas that Nicor Gas had in storage for sales customers at that time. Tr. 193:19-195:10 (Rearden). Meanwhile, Nicor Gas witness Christopher Gulick explained, based upon factual information that was not rebutted, that the Company had ample gas in its storage inventory to serve sales customers, if needed. Gulick Sur., Nicor Gas Ex. 7.0R, 22:431-432 and Table 3.

Staff also attempts to rebut the Proposed Order’s conclusion that it failed to provide “substantive evidence” by arguing that the record shows that “all revenues from the Hub transactions should flow to the PGA” because of “displacement” and because of “the fact that the

only source for the gas loaned to Hub customers was PGA gas.” Staff BOE at 6. These arguments are based on erroneous assumptions, not facts, and have no support in the record. The evidence shows that Nicor Gas’ provision of Hub services did not impact the storage capacity or deliverability available to the Company’s sales customers. Nicor Gas witness Mr. Gulick<sup>6</sup> testified that the gas for the Hub loans was accounted for with third party gas inventories, not inventories allocated to sales customers. Gulick Sur., Nicor Gas Ex. 7.0R, 7:153-155; *see also* Nicor Gas Init. Br. at 27-28; Nicor Gas Rep. Br. at 19. As Mr. Sherwood further explained, “the Hub loan services come out of storage capacity that would be allocated to transportation customers and not storage capacity that would be used to serve firm sales PGA customers ... activity from Hub parks or loans in neither direction changed the activities associated with the injection and withdrawal storage for sales customers.” Tr. 98:2-13 (Sherwood); Nicor Gas Rep. Br. at 19.

The record evidence, in the form of contemporaneous documentation provided by the Company, proves that Hub activity could not, and did not, impact storage inventories for sales customers. For example, the Company’s 2003 Aquifer Reports show that the Hub loans reduce the physical amount of third party gas, not PGA gas, held in the Company’s inventory. Gulick Sur., Nicor Gas Ex. 7.0R, 7, fn. 9, 20:413 – 21:420 and Table 2; Nicor Gas Init. Br. at 27-28; Nicor Gas Rep. Br. at 19-20. Additionally, the Company’s Aquifer Reports show that the Hub inventory accounts are tracked with the other third party gas accounts, and that changes in the Hub inventory levels do not affect the quantity of PGA gas. *Id.* at 21:423 – 23:432 and Table 3; Nicor Gas Init. Br. at 28-31; Nicor Gas Rep. Br. at 20. Lastly, a schedule of Company-owned gas and gas belonging to third parties shows that Nicor Gas’ calculation of its inventories is not

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<sup>6</sup> It is undisputed that Mr. Gulick has extensive experience in managing gas supply operations for a utility and a thorough understanding of how a utility uses and accounts for its storage assets. Gulick Sur., Nicor Gas Ex. 7.0R.

dependent on Hub loans. *Id.* at 23:440 – 24:450 and Table 4; Nicor Gas Ex. 7.7; Nicor Gas Init. Br. at 31-32; Nicor Gas Rep. Br. at 20.

Moreover, Staff has never refuted that Nicor Gas could have withdrawn additional gas from storage to serve sales customers in the amounts, and during each of the months, about which Dr. Rearden complains. Staff, by its own admission, has not conducted any analysis or study to determine whether the status of the Hub loans actually reduced the amount of gas available for sales customers. Tr. 193:19-195:10 (Rearden); Nicor Gas Rep. Br. at 2-3, 20. The evidence demonstrates that the negative inventory shown on the Company's Aquifer Reports for the Hub indicated the amount of gas owed to Nicor Gas' storage fields, not to Nicor Gas' PGA account. Gulick Sur., Nicor Gas Ex. 7.0R, 20:400-402; Nicor Gas Init. Br. at 40; Nicor Gas Rep. Br. at 20. The Company's Aquifer Reports further show that, at the end of March 2003, Nicor Gas had more than 19 Bcf in on-system storage gas available to PGA customers. Gulick Sur., Nicor Gas Ex. 7.0R, 22:431-432 and Table 3; Nicor Gas Rep. Br. at 20. The substantial evidence in the record shows that the Hub loans did not preclude Nicor Gas from withdrawing more storage gas to serve sales customers in March 2003. In contrast, Staff's adjustment is unsupported by any facts, studies, or analyses. Based on the evidence here, the Proposed Order correctly concludes that "the record shows that Nicor Gas' use of Hub services did not impact the amount of gas available for sales customers." PO at 24.

Staff proposes additional modifications to the Commission's conclusions based on its claim that "Nicor Gas has failed to show that ... 'non-PGA revenues' are not subject to the general rule that Hub revenues were to offset PGA costs." Staff BOE at 7, 9-11. First, it is well-established that the only burden of proof applicable in this proceeding is whether Nicor Gas has proven the prudence of its gas supply purchases in 2003. *See* PO at 23. No party to this

proceeding disputes that the Commission’s prudence standard applies in this proceeding. *See* 220 ILCS 5/9-220; Nicor Gas Init. Br. at 2, 15-16; Staff Init. Br. at 4; CUB/AG Init. Br. at 5-6; Staff Rep. Br. at 2; CUB/AG Rep. Br. at 3; Nicor Gas Ex. 7.2 at NG Staff 2.07(a); Tr. 218:5-15, 220:9-12 (Mierzwa). There is no dispute that, under this standard, the Commission must examine the Company’s gas supply purchasing activities in 2003 to determine whether Nicor Gas’ purchases of gas were prudent under the standard of care “which a reasonable person would be expected to exercise under the circumstances encountered by utility management at the time decisions had to be made.” Nicor Gas Init. Br. at 15; Nicor Gas Rep. Br. at 6, citing *In re: Commonwealth Edison Co.*, Docket No. 84-0396, Order at 17 (October 7, 1987).

Second, there is no such “general rule” applicable here. Instead, Nicor Gas’ Hub services were operated and accounted for in accordance with two Commission Orders entered in 1996 that still were in effect in 2003: Docket No. 93-0320 and Docket No. 95-0219 (together, the “1996 Orders”) – this is undisputed. Nicor Gas Init. Br. at 21; Nicor Gas Rep. Br. at 7-8. It also is undisputed that, in the 1996 Orders, the Commission distinguished between PGA Hub services and non-PGA Hub services. As even Staff acknowledges, the Commission allowed for “different ratemaking treatment for certain Hub transactions” in the 1996 Orders. Staff Init. Br. at 10-11; Staff BOE at 10. Specifically, in Docket No. 95-0219, the Commission credited Nicor Gas’ Hub revenues against the revenue requirement, referencing its prior decision from that year in Docket No. 93-0320. *In re Northern Illinois Gas Company*, Docket No. 95-0219, Order at 14-15 (April 3, 1996). In a separate section of the 1996 rate case Order, under the heading “Revenue Items Not Included,” Nicor Gas was directed to treat revenue from a specific storage service as off-system storage revenues credited to the PGA. *Id.* at 17. The findings of the 1996 Orders are not in dispute. Importantly, and contrary to Staff’s assertions, the 1996 Orders

demonstrate that the Commission did not authorize or require Nicor Gas to reflect Hub revenues as an offset to PGA costs. Instead, the Commission's 1996 Orders recognized that PGA and non-PGA Hub activities were clearly distinguishable and directed that they be credited differently.

Third, the evidence shows that Staff's adjustment is premised, in part, upon a misreading of Section 525.40(d) of the Commission's rules. Section 525.40(d) provides that revenues must be credited to the PGA "if any of the associated costs" of providing Hub services "are recoverable gas costs as prescribed by" Section 525.40(a). 83 Ill. Adm. Code § 525.40(d). In 2003, the associated costs for providing Hub services were recovered through Nicor Gas' base rates and, therefore, the associated revenues were not required to be credited to the PGA. *See* Staff Cross Ex. 6 (Nicor Gas Response to Staff Data Request ENG 2.33); Nicor Gas Rep. Br. at 11. Moreover, because Hub services use rate base assets, they are not appropriately treated as "off-system" transactions as such transactions are described in the Commission's Order in Docket No. 94-0403. That is why the Commission approved the revenue allocation that it did for the Company's Hub revenues in the 1996 Orders. *In re Northern Illinois Gas Company*, Docket No. 93-0320, Order at 6 (March 13, 1996); *In re Northern Illinois Gas Company*, Docket No. 95-0219, Order at 14-15, 17 (April 3, 1996); Nicor Gas Rep. Br. at 11-12.

Finally, Staff argues that "the Company failed to provide detailed evidence" demonstrating that the Company is not subject to this so-called "general rule" embodied in Section 525.40(d). Staff BOE at 7-8. This contention is meritless. It is undisputed that the only burden of proof that applies in this proceeding is the prudence standard under Section 9-220 of the Act. Staff is attempting to create a new burden of proof that is not supported by the law, including the 1996 Orders governing the treatment and accounting of PGA revenues during the

2003 reconciliation period. The Proposed Order correctly concludes that Staff's adjustment is unsupported and is contradicted by unrefuted facts in the record. The Commission should reject Staff's Exceptions to the Proposed Order's conclusions.

**5. Staff's Exception to Recommended Reconciliation and Factor O**

Staff proposes an Exception related to its recommended reconciliation for 2003 and the related Factor O, which reflects and incorporates Staff's proposed adjustment. Staff BOE at 14-15. Because Nicor Gas disputes Staff's proposed adjustment, as discussed in detail above, this modification also should be rejected.

**B. CUB's Exception No. 1**

The Proposed Order correctly rejects CUB/AG's proposed adjustment as based on impermissible hindsight review and as unsupported by facts and the law. PO at 23-24. CUB/AG takes exception to the Proposed Order's conclusions in this regard and proposes a number of modifications to the Commission's Analysis and Conclusion. CUB/AG BOE at 13-14. CUB/AG's arguments cannot rebut the findings of the Proposed Order that CUB/AG's proposed adjustment was improperly based on hindsight and is unsupported by "substantive evidence that demonstrates that the Company's gas supply purchases and costs were imprudent or improper." PO at 23-24. Thus, CUB/AG's Exception should be rejected.

Like Staff, CUB/AG argues that CUB witness Jerome Mierzwa "did not employ hindsight in looking at pricing data from 2003, but rather engaged in a damages analysis." CUB/AG BOE at 6. CUB/AG also argues that Mr. Mierzwa's analysis, which was admittedly based on "pricing data from 2003", was simply an element of calculating an "appropriate and reasonable disallowance." *Id.* CUB/AG goes on to justify its disallowance by reiterating its claim that no hindsight was needed in calculating this adjustment because the Company should

have known that “by engaging in Hub loans in February and March 2003, Nicor was reducing the amount of gas it could withdraw for sales customers.” *Id.* at 6-7. CUB/AG’s arguments have no merit, and should be rejected.

First and foremost, CUB/AG cannot argue that its reliance on *post hoc* data about gas prices during February and March of 2003 is not hindsight review when, in fact, CUB/AG used this data to assume that a decision was imprudent because, in hindsight, there was a theoretically cheaper means of supplying gas. This sort of hindsight analysis is strictly prohibited by the Commission’s prudence standard, and the Proposed Order properly rejects it.

Further, as discussed above, Nicor Gas presented substantial evidence in this proceeding that its Hub activities had no impact on the amount of gas available to sales customers. Thus, the Proposed Order correctly finds that the Company’s Hub activities only impacted storage capacity “that does not relate to the provision of services to the Company’s sales customers.” PO at 24. In contrast, CUB witness Jerome Mierzwa admitted that he made “assumptions” in proposing his disallowance and that he did not examine whether the subject Hub loans actually reduced the amount of gas available to sales customers. Tr. 222:16-223:16; Nicor Gas Ex. 7.5 at NG CUB 3.03(a); Nicor Gas Init. Br. at 22; Nicor Gas Rep. Br. at 2; CUB/AG BOE at 6 (“He *assumed* that the gas Nicor took out of storage and loaned to third-parties was used to displace purchases made by Nicor during February and March 2003”) (emphasis added). The evidence demonstrates that Hub activities could not affect the cost of gas to sales customers. Tr. 61:11-14, 97:10-15 (Sherwood) (testifying that the gas for Hub activities comes from storage inventory capacity allocated for transportation customers, not sales customers); Nicor Gas Init. Br. at 36-37; Nicor Gas Rep. Br. at 3, 22-23. Further, the unrefuted evidence proves that even if there was a relationship between Hub activities and sales customers (which there is not), Nicor Gas had

ample gas in its on-system storage – more than 19 Bcf of gas – to serve the needs of sales customers in February and March 2003. Gulick Sur., Nicor Gas Ex. 7.0R, 21:421-23:437 and Table 3; Nicor Gas Rep. Br. at 3, 20.

CUB/AG also argues that “the proper criteria under which to evaluate Nicor’s actions during the reconciliation year is whether it could reasonably be expected that, at the time the Company made its decisions, winter gas prices would be higher than summer gas prices.” CUB/AG BOE at 7. This argument is wrong for several reasons. First, CUB/AG’s pricing claim is linked to its flawed assumption that Hub activities somehow could affect sales customers’ PGA costs. As described in detail above, the facts show that no such link exists. Second, even if there was a link between Hub activities and sales customers’ PGA costs, Nicor Gas presented substantial evidence regarding its “best-cost” gas purchasing strategy, including the timing and the multiple factors that are taken into consideration when establishing its winter season supply plans. Nicor Gas Init. Br. at 8-9, 23-26; Nicor Gas Rep. Br. at 24-25. Although CUB/AG argues that “Nicor witness Gilmore conceded that winter gas prices are typically higher than summer prices” (CUB/AG BOE at 7), CUB/AG disregards Mr. Sherwood’s testimony, which demonstrated that although “more often ... the NYMEX Futures Market prices quoted for the winter are higher than they are in the summer[,]...it’s not always the case and it doesn’t necessarily reflect the costs that you would pay for gas at the time when you are actually acquiring it.” Tr. 40:10-15 (Sherwood); Nicor Gas Rep. Br. at 24-25.

Further, Nicor Gas also presented evidence showing that summer gas prices are not always lower than winter gas prices. For example, in 2003, “the average Chicago city-gate price in January 2003 was less than May and June 2003” and three years prior to that “summer gas prices also were higher than the preceding winter prices.” Sherwood Sur., Nicor Gas Ex. 6.0R,

15:295-298; Nicor Gas Ex. 6.3; Nicor Gas Rep. Br. at 25. Indeed, CUB/AG has never responded to Nicor Gas' point that if prices were as predictable as CUB/AG claim, then the hedging and risk management strategies used throughout the natural gas industry would not be necessary. Sherwood Sur., Nicor Gas Ex. 6.0R, 15:291-292; Nicor Gas Rep. Br. at 25.

CUB/AG also challenges the Proposed Order's conclusion regarding the fact that Hub activities had no impact on storage capacity for sales customers by arguing that this conclusion accepts the "concept that that Nicor can segregate gas in storage ... [which] is akin to suggesting gas can be color-coded." CUB/AG BOE at 8. This argument demonstrates that CUB/AG completely disregards or misunderstands the Company's unrefuted evidence explaining Nicor Gas' accounting treatment for its Hub loans.

The Company's operation of its storage fields and the Company's accounting for the gas in those storage fields are entirely separate and distinct matters. Nicor Init. Br. at 38-40; Nicor Rep. Br at 22-24. Nicor Gas' accounting for its physical underground storage inventories adds quantities of natural gas injected into the storage fields to existing inventories and subtracts withdrawals. Gulick Sur., Nicor Gas Ex. 7.0R, 17:359 – 18:360. For any given account, the costs associated with existing inventories, injections, and withdrawals also are recorded with the corresponding quantities of gas. *Id.* at 18:360-362. Thus, the accounting for the amount of gas held by Nicor Gas' PGA and other storage customers did not change as a result of the Hub loans in 2003. *Id.* at 20:398-400. CUB/AG ignores this basic premise of Hub services – that such gas is not physically segregated, but is accounted for in the Company's records. Nicor Gas witness Mr. Gulick explained how "the physical quantity of gas in the Nicor Gas storage fields changed as a result of making Hub loans, but the accounting for the amount of gas held by Nicor Gas' PGA and other storage customers did not." *Id.* at 20:398-400.

CUB/AG also continues to justify its proposed adjustment by focusing on the negative status of the Hub loans in February and March of 2003 in the amount of approximately 8 Bcf, arguing that the negative balance impacted ratepayers and shows that Nicor Gas should have “allocated the unused portion of transportation customer gas to ratepayers instead of the Hub.” CUB BOE at 8-9. This argument has been shown to be an erroneous assumption. CUB witness Mierzwa admitted that he had not conducted any study or analysis to determine whether the status of the Hub loans actually reduced the amount of gas available for sales customers. Nicor Gas Ex. 7.5 at NG CUB 3.03(a); Nicor Gas Init. Br. at 33; Nicor Gas Rep. Br. at 2, 20. Further, CUB/AG’s argument ignores the fact that the negative inventory shown on the Company’s Aquifer Reports for the Hub indicated the amount of gas owed to Nicor Gas’ storage fields, not to Nicor Gas’ PGA account, and that Nicor Gas had more than 19 Bcf in storage gas available to PGA customers at the end of March 2003. Gulick Sur., Nicor Gas Ex. 7.0R, 20:400-402, 22:431-432 and Table 3; Nicor Gas Init. Br. at 40; Nicor Gas Rep. Br. at 20. Simply put, the facts belie CUB/AG’s erroneous assumptions.

Lastly, CUB/AG argues that the Company did not present evidence supporting the capacity allocated to the Hub in 2003. CUB/AG BOE at 9-13. On the contrary, it is undisputed that Nicor Gas established its gas supply plan months before the winter season began in late 2002. Sherwood Sur., Nicor Gas Ex. 6.0R, 21:433-434; Nicor Gas Init. Br. at 24; Nicor Gas Rep. Br. at 17-18; PO at 24. As Mr. Sherwood testified, among the many activities Nicor Gas undertook in planning for the 2002-2003 winter heating season, Nicor Gas evaluated transportation customer activity over the prior periods and made a reasonable and prudent estimate of the inventory space that transportation customers were likely to leave unfilled going into the winter of 2002-2003. Sherwood Sur., Nicor Gas Ex. 6.0R, 12:224-227, 22:452 – 23:459.

Nicor Gas used historical data reflecting the level of storage gas left uncycled by transportation customers as of April 30th for the several years prior. The level of such uncycled storage ranged between 10.6 Bcf and 14.9 Bcf. The Company used this information to determine the prudent and reasonable level of Hub loans it could offer to the marketplace as a tool in fully cycling storage prior to the end of winter, assuming normal weather. *Id.* at 23:467 – 24:470; Nicor Gas Init. Br. at 26; Nicor Gas Rep. Br. at 17-18.

CUB/AG further argues that “the evidence shows that the amount of storage dedicated to Hub loans had historically been a fraction of the amount assigned to Hub transactions in 2003.” CUB/AG BOE at 10. CUB/AG relies upon a Company memo for the proposition that “Hub loans have traditionally been of the magnitude of 1 or 2 Bcf per year.” *Id.*, quoting Nicor Gas Ex. 7.3 at 25-26. CUB/AG fails to present this document in its proper context, as this memo states that the volume of 1 to 2 Bcf was for “*late winter season loans*,” which “typically involved a February 1 effective date.” Nicor Gas Ex. 7.3 at 25-26 (emphasis added); Nicor Gas Rep. Br. at 18. Hence, the statement CUB/AG points to does not support a full heating season of loans, but rather a limited period. However, CUB/AG does not address this fact, nor does it refute the fact that any review of Nicor Gas’ Hub loan activity must include all Hub loans throughout an entire season. For example, for the 2002-2003 winter heating season, approximately 84% of the total Hub loan balance as of March 31, 2003 was the subject of loan agreements entered into prior to the end of 2002 and 60% of the loans had been withdrawn from storage by December 31, 2002. Sherwood Sur., Nicor Gas Ex. 6.0R, 9:168-172; Nicor Gas Init. Br. at 43-44; Nicor Gas Rep. Br. at 18.

CUB/AG also argues that the Proposed Order “ignores the fact that the Company did not provide any justification for the dramatic increase in Hub loans,” and that Nicor Gas did not

“acknowledge the obvious point that Hub loans are not the only mechanism to pull gas out of storage.” CUB/AG BOE at 11. The facts contradict these arguments. First, as discussed above, there is no evidence in the record to support CUB/AG’s contention that there was a “dramatic increase” in Hub loans. Second, Nicor Gas provided substantial evidence demonstrating the operational benefits of “cycling” the aquifer storage fields, including through the use of Hub loans. *See* Nicor Gas Init. Br. at 10, 14, 23-26; Nicor Gas Rep. Br. at 16-19. Finally, CUB/AG’s arguments are based on supposition, not facts. For example, CUB/AG argues that “Hub activity was not the only means of cycling storage,” and that “if Nicor had withdrawn more gas from storage in the winter of 2003 to serve customers...it would have needed to purchase less flowing supplies and PGA costs would have been lower.” CUB/AG BOE at 12. That statement is not based on fact, it is a hypothetical. Indeed, as described above, Nicor Gas did not need to purchase flowing gas to meet sales customers’ demand in February and March 2003, as it had ample gas in storage available to these customers during that period. Gulick Sur., Nicor Gas Ex. 7.0R, 21:421-23:437 and Table 3.

In short, the evidence demonstrates that Nicor Gas planned properly for its gas supply activities in 2003, including Hub activities, and prudently executed that plan in providing reliable gas supplies to its sales customers during an unexpected cold snap and resulting price spike. *See* Nicor Gas Init. Br. at 5-14, 22-40; Nicor Gas Rep. Br. at 12, 14-24; Gulick Sur., Nicor Gas Ex. 7.0R, 11:217-12:258. CUB/AG has provided no evidence, studies, or analysis of its own to rebut these facts. Because CUB/AG’s Exception has no support in the record and is improperly based on hindsight review, the Commission should reject CUB/AG’s arguments and adopt the Proposed Order’s conclusions in their entirety.

**III. CONCLUSION**

WHEREFORE, for the reasons set forth herein and within its Initial and Reply Briefs, Northern Illinois Gas Company d/b/a Nicor Gas Company respectfully requests that the Commission adopt the Proposed Order in its entirety, and reject those positions set forth in the Briefs on Exception submitted by the Staff of the Commission, the Citizens Utility Board and the Illinois Attorney General.

Dated: August 28, 2015

Respectfully submitted,

NORTHERN ILLINOIS GAS COMPANY  
D/B/A NICOR GAS COMPANY

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**CERTIFICATE OF SERVICE**

I, Anne W. Mitchell, certify that I caused a copy of the Reply Brief on Exceptions of Nicor Gas Company to be served upon the service list in Docket No. 03-0703 by electronic mail, on the 28<sup>th</sup> day of August, 2015.

/s/ Anne W. Mitchell \_\_\_\_\_  
Anne W. Mitchell