

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTHERN ILLINOIS GAS COMPANY)
d/b/a NICOR GAS COMPANY)
)
Application For Approval Of Accounting) Docket No. 01-0439
Treatment Associated With The Sale Of Off-)
System Storage Services To Third Parties.)

REPLY BRIEF OF NICOR GAS COMPANY

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I. INTRODUCTION AND SUMMARY.

In this proceeding, Northern Illinois Gas Company, d/b/a Nicor Gas (“Nicor Gas” or “Company”) proposes to invest \$26 million of shareholder-supplied funds to expand its Troy Grove gas storage field. As the Company’s testimony and Initial Brief demonstrate, projects of this sort are an essential element in supporting expansion of deregulated electric and gas sales, as well as growing electric consumption in Nicor Gas’ service area.

In its Initial Brief, Staff appears to tacitly recognize the importance of the project, and does not dispute the fact that the proposed expansion of Troy Grove for this purpose would be in the public interest and would provide a valuable service. Staff contends, however, that the Commission should require the Company to flow 100 percent of whatever revenues it is able to generate from the proposed expansion of Troy Grove through its PGA rider to ratepayers. Because the proposed project could not rationally be undertaken if Staff’s position is adopted by the Commission, the ultimate issue in this case is, as a practical matter, whether expansion of Troy Grove should proceed or be cancelled.

II. CAPITAL-INTENSIVE PROJECTS WILL NOT BE UNDERTAKEN UNLESS THE COMMISSION ADOPTS A REASONABLE APPROACH TO TREATMENT OF OFF-SYSTEM STORAGE COSTS AND REVENUES.

If the Commission adopts Staff's position in this case, it will effectively insure that capital-intensive projects to serve off-system customers, including the Company's proposed expansion of Troy Grove, could not and would not be undertaken. This proceeding – which, contrary to Staff's contentions, is a case of first impression – affords the Commission an opportunity to articulate a reasonable policy for the future that will fully protect and benefit ratepayers, without stifling responsible capital investment in off-system projects that clearly promote the public policies of this Commission and the State.

A. The Commission's Past Treatment of Off-System Revenues Did Not Address Projects Involving Significant Capital Investment.

In its Initial Brief (pp. 4-6, 9-10), Staff argues that the Company's requested below the line accounting treatment for the Troy Grove storage project is contrary to the Commission's determinations in a PGA rulemaking proceeding (Docket No. 94-0403) and the Company's last general rate case (Docket No. 95-0219). However, these cases are wholly inapposite.

For example, in the PGA rulemaking proceeding, the Commission did indeed determine that revenues from certain off-system transactions should be passed through the PGA to offset recoverable gas costs. That determination, however, is irrelevant to the issues presented for decision in this case for at least four reasons.

First, under the PGA rule, revenues must be credited only if they are generated in connection with recoverable gas costs. Staff has not, and cannot, identify any "recoverable gas costs" associated with the Troy Grove expansion service revenues because there are none. Staff apparently assumes that the revenues from the proposed

Troy Grove off-system storage service are somehow associated with on-system storage costs at Troy Grove. However, costs of on-system storage investment and expense are not recoverable gas costs. Nicor Gas Group Ex. 6, p. 7 (Harms Surrebuttal).

Consequently, the PGA rule simply does not require PGA flow-through of off-system storage revenues. For this very reason, the Company did not change the way it recorded off-system storage revenue when the current PGA rule went into effect in January, 1996.¹ As explained below, that change occurred – for reasons unrelated to the PGA rule – following the Company’s general rate case in April, 1996.

Second, the off-system transactions considered by the Commission in the PGA rulemaking were transactions resulting from the then-recent FERC Order No. 636. As this Commission explained in the PGA rulemaking order, those transactions “include capacity releases, sales for resale, buy/sell transactions and exchanges.” Docket No. 94-0403 (Order at 4) (1995). By their very nature, those transactions involved no investment by a gas utility to expand its existing facilities. Rather, as the Commission’s order expressly notes, the transactions at issue in Docket No. 94-0403 were costs related to recoverable gas costs and utilized existing pipeline “capacity and supply during times when the capacity and supply is not needed to serve the firm requirements of end-users.” Docket No. 94-0403 (Order at 5) (1995). The off-system service at issue here, however, involved a considerable capital investment.

Third, while the Commission’s decision in Docket No. 94-0403 requires revenues from the off-system transactions at issue there to be credited to the PGA, it clearly does not preclude evaluation of other proposed accounting treatments under different

¹ Nor did Staff assert at that time that the PGA rule applied to the Company’s off-system storage revenue. See e.g., Docket No. 95-0219, 1996 Ill. PUC LEXIS 204, *38-39 (1996).

circumstances on a case-by-case basis. In fact, the Commission's order in that proceeding expressly recognizes that utilities could suggest additional incentives to encourage off-system transactions in utility-specific proceedings. Docket No. 94-0403 (Order at 8) (1995).

Fourth, as Staff itself argued in Docket No. 94-0403 (Order at 7), the Commission has "wide discretion in exercising its judgment over such matters." And, as Staff also pointed out in that proceeding, the Commission's ultimate decision on matters of regulatory policy is not constrained by its historical decisions. Docket No. 94-0403 (Order at 7) (1995).

Similarly, the Commission's treatment of off-system storage revenues in the Company's last general rate case, Docket No. 95-0219, does not preclude the Commission from establishing different accounting treatment for costs and revenues associated with the expansion of Troy Grove for several compelling reasons.

First, the revenues at issue in the Company's rate case were generated by utilizing then-existing storage facilities, without expansion, during periods when the associated capacity was not needed for on-system storage use. Unlike the present case, all of those facilities were immediately included in rate base (because the issue was addressed and decided in the context of a general rate case), and no additional capital investment was required to generate the associated revenues.

Second, the Commission ordered off-system storage revenues to be flowed through the PGA in Docket No. 95-0219 as a compromise because the parties did not agree on the level of off-system storage revenues that should be reflected in the Company's test year forecast to establish its base rates. Prior to the rate case, off-system

storage revenues were not flowed through the PGA. In fact, Staff's primary position in Docket No. 95-0219 was that the Company's forecasted test year revenues for off-system storage should be adjusted upward and reflected in the Company's base rates – a position that clearly contemplated that off-system storage revenues would not be flowed through the PGA. Docket No. 95-0219, 1996 Ill. PUC LEXIS 204, *38-39 (April 3, 1996). Thus, contrary to Staff's argument (Init. Br., pp. 5-6), the Commission's order in Docket No. 95-0219 was a compromise adopted to resolve a dispute over the prospective value of off-system storage revenues, and not a determination that such revenues are somehow required by policy, law or rule to be flowed through the PGA.² Docket No. 95-0219, 1996 Ill. PUC LEXIS 204, *39-40 (April 3, 1996); Nicor Gas Group Ex. 4, p. 4 (Harms Direct).

In short, Staff's claim (Init. Br., p. 4) that the Company's proposed accounting treatment is contrary to "longstanding" policies of the Commission is flatly and objectively wrong. Indeed, prior to the Company's last rate case, off system storage revenues were not flowed through the PGA, and Staff itself argued in that rate case that off-system storage revenues would not normally flow through the PGA. Staff's assertion that the Company's proposal violates Commission policy is, therefore, revisionist history. In reality, this is a case of first impression that should be decided on its own merits, not in deference to a skewed view of this Commission's prior decisions.

² For the reasons discussed above and in Section IV below, off-system storage revenues are not, and never have been, subject to PGA flow-through under 83 Ill. Adm. Code 525.40(d).

B. Staff's Argument Erroneously Assumes That The Troy Grove Expansion Project Would Ultimately Be Included In Rate Base.

Staff claims that the Company has sufficient incentive to invest in expansion of Troy Grove because utilities are permitted as part of the ratemaking process to propose to recover their costs and to be given an opportunity to earn a return on all assets that are “prudent” and “used and useful.” Staff disingenuously contends that this approach has provided Nicor Gas with sufficient incentive to invest in its existing storage facilities and should, therefore, provide sufficient incentive to expand Troy Grove. Staff Init. Br., pp. 36-37.

There is, however, a fundamental and fatal flaw in Staff's argument. As the Company has demonstrated – and as Staff has not disputed – the expansion of Troy Grove storage would not be economically used and useful in serving existing utility ratepayers. Consequently, costs associated with this project could not be included in rate base. Nicor Gas Group Ex. 1, pp. 15-20 and Ex. LWU-2 (Confidential) (Upshaw Direct).

Specifically, as explained in Mr. Upshaw's direct testimony and the Company's Initial Brief (pp. 5-7), use of the 200,000 MMBtu per day of additional deliverability that would result from the proposed expansion to serve on-system customers would require acquisition of additional transmission resources to deliver the incremental supply from Troy Grove. One option – an additional \$37 million transmission investment – would result in a total investment that is not the “best cost” alternative for providing on-system peak service. Nicor Gas Group Ex. 1, p. 16 (Upshaw Direct). The other option – purchase of incremental firm interstate pipeline capacity to bring additional Troy Grove deliverability to the Company's system – would also not be the best cost alternative to serve ratepayers, compared to acquiring alternative supply sources to meet peak day

requirements. Nicor Gas Group Ex. 1, pp. 16-20, Ex. LWU-2 (Confidential) (Upshaw Direct).

In addition, increased reliance on on-system storage would not result in the most balanced and flexible supply portfolio to meet the Company's on-system peak day demand requirements. Excessive reliance on on-system aquifer storage fields is not desirable, because these fields are not operationally able to deliver at or near their peak rated capability for more than a limited number of days per year. Pipeline transportation, on the other hand, can deliver the same contracted amount and flexibility every day of the year. Consequently, the Company strives for a balance between on-system storage and pipeline transportation capacity. Nicor Gas Group Ex. 1, p. 17 (Upshaw Direct). Further, increased reliance on on-system storage to serve peak day requirements would decrease the Company's flexibility to utilize other alternative sources of supply, thereby limiting the tools available to the Company to manage its price risk. Id.

In short, before proposing to offer the capacity and deliverability resulting from the proposed Troy Grove expansion as an off-system service, the Company undertook a thorough economic and operational analysis to determine the best way to use the incremental storage. That analysis established that the expansion project would not be used and useful or a best cost alternative to meet on-system peak demand. The results of that analysis are not disputed by Staff. The Company, therefore, will never be able to include the expansion project in rate base or earn a return on it, absent unanticipated changed circumstances. 220 ILCS 5/9-212. Accordingly, Staff's argument that the opportunity to earn a return on the Company's investment and recover its costs in a future

general rate case is sufficient incentive to expand Troy Grove is simply wrong, given the undisputed facts of this case.

C. The Commission Should Adopt An Accounting Policy That Balances Protection Of Ratepayers With Promotion Of Competitive Supply Options.

The evidence in this proceeding is clear and undisputable that, as a matter of sound and prudent business practice, the Company cannot proceed with the proposed expansion of Troy Grove unless the Commission approves its requested accounting treatment, or some reasonable alternative that would provide the Company's shareholders with the opportunity to earn a reasonable return on their \$26 million investment. Nicor Gas Group Ex. 2, pp. 3-4 (Upshaw Rebuttal); Nicor Gas Group Ex. 6, p. 8 (Harms Surrebuttal); see Nicor Gas Init. Br., pp. 17-18. The Company is not aware of any previous case in which the Commission has addressed this important policy issue. Rather, the Commission is faced squarely in this proceeding with the opportunity to forge a policy that properly balances the protection of utility ratepayers with promotion of competitive gas supply options for emerging gas and electric markets.

Staff's "just say no" approach strikes no balance at all. Rather, Staff would forgo all the benefits of the proposed expansion project that would be realized by the general public and Nicor Gas' ratepayers³ in order to absolutely eradicate any possibility – however remote – that Staff's unsubstantiated, unwarranted and purely speculative concerns would come to pass. See Staff Init. Br., pp. 6-36. This is not sound public policy and, indeed, is no policy at all.

³ These benefits are explained in the Company's Initial Brief, pp. 8-13, as well as the testimony of Company witnesses Upshaw and Harms. See Nicor Gas Group Ex. 1, pp. 5-7, 14 (Upshaw Direct); Nicor Gas Group Ex. 2, pp. 3, 8 (Upshaw Rebuttal); Nicor Gas Group Ex. 4, p. 2 (Harms Direct); Nicor Gas Group Ex. 5, pp. 3-5 (Harms Rebuttal); Nicor Gas Group Ex. 7; Nicor Gas Group Ex. 8.

The Company's proposal, in contrast, carefully balances the interests of ratepayers, shareholders and the general public. As explained in the Company's testimony, Initial Brief and below, Nicor Gas' proposal ensures that all three constituencies would enjoy substantial benefits from the project.

Ratepayers would benefit from an annual \$1 million credit to the PGA until the Company's next general rate case is concluded and an estimated \$1 million reduction in base rates when that case occurs. Ratepayers would also benefit from use of expansion facilities when they are not utilized for off-system service or are underutilized for that purpose, improved reservoir pressure and performance, and indirect benefits that would result from the services provided to the public by off-system storage customers, including lower prices and new service offerings in both gas and electric markets. Nicor Gas Group Ex. 1, p. 14 (Upshaw Direct); Nicor Gas Group ex. 2, pp. 2-3 (Upshaw Rebuttal); Nicor Gas Group Ex. 4, p.2 (Harms Direct); Nicor Gas Group Ex. 5, pp. 3-5 (Harms Rebuttal).

At the same time, the Company's proposal protects ratepayers by appropriately allocating costs and risks of the expansion project to the Company, and by ensuring that the expansion construction and the terms of off-system storage contracts would not interfere in any way with Nicor Gas' on-system obligations. Nicor Gas Group Ex. 1, p. 12 (Upshaw Direct); Nicor Gas Group Ex. 2, p. 7 (Upshaw Rebuttal); Nicor Gas Group Ex. 4, pp. 6-7 (Harms Direct).

Moreover, under the Company's proposal, shareholders would be financially at risk for the entire investment, and in return would receive only what shareholders are entitled to receive – an opportunity to achieve a reasonable return on their investment,

subject to maximum FERC-regulated rates. Nicor Gas Group Ex. 4, p. 3 (Harms Direct). And the general public would benefit, because the new FERC-regulated storage service would serve emerging gas and electric markets, stimulating competition, promoting lower prices, and facilitating new gas and electric service offerings. Nicor Gas Group Ex. 1, pp. 4-8 (Upshaw Direct).

The Company strongly believes that its proposal offers meaningful benefits and effective protections for ratepayers, while simultaneously encouraging utilities to continue to pursue innovative projects that stimulate the development of emerging competitive gas and electric markets. Nicor Gas' proposal represents sound, forward-looking public policy and should be approved by the Commission.

III. THE COMPANY'S PROPOSED ACCOUNTING TREATMENT WOULD NOT LEAD TO HIGHER PGA COSTS.

In its Initial Brief (pp. 6-12), Staff argues that the Company's proposal "could have a negative impact on gas costs." Staff Init. Br., p. 7, emphasis added. Staff's argument starts with the premise that costs differ among the sources of supply available to customers on Nicor Gas' system, and that off-system storage customers would contract for the lowest cost source of supply. Staff Init. Br., p. 7. Staff then speculates that the Company would switch its system purchases to higher cost sources of supply – thus allegedly increasing PGA costs – in order to accommodate off-system customer deliveries.⁴ Staff Init. Br., pp. 7-8. As "evidence" of the Company's purported plan to accommodate off-system storage customers by increasing the gas costs of its on-system

⁴ Staff's argument erroneously assumes, without explanation or evidentiary support, that (1) off-system customers would deliver supplies through the pipeline(s) connected to the lowest-cost sources of supply, (2) such pipelines are constrained, and (3) the only way off-system customers could access the lowest-cost sources of supply is if the Company moved a sufficient volume of its system supply off the constrained pipelines. See Staff Init. Br., pp. 7-8.

ratepayers, Staff refers to a September 13, 2001 meeting during which Nicor Gas representatives noted that “displacement transactions” – a term that has entirely different meanings as used by the Company and Staff – would be utilized to accommodate off-system customer deliveries under the Troy Grove expansion service. Staff Init. Br., p. 12. Staff then asserts that the prospect of PGA prudence reviews would not deter the Company from the nefarious plan that could result, because Staff “is not in a position to detect such actions”. Staff Init. Br., p. 9. Finally, as a catch-all argument, Staff contends that the mere hypothetical possibility that the Company could execute an elaborate plan to gouge on-system customers without detection by the Commission would somehow, by itself, create an incentive to do so. Staff Init. Br., p. 9.

Staff’s parade of horrors should be flatly rejected, because each of its underlying premises is baseless, speculative, and wrong. Moreover, Staff’s basic syllogism – if the Company could cheat, it would cheat, so reject its proposal – cannot reasonably form the basis for sound Commission policy.

Remarkably, even Staff’s initial assumption – that gas costs would differ significantly among suppliers – is highly questionable. In fact, Staff’s own witness acknowledged that “the market for natural gas is competitive, and competitive markets tend to eliminate arbitrage opportunities....” ICC Staff Ex. 1.0, p. 16 (Iannello Direct). As Mr. Harms explained, and as common sense confirms, this means that any supply price differentials, to the extent they exist at all, would be eliminated quickly by the market itself. Nicor Gas Group Ex. 5, p. 8 (Harms Rebuttal).

Most importantly, however, Staff’s central assertion (Init. Br., pp. 7-8) – that the Company would reduce its lower-cost gas purchases and replace them with higher-priced

gas supplies, in order to permit its off-system customers access to the lower-cost sources of supply – simply makes no sense for at least four compelling reasons.

First, the Company would have absolutely no economic or other incentive to allow the gas costs of its on-system customers to increase in order to accommodate alternate receipt point preferences of off-system customers. This is objectively and irrefutably the case, because all the revenues that Nicor Gas would receive from providing the proposed off-system storage service would be generated from fixed demand charges. In other words, under the terms of the storage service contract that has been and would be offered to off-system customers, the Company would not receive any incremental revenue if it acted contrary to the interests of its on-system customers by allowing off-system storage customers to utilize alternate receipt points. Nicor Gas Group Ex. 3, pp. 4-5 (Upshaw Surrebuttal); Staff Group Ex. 1P (ENG. 1.18 Confidential).

Significantly, Staff does not even attempt to explain why the Company would have any incentive at all to move its system supply to a higher-cost source or pipeline – and thus place itself at serious risk of adverse regulatory consequences – when its contractual arrangement with off-system storage customers would provide it with no financial reward for doing so. Nicor Gas Group Ex. 6, pp. 5-6 (Harms Surrebuttal).

Faced with the fixed demand charge terms in the Company’s off-system storage contracts, Staff resorts to sheer speculation, baseless suspicion, and false accusations. For example, Staff claims that “[m]uch of the capacity associated with the Expansion is not currently under contract, and contracts that are entered into in the future are not likely to contain terms and conditions that protect ratepayers.” Staff Init. Br., p. 11. However,

3.5 Bcf out of the 5.0 Bcf of expansion capacity, or 70%, is already subject to a fixed demand charge contract for a term of 5 years, conditioned on the outcome of this proceeding. Nicor Gas Group Ex. 1, p. 13 (Upshaw Direct). Moreover, the terms of the Company's off-system storage contracts are subject to regulation by FERC, and the FERC approved tariff pursuant to which the Company offers interstate storage and transportation service requires that storage services sold to third parties not interfere with firm obligations to a utility's on-system customers. See FERC Operating Statement of Nicor Gas Company under 18 C.F.R. Section 284.224, § 2.13; Nicor Gas Group Ex. 1, p. 12 (Upshaw Direct). In other words, the Company would not be permitted (even if it had an evil intent, which it does not), under its FERC blanket certificate, to modify future off-system storage contracts in the on-system-customer-hostile manner that Staff suggests. Staff's argument is thus premised on the utterly baseless assumption that the Company could or would, in the future, violate the terms of its FERC-issued blanket certificate while FERC looks the other way. Such a misguided claim should have no influence on the Commission's decisionmaking.

Second, Staff continues to misconstrue the way the Company would use "displacement" to accommodate off-system storage.⁵ See Staff Init. Br., pp. 12-13; ICC Staff Ex.1.0, pp. 12-13 (Iannello Direct). This is because the term "displacement," as used by the Company in its September 13 conversation with Staff, and as it relates to the

⁵ Staff similarly misconstrues Mr. Harms' testimony in asserting that it is somehow inconsistent with that of Mr. Upshaw on the issue of whether displacement transactions could result in higher PGA costs. See Staff Init. Br., p. 10. In fact, both of the Company's witnesses unequivocally agree that the displacement transactions that the Company would use to operate the off-system storage service (i.e., switching between injection and distribution of delivered gas) would not increase PGA costs, and that the Company has absolutely no economic incentive to accommodate secondary receipt points for off-system storage customers if doing so would raise gas costs. See Nicor Gas Group Ex. 5, p. 7 (Harms Rebuttal); Nicor Gas Group Ex. 3, pp. 4-5 (Upshaw Surrebuttal).

proposed Troy Grove off-system storage service, is the switching of gas supplies between injection into storage and distribution directly to customers.

The real meaning of “displacement” is best provided by an illustration. Assume that the Company has purchased 1000 Mcf of system supply to be delivered by NGPL, planning to inject 800 Mcf into storage at Troy Grove, and to deliver the remaining 200 Mcf directly to customers. At the same time, an off-system storage customer might purchase 200 Mcf of gas, possibly through a different pipeline, which it wishes to have injected into the Troy Grove storage field. Since gas is a fungible commodity, the Company could inject the full 1000 Mcf of its system gas purchases into storage (800 Mcf for system supply and 200 for the off-system customer) and directly distribute to system customers the 200 Mcf of gas delivered to the Company’s system by the off-system customer. Nicor Gas Group Ex. 5, pp. 5-6 (Harms Rebuttal).

Contrary to Staff’s assumption, this displacement transaction would not and could not affect the amount of gas purchased by the Company, the pipeline over which the gas would be delivered, or – most importantly – the cost of the gas. As the term is and always has been used by the Company, displacement can only affect which deliveries are injected into storage and which are distributed directly to customers. Nicor Gas Group Ex. 5, p. 6 (Harms Rebuttal). Thus, as Mr. Harms’ Rebuttal Exhibit AEH-3 clearly demonstrates, the Company’s operation of off-system storage, including use of displacement as Nicor Gas uses that term, would not and could not result in higher gas supply costs for the Company’s ratepayers. Nicor Gas Group Ex. 5, Ex. AEH-3 (Harms Rebuttal).

Third, Staff's assumption of constraints on pipeline deliveries to Troy Grove is simply wrong. As a matter of objective fact, the two pipelines that are directly connected to Troy Grove, NGPL and Northern Border, are connected to the Nicor Gas system at a number of other points. For this reason, it is virtually certain that pipeline deliveries at the primary receipt points from an off-system storage customer would never require the Company to reduce its purchases on a relatively low-cost pipeline, even assuming, *arguendo*, that meaningful price differentials among pipelines would, from time to time, exist.⁶ Nicor Gas Group Ex. 5, pp. 8-9 (Harms Rebuttal). Moreover, the design of the Company's expansion of Troy Grove, the size limitation of the off-system storage service (5 Bcf of capacity and 200,000 MMBtu per day of deliverability) and the daily, monthly and seasonal limitations on flexibility that would apply to the proposed off-system storage service would all insure that the Company could and would provide the off-system storage service without any harm or cost to ratepayers. Nicor Gas Group Ex. 2, p. 12 (Upshaw Rebuttal).

Fourth, even assuming, *arguendo*, that the Company could somehow maximize off-system storage revenues by switching to higher-priced system supply sources (which it could not do, for the reasons explained above), both FERC and this Commission already have ample mechanisms in place to deter and detect such behavior. As noted above, the Company's FERC-issued blanket certificate, under which the storage service would be provided, requires that storage services sold to third parties not interfere with

⁶ Staff makes much of its hypothesis that Nicor Gas could accept deliveries at a secondary receipt point, and thereby cause the Company to switch its purchases in a way that increases PGA costs. See Staff Init. Br., pp. 11-12. However, the Company has committed to this Commission that it would not accept receipt of gas under these circumstances (Nicor Gas Group Ex. 3, p. 5). In addition, Nicor Gas would be prohibited from doing so under 83 Ill. Adm. Code 525.40(d) and its FERC blanket certificate. Nicor Gas Group Ex. 1, p. 12 (Upshaw Direct); Nicor Gas Group Ex. 5, p. 7 (Harms Rebuttal).

any firm on-system obligations to traditional customers. Nicor Gas Group Ex. 1, p. 12 (Upshaw Direct). In addition, shifting purchases in the manner suggested by Staff would violate 83 Ill. Adm. Code 525.40(d), which expressly prohibits a utility from entering into transactions that would raise gas charges.⁷ Of course, any increased gas costs would obviously be subject to disallowance by the Commission in the utility's annual PGA reconciliation proceeding. See Nicor Gas Group Ex. 5, p. 7 (Harms Rebuttal). Moreover, under the Company's presently-effective Performance Based Ratemaking ("PBR") mechanism, which has at least temporarily replaced the traditional PGA prudence review with respect to Nicor Gas, any increase in gas supply costs – for whatever reason – would automatically reduce shareholder benefits. Nicor Gas Group Ex. 5, pp. 7-8 (Harms Rebuttal).

As noted above, Staff maintains that these time tested deterrents would somehow be ineffective to prevent Nicor Gas from increasing gas costs, if doing so would maximize off-system revenues from the proposed storage service, because Staff might not notice or detect the Company's actions.⁸ Staff Init. Br., pp. 8-9. As explained above, Staff's argument makes no sense – among other reasons – because switching system gas purchases to accommodate any preferred secondary receipt points of off-system storage customers would not and could not increase the Company's off-system revenues, which would be generated by fixed demand charges.

⁷ The type of shifting of pipeline purchases suggested by Staff could theoretically occur in the case of any gas utility with multiple supply sources and would be just as likely to occur with or without the proposed Troy Grove expansion.

⁸ Additionally, as a matter of regulatory policy, the Commission should reject Staff's argument that its self-professed inability to review a utility's actions is sufficient grounds to reject any utility proposal. Unless this claim is rejected, Staff could cause any utility request, regardless of its merit, to be rejected on the basis of Staff's claimed inability to provide the requisite regulatory oversight. Nicor Gas Group Ex. 2, pp. 12-13 (Upshaw Rebuttal).

Moreover, Staff's argument is refuted by the Company's spotless record in over 20 years of prudence reviews by the Commission – years during which Staff never even alleged, much less proved, that any of the Company's gas purchase contracts, supply agreements or gas deliveries were imprudent. Nicor Gas Group Ex. 6, p. 5 (Harms Surrebuttal). It is irrational and unfair to suggest that the Company would suddenly chart a course under which it would risk its reputation, its regulatory relations, and its recovery of more than \$1 billion of gas supply costs annually on the mere chance that Staff would fail to notice the bad conduct that Staff hypothesizes might occur. Nicor Gas Group Ex. 6, pp. 6-7 (Harms Surrebuttal). And since the terms of the Company's off-system storage contracts would provide no financial incentive for the Company to improperly accommodate alternate receipt points of storage customers, Staff's theory that Nicor Gas would allow PGA costs to increase in order to do so is utterly baseless, even assuming, *arguendo* and erroneously, an evil intent on the part of the Company. Nicor Gas Group Ex. 6, pp. 5-6 (Harms Surrebuttal).

Nicor Gas takes pride in its long history of responsible and prudent conduct, and looks forward to maintaining this reputation over the long-term future. Consequently, if the Commission grants the Company's request for below-the-line treatment of the costs and revenues of the proposed Troy Grove expansion, Nicor Gas would have every incentive to demonstrate that projects of this sort benefit ratepayers, the public, and shareholders alike.

IV. THE COMPANY'S PROPOSED ACCOUNTING TREATMENT WOULD NOT VIOLATE APPLICABLE PGA RULES.

Section 525.40(d) of the Commission's rules, relating to costs and revenues recovered under the PGA, provides in relevant part:

Recoverable gas costs shall be offset by the revenues derived from transactions at rates that are not subject to the Gas Charge(s) if any of the associated costs are recoverable gas costs as prescribed by subsection (a) of this Section . . .

Staff argues that this sentence somehow applies to the proposed off-system storage service, and requires that all of the revenues from the service be flowed through the PGA to offset “recoverable gas costs”. Staff Init. Br., p. 13. Staff reaches this conclusion on the basis of its wholly unsupported assertion that “the Expansion service, like other off-system service, would be supported by recoverable gas costs”. Id.

In fact, as explained in Section II.A. above, the costs associated with Troy Grove storage are obviously not gas supply costs. Rather, they are capital costs and associated expenses. Thus, by definition, they are not and cannot be “recoverable gas costs” under Section 525.40(d). Nicor Gas Group Ex. 6, p. 7 (Harms Surrebuttal). Accordingly, off-system storage revenues are not and could not be subject to the PGA offset requirement.

Moreover, as noted in Section II.A above, Staff ‘s argument in this case directly contradicts its primary position in the Company’s 1996 rate case, Docket No. 95-0219. As noted above, prior to that case, off-system revenues generated from storage assets were not flowed through the PGA to offset gas costs. Nicor Gas Group Ex. 6, p. 7 (Harms Surrebuttal). In the rate case, Staff’s witness argued that the Company’s projected off-system storage revenues should reflect its historical averages, and that the entire historical revenue amount should be included in the Company’s base rates. Docket No. 95-0219, 1996 Ill. PUC LEXIS 204, *38-39 (April 3, 1996). Ultimately, the Commission adopted Staff’s alternate proposal, but it did so as a compromise, as explained above – not due to any concern that Section 525.40(d) applied to the storage revenues. Id.

V. **THE COMPANY’S PROPOSED ACCOUNTING TREATMENT WOULD NOT LEAD TO AN IMPROPER SUBSIDY.**

While Staff opposes the Company’s proposal on policy grounds, a further theme that runs throughout Staff’s Initial Brief is that the Company’s proposed accounting treatment should be rejected because the proposed off-system storage service would utilize existing utility facilities which would, in turn, purportedly be used to subsidize the off-system utility service. *See e.g.* ICC Init. Br. pp. 25-30; ICC Staff Ex. 2.0, pp. 7-15 (Anderson Direct). Staff’s “backstop” arguments regarding cross-subsidization are baseless and should be rejected.

A. **The Commission’s Rules Clearly Contemplate The Joint Use Of Assets To Serve Utility And Non-Utility Customers. The Company’s Proposed Use Of Existing Rate-Based Facilities Does Not Create A Subsidy.**

Staff appears to contend that the Company’s on-system utility customers would necessarily subsidize the proposed off-system storage service because expansion of Troy Grove would involve, to some extent, use of Nicor Gas’ existing injection/withdrawal wells, gathering system, and dehydration, compression and other plant facilities. Staff Init. Br. at 25-30. Staff’s argument, however, inherently assumes that the joint use of utility assets to serve utility and non-utility customers is unique when, in fact, it is not.

On the contrary, Part 506 of the Commission’s Rules (83 Ill. Admin. Code Part 506), entitled “Accounting for Non-Public Utility Business of Gas Utilities”, explicitly provides for cost allocation of shared facilities that are used to provide both utility and non-utility services. Similarly, the Commission’s cost allocation rules for both electric and telephone utilities contemplate joint use of utility assets for utility and non-utility services. *See e.g.* 83 Ill. Admin. Code Part 416, Accounting for Non-Public Utility Business of Electric Utilities; and 83 Ill. Admin. Code Part 711, Cost Allocation for

Large Local Exchange Carriers (and more specifically, Section 711.7130, Account 7130 Return from Nonregulated Use of Regulated Facilities). The existence of these Commission promulgated rules conclusively establishes that there is no blanket prohibition on the joint use of utility assets in serving utility and non-utility customers. Nicor Gas Init. Br. at 20; Nicor Gas Group Ex. 5, p 3 (Harms Rebuttal); Nicor Gas Group Ex. 6, p. 4 (Harms Surrebuttal).

Naturally, Staff does not directly dispute this fact. Instead, Staff attacks the Company's reliance on Part 506 with the curious argument that Part 506 does not require use of rate-based assets in providing non-utility service. Staff Ex. 5.0, pp.16-17 (Iannello Rebuttal). Staff's argument is a "straw man," because the Company has never claimed that it does. However, the fact that Part 506 does not require use of rate based assets to provide non-utility service does not mean that utility rate based assets cannot or should not be used in conjunction with providing non-utility services. Nicor Gas Group Ex. 6, p. 4 (Harms Surrebuttal). Indeed, if utility rate based assets could not be used in this manner, there would be no point to the Commission's Part 506 rules, which obviously contemplate the use of shared facilities. Nicor Gas Init. Br. at 20.

The real issue thus becomes whether the Company's proposal to allocate approximately \$377,300 annually of operating and maintenance ("O&M") costs below the line at the time of the Company's next rate case is consistent with the Commission's Part 506 allocation rules. Nicor Gas Group Ex. 5, p. 3 (Harms Rebuttal); Nicor Gas Group Ex. 5 (AEH-1). As explained below, it clearly is. Moreover, the benefit to ratepayers if the Company's allocation proposal is accepted would not, as Staff mistakenly argues, be limited to the \$377,300 allocation of O&M costs. Rather, the

Company's proposal would also relieve ratepayers of the costs of depreciation and return on an estimated \$4 million of capital overheads (approximately \$550,800 annually) that would otherwise be allocated to utility service but which, under the Company's proposal, would be allocated below the line to the proposed expansion. Nicor Gas Group Ex. 6, p. 4 (Harms Surrebuttal); Nicor Gas Group Ex. 6 (AEH-2). Therefore, if the proposed expansion goes forward, the Company's rate base in its next general rate case would be approximately \$4 million lower than it would otherwise be, and ratepayers would be relieved of providing depreciation and rate of return totaling approximately \$550,800 annually on capital overheads. Combined with the proposed below the line allocation of \$377,300 of O&M costs, this means that ratepayer costs would be reduced by about \$1 million annually at the time of the Company's next general rate case if the Troy Grove expansion proceeds.

Additionally, until the Company's next general rate case is completed, Nicor Gas proposes to afford ratepayers an immediate and substantial benefit of a \$1 million annual credit which would be flowed through the PGA. Nicor Gas Group Ex. 5, pp. 4-5 (Harms Rebuttal); Staff Group Ex. 1 (POL – 1.07). At the conclusion of the Company's next general rate case, this flow-through would cease and, as noted above, 10 percent of the then current costs (presently expected to reduce rates by about \$1 million annually), would be allocated below the line and reflected as a reduction in the new base rates. Nicor Gas Group Ex. 5, p. 5 (Harms Rebuttal).

In sum, while the Company's proposed expansion and off-system storage service necessitates, as a matter of operating reality, use of on-system facilities, Nicor Gas' proposed allocation of costs and below the line accounting treatment is fully consistent

with the Commission's Part 506 rules and would eliminate any realistic possibility of improper cross-subsidization. Moreover, as a matter of objective fact, the below the line allocations and the interim PGA flow through of \$1 million annually will not occur if the expansion does not go forward. It is hard to see how ratepayers – the constituency Staff purports to represent – would benefit from that result.

B. The Company's Proposed Classification Of Storage Gas Is Appropriate.

As a part of the expansion project, the Company proposes to increase the total gas inventory at Troy Grove by 6.4 Bcf. This would include a 1.4 Bcf increase in non-recoverable base gas and a 5 Bcf increase in top gas. Nicor Gas Group Ex. 1, p. 10 (Upshaw Direct). The Company's current inventory of recoverable base gas would not change. Staff contends, however, that the Company has underestimated the volumes of recoverable and non-recoverable base gas required for the proposed expansion, and overestimated the volume of top gas. According to Staff, such classification of storage gas would result in the use of a utility asset to subsidize a non-utility service. Staff Init. Br., pp. 18-19. As explained below, the Company's proposed classification of storage gas is reasonable and should be accepted by the Commission.

First, the Company's proposed classifications are reasonably based on reservoir characteristics that the Company has observed through its actual experience over the past 40 years. Nicor Gas Group Ex. 2, p. 10 (Upshaw Rebuttal). Despite Nicor Gas' extensive experience in operating its aquifer storage fields, Staff claims that the Company's proposed classifications of top gas and non-recoverable and recoverable base gas should be rejected because they are not supported by a formal theoretical pre-expansion engineering study, which Staff claims would determine whether the Company

has underestimated the requisite base gas volumes at the expense of utility ratepayers. Staff Init. Br. at 19, 21-22.

In response to Staff's interest in preparation of a formal study, the Company has offered to perform an analysis of the impact of the increased working gas on Troy Grove's non-recoverable base gas levels after the proposed expansion is complete and to reflect the results of that analysis in the final allocations. The Company is willing to allow this study to be conducted by an outside consultant, and would make the study available to the Commission within 18 months of the completion of the expansion. Under these circumstances, there is no basis for Staff's claim (p. 22) that the Company would "underestimate the non-recoverable base gas necessary to support the Expansion service since its non-utility operations are responsible for those costs".

Furthermore, even Staff concedes that any engineering study addressing this issue – whether pre or post-expansion – would be purely theoretical. Thus, while Staff claims that "[e]ngineering studies or calculations are the only method to determine the volumes of recoverable and non-recoverable base gas in an active reservoir" it nevertheless admits that "[r]ecoverable and non-recoverable base gas volumes are by definition theoretical until the reservoir is actually abandoned. *Only at abandonment* are the actual recoverable and non-recoverable base gas volumes known." Staff Init. Br. at 21 (emphasis added). Because all gas aquifer studies prior to abandonment are, by their very nature theoretical, the actual operating experience at Troy Grove, together with the post-expansion analysis proposed by the Company, would provide the best evidence regarding the correctness (or lack thereof) of the Company's proposed classifications. It is difficult to understand why Staff opposes this reasonable approach.

Second, the Company's proposal not to classify any of the incremental gas associated with the Troy Grove expansion as recoverable base gas is inherently reasonable as an operating matter. Staff claims, however, that some recoverable base gas "must" be attributable to the expansion in order for the expansion to physically function because, in Staff's view, the expansion requirements for the recoverable base are the same as recoverable base requirements for initial development of the existing utility rate-based Troy Grove storage field. Staff Init. Br., pp. 23-24.

Staff's argument is, as a matter of operational reality, simply wrong. In fact, there is a major difference between development of an aquifer storage field for use in providing utility service, and a small capacity expansion at an existing field for use in providing off-system deliveries. Nicor Gas Group Ex. 3, p. 1 (Upshaw Surrebuttal). This is because unique constraints exist at each of the Company's seven aquifer storage reservoirs and, as explained by Nicor Gas witness Mr. Upshaw, the definition of recoverable base gas is gas that cannot be cycled annually due to constraints within the operating System. Nicor Gas Ex. 2, p. 9 (Upshaw Rebuttal). Such constraints pertinent to the existing volumes of recoverable base gas at Troy Grove include: 1) Nicor Gas' requirement to meet peak day deliverability requirements; 2) the demand of on-system customers to utilize storage volumes and for Nicor Gas to meet the required deliverability for on-system customers' post peak day design; and 3) the ability to inject gas that will create the necessary pressure development in order to meet the required withdrawal profile to match Nicor Gas' winter supply requirements while remaining within the parameters of the aquifer. Id. However, because the Company would be investing in the facilities and non-recoverable base gas only to provide a specific service, such constraints would not apply

to the proposed expansion. Nicor Gas Group Ex. 3, p. 2 (Upshaw Surrebuttal). Moreover, the Company's Storage Term Sheet (Nicor Gas Group Exhibit 2 (LWU-1)) further restricts the volumes available for injection and withdrawal by off-system customers during a calendar year. Nicor Gas Group Ex. 2, pp. 9-10 (Upshaw Rebuttal)). Accordingly, additional injected volumes into Troy Grove would not result in an increase of recoverable base gas as Staff contends.

C. **Staff Would Be Able To Detect Any Cross-Subsidization If It Occurred.**

Even though the evidence shows that the Company's proposed expansion is in the public interest and would be beneficial to utility ratepayers, Staff proposes to entirely scrap the Company's proposal because, in Staff's view, the Company has an incentive to subsidize the off-system storage service with utility assets and it would purportedly be difficult for the Commission to detect any such cross-subsidization. Staff Init. Br. at 15-16, 22, 24-25. As explained in the Company's Initial Brief (pp. 25-26), Staff's argument is severely flawed. For example, because the costs of the Company's proposed expansion would be borne exclusively by the Company's shareholders, the Company would be required to charge enough for the off-system service or else the Company would lose money. Therefore, the Company simply would have no incentive to provide off-system storage service at a discount to the detriment of utility ratepayers. Further, because the Company would be required to record below the line all revenues and costs associated with the expansion, including those costs allocated from utility services, such revenues and costs would be plainly evident to the Commission and it would easily be able to determine the existence of cross-subsidization. Nicor Gas Group Ex. 5, p. 9 (Harms Rebuttal); Nicor Gas Init. Br. at 26.

Moreover, if the Commission adopts Staff's position based on its claimed inability to detect improper utility conduct, any innovative utility program – regardless of its substantive merits – would have to be rejected based solely on Staff's self-proclaimed and unsubstantiated limitations. *Id.* Finally, the Company has over a 20-year track record of responsible and prudent management of all of its costs for the benefit of ratepayers and there is no evidence to suggest that the Company would deviate from such behavior. Thus, Staff's contention that the Company now has the incentive and intent to cross-subsidize the off-system storage service is based on nothing but pure and misguided speculation.

D. The Company's Proposal For Allocating Costs Is Fair And Reasonable.

The Company proposes to allocate away from on-system utility service 10 percent (5 Bcf / 48.1 Bcf) of joint costs common to utility and non-utility storage services. The 10 percent figure represents the percentage increase in top gas capacity that would be added to the Troy Grove storage field as a result of the expansion. Nicor Gas Group Ex. 5, p. 3 (Harms Rebuttal).

Staff opposes the Company's proposed allocation and claims that Nicor Gas' O&M, general administrative and overhead costs should be three to four times greater to reflect Staff's view of the multi-cycle off-system storage service proposed by the Company. Staff Init. Br. at 31-32. For the first time in its Initial Brief, Staff proposes to allocate away from on-system utility service 31 percent $[(3 \times 5 \text{ Bcf}) / 48.1 \text{ Bcf}]$ to 42 percent $[(4 \times 5 \text{ Bcf}) / 48.1 \text{ Bcf}]$ of joint costs. Staff's proposal, however, wholly lacks evidentiary support. Further, because Staff failed to raise its proposal in its testimony,

the Company had no opportunity to rebut Staff's proposal. For these reasons alone, Staff's proposal should be rejected.

Moreover, Staff's proposal is plainly unreasonable on its face, given that the Company's 10 percent figure represents the percentage increase of top gas capacity that would result from the expansion. That is, Staff's proposal would grossly overestimate the incremental proportion of top gas, resulting in an over-allocation of costs to the off-system storage service and an under-allocation of costs to utility ratepayers.

Furthermore, the significant contractual limitations of the storage service agreement that would be offered to off-system customers under the proposed expansion simply preclude gas from being cycled three to four times as Staff speculates. These contractual provisions, like the Company's proposed accounting treatment, are intended to prevent any adverse impact on existing ratepayers. For example, the Company's term sheet: 1) limits daily injections to a range of 25,000 to 100,000 MMBtu based on the month; 2) limits maximum daily withdrawals to a range of 75,000 to 200,000 MMBtu based on the month; 3) further limits daily withdrawals based on the volume of gas in storage at the time of withdrawal; 4) allows no more than 400% of the maximum daily withdrawal quantity ("MDWQ") over a five day period; and 5) limits the average MDWQ over 3 consecutive days in any 5 day period to no more than 85% of the MDWQ. Nicor Gas Ex. LWU-1 (Upshaw Direct). Therefore, with these restrictions, the hypothesis that gas can be cycled three to four times, resulting in a 31 to 42 percent joint cost allocation, is wholly unwarranted.

In addition, contrary to Staff's claim (p. 31) that "multi-cycle storage operations that involve more frequent injection/withdrawal activity should incur higher operating

expenses than a seasonal service,” the multi-cycle off-system storage service proposed by the Company could actually lower operating expenses. This is because the cycles associated with the proposed off-system storage service are expected to differ from existing ratepayers’ annual injection/withdrawal cycles. For example, during the winter heating season, the ratepayers’ storage volumes typically decrease as gas is withdrawn to meet heat load requirements, whereas the off-system storage volumes could increase since service would be provided to different markets including power generation. The converse would be true during the summer months. In such circumstances, reduced volumes would be required to be injected or withdrawn for ratepayers. If less gas is injected or withdrawn, then less equipment (such as line heaters, dehydration facilities and compression) will be used to process the ratepayers’ volumes. This, in turn, would result in a reduction of fuel and O&M costs.

Finally, Staff once again mistakenly asserts that the Company’s proposal should be rejected because it has the incentive to subsidize its non-utility operations at the expense of utility ratepayers in circumstances where the Company is unable to directly track the O&M expenses by individual piece of equipment. Staff Init. Br. at 33. However, as explained above, there would be no subsidy because the Company proposes to allocate approximately \$377,300 annually of O&M costs, depreciation and return on rate base related to jointly used facilities below the line at the time of the Company’s next rate case. Nicor Gas Group Ex. 5, p. 4 (Harms Rebuttal). In addition, the Company commits to relieve ratepayers of depreciation and return on approximately \$550,800 annually on capital overheads that would be allocated to the proposed expansion. Id. Because the Company’s proposed accounting treatment would require it to recover all of

these costs, Staff's bald assertion that the Company has a financial incentive to subsidize its off-system service with ratepayer assets is meritless and should be rejected.

E. It Is Not Necessary Or Appropriate For The Company To Allocate Total System O&M Costs To Off-System Customers.

Staff claims that Nicor Gas should have included an allocation of the total system O&M costs to off-system customers because the Company purportedly has an incentive to provide a "total system benefit" to off-system customers through the use of displacement transactions at the expense of ratepayers. Staff Init. Br., pp. 34-35. However, as explained in the Company's Initial Brief (pp. 21-25) and above, it is an objective fact that Nicor Gas has no financial incentive to utilize displacement transactions to the utility ratepayers' detriment, and even if the Company had such incentive (which it does not), the Company as a practical matter would be precluded from receiving additional revenue from altering receipt points through the use of total system displacement transactions.⁹

As explained above, under the terms of the storage service agreement that would be offered to off-system customers if the Company's proposal is approved, Nicor Gas' revenues from the off-system storage service would be generated from fixed demand charges. Staff Group Ex. 1P (ENG 1.18 Confidential); Nicor Gas Init. Br., p. 21. Therefore, contrary to Staff's claims, the Company could only receive a fixed stream of revenue regardless of where gas is delivered into the system and cannot receive additional revenues by altering pipeline receipt points. Id. Because the Company would not be able to receive more revenue from its off-system service by altering pipeline

⁹ In its Initial Brief (pp. 21-25), the Company explains several reasons why Staff's displacement argument is objectively baseless and should be rejected. In the interest of brevity, such arguments will not be repeated in their entirety here.

receipt points, there would be no financial incentive for the Company to engage in total system displacement transactions to the detriment of utility ratepayers, as Staff mistakenly contends.

Moreover, because the Company's storage service agreement limits the off-system customer to primary receipt points on NGPL or Northern Border only, the Company could, and would, refuse receipt of gas from an off-system customer who sought to deliver to Nicor Gas through another pipeline when such delivery could potentially increase on-system ratepayers' gas costs. Nicor Gas Group Ex. 3, p. 5 (Upshaw Rebuttal); Nicor Gas Init. Br. at 22. On the other hand, if such deliveries would reduce ratepayers' costs, the Company would have the option to accept such volumes.

Id.

The Company also has a number of compelling incentives not to shift gas purchases in a manner that would raise gas costs for on-system ratepayers. *First*, shifting of gas purchases that would increase costs would violate 83 Ill. Adm. Code 525.40(d), and the Commission could – and undoubtedly would – disallow such costs. Id. Nicor Gas Group Ex. 5, p. 7 (Harms Rebuttal); Nicor Gas Init. Br., p. 23. *Second*, as noted above, during the 20 years of prudence reviews regarding Nicor Gas' supply purchasing practices, not once has Staff even alleged that the Company's gas costs increased due to improper displacement transactions or shifts in purchasing activities. Staff presents no evidence to suggest that the Company would now deviate from such responsible past conduct.¹⁰ Id. *Third*, the Company recovers approximately \$1 billion annually in gas

¹⁰ As explained above, under Staff's erroneous hypothesis, Nicor Gas and other utilities already have the same (alleged) incentive to increase PGA costs through the manipulation of so-called "displacement transactions" even without the Troy Grove Expansion Properties. Nicor Gas has never even been accused of engaging in that kind of misconduct.

costs under its Rider 6, Gas Supply Costs, and it would make absolutely no sense for the Company to jeopardize such recovery by attempting to “game” the benefits of its proposed off-system storage service. *Id.* *Fourth*, if the Company increased gas costs as suggested by Staff, the Company would necessarily reduce shareholder benefits under the PBR. *Id.* at 24. *Finally*, the Company is prohibited from conducting off-system sales that would interfere with on-system obligations under the terms of its FERC blanket certificate for off-system storage services, and there is no evidence to suggest that the Company would violate this certificate of authority.

In short, there are a multitude of financial and ethical disincentives preventing utilization of displacement transactions to the detriment of on-system utility ratepayers and – equally important – no incentives under the Company’s fixed charge contracts. Accordingly, Staff’s claims that the Company will utilize displacement transactions to the detriment of on-system ratepayers is baseless.

VI. CONCLUSION

Nicor Gas’ proposed Troy Grove expansion would provide numerous benefits to the general public and Nicor Gas’ ratepayers, and would promote the competitive supply of natural gas to smaller customers within the Company’s service area. These benefits simply cannot be realized unless the Company has a reasonable economic incentive to invest the \$26 million necessary to expand the Troy Grove storage facility.

Staff’s concerns regarding cross-subsidization are unfounded and lack evidentiary support, and are belied by a long history during which neither Staff nor the Commission has ever even alleged (much less determined) that the Company has managed its gas purchases in an imprudent manner. Most importantly, there are ample financial and ethical incentives not to operate the off-system storage service to the detriment of on-

system utility ratepayers and, in fact, no financial incentives to do so under the Company's fixed charge contracts.

For these reasons, and for the additional reasons discussed herein and in the Company's Initial Brief and testimony, the Commission should grant Nicor Gas' request for below the line accounting treatment for the proposed Troy Grove expansion and off-system storage service and should authorize the Company to flow \$1 million annually through its PGA until conclusion of its next general rate case.

Respectfully submitted,

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