

**Énergir, s.e.c**  
**Gazifère Inc.**  
**Intragaz, s.e.c.**

***Demande conjointe relative à la fixation de taux de rendement  
et de structures de capital, R-4156-2021***

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**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**  
**ORDER 18-1775**

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

**Northern Illinois Gas Company** :  
**d/b/a Nicor Gas Company** :  
 : **18-1775**  
**Proposed General Increase in Rates and** :  
**Revisions to Other Terms and Conditions** :  
**of Service. (Tariffs filed November 9, 2018)** :

**ORDER**

**October 2, 2019**

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By the Commission:

**I. INTRODUCTION**

On November 9, 2018, Northern Illinois Gas Company d/b/a Nicor Gas Company (“Nicor Gas” or the “Company”), filed with the Illinois Commerce Commission (the “Commission” or “ICC”) pursuant to Section 9-201 of the Public Utilities Act (the “Act”), 220 ILCS 5/9-201, the following tariff sheets: 16th Revised Sheet No. 1.5, 8th Revised Sheet No. 9, 11th Revised Sheet No. 10, 10th Revised Sheet No. 11, 7th Revised Sheet No. 11.5, 11th Revised Sheet No. 12, 11th Revised Sheet No. 13, 10th Revised Sheet No. 18, 11th Revised Sheet No. 19, 8th Revised Sheet No. 21.4, 13th Revised Sheet No. 22, 10th Revised Sheet No. 24, 13th Revised Sheet No. 25, 11th Revised Sheet No. 26, 10th Revised Sheet No. 27, 6th Revised Sheet No. 35, 8th Revised Sheet No. 35.5, 3rd Revised Sheet No. 38.1, 11th Revised Sheet No. 41, 6th Revised Sheet No. 44, 9th Revised Sheet No. 46, 10th Revised Sheet No. 50, 6th Revised Sheet No. 50.1, 16th Revised Sheet No. 54, 18th Revised Sheet No. 55, 10th Revised Sheet No. 56, 9th Revised Sheet No. 57, 8th Revised Sheet No. 62, 18th Revised Sheet No. 75.1, 12th Revised Sheet No. 75.5, 9th Revised Sheet No. 75.8, 3rd Revised Sheet No. 75.9.1, 2nd Revised Sheet No. 75.9.2, 11th Revised Sheet No. 76, 13th Revised Sheet No. 77, 9th Revised Sheet No. 78, 5th Revised Sheet No. 79.1, 4th Revised Sheet No. 79.6, 4th Revised Sheet No. 85, 2nd Revised Sheet No. 87, 3rd Revised Sheet No. 87.1, 2nd Revised Sheet No. 88, 1st Revised Sheet No. 88.1, 1st Revised Sheet No. 88.2, Original Sheet No. 90, Original Sheet No. 90.1, Original Sheet No. 90.2, Original Sheet No. 91, Original Sheet No. 91.1, Original Sheet No. 91.2, and Original Sheet No. 91.3.

This rate filing embodies a general increase in rates for natural gas service as well as other proposed changes in terms and conditions. Notice of the proposed changes reflected in this rate filing was posted in Nicor Gas’ business offices and published in a newspaper of general circulation in Nicor Gas’ service area, as evidenced by publisher’s certificates, in accordance with the requirements of Section 9-201(a) of the Act, 220 ILCS 5/9-201(a), and the provisions of 83 Ill. Adm. Code Part 255. The Commission issued an Order on December 4, 2018 suspending the tariffs up to and including April 7, 2019 and

initiating this proceeding. Subsequently, the Commission resuspended the tariffs on March 6, 2019 up to and including October 7, 2019.

Staff of the Commission ("Staff") and the Illinois Attorney General's office (the "AG") participated in this proceeding. The following parties were given leave to intervene in this proceeding: the Citizens Utility Board ("CUB"); the Retail Energy Supply Association ("RESA"); International Brotherhood of Electrical Workers Local 19, ALF-CIO ("Local 19"); ArcelorMittal USA LLC, ExxonMobil Power and Gas Services, Inc., FCA US LLC, Cargill, Inc., Caterpillar Inc., and Sterling Steel Company (collectively, "Illinois Industrial Energy Consumers" or "IIEC"); the Illinois Competitive Energy Association ("ICEA"); and the Construction & General Laborers' District Council of Chicago and Vicinity ("District Council").

Pursuant to due notice as required by law and by the rules and regulations of the Commission, a prehearing conference was held in this matter before duly-authorized Administrative Law Judges at the Commission's office in Chicago on January 3, 2019. Evidentiary hearings were held on May 29 and 30, 2019, at which time the written testimony and exhibits of Nicor Gas, Staff, AG, CUB, and IIEC were admitted into the record. The record was marked "Heard and Taken" on July 8, 2019.

The following witnesses testified on behalf of Nicor Gas: Patrick E. Whiteside, Vice President of Business Support, Nicor Gas; Todd Perkins, Assistant Treasurer, Southern Company; Michael J. Morley, Director of Regulatory Reporting and Strategy, Southern Company Gas; Matthew Kim, Vice President and Gas Utilities Controller, Southern Company Gas; Steven M. Murphy, Vice President, Engineering and Construction, Southern Company Gas; Margaret Schiemann, Director of Community Affairs, Nicor Gas; Jason R. Mathews, Manager of Rates, Nicor Gas; Timothy S. Sherwood, Vice President of Gas Supply Operation, Southern Company Gas; James M. Garvie, Senior Vice President of Human Resources Total Rewards & Information Systems, Southern Company Services, Inc.; Emeka Igwilo, Vice President of Operations Support, Southern Company Gas; Daniel P. Yardley, Principal, Yardley Associates; Thomas J. Flaherty, Senior Advisor, Strategy&; Frank C. Graves, Principal, The Brattle Group; Robert S. Mudge, Principal, The Brattle Group; John Hengtgen, Consultant, Hengtgen Consulting LLC; David Kopsch, Principal, Mercer (US) Inc.; Stephen Wassell, Vice President of Storage & Peaking Operations, Southern Company Gas; and Vida Hotchkiss Director of Strategic Billing and Solutions, Southern Company Gas.

The following witnesses testified on behalf of Staff: Dianna Trost, Accountant, Financial Analysis Division; Theresa Ebrey, Accountant, Financial Analysis Division; Mark Maple, Senior Gas Engineer in the Energy Engineering Program, Safety & Reliability Division; Rochelle Phipps, Senior Financial Analyst in the Finance Department of the Financial Analysis Division; and Cheri L. Harden, Rate Analyst in the Rates Department of the Financial Analysis Division.

The following witnesses testified on behalf of the AG: Mary E. Selvaggio, a regulatory consultant; David J. Efron, also a regulatory consultant; Sebastian Coppola, President of Corporate Analytics, Inc.; Scott J. Rubin, an independent consultant and attorney; and Benjamin Dwyer, President of CardFellow, LLC.

IIEC and CUB (jointly “IIEC/CUB”) presented joint witness Michael P. Gorman, a consultant in the field of public utility regulation. IIEC also presented an additional witness Brian C. Collins, a consultant in the field of public utility regulation. Nicor Gas, Staff, the AG, IIEC/CUB, and IIEC filed Initial Briefs on June 12, 2019. Reply Briefs were filed by Nicor Gas, Staff, the AG, IIEC/CUB, IIEC, and RESA on June 26, 2019. A Proposed Order was issued on July 25, 2019. Nicor Gas, Staff, the AG, IIEC/CUB, IBEW and the District Council filed Briefs on Exceptions on August 8, 2019. Nicor Gas, Staff, the AG, IIEC/CUB, RESA and ICEA filed Reply Briefs on Exceptions on August 15, 2019. In their respective Briefs on Exceptions, Nicor Gas and the AG each requested oral argument before the Commission under Section 9-201(c) of the Act. 220 ILCS 5/9-201(c). The Commission granted this request on August 21, 2019. The oral argument was held by the Commission on September 13, 2019.

#### **A. Nicor Gas – Staff Stipulation**

On April 16, 2019, Staff and Nicor Gas entered into a stipulation. Nicor Gas-Staff Joint Ex. 1.0 (the “Stipulation”). The Stipulation resolves a number of contested issues and sets an agreed overall rate of return as between Staff and the Company. No other party adopted the Stipulation. Staff states that, with regard to non-unanimous settlements or stipulations, the Illinois Supreme Court has held that any non-unanimous proposal to resolve issues in a litigated proceeding at the Commission must be supported by substantial evidence based on the entire record before the Commission, and otherwise be in accordance with established law. *Bus. and Prof'l People for the Pub. Interest v. Ill. Commerce Comm'n*, 136 Ill.2d 192, 216-217 (1989). “Substantial evidence” means more than a mere scintilla, but it does not have to rise to the level of a preponderance of the evidence. *Commonwealth Edison Co. v. Ill. Commerce Comm'n.*, 405 Ill.App.3d 389, 398, 344 Ill.Dec. 662, 937 N.E.2d 685. Given the Stipulation, Staff filed no rebuttal testimony.

### **II. OVERALL REVENUE REQUIREMENT AND REVENUE DEFICIENCY**

The overall revenue requirement is shown in the attached Appendix to this Order.

### **III. TEST YEAR**

Nicor Gas proposes the use of a future test year starting on October 1, 2019 and ending on September 30, 2020 (the “Test Year”), which is permissible under the Commission’s Rules. No party objects to the proposed Test Year, and it is adopted.

### **IV. RATE BASE**

#### **A. Uncontested Issues**

##### **1. Original Cost of Gross Plant Balance**

Nicor Gas presented evidence that its Gross Plant balance for the period ending on September 30, 2018 was \$6,995,028,000. Based on the Company’s evidence, Staff witness Ebrey recommended that the Commission conclude and make a finding in the Final Order in this proceeding that Nicor Gas’ September 30, 2018 plant balance of \$6,995,028,000, as reflected on the Company’s Schedule B-5, be approved for purposes

of an original cost determination, subject to any adjustments ordered by the Commission in this proceeding. Ms. Ebrey further recommended that the Commission include an ordering paragraph in its Final Order identifying and unconditionally approving \$6,995,028,000 as the original cost of Nicor Gas' Gross Plant at September 30, 2018.

The Original Cost of Gross Plant Balance in the amount of \$6,995,028,000 is not contested and is approved. Further, the Commission adopts the recommended language in the Findings and Ordering paragraphs.

## **2. Cash Working Capital**

Nicor Gas and Staff agree by stipulation that Cash Working Capital ("CWC") should be adjusted to recognize pension expense lead days at the intercompany billing lead of 40.60 days for pension expense. The adjustments are reflected in the Test Year revenue and expenses for revenue requirement. The Commission finds that this issue is uncontested and approves the agreed-upon CWC methodology. Further, Staff testified that the final balance of CWC will be established using the revenue requirement and methodology that is ultimately approved by the Commission in this proceeding. Staff Ex. 2.0 at 3. Therefore, appropriate changes to CWC for the final revenue requirement inputs reflected in the Appendix are approved.

## **3. Net Pension Asset**

Nicor Gas and Staff agree by stipulation to exclude the Company's pension asset from rate base. Staff agrees to amend its proposed pension asset adjustment to eliminate the amortization of the excess deferred income taxes in the Test Year, in the amount of \$3,951,000, currently reflected as a reduction to federal deferred income tax expense. The Commission finds that the parties are in agreement on this issue and approves the exclusion of the Company's pension asset from rate base.

The Commission also notes that IIEC/CUB recommend that the Commission advise Nicor Gas to refrain from seeking pension asset in future rate cases. However, it should be noted that Illinois law is clear that Commission orders are not precedential, and the Commission agrees with Nicor Gas that the Company cannot be precluded from raising this issue in a future rate case. *Mississippi River Fuel Corp. v. Ill. Commerce Comm'n*, 1 Ill. 2d 509, 513 (1953) ("the . . . Commission is not a judicial body, and its orders are not res judicata in later proceedings before it."). The Commission declines to adopt IIEC/CUB's proposal to issue an instruction on what a party can propose in a future proceeding.

## **4. 2019 Qualified Infrastructure Plant Amounts**

Nicor Gas presented evidence that the rate base component of its proposed Test Year revenue requirement included plant investments subject to the Company's Rider 32 – Qualified Infrastructure Plant ("Rider QIP"). Nicor Gas witness Morley explained that the Company proposed to transfer all Rider QIP investments made through September 30, 2019 to the Gross Plant component of the Company's Test Year rate base. Staff witness Ebrey requested that Nicor Gas include in its rebuttal and surrebuttal testimony a schedule reflecting: (1) the most recent 2019 actual qualified infrastructure plant ("QIP") amounts that the Company is including in rate base, (2) any forecasted 2019 amounts that the Company also is including in rate base, and (3) the sum of (1) and (2), which

should represent the amounts at the end of the QIP forecast period used in the Company's rate case. Nicor Gas complied with Ms. Ebrey's request and included the requested schedules in its rebuttal and surrebuttal testimony. Ms. Ebrey and the Company agree that the Commission should include in the Final Order in this docket an ordering paragraph that specifically identifies each of the 2019 QIP amounts to be included in base rates.

Nicor Gas further explains that Ms. Ebrey and the Company agree that the prudence and reasonableness of the Company's 2018 and 2019 QIP costs should be reviewed in the annual QIP proceedings. To that end, Ms. Ebrey recommends that the Commission include in the Findings and Ordering section a paragraph consistent with this agreement.

There is no dispute among the parties, and the evidence demonstrates that Nicor Gas' QIP investments made through September 30, 2019 should be included in the Test Year rate base. Further, the Commission adopts the language described above in the Findings and Ordering paragraphs.

#### **5. Capitalized Incentive Compensation**

AG witness Selvaggio proposed an adjustment to rate base for capitalized incentive compensation based upon financial metrics from February 2018, when rates from Docket No. 17-0124 ("2017 Rate Case") became effective, through September 30, 2019. The Company included adjustments to remove capitalized incentive compensation based upon financial metrics for calendar year 2018, and separately for the following nine months from January 1, 2019 through September 30, 2019. Accordingly, Nicor Gas' proposed capitalized incentive compensation, as adjusted in this proceeding, is not a contested issue, and is therefore approved.

#### **6. ADM Project**

Staff and Nicor Gas agree by stipulation to an adjustment to plant associated with the Company's construction of a main extension to serve Archer Daniels Midland Company ("ADM") in Mendota Township, LaSalle County, Illinois. Nicor Gas agrees to decrease the total rate base associated with the ADM project from \$0.2 million to \$0.05 million, as proposed in Staff Schedule 2.04. The Commission finds the parties agree on this issue and therefore approves the adjusted rate base associated with the ADM project.

#### **7. Cushion Gas**

Staff initially proposed an adjustment to the level of cushion gas reflected in rate base. The Company and Staff have agreed that, based on the totality of evidence provided by the Company, Staff's proposed adjustment should not be adopted. As a result, no party objects to the level of cushion gas reflected in the Company's rate base, and it is therefore approved.

## **B. Contested Issues**

### **1. Customer Deposits**

#### **a) Nicor Gas' Position**

In certain circumstances, Nicor Gas requires deposits from customers that initiate new service to secure against potential unpaid debts. AG witness Selvaggio proposes an adjustment to the Company's projected customer deposit balance to account for the percentage change between prior actual and projected customer deposit balances and the impact of the proposed rate increase.

Nicor Gas disagrees with the AG's proposed adjustment and argues that it violates the Commission's rules and Illinois law against single-issue ratemaking. The Company notes that Ms. Selvaggio's approach would require Nicor Gas to update one aspect of its multi-faceted case on a piecemeal basis, based on differences between actual amounts and forecasted amounts included in rate base. Nicor Gas maintains that Ms. Selvaggio's proposed adjustment should be rejected because it functionally constitutes single-issue ratemaking, which is prohibited. *People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654, ¶ 27.

Nicor Gas argues that if the Commission were to accept Ms. Selvaggio's proposed adjustment, her calculations should be corrected in two ways. First, the Company argues that the adjustment should take into account the average of the balances at the beginning and at the end of the Test Year, because the impact to customer deposits would be gradual over time. Second, the Company asserts that the adjustment should be based on the average impact to customer deposits and the final percentage increase in the average residential bill, as approved by the Commission. These corrections would reduce Ms. Selvaggio's proposed adjustment to rate base from \$1.358 million to \$0.964 million.

#### **b) AG's Position**

The AG notes that utilities may request deposits from customers in certain circumstances and hold customer deposits as cost-free, consumer-supplied capital that is ordinarily deducted from rate base. 83 Ill. Adm. Code 280.40; 280.45. Nicor Gas identified \$25,595,000 in customer deposits as a deduction to rate base. Nicor Gas Ex. 19.01 at 3, Sch. B-1, line 11. The AG asserts that Nicor Gas understates the amount of customer deposits expected in the Test Year, and that the customer deposit balance should be increased to reflect (1) Nicor Gas' recent experience with customer deposits and (2) the increase in deposits expected as a result of the rate increase sought in this case. The AG requests that the Commission revise the customer deposit balance to \$26,559,000. This adjustment increases the customer deposit balance by \$964,000, resulting in a reduction to Nicor Gas' proposed rate base of the same \$964,000.

AG witness Selvaggio revised the customer deposit balance based on (1) the difference of 1.0295% between the actual and projected customer deposit balances for November 2018 through March 2019 and (2) the impact of the Company's proposed rate increase in residential rates of 6.3%, based on the Company's surrebuttal position. Ms. Selvaggio incorporated Nicor Gas testimony that the adjustment should exclude customer deposit data for anomalous months (October and November 2018), that it should reflect

timing issues, and that it should reflect total bill increases rather than delivery services increases.

The AG rejects Nicor Gas' argument that making an adjustment to remove the correct figure for customer deposits constitutes single-issue ratemaking, pointing out that this adjustment is a regular issue in rate cases, and is not being isolated from the total determination of rate base. The AG points out that the use of adjustments in a rate case, even one using a future test year, is not single-issue ratemaking. The AG cites the full discussion of single-issue ratemaking, found in *People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654, as follows:

The amount a utility is permitted to recover from its customers in the rates it charges is determined by its revenue requirement. *City of Chicago v. Illinois Commerce Comm'n*, 281 Ill. App. 3d 617, 627 (1996). "A company's revenue requirement is the sum of a company's operating costs and the rate of return on its invested capital." *City of Chicago*, 281 Ill. App.3d at 627 (citing *Citizens Utilities Co. of Illinois v. Illinois Commerce Comm'n*, 124 Ill. 2d 195, 201 (1988)). Therefore, ratemaking considers costs and earnings in the aggregate because potential changes in one or more items might be offset by changes in other items. *City of Chicago*, 281 Ill. App. 3d at 627 (citing *A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill. App. 3d 317, 325 (1993) (Finkl)).

Single-issue ratemaking is prohibited because it considers changes in particular portions of a utility's revenue requirement in isolation, which ignores potentially offsetting considerations and risks understating or overstating the overall revenue requirement. *Business & Professional People for the Public Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 244 (1991) (*BPI*). However, a rider can change a rate without requiring the utility to delay recovery until it files a general rate case. *Citizens Utility Board v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 133 (1995).

*People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654 ¶¶ 26-27. The adjustment to rate base to include a correctly calculated customer deposit balance is one input into the aggregate costs of the utility and is not single-issue ratemaking. It does not involve a rider and is simply an adjustment in a rate case that considers the "sum of a company's operating costs and the rate of return on its invested capital." *Id.* The AG asserts that the Commission should reject the argument that single-issue ratemaking is somehow implicated in this adjustment. The AG directs the Commission's attention to other cases with adjustments to customer deposit balances. See, e.g., *N. Ill. Gas Co. d/b/a Nicor Gas Co. – Proposed General Increase in Gas Rates*, Docket No. 04-0779, Order at 29 (Sep. 20, 2005).

The AG argues that in this case, like in Docket No. 04-0779, Nicor Gas expected a decrease in its balance for customer deposits and while actual balances did not

increase, actual balances did not decrease to the extent Nicor Gas projected. As in Docket No. 04-0779, Nicor Gas' projected balance of customer deposits is unreasonable and the AG's proposed adjustment is not a selective revision. The AG asks the Commission to reach a conclusion in this proceeding similar to its conclusion in Docket No. 04-0779 and reject the notion that this rate base adjustment is "single-issue ratemaking." The customer deposit balance should reflect actual data, and Ms. Selvaggio's adjustment to increase the customer deposit balance by \$967,000 should be adopted.

### **c) Commission Analysis and Conclusion**

The Commission adopts the AG's proposal to adjust rate base by \$967,000 to account for that same amount held by the Company as customer deposits. As the AG states, the customer deposit balance should be increased to reflect: (1) Nicor Gas' recent experience with customer deposits and (2) the increase in deposits expected as a result of the rate increase sought in this case. The Commission disagrees with the Company that this adjustment constitutes single-issue ratemaking as discussed in *People ex. rel Madigan*. Customer deposits is merely one of several components of a Company's revenues that are examined during a rate case. As the AG points out, the Commission has made adjustments to this amount in other rate cases.

## **2. AGSC Construction Work in Progress**

### **a) Nicor Gas' Position**

AGL Services Company ("AGSC") is a Nicor Gas affiliate whose allocated plant is included in rate base. The Company projects an AGSC construction work in progress ("CWIP") balance of \$72,546,437 for the Test Year. Nicor Gas states that this forecast is based primarily on AGSC's 2019 and 2020 capital expenditure budgets and estimates of retirements. The Company adds that the 2019 and 2020 capital expenditure amounts were assumed to be the amounts for plant additions for each year, with CWIP remaining constant. Nicor Gas explains that as capital expenditures are incurred, the amounts are charged to CWIP until the project is placed in service, at which point they are transferred out of CWIP to plant in service. As a result, the Company says, a decrease in CWIP would result in an equal increase to plant in service, and the result would be the same combined balance of AGSC CWIP and plant in service for the Test Year.

AG witness Selvaggio proposes an adjustment to reduce AGSC CWIP, describing the Company's methodology as overly simplistic. Nicor Gas states that Ms. Selvaggio's proposal is primarily based on her claim that the CWIP balances at September 30, 2018 are unreliable. The Company responds that it has provided substantial support for its CWIP balances as of September 30, 2018, including financial records and data describing CWIP balances by project/work order number, costs incurred through September 30, 2019, and the estimated completion dates of the projects. The Company argues that Ms. Selvaggio does not present any evidence demonstrating that this information was unreliable.

Nicor Gas also provides a schedule that shows an annual increase in gross plant of approximately \$20 million per year, which the Company says is not an unreasonable increase for AGSC. The Company provides two more schedules, showing a comparison

of the actual AGSC allocable gross and net plant balances as of September 30, 2018 to the estimated AGSC allocable gross and net plant balances as of September 30, 2020, accounting for Ms. Selvaggio's proposed adjustment. Nicor Gas explains that the comparisons show that Ms. Selvaggio's adjustment would substantially reduce gross plant and net plant from 2018 to 2020, by approximately \$6.6 million and \$47.9 million, respectively. Nicor Gas argues that, in sum, Ms. Selvaggio unreasonably expects AGSC to have zero capital expenditures and a 45% decrease in net plant over the next two years and avers that her proposed adjustment should be rejected as and unsupported by fact.

### **b) AG's Position**

The AG states that AGSC is the "service company" that provides various services to Nicor Gas as well as to other affiliated companies. Costs are distributed or allocated from AGSC to Nicor Gas. Nicor Gas Ex. 13.0 at 3. Nicor Gas seeks a return on CWIP based on plant balances that are 179% and 261% higher than the actual CWIP balances of \$45.7 million at September 20, 2016 and \$31.3 million at September 30, 2017. The AG points out that the CWIP balances for 2019 and 2020 included in the Test Year by Nicor Gas are each \$72,546,437, which was the actual September 30, 2018. The AG requests that the Commission reject these CWIP balances as unrepresentative of actual plant under construction.

In response to Nicor Gas' explanation that the higher number was due to some projects being longer-term projects extending over several years, AG witness Selvaggio reviewed the actual plant investment. She found that only one project had an estimated completion date of December 31, 2019. AG Ex. 1.2, Att. B at 4, line 1. The AG maintains that the Company's assertion that the CWIP balance included projects with long development and implementation times is not supported by the detail of the projects constituting the AGSC CWIP balance at September 30, 2018. *Id.*

The Company also argues that it used a "simplified" approach to CWIP allocation and did not do a detailed review and roll-forward of CWIP and plant-in-service. Nicor Gas Ex. 19.0R at 21-22. Nicor Gas witness Morley asserted that if the plant were not in CWIP it would be in rate base, and so it does not matter how high the CWIP balance is. *Id.* at 21. In response, the AG looks at the actual plant additions for the test year which demonstrated that the "simplified" method overstated plant additions and CWIP and was unreasonable.

Nicor Gas cites three exhibits attached to the surrebuttal testimony of Nicor Gas witness Morley as support for its use of the high AGSC CWIP value. The AG points out that while Nicor Gas argues that Ms. Selvaggio's adjustment would reduce gross plant from 2018 to 2020 implying that Nicor Gas would have zero plant additions in those years, the AG demonstrates that Nicor Gas' exhibits did not include the CWIP amounts that Nicor Gas sought to include in rate base, and so were not relevant to whether the CWIP amounts were overstated. To the extent that they showed expected plant investment for the future test year, they supported Ms. Selvaggio's adjustment that brought the AGSC CWIP closer to Company expectations.

The AG maintains that the Commission should reduce the Company's overstated AGSC CWIP balance by \$47,959,643 to \$24,586,814. AG Ex. 8.1, Sch. B-4. Applying

the 36.90% allocator to the overstatement of \$47,959,643 derives an adjustment to the jurisdictional AGSC CWIP balance of \$17,697,108. *Id.* This amount is more representative of recent actual experience and reflects that most of the 2018 AGSC CWIP was in fact placed in service (and in rate base) in 2019.

**c) Commission Analysis and Conclusion**

The Commission finds that Nicor Gas has presented substantial evidence that the AGSC CWIP amounts for the Test Year are reasonable and prudently incurred. The Commission does not agree with the AG's argument that the CWIP balances at September 30, 2018 are unreliable. The record demonstrates that the CWIP balances at September 30, 2018 are supported by substantial evidence in the form of financial records and other data, which the AG does not dispute as inaccurate. Additionally, the Company's evidence demonstrating that Ms. Selvaggio's proposed adjustment is unreasonable and would result in unsustainable reductions to AGSC capital expenditures and net plant is persuasive. Accordingly, in light of the record evidence in this case, the Commission approves Nicor Gas' forecasted AGSC CWIP amounts.

**3. Cloud Computing**

**a) Nicor Gas' Position**

Nicor Gas and Staff recognize in the Stipulation that the proposed cloud computing rules are pending in Docket No. 17-0855. Nicor Gas and Staff agree that if the Commission enters an Order adopting the proposed cloud computing rules by July 5, 2019, the Company's proposed cloud computing cost should be included in rate base. If not, such costs should be excluded from rate base. Nicor Gas asserts that this position is in accord with AG witness Selvaggio's testimony. Accordingly, Nicor Gas maintains that the agreement between Nicor Gas and Staff provides for resolution of this issue consistent with the Commission's action in Docket No. 17-0855.

**b) AG's Position**

The AG agrees with Nicor Gas and Staff that cloud computing services should be recovered under existing rules. On June 26, 2019, the Commission withdrew the proposed amendments to 83 Ill. Adm. Code Part 289 and accordingly cloud computing expenses should not be recovered in rate base.

**c) Commission Analysis and Conclusion**

The Commission agrees with the parties that because the cloud computing rulemaking was not adopted prior to July 5, 2019, the associated costs should be removed from rate base.

**4. Accumulated Deferred Income Taxes ("ADIT")**

**a) Nicor Gas' Position**

Nicor Gas states that it incorporated certain adjustments proposed by AG witness Selvaggio to address corrections related to the amortization of the excess income tax balance and the income tax gross-up for property excess deferred taxes. The Company explains that the impact of these adjustments, combined with an adjustment to reduce the regulatory tax liability and incorporate the tax return to book provision true-ups, is a

decrease in rate base of \$12.25 million. Ms. Selvaggio also calculated additional adjustments to ADIT to account for AG witness Coppola's proposed adjustments to capital investment projects. Nicor Gas argues that Mr. Coppola's proposed disallowances should be rejected, and that Ms. Selvaggio's corresponding adjustments to ADIT should also be rejected.

In addition, IIEC/CUB witness Gorman proposes extending the amortization period on excess ADIT regulatory assets from 5 years to 22 years, while maintaining a 5-year amortization period for the unprotected ADIT liability balance. Nicor Gas notes that this proposal would require a corresponding adjustment to rate base. However, the Company argues that its proposal to amortize both the unprotected asset and liability balances over the same 5-year period is appropriate and consistent with the amortization period approved by the Commission in the Company's 2017 Rate Case.

#### **b) AG's Position**

AG witness Selvaggio calculated adjustments to ADIT to account for AG witness Coppola's proposed adjustments to capital investment projects.

#### **c) IIEC/CUB's Position**

IIEC/CUB propose to amortize excess ADIT regulatory assets over the life of those assets – 22 years rather than 5 years as proposed by the Company. The argument is set forth below in V.B.11. IIEC/CUB agree with Nicor Gas that if IIEC/CUB's position is adopted, a corresponding adjustment to rate base should be made. Nicor Gas Ex. 19.0R at 28.

#### **d) Commission Analysis and Conclusion**

The Commission finds that maintaining a 5-year amortization period on excess ADIT regulatory assets is reasonable, and consistent with the Commission's approach in the 2017 Rate Case of amortizing both the unprotected asset and liability balances over the same number of years. For the same reasons, IIEC/CUB's recommendation to amortize excess assets over 22 years is rejected. The Commission approves the Company's adjustment to rate base incorporating its corrections relating to the amortization of the excess income tax balance and the income tax gross-up for excess deferred taxes.

### **5. Nicor Trade Name**

#### **a) Nicor Gas' Position**

Nicor Gas argues that the AG's proposed adjustment to the Test Year rate base and operating expense related to a third-party's use of a "Nicor" name should be rejected and notes that no other party supports the AG's claim. The Company states that there are two reasons why the AG's position is flawed. First, the Company explains that it has no ownership interest in the "Nicor" name or brand, which originally resided with its prior parent company, Nicor, Inc., and now resides with its current parent company, The Southern Company ("Southern Company"). Nicor Gas notes that Nicor Inc. used the "Nicor" name for more than two decades before the utility adopted the name as an assumed name. Nicor Inc. subsequently sold its assets, including its "Nicor" name to AGL Resources, Inc. ("AGLR") in December 2011. Then, in 2016, AGLR sold its assets,

again including the “Nicor” name, to Southern Company. Further, the Company states that the Commission also recognized that the “Nicor” name belonged to its former parent company, Nicor Inc. (“the *parent corporation*, Nicor Inc., takes care ‘to protect its brand name and corporate goodwill’ from diminution...” *AGL Res., Inc., Nicor Inc., and N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 11-0046, Order at 48 (Dec. 7, 2011) (emphasis added). As such, the Company states that neither Nicor Gas nor its customers are entitled to any alleged “value” that is attributable to the “Nicor” name. The Company notes that the AG offered no evidence to refute its point on ownership of the “Nicor” name. Instead, the AG attempts to link the Nicor Gas brand to the “Nicor” name. The Company asserts that the AG offers no legal authority to support such a theory.

Nicor Gas’ second point is that its customers have never paid for the “Nicor” name or brand, as Section 9-225 of the Act prohibits branding costs from being passed on to customers. 220 ILCS 5/9-225(2). In support of this assertion, the Company cites to Commission Orders in prior Nicor Gas rate cases precluding recovery of such costs. Docket No. 04-0779, Order at 37 (Sep. 20, 2005); Docket No. 08-0363, Order at 25 (Mar. 25, 2009). Rather, Nicor Inc., AGLR, and Southern Company shareholders paid for any costs associated with the branding of the “Nicor” name. On this point, Nicor Gas argues that the AG failed to present any evidence suggesting, let alone proving, that customers somehow paid to brand the “Nicor” name. Additionally, the Company notes that Illinois law provides that utility customers do not obtain an ownership interest in utility assets through their payments for service. *Bd. of Pub. Util. Comm’rs v. N. Y. Tel. Co.*, 271 U.S. 23, 32 (1926); *Continental Tel. Co.*, Docket No. 81-0114 (Dec. 24, 1981), 1981 Ill. PUC LEXIS 1. As such, Nicor Gas avers that even if it owned the “Nicor” name, customers would not be entitled to any value associated with the name.

The Company also argues that the AG’s valuation of the “Nicor” name is without merit. As an initial matter, Nicor Gas states that the witness the AG presented on this issue has no educational experience valuing a brand name, or in brand marketing generally. The Company argues that the AG witness assumed, incorrectly, that the removal of an intangible asset detailed in a Southern Company Securities and Exchange Commission (“SEC”) filing somehow represented the value of the “Nicor” name. Nicor Gas further argues that Pivotal Home Solutions (“PHS”), which can use the “Nicor” name, operates in multiple states under a variety of different names that do not include the “Nicor” name, so the intangible asset described in the filing cannot represent the value of the “Nicor” brand, as the AG claims. Finally, the Company points to the evidence that the sale of PHS actually resulted in a net loss to Southern Company, and thus the claims about the supposed value of the “Nicor” name are not grounded in fact. Accordingly, the Company argues that the AG’s attempt to value the “Nicor” name is flawed and cannot be relied upon.

#### **b) AG’s Position**

The AG states that PHS, the warranty service product known and marketed in the Nicor Gas service territory as Nicor Home Solutions, was formerly a Nicor Gas affiliate company. Tr. at 90. Southern Company, Nicor Gas’ parent company, sold PHS on June 4, 2018 to American Water Enterprises LLC. Nicor Gas Ex. 20.0 at 2. While no longer affiliated with Nicor Gas, PHS continues today to market this warranty service product as Nicor Home Solutions in Illinois through the Intellectual Property License Agreement of

the unregistered trademark “Nicor Home Solutions” that became effective on the date of the sale. AG Ex. 1.2, Attachment F; Tr. at 114.

Despite this contractual arrangement, the AG points out that the Company recorded no adjustment to recognize the proceeds of the sale of the “intangible assets” associated with the continued use of the “Nicor” name by PHS as the Nicor Home Solutions warranty product in the Nicor Gas revenue requirement. Southern Company’s SEC Form 10-Q (“Form 10-Q”) filing for June 30, 2018 revealed that Southern Company recorded a net book value of the trademark “Nicor” name associated with the sale of PHS of approximately \$86 million, based on the difference in the value of the trade names recorded at June 30, 2018 of \$20 million after the sale, and at December 31, 2017 of \$106 million before the sale, with the change indicated to be the result of Southern Company’s sale of PHS. See AG Ex. 1.2, Att. I at 3.

AG witness Selvaggio testified that a company whose name is being used by another entity should be compensated by the other entity. The AG points out that, indeed, Nicor Gas witness Kim explained that “Tradename is a type of intangible asset for accounting purposes that basically speak(s) to the value of the name, itself.” Tr. at 132. Ms. Selvaggio proposed an adjustment that amortizes the \$86 million value of the trademark “Nicor” name, as provided in Southern Company’s Form 10-Q, over 10 years and reduces rate base for the unamortized balance. The AG asserts that its adjustment is based on the premise that the positive value of the “Nicor” trademark name that was sold should be applied to the Nicor Gas rate base. AG Ex. 1.0 at 32. The adjustment reduces operating expenses by \$8.6 million and reduces rate base by \$81.7 million. AG Ex. 8.0 at 24.

The premise for Ms. Selvaggio’s adjustment is supported by current PHS marketing and revenue numbers, according to the AG. There can be no doubt that the owner of PHS, which continues to market the service as Nicor Home Solutions in the Nicor Gas service area, derives tangible value from the “Nicor” name, the AG states. PHS continues its billing relationship with Nicor Gas, with the utility serving as the collection agent. As noted in Section XI.C.1 of this Order, Nicor Gas, in fact, prioritizes the application of partial bill payments on a pro rata basis to past due warranty product charges over and above Nicor Gas current charges and both past due and current third-party supplier charges. Nicor Gas Ex. 39.0 at 4. The dollars collected for PHS are significant: during 2018, Nicor Gas collected \$45,863,000 from its customers for charges from Nicor Home Solutions. AG Ex. 8.2, Att. E.

The AG highlights that Nicor Gas witness Kim confirmed that PHS sees value in adopting the name of the local utility when transacting business in various markets across the country. For example, he pointed out that PHS operates under other trade names in other states, including Columbia Home Solutions, which adopts the “Columbia” of Columbia Gas of Ohio, and NIPSCO Home Solutions, which incorporates the name of the Northwest Indiana utility, NIPSCO. Tr. at 119-24. Clearly, the use of the local utility’s name – in this instance, Nicor Gas – is essential to the marketing strategy of the PHS business plan, the AG argues. Mr. Kim testified that at the time of the sale, 45% of PHS’s revenues came from Illinois. Tr. at 113, 133-34; Nicor Gas Ex. 34.0 at 5.

The AG suggests that it is not credible that Nicor Gas witness Kim disagreed that the value of the trademark “Nicor” name is driven by its association with Nicor Gas. He asserted that because the use of the trademark “Nicor” by Nicor Inc., Nicor Gas’ former parent company, pre-dates the adoption of the name “Nicor” by Nicor Gas, no brand identify can be claimed by Nicor Gas. Mr. Kim thus claims that there is no authority or Commission orders that would justify compensation to ratepayers. Nicor Gas Ex. 20.0 at 3-5.

According to the AG, contrary to Mr. Kim’s claims, the trademark “Nicor” name is, in fact, linked to Nicor Gas. Indeed, the AG points out that the Commission expressly linked the value of the trademark “Nicor” name with Nicor Gas in the 2011 merger docket. In its Final Order, the Commission stated that the value of the “Nicor” brand had been derived from the name recognition and customer goodwill that Nicor Gas earned as a long-established Illinois public utility, and that Nicor Gas paid for that name recognition with promotional activities:

*That value is magnified by the Nicor brand identity shared by NG [Nicor Gas] and NS [Nicor Energy Services]. The brand itself has value, derived from the name recognition and customer goodwill that NG both earned as a long-serving public utility and paid for with promotional activities. Thus, the parent corporation, Nicor, Inc., takes care “to protect its brand name and corporate goodwill” from diminution, precisely because it is commercially valuable. Through the call centers, NS [Nicor Energy Services] is positioned to add that value to customer calls originated to NG for utility business (FN 265). Of course, NS, by virtue of its name, shares the reputation of the Nicor brand in any context.*

*AGL Resources Inc., Nicor Inc. and N. Ill. Gas Co. d/b/a Nicor Gas Co., Docket No. 11-0046, Order at 48 (Dec. 7, 2011) (emphasis added).*

The value of the reputation of the “Nicor” brand was also recognized by Gerard P. O’Connor, Senior Vice President for Finance and Strategic Planning for Nicor Gas, in the same case:

*Nicor recognizes the potency of brand commonality among the Nicor entities. To explain why NS’s GLCG [Gas Line Comfort Guard] customers are often also customers of Nicor Advanced Energy’s (“NAE’s”) Customer Select gas service, NG witness O’Connor stated: “Typically when a customer has a favorable experience with a Customer Select supplier, it would be logical for that customer to have a higher propensity to purchase additional products and services offered by that supplier.” JA Ex. 5.0 at 28 (emphasis added). The reference to “that supplier” is significant, since NAE and NS are, in fact, nominally distinct entities - but they share the reputation of the Nicor brand.*

*Id.* at 48 (emphasis added); AG Ex. 8.0 at 17-18. The AG notes that common sense and the fact that it is Nicor Gas – not the former parent company, Nicor Inc., which no longer exists – that actually interacts with customers, contradict Mr. Matthew’s position.

There are other reasons Mr. Kim’s opinion fails to persuade, according to the AG. He testified that he conducted no survey of how Nicor Gas customers’ view the Nicor Gas brand or name. Tr. at 89. And, as a resident of Georgia, not Illinois, Mr. Kim’s opinion on the thoughts and brand deference of Nicor Gas customers here in Northern Illinois is, arguably, less than informed, the AG argues. *Id.*

The AG states that the record evidence shows that both Nicor Gas and its corporate parent see value in the Nicor Gas name at the local utility level, and both promote and recognize that the Nicor Gas brand resonates with its customers. For example, each time Nicor Gas was acquired – both in 2011 and 2016 – each parent retained the Nicor Gas name for the acquired utility. Tr. at 94. On the other hand, the “Nicor Inc.” former corporate parent name no longer exists, a fact that flies in the face of Mr. Kim’s theory that the former corporate parent, Nicor Inc. is the source of the tradename value, the AG points out.

The AG presented Nicor Gas witness Kim with the Nicor Gas website, which showed that the Nicor Gas name that is trumpeted on every page – not Nicor Inc. Tr. at 95. This observation is supported by Nicor Gas’ own published communications with its customers, for example. As noted during cross-examination of Mr. Kim, in a booklet on its website entitled, “2017 Year in Review, 2018 Look Ahead,” Nicor Gas President Melvin D. Williams introduces a series of Nicor Gas accomplishments, including it being awarded two awards tied to its brand identity: one recognizing Nicor Gas among 44 gas, electric or combination utilities that were named “Most Trusted Brand”, a distinction, according to the Company, based on “a utility’s Brand Trust index”; as well as “Utility Customer Champion in the 2017 Utility Trusted Brand & Customer Engagement: Residential report.” AG Cross Ex. 9 at 10. Mr. Kim confirmed that the references there were to “Nicor Gas” – not “Nicor Inc.” Tr. at 110-11.

The AG points out that the booklet also calls its employees who wear Nicor Gas uniforms “brand ambassadors for the company.” *Id.* at 8. Indeed, Nicor Gas, when referencing its employees, states that “We are all representatives of the great Nicor Gas and our brand in the communities where we are proud to live and work.” AG Cross Ex. 9 at 9. Mr. Kim confirmed that such employees wearing the brand “will portray himself or herself positively to the customers.” Tr. at 107-109.

In addition to opposing the benefit that PHS receives from appropriating the “Nicor” name and its associated positive reputation within the state, Mr. Kim also challenged the numerical derivation of the AG adjustment, which again was based on the reporting of an \$86 million intangible asset shown in Southern Company’s Form 10-Q as of June 30, 2018. Nicor Gas Ex. 20.0 at 5. Mr. Kim’s principal argument is that the sale of PHS “resulted in a net loss.” *Id.*

However, the AG points out that the Form 10-Q, page 254 (AG Ex. 8.2, Att. F at 5) states that Southern Company completed a stock sale of PHS to American Water Enterprises LLC for a total cash purchase price of \$358 million and an additional \$6 million for working capital. Ms. Selvaggio reported that, at the same time, the Form 10-Q clearly

reports a decrease in the value of the trade names for gas marketing services from \$106 million to \$20 million. Further, as AG witness Selvaggio testified, the Form 10-Q further reported:

This decrease of \$86 million was made to ‘...reflect Southern Company Gas’ sale of Pivotal Home Solutions.’ The same page of the Form 10-Q also clearly states that the value of customer relationships under gas marketing services was reduced \$59 million from \$144 million to \$85 million due to the sale of Pivotal Home Solutions. Clearly, the value The Southern Company attributable to the Nicor trade names used by Pivotal Home Solutions was no less than \$86 million prior to the sale of Pivotal Home Solutions, and arguably as much as \$145 million (\$86 million + \$59 million) when the value of customer relationships under gas marketing services is also included.

*Id.* at 19. This decrease of \$86 million was made to “...reflect Southern Company Gas’ sale of PHS.” *Id.* The same page of the Form 10-Q also clearly states that the value of customer relationships under gas marketing services was reduced \$59 million from \$144 million to \$85 million due to the sale of PHS. *Id.* It is apparent, the AG notes, that the value Southern Company attributed to the trade names used by PHS was no less than \$86 million prior to the sale of PHS, and arguably as much as \$145 million (\$86 million + \$59 million) when the value of customer relationships under gas marketing services is also included. AG Ex. 8.0 at 19.

AG witness Selvaggio also noted that there would have to have been an undisclosed benefit to execute the sale that would offset the resulting book loss and that Southern Company would have benefitted by the transaction or the transaction would not have occurred. She further testified that the net book loss may have been executed due to the settlement of class action litigation as indicated on page 168 of the Form 10-Q (AG Ex. 8.2 Att. F at 2) in the states of Indiana and Ohio. See AG Ex. 8.2, Att. F at 4.

Even if one considered that the sale resulted in a “net loss” due to the settlement of a class action litigation, the AG argues, the sales price of PHS was \$386 million and the value of the trade name associated with PHS was diminished on the books of Southern Company Gas by \$86 million. AG Ex. 8.0 at 20-21. The AG points out that the Company supplied no proof that it credited Nicor Gas for any of the \$86 million or \$59 million to reflect the value of the “Nicor” tradename or the value of customer relationships, respectively, identified in the Form 10-Q as diminished after the PHS sale, the AG states.

Mr. Kim’s only response to the notion contained in the SEC Form 10-Q that the transaction resulted in a loss was to opine that Southern Company “retained most of the financial responsibility for (class action) lawsuits following the completions of the sale.” Nicor Gas Ex. 34.0 at 5-6. But neither Mr. Kim nor anyone at Nicor Gas explained (1) why the PHS sale allegedly resulted in a net loss to Southern Company (except to say it was not the class action settlement costs); and, even if it did, (2) why the alleged loss justified not assessing a fee to the new PHS owner, American Water Enterprises LLC, to compensate the corporate entity and its affiliates for the individual utility company names

in the respective utility territories. Mr. Kim's limited his criticism of Ms. Selvaggio's calculation of the value of the "Nicor" brand to pointing out that 55% of revenues from PHS at the time of the sale came from outside Illinois. Nicor Gas Ex. 34.0 at 5. That statement, however, does not obviate the need for Ms. Selvaggio's proposed adjustment. Moreover, it does not address the \$59 million identified in the Form 10-Q associated with the "value of customer relationships under gas marketing services." AG Ex. 8.2, Att. F at 3.

Notwithstanding these facts, as an alternative to Ms. Selvaggio's \$86 million adjustment, the AG points out that the Commission could apply a 45% factor, identified by Mr. Kim as the Illinois share of the \$86 million, which would result in a \$3.87 million operating expense adjustment and a \$34.8 million rate base adjustment. At a minimum, the AG argues that these adjustments should be adopted by the Commission.

Notwithstanding the sale to American Water, Nicor Gas continues to operate as PHS' billing agent but fails to credit the Test Year revenue requirement with any sort of compensation for PHS's continued use of the "Nicor" name and logo, either through the sale itself or PHS fees. Indeed, the AG states that no other warranty service provider has such an arrangement with Nicor Gas, and it is unimaginable that Nicor Gas (or its parent company, Southern Company, which negotiated the sale of PHS) would permit such a marketing arrangement without some compensation for the intangible asset of the "Nicor" name and the marketing advantages that name carries with Chicago area customers. Ms. Selvaggio's proposed adjustment simply requires the Commission to use its authority under Section 7-101 of the Act to oversee the affiliated transactions of the utility's corporate parent to ensure that ratepayers are neither saddled with costs attributable to affiliates nor denied revenues that the corporate parent receives that are attributable to its relationship with the utility. 220 ILCS 5/7-101. Indeed, the AG notes that the Commission is obligated under the Act to ensure that no public utility permits the use of any public utility employee's services by any affiliated interest except by contract or arrangement, nor may sell, lease, transfer to or exchange with any affiliated interest any property except by contract or arrangement, subject to Commission review. 220 ILCS 5/7-204A(b) (emphasis added). Ms. Selvaggio's adjustment is entirely consistent with this regulatory obligation, contrary to Nicor Gas' claims, the AG avers.

The AG also criticizes Nicor Gas' argument that Section 9-225(2) of the Act, which prohibits the inclusion in rates of costs associated with promotional advertising, somehow obviates the need for the AG's proposed adjustment. Nicor Gas attempts to confuse the issue, arguing that Nicor Gas customers have never paid for the "Nicor" brand. Nicor Gas cites two Commission orders in two prior Nicor Gas rate cases, Docket Nos. 04-0779 and 08-0363, involving the Commission's rejection of promotional advertising expense in rates to support its rejection of Ms. Selvaggio's proposed adjustment to test year revenues for PHS's use of the Nicor brand. These citations are inapposite to the issue at hand, and constitute yet another strawman argument, according to the AG.

For all of these reasons, the AG urges the Commission to adopt Ms. Selvaggio's adjustment to Test Year revenues and the Company's rate base, which imputes a value for Southern Company's sale to PHS of a license to use the trademark "Nicor" name. Arguably this adjustment could also include the \$59 million reduction in the "value of customer relationships under gas marketing services" that Southern Company's Form 10-

Q attributed to the sale of PHS, increasing the value that PHS received from its right to use the “Nicor” tradename to \$145 million, making Ms. Selvaggio’s proposed \$86 million adjustment conservative. AG Ex. 8.0 at 19.

### **c) Commission Analysis and Conclusion**

The Commission rejects the AG’s proposed adjustment to the Test Year rate base and operating expense related to PHS’ use of the “Nicor” name. The Commission agrees with the Company that it has no ownership interest in the “Nicor” name or brand, which originally resided with its prior parent company, owned by its current parent company, Southern Company. As such, no revenue requirement adjustment to reflect the sale is necessary. The Commission found in the merger docket that the “Nicor” name belonged to its former parent company, Nicor Inc., and stated: “the parent corporation, Nicor, Inc., takes care ‘to protect *its* brand name and corporate goodwill’ from diminution...” *AGL Res., Inc., Nicor Inc., and N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 11-0046, Order at 48 (Dec. 7, 2011) (emphasis added). Further, the Commission agrees with Nicor Gas that customers paid nothing for the branding of the “Nicor” name. As the Company noted, the Act requires that the costs of such promotional and goodwill venture shall not be included in rates, and the Commission has consistently excluded these costs from recovery in prior rate cases. Thus, Nicor Inc. shareholders, and subsequently the shareholders of AGL Resources Inc., and then Southern Company, paid for any branding of the “Nicor” name. The evidence shows that at no time did Nicor Gas or its ratepayers own or have any legal right to the “Nicor” name or a right to any value associated with that name.

## **6. Capital Additions**

### **a) Introduction**

Nicor Gas argues that it has demonstrated that its proposed capital additions are prudent and reasonable and established a prima facie case. The Company states that it has provided substantial evidence regarding its capital budget development process, which the Company explains involved consideration of various data from across departments within the organization, and careful review by Company management for prudence and reasonableness.

The AG challenges several capital expenditures claiming the Company has not justified their prudence and reasonableness or shown that the capital projects maintain the safety and reliability of the system.

### **b) Contingent Capital Expenditures**

#### **i. Nicor Gas’ Position**

Nicor Gas observes that a future test year necessarily relies on forecasted costs and argues that contingency costs are a prudent and reasonably anticipated component of forecasted costs. The Company avers that the inclusion of such costs is proper under future test year principles. Indeed, Nicor Gas states that it would be imprudent to fail to account for such reasonably anticipated costs in planning its capital additions projects, which would result in insufficient funding to complete planned projects. The Company also points to historical data showing that the Company has a history of regularly using contingency allowances to address contingencies.

AG witness Coppola argues that Nicor Gas' capital contingency costs are too tentative to warrant inclusion in rate base. Nicor Gas responds that while the specific contingencies cannot be identified in advance, it is known that contingency costs will occur. The Company explains that it regularly experiences certain previously-unknown project conditions after construction commences, and lists several examples, ranging from unexpected soil conditions to late requests by landowners or municipalities. Nicor Gas states that it takes a nuanced approach to estimating such costs, taking into account its general historical experience with contingency costs and the complexity and developmental stage of each project.

Nicor Gas avers that its projected contingent capital expenditures for the Test Year are reasonable and based on its extensive experience and track record in planning for such costs. Nicor Gas describes its budgeting methodology as a comprehensive process that involves the annual development of a five-year capital expenditure forecast, with input from the Company's various departments and approval by its senior management. Nicor Gas points out that its overall budgeted capital expenditures, which include contingency costs, did not exceed actual capital expenditures in the past five years. Accordingly, the Company argues that its experience in successfully developing and implementing capital projects provides for a high degree of confidence in its budget and cost estimation processes, including contingency costs. Nicor Gas argues that, as a result, it has established that the costs are reasonable and prudently incurred, and therefore recoverable.

The Company argues that the situation here is similar to that in *Ameren III. Co. d/b/a Ameren III.*, Docket No. 12-0282, Order at 34 (Jan. 10, 2012), where the Commission rejected an argument to exclude merger costs and savings as too uncertain and found instead that inclusion of projected merger costs and savings was proper given the use of a future test year. The Company also argues that the AG's reliance on a Michigan Public Service Commission ("MPSC") order reflecting that the MPSC has decided to exclude contingency costs under the laws applicable in Michigan is not based on Illinois law and is not binding here. The Company also responds that there are orders in other jurisdictions allowing contingency costs, such as *Rocky Mountain Power*, 279 P.U.R.4th 1, Docket No. 09-035-23, (2010), where the Utah Public Service Commission ("UPSC") declined to adopt a policy to exclude contingency costs and found merit in the proposition that the best estimates include contingency amounts which are then subject to a normal prudence review. The Company argues that the approach of the UPSC is appropriate under the record here where Nicor Gas' contingency costs have been shown to be prudent and reasonable.

## ii. AG's Position

The AG states that Nicor Gas has included approximately \$28.6 million of contingency capital expenditures in this rate case. AG Ex. 10.0 at 16 (citing Nicor Gas Ex. 1.1 (Schedule F-4) and AG Ex. 3.5). Contingency expenditures are amounts added to the forecast of identified capital expenditures for non-routine projects and are intended to cover unforeseen costs. *Id.* at 16-17. As "contingent," the AG argues, these amounts may not be spent, either in whole or in part. *Id.* at 16-17. The AG points to a MPSC holding to support its position that inclusion of such speculative costs in rate base is inappropriate. *In the matter of DTE Gas Company*, Case No. U-18999, Order at 5 (Sep.

13, 2018) (holding that contingency costs are far too speculative to be included in rate base).

The Company argues that it is reasonable to anticipate these costs and that it regularly uses the contingency costs allotted. In response, the AG points out that the Company fails to provide any identifiable methodology for determining the size of the contingency cost it adds to the costs of its projects. The AG further argues that the record shows that the Company regularly exceeded its budgets, irrespective of contingency costs. AG Ex. 10.0 at 48 (citing AG Ex. 10.14). As support, the AG provides the following examples: (1) Station Work – 2018 budgeted amount was \$10.4 million; actual spend was \$19.9 million (Nicor Gas Ex. 17 at 38); (2) Peaking Ops – 2018 budgeted amount was \$10.7 million; actual spend was \$17.9 million (*Id.* at 39); (3) Corrosion Work - 2018 budgeted amount was \$1.6 million; actual spend was \$5.4 million (*Id.* at 41); and (4) Aux Sable Transmission Replacement project - estimated per-mile cost to install the first three phases of pipe was \$4,347,826; actual amount spent was \$8,903,640 per mile or a 105% increase. *Id.*

The Company argues that denying it contingency costs would result in insufficient funding to complete planned projects due to “not readily observable project conditions such as: (1) contaminated soil; (2) finding unusable corroded pipe; (3) higher-than-expected water tables; (4) deeper-existing gas mains than expected; (5) unanticipated soil conditions; and (6) late requests by landowners or municipalities.” The AG responds by pointing to a number of change orders identified by AG witness Coppola that indicated, irrespective of budgets inclusive of contingency costs, the Company regularly approved change orders addressing the above issues that caused actual project expenditures to exceed budgeted expenditures. AG Ex. 7.0 at 10-11.

In sum, Nicor Gas’ requested contingency costs are too uncertain to include in rate base in this case. A \$21.366 million disallowance in rate base costs should be adopted, with a revenue requirement effect of \$2,906,000. AG Ex. 8.1, Sch. A & Sch. B-8.

#### **i. Commission Analysis and Conclusions**

The Commission approves the Company’s contingency costs. The record demonstrates that contingency costs are reasonably anticipated costs in planning its capital additions projects, and historical data shows that the Company has a history of regularly using contingency allowances to address contingencies.

The Commission disagrees with the AG that contingency costs are too tentative to warrant inclusion in rate base. The Company explains that it regularly experiences certain previously-unknown project conditions after construction commences, and lists several examples, ranging from unexpected soil conditions to late requests by landowners or municipalities. Nicor Gas estimates such costs, taking into account its general historical experience and the complexity and developmental stage of each project. The Commission finds that Nicor Gas has established that the costs will be reasonable and prudently incurred and therefore recoverable.

**c) Other Capital Expenditures**

**i. Nicor Gas' Position**

The Company argues that the AG's oversimplified approach of comparing certain forecasted costs to 2018 budgeted costs, and simply proposing to disallow those forecasted amounts that exceed the 2018 budgeted costs, is superficial and not adequate to challenge the *prima facie* case established by the Company's testimony or to meet the AG's burden to come forward with evidence supporting its proposed adjustments. *City of Chicago v. Ill. Commerce Comm'n*, 13 Ill. 2d 607, 610-611 (1958). The Company also avers that it provided evidence establishing that the projected costs of specific capital programs at issue here are prudent and reasonable and should not be disallowed.

Inside Meter Move-Outs (Cross Ties)

Nicor Gas plans to move 10,000 to 13,000 meters from inside to outside of customers' homes in 2019. The Company notes that this category of work is listed as QIP eligible for recovery under Section D(4)(b) of Rider QIP and Section 9-220.3 of the Act. The Company states that these meter move-outs will include a number of safety and service benefits: (1) provide enhanced safety to customers by moving meters which have the potential to leak from inside a customer's home to outside; (2) less inconvenience to customers for routine maintenance and inspections required by law; (3) no need for workers to enter the home to perform routine tasks; (4) outside meter locations provide emergency responders with easier access to the natural gas valve; and (5) a new valve located on the outside of the meter can be operated, if needed, by the customer. The Company also notes that the projected costs for customer generated cross ties represent a shift from other categories of now-completed cross ties, and not an actual increase. Nicor Gas avers that these planned costs are sufficiently supported as prudent and reasonable, and that they are recoverable.

Station Work

Nicor Gas states that it has planned capital expenditures related to work for its Transmission Regulator Stations. This category of work is specifically listed as QIP eligible for recovery under Rider QIP and Section 9-220.3 of the Act. The Company emphasizes the importance of maintaining and updating its Regulator Stations and notes that the work scheduled for 2019 includes a variety of projects designed to enhance the safety and reliability of the Company's distribution system. Nicor Gas avers that these forecasted costs are reasonable and prudently incurred, and that the Company should be allowed recovery.

New Business

Nicor Gas states that it will incur costs to install facilities to serve new customers at new locations within the Company's service territory, in large part due to a planned expansion for the Galena Territory, a Schedule F-4 project. The Company notes that the Commission has approved its request for a certificate of public convenience and necessity ("CPCN") for the Galena Territory project, and states that the project is moving forward on schedule. Nicor Gas avers that the forecasted costs for new business are reasonable and prudently incurred, and properly supported by the record, and argues that the Company should be allowed recovery of those costs.

### Peaking Operations

Nicor Gas explains that Peaking Operations (“Peaking Ops”) refers to the Company’s gas storage and compression facilities and that the disputed costs are necessary for the Company to guarantee capacity to meet customer loads during periods of peak demand. The Company notes that the Peaking Ops budget includes several maintenance and replacement projects, including the Ancona Compression Replacement project, the Hudson Compressor project, and the start of the next compressor project – either Lexington or Lake Bloomington – as well as several smaller maintenance projects. The Company states that the balance of the budget is for normal run-rate capital required to keep the facilities operational and reliable through the winter season. Nicor Gas avers that these costs are prudent and reasonable and supported by the record, and therefore recoverable.

### Department of Transportation

The Company notes that it has budgeted costs to modify or relocate gas utility infrastructure to accommodate Illinois Department of Transportation (“DOT”) public improvement projects. Nicor Gas explains that where there is an unavoidable conflict between existing gas facilities and DOT public improvement projects, Nicor Gas must adjust its work to meet state timelines. The Company explains that the increase in 2018 actuals were due to a change in DOT work resulting from a new midyear DOT budget. Nicor Gas states that its estimated costs for this purpose are in line with actual costs for this work in 2018 and are also based on the Company’s knowledge and experience of DOT’s fiscal processes. Accordingly, the Company avers that the projected capital expenditures for DOT work are prudent, reasonable, and recoverable.

### Pressure Improvement

Nicor Gas explains that Pressure Improvement (“PRIM”) projects are proposed to maintain system integrity and ensure safe and reliable service for customers. The Company states that the amount of PRIM costs estimated for the 12-month periods ending September 30, 2019 and 2020 are based on anticipated PRIM projects and are adequately supported and in line with prior actuals in 2017 and 2018. Nicor Gas avers that these estimated costs are prudent and reasonable and should be recovered.

### Corrosion Work

Nicor Gas states that the 2019 and 2020 forecasted budgets for corrosion work reflect the funds needed to continue to ensure the maintenance and preservation of the Company’s assets, to provide safe and reliable service to customers. The Company notes that the 2019 and 2020 forecasted budgets for corrosion work are comparable to 2018 actuals, and that 2018 actuals exceeded budget because the Company found and addressed additional corrosion issues through its continued focus on monitoring and maintaining system integrity. Nicor Gas avers that the AG has not identified any substantive issues with this work, and that estimated costs are prudent and reasonable and should be recoverable.

### Operations (Construction) Blanket Services

Nicor Gas states that the budgeted amounts for Operations (Construction) Blanket Services are for service replacements, bollard installations, and encoder receiver

transmitter replacements. The Company argues that the AG has not identified any substantive issue with this category of expense. Nicor Gas asserts that the budgeted costs are prudent and reasonable and are in line with the budgeted or actual amounts for 2018. The Company avers that it should be allowed recovery of these costs.

#### Transmission Integrity Management Program

Nicor Gas asserts that it budgeted certain costs related to its Transmission Integrity Management Program to meet applicable Federal and State requirements. According to the Company, these costs go towards proactively monitoring, maintaining, and ensuring transmission pipeline safety. The Company explained that the projected increase in costs related to accelerating the integrity assessment of pipelines in High Consequence Areas. Nicor Gas argues that the forecasted costs for this program are prudently incurred, reasonable in amount and should be recovered.

#### Transmission Integrity Management Program – Integrity Verification Process

The Company argues that the costs related to the Integrity Verification Process for the Transmission Integrity Management Program are critical to safety for the same reasons stated above. The Company argues that the forecasted costs for this program are prudently incurred and reasonable in amount.

### **ii. AG's Position**

The AG reviews the differences between Nicor Gas' calendar year 2018 budget, which totaled \$693.6 million, and the forecasted budgets for the years ending September 30, 2019 and September 30, 2020, which are \$882.6 million and \$842.1 million. AG Ex. 3.16 at 2. On average, these forecasts are 24% greater than the 2018 budget. AG witness Coppola analyzed each category of spending and identified capital increases that are unusual and unsupported. AG Ex. 3.0 at 41.

The AG identifies \$90.7 million and \$85.1 million of significant capital expenditure increases for 2019 and 2020, respectively, that were unusual and unsupported. *Id.* Of the total capital expenditures requested for 2019 and 2020, Mr. Coppola recommends that \$68,025,000 and \$85,100,000 be disallowed. AG Ex. 3.18; AG Ex. 8.1, Sch. B-16.

#### Meter Move-Outs/Cross Ties

The AG references the Company's budget which illustrates a 2018 budget of \$0.5 million for "Cross Ties - customer generated," a 2019 forecast of \$7.2 million and no 2020 forecasted capital expenditures in that category. AG Ex. 3.15; AG Ex. 10.0 at 25. The AG argues that the Company failed to meet its burden to prove that its claimed expenditures are reasonable and prudent according to 220 ILCS 5/9-201(c). The AG points out that Nicor Gas increased this category of spending 14-fold essentially by arguing a tautology: that the increase in cost is due to its decision to increase the budget for this item.

Nicor Gas witness Whiteside described the reasons for the expenditures as reducing inconvenience to customers and providing easier access to valves "[i]n the unlikely event of an emergency." Nicor Gas Ex. 17.0 at 37. Nicor Gas also claimed that, in addition to safety considerations and qualifying QIP investment, "[t]he increase in projected costs for the customer generated category of cross ties is a function of the

increased number of cross ties which will be performed in this subcategory [customer generated], and actually represents a shift from other categories rather than an increase.” *Id.* at 34. However, the AG emphasizes that Nicor Gas failed to provide any information showing specific meter types to be replaced, quantity, associated per-unit cost, cross-category comparisons, or other basic information needed for a meaningful prudence analysis. Given the extraordinary increase in investment Nicor Gas is pursuing, the AG asserts, the Commission and the public are entitled to know why costs are increasing, not hear that costs are increasing because Nicor Gas is spending more money on cross-ties. *Id.* The AG states that, if in fact Nicor Gas has shifted costs from another category, it is incumbent upon the Company to show where that shift occurred.

The AG points to what they argue is a more reasonable budget increase by stating that while the difference between the 2018 and 2019 budgets is \$6.7 million, the AG requests that the Commission disallow \$5 million for this item, reflecting the nine months in 2019 that are included in the Test Year. See Nicor Gas Ex. 17.0 at 36, fn 9; AG Ex. 10.0. The AG concludes that this budget still includes an increase from \$0.5 million to \$1.7 million, as well as the \$12.1 million cross ties budget and is sufficient for the Company’s operations while still accommodating growth. AG Ex. 3.15.

The AG argues that the record shows that the 14-fold increase in costs for cross-ties is unreasonable, and that an increase from \$0.5 million to \$1.7 million is reasonable. Further, given the substantial QIP DIMP budget for cross ties, the AG notes it is not prudent to increase the cross tie budget by another 50% when the Company has not identified an actual plan for cross tie expenditures.

#### Station Work

The AG explains station work as work for Transmission Regulator Stations and falls under Rider QIP. Nicor Gas Ex. 17.0 at 38. The AG posits that in the Company’s 2018 budget, Nicor Gas included \$10.4 million for “station” under Investing in Illinois – GAS OPS, and in this docket, doubled that budget to \$20.0 million for station work. AG Ex. 3.15.

The Company argues that because station work falls within the QIP category, the request should not be questioned. Nicor Gas Ex. 31.0 at 22-23. However, the AG responds that all expenditures are subject to the reasonableness and prudence standard, including QIP investment. 220 ILCS 5/9-220.3(e)(1)-(2). The AG notes that an increase of close to 100% over a single year requires explanation even if the expenditure falls within the QIP statute, and Nicor Gas has failed to provide a reasonable explanation for the increase. *Id.*

Nicor Gas witness Whiteside argues that while its 2018 budget shows \$10.4 million for station work, Nicor Gas spent well over the 2018 budget and spent \$19.9 million in 2018, an increase of more than 90%. Nicor Gas Ex. 17.0 at 38. The Company states that “work scheduled for 2019 includes the installation of two pig barrels to make a section of the 30” Ancona line inspectable, two valve replacement projects, one line heater replacement, and three station rebuilds, which will enhance the safety and reliability of the Company’s distribution system.” *Id.* The AG points out that while the Company generally described the work, it did not identify the costs associated with these projects,

their design, technical specifications, authorization for expenditures, or otherwise provide substantiating documentation supporting costs.

The AG also points out that the Company did not disclose actual capital expenditures for 2018 at the program category level before Staff and Intervenor testimony was filed and reflected the original 2018 budget amount in its response to AG data requests. AG Ex. 10.0 at 26. The Company argues that it did not appear aware before filing testimony in this case that actual expenditures for “stations” would rise to \$19.9 million in 2018, and it did not provide that number until responding to AG witness Coppola’s proposed adjustment. See AG Ex. 3.15. The AG argues that given the overall, extraordinary increase in capital spending reflected in this docket and in Nicor Gas’ last rate case, the Commission should be concerned that the Company set a capital budget of \$10.4 million for 2018 and then exceeded that amount by 91% without any explanation. AG Ex. 10.0 at 26-27. The AG posits that in most businesses, such a large cost overrun would be considered imprudent project cost management. *Id.*

The AG modifies its proposed adjustment to accommodate the types of expenditure Nicor Gas identified. The evidence shows that Nicor Gas has not demonstrated how it plans to spend \$20 million for station work. The Commission should adopt Mr. Coppola’s adjustment for “station work” which disallows \$7.2 million of capital expenditures from the “station” capital program category, and reduces the \$20 million budget to \$12.8 million, which is still 28% more than the 2018 budget.

#### New Business

The AG explains that Nicor Gas includes “New Business” as a budget category and defined it as the costs “incurred for installing facilities to service new commercial and residential business at new locations within Nicor Gas’ service territory.” Nicor Gas Ex. 17.0 at 38. The AG explains that Nicor Gas’ 2018 budget includes \$42.2 million for New Business and escalates that amount by \$4.4 million in the 2019 budget and by \$8.8 million in the 2020 budget. AG Ex. 3.15; AG Ex. 10.0 at 27. The AG points out that Nicor Gas provided no support for these increases other than the general assertion that it expects new business due to the Galena Territory expansion. Nicor Gas Ex. 17.0 at 38. However, the AG states that the Company failed to identify the amounts tied to the Galena Territory, the amounts for other portions of its service area, whether the new business was commercial or residential, or to reconcile costs for the Galena Territory and other expansions and New Business expenses. AG Ex. 10.0 at 27.

The AG argues that a key cost associated with New Business is an increase in service lines and meters, but that the Company is unable to provide the number of service lines, the number of meters, or other work units to support the capital expenditures for each annual period presented. AG Ex. 3.17; AG Ex. 10.0 at 28. This information, the AG posits, is basic to the development of capital budgets, and if the Company does not know how many meters, service lines, and other work units it completed in prior years, and how many it expects to complete in future years, then the increase in capital expenditure forecasts for New Business are without any foundation and cannot be found reasonable. *Id.* at 28.

Nicor Gas also argued that the New Business projection is prudent and reasonable because the Company was granted its request for a CPCN for the Galena project on May

30, 2019, and [is therefore] on schedule according to plan.” However, the AG argues that this statement is disingenuous, stating that the Company failed to mention that it had a scheduled construction start date of February 2019 for the Galena project, with the main extension scheduled to be in service at the end of 2019. Specifically, the AG points out that the Company estimated it would have one gate station in-service in June 2019; 105,731 feet of main with 78 service lines in-service in September 2019; and the remaining main and facilities would be installed later in 2019 and throughout the first 9 months of 2020. *Id.* The AG argues that having received its CPCN nearly four months later than its projected start date, it cannot be said that the Company is “on schedule and according to plan.” *Id.* The AG states that the Company is highly unlikely to meet its original in-service dates given the delay in acquiring its CPCN, making the projected \$12.3 million for New Business premature, unsupported, and unreasonable.

The Company justifies the projected cost for New Business as reasonable because it “include[s] annual wage increases for internal resources (3% annually), more services outsourced to contractors due to union attrition, and higher company and contractor costs due to lack of available subdivision-type service groupings.” The AG responds that these general assertions are based on the premise that the Galena project would be further along than it is and are therefore irrelevant. *Id.*

#### Peaking Ops

The AG points out that Nicor Gas included \$10.7 million in its rate base investments for Peaking Ops. It increased the budget to \$38.7 million in 2019 and to \$44.5 million in 2020. AG Ex. 3.15. While the AG initially proposed a \$54.8 million disallowance to match the 2018 budget, AG witness Coppola reduced his disallowance to account for the projects Nicor Gas identified in testimony and subsequent discovery, making his final disallowance \$18.8 million. AG Ex. 10.0 at 29.

In response, Nicor Gas witness Whiteside identified the Ancona and Hudson Compressor replacement projects and “several smaller maintenance capital type projects for equipment replacements and upgrades.” Nicor Gas Ex. 17.0 at 39. Nevertheless, the AG argues that the Company failed to account for \$11.1 million expenditures in 2019. *Id.* at 39. After adjusting the 2019 amount to reflect nine of twelve months, Mr. Coppola recommended that the Commission remove \$8.3 million from the 2019 Peaking Ops budget. AG Ex. 10.0 at 29.

The AG points out that for the \$44.5 million 2020 budget, Nicor witness Whiteside states that the Company included \$10.5 million “to start the next compressor replacement project (either Lexington or Lake Bloomington). The balance would be for normal run-rate capital.” Nicor Gas Ex. 17.0 at 39. The AG argues that given that the Company does not know which compressor replacement project it will pursue, Mr. Coppola concluded that the Company request for \$10.5 million is too preliminary to be included in rates. AG Ex. 10.0 at 29. The AG posits that this disallowance leaves \$34.5 million for Peaking Ops in the 2020 budget – more than three times the \$10.7 million budgeted in 2018, which is ample for the unspecified “normal run-rate capital” Mr. Whiteside said was also funded in Peaking Ops.

The AG does not challenge the Ancona Compressor project because Nicor Gas provides the requested substantiating documents for that expenditure. AG Ex. 3.0 at 23.

The AG takes issue, however, with the remainder of the expenditures as premature, unidentified, and unsubstantiated. The Hudson Compressor project is in its infancy; the “several smaller projects” noted by the Company were not described at all; and the “next compressor project” has yet to even be identified and cannot therefore be designed, yet the Company seeks to include it in rate base. *Id.* The AG argues that the Company bears the burden to prove that its claimed expenditures are reasonable and prudent pursuant to Section 9-201(c), and the kind of generalized explanations related to this budget item cannot justify the 180% and 315% increases requested the Company. *Id.*

### DOT Projects

The AG points out that the Company’s budget for 2018 DOT work was \$20 million, and the forecasted 2019 and 2020 amounts are \$32.3 million and \$29 million respectively. AG Ex. 3.18. The Company states that these costs are “incurred for modifying or relocating gas utility infrastructure when DOT decides to undertake a public improvement project and there is an unavoidable conflict between existing gas facilities and the proposed improvement.” Nicor Gas Ex. 17.0 at 40. The AG points to the increases in capital expenditures over the 2018 budget for the 12 months ending September 2019 as \$12.3 million, and for the 12 months ending September 2020, \$9 million, a 61.5% and 45% increase over 2018, respectively. AG Ex. 10.0 at 30.

The Company attempts to justify these increases by referring to the actual, as opposed to the budgeted, 2018 expenditure of \$31.4 million. Nicor Gas Ex. 17.0 at 40. The AG then points out that this indicates that the actual DOT cost was about 50% higher than the budgeted amount. Mr. Whiteside suggests that the current budgeted amounts are “relatively flat” to the 2018 actual cost, and therefore should not be disturbed. *Id.* However, the AG argues that the Company provides no examples of DOT past or predicted projects or required expenditures.

The Company further attempts to explain the increase by arguing that during the second half of 2018, DOT increased funding of projects and that increased the Company’s capital expenditures. Nicor Gas Ex. 17.0 at 40. The AG again asserts, however, that no projects or expenditures were identified by the Company, so this only partially explains some of the increase. The AG contends that the Company fails to provide detailed explanations and documented support for capital expenditures added to rate base. AG Ex. 10.0 at 30.

The AG represents that the Company apparently did not have the 2018 actual costs information when it prepared the DOT forecasted expenditures for 2019 and 2020, or it presumably would have updated the 2018 budget in its filing. AG Ex. 10.0 at 31. Therefore, the AG claims it is disingenuous to justify the 2019 and 2020 capital forecasts based on 2018 actual results. *Id.* The AG points out that this increase is part of a recent pattern of increasing budgets well beyond a reasonable rate of inflation.

### Pressure Improvement Projects & Corrosion Work

The AG points out that the Company’s 2018 budget is \$8 million, and the forecasted amounts for 2019 and 2020 increased significantly to \$16.5 million and \$10.7 million, respectively. AG Ex. 3.18. Mr. Whiteside’s rebuttal testimony stated that the amount of Pressure Improvement Project costs “are based on anticipated PRIM projects,

are in line with prior actuals over the last two years and will be prudently incurred.” Nicor Gas Ex. 17.0 at 41. However, the AG asserts that he does not identify any particular project, nor acknowledge that the 2019 budget is more than 80% greater than the “actual” 2018 spend of \$9.0 million. *Id.* at 40-41. Mr. Whiteside’s assertions, the AG states, are not backed up with any specifics, and it is not reasonable for the Commission to accept them as justification for the increased spending indicated for Pressure Improvement Projects.

The AG argues that corrosion work is another category showing a large discrepancy between budgeted and actual spend, which the Company then uses to try to bootstrap increased budgets. The AG points out that the Company budgeted \$1.6 million for 2018 but according to Mr. Whiteside, it actually spent \$5.4 million, a three-fold increase. AG Ex. 3.15; AG Ex.10.0 at 32; Nicor Gas Ex. 17.0 at 41. The AG also shows that in 2019 and 2020, the Company budgeted \$4.7 million and \$6.8 million for Corrosion Work, respectively. AG Ex. 3.15.

The AG maintains that while Mr. Whiteside stated that the budgets are “needed to continue to ensure our assets are protected so as to provide safe and reliable service to our customers,” he does not identify any specific project or expenditure, making it impossible to test the reasonableness of the budgeted amount. Nicor Gas Ex. 17.0 at 41. The AG asserts that Nicor Gas has not identified an infrastructure crisis that could justify the large increases in spending for “safe and reliable” service. Tr. at 263-266

The AG again asserts that Nicor Gas bears the burden of proof to show that its expenditures are reasonable. It contends that bald assertions about protecting assets and providing safe and reliable service do not provide the detail necessary to assess the \$3.1 million and \$5.2 million in capital spending increases in the 2019 and 2020 periods over the 2018 budget. AG Ex. 10.0 at 32. In addition, the AG adds, Nicor Gas offered no explanation for the 2018 increase of actual expense over budgeted expense, giving Nicor Gas’ reliance on the actual spend, that itself was more than three times over budget, a weak foundation. *Id.*

#### Operations (Construction) Blanket Services

The AG represents that this budget category includes costs associated with Field Delivery operations (tasks performed by the Company) and Construction operations (tasks performed by outside contractors). AG Ex. 10.0 at 33; AG Ex. 10.11. The Company maintains that the 2018 actual capital expenditures for these categories were \$15.9 million, and the forecasted expenditures were \$19.2 million and \$21.3 million for the 12 months ending September 2019 and September 2020. Nicor Gas Ex. 17.0 at 41; AG Ex. 10.0 at 33. The AG posits that the Company provides no explanation for the growth of these costs. Despite the 2019 budget increase of more than 20% over actual cost in one year and the 2020 budget increase of almost 34% higher than the 2018 actual cost, Nicor Gas witness Whiteside erroneously asserted that “the amounts for 2019 and 2020 do not exceed the budgeted or actual amounts for 2018.” Nicor Gas Ex. 17.0 at 41. Without explanation or support for these increased costs over a short, three-year period, the AG urges the Commission to disallow the \$9.45 million of capital expenditures for this capital program category.

### iii. Commission Analysis and Conclusion

Based on a careful review of the evidence in the record, the Commission makes the following findings concerning the Company's capital programs at issue:

#### Inside Meter Move-Outs (Cross Ties)

The Commission agrees that the inside meter move-outs and cross ties expenditures reduce inconvenience to customers and provide easier access to valves in the event of an emergency. The Commission finds that these planned costs are sufficiently supported as prudent and reasonable, and they are recoverable.

#### Station Work

The Commission finds that these planned capital expenditures related to work for Nicor Gas' Transmission Regulator Stations are reasonable and prudently incurred, and that the Company should be allowed recovery.

#### New Business

The Company notes that the Commission has approved its request for a CPCN for the Galena Territory project, and states that the project is moving forward on schedule. The Commission finds that the forecasted costs for new business are reasonable and prudently incurred, and properly supported by the record, and therefore the Company should be allowed to recover those costs.

#### Peaking Operations

The Commission disagrees with the AG that the Company did not adequately describe the Hudson Compressor Project and "several smaller project" encompassed by the Peaking Operations budget. Therefore, those costs are approved.

#### Department of Transportation

Nicor Gas states that its estimated costs for this purpose are in line with actual costs for this work in 2018 and are also based on the Company's knowledge and experience of DOT's fiscal processes. The Commission finds that the projected capital expenditures for DOT work are prudent, reasonable, and recoverable.

#### Pressure Improvement

The Commission agrees with the Company that its PRIM projects are proposed to maintain system integrity and ensure safe and reliable service for customers. The Commission finds that the PRIM costs are adequately supported and in line with prior actuals in 2017 and 2018. The Commission finds that these estimated costs are prudent and reasonable and should be recovered.

#### Corrosion Work

The Commission disagrees with the AG that the Company did not justify its increase in corrosion work costs. The Commission agrees with the Company that the forecasted budgets reflect the continued need to ensure the maintenance and preservation of the Company's assets. The Company's costs are reasonable and approved.

### Operations (Construction) Blanket Services

The Commission finds that the budgeted costs are prudent and reasonable, and in line with the budgeted or actual amounts for 2018.

### Transmission Integrity Management Program

The Company explained that the projected increase in costs is related to accelerating the integrity assessment of pipelines in High Consequence Areas. The Commission agrees that the forecasted costs for this program are prudently incurred, reasonable in amount and should be recovered.

### Transmission Integrity Management Program – Integrity Verification Process

The Company argues that the costs related to the Integrity Verification Process for the Transmission Integrity Management Program are critical to safety for the same reasons stated above. The Commission agrees that the forecasted costs for this program are prudently incurred and reasonable in amount.

#### **d) Aux Sable**

##### **i. Nicor Gas' Position**

Nicor Gas describes the Aux Sable project as a long-term, multiphase project to replace more than 38 miles of transmission pipeline that was originally installed in 1977. The Company states that it made the prudent and reasonable decision to pursue this pipeline replacement project after a thorough assessment of current and future repairs. Nicor Gas asserts that the Aux Sable project is important to ensure long-term safety and reliability of the Company's distribution system, and that the assets will be used and useful for supplying customer demand for natural gas. The Company adds that the assets will be acquired and placed into service prudently and at reasonable cost.

Nicor Gas responds to AG witness Coppola's concerns about "cost overruns" by pointing out that Mr. Coppola's analysis relied upon preliminary project cost estimates from 2010. The Company notes that the scope of the Aux Sable project has since revolved from 13.6 miles of pipeline replacement over three phases to 38.4 miles of pipeline replacement over seven phases. According to the Company, the project was expanded to address newly observed anomalies and disbonding of corrosion protection coatings, rendering it a high-risk line that needed to be replaced to avoid development of safety issues. The Company argues that Mr. Coppola's comparisons between the preliminary budgets for a 13.6-mile project and the costs of a 38.4-mile project are improper and should not be credited.

Nicor Gas avers that its plans and costs for the Aux Sable project are prudent and reasonable, and that the Company has successfully managed costs over its lengthy duration. The Company explains that it presented evidence of the relative consistency of replacement costs per mile, from the project's inception to date. The Company adds that it presented further evidence accounting for the most costly phase of the Aux Sable project, which involved unique features that drove up the cost per mile compared to other phases. Accordingly, Nicor Gas argues that the AG has not established any basis to challenge the costs at issue.

## ii. AG's Position

The AG points out that in the 2017 Rate Case, the Company represented that prior Aux Sable project phases (Phases 1, 2A, 2B, 3, 4, & 5) required \$258.9 million in capital expenditures, which was significantly more than the \$68.4 million original cost. AG Ex. 3.0 at 42; Nicor Gas Ex. 17.0 at 22. In this docket, Company witness Whiteside discussed additional Phases 6, 7A, and 7B, and costs of \$63.5 million, \$52.3 million and \$32.5 million, respectively, for a total additional cost of \$148.3 million. Nicor Gas Ex. 1.0R at 17. Therefore, between the 2017 Rate Case and the current rate case, the Company identified total capital expenditures of \$407.2 million for the Aux Sable project, or \$339 million over the original estimate. AG Ex. 3.0 at 42-43.

The AG points out that while the number of miles replaced increased from 13.6 miles to 38.4 miles (close to tripling) since the original analyses, the total cost increased nearly six-fold and the cost-per-mile doubled from \$4,347,826 to \$8,903,640 for the first three phases alone. AG Ex. 10.0 at 18. Company witness Whiteside reported that the costs-per-mile for Phases 6 and 7a are \$9,564,257 and \$9,378,440 respectively. Nicor Gas Ex. 17.0 at 23, Figure 1 (no cost given for phase 7b). Despite these major increases in cost, the AG argues, Nicor Gas failed to produce any documentation justifying or addressing the increased cost.

Next, the AG argues that the increase in project scope from 13.6 miles to 38.4 miles, i.e. the addition of phases 4, 5, 6, 7A, and 7B, required cost and engineering analyses at least equal to the analyses done when the cost was determined to be \$68.4 million, particularly in light of the increase in cost to \$407.2 million. See AG Ex. 3.19 (Conf.). The AG maintains that while Mr. Whiteside admitted that the analyses Nicor Gas produced did not include cost information for Phases 4, 5, 6, 7a and 7b, Tr. at 238, the Company relies on reports of physical pipeline anomalies to justify both the need and the cost of the expanded project. The AG asserts that Nicor Gas failed to produce: (1) a Full Engineering Study; (2) Project Analysis; (3) Cost/Benefit Analysis; (4) Executive Summary; (5) Spend Authorization; (6) Project Estimate; (7) Cash Flow; (8) Nicor Gas Board Presentation or Approval; or (9) relevant Authorization for Expenditures of Capital ("AFE"), as it did for the original project scope, i.e. Phases 1, 2A, 2B, and 3, and therefore failed to explain or justify project costs growing from \$68.4 million to over \$407 million or provide the necessary information to demonstrate that the costs of the project were reasonable and prudent. *Id.*

The AG also argues that in place of the requested cost analyses for the additional phases, Nicor Gas witness Whiteside produced a table showing AFE costs per-mile for each project phase that exceeded the original cost by a factor of 1.67 to 3.0. Nicor Gas Ex. 17.0 at 23. When asked for cost studies underlying these AFE numbers, the AG states, Nicor Gas referred back to its "original cost estimate and project analysis performed in 2010." AG Ex. 10.0 at 18. Mr. Whiteside testified that the documents contained in AG Exhibit 13.19, specifically Exhibit 7, support the need for the projects. Nicor Gas Ex. 31.0 at 4.

Nicor Gas suggests the 2010 cost analyses were "preliminary" and the project "has since evolved" so the 2010 cost analyses should not be relied upon by Mr. Coppola or the Commission. The AG points out, however, that the Company was unable to identify

or produce any other cost analyses that reflect the current scope of the project, leaving the 2010 analysis of the original project the only cost analysis.

As noted above, the Company initially estimated a cost per mile of \$4,347,826 and the actual cost per mile was \$8,903,640 for the first three phases of the project – double the initial estimate. AG Ex. 10.8; AG Ex. 10.0 at 18. Mr. Whiteside suggests that the difference between the original estimated cost per mile and actual cost per mile “do not suggest cost overruns” and “is an inappropriate apples and oranges comparison.” Nicor Gas Ex. 17.0 at 22-23. However, the only difference between the original \$4.35 million estimate and the \$8.9 million final cost that AG Ex. 10.8 and Nicor Gas witness Whiteside identified were “overheads and Nicor OPS,” with these being “normal corporate overheads.” Tr. at 244. In the AG’s opinion, the Commission should conclude that it is not reasonable or prudent to increase costs three-fold for “overheads and Nicor OPS,” and that Nicor Gas has failed to explain the increased cost associated with this project.

Referring to the treatment of Aux Sable as a QIP project, the Company finally argues that “this is also an example where Mr. Coppola brings up costs that have been previously reviewed and approved by the Commission for completed phases of the Aux Sable pipeline.” Nicor Gas Ex. 31.0 at 12. The AG emphasizes, however, that the Company’s Schedule F-4 Revised, which delineates “Additions to Plant In Service Since The Last Rate Case,” expressly treats the \$148.3 million related to the Aux Sable project, phases 6, 7A, and 7B, as plant additions in this proceeding. Nicor Gas Ex. 1.1R2. Further, the QIP reconciliation for 2018 plant is currently pending, and these three phases are listed as complete in 2018. Commission review of these projects in the Rider QIP annual reconciliation is in early stages, with no schedule other than a second status on August 20, 2019. See *N. Ill. Gas Co., d/b/a Nicor Gas Co., Petition Pursuant to Rider QIP of Schedule of Rates for Gas Service to Initiate a Proceeding to Determine The Accuracy and Prudence of Qualifying Infrastructure Investment*, Docket No. 19-0294, Tr. at 4-5 (May 16, 2019). These costs have not been reviewed, and this docket is the proper forum to challenge the prudence of expenditures for capital investments like the Aux Sable Project that have not yet been reviewed.

The AG requests that the Commission exclude the \$124.2 million in capital additions from rate base proposed in this rate case for the Aux Sable pipeline replacement project until the investigation is completed. AG Ex. 10.0 at 19. This amount represents all capital expenditures proposed in this rate case for phases 6, 7A and 7B, which are for the period 2018 to September 2020 and excludes the amounts associated with the Aux Sable change order disallowances as laid out in the Change Orders section, below. In addition, the AG urges the Commission to initiate an investigation of the Aux Sable replacement pipeline to determine why costs increased from \$68.4 million to \$407.2 million when the project was expanded from 13.6 miles to 38.4 miles.

### **iii. Commission Analysis and Conclusion**

The Commission finds that the costs of the Aux Sable project are prudent and reasonable. As the Company points out, the actual project expanded considerably in scope, both in length and to address newly observed anomalies and disbonding of corrosion protection coatings which presented a safety issue.

The Commission declines to open an investigation into the Aux Sable project, as requested by the AG. As the AG points out, the Company's 2018 QIP reconciliation proceeding is ongoing. As three phases of the Aux Sable project concluded during 2018, that docket is the appropriate venue to examine these costs.

**e) Joliet Header**

**i. Nicor Gas' Position**

Nicor Gas describes the Joliet Header project as approximately 10 miles of new gas transmission line and related facilities, connecting three stations in the Joliet area with the transmission system. According to the Company, the project will increase Nicor Gas' gas supply options and allow it to meet forecasted customer load growth, and the assets included in the Test Year rate base will be used and useful. Nicor Gas notes that in Docket No. 17-0302, the Commission determined that the project is necessary to provide reliable service to customers, and granted a CPCN to construct, operate, and maintain the Joliet Header. See *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 17-0302, Order (Apr. 19, 2018).

AG witness Coppola proposes a disallowance because the Company did not produce an AFE for the Joliet Header project, meaning that no specific project authorization had been granted by Company management. Nicor Gas responds that the project has been prudently and reasonably planned and budgeted through the Company's Asset Development Process ("ADP"). The Company describes its ADP as five stages of assessment, planning, design, and construction. The Company explains that the ADP results in fully developed cost estimates, reviewed and approved by senior management, before the issuance of the Stage 4 AFE, including specifically for bids with respect to the Joliet Header project.

The Company notes that the design work for the Joliet Header project is complete and the estimated costs fully developed. Nicor Gas further notes that the project has been out to bid, with construction scheduled to begin by February 2020. Nicor Gas explains that while the project has undergone extensive planning and design work, the Stage 4 AFE will not be issued until the contractor recommendation is finalized. However, the Company avers that the timing of the Stage 4 AFE is not unusual, and that the forecasted costs are reasonable and prudently incurred.

**ii. AG's Position**

The AG states that the Company shows a start date of 2016, and a completion date of September 2020. The AG argues that when they asked the Company to provide the AFE supporting the capital expenditure estimate and showing approval of the project, the Company stated that the project has not yet progressed to any stage in the funding process at which an AFE would be completed. AG Ex. 3.0 at 19. The AG also argues that inclusion of the Joliet Header project in rate base is premature because the Company is still involved in pending litigation regarding property for the project and eminent domain. See *N. Ill Gas Co. d/b/a Nicor Gas Co. – Petition for Authorizing the Use of Eminent Domain Power*, Docket No. 18-1306, Tr. at 108 (May 1, 2019).

The AG points out that, like most utilities, Nicor Gas utilizes AFEs in its capital review process, and that it filed workpapers under Schedule F-4 that included AFEs to

support the forecasted capital expenditures for some projects or portions of those projects, but not for all of the major projects. AG Ex. 3.0 at 20, 21. The AFEs that the Company provided show a process where the engineering department of the Company outlines the key characteristics of the project and the applicable components of the cost estimate for that phase and stage of the project. *Id.* The AG further states that the components can include cost estimates for discrete items, such as engineering work, environmental costs, land acquisition, pipe and other materials, contractor construction costs, project management costs and contingency costs. The AFE is then forwarded to different levels of management for approval of the expenditures and initiation of project work for that approved stage of the project. *Id.* Put differently, the AG contends, the AFE provides a detailed work-up of the proposed project that once properly reviewed, is approved and signed by management in order for the project to be funded and to proceed. *Id.*

The AG further illustrates that Nicor Gas witness Whiteside described a 5-Stage ADP Nicor Gas uses to develop its projects. Under this process, incremental funding is updated and approved during various stages of a project, with each subsequent AFE showing the approved cumulative funding of the project. AG Ex. 3.4; AG Ex. 3.0 at 21; Nicor Gas Ex. 17.0 at 26-29. The Company posits that the project cannot proceed without AFE approval for each stage, and if the Company cannot provide an AFE for a project, in whole or in part, beyond a particular stage in the Company's ADP, then the project has not been reviewed beyond that stage, and additional costs associated with that project are still preliminary. *Id.* The AG notes that although the Company has supplemented documents throughout this proceeding, it did not produce additional AFEs indicating that the Joliet Header project has progressed to a point where the total cost has been reviewed and approved. *Id.* Therefore, the AG concludes, the Joliet Header should not be included in rate base.

The Company responds by asserting that having an approved AFE is irrelevant to whether the project should be included in rate base, and that irrespective of where the project is in the ADP multi-stage process, if there is an initial cost estimate, the capital cost must be included in rate base. Nicor Gas Ex. 17.0 at 29; AG Ex. 10.0 at 21. The AG further argues that AG witness Coppola is the only expert witness to pursue discovery to uncover the Company's ADP and its integration with AFEs, and that Mr. Coppola's understanding and analysis is based on information the Company provided and is entirely supported by the record. *Id.* The AG contends that Nicor Gas' use of a process to review plant investment does not shield it from review nor guarantee that every decision is reasonable and prudent. *Id.*

The AG further adds that the ADP lays out the developmental stages of a project but does not, by itself, demonstrate that a project has been fully vetted. In fact, the ADP incorporates the issuance of AFEs throughout the process to indicate management approval. Nicor Gas Ex. 17.0 at 27. The AG points out that Mr. Whiteside testified that "[a]t that time, the Stage 2 AFE will be created and approved for the costs associated with various activities of the project, including design, environmental review, land services and material ordering." *Id.* An AFE is also issued at Stage 4 of the ADP, indicating that all costs have been finalized. *Id.* at 27-28. The AG concludes that a review of the ADP

shows that an AFE is an important milestone, showing that a project has been finally reviewed by management and its final cost and scope approved. AG Ex. 3.0 at 20.

The AG points out that although the Company was granted a CPCN for the project, it is still involved in litigation regarding eminent domain. Even if the Commission authorizes the Company to assert eminent domain, it still must either reach agreement with property owners or pursue litigation to secure the property rights needed for the Joliet Header project. The AG concludes that this process is lengthy and its outcome uncertain; therefore, this unresolved issue, by itself, is enough to exclude the project from rate base.

Lastly, the Company claimed that the project is ready to be included in rate base because “estimated costs for the Joliet Header project have been fully developed, [t]he design work for the Joliet Header is complete, the project has been out to bid since February 20, 2019, and has a target award date of May 24, 2019.” Nicor Gas Ex. 17.0 at 28. In response, the AG notes that the Stage 4 AFE for the project will not be issued until the contractor recommendation is finalized, according to Nicor Gas. The AG argues that the evidentiary record lacks any indication that the target award date was met or whether a winning bid has been selected, and that the Company did not supplement the record at the hearing on May 29-30 nor provide the Stage 4 AFE pertaining to the Joliet Header despite the fact that the Commission’s rules allow updates to future test years to support “significant and material” changes such as contractual obligation. 83 Ill. Adm. Code 287.30(c)(1). Therefore, they concluded, the record still fails to support a finding that the Joliet Header project has been finalized and that it will be in service before the end of the test year.

### **iii. Commission Analysis and Conclusion**

The Commission finds that the costs of the Joliet Header should be recovered in rate base. As the Company states, the Commission has granted the CPCN for the project, and the estimated costs are fully developed. As the AG notes, the ADP and AFE process is commonly used among utilities for capital projects. The AG also agrees with the Company that each AFE provides a detailed work-up of the proposed project that once properly reviewed, is approved and signed by management in order for the project to be funded and to proceed. The Commission disagrees that because the eminent domain docket is still pending, those costs are imprudent. The Commission finds the Company properly forecasted the Joliet Header costs, and they are approved.

#### **f) Skokie-Mulford, Elmhurst, and Lemont Mains**

##### **i. Nicor Gas’ Position**

AG witness Coppola recommends disallowances associated with the Skokie-Mulford Main Replacement project, the Elmhurst Phase 4 Main Replacement project, and the Lemont Main Replacement project, based on the status of the AFEs. Nicor Gas argues that Mr. Coppola’s reliance on the issuance of a final AFE is misplaced and based on a misunderstanding of the Company’s Asset Development Process. As with the Joliet Header project, the Company avers that the design work for the Skokie-Mulford, Elmhurst, and Lemont Main Replacement projects is complete, and all have approved construction drawings and fully developed cost estimates.

The AG also asserts that the Skokie-Mulford project is behind schedule and will not be in service by the end of the Test Year, ending on September 30, 2020. Nicor Gas responds that all three of the projects have been out to bid, with planned in-service dates in September 2019, and reiterates that the timing of the Stage 4 AFEs for these projects is not unusual. The Company states that there is no reasonable basis to assert the projects will not be in service, consistent with the projected costs and schedules, before the end of the Test Year. Nicor Gas avers that the estimated costs for these projects are reasonable and prudently incurred.

## ii. AG's Position

### Skokie-Mulford

The Company states that it plans to install 8,100 feet of 24" main in Skokie, IL, and remove an existing main from the Commonwealth Edison Company right-of-way. Nicor Gas Ex. 1.0 at 23. The AG stated that the Company shows a completion cost of \$23.8 million, a project start date of 2018 and a completion date of 2019. AG Ex. 3.0 at 24-25 (referencing line 10 of Schedule F-4 Revised). The Company provided forecasted capital expenditures for the main replacement totaling approximately \$24.1 million. AG Ex. 3.0 at 25.

The AG argues that while the Company seeks to include approximately \$23.8 million in rate base, the AFE produced by Nicor Gas in Schedule F-4 WP16 (Conf.) was substantially less than this amount. AG Ex. 3.10 (Conf.) at 2. The Company explains that the amount in the AFE did not match the \$23.8 million shown on line 10 of Schedule F-4 because:

For certain projects and programs, including this project, the Company's Engineering and Construction departments utilize a 5 Stage project management process. Under this process, incremental funding is updated and approved during various stages of a project. *This project is currently at the second stage of funding in the 5 Stage funding process.* Therefore, the AFE provided at Schedule F-4 WP 16 represents initial, not full funding, for this project. Additional funding will be obtained as the project progresses through the remaining stages of the process.

AG Ex. 3.0 at 25 (emphasis in original).

The Company claims that because it utilizes its 5-step ADP, AFEs and their respective approvals should not be controlling. However, the project is "at the second stage of funding in the 5 Stage funding process." AG Exhibit 3.10 Public. The AG points out that, as Nicor Gas witness Whiteside explains, Stage 2 is the "Definition and Planning" stage when the Company "evaluate[s] alternatives and define[s] scope." Nicor Gas Ex. 17.0 at 26. Mr. Whiteside added that "[t]he design work for the Skokie-Mulford Street project is 100% complete, [t]hat the project has approved construction drawings and has been out to bid since February 4, 2019," and that "[it] was awarded [to a contractor] on April 9, 2019." *Id.* at 29. However, the AG argues that while the Company has supplemented documents throughout this proceeding, it has not produced additional

AFEs or other documents showing management authorization to spend the \$23.8 million the Company seeks to include in rates.

The AG contends that it is the Company's position that the Commission simply accept the Company's word and approve the inclusion of over \$23 million in rate base with nothing more than an AFE showing a very small expenditure for the development of the Skokie-Mulford project.

The AG finally argues that the utility bears the burden of proof to justify its expenditures as reasonable and prudent, and further that they will be in service by the end of the test year. 220 ILCS 5/9-201(c). The AG contends that the utility is under the legal obligation to justify its expenditures and produce evidence that the expenditures it seeks to include in rate base are necessary, reasonable, and prudent, and that conclusory statements should be rejected as insufficient. The AG concludes that if the project is ready to begin construction and be in service by September 30, 2020, Nicor Gas should be able to provide documentation verifying its projections; it has failed to do so for the project.

#### Elmhurst and Lemont Mains

The Company maintains that it plans to replace segments of the distribution main in the Elmhurst area and install 11,500 feet of 16" main in Lemont, IL. Nicor Gas Ex. 1.0R at 23. The AG points out that the Company showed a completion cost of \$19.8 million for the Elmhurst Phase 4 replacement project and a total completion cost of \$12.2 million for the Lemont main on Schedule F-4 Revised. AG Ex. 3.0 at 27. AG Exhibits 3.11 and 3.12 show the monthly capital forecast for these projects from January 2019 to October or November 2019 provided by the Company.

AG witness Coppola testified that the Company has not provided the "completed design work," request for proposals ("RFPs"), AFEs, or any other documentation in support of the forecasted capital expenditures for the Elmhurst and Lemont mains. AG Ex. 3.0 at 28. Nicor Gas witness Whiteside responded by asserting that the Elmhurst and Lemont main projects were either out for bids or awarded. Nicor Gas Ex. 17.0 at 28. However, the AG argues that the internal Nicor Gas approval process Mr. Whiteside describes provides that a Stage 4 AFE will need to be issued once the construction contract is awarded. Specifically, Mr. Whiteside stated that "[i]f a project is to be competitively bid, the Stage 4 AFE is placed on hold until such time as the recommendation of the contractor is finalized." Nicor Gas Ex. 17.0 at 28. Mr. Whiteside further asserted that the project cost estimate is updated as needed with the bid pricing and routed for approvals. *Id.* at 29. The AG contends that Nicor Gas has not offered the Stage 4 AFE for these projects into the record. The AG states that without evidence that management has accepted the final bids and authorized construction by approving the necessary AFE, it is not possible to be confident of the scope of the project or of its cost. AG Ex. 3.0 at 28.

The AG requests that the Commission disallow the incremental \$18,144,000 of capital expenditures for the Elmhurst Phase 4 project and \$11,200,000 for the Lemont main replacement above the contingency capital costs previously discussed. These amounts exclude the disallowances of \$1,620,000 and \$1,000,000 for contingency capital costs, respectively. AG Ex. 3.0 at 29; AG Ex. 8.1, Sch. B-12 and B-13.

### iii. Commission Analysis and Conclusion

The Commission agrees with Nicor Gas that the design work for the Skokie-Mulford, Elmhurst, and Lemont main replacement projects is complete, and all have approved construction drawings and fully developed cost estimates. The Commission does not find that because the Stage 4 AFE is not yet issued, the costs for these main replacements is imprudent. The record indicates that the projects are either out for bid or waiting to be awarded. Therefore, the costs of Skokie-Mulford, Elmhurst and Lemont main replacements are fully developed and approved.

#### g) Hudson Storage Compressor

##### i. Nicor Gas' Position

Nicor Gas states that it has prudently determined that it is necessary to replace the compressor at the Hudson storage facility, which was installed in 1971. The Company explains that it undertook a study to identify the compressors in most critical need of replacement to maintain safe and reliable service. Based on the study, the Company prudently identified the Hudson Unit 21 compressor as a candidate for prioritized replacement. The Company notes that it is uncontested that the Company needs to replace this 48-year-old compressor before the end of the Test Year. However, AG witness Coppola proposes disallowing capital expenditures for the project as too preliminary and tentative, and because the project has not received a final AFE. Nicor Gas responds that Mr. Coppola's focus on the issuance of a final AFE is arbitrary and misplaced, pointing out that the Company has developed a detailed budget and timeline for the Hudson Unit 21 project, and is on track to complete the project as scheduled. Specifically, the Company notes that as of April 2019, the Hudson storage compressor replacement project entered the third of five stages in the ADP process, and is proceeding in accordance with the timeline presented in the Company's direct testimony. Nicor Gas also notes that it has substantial experience with storage compressor replacement projects and is therefore well-versed in the costs and timelines for such projects. Accordingly, the Company avers that its plans and projected costs for the Hudson storage compressor placement project are prudent and reasonable.

##### ii. AG's Position

The AG points out that on line 7 of Schedule F-4 Revised for the Hudson compressor replacement, the Company shows a completion cost of \$39.6 million, a project start date of June 2019 and a completion date of September 2020. AG Ex. 3.0 at 22. The AG states that when the Company was asked to provide the horsepower and other technical specifications of each new compressor with the related capital cost, the Company provided some of the technical specifications for the Ancona compressors, but stated that the type and size of the Hudson compressor has not yet been determined. *Id.* at 23. The AG points out that the Company also did not provide the AFE for the Hudson compressor. *Id.* The AG concludes that the inclusion of the Hudson Storage Compressor in rate base is premature.

In response, the Company asserted that "in mid-April 2019, the Hudson storage compressor replacement project entered the third of five stages in the ADP process, and [that] the Company prepared a presentation summarizing progress on the project,

remaining tasks to be completed, and a detailed timeline for completion.” The AG argues that this does not by itself demonstrate that the project has been reviewed and approved by Nicor Gas management or that it has gone through the ADP and is final.

Further, the AG points out that Nicor Gas witness Wassell stated that the Hudson Compressor project was only “moving into the third stage - initial design” and that the “meeting to review the project schedule and budget before entering stage three is scheduled to occur in April 2019.” Nicor Gas Ex. 25.0 at 7. Therefore, the AG argues, it is uncertain whether the project has actually entered Stage 3 of the Company’s ADP. Regardless, stage three is only the initial design stage, still early in the five step ADP. *Id.* at 7. The AG again contends that without an AFE, engineering documents, or some evidence, other than legal conclusions and bald assertions by the Company, indicating the project is in fact at some stage in the ADP beyond initial design, the Commission cannot be confident as to where the project is in its developmental stages or whether it will be in service by the end of the Test Year.

### **iii. Commission Analysis and Conclusion**

The record indicates that the Hudson Storage Unit 21 compressor needs to be replaced, the Company has developed a detailed budget and timeline for the Hudson Unit 21 project and is on track to complete the project as scheduled. The AG argues that because the Company is only on stage three of the initial design means there is no assurance the project will begin during the Test Year. The Commission disagrees. The record demonstrates that as of April 2019, the Hudson storage compressor replacement project entered the third of five stages in the ADP process, and is proceeding in accordance with the Company’s proposed timeline. The costs are reasonable and approved.

#### **h) Galena Territory Main Extension**

##### **i. Nicor Gas’ Position**

Nicor Gas states that it proposed the construction of the Galena Territory main extension after Galena Territory residents expressed interest in obtaining natural gas service. The Company asserts that the assets in the Galena Territory main extension will be used and useful for supplying gas to a new area of service territory. Nicor Gas explains that it analyzed the project’s costs and economic feasibility and followed its standard practices to ensure that the assets included in rate base were put into service prudently and at reasonable cost. The Company has also received the CPCN from the Commission that is necessary to begin construction. Nicor Gas explains that the evidence shows construction is scheduled to begin in June 2019 – not various other dates referenced by the AG – and conclude in October 2019. As a result, the Company states that, contrary to the AG’s suppositions, the project is not delayed, and construction will be completed well before the end of the Test Year.

AG witness Coppola takes issue with the permitting status and in-service timing of the project, and status of the AFE. Nicor Gas responds that Mr. Coppola’s emphasis on the AFE is misplaced, and that each permit item raised by Mr. Coppola has been submitted and approved or has been determined to be inapplicable or to not require further action. The Company adds that it has obtained the permits required for the current

stage of the project and will continue to prudently manage the permitting process going forward. Accordingly, the Company avers that its plans and projected costs for the Galena Territory main extension are prudent and reasonable.

## ii. AG's Position

The AG contends that the Company did not receive a CPCN for the Galena main extension until May 30, 2019. *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 18-0285, Order (May 30, 2019). Therefore, the AG states, the Company is at a minimum 3 to 4 months behind its anticipated start date for construction, which also pushes back the remaining project start dates that are dependent upon the first start date. Notwithstanding this significant delay and new issues arising therefrom – such as construction cost changes and/or delays due to winter weather – the Company has unresolved permitting requirements. The Company must receive several permits from the Illinois Environmental Protection Agency (“IEPA”), the Illinois Department of Natural Resources (“DNR”), the Illinois Historic Preservation Agency, the United States Army Corps of Engineering, and from Jo Daviess County in order to begin construction of the pipeline and related facilities. AG Ex. 3.0 at 31; AG Ex. 3.14. The Company indicates that “[p]ermit applications and/or letters requesting necessary approvals will be prepared and submitted to the appropriate agencies once Nicor Gas receives approval on the CPCN in Docket No. 18-0285.” AG Ex. 3.14 at 2. Nicor Gas witness Whiteside states that each permit identified by Mr. Coppola “either has or will be submitted and approved or has or will be determined to be inapplicable or not require further action, so as to allow the Company to proceed with the Galena Territory project in a timely manner.” Nicor Gas Ex. 17.0 at 32-33. Nicor Gas witness Whiteside states that Nicor Gas has received certain clearances from the Illinois Historic preservation Agency and the US Army Corps of Engineers. Nicor Gas Ex. 31.0 at 16.

The AG argues that at the time of its initial filing, Nicor Gas sought to include in rate base a project that it did not have the legal authority to build. In response to the need for various permits, the Company claimed that “[o]btaining environmental, land, and other permits is a recurring and common component of pipeline installation projects such as the Galena Territory Main Extension project,” and that “the Company’s estimated timeframe . . . is based on the Company’s past experience in obtaining similar permits for other projects.” Nicor Gas Ex. 17.0 at 32. However, in surrebuttal testimony, when he defended cost overruns on other Nicor Gas projects, Mr. Whiteside stated that “the unpredictable nature of external entities, *particularly related to permitting*, can *significantly* impact the timing of these projects.” Nicor Gas Ex. 31.0 at 8 (emphasis in the original).

The AG contends that given that the CPCN was just obtained, and that various permits as well as contracting and internal approvals are required, the in-service date of the Galena Territory Main Extension is delayed. The AG argues it would be unreasonable to include the full estimated cost of this project when Nicor Gas just obtained approval, four months of planned expenditures has elapsed, and it is unclear whether or how much of the project will be in service by the end of the test year. The AG points out that, as shown in AG Exhibit 3.13, the forecasted schedule of major expenditures (\$3.367 million) is predicted for August, September and October, and the delay in the starting date may push the project into winter and next spring. *Id.* They contend that the Commission

should not overlook these timing issues and the fact that the Company has not even started the project at the time of briefing. *Id.*

The AG further references that, given the lack of a CPCN while this litigation was pending, it is not surprising that Nicor Gas did not produce AFEs for this project. *Id.* However, the AG states, rates should not include costs for construction that the Company's management has not reviewed and approved. *Id.* Another critical point, the AG adds, is that the Company does not have, nor has produced in this rate case, evidence that the project has been fully designed and vetted as evinced by an AFE. AG Ex. 3.0 at 31; AG Ex. 10.0 at 23. The AG maintains that, although Mr. Whiteside asserted that an AFE is irrelevant in determining whether a project should be included in rate base because of its ADP, Nicor Gas Ex. 17.0 at 34, his description of Nicor Gas' ADP includes the issuance of AFEs at several key points in the process, including Stages 2 and 4. Nicor Gas Ex. 17.0 at 27.

The AG concludes that, according to the Company's ADP, once the project progresses to a stage necessitating financing, an AFE indicating that a particular project "phase" has been approved, and at what cost, is required. The AG contends that the Commission is entitled to see these documents to verify both the cost and the timing of this project, and it is unreasonable to ask the Commission to include costs that have not been approved by Nicor Gas management in rates. *Id.* Lastly, the AG posits, the cost of the Galena Territory project is unclear. *Id.* The AG points out that in Docket No. 18-0285, Nicor Gas estimated the cost of the project at \$17.6 million. AG Ex. 3.0 at 32. The Company included a project cost estimate of less. *Id.* In Nicor Gas Exhibit 1.1R2, the Company provided still a different cost estimate of \$11.7 million for the project. Finally, the AG argues that the lack of certainty is not surprising given the early stage of this project, when no AFEs have been issued and project design and implementation are still underway, and this same lack of certainty should lead the Commission to decline to include this project cost in rate base. *Id.*

### **iii. Commission Analysis and Conclusion**

The Commission finds that the record indicates the Galena Main Extension project is planned for June to October of 2019. The Company received CPCN approval and some permitting approvals. According to the Company, the permits from the IEPA, DNR, the Illinois Historic Preservation Agency, the United States Army Corps of Engineering, and Jo Daviess County are either approved or deemed unnecessary for the current stage of the project. The Commission finds that the project will be completed before the end of the Test Year. Therefore, the costs are reasonable and approved.

#### **i) Change Orders**

##### **i. Overview**

##### **(a) Nicor Gas' Position**

Nicor Gas explains that it uses change orders to account for and address the complexities of construction and unforeseen conditions. By the Company's definition, a change order is a written order, signed after a contract has been executed, authorizing changes to the statement of work. Nicor Gas states that the use of change orders is common in the industry, and the existence of a change order is not evidence of

imprudence on the part of the owner or contractor. The Company asserts that its use of change orders to address unexpected conditions is prudent, and that the imputation of fault in such circumstances would involve impermissible hindsight analysis.

**(b) AG's Position**

The AG states that if approved, the terms of the change order are treated as an addendum to the original contract. The AG posits that a change order is typically used when, during the course of a project, unforeseen circumstances arise necessitating different or additional labor and/or materials to complete the task as originally defined. Nicor Gas produced in excess of 350 change orders submitted by its construction contractors during 2017 and 2018. AG Ex. 10.0 at 35. Upon review, AG witness Coppola found that 22 out of approximately 350 change orders were the result of imprudent decisions by the Company. The AG highlights that a review of this material is critical to a fair determination of whether the Company's charges to consumers are fair, just, and reasonable. *Id.*

Mr. Coppola divided the 22 change orders he identified for further review into three categories: (1) Railway Right of Way ("ROW") and Other Permit Issues; (2) Water Encroachment; and (3) Other Change Orders.

The AG notes that the Company begins its discussion of change orders with a legal standard, pointing to Section 9-211 of the Act which provides that the Commission "shall include in a utility's rate base only the value of such investment which is . . . prudently incurred. . ." 220 ILCS 5-9-211.

Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. When a court considers whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible. *Ill. Power Co.*, 339 Ill. App. 3d at 428. The AG notes that the Company then makes a point to include language from a Commission order that holds that imprudence cannot be sustained by substituting one's judgment for that of another. The AG agrees that the prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being "imprudent." *Commonwealth Edison Co.*, Docket No. 84-0395, Order at 17 (Oct. 7, 1987). The Company then concludes that review of Nicor Gas' project change orders must take into account both management judgment and information that was available to Nicor Gas at the time it made its decisions. The AG agrees that the time in question is when the change order work was required due to Nicor Gas direction or presented by the contractor.

AG witness Coppola identifies changes orders that showed unnecessary and unreasonable expenditures, many of which could have been avoided through more prudent management. The AG explains that the adjustments Mr. Coppola recommends go far beyond "honest differences of opinions." As detailed in the AG's testimony and briefs, the evidence in the record indicates that the Company uses change orders to cover the cost of project-management failures, avoid contract disputes with third-party vendors and service providers, and implement construction upgrades, bypassing the bid-proposal process, demonstrating a disregard for budget constraints. The options Mr. Coppola

identifies were available at the time decisions were made and do not require “hindsight review.”

### **(c) Commission Analysis and Conclusion**

The AG’s proposed disallowances related to the specific change orders are discussed below.

#### **ii. Railway Rights of Way Permissions**

##### **(a) Nicor Gas’ Position**

The Company argues that its actions with respect to planning for work at railway crossings were prudent and reasonable, based on the information available at the time those decisions were made. AG witness Coppola challenges several change orders involving railway ROW issues relating to the Aux Sable project. Nicor Gas responds that the change orders were prudently and reasonably entered to address a previously unknown issue that arose during the course of construction.

Nicor Gas explains that it had approval from Wisconsin Central Ltd. d/b/a Canadian National Railway (“CN”) to install new pipeline in the vicinity of railway crossings for Phase 5 of the Aux Sable project. However, on June 30, 2017, a train derailed near this pipe replacement work, which CN asserts was caused by a Nicor Gas contractor, an allegation the contractor denies. Regardless, Nicor Gas avers that CN would not approve any subsequent permit application or request by Nicor Gas for pipeline replacement work in a CN ROW. The Company states that, in September 2017, CN issued cease and desist letters to attempt to revoke Nicor Gas’ authority to perform Phase 5 work in CN’s ROW. In September 2017, Nicor Gas filed an action in Circuit Court for injunctive relief to allow the Company to resume this work.

The Company explains that months later, on February 19, 2018, the Company properly submitted requests for approvals to CN for work on Phases 6 and 7 of the Aux Sable project which were never acted upon. Nicor Gas argues that CN’s permitting moratorium was unforeseeable, and the Company used the change order process to complete the work that was planned before there was any indication that CN would not issue permits for crossings unrelated to the derailment.

The AG asserts that Nicor Gas knew when it filed the September 2017 lawsuit that CN would not allow any construction work in CN’s rights-of-way for Phases 6 and 7 work. The Company states that the AG relies on an impermissible hindsight analysis for its argument. The Company argues that the evidence shows it did not have such knowledge at the time, because the CN cease and desist letters were related to the Phase 5 crossings, which were the subject of disputed claims as to the cause of the derailment. Nicor Gas explains that its experience prior to the derailment was the CN processed and approved ROW requests in due course and without delay. The Company notes that even after the derailment, CN ultimately agreed to allow Nicor Gas to complete the Phase 5 replacement of the Aux Sable line after the Circuit Court case was filed. Thus, Nicor Gas avers that it could not know in September 2017 that CN would not act upon subsequent applications for work on Phases 6 and 7 of the Aux Sable project at crossings different and distant from the Phase 5 work alleged to be implicated in the derailment. As a result, the Company argues that CN’s moratorium on permitting was unforeseeable,

and the Company's use of the change order process in response to an unforeseen circumstance was prudent and reasonable.

The Company also argues that Mr. Coppola relies on speculation that CN would have eventually issued the necessary approvals, but the Company points out that there is no evidence to support this assumption. Moreover, the Company claims that it would have been imprudent to further delay the replacement of the high-risk portions of the pipeline. The Company also notes the operational importance of putting the Aux Sable line back in service to meet winter demand. In sum, the Company argues that the challenged change orders were prudent and necessary to sustain safe and reliable service to customers, and that it should be allowed to recover such prudently incurred costs.

### **(b) AG's Position**

The AG argues that the Commission should disallow the \$8,014,310 for seven change orders related to the CN ROW. In each of the change orders, the contractor requested cost increases due to railway ROW access restrictions that were caused by the Company's failure to timely obtain the proper access to the ROW or reschedule construction work so that needed access to ROW was secured.

The AG explains that the Company knew since September 2017 that CN was not going to allow it to proceed with any construction work in its ROW as indicated by the Company's filed Complaint against CN in Circuit Court seeking injunctive and other relief. Nicor Gas Ex. 17.0 at 52. The change orders are dated April through September 2018, the first being nearly 6 months after the filed complaint. Therefore, the AG further explains, there is no "hindsight review" here, but rather construction management decisions resonating with imprudence. Notwithstanding the knowledge that it could not enter CN's ROW, the AG notes that the Company proceeded with "business as usual," scheduling contractors to perform work in an area that it had no permission to enter. AG Ex. 10.0 at 37. The AG argues that as a result, the contractors had to mobilize (set up equipment and stage materials), demobilize, and mobilize again, driving up construction costs unnecessarily.

The AG disputes the Company's justification for its actions that it would have been highly imprudent to wait for approval "given the condition of the pipe." Nicor Gas Ex. 17.0 at 52. The AG notes that the Company had to wait for permission regardless of the condition of the pipe. At issue is that the Company sent contractors to work in CN's ROW before it had permission to do so, not whether it should have taken action against CN to obtain access to the ROW sooner. The AG argues that these decisions were imprudent, and ratepayers should not have to pay the associated costs. The AG further reasons that allowing the Company to include these costs in rates would unreasonably drive up rates and reward the Company's imprudence by paying it a return on the costs associated with such decisions.

In response to the Company's argument that the AG utilizes impermissible hindsight review, the AG points out that both parties agree that hindsight is the understanding of a situation or event after it has happened. Taken literally, there would never be a situation in which a review of a past decision would not include hindsight. The AG highlights that courts in Illinois accordingly conclude that is why "when a court

considers whether a judgment was prudently made, *only those facts available at the time judgment was exercised can be considered.*" *Ill. Power Co. d/b/a AmerenIP Power v. Ill. Commerce Comm'n*, 339 Ill. App. 3d 425, 428 (2003)(emphasis in the original). The AG contends that the Company acts as if simply pointing out an imprudent decision made after the fact is impermissible hindsight review, but, as Illinois courts have made clear, that is not the standard.

The AG argues that the facts demonstrate that the Company knew it did not have permission to enter CN's ROW before it scheduled contractors to work within the ROW, creating \$8 million in additional costs it now seeks to recover from ratepayers.

The Company also argues that "Mr. Coppola relies on speculation that CN would have eventually issued the ROW approvals, and that if it had to wait for CN approval, it would still be waiting." The AG states that this implied accusation is unwarranted. The AG never suggests that the Company do nothing and simply wait for CN to grant it approval. Rather, the AG argues that the Company should not have scheduled work in CN's ROW when it knew it did not have permission to do so. *Id.* The AG points out that the Company was able to eventually commence work in CN's ROW because it sought injunctive and other relief from CN's moratorium in Circuit Court, which was eventually granted. *Nicor Gas Ex. 17.0 at 49.* The AG's position is that regardless of whether it was working for approval through negotiations with CN or seeking a Court order, the Company had the authority and the ability, during that time, to schedule contractor work in areas that would not require multiple and costly moves due to lack of ROW access. The AG further reasons that it is basic project management to schedule contractors only in areas they are authorized to be, and in a manner that will not unnecessarily drive up costs. The Company's failure to prudently schedule contractor time will potentially cost consumers over \$8 million. *Id.*

### **(c) Commission Analysis and Conclusion**

The Commission agrees with both parties that the prudency standard, as highlighted in *Illinois Power*, is a fact-specific inquiry. Prudence is "that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made." *Ill. Power*, 339 Ill. App. 3d at 428. The Commission finds that Nicor Gas could not know in September 2017 that CN would not act upon subsequent applications for work on Phases 6 and 7 of the Aux Sable project at crossings different and distant from the Phase 5 work alleged to be implicated in the derailment. Even after the derailment, CN ultimately agreed to allow Nicor Gas to complete the Phase 5 replacement of the Aux Sable line after the Circuit Court case was filed. The Company's use of the change order process in response to an unforeseen circumstance was prudent and reasonable; therefore, those costs are recoverable.

### **iii. Water Encroachment**

#### **(a) Nicor Gas' Position**

The Company argues that it is prudent and reasonable to use the change order process to perform de-watering work in connection with the work on the Dubuque and Aux Sable transmission lines. Nicor Gas states that, in the summer of 2017, the Company

was in the process of replacing higher risk portions of these transmission lines. The Company reports that, during this time, Northern Illinois experienced above-normal rainfall and flooding, affecting the worksites. In light of the information available at the time, the Company proceeded with change orders for de-watering work in these areas to timely resume the replacement work.

AG witness Coppola challenges these change orders as unnecessary and argues that Nicor Gas should have waited for the ground to dry out to resume work. Nicor Gas responds that if the Company had delayed, the timeframe to complete the necessary pipeline replacement work would have been imprudently pushed into 2019. The Company further explains that the de-watering work was necessary given the operational importance of putting the lines back in service to meet higher demand during the winter months. Nicor Gas also points out that it could not precisely predict when the underground water table would drop, and therefore Mr. Coppola's assumptions are based on hindsight review and facts not available to the Company at the time.

Nicor Gas also responds to the AG's assertion that the Company should not have proceeded with two pipeline replacement projects at the same time. The Company explains that both lines were identified as high-risk lines needing replacement, and that delaying such replacement would have subjected customers to safety and outage risks. The Company also points out that the Dubuque and Aux Sable lines were the only two transmission lines under construction in 2017 and argues that proceeding with two lines given the short construction season and necessary work is not unreasonable. As a result, Nicor Gas avers that it acted prudently in using the change order process for de-watering work, and that it should be allowed to recover its prudently incurred costs.

### **(b) AG's Position**

The AG highlights seven change orders for additional costs associated with working through periods of high rain water on the ground and in the dug trenches during the scheduled construction period. AG Ex. 7.0 at 10. In each change order, the AG demonstrates the contracting company requested cost increases to (1) alter the process of construction in order deal with the water encroachment; (2) pump, treat, and remove water from the work site; and/or (3) hire additional crews in order to accelerate the project due to the delays caused by the presence of rain water. AG Ex. 7.0 at 10-14. The AG relies upon record evidence indicating that the first and third change orders were approved within seven and 19 days, respectively; the second and fourth through seventh were submitted and approved on the same day. *Id.* at 10-11.

The Company asserts that Mr. Coppola's analysis of the above change orders is superficial and incomplete, and that approving these change orders was necessary to maintain the safety and reliability of the system. Nicor Gas Ex. 17.0 at 54. The Company argued that "waiting for two or three weeks [for the water to recede], as Mr. Coppola suggests, would have pushed final construction into 2018; deferred replacement of a high-risk pipe; and placed approximately 375,000 customers at risk of losing their natural gas supply [for the winter months] if the Aux Sable and Dubuque pipelines were not reinstated. *Id.* at 56.

As to timing, the AG points to the record that indicates that the Aux Sable Phase 5 project was completed on October 27, 2017, and that the Dubuque Phase 1 project was

completed on December 7, 2017. In light of this, the AG argues that waiting 2 to 3 weeks would not have pushed the project into 2018, but to the middle or end of November and December, respectively. The AG argues that delays of two or three weeks cannot be considered unreasonable or not manageable, particularly on projects of this size, and there should be contingent plans to address such delays.

The Company claims that if it had waited for the water to recede as Mr. Coppola suggests, “hundreds of thousands of customers would have been placed at risk of losing their natural gas supply . . . because the Dubuque and Aux Sable lines are major transmission lines [sic] that must be in service for the Company to ensure it has adequate supply sources to serve its customers.” However, the AG responds that, if the Dubuque and Aux Sable lines are the only major transmission lines supplying hundreds of thousands of people, and not completing them by a date certain was a real risk, then it was imprudent to schedule work on them concurrently and to not anticipate rain delays. The AG further argues that this raises an entirely different imprudence issue but does not negate its imprudent and costly decision to pump water rather than wait a few weeks for it to recede and dry out. The AG also contends that Nicor Gas’ argument, that it had to finish both projects simultaneously, indicates that the speed at which it is undertaking multiple, capital projects may be putting its customers at risk due to the failure to maintain redundant service capability.

Finally, the Company argues that Mr. Coppola erroneously “assumes that Nicor Gas could determine when the underground water table would drop,” and that he “ignores the applicable requirements and construction practices for this type of work.” The AG states that Nicor Gas did not identify the “applicable requirements and construction practices” it suggests are relevant in its brief or in testimony. Further, the AG contends that the “underground water table” cited by the Company refers to the level of water in the trenches caused by the excessive rain that fell during construction, not an unexpected condition of high ground water. AG Ex. 7.0 at 11. Again, the AG points out that the Company could have waited for the rain to stop, abated what little water remained as a result of grade retention, and mitigated its additional costs. *Id.* The AG notes that it is obvious that heavy rains are a foreseeable site condition. The AG therefore argues that Nicor Gas should have exercised prudence and had a plan to limit the costs associated with wet weather conditions.

In sum, the AG maintains that none of the above recommendations involve hindsight review. The AG reasons that based on the facts at the time the Company did not take steps to minimize costs, but rather proceeded with an unreasonable and costly course of action. The AG references that sophisticated companies such as Nicor Gas and its specialized pipeline contractors must always be cognizant of the weather, as such conditions are a daily factor in the planning of a project involving excavations. The AG asserts that if the weather forecast involved heavy rains, common sense dictates that an analysis should be conducted to determine the most appropriate course of action. However, no such analysis was produced by the Company. Instead, as the AG illustrates, the Company decided to move forward with construction through what it describes as unprecedented flooding, with no articulable plan or cost/benefit analysis, resulting in \$6.701 million in change orders to move water rather than let it recede or dry out. The

AG accordingly requests that the Commission disallow the \$6,701,222 for the seven change orders related to water encroachment.

**(c) Commission Analysis and Conclusion**

The Commission finds Nicor Gas' actions in response to the above-average rainfall which affected the Aux Sable and Dubuque project sites were reasonable. The record indicates that the amount of rainfall was unprecedented. The AG's suggestion that the Company should have known the flooding would stop, wait for the water to recede and continue with the main replacement is impermissible hindsight review. The Commission finds the Company acted reasonably, and the costs related to the water encroachment change orders are recoverable.

**iv. Other Change Orders**

**(a) Nicor Gas' Position**

AG witness Coppola proposes disallowing recovery of incremental costs for seven additional change orders, on grounds that they resulted from some imprudent action or inaction by Nicor Gas. The Company responds that Mr. Coppola demonstrates a lack of understanding of how and why change orders are used. Nicor Gas asserts that the costs associated with each of the challenged change orders were prudently incurred.

Dixon Reporting Center, Change Order 055, dated 12/14/18

The Company argues that the change order costs for this project primarily relate to soil corrections, the purchase and installation of equipment, and scope changes including epoxy flooring and signing. Nicor Gas states that there is nothing imprudent about the use of change orders to account for such specific items and circumstances that could not reasonably have been known at the time of design.

The Company avers that, as to the change orders related to the soil corrections, the AG did not identify any imprudence with the soils report. The Company explains that the soils report, prepared for the project by a soils engineering firm, characterized the soils as generally suitable for compaction. Nicor Gas argues that it prudently relied upon the general conclusions of the soils report to proceed, however, the report did identify some risks of attempting to achieve proper soil compaction during periods of precipitation. The Company states that the conditions for this potential risk and the risk itself materialized while the project was underway, and as a result, soil modifications were required. However, the Company notes that the soils issues were within the risk parameters identified in the report, and that under these facts, there was no deficiency in the soils report, nor was it imprudent to incur these costs.

With respect to project upgrades, Nicor Gas states that it was reasonable to make those changes to obtain performance or functionality benefits. The Company explains that most of the scope items such as signage and furniture were expected, as the project always contemplated them as change orders. The Company adds that the scope change orders affected how those costs were incurred but did not result in extra costs.

Oak Brook Station 256 – Change Order COR 015, dated 11/5/18

Nicor Gas states that multiple unanticipated delays outside of the Company's control pushed out the in-service timing of a critical station that serves a significant area

during winter months. The Company argues that the labor and equipment costs in the resulting change order were prudently incurred to ensure that the station would return to service. Nicor Gas points out that the AG does not contest that work necessitated by discovery of severe corrosion on a high-pressure line, and work to de-energize and remove a transformer sitting over the gas main to be replaced, were matters beyond the Company's control that pushed back the timeline for the work. Nicor Gas explains that these facts provide context for why the change orders were necessary. The Company refutes Mr. Coppola's assertion that the costs arose from scheduling and access issues that were within the Company's control and argues that Mr. Coppola's proposal is based on impermissible hindsight review.

Oak Brook Station 256 – Change Order COR 008, dated 10/4/18

The Company explains that these change order costs resulted from a supply issue beyond the Company's control and were prudently incurred. Nicor Gas explains that a supply vendor was delayed in fulfilling an equipment order, and the Company prudently and reasonably opted to issue a change order for the contractor to work around the issue and avoid further delay. The AG argues that costs associated with this change order be denied on the basis that the costs were caused by the vendors and the Company should seek recourse from its vendors. Nicor Gas avers that the AG's argument fails because, even assuming a claim could be brought against the vendor for the underlying costs, the existence of such a claim does not render imprudent the Company's decision to replace or maintain its system. Moreover, the Company argues that the AG does not establish that a definite claim even exists or take into account the costs of litigation. The Company argues that Mr. Coppola fails to consider the actual facts and circumstances, and his proposed disallowance should be denied.

Aux Sable Phase 6 – Change Order 11, dated 5/10/18

Nicor Gas explains that when ordering pipe for Aux Sable Phase 6, the Company intended to use leftover pipe from a prior phase, and to order installation of additional pipe if needed. The Company states that after construction commenced, field estimates showed that some additional pipe would need to be used, and Nicor Gas instructed the contractor to install this pipe, resulting in a change order. The Company avers that there is nothing imprudent about these actions.

Galena Station 100 Revision – Change Order 001, dated 8/25/17

Nicor Gas explains that the Company's Operating department requested that Construction move a station's in-service date forward to reduce the number of transmission lines out of service simultaneously. The Company argues that its action in moving the in-service date to preserve operational safety and reliability was prudent and reasonable.

Dubuque Line Replacement – Change Order 18, dated 9/13/17

Nicor Gas states that it acted prudently in issuing a change order to allow a contractor to begin work on a project while awaiting an Illinois Department of Natural Resources ("IDNR") permit. The Company avers that utilities commonly partially release projects when there are construction activities that can be completed in areas not affected by permitting issues. Nicor Gas explains that this practice allows utilities to manage costs

and scheduling, and in this instance, the time for the IDNR to process the permit application exceeded the Company's reasonable expectations. However, the Company argues that the project was appropriate for a partial release, and that its action in authorizing the work was prudent and reasonable, based on information available at the time.

Dubuque Line Replacement – Change Order 19, dated 10/16/17

Nicor Gas states that the costs of this change order were driven by a lack of flagger resources available to work in a railway ROW, because those flaggers had been unexpectedly relocated to flood areas due to Hurricane Harvey. The Company argues that it could not anticipate the railroad's delay in achieving a flagger, and the Company acted prudently based on the facts available at the time.

**(b) AG's Position**

Dixon Reporting Center, Change Order 055, dated 12/14/18

The AG points to record evidence showing that during its construction period of November 2017 through December 2018, the Company entered into 55 cost change orders. Change order No. 55 shows the original cost of the project and the cumulative cost overruns for the 55 change orders. AG Ex. 7.0 at 16.

The Company argues that an increase in construction costs via change orders is reasonable and prudent because first, several of the change order costs relate to unknown contingencies (the soil condition), and second, the other modifications allow the facility to better meet the Company's operational needs. Nicor Gas Ex. 17.0 at 59. The AG notes that the Company hired an engineering firm to perform a typical pre-construction soil profile analysis, which indicated that the existing soil material could be compacted to a compaction rate of 95% in order to meet the structural requirements for construction. Nicor Gas Ex. 17.0 at 60. However, as the record shows, after initial excavation and compaction were performed, an inspection indicated that the required compaction rate could not be met due to soil conditions. *Id.* The soil engineers recommended that the soil be excavated to a greater depth and filled with aggregate (gravel) in order to meet the required compaction requirements, resulting in multiple change orders. *Id.* The AG describes the total incremental cost of \$998,716 through 4 change orders to achieve this massive soil removal and replace it with compacted aggregate. AG Ex. 10.0 at 41. Therefore, the AG reasons, either the soil samples or analysis failed to detect the weakness of the ground soil, or the Company proceeded with the project without adequately considering the warnings or caveats provided by the engineering firm's report about potential compaction problems with the soil. In either case, the AG argues that ratepayers should not bear the cost of this error as it is clearly the fault of either the Company or the engineering firm hired to perform the analysis. *Id.*

The AG also observes that the "modifications that would allow the facility to better meet the Company's operational needs" refer to an epoxy flooring upgrade, certain fixtures, furniture, and signage, not included in the Company's original bid estimate. These change orders, combined with those associated with the soil issue, contributed to the Company exceeding its budget. The Company argues that "specific items [such as those listed above] that are not specified at the time of the original design and not included

in the original bid are purchased and coordinated through the general contractor and tracked via the change order process.” Nicor Gas also posited that some of these costs could not have been reasonably known at the time of the design. Again, the AG argues that these statements do not justify the additional costs associated with this project.

The AG reasons that the epoxy flooring was included in the original design as evinced by Mr. Whiteside’s rebuttal testimony which states that “the epoxy flooring contractor was brought in to discuss . . . a thicker built-up [epoxy] system.” Nicor Gas Ex. 17.0 at 61. The AG notes that this is not the first time the Company has built a building that must accommodate large trucks, heavy traffic, and office personnel. *Id.* Costs of signage, furniture, and flooring for a project as simple as this, should not be difficult to estimate, especially for a Company as sophisticated as Nicor Gas. *Id.* Accordingly, the AG maintains that the need and specifications of these items was known at the time the Company put together its respective RFP, therefore making change orders an imprudent and inappropriate vehicle for these significant cost additions. *Id.*

The AG notes that change orders are intended to address truly unforeseen circumstances; they are not an alternative to poor project management or insufficient budgets. *Id.* Therefore, the AG argues that the Commission should disallow the amounts pertaining to the change orders associated with the Dixon Reporting Center, excluding the Company’s acknowledged 10% contingency allowance.

#### Oak Brook Station 256 – Change Order COR 015, dated 11/5/18

The AG highlights change order No. 015, which was requested by the contractor, NPL, to be compensated for incurred costs associated with accelerating the completion of the Oakbrook Station project, and demobilizing/remobilizing its crews and equipment due to gate station access restrictions. AG Ex. 7.0 at 17.

The Company argues that Mr. Coppola uses impermissible hindsight to recommend a disallowance associated with this change order. The Company contends that its costly acceleration of the project was due to “multiple unanticipated delays” which pushed the timeline out. The Company defined these multiple unforeseen delays as severe pipe corrosion that was discovered during construction and the additional time ComEd required to de-energize and remove transformers sitting over the gas main to be replaced. These delays, the Company posits, were outside of its control. Nicor Gas argues that Mr. Coppola “points to no alternatives available to the Company at the time the decision was made, given the circumstances facing the Company at the time.” The AG states that Mr. Coppola did, however, provide an alternative: do not schedule contractors to work in areas they do not yet have permission to enter, which is the real basis for this disallowance.

The AG contends in response to the Company that the facts evinced in the change order are very clear: additional costs were incurred because the contractor “had to mobiliz[e] and demobiliz[e] multiple times waiting for work to free up” because it was not granted full access to the gate station where the work was to be performed. AG Ex. 7.0 at 17. Additionally, the AG reasons that ComEd’s transformers did not materialize out of thin air; the Company knew the work was taking place in ComEd’s right-of-way.

The AG argues that appropriate planning on the part of the Company includes not only obtaining timely permission for property access, but timely communications with third-parties responsible for work affecting the Company's construction timeline. The AG argues that these facts were known to Nicor Gas at the time the project was planned and when the decision to send contractors to a location for which Nicor Gas did not have lawful access was made. The AG maintains that sending contractors to a location they could not enter will obviously unnecessarily drive up cost. *Id.* The AG also argues that hindsight review is not necessary to conclude that it was imprudent to send contractors to a location they could not enter. The AG asserts that if Nicor Gas did not know it lacked access, it should have as a basic tenet of construction management.

Oak Brook Station 256 – Change Order COR 008, dated 10/4/18

The AG points to another change order, No. 008, dated October 4, 2018, which was requested by NPL to be compensated for additional labor and materials needed to modify, on site, valves that were delivered contrary to the original order. AG Ex. 7.0 at 18-19. The Company argues that the proper valves were ordered with the expected lead time of 26 weeks, but that just prior to shipment, the vendor indicated that the valves could be shipped but not fully assembled as ordered, and that full assembly would require 2 to 4 additional weeks. Nicor Gas Ex. 17.0 at 64.

The AG states that this is another example of the Company's inappropriate use of change orders. The AG contends that this change order was to address the costs of additional labor and materials needed to modify, on site, valves that were delivered contrary to the Company's specifications; in other words, to avoid a contract dispute with its vendor. The AG points to the fact that the Company admits that it ordered specific valves with the appropriate lead time; however, "the specific valves at issue were not available due to an expected [sic] supply issue beyond the Company's control." AG Ex. 7.0 at 18. Under the Uniform Commercial Code, Article II, the AG argues that an action for the additional cost for damages incurred as a result of the vendor's shipment of nonconforming goods was appropriate, and, in contrast, asking ratepayers to foot the bill is not. See U.C.C. § 2-714 (Buyer's Damages for Breach in Regard to Accepted Goods); see also U.C.C. § 2-715 (Buyer's Incidental and Consequential Damages). Therefore, because the costs associated with this change order were imprudently incurred, the AG argues that the Commission should disallow it from rate base.

Aux Sable Phase 6 – Change Order 11, dated 5/10/18

The AG also highlights change order No. 11, which was requested by the contractor, Precision Pipeline ("PPL"), to be compensated for costs associated with additional operations needed to complete the installation of a section of Aux Sable Phase 6. AG Ex. 7.0 at 19. The AG observes that the Company lacked the appropriate amount of 0.375" wall pipe and instructed PPL to utilize leftover 0.500" wall pipe from another Phase of Aux Sable. *Id.*

The Company argues that this change order cost is prudent and justified because it utilized heavier wall pipe it had available from another Aux Sable phase. Nicor Gas Ex. 17.0 at 66. It posited that "when ordering pipe, a small amount of additional pipe is ordered to cover field adjustments, other unknowns, and possible mistakes that could

require more pipe and result in delays or standby.” *Id.* at 65. The AG argues, however, that Nicor Gas did not order additional pipe for this phase and “[a]fter construction had started on Aux Sable Phase 6, field measurements showed that the 0.375” pipe may be short and approximately 250 feet of 0.500” pipe would need to be utilized.” *Id.*

Rather than order the correct linear footage of pipe with the correct wall thickness, the AG argues, the Company decided to utilize thicker leftover pipe, driving up labor costs, which it seeks to recover from ratepayers despite its failure to have the correct amount of pipe available for the job. The AG reasons that not having sufficient pipe to complete a specialized project of this magnitude is unreasonable, and the additional costs arising from improper project management should be borne by the Company and not be passed onto ratepayers.

#### Galena Station 100 Revision – Change Order 001, dated 8/25/17

The AG notes that Change order No. 001, dated August 25, 2017, was requested by the contractor NPL, for costs associated with additional labor and equipment needed to drastically move up the tie-in date and complete the project ahead of schedule. The Company posits that its Operating department requested the project be accelerated in order to reduce the number of transmission lines out of service at the same time and reduce the risk of an outage. Nicor Gas Ex. 17.0 at 66.

The AG argues that the Company’s repeated defense that it incurred additional costs to assure reliability because it may have too many transmission lines out of service at a given time, raises the question about the rate at which Nicor Gas has increased capital spending. A utility the size of Nicor Gas must be able to plan to avoid concurrent work on critical transmission lines that may lead to service disruption or inflexible work schedules.

The AG contends that, while the Commission should find that Nicor Gas’ rush to spend money on concurrent transmission projects was imprudent, particularly when the Company defends unnecessary inflexibility and cost overruns on the risk of loss of service reliability, the Company has failed to explain what outage risk the Company feared and why this risk was higher compared to other projects. AG Ex. 10.0 at 44. A lack of proper planning and unilateral project modification resulting in higher project costs is imprudent and should not be charged to rate payers.

#### Dubuque Line Replacement – Change Order 18, dated 9/13/17

The AG notes that change order No. 18, dated September 13, 2017, was requested by the contractor Henkels & McCoy for costs associated with additional labor resulting from the Company’s late receipt of a required Endangered Species Permit. AG Ex. 7.0 at 22. The Company released the contractor to commence working on the Dubuque Line before it had the necessary permit, resulting in mobilization costs. *Id.*

The Company claims that “[p]artially releasing a project is a common tool utilized by utilities to manage permitting on large projects and may be undertaken on a case-by-case basis when there are construction activities which can be completed without working in the areas where no permit has been received.” The AG argues that this “common tool” alleged by the Company resulted in hundreds of thousands of dollars of additional and

unnecessary costs. Scheduling contractors, the AG argues, before proper permitting has been obtained, is a costly practice, and the Commission should not require ratepayers to pay for this poor scheduling and management.

Dubuque Line Replacement – Change Order 19, dated 10/16/17

The AG notes that this change order was also requested by the contractor Henkels & McCoy, for costs associated with additional labor resulting from the Company's late receipt of a required Endangered Species Permit. AG Ex. 7.0 at 22. In this instance, however, the Company posited that the reason for the change order is premised on the shortage of railroad flaggers caused by Hurricane Harvey. Nicor Gas Ex. 17.0 at 69-70. This argument, the AG asserts, is a red herring. The AG contends that if the Company had obtained the appropriate permitting and prudently scheduled the contractor so that only one mobilization was required, the shortage of flaggers would not have been a factor.

**(c) Commission Analysis and Conclusion**

The Commission makes the following findings concerning AG witness Coppola's proposed disallowance of the Company's incremental costs for the seven additional change orders at issue:

Dixon Reporting Center, Change Order 055, dated 12/14/18

The Commission disagrees with the AG that the Company improperly issued change orders with respect to soil corrections. The Company identified, during construction, that due to precipitation, the predicted soils compactions occurred. As a result, soil modifications were required. The Commission does not find that the soil modification was a result of either poor project management or insufficient budgeting. The costs associated with the change orders are reasonable and approved.

Oak Brook Station 256 – Change Order COR 015, dated 11/5/18

The Commission finds that the labor and equipment costs in the resulting change order were prudently incurred to ensure that the Oak Brook station would return to service. The AG does not contest that this work was necessitated by discovery of severe corrosion on a high-pressure line. Nicor Gas also prudently de-energized and removed a transformer sitting over the gas main to be replaced. The costs associated with this change order are reasonable and approved.

Oak Brook Station 256 – Change Order COR 008, dated 10/4/18

The Commission agrees with the Company that even if a claim against the vendor exists, that does not render the Company's decision imprudent at the time. On the contrary, the Commission finds that Nicor Gas prudently and reasonable opted to issue a change order for the contractor to work around the issue of an equipment supply delay. The costs are reasonable and approved.

Aux Sable Phase 6 – Change Order 11, dated 5/10/18

The Commission finds that Nicor Gas properly ordered additional pipe to finish Phase 6 project work. Those costs are reasonable and approved.

Galena Station 100 Revision – Change Order 001, dated 8/25/17

The Commission finds the Company's actions in moving the Galena station's in-service date to preserve operational safety and reliability were prudent and reasonable.

Dubuque Line Replacement – Change Order 18, dated 9/13/17

The Commission finds the Company prudently began work on a project while waiting for an IDNR permit. Therefore, those costs are reasonable and approved.

Dubuque Line Replacement – Change Order 19, dated 10/16/17

The Commission finds that the Company's change order related to a shortage of flaggers due to Hurricane Harvey is reasonable and approved.

**j) Woodridge Pipeline**

**i. Nicor Gas' Position**

The Woodridge Pipeline project refers to a Nicor Gas pipeline replacement project. The Company explains that work on the project was awarded to a contractor through a "scorecard" evaluation process, even though the contractor was not the lowest-cost bidder. AG witness Coppola criticizes this process and suggests that the scorecard results were suspect or improper.

Nicor Gas states that its project bid evaluation process utilizes a weighted scorecard that considers both subjective and objective criteria. The Company avers that considering multiple criteria, such as the background and experience of the bidding contractors, leads to projects that are safer and more reliable than awarding work based solely on price. Nicor Gas claims that it used this process to prudently award work at reasonable cost to the contractor best-suited for the specific project.

Mr. Coppola objects to the two-stage process Nicor Gas uses to evaluate contractors, in which the initial score assigned to the bids are refined based on interviews with each contractor. Nicor Gas responds that it is a common industry practice to conduct an interview process to learn more about each contractor and bid, and to incorporate that new information into the scoring analysis. Nicor Gas maintains that using this process, the Woodridge Pipeline work was properly awarded to the contractor best-equipped to perform the work, and that the Company's actions were prudent and reasonable.

**ii. AG's Position**

The AG points out that Nicor Gas selected a winning bidder to work on the Woodridge Pipeline Project over a bidder that came in lower. AG Ex. 3.0 at 36. The AG states that awarding construction work to a contractor at a higher cost is unreasonable, imprudent, and should not be accepted by the Commission. *Id.* The Company argues that its selection of a higher priced contractor is no cause for alarm because it uses other criteria, in addition to cost, to determine the appropriate contractor.

The AG further argues that irrespective of the processes Nicor Gas cites in its testimony, the results were that the low bid of a contractor that has done extensive work for Nicor over more than 10 years was rejected, and consumers are paying close to 20% more for a project than they would have paid had the low bid been selected. They contend that the evidence concerning the selection of the Woodridge contractor also calls into question how Nicor Gas manages its contracting and its competitive bidding processes.

### **iii. Commission Analysis and Conclusion**

The Commission finds that the selection of the Woodridge pipeline replacement project contractor is reasonable. There are many elements to consider when awarding a contract, in addition to price. The record indicates Nicor Gas considered multiple criteria, such as the background and experience of the bidding contractors, and therefore, the Commission finds the costs prudent and reasonable.

#### **k) Competitive Bidding**

##### **i. Nicor Gas' Position**

Nicor Gas argues that it is prudent and reasonable for the Company to enter into blanket agreements or strategic alliance agreements with contractors for lower cost, lower complexity projects that rely on the availability of qualified union labor to perform the work. Nicor Gas notes that other utilities in Illinois compete for the limited labor resources available for such projects, and blanket and strategic alliance agreements minimize overhead costs and secure the availability of labor for projects to proceed. The Company argues that the alternative of competitive bidding every small project increases the overall administrative costs and exposes the Company and customers to market demand risk.

The Company currently has one strategic alliance with NPL, which the Company asserts has provided customers with good value. AG witness Coppola criticizes this arrangement because certain work given to NPL was not awarded through a competitive bidding process. The Company responds that it awards work on a project-specific basis, whereby each project is evaluated by Nicor Gas management to determine whether it is of the type that should be awarded through a blanket program or competitive bidding.

Nicor Gas explains that the evidence shows the blanket agreement approach is more appropriate for less complex projects that are repetitive in nature (such as distribution work), while a project agreement approach is more appropriate for higher cost, higher complexity projects that are unique and rely on skilled labor (such as transmission work). The Company avers that it is prudent and economical to distribute the former category of work through blanket and alliance agreements, and the latter category of work through competitive bidding.

In response to the AG's claim that NPL is not always the lowest bidder on those projects appropriate for competitive bidding, the Company states that NPL has proven to be an effective and efficient contractor for blanket distribution work, even if it is not always as competitive when it comes to transmission work. The Company notes that the AG takes the results of a select few transmission project bids and inappropriately applies them to blanket projects for distribution type work, even though there is no basis to assume that price differences encountered in transmission bids will directly correlate to potential bid differences in distribution work.

The Company further notes that the use of strategic alliance agreements is a common industry practice, and that the Commission's independent auditor, Liberty Consulting Group, recognized the benefits of such source strategies in the Commission's investigation in the Peoples Gas Light and Coke Company's Accelerated Main Replacement Program:

The AMRP's long-duration and multi-billion-dollar budget *should encourage contractors to form partnerships with Peoples Gas. Liberty expected reasonably lower prices, higher efficiency, higher quality, better performance, and strong working relationships to result from such partnerships.*

Contractors have significant incentives to conduct themselves in accord with this long-term opportunity.

Liberty Report at M-5 (emphasis added).

The Company also notes that these contracts do not guarantee some minimal level of work, which maintains its ability to adjust to market conditions. Nicor Gas adds that it has tested the value of its arrangement with NPL through an analysis conducted by an outside consultant, which concluded there were significant benefits to the alliance partner arrangement with NPL. Nicor Gas confirms that it has and will continue to evaluate its alliance and blanket contracts on a regular basis. Accordingly, the Company argues that there is nothing imprudent or unreasonable about its relationship with NPL, or any of its other contractors subject to blanket agreements or strategic alliance agreements, and that Mr. Coppola's recommendation regarding competitive bidding should be rejected.

## ii. AG's Position

The AG points out that Nicor Gas paid NPL for work that was not competitively bid out to other parties. AG Ex. 3.0 at 34. As shown in AG Exhibit 3.20, Nicor Gas points to a study performed by an outside consultant hired to support its decision to utilize blanket agreements over competitive bidding. AG Ex. 3.0 at 34. The study concluded that during the four-year period from 2005 to 2009 the alliance saved the Company millions in construction costs and millions in soft savings or value, among other operating benefits. AG Ex. 3.0 at 34. The AG states that, assuming the 2017-2018 contract sizes are representative of 2005-2009, the savings are negligible.

The AG notes that NPL has provided underground pipeline construction services for Nicor Gas for more than 30 years. They posited that in 2006, about 13 years ago, NPL was selected as an alliance partner for pipeline construction services through an RFP process, and Nicor uses NPL for "blanket projects." AG Ex. 3.0 at 33. The Company defined a blanket agreement approach as follows:

A blanket agreement approach is commonly used for lower cost, lower complexity, lower pressure smaller diameter pipe (up to 12") projects (Distribution) that are repetitive in nature and rely on the availability of union labor qualified to perform such work. This labor is then efficiently moved from project to project with minimum "friction cost" (e.g., bid cost, employee qualification costs, retention costs, lost productivity / downtime costs). . . With longer term blanket contracts, the contractors are held accountable for cost efficiency, quality, safety and deliverability over multiple projects through service level mechanisms.

Nicor Gas Ex. 17.0 at 12-13. Nicor Gas witness Whiteside argued in his rebuttal testimony that blanket work agreements are more cost efficient than discrete project work bid out to multiple contractors. Nicor Gas Ex. 17.0 at 12; AG Ex. 10.0 at 11. The AG notes that he assigns a higher “friction cost” to non-blanket work agreements due to unquantified bid costs, employee qualification costs, retention costs, lost productivity and downtime costs, but he did not provide an analysis or evidentiary basis for these assertions. Nicor Gas Ex. 17.0 at 12-13; AG Ex. 10.0 at 11. The AG contends that the Commission should reject this notion because: (1) employee qualification and retention costs should not be any different whether the contractor works through a blanket contract or a contract that is bid out; (2) the contractor is expected to bring qualified workers to a project and retain them for the duration of the project, regardless of the type of agreement; (3) lost productivity and downtime between jobs are not necessarily a cost that Nicor Gas would pay if the project is adequately bid out and the lowest qualified bidder is chosen for the project; and (4) any costs to prepare and screen bids should be more than offset by a lower competitive price. AG Ex. 10.0 at 12.

The AG argues that Mr. Whiteside failed to explain or identify the types of work that are more efficiently performed through blanket agreements or to address the option that blanket projects can be bid out. By not competitively bidding blanket projects, the AG argued, it is not possible to assess whether the current cost structure ensures the Company is maximizing ratepayer dollars. The AG asserts that the alliance contractor designation occurred about 13 years ago, and there is no current baseline from which to gauge costs and savings. *Id.*

AG witness Coppola testified that many smaller projects completed under blanket contracts can be aggregated into common groupings and bid out to multiple contractors, and still be considered blanket agreements. AG Ex. 10.0 at 12. Instead of bidding out those aggregated blanket agreements annually, he stated, they could be bid out every two or three years to ensure that the contractor’s costs are still competitively set periodically. *Id.* The AG points out that in practice, Nicor Gas conducted only one bid event for blanket contracts in the five years from 2014 to 2018, and it did not consider aggregating smaller projects to bid out as a package. AG Ex. 10.0 at 12; AG Ex. 10.4. This failure to seek bids for more than \$1 billion in contracts means that Nicor Gas has not taken advantage of the competitive market to obtain least cost services.

The AG also argues that during 2017 and 2018, the Company paid the two blanket contractors (KS Energy and NPL) in excess of \$403 million for unbid blanket work, while paying them only \$45 million for projects bid out competitively. AG Ex. 10.0 at 12. In other words, they posited, 90% of the work performed by the Company’s two major contractors was performed under blanket contracts. AG Ex. 10.0 at 12.

The AG next contends that the lack of competitive bidding is not limited to blanket agreements and points out that the Company reported that during 2017 and 2018, it completed 2,530 construction projects that it did not bid out. AG Ex. 7.0 at 25-26. This work included many individual low-cost projects that collectively constitute a substantial level of investment. The AG contends that these projects could have been bundled into groups so that the Company could bid them out and secure competitive bids. The AG points out that the only way to determine whether costs have been minimized – and rate

payer dollars maximized – is to competitively bid projects, and work done under blanket contracts without competitive bidding should be an exception. *Id.*

The AG notes that these are basic tenets of responsible project management and stewardship. The Illinois Procurement Code, 30 ILCS 500/50-1, reads in relevant part:

It is the express duty of all chief procurement officers, State purchasing officers, and their designees *to maximize the value of the expenditure of public moneys in procuring goods, services, and contracts for the State of Illinois and to act in a manner that maintains the integrity and public trust of State government.* In discharging this duty, they are charged to use all available information, reasonable efforts, and reasonable actions to protect, safeguard, and maintain the procurement process of the State of Illinois.

30 ILCS 500/50-1 (emphasis added). Further, Section 30-15 of the Procurement Code states that “all State construction contracts shall be procured by competitive sealed bidding . . .,” subject to a few, well-articulated exceptions that are not relevant here. *Id.* at 30-15(a).

The AG states that the Code pertains to the procurement of State contracts funded by tax dollars, but the analogy, is noteworthy. The AG further illustrates the point in noting that Nicor Gas enjoys state-sanctioned monopoly status as an essential service provider, and that its customers have no say, other than to reject service altogether, on what they are charged for service, and rely wholly on the Commission as to the reasonableness of these charges. The AG argues that the Commission should hold the Company to the same standard as other stewards of public monies, and that not competitively bidding hundreds of millions of dollars of construction work per year should not be an acceptable practice. *Id.*

The AG argues that, as illustrated by the cases where Nicor Gas did competitively bid out work, the differences among contractors can be significant, and the potential savings can quickly dwarf the four-year savings identified by Nicor Gas’ consultant, included in the record. AG Ex. 3.0 at 35-36.

The AG contends that the expenditures on the Woodridge Pipeline, where the lowest bidder was not selected despite having an ongoing relationship with Nicor Gas, demonstrate that Nicor Gas is not utilizing competition among contractors to best effect.

The AG notes that this practice demonstrates (1) the significant cost associated with not competitively bidding out work to multiple contractors; (2) that in three of the five examples listed above, NPL, a contractor that handles hundreds of millions of dollars of work for Nicor Gas without competitive bidding, was outbid, and (3) a troubling practice by the Company in awarding construction work to contractors who were not the low bid.

While the AG does not dispute that blanket arrangements can be efficient, the record fails to show cost savings. Instead, the record shows hundreds of millions of dollars in no-bid projects, some individually worth tens of millions of dollars, and many of which could be bundled and bid out. The AG further argues that periodically submitting work to competitive bidding will allow Nicor Gas to test whether the alliance contracts

continue to reflect fair prices, and that Nicor Gas' failure to bid out a reasonable portion of its very large capital spending exposes consumers to excessive costs and denies them the benefits of the competitive construction market.

The AG finally argues that the Commission should make it clear to Nicor Gas hat in future rate proceedings, whether in general rate cases or the Rider QIP reconciliations, capital additions to rate base must be subject to competitive bidding so that a wide group of qualified pipeline contractors doing work in the utility industry may bid on the work. AG Ex. 3.0 at 38.

### **iii. Commission Analysis and Conclusion**

The Commission disagrees with the AG that Nicor Gas has not properly demonstrated the benefits of alliance partnerships and blanket contracts. As the record reflects, blanket and alliance agreements are used primarily when projects are lower cost, lower complexity, and are repetitive in nature so they can rely on the availability of union labor qualified to perform such work. As the AG admits, Nicor Gas' studies by outside consultants have proven that alliance partnerships have saved the Company millions in construction costs and millions in soft savings or value, among other operating benefits. The Commission finds that Nicor Gas' blanket partnerships are reasonable, and that Nicor Gas should continue to reevaluate such relationships regularly to ensure they are still efficient, productive and cost-effective.

## **7. AGSC Depreciation Expense**

The Company's AGSC depreciation expense is discussed in detail in Section V.B.2. below. As noted below, the Commission adopts the AG's AGSC depreciation expense adjustment. Therefore, accumulated depreciation is reduced by \$2,494,000 in the Test Year average rate base.

## **V. OPERATING EXPENSES**

### **A. Uncontested Issues**

Nicor Gas presented its revised proposed base rate operating expenses, which reflect the Company's acceptance of several Staff and Intervenor proposed adjustments. In light of Nicor Gas' acceptance of these proposed adjustments, the items identified below are uncontested.

#### **1. Compressor Fuel Rider Adjustment**

Nicor Gas initially proposed a new rider, Rider 37 – Compressor Fuel Recovery Rider ("Rider 37"). Rider 37 intended to recover the annual cost of Compressor Fuel incurred to operate the Company's storage fields. Staff witness Trost recommended that recovery of compressor fuel costs remain in base rates. Staff Ex. 1.0 at 20. Staff and Nicor Gas have agreed by stipulation to the inclusion of the compressor fuel costs in base rates and the withdrawal of proposed Rider 37, while reserving the Company's right to propose this Rider and address the recovery of these costs in a future proceeding. Nicor Gas-Staff Joint Ex. 1.0 at 5. The Commission finds that this issue is uncontested, and Rider 37 is not adopted.

## **2. Invested Capital Tax Expense**

Nicor Gas agrees to Staff witness Trost's proposal to include certain information in its compliance filing in this proceeding, including an exhibit that explicitly sets forth the Invested Capital Tax ("ICT") amount, along with workpapers supporting the exhibit. Staff Ex. 1.0 at 27; see *also* Nicor Gas Ex. 22.0 at 3. The Commission finds that this issue is uncontested and directs Nicor Gas to include the requested information with its compliance filing in the Final Order in this proceeding.

## **3. Rate Case Expense**

In accordance with the Commission's Rules, 83 Ill. Adm. Code Part 288, Nicor Gas presented evidence that its rate case expense of \$4,740,000 is true and accurate, reasonable, reviewed and approved prior to payment, and not duplicative. To support this expense, Nicor Gas submitted a summary schedule identifying all of the compensation costs for which the Company seeks recovery, which the Company updated during the course of the proceeding. Nicor Gas Exs. 3.4, 19.3, and 33.4R. Nicor Gas also presented as evidence true and accurate copies of invoices and other supporting documentation that the Company received from its outside counsel and third-party experts for work performed in connection with this rate case. Finally, Nicor Gas has provided the affidavit supporting its rate case expense as provided for in Section 288.30(e) of the Commission's Rules. As required by Section 288.30(f) of the Commission's Rules, Nicor Gas moved into evidence all updates and supporting documentation of the rate case expense amounts the Company requests for recovery in rates. 83 Ill. Adm. Code 288.30(f).

Staff proposed an adjustment to rate case expense, which Nicor Gas accepted. Nicor Gas-Staff Joint Ex. 1.0 at 4. Nicor Gas also proposes to recover the remaining unamortized costs from the 2017 Rate Case and proposes a two-year cost recovery period for its rate case expense.

The Commission, having considered the costs expended by Nicor Gas to compensate attorneys and technical experts to prepare and litigate rate case proceedings, finds that the amount included as rate case expense in the revenue requirement of \$4,740,000 is just and reasonable pursuant to Section 9-229 of the Act. This issue is uncontested and Nicor Gas' rate case expense is approved.

## **4. Lobbying Expense**

Nicor Gas produced evidence supporting its lobbying expense costs. Staff proposed an adjustment that was later withdrawn under the parties' stipulated agreement. Nicor Gas – Staff Joint Ex. 1.0 at 4. This issue is uncontested and is approved.

## **5. Outside Professional Services Expense**

In response to a data request from the AG, Nicor Gas agreed to remove the costs of certain professional services from its Outside Professional Service Expense, reducing its administrative and general expenses by \$214,520. AG Ex. 1.0 at 27; Nicor Gas Ex. 19.0R at 9. This adjustment is uncontested and is approved.

## 6. Locating Services

Nicor Gas proposes to develop an in-house facility locator program. Nicor Gas presented evidence that its plans are prudent and that the associated costs are reasonable. Nicor Gas explains its current use of a single outside contractor to perform all facility locate work under the Joint Utility Locating Information for Excavators (“JULIE”) program exposes the Company to sole-source contracting risk. Nicor Gas Ex. 11.0 at 2. Nicor Gas further explains that it anticipates an in-house program will improve pipeline safety by reducing the risk of damage to Company facilities. It will also reduce rates of attrition and allow locators to gain experience and expertise. *Id.* Nicor Gas expects the in-house locator program to be fully staffed by September 2020, with approximately 32 employees. The total annual cost associated with the program is expected to be \$2,500,00, while the cost included in the Test Year is approximately \$723,000. *Id.* at 7.

No party disputed the prudence of the Company’s plans to develop an in-house locate program, or the reasonableness of its costs. This adjustment is uncontested and is approved.

## 7. Income Tax Expense

Nicor Gas revised its regulatory tax liability in response to a data request from the AG and incorporated the impacts of the Company’s tax return to book provision true-ups. Nicor Gas Ex. 19.0R at 17. With these revisions, Nicor Gas’ income tax expense is uncontested and is approved.

### B. Contested Issues

#### 1. Shared Services Expense

##### a) Nicor Gas’ Position

Nicor Gas proposes an expense of \$109,463,000 in shared services. Nicor Gas identifies an increase in shared services costs due to factors not previously present, such as the ongoing integration between AGSC and Southern Company Services, Inc. (“SCS”), along with the divestiture of certain Southern Company Gas subsidiaries. Nicor Gas argues that it has presented substantial evidence that its shared services costs included in the Test Year are prudent and reasonable, and competitive with costs Nicor Gas would incur through alternative methods of obtaining the same services.

Nicor Gas explains that it operates under a shared services model by which its affiliate, AGSC, provides common services to Southern Company Gas companies, and charges for these services to the appropriate companies in accordance with its services agreements. Nicor Gas states that this practice is common among large utility companies as it promotes efficiency and improved quality of service by offering more robust services at lower cost than if each company were to provide the services individually.

Nicor Gas states that through the shared services model, Nicor Gas incurs costs for services provided by AGSC, as well as costs for certain corporate-level services undertaken by SCS that are charged to AGSC and, in turn, to Nicor Gas. The services provided to Nicor Gas include but are not limited to: gas supply and capacity management; financial services; information systems and technology; and engineering. The Company asserts that many of these AGSC costs are assigned to Nicor Gas on a

cost causation basis, and the remainder are distributed using appropriate allocation ratios. Nicor Gas also notes that there are numerous mechanisms in place to ensure that the AGSC costs are reflective of the services provided to the Company.

Nicor Gas emphasizes that through the integration of certain functions with SCS, AGSC enhances the level of service to Nicor Gas and benefits to its customers, while still maintaining its costs at a reasonable competitive level. For example, Information Services now provide higher quality and improved services as a result of the integration with SCS, including more robust cybersecurity protections. Nicor Gas explains that, although AGSC had a sufficient cybersecurity program, SCS has a much more robust program that ultimately helps to facilitate the reliability of all the operating companies, including Nicor Gas. Nicor Gas further explains that, as a result of the integration process, the cybersecurity protection program currently in place has more robust monitoring at the security operation center and vulnerability management, timelier incident response, more comprehensive phishing-prevention program, and upgraded hardware and software to prevent, detect and respond to cyberattacks. Having a robust cybersecurity protection program is critical to Nicor Gas given the ever-changing and increasing risk in this area.

Nicor Gas states that it presented evidence of the value of becoming part of a larger enterprise at SCS and Southern Company Gas. Nicor Gas explains that this value flows from benefits associated with greater scale, deeper capabilities, and broader resources, arising from enhanced financial, governmental, regulatory, operational, investment, and community focus. Nicor Gas witness Flaherty performed numerous evaluations in his review of the Company's shared services costs and provided substantial documentation in support of his conclusion that SCS and AGSC service company costs and those costs that are ultimately directly charged or allocated to Nicor Gas by AGSC are reasonable, and the costs to Nicor Gas are lower than those that could generally be attained under other forms of service provision.

Nicor Gas further states that while the shared services costs billed to Nicor Gas have increased, the service companies have an objective to mitigate additional increases in cost allocations to Nicor Gas. Among other evidence, Mr. Flaherty testified that AGSC has a history of successfully controlling costs, and that AGSC and Nicor Gas direct Administrative & General ("A&G") costs are expected to decrease in 2019 and 2020 from 2018 levels, which indicates that tight cost control remains intact at AGSC and Nicor Gas. Mr. Flaherty further testified that SCS costs will increase for legitimate business purposes and will flatten out by 2020 with only a nominal increase below the rate of inflation.

Nicor Gas notes the AG's proposal of a reduction to the shared services expense for the Test Year based on AG witness Efron's judgment that such expenses should only increase at the rate of 3% per year. The Company argues that Mr. Efron's assertions are based on an oversimplified and erroneous approach, and not a substantive assessment of the bases for cost increases to Nicor Gas. Instead of evaluating why A&G costs are increasing, he simply applied a purely arithmetic factor to a prior year cost baseline with no consideration of underlying future annual business requirements, essentially substituting his judgement for that of SCS, AGSC and Nicor Gas management regarding future cost necessity and legitimacy.

Nicor Gas explains that, in doing so, Mr. Effron ignores several factors involving SCS, AGSC and Nicor Gas A&G costs that would affect his analysis, including but not limited to: (1) AGSC and Nicor Gas' subjectivity to increasing cost pressures on a stand-alone basis; (2) SCS' subjectivity to increasing cost pressures on behalf of a broad and diverse enterprise; (3) SCS directed corporate attention and resources toward specific areas, particularly information technology, which drives cost increases; (4) SCS' cost increases associated with the transfer of AGSC costs in information technology and other functions, creating an artificial cost "bubble"; and the restructuring of SCS and AGSC in 2017 and 2018, which was not foreseeable in 2015 and caused identifiable and uncontrollable cost impacts.

Thus, Nicor Gas asserts that Mr. Effron's methodology is overly simplistic, contains errors, and fails to take into consideration cost patterns and business evolution. Nicor Gas maintains that the record evidence shows that Nicor Gas' customers receive valuable and necessary benefits from the Company's shared services arrangements, and that the costs of these services included in the Test Year are prudent and reasonable and are competitive with costs Nicor Gas would incur if it arranged for those services on its own. For these reasons, Nicor Gas requests that the Commission approve the Company's shared services expense as presented in this proceeding and reject the AG's proposed disallowance.

#### **b) AG's Position**

The AG requests that the Commission reduce Nicor Gas' total A&G expense by \$17,358,000 to reflect a more reasonable level of shared services. AG witness Effron testified that the total allocated AGSC/SCS A&G expenses plus Nicor Gas direct A&G is \$109,463,000. AG Ex. 2.0 at 16. Mr. Effron further reviewed the growth in the shared services portion of the A&G expenses since 2017, the first full year subsequent to the acquisition of Nicor Gas by Southern Company and noted that the allocation of shared services to Nicor Gas increased from \$6,369,000 in fiscal year 2017 to \$42,059,000 in the test year, an increase of 560% in four years. AG Ex. 2.0 at 10. The AG avers that this rate of increase is unreasonable and not justified by the Company.

AG witness Effron reconstructed the shared services allocations starting in 2017 to incorporate the rates of increase identified by Company witnesses Kim and Flaherty, and a reasonable rate of inflation. Mr. Effron included Nicor Gas' direct A&G expenses to reflect the interaction between direct A&G expenses and allocated shared services expenses and found that a reasonable total A&G expense should be \$92,105,000. AG Ex. 2.0 at 16 & Sch. DJE-3 at 3. The AG notes this is \$17,358,000 less than the total A&G expense Nicor Gas is requesting.

The AG notes Nicor Gas offered conflicting reasons for the large increase in shared services expense allocated to Nicor Gas' A&G. For example, Nicor Gas witness Kim argued that the increase was due to shifting information service to the service company in early 2018. Mr. Effron found that the AGSC and SCS Information Service expenses increased 60% from 2017 to 2018, but that: (1) Nicor did not identify any particular change in what information services were provided or identify any deficiencies in the quality of prior information services; and (2) there was no reduction in direct Nicor information services expense. AG Ex. 2.0 at 12-13.

The AG also points out that Nicor Gas witness Flaherty presented conflicting testimony. Mr. Flaherty testified that the total allocations were expected to increase by 7.5% from 2017 to 2018, and that moving into 2019, GAS leadership believes further escalations will be tightly managed as SCS focuses on cost reduction, including achieving a net zero impact due to Southern Company Gas' recent divestitures. Nicor Gas Ex. 13.0 at 41. However, the AG notes as shown on AG Ex. 2.0, Sch. DJE-3, page 1, Nicor Gas included shared services expenses that increased 7.6% from 2016 to 2017 before mushrooming to reflect a 25.8% and 17.9% increase for 2018 and 2019. The AG asserts that these increases are inconsistent with Mr. Flaherty's testimony and that Mr. Effron's proposed adjustment matches the increase from 2017 to 2018 with the increase Mr. Flaherty described in his testimony. See Nicor Gas Ex. 13.0 at 41. The AG maintains that this is a more reasonable escalation level and is supported by Mr. Flaherty's testimony.

For the years 2019 and the 2020 Test Year, the Mr. Effron relies on Nicor Gas witnesses Flaherty and Kim's statements that the overall cost allocation to Nicor Gas is not expected to increase significantly from the 2018 level when determining the \$92,100,000 in total Nicor A&G, which includes both shared services and direct Nicor A&G. Nicor Gas Ex. 4.0 at 12. Mr. Effron increased each year by 3%, which exceeds inflation, resulting in a 6.09% increase from \$86,800,000 as of 12/30/18 to \$92,100,000 for the test year. The AG avers that this is a reasonable level for this expense.

In response to Nicor Gas' assertions that the divestiture of various Southern Company subsidiaries reduced the number of companies paying shared costs, the AG points out that Nicor Gas witness Kim testified that the costs associated with the divested entities are charged to the buyers of the divested entities and are not charges to Southern Company Gas' entities, including Nicor Gas. Nicor Gas Ex. 4.0 at 11. The AG notes that: (1) Nicor Gas' testimony that its shared services costs are not expected to increase significantly conflicts with these more vague assertions of benefits; and (2) increases of 25.8% and 17.9% per year are not reasonable and require more detailed justification and quantification than a reference to higher quality and improved services. *Id.* at 10. The AG avers that Mr. Effron's recommended adjustment of shared services to include in Nicor Gas' A&G expense is fair, fully supported by the record, and should be adopted.

### **c) Commission Analysis and Conclusion**

The record shows that the Company's increase in costs are due in part to additional safeguards regarding upgraded cybersecurity protections across Nicor Gas' delivery system. The Company also asserts an increase in Nicor Gas' proportioned allocated costs is due to the divestiture of certain Gas subsidiaries. The AG argues that the rate in which the shared services costs increased within the past four years is unreasonable and not justified by the Company. The Company explains that many of the Shared Services Expenses are assigned to Nicor Gas on a cost causation basis, with the remaining costs distributed using appropriate allocation ratios. The Company notes this increase in costs was not foreseeable in the 2017 Rate Case and caused identifiable and uncontrollable cost impacts.

The Commission finds the Shared Services Expense is reasonable and prudent as the costs impact the quality of service being provided to ratepayers at a rate that is

competitive with costs Nicor Gas would otherwise incur through alternative methods to provide the same services. The Commission notes the AG fails to substantially address how the proposed adjustment would affect the safety and quality of service ratepayers currently enjoy. The Company has indicated future costs impacts will be tightly managed and controlled and the Commission expects this to be the case. Therefore, the Commission adopts the Company's proposed Shared Services Expense.

## **2. AGSC Depreciation Expense**

### **a) Nicor Gas' Position**

Nicor Gas proposes an expense of \$12,029,000 in AGSC depreciation. Nicor Gas states that the increase in AGSC depreciation, which is the basis for AG witness Effron's proposed adjustment, is the result of the Company's methodology in translating AGSC allocated costs to the Illinois uniform system of accounts format in which the Commission requires ("ICC Accounts"). According to the Company, this methodology can result in overstatements in certain ICC accounts offset by understatements in others. Nicor Gas explains that in this instance, the AGSC allocated depreciation expense was overstated by approximately the same amount as Mr. Effron's proposed adjustment, and that overstatement in AGSC depreciation expense is offset in other ICC accounts. Accordingly, the Company argues that the "increase" is not a true increase but rather an overstatement that is offset by other accounts, and that the AG's proposed adjustment should be rejected.

### **b) AG's Position**

The AG recommends the Commission apply the ratio of AGSC depreciation expense to AGSC plant in service used in the 2017 Rate Case to calculate the Test Year AGSC depreciation expense. The AG states that this reduces the AGSC depreciation expense by \$4,987,000.

The AG argues that increasing AGSC plant does not necessarily increase or decrease the depreciation expense to plant ratio. The AG notes depreciation is computed by multiplying average depreciable property of each class by the applicable depreciation rates approved by the Commission in the 2017 Rate Case. Nicor Gas Ex. 3.0R at 20. The AG further notes that each property class and its corresponding depreciation rate determines the depreciation expense for that particular class, and that the aggregate of the various class expenses in the AGSC depreciation expense account are what make up the total AGSC depreciation expense. This expense account is then applied to the total plant, in this case AGSC plant, to determine the depreciation expense account ratio to plant. *Id.* The AG asserts that because the total plant is made up of various classes of plant property with differing depreciation rates, the type of plant being added to total plant plays a significant role in determining the depreciation expense to plant ratio. *Id.*

The AG further points out that the total Test Year depreciation expense allocated from AGSC to Nicor Gas in this rate case is \$12,029,000. AG Ex. 2.0 at 17 (citing Nicor Gas Schedule C-12 at 1); AG Ex. 2-1-2.5, Schedule DJE-4. According to AG witness Effron's direct testimony, Schedule DJE-4, Mr. Effron's depreciation adjustment schedule also reflects a rate base impact that reduces the accumulated depreciation by \$2,494,000 in the test year average rate base. *Id.* The AG adds that this represents 26% of the

\$46,300,000 of total AGSC plant allocated to Nicor Gas, which is 71% higher than the 15.21% ratio approved by the Commission in Nicor Gas' 2017 Rate Case. AG Ex. 2.1-2.5 at Sch. DJE-4. In that case, the AG contends, the total Test Year depreciation expense allocated from AGSC to Nicor Gas was \$4,578,000, significantly less than the amount requested in this docket. AG Ex. 2.1-2.5 at Sch. DJE-4. The AG also notes that, in addition to an increased depreciation ratio, AGSC allocated more than twice the amount of plant to Nicor Gas, despite the passage of less than two years.

The AG argues that Nicor Gas' position that the increase in AGSC depreciation expense is the result of the Company's methodology in translating AGSC allocated cost to ICC accounts, which can result in overstatements in certain ICC accounts offset by understatements in others is vague, unresponsive, and raises concerns regarding the Company's accounting practices. The AG explains the Company failed to provide any data describing its methodology; specifically, identifying which ICC accounts were targets during the translation of AGSC allocated costs, or explain the corresponding effect on the depreciation expense to plant rate. The AG argues that simply arguing "overstatement in AGSC depreciation expense is offset in other Commission accounts, primarily A&G expense accounts" only labels the process, it does not identify where this supposed "offset" takes place. The AG further contends that without knowing precisely which ICC accounts were targets during the translation of AGSC allocated costs, and the corresponding effect on the depreciation expense to plant rate, the Commission cannot accept that the proposed depreciation expense to plant ratio for AGSC plant accurately reflects the property classes and depreciation rates set forth by the Commission in the last rate case. The AG avers the record is devoid of evidence explaining the increase in AGSC plant to AGSC depreciation expense ratio.

### **c) Commission Analysis and Conclusion**

The Commission adopts the AG's proposal to adjust the AGSC depreciation expense by \$4,987,000 and apply the ratio of AGSC depreciation expense to AGSC plant in service used in the 2017 Rate Case to calculate the test year AGSC depreciation expense. The Commission agrees with the AG that the Company's explanation of the methodology used in translating AGSC allocated cost to ICC accounts is vague and does not identify with specificity the accounts in which the alleged overstatements and understatements occurred. The lack of evidence presented does not afford the parties a reasonable opportunity to address the financial impacts of the proposal presented by the Company. Therefore, the Commission finds the Company failed to meet its burden and rejects the Company's proposal. Additionally, this adjustment shall reduce the accumulated depreciation by \$2,494,000 in the test year average rate base.

## **3. Nicor Trade Name Amortization**

### **a) Nicor Gas' Position**

Nicor Gas argues that there is no basis for the AG's proposed adjustment relating to the "Nicor" trade name, and that the Commission should reject the AG's proposal for the reasons discussed above in Section IV.B.5.

### **b) AG's Position**

The AG proposes an adjustment to operating expenses of \$8.6 million annually for an amortization period of 10 years. This issue is discussed above in Section IV.B.5.

**c) Commission Analysis and Conclusion**

As discussed above in Section IV.B.5, the Commission rejects the AG's proposed adjustment.

**4. Pension and Other Post-Employment Benefit ("OPEB") Expense**

**a) Nicor Gas' Position**

Nicor Gas proposes an expense of \$20,344,000 in pension and OPEB. Nicor Gas states that it complied with this filing requirement in its initial filing, and that the filing requirements are not rolling requirements that require continual updates through the duration of the case, unless otherwise set forth in the rules. The Company argues that the standard information requirements in 83 Ill. Adm. Code 285 apply to the utility's initial filing, and not as continuing requirements to update. See 83 Ill. Adm. Code 285.305(g).

Nicor Gas also avers that the AG's proposal violates the Commission's rules and single-issue ratemaking principles. The Company argues that a future test year, by definition, includes forecasted data, and that to change the Company's Test Year data on a piecemeal basis to incorporate "updated" data is antithetical to the purpose of a future test year, which identifies forecasted costs at the time of the Company's filing. Accordingly, the Company argues that the AG's recommendation should be rejected.

**b) AG's Position**

The AG recommends the Commission modify the pension and OPEB expense to reflect the most recent actuarial study to capture the best available data and reduce the Company's pension and OPEB expense by \$3,758,000. The AG explains the Company, in compliance with 83 Ill. Adm. Code 285.305(g), provided an updated actuarial study that was distributed to the service list via email on April 5, 2019 and supplemented on April 25, 2019. AG witness Selvaggio testified that this updated actuarial study shows that the anticipated pension and OPEB expense for the Test Year is \$3,758,000 less than what Nicor Gas originally requested. The AG recommends the Commission reduce the pension and OPEB expenses by this amount based on the most recent actuarial study as reflected on AG Exhibit 8.0, Schedule C-8.

The AG asserts that the Commission rule establishing Standard Information Requirements for Public Utilities and Telecommunications Carriers in Filing for an Increase in Rates requires utilities to submit the most recent actuarial report supporting post-retirement benefits, including pensions and post-retirement benefits other than pensions. 83 Ill. Adm. Code 285.305(g). The AG posits that this requirement is intended to assure that the most recent pension and OPEB expense is included in rates, otherwise, this requirement would be pointless. The AG avers the law will not treat a rule as without effect when the purpose of the rule can be met without violating the terms of the rule. *Wal-Mart Stores, Inc. v. Indus. Comm'n*, 324 Ill. App. 3d 961 at 967, (2001) (In order to ascertain the legislature's intent, courts must construe the language so that no word or phrase is rendered meaningless or superfluous).

The AG notes the Commission has previously rejected the Company's argument that it should ignore an adjustment based on credible information because it "selectively" updates components of the revenue requirement. In Docket No. 04-0779, Nicor Gas argued against an AG adjustment to a corporate benefit plan expense because it was "...another inappropriate attempt to make a selective update of Nicor Gas' test year forecast." *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 04-0779, Order at 40 (Sep. 20, 2005). The Commission disagreed with Nicor Gas' argument that the AG's adjustment was unreasonable and reduced the corporate benefit plan expense. The Order states:

[The AG's] proposed adjustment clearly reflects the Company's actual experience with corporate benefit plan expense over the last four years. The Company has not provided any reason to believe that the forecast payout ratio of 100% is any more likely than the actual payout ratio of 50% experienced in 2003.

*Id.* at 41-42. The AG also cites a recent Ameren Illinois Company d/b/a Ameren Illinois gas rate case settlement, where both the utility and the Commission accepted an adjustment to pension and OPEB expense based upon updated actuarial information. *Ameren Ill. Co. d/b/a Ameren Ill.*, Docket No. 18-0463, Order at 6-7 (Nov. 1, 2018). In that docket, the utility accepted an adjustment to reflect the February 2018 updated actuarial information, and then in its surrebuttal filing, further decreased pension and OPEB expenses based on a more recent actuarial study. The AG asserts that Commission rules require the filing of updated pension and OPEB studies to enable the Commission to reflect pension and OPEB expenses as accurately as possible and that it is unreasonable to ignore reported changes in this expense.

### **c) Commission Analysis and Conclusion**

The Commission agrees with the AG that 83 Ill. Adm. Code 285 is intended to assure that the most recent pension and OPEB expense is included in rates. According to 83 Ill. Adm. Code 285, when filing for a general increase in rates, a utility shall provide the "[m]ost recent actuarial report supporting post-retirement benefits, including pensions and post-retirement benefits other than pensions." 83 Ill. Adm. Code 285.305(g). In the present case, and in conformity with 83 Ill. Adm. Code 285, Nicor Gas filed and entered an updated actuarial report into the record on April 25, 2019. The Commission finds this requirement ensures that the most recent pension and OPEB expense is in the record and available for consideration to the Commission and all parties.

The Commission disagrees with the Company that this adjustment constitutes single-issue ratemaking as discussed in *People ex. rel Madigan*. Pension and OPEB expense are merely one of several components of a Company's revenue requirement that are examined during a rate case.

The Commission notes it recently accepted proposed adjustments to pension and OPEB expense on the basis of an updated actuarial study that was provided after the Company filed its request for a rate increase in Docket Nos. 18-0463 and 17-0259. See *Ameren Ill. Co. d/b/a Ameren Ill.*, Docket No. 18-0463 Order (Nov. 1, 2018); *Aqua Ill., Inc.* Docket No. 17-0259 Order (Mar. 7, 2018). Therefore, the Commission adopts the AG's

proposal to adjust the pension and OPEB expense by \$3,758,000 to reflect the most recent actuarial study.

## **5. Meter Reading Expenses**

### **a) Nicor Gas' Position**

Nicor Gas proposes a meter reading expense of \$5,131,000. Nicor Gas explains that customers have realized additional benefits and avoided costs due to the Company's capital investment in Automated Metering Infrastructure ("AMI"). The Company notes that the modification to the AMI deployment schedule resulted in a \$31,000,000 reduction in capital investment through the end of the Test Year, reducing the amount of meter reading expense benefits that will be realized in the Test Year. Nicor Gas posits that while customers are not experiencing the lower meter reading expenses to the extent forecasted in the 2017 Rate Case, they are also not paying for the associated capital investment.

Nicor Gas disagrees with the AG's proposal to reduce Nicor Gas' Test Year meter reading expenses based on the difference between the estimated meter reading costs included in the 2017 Rate Case and the estimates for the instant Test Year. According to the Company, AG witness Selvaggio implies that ratepayers were "promised" the estimated meter reading costs included in the 2017 Rate Case. However, the Company avers that the reduction in meter-reading costs resulting from the AMI program will be realized beginning in 2019, due to the delayed deployment of AMI. The Company thus argues that the AG's proposal should be rejected.

### **b) AG's Position**

The AG recommends the Commission reduce Nicor Gas' meter reading expense by \$671,000 (\$2,800,000 -\$3,471,000). AG Ex. 8.1, Sch. C-3. The AG explains the Meter Reading Expense should be reduced to capture the savings Nicor Gas promised when AMI was approved in the 2017 Rate Case, and to compensate ratepayers for the increased costs due to Nicor Gas' delay in the deployment of AMI. The AG notes that in the 2017 Rate Case, Nicor Gas represented that its meter reading expense would drop to \$2,800,000 in 2020 as a result of its investment in AMI. AG Ex. 1.0 at 26; AG Ex. 1.2, Att. C at 2. In reliance at least in part on that representation, the Commission approved the investment in AMI despite the results of a cost-benefit study showing a net present value of only \$28,000,000 over a twenty-year period, noting the most significant driver of the savings was the elimination of the monthly manual meter read. 2017 Rate Case, Order at 6, 17.

In the present case, Nicor Gas seeks \$3,471,000 for meter reading expenses (Account 902), \$671,000 more than was projected by Nicor Gas in justifying the AMI investment. AG Ex. 8.0 at 14. The AG maintains ratepayers should not pay an increased level of costs for meter reading due to the delays by Nicor Gas in deploying AMI. The AG disagrees with Nicor Gas witness Whiteside's belief that this adjustment is inappropriate because while "customers are not benefitting from lower meter reading expenses to the extent forecasted in the 2017 Rate Case, they are also not paying for the associated investment." Nicor Gas Ex. 31.0 at 41. The AG asserts this adjustment is limited to the increased costs due to Nicor Gas' delay in implementation of AMI.

### c) Commission Analysis and Conclusion

The Company states that during the 2017 Rate Case, the 2020 meter reading expense was based on the projected timing of AMI deployment at that time. The AG argues the Company's proposed meter reading expense should be reduced to the level of expense that was projected for 2020 during the prior 2017 Rate Case. The AG asserts the increase in costs does not justify the AMI investment that was previously approved by the Commission. The Company explains the proposed meter reading expense takes into consideration the deployment of AMI up until now and is based on the latest estimate of AMI deployment for the 2020 meter reading expense that was not perceived during the 2017 Rate Case. The Company also states customers have realized additional benefits and avoided costs due to the Company's capital investment in AMI.

In the 2017 Rate Case, the Commission found that there will always be modifications to a large-scale project such as AMI, and that costs may be revised from time to time to achieve the associated benefits. 2017 Rate Case, Order at 17 (Jan. 31, 2018). Consistent with the finding in the 2017 Rate Case, the Commission agrees with the Company in this docket and finds that Nicor Gas' proposed meter reading expense for the 2020 test year reasonably reflects the most up to date projections of AMI deployment. The AG's argument fails to consider the cost of AMI deployment as it relates to the benefits ratepayers enjoy other than a reduction in meter reading expense. Therefore, the Commission adopts the Company's proposal.

## 6. Interest Expense on Customer Deposits

### a) Nicor Gas' Position

Nicor Gas proposes a forecasted customer deposit interest rate of 3.5%. The Company disagrees with the AG's proposed adjustment to update its forecast interest rate for 2019 based on the current one-year rate of 2.5% that was approved by the Commission on December 19, 2019, following the filing of this case. Nicor Gas argues that this proposal is incompatible with the concept of a future test year, and that it runs afoul of Illinois law and principles against single-issue ratemaking. *People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654, ¶ 27. Nicor Gas points out that the AG cannot cite to any proceeding in which the Commission required the utility to update its forecast interest rate mid-case. Nicor Gas further argues that any proposed adjustment should be based on the average impact to the customer deposits balance and the final percentage increase in the average residential bill.

### b) AG's Position

The AG points out that utilities like Nicor Gas hold customer deposits as capital that is available to the utility. While Nicor Gas holds on average more than \$20,000,000 in customer deposits, it regularly returns deposits to customers with interest at a rate determined by the Commission. 83 Ill. Adm. Code 280.40(g). The Commission sets the customer deposit interest rate in December of every year, and the rate mimics the rate for of average one-year yield on U.S. Treasury Securities for the last full week in November. That interest rate is rounded to the nearest 0.5%. *Id.* at 280.40(g)(1). Interest paid to customers are treated as an expense, meaning if the interest rate is higher, the utility expense is higher. Tr. at 33.

The AG proposes the Commission reduce the interest expense on customer deposits by \$152,000 to reflect the most recent Commission authorized customer deposit rate of 2.5% rather than the forecasted customer deposit rate of 3.5% proposed by the Company. The AG notes Nicor Gas based its high rate of interest on a forecast prepared on August 10, 2018 that Nicor Gas received from an investment advisor company called IHS MarkIt. Nicor Gas Ex. 33.2. The AG further notes Nicor Gas' proposed rate is not based on the current 2.5% rate that will be in effect when these rates take effect in October 2019. Additionally, the rate for 2020 will not be determined until December 2019.

The AG argues that until a new rate is established, the current customer deposit rate of 2.5% should be applied to the adjusted balance of customer deposits. The AG points out the actual 1-year U.S. Treasury yield rate at August 10, 2018 was 2.42% and no rate between August 10, 2018 and May 24, 2019 has been higher than 2.74%. The rate on May 24, 2019 was 2.33%. AG Cross Ex. 5. These rates, when considered together, round to the current authorized rate of 2.5%.

The AG also cites Commission precedent showing that the Commission has historically used the existing customer deposit interest rate in rate cases and current rates to date are consistent with the 2.5% rate. Examples include the following cases:

- 2017 Rate Case (Future test year ending December 31, 2018 filed on March 15, 2017): A customer deposit rate of 1.00% was applied to the customer deposit balance based upon the Order in Docket No. 16-0585 that authorized a rate of 1.00% to be paid on customer deposits during 2017 and
- Docket No. 18-0463 - Ameren Illinois Company d/b/a Ameren Illinois, Request for Increase in Natural Gas Rates, Order (Nov. 1, 2018) (Future test Year ending December 31, 2019 filed January 31, 2018): A rate of 1.50% was applied to the customer deposit balance based upon the Order in Docket No. 17-1018, entered Dec 13, 2017, that authorized a rate of 1.50% to be paid on customer deposits during 2018.

The AG adds that the forecasts on Nicor Gas' Exhibit 33.2 are consistently higher than the actual, daily one-year yields on U.S. Treasury Securities reported by the U.S. Department of the Treasury in 2019, as shown by AG Cross Exhibit 5 (2019). Nicor Gas' Exhibit 33.2 shows an average rate of 2.97% for the first quarter of 2019. The actual rates for that period reached a high of 2.60% on six days in January before dropping to 2.40% on March 29, 2019. The AG states the actual average of the rates during that time was considerably lower than 2.97%.

The AG further explains that since April 1, 2019, the rates have not exceeded 2.46% (on April 22, 2019), although Nicor Gas Exhibit 33.2 shows the second quarter of 2019 jumping to 3.19%. See AG Cross Ex. 5. The AG avers this demonstrates that the forecast Nicor Gas relied upon over-estimates the applicable rate (compare Q1 2019 on Nicor Gas Ex. 33.2 to actual January 2, 2019 to March 29, 2019 and Q2 2019 to actual April 1, 2019 to May 23, 2019).

### **c) Commission Analysis and Conclusion**

The Commission notes the Company's proposed interest expense on customer deposits exceeds the current Commission-approved customer deposit interest rate by 1%. The Commission agrees with the AG that the historical progression of interest expense on customer deposits throughout recent years does not reasonably justify a 1% rate increase for the Test Year. The Commission is not convinced the Company's projected interest rate of 3.5% is more reliable than the currently approved interest rate of 2.5% that was set by the Commission in December 2018.

The Commission further finds the interest expense on customer deposits is not a method of single-issue ratemaking as discussed in *People ex. rel. Madigan*. The interest rate being considered is for the forecasted future Test Year, as identified by the Company. Interest expense on customer deposits is merely one of several components of a Company's revenue requirement that are examined during a rate case.

The Commission also notes the interest expense on customer deposits account for only those costs approved by the Commission as part of its entire operating expense. Therefore, the Commission adopts the AG's adjustment of \$152,000.

## **7. Charitable Contributions Expense**

### **a) Nicor Gas' Position**

Nicor Gas proposes to recover \$2,200,000 in its direct case, which includes an increase of \$500,000 in charitable contributions. Nicor Gas proposes to increase its charitable contributions in the Test Year to address what the Company describes as an increased need for charitable grants in Illinois and to bring its charitable giving in line with its peers in the utility industry. Nicor Gas explains that it proposed in its direct case an additional \$500,000 in grants to be given to more than 100 charitable organizations. The Company states that the proposed additional contributions conform to the requirements of Section 9-227 of the Act because all the contributions will be for the public welfare or for charitable scientific, religious, or educational purposes. 220 ILCS 5/9-227. The Company notes that no party has presented evidence suggesting otherwise.

Nicor Gas states the AG's attempt to micromanage and direct the Company's charitable giving is inappropriate and inconsistent with the law, particularly where no party has claimed that the proposed increase is contrary to the requirements of Section 9-227. Nicor Gas asserts that the AG presented no evidence demonstrating that these costs should be disallowed.

In response to the AG's proposal regarding customer energy assistance, Nicor Gas proposes to add an additional \$500,000 in charitable contributions to be directed to customer energy assistance. The Company agrees that charitable giving for customer energy assistance falls within the scope of allowable charitable contributions and agrees to provide an annual report for the disposition of these funds.

Nicor Gas avers the full amount of \$2.7 million for Nicor Gas' charitable contributions proposed for the Test Year – including both the additional \$500,000 directed to customer energy assistance and the additional \$500,000 in general charitable contributions – should be approved.

## b) AG's Position

The AG recommends the Commission approve Nicor Gas' proposed \$500,000 increase in its charitable contribution so long as that increase is solely used to provide energy assistance to its customers. The AG states that while an increased charitable contribution for energy assistance would benefit customers, the \$500,000 additional increase that Nicor Gas requests would not provide the direct benefits of payment to troubled Nicor Gas customers.

The AG notes that while Nicor Gas agreed to make an additional \$500,000 in charitable contributions during the Test Year for energy assistance to its customers, this would *double* the incremental increase Nicor Gas originally requested to \$1 million, an increase of almost 60% over its unadjusted \$1.7 million expense. Nicor Gas Ex. 21.0 at 4. The AG maintains that is too large of an increase. The Commission should either limit the increase in charitable giving to \$500,000 for energy assistance or reject Nicor Gas' request to increase charitable expense beyond the \$1.7 million it has identified.

In support of its position, the AG asserts that if Nicor Gas is allowed to increase its charitable giving to provide energy assistance, more Nicor Gas customers would be able to afford service and avoid disconnection. The AG notes that Nicor Gas currently administers a "Sharing Program" that in 2017 was funded from \$285,933 in voluntary contributions from customers of Nicor Gas and \$1,067 in voluntary contributions from employees of Nicor Gas. AG Ex. 1.2 Att. H at 4-5.

The AG explains that the need for energy assistance is highlighted by the fact that for the twelve-month period ending November 2018, Nicor Gas issued a total of 248,198 shut-off notices to its customers due to non-payment, constituting 11.28% of its customers (248,198 / 2.2 million total customers). *Id.* at 6; AG Ex. 1.0 at 29. Nicor Gas further reported that during the twelve months ending November 2018, 113,193 Nicor Gas customers received assistance from the Low-Income Home Energy Assistance Program ("LIHEAP"), the Percentage of Income Payment Plan ("PIPP"), or Nicor Gas' sharing with a total of \$21,038,445 dollars given. See AG Ex. 1.0 at 29; AG Ex. 1.2, att. H at 8.

The AG adds that a total of 28,232 customers were disconnected due to non-payment during the twelve-month period ending November 2018, making it apparent that more energy assistance dollars are needed to make Nicor Gas service affordable to a significant portion of Nicor Gas' customers.

The AG understands that an additional customer benefit of using increased charitable giving for energy assistance is that it can be expected to reduce the uncollectible expense paid by Nicor Gas consumers. Nicor Gas has projected a 59.6% increase in its uncollectible expense from \$10.65 million in 2017 to \$17 million in 2020, indicating that more customers can be expected to require assistance to pay their Nicor Gas bills. AG Ex. 1.0 at 30. The AG argues that if more assistance dollars are available to Nicor Gas customers who are struggling to pay their increasing gas bills, Nicor Gas may be able to minimize the increase in uncollectible expense as well as keep customers warm and on the system.

The AG further notes that Nicor Gas committed to provide an annual report that identifies (1) each organization receiving a portion of the incremental \$500,000 in

charitable contributions for customer energy assistance, and (2) the amount donated to each organization. Nicor Gas proposes to file the annual report as a compliance filing in this proceeding by March 1 of each year, with the first such annual report filed by no later than March 1, 2021. Nicor Gas Ex. 21.0 at 4-5.

### **c) Commission Analysis and Conclusion**

Nicor Gas initially proposed an increase in its charitable contributions expense by \$500,000 in general charitable giving. The AG argues the Company should be allowed a total increase of \$500,000 so long as it is used only for energy assistance. In response to the AG's proposal, the Company now recommends the Commission increase its charitable contributions by an additional \$500,000 that will be dedicated towards customer energy assistance – for a total increase of \$1,000,000.

The Commission agrees with the AG's proposal and finds that directing an increase in charitable contribution towards customer energy assistance, provides a direct benefit for all customers. More customers will now be able to access additional funds to afford service to avoid disconnection. The Commission notes the Company's new proposal to add an additional \$500,000 to cover customer energy assistance is unnecessary and puts an undue burden on all ratepayers. The Company agrees that charitable giving for customer energy assistance falls within the scope of allowable charitable contributions and agrees to provide an annual report for the disposition of these funds.

Therefore, the Commission adopts the AG's proposal to approve Nicor Gas' \$500,000 increase in its charitable contribution from \$1,700,000 to \$2,200,000. The \$500,000 increase shall be directed towards customer energy assistance initiatives and programs. The Commission further approves the parties' agreement that an annual report shall be filed as a compliance filing in this proceeding by March 1 of each year that identifies: (1) each organization receiving a portion of the incremental \$500,000 in charitable contributions for customer energy assistance; and (2) the amount donated to each organization. The first annual report shall be filed by no later than March 1, 2021.

## **8. Interest Synchronization**

### **a) Nicor Gas' Position**

The Company proposes that interest synchronization be calculated to reflect the adjustments approved in the Commission's Final Order in this proceeding. Nicor Gas notes no party other than Staff addressed interest synchronization.

### **b) Staff's Position**

Staff witness Trost proposed an interest synchronization adjustment to ensure that the revenue requirement reflects the tax savings generated by the interest component of the revenue requirement. Staff Ex. 1.0 at 5-6. Staff Ex. 1.0, Schedule 1.06 sets forth Ms. Trost's computation. An interest expense component is compared to the interest expense used by the Company in its computation of income tax expense. The tax effect of the difference in interest expense is the adjustment for interest synchronization. *Id.*

Staff and the Company stipulated to an interest synchronization using Staff's methodology reflected in Staff Ex. 1.0, Schedule 1.06, but using the rate base and

weighted cost of debt stipulated to by Staff and the Company. Nicor Gas-Staff Joint Ex. 1.0 at 5. As discussed above in Section II of this Order, Staff's final recommended revenue requirement reflects additional corrections from the Company's rebuttal testimony revenue requirement schedules. It is Staff's belief and understanding that the Company agrees that an interest synchronization adjustment is no longer necessary unless the Commission approves a weighted cost of debt and rate base different than that agreed to in the Stipulation.

### **c) Commission Analysis and Conclusion**

Staff and Nicor Gas stipulated to an interest synchronization using Staff's methodology. Accordingly, Staff's methodology is adopted, however, interest synchronization shall be modified to reflect the rate base and weighted cost of debt approved in this Order.

## **9. Payroll Expense**

### **a) Nicor Gas' Position**

Nicor Gas proposes 1,960 full-time equivalent employees ("FTE") in its Test Year projections. The Company maintains that this proposal is reasonable and reflects the forecasted payroll expense for the Test Year. The Company notes that its payroll expense for the Test Year is supported by sound managerial experience and that the evidence shows that Nicor Gas has consistently achieved payroll expenses closely following its forecasts. The Company points out that 2015 and 2016 FTE numbers were higher than budgeted, and the 2017 forecast number was within 2 employees of the actual number.

The Company adds that in the 2017 Rate Case, the Commission found that Nicor Gas' future workforce cannot be addressed using a historical FTE average, because that analysis ignores the evidence supporting the Company's need to increase its workforce size. Nicor Gas maintains that IIEC/CUB witness Gorman has produced no evidence, apart from his improper examination of historical data and his own assertions to suggest that Nicor Gas will not utilize the added positions. The Company notes that all 117 FTEs approved in the 2017 Rate Case have been filled. Moreover, Nicor Gas argues that it has demonstrated that its actual payroll expense in 2018 was higher than what was reflected in its cost of service and that there is therefore no basis to assume that the Company recovered in base rates a higher payroll cost than it actually incurred. Nicor Gas avers that it has provided sufficient evidence showing that its payroll expenses included in the Test Year are reasonable and prudent, and therefore these costs should be recovered.

### **b) IIEC/CUB's Position**

IIEC/CUB urge the Commission to reject the Company's FTE levels and proposed test year payroll expense. IIEC/CUB aver substantial evidence presented in the docket justifies 1,927 FTE for the test year and a corresponding reduction in the payroll expense of approximately \$4.245 million. IIEC/CUB Ex. 1.6. IIEC/CUB contend Nicor Gas has not provided any credible evidence or plans to hire to the 1,960 FTE level by the end of the test year.

IIEC/CUB contend Nicor Gas' actual annual average of FTEs in 2017 was 1,920 and dropped to 1,901 in 2018. Despite the near-term decreasing trend, the Company's projected test year level is now increasing to 1,960. IIEC/CUB state the requested 1,960 FTE level is an unwarranted increase from the actual 12-month average FTE for the period ending September 2018 of 59 FTE, or 37 FTE positions above the December 31, 2019 actual level. IIEC/CUB Ex. 1.0, Vol. I at 28-29.

IIEC/CUB argue Nicor Gas' projected FTE level is excessive due to the implementation of AMI, employee position choices, failure to pass testing requirements, the decreasing number of positions resulting from retirements or employees leaving the system, and other attrition factors. See IIEC/CUB Cross Ex.1. IIEC/CUB note that Nicor Gas admitted it did not keep information that would bear upon actual or budgeted payroll expense due to vacant positions attributable to planned retirement or other factors. IIEC/CUB Cross Ex. 7.

IIEC/CUB aver that the Company has successfully operated with around 1,901 to 1,928 FTE over the past four years, yielding an average of 1,914 FTE. IIEC/CUB contend these levels are far below the Company's projected test year level of 1,960 FTE, adding there is no definitive proof that increasing these FTEs prospectively will either be accomplished or that it is necessary to maintain service quality and reliability that has been provided over the last four-year period. IIEC/CUB Ex.1.0, Vol. I at 30. Lacking such evidence, IIEC/CUB state the Commission cannot approve Nicor Gas' payroll expense level.

IIEC/CUB state "[T]he burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility." 220 ILCS 5/9-201(c). IIEC/CUB argue the evidence in this case does not support the Company's claim that its payroll expense has been stable, while actual payroll expense exceeded budgeted payroll expenses in four of the past five years. Nicor Gas Ex. 17.0 at 76-77; Nicor Gas Ex. 31.0 at 37-38; IIEC/CUB Cross Exhibit 6.

IIEC/CUB note FTE drive payroll expense. When the Company has fewer FTE, payroll expenses are expected to be lower. Moreover, when the Company has more FTE payroll expenses are expected to be higher. IIEC/CUB agree with the Company that FTEs are a critical component to the development of budgeted costs. Nicor Gas Ex.17.0 at 77.

IIEC/CUB note payroll expenses increased significantly in 2018 relative to 2016 and 2017, even though the FTE number was lower in 2018. Mr. Whiteside suggests that overtime could be one factor that might bear upon FTE and payroll expense; however, IIEC/CUB aver Nicor Gas has not demonstrated that the changes in the amount of overtime costs were based on reasonable and normal recurring overtime payroll costs. IIEC/CUB explain the payroll expenses in Table 1 from Mr. Gorman's rebuttal testimony are Nicor Gas' total fixed compensation, including expensed and capitalized portions. IIEC/CUB note the payroll expenses in Mr. Whiteside's rebuttal testimony reflect only the expensed portion.

IIEC/CUB state that in Nicor Gas' last rate case, the Company projected annual average FTEs in the 2018 test year at 2,032, an increase of around 117 employees from

2015 actual annual average of 1,919. IIEC/CUB adds the Company's actual annual average number of FTEs in calendar year 2016 was 1,925; however, after rates were set to support an FTE level of 2,032 positions, Nicor Gas' actual annual average level of FTEs for calendar years 2017 and 2018 were far less than the FTE cost reflected in its cost of service. IIEC/CUB Ex. 1.0, Vol. I at 28. Thus, IIEC/CUB conclude the payroll expense included in the approved revenue requirement was excessive and borne by customers who paid inflated rates as a result.

Mr. Gorman examined the record from the last rate case and the representations made by Nicor Gas concerning the anticipated hires that would allegedly be made after the record closed. According to Mr. Gorman, the Commission took the word of Nicor Gas that these positions would be filled in the times stated. IIEC/CUB explain in the last rate case Nicor Gas repeatedly implied that if they did not hire certain employees, the system would be at risk. IIEC/CUB argued there is no evidence in the record from which to justify Nicor Gas' statement that adoption of IIEC/CUB's position would lead to an unreasonable and unsafe result. IIEC/CUB state the Commission noted Nicor Gas' position in agreeing to these 117 FTE positions. IIEC/CUB state Nicor Gas specifically emphasized the need to increase staffing due to the Pipeline and Hazardous Materials Safety Administration requirements and Commission directives from the last merger docket to work with Pipeline Safety Staff on an operators' framework, as well as the Company's soft close process. IIEC/CUB add Nicor Gas also discussed the need for an increase in on-site inspections. 2017 Rate Case, Order at 47. IIEC/CUB argue not all hires took place and any additional hires that were made did not make up for FTE that were not filled or replaced.

IIEC/CUB aver their Cross Exhibit 1 shows that many of the FTE positions were not filled when anticipated. While Mr. Whiteside disagrees with Mr. Gorman's interpretation of the exhibit in some respects, IIEC/CUB contend it is indisputable that many FTEs were hired several months after the planned date. IIEC/CUB point out that out of the 84 FTEs expected to be hired by April 1, 2018, only 58% were hired in that time frame. IIEC/CUB add that five of the Safety Associates were also hired months after the expected hire date. IIEC/CUB maintain their Cross Exhibit 1 also shows that some of the FTE positions (6) were not filled by the end of 2018, and that 12 FTEs were hired post January 1, 2019. Nicor Gas Ex. 31.0 at 39.

IIEC/CUB explain many factors bear upon the timing, or need, for hiring FTEs. IIEC/CUB question Nicor Gas' ability to accurately assess or measure those factors that affect FTE levels. Further, IIEC/CUB argue Nicor Gas has not provided the Commission with the necessary information that would allow an assessment or measurement of those same factors. It offers a proposed payroll expense level but cannot provide data as to what is the normalized expense, or what impact overtime, resignations, or retirements have on the payroll. IIEC/CUB believe Nicor Gas has a poor history of hiring FTEs when promised. IIEC/CUB believe it has offered the Commission a rational, thoughtful position, based on undisputed record evidence, on payroll expense level that is fair and justified.

### **c) Commission Analysis and Conclusion**

The Commission agrees with the Company that the Test Year FTE level should be derived from objective observations of what the Company anticipates its workforce will

need to address the test year and beyond. The Commission notes IIEC/CUB's argument that the Company's Test Year FTE level should be obtained from a historical trend was rejected by this Commission in the 2017 Rate Case. There, the Commission held Nicor Gas' future workforce needs cannot be addressed using a historical FTE average as IIEC/CUB suggest, because such analysis ignores evidence supporting the Company's need to increase its workforce size. The Commission declines to stray from that reasoning now.

Therefore, the Commission finds that Nicor Gas has met its burden establishing that the forecasted FTE level for the Test Year is reasonable. The Commission hereby adopts the Company's 1,960 FTE employees as proposed in its Test Year projections.

## **10. Incentive Compensation Expense**

### **a) Nicor Gas' Position**

Nicor Gas explains its proposed incentive compensation expense is reasonable and prudently incurred for the purpose of attracting and retaining the talent necessary to ensure that the Company continues to provide safe and reliable service to customers at reasonable cost. Nicor Gas states that it has presented substantial evidence showing that its compensation program is reasonable and consistent with market best practices in terms of compensation benchmarking approach and pay philosophy. The Company notes that no party contests the Company's total rewards compensation philosophy or the evidence showing that the Company's compensation approach is consistent with the market.

Nicor Gas agrees to withdraw its request to recover the portion of its incentive compensation costs that is based on financial performance, which satisfies the concerns of Staff and the AG. Nicor Gas notes the only contested portion of its proposed incentive compensation costs is IIEC/CUB's proposed disallowance of costs that are issued as Restricted Stock Units ("RSU"). Nicor Gas disagrees with IIEC/CUB's proposal.

The Company points out that IIEC/CUB witness Gorman incorrectly believes the costs of the RSUs are tied to financial metrics. The Company further notes that Mr. Gorman provides no evidence rebutting the Company's showing that the costs of the RSUs are not tied to financial performance of the Company. In particular, Nicor Gas presented evidence that the RSUs are stock units that vest over a defined period of time based solely on continued employment and are not subject to corporate performance measures nor based on financial metrics. The Company also notes that the same type of RSU costs were at issue in the 2017 Rate Case and that Nicor Gas was allowed to recover these costs. Nicor Gas emphasizes that IIEC/CUB withdrew its proposed adjustments to Nicor Gas' incentive compensation expense as reflected in the Final Order in that proceeding. Thus, Nicor Gas argues that the evidence shows that the RSU costs are not based on financial metrics and should be recovered in the revenue requirement.

### **b) Staff's Position**

Staff witness Trost recommends that operating expenses and rate base should be reduced for incentive compensation cost amounts which are based upon financial metrics that do not provide ratepayer benefit such as dollar savings or other tangible benefits. Staff Ex. 1.0 at 6. Ms. Trost's adjustment amounts are set forth in Staff Ex. 1.0, Schedule

1.08. Ms. Trost's recommendation is consistent with prior Nicor Gas rate orders and other utility rate orders disallowing incentive compensation costs based upon financial metrics. Staff Ex. 1.0 at 8-17.

Staff and the Company reached an agreement to remove incentive compensation costs that are based upon financial metrics, specifically those costs related to the corporate and business components of the Performance Pay Plan, and the Long-term Incentive Plans' Performance Share Unit ("PSU") goals. Staff and the Company agreed to make related adjustments to depreciation expense and accumulated deferred income tax. The adjustments are set forth in Staff Ex. 1.0, Schedule 1.08, subject to modifications Staff agreed to in response to Company DR NG Staff 3.03, which is attached as Exhibit 1 to the Stipulation. Nicor Gas-Staff Joint Ex. 1.0 at 3.

### **c) IIEC/CUB's Position**

IIEC/CUB aver that Nicor Gas initially proposed to recover costs associated with certain incentive compensation plans that were based, in whole or in part, upon the Company's financial performance. Nicor Gas Ex. 10.0 at 6-7. IIEC/CUB state that the Commission has repeatedly rejected utilities' attempts to recover costs for incentive compensation aligned with financial goals to be recovered through rates. See *N. Shore Gas Co./Peoples Gas Light and Coke Co.*, Docket Nos. 09-0166/0167 (Cons.), Order at 58 (Jan. 21, 2010) ("2009 NSG/PGL Rate Case").

IIEC/CUB further note that in a recent Illinois-American Water Company rate case, the Commission affirmed its conclusion from the 2009 NSG/PGL Rate Case, noting that "when incentive compensation seeks to achieve goals that primarily benefit shareholders, it is reasonable to require that shareholders bear the cost of that incentive compensation." *Ill.-Am. Water Co.*, Docket No. 16-0093, Order at 37-38 (Dec. 13, 2016). IIEC/CUB add that most recently, the Commission accepted an adjustment to reduce a utility's operating expenses for incentive compensation based on financial performance in September of last year. *Utility Serv. of Ill., Inc.*, Docket No. 17-1106, Order at 21 (Sep. 24, 2018).

Mr. Gorman testifies that it is not appropriate to include in the revenue requirement costs for incentive compensation programs which are designed to align the interests of executives with shareholders. IIEC/CUB Ex. 1.0 Vol. I at 24. IIEC/CUB state that in some situations, where incentive compensation is tied to customer benefits such as increased service, reliability, and/or employee safety, the costs of the programs may be incurred by customers if performance metrics are met. However, when the compensation programs are based upon financial goals, IIEC/CUB argue the program costs primarily benefit shareholders, and therefore should be paid by shareholders themselves. Not only is it consistent with regulatory practices to exclude from the revenue requirement incentive compensation costs that are related to financial goals because those costs benefit shareholders, but Mr. Gorman testified exclusion of these costs are necessary to ensure the rates set are just and reasonable. *Id.*

By way of example, Mr. Gorman explains, when incentive compensation costs are paid by shareholders, the costs are paid only where the incentive goals are achieved. *Id.* at 24-25. IIEC/CUB argue the risk to investors is balanced, as shareholders can pay for the programs out of higher earnings realized when the financial goals are achieved. Conversely, IIEC/CUB explain, ratepayers pay incentive compensation costs built into

rates regardless of whether the financial targets are actually achieved. IIEC/CUB assert this exposes customers to the risk of paying these large costs without any benefit to customers. IIEC/CUB avers that in the event that the goals are not achieved, customers would compensate Nicor Gas, who may then be unjustly enriched. *Id.* at 25.

In the present case, IIEC/CUB witness Gorman recommended in his direct testimony that the Commission disallow for ratemaking purposes \$12,031,000 of incentive compensation related to financial performance, as those costs benefit shareholders only and therefore do not provide tangible benefits to consumers. IIEC/CUB Ex. 2.0 at 11. As part of the Stipulation, Nicor Gas accepted Staff's adjustment and removed from the revenue requirement certain costs associated with compensation based upon financial performance. *Id.* IIEC/CUB aver that a portion of incentive compensation costs with which Mr. Gorman took issue remain in the Company's proposed operating expenses and should be disallowed. Additionally, IIEC/CUB argue, in the event that the Commission rejects the Stipulation, as IIEC/CUB believe it should, IIEC/CUB urge the Commission to adopt Mr. Gorman's proposal to disallow the \$12,031,000 in incentive compensation costs consistent with Mr. Gorman's rebuttal testimony.

IIEC/CUB explain that in rebuttal testimony, Nicor Gas witness Garvie testified that the Company agreed to remove costs associated with the corporate performance and financial business segment performance categories of the PPP and the PSU component of the LTI, as a part of its Stipulation with Staff. Nicor Gas Ex. 24.0 at 3. IIEC/CUB state the Company did not agree to remove the costs associated with the RSU component of LTI. IIEC/CUB Ex. 2.0 at 8. Nicor Gas alleges RSU is stock awarded over time based upon continued employment and therefore are not subject to corporate performance measures, nor awarded upon basis of financial metrics. Mr. Garvie further testified that RSU attracts and retains employees by rewarding longevity, which he claims is beneficial to customers, and therefore should be included in the cost of service. Nicor Gas Ex. 24.0 at 6-8.

IIEC/CUB point out that while Mr. Garvie testified that RSUs are based solely upon longevity, other record evidence indicates that the long-term incentive program goals are designed to reward financial performance based on evidence presented by Nicor Gas. IIEC/CUB believe that how or when the awards are given have no bearing as to their origin. IIEC/CUB refer to a statement by Nicor Gas' parent company, in which they state "The objective of the LTI is to promote strong long-term business results by rewarding continued employment and *value drivers* that distinguish the Southern Company (Southern Company or Company) *performance* in the utility industry." Nicor Gas Ex. 24.3 at 3. (*emphasis added*). IIEC/CUB argue that Nicor Gas' own evidence demonstrates that the components of the LTI program are designed to reward "business results" and "value drivers" of company performance. Mr. Gorman's incentive compensation adjustment on direct removed the full costs of the LTI program, including the cost of RSUs. IIEC/CUB Ex. 1.0 Vol. I at 26.

In rebuttal testimony, Mr. Gorman reiterated that the cost of RSUs must also be removed from the revenue requirement, as they are a component of an incentive compensation program based fully on performance metrics. IIEC/CUB Ex. 2.0 at 9. Furthermore, IIEC/CUB assert RSU awards for executive officers are specifically tied to

performance requirements. *Id.* IIEC/CUB state AG witness Selvaggio testified RSUs awarded to the executive officers of Southern Company are subject to company performance measures. AG Ex. 1.0 at 22. IIEC/CUB explain record evidence demonstrates RSUs for executives includes financial performance goals which include “Cash from Operations” “Greater than \$2.3 B” and “2017 Dividends Paid.” IIEC/CUB Ex. 2.0 at 10. IIEC/CUB note additional evidence demonstrating that the RSUs are tied to financial performance includes the materials that Southern Company Gas provided to its board as part of the compensation governance statement, which specified that “100% of short- and long-term incentive awards are performance-based.”

IIEC/CUB aver the record evidence demonstrates that the RSUs are a part of an incentive compensation program based on financial performance, and the associated costs should be removed from the Company’s operating expenses. While Nicor Gas has tried to suggest that there is a link between the RSUs and a customer benefit, IIEC/CUB argue the Company has failed to meet its burden of proof to establish a tangible benefit to ratepayers which arises from the RSUs. Accordingly, IIEC/CUB recommend these costs be denied, and the operating expenses adjusted accordingly.

#### **d) Commission Analysis and Conclusion**

The Commission finds the Company reasonably established that RSUs are stock units that vest over a defined period of time based solely on continued employment and are not subject to or based on financial metrics for the benefit of shareholders. The Commission holds that employee longevity provides a tangible benefit to ratepayers through reduced expenses and the creation of greater efficiencies in operations due to a more seasoned workforce. The Commission further finds the Company reasonably explained that RSUs for executive officers of Southern Company Gas are subject to an additional financial safeguard that ensures the award is not issued to executive officers in the event the Company’s financial situation would not support the issuance of the award. Nicor Gas ex. 24.0. The Commission understands this financial safeguard is appropriate as it serves as a benefit for ratepayers rather than shareholders. The Commission notes the record does not support IIEC/CUB’s argument that performance alone infers an underlying financial metric. Therefore, the Commission adopts the Company’s proposed incentive compensation expense.

### **11. Excess ADIT Amortization**

#### **a) Nicor Gas’ Position**

Nicor Gas proposes to amortize both the unprotected asset and unprotected liability balances over a 5-year period. Nicor Gas notes this proposal is appropriate and consistent with the amortization period previously approved by the Commission in the 2017 Rate Case. Nicor Gas adds Staff and the AG supported a compliance filing for the final amounts for the amortization of the excess ADIT baseline. Nicor Gas agreed to this proposal and recommended additional information to be included in the final schedule.

Nicor Gas disagrees with IIEC/CUB witness Gorman’s proposal to extend the amortization period on excess ADIT regulatory assets from 5 years to 22 years, while maintaining a 5-year amortization period for the unprotected ADIT liability balance. The Company argues that its proposal to amortize both the unprotected asset and unprotected

liability balances over the same 5-year period is appropriate and consistent with the amortization period approved by the Commission in the Company's 2017 Rate Case. Accordingly, the Company avers that its excess ADIT amortization proposal should be approved.

**b) IIEC/CUB's Position**

IIEC/CUB urge the Commission to adopt a 22-year amortization period for the unprotected excess ADIT regulatory asset balances. IIEC/CUB note that as a result of the Tax Cuts and Jobs Act ("TCJA"), Nicor Gas' corporate income tax rate decreased from 35% to 21%, resulting in a reduction of the cost of service in the form of income tax expense. IIEC/CUB Ex. 1.0 Vol. I at 19. IIEC/CUB explain as a further result of the TCJA income tax rate reduction, each utility was then required to re-value its recorded ADIT balances in order to reflect the new federal tax rate. *See N. Ill. Gas Co. d/b/a Nicor Gas*, Docket No. 17-0473, Order at 7 (Apr. 19, 2018). The TCJA likewise affects Nicor Gas' ADIT, which was collected from customers at the 35% rate, but is now payable at the 21% rate under the TCJA. Because the federal income tax rate has been reduced by 14%, the ADIT collected in past periods now exceeds Nicor Gas' future income tax liability. IIEC/CUB Ex. 1.0, Vol. I at 19.

IIEC/CUB point out the Company identified two separate categories of excess ADIT and determined the amount to be returned to ratepayers in each category. The first, referred to as "protected" excess ADIT, is subject to Internal Revenue Code ("IRC") normalization rules in determining the amortization period under which the excess ADIT will be returned to customers. *Id.* at 20. Nicor Gas proposes to amortize these balances over an approximate 22-year period, which IIEC/CUB explain is appropriate and consistent with the IRC normalization rules. *Id.* IIEC/CUB note the second category is known as "unprotected" excess ADIT, which need not follow IRC normalization rules. *Id.* IIEC/CUB add the Commission may use its discretion to set the amortization period. *See Commonwealth Edison Co.*, Docket No. 18-0808, Order at 57 (Dec. 4, 2019).

IIEC/CUB explain unprotected excess ADIT balances can be further broken out into excess ADIT regulatory "liabilities" and "assets." IIEC/CUB Ex. 1.0 Vol. I at 20. The unprotected excess ADIT classified as regulatory liabilities reflect collections of income tax from customers in the past that must be refunded to customers over the amortization period determined by the Commission. *Id.* at 20. Nicor Gas proposes to amortize the unprotected balances over a five-year period, consistent with the Commission's determination that this period would be appropriate according to the 2017 Rate Case. *Id.* IIEC/CUB explain the five-year amortization period for the entire unprotected excess ADIT balance is unreasonable, considering Nicor Gas holds a significant balance of unprotected excess ADIT regulatory assets.

IIEC/CUB witness Gorman testifies that it is appropriate to amortize the excess ADIT liabilities over a relatively short period of time, as they reflect cost collections from customers for income tax purposes that are now in excess of the future tax liabilities. IIEC/CUB argue those classified as regulatory assets represent investment costs for specific assets incurred by Nicor Gas that should be amortized over the expected operating life of the asset. IIEC/CUB argue utilization of the operating life of the assets as an amortization period ensures that all customers pay a prorated share of the costs of

operating the asset, including unrecovered deferred taxes incurred by the utility relative to the asset. IIEC/CUB state this methodology equitably aligns the costs of the asset to the customer with the period of time that customers receive service for the asset. Furthermore, by carrying the unamortized balance of excess ADIT regulatory assets, IIEC/CUB argue Nicor Gas will be allowed to include these as a reduction for total ADIT, and essentially earn a carrying charge on the unamortized regulatory assets. Mr. Gorman testified that this amortization treatment reasonably spreads the costs of the excess ADIT regulatory assets over the life of the plant assets and is equitable for the Company and customers alike. *Id.* at 21-22.

IIEC/CUB note that in rebuttal testimony, the Company disagreed with Mr. Gorman's proposal to amortize the unprotected excess ADIT asset balances over 22 years. Nicor Gas Ex. 19.0R at 27. Nicor Gas witness Morley testified that the Company considers its proposal to amortize both the unprotected asset and liability balances over the same number of years to be appropriate and consistent with the amortization period approved by the Commission in the 2017 Rate Case. *Id.* IIEC/CUB aver Mr. Morley provided no additional support for the position beyond the quoted statement, nor did he dispute any of Mr. Gorman's statements on the topic. *Id.* Furthermore, IIEC/CUB note neither Mr. Morley nor any other Nicor witness testified that Mr. Gorman's proposal was unreasonable. Nicor Gas did opine that if IIEC/CUB's position is adopted, a corresponding adjustment to rate base should be made. *Id.*

IIEC/CUB argue that their proposal to amortize excess ADIT regulatory assets over the life of those assets is reasonable, equitable to both customers and Nicor Gas alike, and should be adopted. IIEC/CUB explain the Company's argument that the Commission's finding in a previous docket establishes the amortization period for excess ADIT in this case ignores the undisputed evidence in this record, that Mr. Gorman's proposed treatment of excess ADIT is more reasonable and balanced. IIEC/CUB do not oppose Nicor Gas' recommendation to make a corresponding rate base adjustment if its excess ADIT amortization adjustment is adopted.

The impact of this adjustment is shown in IIEC/CUB Exhibit 1.3, which demonstrates Nicor Gas' income tax expense would be reduced by \$5.6 million. The impact on the revenue requirement is \$7.9 million. IIEC/CUB Ex. 1.0 Vol. I at 22.

### **c) Commission Analysis and Conclusion**

The Commission notes the parties agree a 22-year amortization period is appropriate for protected excess ADIT, as it is consistent with IRC normalization rules. The Commission also notes the parties agree a 5-year amortization period is appropriate for unprotected excess ADIT liabilities. IIEC/CUB explain the relatively short period of time is appropriate here as it reflects cost collections from customers for income tax purposes that are now in excess of the future tax liabilities.

Nicor Gas and IIEC/CUB disagree on the appropriate amortization period proposed for unprotected excess ADIT assets. Nicor Gas proposes to utilize a 5-year amortization period for unprotected excess ADIT assets. The Company explains its proposal to amortize both unprotected excess ADIT liabilities and assets over a 5-year amortization period is consistent with the amortization period agreed to by the parties and approved in the 2017 Rate Case. IIEC/CUB argue that excess ADIT assets should be

amortized over a longer 22-year period, since these costs are related to specific assets and should be amortized over the expected operating life of the corresponding assets.

The Commission finds the Company's proposal to amortize both the unprotected excess ADIT asset and unprotected excess ADIT liability balances over a 5-year period is reasonable. IIEC/CUB failed to provide convincing justification as to why unprotected assets should be amortized across a longer span than unprotected liabilities. Under IIEC/CUB's proposal the Company would return excess ADIT liabilities to ratepayers over 5 years, while collecting excess ADIT assets for over 22 years. The Commission therefore adopts the Company's excess ADIT amortization period.

## **VI. REVENUES**

### **A. Overview**

Nicor Gas' Test Year includes a forecast for revenues for the 12-months ending September 30, 2020. The Company states that it used the same approach to forecast revenues that the Commission found reasonable in Nicor Gas' last rate case. The Company asserts that the AG seeks to artificially inflate test year revenues through several proposed adjustments in an effort to unreasonably reduce the Company's revenue requirement increase.

### **B. Uncontested Issues**

#### **1. Reconnection Fee Adjustment**

Nicor Gas initially proposed to increase the service reconnection charge to more accurately reflect the increased cost associated with reconnection. Nicor Gas and Staff agree by stipulation to maintain the current service reconnection fee of \$74. No other party addressed this topic. As a result, this issue is uncontested and is approved.

### **C. Contested Issues**

#### **1. Forecasted Commercial Sales**

##### **a) Nicor Gas' Position**

Nicor Gas states that it examined historical customer count and use-per-customer data for each customer category to identify trend information in order to develop a forecast of test year throughput, or deliveries of gas to customers. The Company explains that customer count trends were applied to the actual May 2018 customer count figures to forecast customer count for the Test Year. The Company adds that a three-year historical average of the use-per-customer was used to determine the forecasted use-per-customer in the Test Year for commercial heating and non-heating customers, and that it is reasonable to use this commercial sales forecast.

The Company argues the AG's proposal to inflate commercial sales in the Test Year is undermined by the fact that its witness failed to consider the trend showing the historical and ongoing reduction in the number of commercial sales customers. In doing so, the Company argues that the AG's approach fails to capture the importance of customer count as part of the forecast, as deliveries vary in proportion to the number of customers served. Nicor Gas explains that when that decline is considered, that amounts to an approximately 42 million therm decline in commercial customer usage, and that

decline more than offsets the AG's proposed increase in therm usage. Accordingly, the Company concludes that there is no basis to adopt the AG's proposal to increase commercial sales beyond the Company's forecast for the Test Year.

### **b) AG's Position**

The AG asserts that the Commission should increase the commercial sales volumes used by Nicor Gas in its test year by \$1.95 million to reflect actual experience and increase commercial revenues under present rates. The AG notes that when sales volumes are under-estimated, the utility's rates are marginally higher to assure that the revenue requirement is met. Tr. at 47.

The AG relies on AG Exhibit 9.1 to demonstrate that Nicor Gas under-estimated its commercial sales volumes. The Commission should reject this low estimate because the actual data for the twelve months ending September 30, 2018 show commercial volumes higher than for any of the last three actual years. AG Ex. 2.0 at 7; AG Ex. 9.1. Both commercial sales and commercial transportation customers' sales volumes were higher in 2018 than in prior years. *Id.* The AG states that Nicor Gas has understated commercial revenues by approximately 6% below the weather normalized 2018 commercial sales volumes, which is unreasonable given the steady increase in commercial sales over the last three years. AG Ex. 2.0 at 7.

Nicor Gas witness Yardley asserted that the commercial volumes could be decreased because the number of commercial customers has decreased. Nicor Gas Ex. 27.0 at 21. However, the AG highlights that on cross-examination, Mr. Yardley conceded that total weather normalized throughput "reflects the changes in customer count and all other factors that reflect throughput." Tr. at 52.

To achieve a reasonable and accurate level of commercial sales, AG witness Effron averaged the annual, actual weather normalized commercial volumes for the three years ended September 30, 2018. The effect of using the three-year average of actual sales is to increase commercial sales volumes by 17,499,000 therms and to increase commercial transportation volumes by 30,766,000 therms. This change in volumes increases pro forma test year commercial base rate revenues under present rates by \$1,950,000.

### **c) Commission Analysis and Conclusion**

The Commission declines to adopt the AG's approach as it does not consider the Company's expected decline in average customer count during the Test Year. The Commission finds that the Company's methodology to calculate forecasted commercial sales for the Test Year is reasonable as it accounts for the projected number of customers and utilizes a three-year historical average use-per customer to calculate projected sales.

## **2. Leap Year Adjustment**

### **a) Nicor Gas' Position**

Nicor Gas' Test Year falls during a leap year, which has one additional day in the calendar year (366 days). The Company included a leap year adjustment to remove  $\frac{3}{4}$  of one day's expenses and revenues from the Test Year. The AG proposes to eliminate the leap year adjustment, on grounds that the Company has not proposed such an

adjustment in rate cases where the test year does not fall on a leap year. Nicor Gas responds that the Company had, in fact, proposed a leap year adjustment the last time it filed a rate case with a test year falling in a leap year, Docket No. 95-0219, and that the Commission accepted the adjustment. Nicor Gas states that the AG offered no rebuttal testimony in response to this point and avers that the AG's proposal to eliminate the leap year adjustment should be rejected.

**b) AG's Position**

The AG requests that the Commission reject Nicor Gas' leap year adjustment that marginally increases the revenue requirement, arguing that it is unnecessary and one-sided. The adjustment to which the AG objects would remove three-quarters of one day of revenues and expenses from Nicor Gas' test year, 2020, which is a leap year containing 366 days. Under Nicor Gas' proposal, over four years, the average number of sales and expense days would be 365.25. AG Ex. 2.0 at 8. AG witness Effron objected to this adjustment, citing the need for ratemaking consistency over multiple years. The AG argues that Nicor Gas' leap-year adjustment is unreasonable because Nicor has not proposed a 365.25-day year for years that are not leap years. AG Ex. 2.0 at 8-9.

The AG contends that Nicor Gas' adjustment only makes sense if it is applied every year, and for every utility. The AG asserts that since the Commission has not espoused such a policy, it should not adopt Nicor Gas' leap year adjustment, which has the effect of lowering the Company's revenues and expenses. Instead, the AG requests that the Commission adopt Mr. Effron's approach and not adjust revenues and expenses when the test year consists of 366 days. Rejecting Nicor Gas' proposed adjustment increases *pro forma* test year revenues under current rates by \$614,000, and increases *pro forma* test year expenses, other than income taxes, by \$369,000. *Id.*

**c) Commission Analysis and Conclusion**

As an initial matter, the Commission recognizes that it previously approved a leap year adjustment in the last Nicor Gas rate case with a test year falling in a leap year, Docket No. 95-0219. The Commission also agrees with the AG that consistency is an important consideration. Accordingly, given that the Commission has accepted this adjustment previously, we decline the AG's proposal to eliminate the leap year adjustment in this proceeding.

**3. PHS Billing Service Revenue**

**a) Nicor Gas' Position**

Nicor Gas argues that the AG's proposal to impute an additional \$0.03 per bill charge to PHS lacks evidentiary support and is inconsistent with a prior Commission order. The Company explains that it has offered billing services to third-parties for many years, including PHS. Nicor Gas states that the billing charges for PHS were developed on a fully distributed cost basis, and the Commission approved the level of charge in Docket No. 08-0363. Nicor Gas further explains that in 2018 it updated its cost study, using the Commission's approved methodology, to confirm that the rate charged to PHS was appropriate. On this point, the Company argues that the AG fails to acknowledge that PHS's current billing charge is based on the 2018 cost study. Meanwhile, the

Company points to evidence showing that it plans to continue to update the cost study for PHS's charges on an annual basis and make revisions as necessary.

In addition to the fact that the \$0.22 per bill charge to PHS for billing service is supported by a current cost study, Nicor Gas argues that there is no basis for the AG's adjustment because there is a reasonable rationale for the difference in pricing for the billing service provided to PHS. The Company explains that the billing service Nicor Gas provides to PHS is demonstrably different from what is offered to Customer Select suppliers. First, the Company notes that PHS is subject to other charges that are not applicable to other third parties, such as bill messages or additional line items on a bill. Second, the Company also notes that the charge PHS assesses to customers does not vary from month-to-month, which makes its billing services less costly to administer compared to Customer Select suppliers. The Company asserts that the AG does not respond to Nicor Gas' reasoning or provide further evidence in support of its position. Accordingly, the Company avers that the facts establish that there is no reasonable basis to impute \$104,700 in additional Test Year revenues.

#### **b) AG's Position**

As discussed further in the Third-Party Billing Service Tariff section, the AG urges the Commission to order Nicor Gas to cease providing billing services on Nicor Gas customer bills to Nicor Gas' former affiliate, PHS, in Illinois. AG witness Selvaggio testified that discontinuing that billing relationship would decrease Nicor Gas' test year revenues by \$768,000, reflecting the removal of current billing revenues from PHS. AG Ex. 8.0 at 26. The AG suggests that the Commission adopt this adjustment should it adopt Mr. Rubin's recommendation to order Nicor Gas to cease its billing relationship with PHS.

The AG adds that if the Commission disagrees and concludes that Nicor Gas should be allowed to continue billing ratepayers for non-utility products and services for PHS on its utility bills, then the billing service revenues for PHS would need to be increased to reflect AG witness Rubin's recommended an increase in billing rates for third parties from \$0.25/bill to \$0.36/bill as calculated on AG Ex. 8.1, Sch. C-7, as discussed below.

#### **c) Commission Analysis and Conclusion**

The Commission finds that Nicor Gas' charge to PHS is based on an updated cost study, using a Commission-approved methodology, and is reasonable and appropriate. Additionally, the Company has explained why its charge to PHS is different than the charge to other third-parties. The Company states that the billing procedure for Customer Select suppliers is more complex and administratively costly than the billing procedure for PHS, due to differences in their charging practices. The Commission finds this rationale persuasive and declines to adopt the AG's proposal.

### **4. Third-Party Billing Service Charge**

#### **a) Nicor Gas' Position**

Nicor Gas states that it charges Customer Select suppliers \$0.25 per bill for the provision of billing service. The Company explains that the Commission previously approved this charge, and it is reflected in the Company's tariffs. The Company opposes the AG's proposal to increase the current per-bill charge by 45%, or to \$0.36 per bill, in

this rate case. In support of its position, Nicor Gas argues that the AG failed to demonstrate that the current charge under-recovers the cost to provide billing service to Customer Select Suppliers, as the AG presented no evidence to that effect. The Company states that the AG relies on the incorrect assertion that its witness has demonstrated that the Company's costs to provide billing service to third-parties has increased by 45%. Nicor Gas states that AG witness Rubin notes only that the Company's aggregate billing and collections expense increased over a period of time. However, he did not present any evidence showing that Nicor Gas' cost specific to provide billing service to third-parties had increased. Consequently, the Company argues that absent any evidence showing that the current per-bill charge fails to recover the Company's cost of service, there is no basis to increase the current charge.

The Company has proposed an alternative solution, which it argues is reasonable. Specifically, Nicor Gas has committed to providing an updated cost study specific to analyzing the cost of third-party billing service in its next rate case. The Company contends that this proposal is consistent with long-standing regulatory policy to set rates based on cost-causation principles. Under its proposal, the Company will examine whether the costs unique to provide billing service to the third-parties have increased. If so, Nicor Gas will propose a cost-based adjustment to the charge in its next rate case.

Given the foregoing, the Company argues that there is no basis to impute revenues equivalent to a \$0.36 per-bill charge for billing services provided to Customer Select Suppliers. As such, Nicor Gas states that the AG's proposal to impute revenues associated with its proposed rate increase should be rejected.

#### **b) AG's Position**

The AG contends that Nicor Gas should increase the third-party billing service charge in its tariff to reflect its current associated costs. The AG asserts that the record shows that Nicor Gas has not re-evaluated the rate charged to third parties for billing service in nearly 20 years. Tr. at 225. AG witness Rubin recommended that the rate for providing third-party billing service be increased. Nicor Gas' current tariff authorizes a rate of \$0.25 per bill for third-party billing service. The AG maintains that the Commission's past approval of an alternative fee schedule for PHS in Nicor Gas' 2008 rate case, Docket No. 08-0363, was issued when PHS was an affiliate of Nicor Gas. AG Ex. 4.0 at 30. Nicor has since sold PHS to American Water Enterprises LLC, which the AG argues makes it a third party like any other and therefore subject to the same billing charges as any other unaffiliated third party. *Id.* at 28.

Mr. Rubin calculated that in the years since the 25-cent-per-bill charge was established, Nicor Gas' billing and collections costs have increased by approximately 45%. Based on his calculation, the AG requests that if the Commission permits Nicor Gas to continue its current billing relationship with PHS, the charge for third-party billing should be increased by 45%, consistent with the increase in overall billing costs, to 36 cents per bill. *Id.* at 33. AG witness Selvaggio quantified that increasing the billing service rate to 36 cents per bill would increase billing service revenues for PHS by \$498,000 to \$1,255,000. AG Ex. 8.0 at 26.

In support of this adjustment, the AG cites Nicor Gas witness Mathews' admission in testimony that 25-cent amount is "based on dated information" and Nicor witness

Hotchkiss' statement on cross-examination that Nicor Gas has not revisited the amount of this charge in nearly 20 years. Nicor Gas Ex. 22.0 at 9; Tr. at 225. In response to Nicor Gas' assertions that increasing the third-party billing charge in proportion to Nicor Gas' increased customer records and collections expense is an "overly simplistic" approach that is "contrary to cost-causation principles," the AG argues that Nicor Gas admitted the need for the adjustment, which is based on Nicor Gas' own cost of service study submitted in this docket, and that Nicor Gas offered no alternative means to calculate the amount based on the information in the record. Nicor Gas Ex. 26.0 at 9-10.

While Nicor Gas committed to providing an updated analysis of third-party billing costs in the next rate case, the AG counters Nicor Gas' request to delay consideration of the issue until its next rate case by stating that Mr. Rubin's recommended 45% increase in the fee is appropriate based on Nicor Gas' current cost of service study in the record and that if Nicor Gas' future studies show a need for further refinement, Nicor Gas can recommend an appropriate remedy in its next rate case. The AG further notes that the delay Nicor Gas seeks would be indefinite, as Nicor Gas has not indicated when it will file its next rate case. Tr. at 68-69.

Further, the AG argues that Nicor Gas is violating its tariff by undercharging PHS for third-party billing service and requested that the Commission credit customers for the amount that PHS is undercharged. The AG observes that Nicor Gas collects only 22 cents per bill from PHS for third-party billing service, which is less than the 25-cent third-party billing service charge stated in Nicor Gas' tariff that the utility charges other third parties. AG Ex. 4.0 at 28, 29-31. The only other party for which Nicor Gas provides third-party billing service at a rate other than the tariffed 25 cents per bill is Illinois Energy Services (formerly known as Nicor Advanced Energy), which is an affiliate.

The AG contends that by offering PHS a lower billing service rate than other unaffiliated third parties, Nicor Gas violates its tariff. Although PHS, when it was a Nicor affiliate was apparently granted a lower billing rate, PHS has had no affiliate relationship with Nicor Gas since the sale of PHS in June of 2018, and as an unaffiliated third party, the AG argues that PHS is subject to the same 25-cent charge Nicor Gas' tariff applies to all third parties. AG Ex. 4.0 at 28 (quoting Nicor Gas' Tariff Ill.C.C. No. 16 – Gas, 6th Rev. Sheet No. 52.5 (eff. Apr. 3, 2009)). By continuing to charge PHS 22 cents per bill charge, the AG maintains, Nicor Gas is denying ratepayers the benefit of the increased revenues as well as discriminating against other third parties. To remedy this alleged revenue shortfall, the AG requests that if the Commission continues to allow Nicor Gas to bill on behalf of PHS, the Commission should recognize a \$104,700 increase in revenue attributed to PHS to make up for the amount that Nicor Gas underbills PHS. *Id.* at 31; see also AG Ex. 1.1, Sch. C-7 (reflecting this adjustment).

The AG responds to Nicor Gas' assertion that the utility's contract provides for a lower charge to PHS based on a fully distributed cost study by citing the tariff's explicit statement that the charge for third-party billing service is 25 cents per bill and the lack of any language in the tariff providing for a lower charge. Nicor Gas Ex. 26.0 at 5-7. The AG quotes the tariff as referring to "any party desiring to have Nicor Gas to include its charges to the customer Nicor Gas' bill" and establishing a 25-cents-per-bill charge as the floor. The AG notes that the tariff provides for "additional fees," for "additional services," but it does not provide for charging third parties less than 25 cents per bill for

billing service. AG Ex. 4.0 at 28 (quoting Nicor Gas' tariff Ill.C.C. No. 16 – Gas, 6th Rev. Sheet No. 52.5 (eff. Apr. 3, 2009). The relevant tariff language reads:

**Third Party Billing Service.**

Any third party desiring to have Nicor to (*sic*) include its charges to the customer on Nicor's bill shall enter into Nicor's standard contract that stipulates the procedures to be followed. Nicor will provide up to six (6) standard lines of text that may be used by the third party. Nicor will process customer payments in a timely manner and will electronically forward payments to the third party's bank account and notify the third party of the customer's payment on a daily basis. *The fee for billing and payment processing will be \$0.25 per bill.* If the third party would like additional services with respect to billing, Nicor and third party will negotiate in good faith the fees for such additional services. Nicor will report these additional services and fees to the Illinois Commerce Commission as assurance that any such additional services and fees are being offered on a nondiscriminatory basis.

*N. Ill. Gas Co. d/b/a Nicor Gas Co., Ill.C.C. No. 16 – Gas, 6th Rev. Sheet No. 52.5 (eff. Apr. 3, 2009) (emphasis added).*

The AG cites Illinois Supreme Court precedent establishing that a tariff is approved by the Commission and “has the force and effect of a statute.” *Sheffler v. Commonwealth Edison Co.*, 955 N.E.2d 1110, 1119 (2011); *Adams v. N. Ill. Gas Co.*, 211 Ill. 2d 32, 55 (2004). Wherever a contract conflicts with the tariff, the AG asserts, the tariff controls. In this case, the AG posits that the tariff requires Nicor Gas to charge an unaffiliated third party at least 25 cents for each Nicor Gas customer bill that includes the third party's charges.

If the Commission allows Nicor Gas to continue billing on PHS's behalf, the AG requests that the rate for billing service for PHS be updated. The AG contends that the charge should be based on the third-party billing service rate stated in Nicor Gas' tariff, which is currently \$0.25 per bill. This adjustment would not affect the billing service charge for third parties other than PHS. Mr. Rubin estimated that increasing PHS's billing service charge from \$0.22 to \$0.25 per bill would result in an increase in billing revenues for PHS of \$104,700. AG Ex. 4.0 at 31.

**c) ICEA's Position**

ICEA requests that the Commission adopt Nicor Gas' position of maintaining the current per bill charge for Customer Select participants using Nicor Gas' billing services and reject the AG's proposed per bill increase.

ICEA agrees with the analysis provided by Nicor Gas. While ICEA does not dispute that the AG has provided ample evidence to justify Commission review of Nicor Gas' costs to provide Customer Select billing services, the absence of any record evidence specific to those costs prevents the AG from carrying its evidentiary burden to support an increase in the per-bill charge. Historically, the Commission has taken a

cautious approach to modifying fees when the Commission believes the record is incomplete. In Docket No. 08-0532, the Commission found sufficient evidence to cast doubt on ComEd's allocation of Customer Care Costs to the supply and delivery function to order ComEd to undertake a study of how to allocate those costs but insufficient evidence to actually modify that allocation. ICEA notes that Docket No. 08-0532 was opened in part to investigate these costs, but the Commission nevertheless found that the record was sufficient to direct further study but insufficient to direct specific changes.

#### **d) RESA's Position**

RESA agrees with Nicor Gas that the AG's proposal should be rejected and Nicor Gas' alternative proposal of conducting an analysis of the costs of third-party billing services in its next rate case should be accepted. The AG's proposal is based on AG witness Rubin's recommendation and was fully refuted by the rebuttal testimony of Nicor Gas witnesses Mathews and Hotchkiss in this proceeding. Nicor Gas Ex. 22; Nicor Gas Ex. 26.

In rebuttal, Mr. Matthews pointed out that Mr. Rubin proposes to increase the charge for third-party billing service without arguing that the current 25 cent per bill charge under-recovers Nicor Gas' actual cost to provide the third-party billing service. Nicor Gas Ex. 22 at 9. RESA agrees that only with a cost study analyzing the cost of third-party billing services can an appropriate charge be established.

RESA states that the AG ignores the surrebuttal testimony of Mr. Mathews where he reiterates that the AG's witness did not provide any evidence showing that Nicor Gas' overall billing costs are directly related to the bill charge for third-party billing. Thus, there is no cost causation justification for the AG's proposal. Nicor Gas Ex. 36 at 6. Mr. Mathews also pointed out the risks associated with revising a customer charge without any evidence of cost causation—namely that speculative change would increase the risk of subsidization. As an example, he stated that if the specific third-party billing cost study reflected a cost of 21 cents per bill, less than the 25 cents currently charged, then the AG's proposal creates more subsidization by customers. He concludes that a detailed cost study, which Nicor Gas has already agreed to provide in its rate case, eliminates this risk of cross-subsidization. Mr. Morley accurately characterizes the AG's recommendation as "premature, speculative and unsupported by evidence". *Id.* at 6-7.

There are a number of arguments that the AG raises in support of its position that are without support. First, the AG argues that no Nicor Gas witness "proposed an alternative approach". However, both Nicor Gas witnesses proposed the appropriate regulatory approach—perform a cost study in Nicor Gas' next rate case to determine whether Nicor Gas' current charge for third-party billing services recovers the cost of such services.

Second, the AG disingenuously claims that both Nicor Gas witnesses "conceded" that the current 25 cent charge is "outdated." *Id.* A review of the cited basis for this claim shows that Mr. Matthews stated that the current charge is based on "dated information". Nicor Gas Ex. 22 at 9. This simply means that the charge is based on a cost study performed at an earlier date but does not mean that the charge is not appropriate. "Outdated" implies that the charge is no longer appropriate because it is based on out of date information. However, absent the cost study proposed by Nicor Gas, this is nothing

more than conjecture. Ms. Hotchkiss simply stated that “some time has passed since this charge was reviewed” and because of this she stated that Nicor Gas is committed to providing an updated analysis of the cost of providing third-party billing services in its next rate case. Nicor Gas Ex. 26 at 10.

Third, the AG argues that there is no reason to wait because its witness has “already demonstrated that the associated costs have increased 45% and that according to Ms. Hotchkiss’ cost causation principles, the charge should be increased by 45%”. However, RESA points out that Mr. Rubin did not demonstrate that the costs of third-party billing services have gone up by 45%, because there is no updated analysis of the cost of providing such services. Ms. Hotchkiss’ proposal that Nicor Gas perform an updated cost analysis is consistent with cost causation principles. Again, without such a study, it is not possible to know whether the current 25 cent charge is too low, too high, or just right.

Fourth, the AG disingenuously claims that the “modernization” of the third-party billing charge will increase revenues to Nicor Gas. While RESA is not exactly sure what “modernization” means in this context, slapping an arbitrary 45% increase on a charge does not make it “modern”. Moreover, increasing the third-party billing charge will not result in an increase in revenues to Nicor Gas; the increase in revenues from third-party billing services would be offset by reductions in revenues from other customers in this case according to the proposal of the AG’s witness. AG Ex. 4.0 at 33. Presumably, this is the motive for the AG’s arbitrary proposal.

Finally, the AG requests that the Commission adopt its witness’ recommendation and order Nicor Gas to increase its third-party billing charge by 45% to “reflect current costs, pending Nicor’s review of the cost of this service”. Initially, RESA reiterates that a \$0.36 charge per bill does not reflect “current costs” because it is not possible to know what current costs are without a cost study. However, more importantly, the AG is recommending that the Commission order an increase in charges and determine later, based on a cost study, whether the increase was appropriate. This recommendation flies in the face of cost of service principles and begs the question of what can be done if the cost study determines that the charge should be less than 36 cents, possibly that it should remain at 25 cents or lower. Under the filed rate doctrine, there can be no refund for parties utilizing third-party billing services who were required to pay a charge that has no basis in fact.

#### **e) Commission Analysis and Conclusion**

The Commission agrees with Nicor Gas, RESA and ICEA that the Company should conduct a cost study related to the billing service charge before imposing a 45% increase in the per-bill charge to Customer Select suppliers for billing service. The Company has committed to providing an updated analysis of the cost of third-party billing service in its next rate case, and the Commission finds that Nicor Gas’ proposal provides a reasonable course of action to address this issue. Therefore, the Commission finds the AG’s proposal to increase rates for third-party billing services to be inappropriate and premature at this time and declines to adopt it, as well as the AG’s corresponding proposal to impute additional Test Year revenues based on that increase.

## VII. RATE OF RETURN

### A. Overview

The rate of return (“ROR”) is developed from a utility’s cost of capital. The overall cost of capital for a public utility equals the sum of the costs of the components of the capital structure (i.e., short-term debt, long-term debt, and common equity) after weighting each by its proportion to total capital. Staff Ex. 4.0 (Public) at 3.

As per the Stipulation, Nicor Gas and Staff recommend a test year capital structure containing 54.20% common equity, 40.90% long-term debt, and 4.90% short-term debt. Nicor Gas and Staff stipulate that the overall cost of capital is 7.2675%. IIEC/CUB recommend a capital structure consisting of 52.000% common equity, 45.581% long-term debt, and 2.419% short-term debt. IIEC/CUB’s overall recommended ROR is 7%.

Nicor Gas and Staff propose a 9.86% return on equity (“ROE”), which is based on a range of estimates provided by witnesses for Nicor Gas, Staff and IIEC/CUB. IIEC/CUB recommend a ROE of 9.2%, which is a midpoint of IIEC/CUB witness Gorman’s recommended range of 8.90% to 9.5%.

The AG did not offer any evidence or argument but supports IIEC/CUB’s capital structure and ROE and the Stipulation’s cost of short-term and long-term debt.

### B. Uncontested Issues

#### 1. Remaining Construction Work-In-Progress (“CWIP”) Accruing Allowance for Funds Used During Construction (“AFUDC”) Adjustment

Staff witness Phipps recommends in her direct testimony that the Company’s long-term debt and common equity balances should be adjusted to recognize the Commission’s formula for calculating an AFUDC. Because the Stipulation includes long-term debt and common equity balances that resolve all issues between Staff and the Company, this issue is no longer contested.

#### 2. Cost of Debt

##### a) Cost of Short-Term Debt, Including Credit Facility Fees

The Stipulation recommends a 2.494% cost of short-term debt for the Test Year, with 2.2 basis point adder to overall cost of capital to account for commercial paper fees. The record supports this cost, and it is adopted.

##### b) Cost of Long-Term Debt

The Stipulation recommends a 4.350% cost of long-term debt for the Test Year. The record supports this cost, and it is adopted.

### C. Contested Issues

#### 1. Capital Structure

##### a) Nicor Gas’ Position

Nicor Gas argues that the capital structure recommended by the Company and Staff is reasonable and appropriate, and that no party has provided a legitimate reason

for it to be rejected. Nicor Gas and Staff propose a Test Year capital structure containing 54.20% common equity, 40.90% long-term debt, and 4.90% short-term debt. Nicor Gas states that, in addition to being reasonable and appropriate, this capital structure takes into account material changes since the last rate case, including important changes in tax laws worked by the TCJA, Public Law 115-97, and is undeniably realistic, as it is the capital structure being implemented now.

Nicor Gas also points out the Stipulation's recognition that substantial evidence supports the components of, including the level of equity in, Nicor Gas' capital structure, for ratemaking purposes, with proposed equity ratios as follows: Nicor Gas, 54.354%; Staff, 54.414%; and IIEC/CUB, 52.0%. The record contains substantial evidence supporting the level of long-term debt in Nicor Gas' capital structure, for ratemaking purposes, with proposed long-term debt ratios as follows: Nicor Gas, 43.227%; Staff 43.213%; and IIEC/CUB, 45.581%. The record also contains substantial evidence supporting the level of short-term debt in Nicor Gas' capital structure, for ratemaking purposes, with proposed short-term debt ratios as follows: Nicor Gas, 2.419%; Staff 2.373%; and IIEC/CUB adopted the Company's short-term debt ratio of 2.419%.

Nicor Gas states that the capital structure proposed in the Stipulation is supported by experienced, professional financial management. Further, the Company states that there is no evidence that it lies outside the range of reasonable capital structures or represents imprudent financial management. Nicor Gas states that no party has disputed the need for a strong capital structure, and the capital structure proposed in the Stipulation supports the Company's essential capital investment program, achieves the accepted goals of capital market access and financial resiliency, and properly accounts for the recent change in the tax laws. Nicor Gas further states that the reasonableness of this capital structure is supported by the fact that even before the development of the Stipulation, Staff supported a largely similar capital structure for the Company.

Nicor Gas explains that a significant consideration in Nicor Gas' proposed capital structure is the greater use of common equity as a result of recent changes made to the federal tax law, through the TCJA, a change that also affects other natural gas utilities and their capital structures. Nicor Gas further explains that the TCJA could negatively affect utilities' creditworthiness and impair their ability to meet credit metrics if adjustments were not made, as acknowledged by credit rating agency publications. The Company states that, because of the change in the federal corporate tax rate, utilities collect a lower amount of tax from customers, resulting in lower cash flow and a lower Funds from Operations ("FFO") to debt ratio. The Company further explains that the TCJA also excluded public utility property from bonus depreciation eligibility, further reducing the cash flow contribution from deferred taxes. The Company states that utilities and regulators nationwide have responded to the TCJA by issuing credit-supportive orders and by approving higher common equity ratios that compensate for the effects of the TCJA. Nicor Gas states that it calculated the impact of the TCJA on its FFO to debt under various potential outcomes and concluded that an increased common equity balance is necessary to produce credit metrics within the target range of the credit rating agencies in order to maintain Nicor Gas' high credit quality. Nicor Gas further stated that by modestly increasing its common equity ratio to the 54.2% ratio included in the Stipulation, Nicor Gas can maintain its quality credit rating and the reliable and reasonably-priced

access to financial markets it has long enjoyed, both of which benefit the Company's customers.

Nicor Gas states that its proposed capital structure is not a hypothetical capital structure and it represents how Nicor Gas actually expects to finance the Company's natural gas utility services and is consistent with the Company's current actions and financing plans. Further, Nicor Gas points out that the 54.2% common equity balance proposed in the Stipulation is the same as the Company's actual common equity balance for the 12 months ending September 30, 2018. The Company further argues that no party has indicated that Nicor Gas' capital structure is not representative of its actual plans for the Test Year, or that any other proposal is more representative of Nicor Gas' actual plans for the Test Year. Nicor Gas argues that there is no basis for displacing its proposed capital structure with a higher risk artificial capitalization for ratemaking purposes.

Nicor Gas states that the only contested issue in the capital structure is IIEC/CUB's recommendation that the Company increase its borrowing and reduce its Test Year common equity balance. Nicor Gas argues that IIEC/CUB's proposal relies almost entirely on backward-looking averages that include periods when Nicor Gas' investment and capital needs, as well as tax and bonus depreciation rules critical to credit metrics, were different. Nicor Gas argues that IIEC/CUB's recommendation is not supported by the evidence.

Nicor Gas opposes IIEC/CUB's argument that a common equity ratio of 52% will produce credit metrics supporting the benchmarks necessary to support Nicor Gas' bond rating. Nicor Gas argues that this assertion is based on IIEC/CUB witness Gorman's flawed and inapplicable FFO to debt calculation which, among other things, ignores the fact that more capital-intensive companies can be more seriously affected by loss of bonus depreciation. Nicor Gas further argues that actual Nicor Gas data shows that the loss of bonus depreciation alone has a profound impact on the Company's credit metrics, reducing cash flows by approximately \$71,000,000 and decreasing FFO to debt by over 400 basis points.

Nicor Gas contends that IIEC/CUB's proposed capital structure should not be adopted because, in addition to being based on backward looking and flawed analyses, it is unreasonable. Further, Nicor Gas argues that the evidence does not show that Nicor Gas' choice is imprudent or unreasonable, nor does it provide a basis to overrule the considered judgment of the Company's experienced financial management.

#### **b) Staff's Position**

Initially, Ms. Phipps recommended adopting the Company's forecasted capital structure with three adjustments. Staff explains that the first adjustment was to the long-term debt and common equity balances to reflect the Commission's formula for calculating an AFUDC. Staff Ex. 4.0 (Public) at 3-5. The second adjustment was to weight the new indebtedness that the Company expects to issue during the capital structure measurement period based upon the fact that it was expected to be outstanding for only a portion of the 12-month capital structure measurement period. *Id.* at 3, 6-7. The third adjustment was to make a correction to the Company's calculation of the short-term debt balance. *Id.* at 3, 5-6. With those three adjustments, Ms. Phipps testified that the

Company's average capital structure contains 2.37% short-term debt, 43.21% long-term debt, and 54.41% common equity. Staff Ex. 4.0 (Public) at 3-4.

Thereafter, Staff and the Company agreed to a capital structure as follows: 4.90% short-term debt, 40.90% long-term debt, and 54.20% common equity. Nicor Gas-Staff Joint Ex. 1.0 at 3. Staff asserts that the stipulated capital structure is supported by the Stipulation and the Company's rebuttal and surrebuttal testimony. *Id.* at 1-3; Nicor Gas Ex. 18.0 at 3-6, 14; Nicor Gas Ex. 32.0 at 3-5.

### **c) IIEC/CUB's Position**

IIEC/CUB point out that Nicor Gas originally proposed a capital structure in this case consisting of 43.227% long-term debt, 2.419% short-term debt, and 54.354% common equity. Nicor Gas Ex. 2.0 at 8. According to IIEC/CUB, Nicor Gas argued that its capital structure would support its access to capital markets on reasonable terms and support its financial stability, all while balancing the costs and benefits of leverage. *Id.* at 9-10.

IIEC/CUB also observe that in addition to addressing return on equity, Staff and Nicor Gas entered into a Stipulation that contemplates a capital structure containing: 40.9% long-term debt, 4.90% short-term debt, and 54.2% common equity. The Stipulation claims that this capital structure is supported by evidence in the record. Nicor Gas-Staff Joint Ex. 1.0 at 2.

IIEC/CUB object to Nicor Gas' capital structure containing 54% common equity. They point out IIEC/CUB witness Gorman proposed a capital structure that would support Nicor Gas' access to capital markets and provide financial stability at a lower cost to Nicor Gas customers. Specifically, Mr. Gorman recommended a capital structure for Nicor Gas consisting of 45.581% long-term debt, 2.419% short-term debt, and 52% common equity. IIEC/CUB Ex. 1.0, Vol. II at 64.

According to IIEC/CUB, Nicor Gas' proposed capital structure and the Stipulation capital structure both contain an excessive amount of common equity. IIEC/CUB argue that the IIEC/CUB proposed capital structure, with a more balanced weight of common equity, will achieve the Company's stated goals of financial integrity and access to capital, but at a more reasonable cost to customers. IIEC/CUB say that this is evidenced by (i) a review of Nicor Gas' historical capital structure and bond ratings, (ii) a review of regulated gas industry capital structures that have supported access to significant amounts of capital under reasonable terms and conditions for the industry, and (iii) a review of the credit rating metrics that show IIEC/CUB's proposed capital structure produces credit metrics that are conservatively strong enough to support Nicor Gas' investment grade rating and financial integrity, but at a much lower cost to customers.

In the opinion of IIEC/CUB, a capital structure with 54% common equity is not reasonable in this case. They observe the Commission has previously rejected Nicor Gas' proposals to set rates based on an unjust and unnecessarily high common equity ratio. In Docket No. 08-0363, Nicor Gas' proposed common equity ratio of 56.8% was rejected and the Commission approved a stipulated capital structure consisting of 52% common equity. *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 08-0363, Order at 51 (Mar. 25, 2009). In the same proceeding on rehearing, the Commission modified its

earlier decision and approved a capital structure containing a 51.07% common equity ratio. *N. III. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 08-0363, Order on Rehearing at 13, App. A at 8 (Oct. 7, 2009).

IIEC/CUB also observe that Nicor Gas' capital structure with a common equity ratio in excess of 54% does not reflect the Company's actual capital structure over the period 2012 through September 30, 2018. During that time, IIEC/CUB point out that Nicor Gas' common equity ratio, including all invested capital, (including all short-term debt), has consistently been approximately 45% to 46% as a percentage of total capital. According to IIEC/CUB witness Gorman, the Company is effectively replacing its less costly short-term debt with the more expensive equity. IIEC/CUB Ex. 1.0, Vol. II at 57.

IIEC/CUB maintain that a capital structure overly weighted with common equity is unreasonable for setting rates because it will unnecessarily increase the utility's cost of capital and revenue requirement to ratepayers because common equity is the most expensive form of capital and is subject to income tax expense. *Id.* at 57-58. IIEC/CUB aver that capital structures such as the one proposed by Nicor Gas, or contained in the Stipulation, are not in line with the industry norm of capital structures.

In the opinion of IIEC/CUB, contrary to suggestions by Nicor Gas witnesses, it is not necessary to increase Nicor Gas' ratemaking common equity ratio to support credit metrics that maintain its current bond rating. IIEC/CUB observe that regulated utility companies with various bond ratings have adjusted ratios that typically range between 51% and 56%. *Id.* at 60. IIEC/CUB point out that in support of its capital structure, Nicor Gas argued that its FFO to debt ratio will be a controlling credit rating factor. IIEC/CUB state that Nicor Gas projected an FFO to debt ratio of around 22% in this case. *Id.* at 61-62; see also, Nicor Gas Ex. 2.0 at 11. IIEC/CUB witness Gorman adjusted this ratio to reflect an increase in revenues up to his proposed rate of return, including the return on equity and proposed capital structure set at the same capital structure weights last approved in Nicor Gas' most recent rate case. Mr. Gorman estimated the FFO to debt ratio based on Nicor Gas' current rates and a rate increase reflecting Mr. Gorman's 9.2% return on equity. IIEC/CUB Ex. 1.0, Vol. II at 62-63. IIEC/CUB show that he calculated Nicor Gas' FFO to debt ratio to be around 24%, which would support Nicor Gas' current A- bond rating and would actually fall within a range that would support a bond rating upgrade for Nicor Gas to A. *Id.* at 63. Thus, it is IIEC/CUB's position that there is no need to adjust Nicor Gas' capital structure to maintain an FFO to debt ratio that is in the range identified by Standard & Poors as supportive of an A- bond rating. *Id.* at 63.

Overall, IIEC/CUB state their proposed capital structure will support Nicor Gas' credit standing and financial integrity at a much lower cost to ratepayers compared to Nicor Gas' capital structure with an excessive 54.2% common equity ratio. IIEC/CUB argue that their capital structure includes a common equity ratio of 52% and represents a means of maintaining the Company's current bond rating, supporting its financial integrity, and giving it access to capital at a cost that is not excessive for ratepayers. *Id.* at 64-65.

IIEC/CUB respond to the Company's reliance on two factors to justify what IIEC/CUB argue is an inflated common equity ratio: the TCJA and a single financial metric, the FFO. IIEC/CUB argue that Nicor Gas offers little in the way of credible support,

and what support is provided lacks substance. IIEC/CUB aver that the excessive common equity ratio relies heavily on the most expensive form of capital, common equity, which is subject to an income tax gross-up unlike debt capital. If allowed, maintain IIEC/CUB, the associated revenue requirement would be unjustifiably recovered from customers along with the additional cost related to the QIP surcharge every year until new rates are set.

IIEC/CUB note that Nicor Gas heavily relies on the recent tax reform legislation, the TCJA, for the proposition that affected cash flows and a credit metric, the FFO, are grounds for a higher than necessary common equity ratio. IIEC/CUB argue that Nicor Gas ignores Mr. Gorman's unrefuted response that (1) some utilities credit metrics were already at risk and so a downgrade because of the FFO means nothing, and (2) that the TCJA had the effect of reducing utilities' equity cost of capital, based on the reduced income tax cost of a utility dividend. Mr. Gorman testified that this means the impact of lower cash flows, if any, have been negated. IIEC/CUB Ex. 1.0, Vol. II at 36.

Furthermore, claim IIEC/CUB, Nicor Gas overlooked or failed to acknowledge that the TCJA preserved a provision supported by the utility industry to encourage investment: the deductibility of interest expense for regulated utilities. *Id* at: 38. The impact of this provision is to lower income tax expense, which according to IIEC/CUB is a benefit conveniently ignored by Nicor Gas.

Mr. Gorman concluded, relying on independent and objective industry data, that "[i]n 2018, after the change in federal tax law, all utilities maintained investment grade credit ratings." *Id.* at 38. IIEC/CUB conclude that Nicor Gas has failed to show any material detriment that resulted from the tax legislation which justifies the increase in cost to its customers resulting from the inflated common equity component.

IIEC/CUB also respond to the Company's claim that the TCJA significantly impacted the FFO, which metric it says is the most common cause of downgraded utilities. Notably, say IIEC/CUB, the TCJA has been in effect for over a year and there has been no showing of a downgrade in credit ratings for Nicor Gas.

IIEC/CUB explain away Nicor Gas' reliance on the FFO argument by pointing out that, based on current rates and its proposed capital structure and component parts for the test year, before a rate increase in this proceeding, Nicor Gas was projecting an FFO to debt ratio of around 22%. Mr. Gorman adjusted this debt ratio to take into account a number of factors and considered the proposed capital structure set at the same capital structure weights approved in the 2017 Rate Case. IIEC/CUB show that Nicor Gas' FFO to debt ratio would then range between 22% at current rates, up to around 28% at proposed Nicor Gas rates. Mr. Gorman adjusted the estimate of the FFO to debt based on his recommended overall rate of return including a capital structure adjustment of 9.2% return on equity and calculated Nicor Gas' FFO to debt ratio to be around 24%, which continues to support Nicor Gas' investment grade bond rating. IIEC/CUB Ex.1.0, Vol. II at 62-63. IIEC/CUB claim that no party challenged or refuted these credit metric impact conclusions and, in the end, this analysis proves Nicor Gas' FFO is not at risk due to the TCJA.

IIEC/CUB maintain that the record evidence demonstrates that to support Nicor Gas' A- bond rating at an "Excellent" financial position and a slightly higher business risk

rating, an FFO within the range of 13% to 23% is required. *Id.* at 63. IIEC/CUB state that Nicor Gas' current FFO with no rate increase is already near the high end of the FFO/debt range that would support its A- bond rating. IIEC/CUB aver that any increase in its operating income and net income would increase its FFO so that it falls at the high-end of an A- credit metric range published by S&P, and actually will fall within the range that would support a bond rating upgrade for Nicor Gas to an A rating. *Id.* at 63.

In short, say IIEC/CUB, there is no basis to increase rates to customers to adjust Nicor Gas' capital structure from its current Commission-approved structure in order to increase the FFO to debt ratio. Rather, IIEC/CUB's recommended ratemaking capital structure weights comply with the financial target range identified by S&P as supportive of Nicor Gas' bond rating of A-. IIEC/CUB explain that the financial metrics at IIEC/CUB's recommendation actually support a bond rating of a one notch improvement, or to an A rating, which is Nicor Gas' actual bond rating. *Id.* at 63.

Contrary to the Company's dire and unfounded concerns about its ability to fund capital structure investments, IIEC/CUB demonstrate with observable market evidence that investment grade credit ratings have been maintained by utilities in recent years, even in the midst of large capital improvement plans such as those of Nicor Gas. IIEC/CUB Ex. 1.0, Vol. II at 37. Therefore, IIEC/CUB assert, improvements to Nicor Gas' credit metrics are not needed. Rather, IIEC/CUB suggest that a reasonable approach that considers observable market evidence, and measures factors that define the financial health of Nicor Gas and the utility industry as a whole, should be given primary consideration in determining a balanced and fair ratemaking capital structure. IIEC/CUB's recommendation of a 52% common equity ratio relies on such evidence, including Nicor Gas specific and industry data.

According to IIEC/CUB, the Company attempts to justify the 54.2% common equity ratio by suggesting it is needed to maintain financial integrity. However, Nicor Gas' adjusted total debt ratio is approximately 49%, and IIEC/CUB argue that this supports the strong credit rating that Nicor Gas currently enjoys. IIEC/CUB Ex. 1.22; IIEC/CUB Ex. 1.0, Vol. II at 100. Based on a common equity component of 9.2%, IIEC/CUB point out that Nicor Gas is able produce a debt to Earnings Before Interest, Taxes, Depreciation and Amortization ratio of 3.1x, which is well within S&P's "Intermediate" guideline range of 2.5x to 3.5x and supports an investment grade credit rating. IIEC/CUB observe that Nicor Gas' retail operations FFO to total debt coverage at a 9.2% equity return is 25%, which is within S&P's "Intermediate" metric guideline range of 23% to 35%. IIEC/CUB aver that this FFO/total debt ratio is stronger than the metric needed to support Nicor Gas' A- bond rating. At IIEC/CUB's return on equity of 9.2% and resultant capital structure, Nicor Gas' financial credit ratios will support its A- bond rating. *Id.* at 100-101.

IIEC/CUB suggest that, perhaps in an effort to infer that the Stipulation's 54.2% common equity ratio was a middling position, Nicor Gas argues that common equity ratios in the past have ranged from 51.07% to 58.08%. IIEC/CUB claim that Mr. Gorman thoroughly discounted this argument. IIEC/CUB Ex. 1.0, Vol. II at 56-57.

According to IIEC/CUB, Nicor Gas essentially claims that the Commission should support the 54.2% common equity ratio because "it is the capital structure being implemented now." IIEC/CUB argue that this point is erroneous for several reasons.

First, say IIEC/CUB, setting the common equity ratio based on what it is today is the poorest of reasons for doing so. IIEC/CUB explain that the Commission cannot set rates based on what the utility determines it wants; rather, costs must be proven to be just and reasonable, and the Commission must ensure that tariffed rates are just and reasonable. 220 ILCS 5/9-201(c). IIEC/CUB argue that, to make this determination, the Commission should rely on the evidence in this record.

More importantly, IIEC/CUB state that the claim is misleading because Nicor Gas' common equity ratio including all investor capital (including all short-term debt) has consistently been approximately 45%-46% as a percentage of total capital. From 2012 through September 2018, state IIEC/CUB, Nicor Gas had significantly more short-term debt than it proposes for 2018 through 2020 in this case. Mr. Gorman testified that, "[i]n effect, the Company is explicitly adjusting its capital structure to reduce its reliance on short-term debt and increase its common equity ratio in the projected 2018-2020 time period." IIEC/CUB Ex. 1.0, Vol. II at 57. In IIEC/CUB's opinion, the Commission should not endorse Nicor Gas' effort to manipulate its capital structure.

IIEC/CUB note that utilities have ready access to capital to support their capital improvement plans, contrary to Nicor Gas' conclusory remarks on the subject (Nicor Gas cites to just three lines of conclusory testimony to support its claim that its inflated capital structure is appropriate). According to IIEC/CUB, Nicor Gas' high level assertions claiming its capital structure is well supported are insufficient to support the proposed increase to its common equity ratio when just 18 months ago the Commission found a 52% common equity ratio appropriate for Nicor Gas. In this proceeding, say IIEC/CUB, Nicor Gas did not offer evidence that it was denied ready access to the capital markets on reasonable terms. To the contrary, IIEC/CUB show that utilities were continuing to acquire significant amounts of capital. IIEC/CUB Ex. 1.0, Vol. II at 39-40.

IIEC/CUB reiterate that strong credit ratings have been maintained in recent years, even in the midst of large capital improvement plans, such as those of Nicor Gas. *Id.* at 37. Capital expenditures for electric and natural gas utilities have increased considerably over the period 2007 into 2018, and the forecasted capital expenditures remain high but are starting to abate, say IIEC/CUB. *Id.* at 39. Mr. Gorman rightfully concluded, "Observable market evidence is quite clear that capital market costs are near historically low levels. While authorized returns on equity have fallen to the mid-9% range, utilities continue to have access to large amounts of external capital even as they are funding large capital programs." *Id.* at 40.

#### **d) Commission Analysis and Conclusion**

Nicor Gas and IIEC/CUB agree that the capital structure should balance just and reasonable prices to customers while still supporting the Company's financial integrity and credit standing. However, IIEC/CUB claim Nicor Gas' proposed capital structure, pursuant to the Stipulation, contains an excessive equity balance that imposes unreasonable costs on customers. IIEC/CUB support approval of a capital structure that reflects the capital structure mix approved in the 2017 Rate Case, with 52.00% common equity. Nicor Gas and Staff stipulate to a capital structure including 54.20% common equity.

Generally, a utility's actual capital structure is typically adopted unless it is found to be unreasonable, imprudent or unfairly burdensome. If the utility's actual capital structure is found to be unreasonable, imprudent or unfairly burdensome, then an imputed capital structure such as that proposed by Mr. Gorman in this proceeding may be adopted. IIEC/CUB assert that a capital structure with 54.20% common equity results in an unreasonable level of common equity. IIEC/CUB's reasoning looks toward historical capital averages from 2012-2018 in noting that Nicor Gas' common equity ratio was approximately 45% to 46% as a percentage of total capital. However, the record shows that the 54.20% common equity balance proposed in the Stipulation is the same as the Company's actual common equity balance for the 12 months ending September 30, 2018. Additionally, as Staff notes, the mean common equity ratio for the gas distribution industry is 46.98%, with a standard deviation of 9.58%. Staff Ex. 4.0 (Public) at 8-9. Therefore, a common equity ratio of 54.20% is consistent with the gas distribution industry, contrary to IIEC/CUB's claim. The Commission further observes that Staff initially supported a common equity ratio of 54.41%, which is higher than the Stipulation's common equity ratio.

Nicor Gas asserts its proposed capital structure is in response to recent changes in the federal tax structure due to the TCJA. Nicor Gas states that, because of the change in the federal corporate tax rate, the Company collects less tax from its customers, resulting in lower cash flow and a lower FFO to debt ratio. Additionally, Nicor Gas states that the TCJA excludes public utility property from bonus depreciation eligibility, which reduces the cash flow contribution from deferred taxes. IIEC/CUB maintain that the impacts of the TCJA have been negated. IIEC/CUB further point out that the TCJA has been in effect for over a year and there has been no showing of a downgrade in credit ratings for Nicor Gas.

The Commission notes that adjustments were made to address the changes due to the TCJA in the 2017 Rate Case, and that Nicor Gas was authorized to reflect tax-related impacts through Rider 36 – Variable Income Tax Adjustment that would minimize the impact on cash flows. Nevertheless, the impact of the TCJA is not clear. The regulatory actions adopted to offset reduced cash flow may not improve financials until 2020.

The Commission finds that Nicor Gas provided reasonable justification for its proposed capital structure and that IIEC/CUB has not produced sufficient evidence to establish that the capital structure proposed by Nicor Gas and Staff is unreasonable, imprudent, or unfairly burdensome. The Commission finds that there is no reason to set aside the Stipulation's proposed capital structure and it is therefore adopted.

## **2. Cost of Common Equity**

### **a) Nicor Gas' Position**

Nicor Gas, in agreement with Staff, recommends a ROE of 9.86%. Nicor Gas states that this ROE is reasonable and appropriate for ratemaking purposes. Nicor Gas also states that this ROE is supported by the record as a whole, as it falls squarely within the range of recommendations presented by the various witnesses who testified on the subject – Nicor Gas witnesses Graves and Mudge, Staff witness Phipps, and IIEC/CUB witness Gorman. Nicor Gas further states that the reasonableness of the 9.86% ROE is

supported by expert testimony specifically confirming that a 9.86% annual return falls within the reasonable range for Nicor Gas' common equity, albeit at the lower end of that range.

Nicor Gas points out that the recommended 9.86% ROE is supported in the evidentiary record by a diverse range of sound financial models, and Nicor Gas witnesses Graves and Mudge stressed the importance of reviewing multiple models in the course of evaluating the appropriate ROE for a utility. Nicor Gas further argues that the Commission has, in recent orders, implicitly and explicitly recognized the importance of different models by taking into account the results of multiple models and/or versions of models, including the Implied Risk Premium model and the Expected Earnings model, in its analysis and synthetization of the evidence supporting its awarded ROEs. Nicor Gas argues that this Commission history is contrary to IIEC/CUB's position that the Commission should be limited to only consider Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") methodologies.

Nicor Gas argues that it is important for the Commission to consider different models, as they provide different insights into the required return. Further, Nicor Gas argues that the need for diverse models is especially important in the current economic conditions, since the unprecedented sustained low interest rate environment among investors can affect the results from various standard models in different ways. The Company explains that utilizing multiple models can help establish whether there should be any concern about any one model giving unusual or atypical results, and certain models can compensate for the shortcomings of other models. Nicor Gas also cites to the increased focus on variety of models at the Federal Energy Regulatory Commission, which stated that by "relying on a broader range of record evidence to estimate [the utility's] cost of equity, we ensure that our chosen ROE is based on substantial evidence and bring our methodology into closer alignment with how investors inform their investment decisions." Nicor Gas Br. on Exc. at 13; Nicor Gas Ex. 14.0, 13:250-259 *citing* 165 FERC ¶ 61,030 at 15.

Nicor Gas argues that IIEC/CUB's recommendation to discount all alternative models, regardless of the academic and practical support of those models, can and often does yield ROE estimates that are unreasonable. Nicor Gas argues that limiting review to these two methodologies, which Nicor Gas refers to as the "Unadjusted Two-Model Approach," results in ROE estimates that are significantly below actual ROEs issued in Illinois and nationwide.

Nicor Gas further argues that IIEC/CUB's argument that the Commission should consider its witness Mr. Gorman's "adjusted" version of the Company's recommendation as if it were the Company's proposal should be rejected. Nicor Gas argues that the Company never recommended Mr. Gorman's "adjusted" value, and Mr. Gorman's "adjustment" methodology is inconsistent with Nicor Gas witnesses Graves and Mudge's own testimony. Nicor Gas argues that any efforts to assert that the Company somehow supported Mr. Gorman's proposal are flatly contradicted by the record.

Nicor Gas argues that IIEC/CUB's recommendation is clearly insufficient because it is more than 65 basis points below the ROE approved by the Commission for Nicor Gas just last year. Nicor Gas states that the evidence supports no such reduction. Nicor Gas

further states that, if anything, Nicor Gas' continued need for additional capital and cash flow to retain strong credit metrics support an increase in its overall return, although the recommendation in the Stipulation holds it essentially flat.

Nicor Gas argues that the 9.86% ROE recommended by Nicor Gas and Staff is supported by ample evidence in the record and is reasonable and appropriate. Nicor Gas further states that it takes into account all the evidence in the record, including a diverse range of sound financial models.

#### **b) Staff's Position**

Staff witness Phipps testifies that, based upon her analysis, she estimated that the Company's ROE is 9.115%. Staff Ex. 4.0 (Public) at 12; Sch. 4.01. Ms. Phipps measured the Company's ROE using DCF and CAPM analyses. Because the Company does not have market traded common stock, the DCF and CAPM models cannot be directly applied to the Company. Given that the Company stock is not traded in the market, Ms. Phipps applied the models to a sample of public utilities that are comparable in risk to Nicor Gas, which she called the "Gas Sample." Staff Ex. 4.0 (Public) at 12-13.

Ms. Phipps testifies that for a utility to attract common equity capital, investors must expect the utility to provide a ROE that is sufficient to meet their return requirements. DCF analysis establishes a rate of return directly from investor requirements. Implementation of a DCF analysis does not require a direct measurement of a utility's operating and financial risks since the market price of a utility's stock already embodies the market consensus of those risks. Staff Ex. 4.0 (Public) at 13-14. The DCF model assumes that a security price equals the present value of the cash flow investors expect it to generate. Therefore, the market value of common stock equals the cumulative value of the expected stream of future dividends after each dividend is discounted by the investor-required rate of return. *Id.* at 14.

Ms. Phipps explains that since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that stock prices embody. Since the Gas Sample companies pay dividends quarterly, Ms. Phipps applied a constant-growth quarterly DCF model to measure ROE.

Ms. Phipps explains in her direct testimony that determining the market-required ROE using DCF methodology requires a growth rate that reflects investors' expectations. For her constant growth DCF analysis, Ms. Phipps measured market-consensus growth using 3-5 year growth rates forecasted by security analysts, which are compiled and disseminated to investors by Zacks Investment Research ("Zacks") and Reuters. *Id.* at 16, Sch. 4.07.

Ms. Phipps testifies that a current stock price reflects all information that is available and relevant to the market; thus, it represents the market's assessment of the common stock's current value. She measured the current stock for the Gas Sample companies using closing market prices from February 13, 2019. Staff Ex. 4.0 (Public) at 19; Schedule 4.09. Since most utilities declare and pay the same dividend per share for four consecutive quarters before adjusting the rate, Ms. Phipps' analysis assumes that the current declared dividend rate will remain in effect for a minimum of four quarters and then adjust during the same quarter it changed its dividend during the preceding year.

Ms. Phipps applied the average expected 3-5 year growth rate estimate to the current declared dividend rate to estimate the expected dividend rate for her constant growth DCF analysis.

Using DCF analysis and the inputs above, Ms. Phipps estimated a ROE of 8.95%. Staff Ex. 4.0 (Public) at Sch. 4.11.

In addition to DCF analysis, Ms. Phipps used the CAPM, a one-factor risk premium model, to estimate ROE. The risk premium methodology is consistent with the theory that investors are risk-averse, in other words, investors require higher returns to accept greater exposure to risk. A risk premium model is based on the theory that the market required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with that security. Staff Ex. 4.0 at 21. In other words, Staff states that the rate of return for a security equals the risk-free rate of return, plus a security-specific risk premium. *Id.*

Ms. Phipps explains that in the CAPM the risk factor is market risk, which is defined as risk that cannot be eliminated through portfolio diversification. Staff Ex. 4.0 (Public) at 22. Ms. Phipps testifies that beta measures risk in a portfolio context. When multiplied by the market risk premium, a security's beta produces a market risk premium specific to that security. *Id.* at 28. To implement the CAPM, Staff explains, one must estimate the risk-free rate of return, the expected rate of return on the market portfolio, and a security- or portfolio-specific measure of market risk (i.e., beta). *Id.* at 22

Ms. Phipps explains that the proxy for the nominal risk-free rate should contain no risk premium and reflect similar inflation and real risk-free rate expectations to the security being analyzed through the risk premium methodology. *Id.* at 23. After evaluating forecasts of inflation and real GDP growth expectations, Ms. Phipps relied upon the long-term U.S. Treasury bond yield of 3.06% as a proxy for the long-term risk-free rate. *Id.* at 26. She also notes that the U.S. Treasury bond yield is an upwardly biased estimator of the long-term risk-free rate due to the inclusion of an interest rate risk premium associated with its relatively long term to maturity. *Id.*

Ms. Phipps estimated the expected return on the market by conducting a DCF analysis on the dividend-paying firms composing the S&P 500 Index as of December 31, 2018. Staff Ex. 4.0 (Public) at 27. She explains that the resulting company-specific estimates of the expected rate of return on common equity were then weighted according to market value. *Id.* Using this methodology, Ms. Phipps estimated the expected return on the market equals 12.77%. *Id.* at 28.

Ms. Phipps used Value Line betas, Zacks betas, and regression analysis to estimate beta for the Gas Sample. *Id.* at 28. Ms. Phipps explains that she relied on multiple beta estimates for her Gas Sample because true betas are unobservable, forward-looking measures of investors' expectations of market risk. *Id.* at 31. Therefore, like all proxies, beta estimates are subject to measurement error. Thus, using multiple approaches to estimate beta mitigates the effect on her cost of common equity estimate of measurement error in her Gas Sample's beta estimates. *Id.*

Since both the Zacks beta estimate and the regression beta estimate are calculated using monthly returns rather than weekly returns (as Value Line uses), Ms.

Phipps averaged the Zacks and regression betas to avoid overweighting the monthly return-based betas. She then averaged that result with the Value Line beta to obtain a single estimate of a beta for the sample. For the Gas Sample, the regression beta estimate is 0.60 and the Value Line beta and Zacks beta average 0.69 and 0.59, respectively. *Id.* at 32. The average of the Zacks and regression betas is 0.60. Averaging this monthly beta with the weekly Value Line beta (0.69) produces a beta for the Gas Sample of 0.64. *Id.*

Using the CAPM model and the inputs discussed above, Ms. Phipps estimated a ROE of 9.28%. Staff Ex. 4.0 (Public) at Sch. 4.12.

According to Staff, a thorough analysis of the required rate of return on common equity requires both the application of financial models and the analyst's informed judgment. In Staff's opinion, an estimate of the required rate of return on common equity based solely on judgment is inappropriate. Nevertheless, Staff states, because techniques to measure ROE necessarily employ proxies for investor expectations, judgment remains necessary to evaluate the results of such analyses. Along with DCF and CAPM analyses, Ms. Phipps considered the observable 4.27% rate of return the market currently requires on less risky A-rated long-term debt. Based on her analysis, in her judgment, the investor-required rate of return on common equity for natural gas distribution operations equals 9.12%. *Id.* at 33.

Ms. Phipps explains that to estimate ROE for the Company, she estimated the ROE for the Gas Sample, which is the simple average of the constant growth DCF-derived results (8.95%) and the CAPM-derived results (9.28%) for the Gas Sample, or 9.115%. Ms. Phipps testified that the models from which the individual company estimates were derived are correctly specified and thus contain no source of bias. Moreover, excepting the use of U.S. Treasury bond yield as a proxy of the long-term risk-free rate and the use of overall economic growth as a proxy for long-term utility growth, she is unaware of bias in her proxies for investor expectations. *Id.* at 34. In addition, Staff claims that measurement error has been minimized through the use of a sample, since estimates for a sample as a whole are subject to less measurement error than individual company estimates. *Id.*

In summary, Ms. Phipps' ROE estimate is 9.115% (9.12% rounded). Staff Ex. 4.0 (Public) at 34. Staff states that it is based upon the average of the result from the constant growth DCF analysis (8.95%) and the result from the CAPM risk premium model (9.28%) for the Gas Samples along with Ms. Phipps' informed judgement. *Id.* at 33.

Staff and the Company stipulated the cost of common equity, or ROE, is 9.860%. Nicor Gas-Staff Joint Ex. 1.0 at 3, ¶ 8. The ROE is supported by the Staff-Nicor Stipulation and the Company's rebuttal and surrebuttal testimony according to Staff. *Id.*; Nicor Gas Ex. 29.0 at 2-6; Nicor Gas Ex. 42.0 at 1-10.

### **c) IIEC/CUB's Position**

IIEC/CUB aver that, as has historically been the accepted practice of this Commission, IIEC/CUB witness Gorman used several models based on financial theory to estimate Nicor Gas' cost of common equity. IIEC/CUB explain that these models were: (1) a constant growth DCF model using consensus analysts' growth rate projections; (2)

a constant growth DCF using sustainable growth rate estimates; (3) a multi-stage growth DCF model; and (4) a CAPM. IIEC/CUB observe that these models are commonly relied upon by the Commission is assessing a utility's return on common equity.

IIEC/CUB state that because Nicor Gas does not issue stock, the models used to estimate Nicor Gas' cost of equity were applied to a group of publicly traded utilities with investment risks similar to Nicor Gas. The gas utility proxy group relied upon by IIEC/CUB witness Gorman, was the same as the proxy group relied on by Nicor Gas witnesses Mr. Graves and Mr. Mudge, with one exception: Chesapeake Utilities Corporation was excluded because it is not rated by S&P and Moody's. IIEC/CUB Ex. 1.0, Vol. II at 67.

IIEC/CUB show that the proxy group utilized by Mr. Gorman has an average corporate credit rating from S&P of A-, which is identical to Nicor Gas' credit rating and an average corporate credit rating from Moody's of A3, which is a notch lower than Nicor Gas credit ratings of A2. *Id.* at 68.

IIEC/CUB point out that the proxy group has an average common equity ratio of 46.1 % (including short-term debt) from SNL, and 51.7% (excluding short-term debt) from The Value Line Investment Survey. IIEC/CUB's proposed capital structure has a common equity ratio of 52% which is comparable to the proxy group average common equity ratio. *Id.*

IIEC/CUB explain that their witness Mr. Gorman used several versions of the DCF model in his analysis of the cost of equity for Nicor Gas. IIEC/CUB describe the DCF model as one that posits that a stock price is valued by summing the present value of expected future cash flows discounted at the investor's required rate of return or cost of capital. IIEC/CUB clarify that the DCF model requires a current stock price, expected dividend, and expected growth rate in dividends as described in full in Mr. Gorman's testimony. *Id.* at 68-69. IIEC/CUB observe that their witness Mr. Gorman included a quarterly compounding adjustment to his DCF return estimate because it is the Commission's standard practice to include this quarterly compounding return in DCF estimates.

For the constant growth DCF model analyses, IIEC/CUB explain that Mr. Gorman used the average of the weekly high and low stock prices of the proxy group over a 13-week period ended February 15, 2019. IIEC/CUB claim that Mr. Gorman did so because an average stock price is less susceptible to market price variations than a spot price. *Id.* at 70. For the dividend component of the DCF model, Mr. Gorman used the most recently paid quarterly dividends from Value Line Investment Survey of November 30, 2018: the dividend was annualized (multiplied by 4) and adjusted for next year's growth. *Id.*

IIEC/CUB witness Mr. Gorman relied on a consensus, or mean, of professional security analysts' earnings growth estimates as a proxy for the investor consensus dividend growth rate expectations, and then used the average of three sources of analysts' growth rate estimates: Zacks, S&P Global Market Intelligence ("MI"), and Reuters. *Id.* at 72. The average growth rate for the proxy group is 5.86%. *Id.* IIEC/CUB report that the results of the average and median constant growth DCF returns for Mr. Gorman's proxy group for the 13-week analysis are 8.84% and 8.50%, respectively. *Id.* at 73.

IIEC/CUB witness Gorman also used a sustainable growth rate DCF analysis to develop his return on equity recommendation. IIEC/CUB explain that a sustainable growth rate is based on the percentage of the utility's earnings that are retained and reinvested in utility plant and equipment and that the interim growth rate methodology is tied to the percentage of earnings retained in the Company and not paid out. IIEC/CUB aver that Mr. Gorman calculated the payout ratios for the proxy group. *Id.* at 74-75; IIEC Ex. 1.16. IIEC/CUB highlight that the data used to estimate the long-term sustainable growth rate is based on current market to book ratios and on Value Line's three-to-five-year projections of earnings, dividends, earned returns on book equity, and stock issuances. IIEC/CUB Ex. 1.0, Vol. II at 75. IIEC/CUB show that the average sustainable growth rate for the proxy group using this internal growth rate model is 7.78%. *Id.* According to IIEC/CUB, a sustainable growth DCF analysis produces proxy group average and median DCF results of 7.78%.

IIEC/CUB explain that Mr. Gorman also performed a multi-stage growth DCF analysis to reflect the outlook of changing growth expectations. *Id.* at 76.

IIEC/CUB state that Mr. Gorman explained how growth rates can change over time. *Id.* at 77. IIEC/CUB explain that the multi-stage growth DCF model reflects the possibility of non-constant growth, or changing growth, for a company over time, and reflects three growth periods: (1) a short-term growth period, which consists of the first five years; (2) a transition period, which consists of the next five years (6 through 10); and (3) a long-term growth period, starting in year 11 through perpetuity. *Id.*

IIEC/CUB report that for the short-term growth period, Mr. Gorman relied on the consensus analysts' growth projections described above in relationship to his constant growth DCF model. For the transition period, say IIEC/CUB, the growth rates were reduced or increased by an equal factor, which reflects the difference between the analysts' growth rates and the GDP growth rate. For the long-term growth period, Mr. Gorman assumed each company's growth would converge to the maximum sustainable growth rate. *Id.* at 78. Mr. Gorman explained further why the GDP projection was a reasonable proxy for the maximum sustainable growth rate. *Id.* at 78-80.

IIEC/CUB point out that Mr. Gorman developed his long-term sustainable growth rate based on consensus analysts' projections of long-term GDP growth, and the consensus economists' published GDP growth rate outlook is 4.2% over the next 10 years. *Id.* at 81. Mr. Gorman also considered other sources of projected long-term GDP growth, including Blue Chip Financial Forecasts, EIA – Annual Earnings Outlook, Congressional Budget Office, Moody's Analytics, Social Security Administration, and the Economist Intelligence Unit. According to IIEC/CUB, the real GDP and nominal GDP growth projections made by these independent sources, support the use of the consensus economists' 5-year and 10-year projected GDP growth outlook of 4.2% as a reasonable estimate of market participants' long-term GDP growth outlooks. *Id.* at 82-83.

IIEC/CUB state that for the stock price, dividend, and growth rates for the multi-stage growth DCF analysis, Mr. Gorman relied on the same 13-week average stock prices and the most recent quarterly dividend payment data discussed above. *Id.* at 84. The results of IIEC/CUB's average and median DCF returns on equity for the proxy group using the 13-week average stock price are 7.50% and 7.24%, respectively. *Id.*

IIEC/CUB observe that Mr. Gorman expressed some concern with the constant growth DCF based on sustainable growth rate projections and concluded that it produced a result that was too high. He expressed concerns with the multi-stage growth DCF model because it produced results less than 8.0%, which may understate a fair estimate of the current cost of equity. He concluded that the DCF studies support a return on equity of 8.9%, placing primary reliance on the constant growth DCF results, which he considered a reasonable DCF return estimate. *Id.* at 85.

IIEC/CUB clarify that the CAPM method of analysis is based upon the theory that the market required rate of return for a security is equal to the risk-free rate, plus a risk premium associated with the specific security. *Id.* at 86. The CAPM theory suggests that the market will not compensate investors for assuming risks that can be diversified away; therefore, the only risk that investors will be compensated for is systematic or non-diversifiable risks. IIEC/CUB state that the beta is a measure of the systematic or non-diversifiable risks. *Id.* at 87. IIEC/CUB witness Mr. Gorman used long-term treasury bond yields as an estimate of the risk-free rate. IIEC/CUB report that for the risk-free rate, Mr. Gorman used Blue Chip Financial Forecasts' projected 30-year Treasury bond yield of 3.50% for his CAPM analysis, because long-term Treasury bonds are considered to have negligible credit risk. *Id.*

IIEC/CUB also point out that Mr. Gorman used the average proxy group beta from Value Line of 0.65. *Id.* at 88. IIEC/CUB state Mr. Gorman developed two versions of a market risk premium estimate. First, IIEC/CUB state that the forward-looking estimate was derived by estimating the expected return on the market (as represented by the S&P 500) and subtracting the risk-free rate from this estimate. Mr. Gorman estimated the expected return on the S&P 500 by adding an expected inflation rate to the long-term historical arithmetic average real return on the market, which represents the achieved return above the rate of inflation. Deriving the estimates from the stated sources, Mr. Gorman determined that this market risk premium had a value of 7.90%. *Id.* at 89-90.

Second, Mr. Gorman's historical estimate was based on the Duff & Phelps study that estimated the arithmetic average of the achieved total return on the S&P 500- 12.1%, the total return on long-term Treasury bonds- 6.00% and the indicated market risk premium is 6.1% (12.1% - 6.0% = 6.1%). *Id.* at 90. Thus, Mr. Gorman's market risk premium ranges from 6.11% to 7.9%, with a 7.0% mid-point. *Id.* at 90.

IIEC/CUB report that the Duff & Phelps analysis indicates a market risk premium that falls somewhere in the range of 5.0% to 7.1%, while Mr. Gorman's risk premium falls within the range of 6.1% to 7.9%, the 7.0% is at the high end of that study. Mr. Gorman explained his average market risk premium of 7.0% is at the high end of the Duff & Phelps range. *Id.* at 90-91.

IIEC/CUB argue that the Commission has previously relied on Staff's position that a market risk premium should be based on prospective estimates of the market return and current risk-free rate. *Id.* at 93. IIEC/CUB note that the Staff has historically relied on a DCF model of the S&P 500 to develop the market risk premium. IIEC/CUB explain that because of this preference for a forward-looking development of a market risk premium, IIEC/CUB witness Mr. Gorman provided two versions of a prospective market risk premium for use in his CAPM study. IIEC/CUB point out that the two versions include

a risk premium estimate of the forward-looking market risk premium, and a DCF return on the market. *Id.* Mr. Gorman explained the development of these market risk premiums, and that the resultant value for the prospective market risk premium is 7.9%, and the DCF-derived market risk premium is 8.6%. *Id.* at 93, 96.

IIEC/CUB explain that as shown in IIEC/CUB Exhibit 1.21, using the CAPM equation, based on Mr. Gorman's low prospective market risk premium of 7.9% and his high prospective DCF market risk premium of 8.6%, a risk-free rate of 3.5%, and a beta of 0.7, IIEC/CUB's CAPM analysis produces return estimates of 9.03% to 9.59%, with a midpoint of 9.5%. *Id.* at 91.

IIEC/CUB observe that Mr. Gorman explained his disagreements with some of Duff & Phelps' claims, but nevertheless used its conclusion to show the reasonableness of his market risk premium estimates. *Id.* at 91. IIEC/CUB state that based on his analyses, Mr. Gorman estimated Nicor Gas' current market cost of equity to be 9.2%, as shown in Table 14 from his testimony. *Id.* at 97.

It is the position of IIEC/CUB that the recommended overall rate of return and return on common equity of 9.2% will support an investment grade bond rating for Nicor Gas. IIEC/CUB note that Mr. Gorman reached this conclusion by comparing the key credit rating financial ratios for Nicor Gas at his proposed return on equity and capital structure, to S&P's benchmark financial ratios using S&P's credit metric ranges. *Id.*

IIEC/CUB observe that Nicor Gas offered the testimony of Mr. Graves and Mr. Mudge, who recommended a 10.5% return on common equity for Nicor Gas within a range of 10.25% to 10.75. Nicor Gas Ex. 14.0 at 6; Nicor Gas Ex. 2.0 at 3, 13. IIEC/CUB note the Company also proposed a 10-basis points adder to account for past unrecovered flotation costs, which produced a 10.60% ROE.

IIEC/CUB report that Nicor Gas' current market return on equity is in the range of 8.7% to 9.5% based on their CAPM and DCF studies, respectively, and 9.1% to 9.6% based on their risk premium studies. IIEC/CUB observe that Mr. Graves and Mr. Mudge then increased their market return on equity estimate by adding a return on equity adder in the range from 0.9% to 2.0% using an After-Tax Weighted Average Cost of Capital ("ATWACC") adder methodology that increases their recommended range to 10.25% to 10.75%. According to IIEC/CUB, Mr. Graves and Mr. Mudge assert this ATWACC return on equity adder is necessary to properly recognize Nicor Gas' financial risk when applying a market return on equity to its book value common equity. Nicor Gas Ex. 14.0 at 17-23; IIEC/CUB Ex. 1.0, Vol. II at 103-104. IIEC/CUB reason the ATWACC adder is simply without merit, and only serves one purpose: to artificially increase the ROE. Removing the ATWACC return on equity adder and incorporating more reasonable adjustments, Nicor Gas' own witness studies support a return on equity in the range of 8.7% to 9.6% using their CAPM, DCF and risk premium studies. IIEC/CUB Ex. 1.0, Vol. II at 103.

According to IIEC/CUB, the ATWACC increases the estimated market return on equity based on Mr. Graves and Mr. Mudge's CAPM and DCF analyses to a higher return on equity that can be applied to Nicor Gas' book value common equity. *Id.* at 105. IIEC/CUB witness Mr. Gorman explains the ATWACC methodology suggests that the sample firms' financial risk is different based on the market value of common equity. *Id.* at 106. IIEC/CUB argue that Mr. Graves and Mr. Mudge propose to upwardly adjust their

CAPM and DCF model results to account for the difference in financial risk based on the proxy companies' market value of common equity, compared to their book value common equity. Mr. Graves and Mr. Mudge are in effect suggesting that firms have a different level of financial risk, depending on whether one is observing their market value capital structure or the book value capital structure. *Id.* at 106.

IIEC/CUB argue that the ATWACC adjustment is flawed for several reasons. According to IIEC/CUB, the Company has only one level of financial risk, not two. IIEC/CUB aver that investors do not assess a different amount of financial risk based on market value common equity versus book value common equity; rather, financial risk is a singular risk factor, which describes its financial capital structure, cash flow strength to support financial institutions, and default provisions in its financial obligations. Moreover, say IIEC/CUB, Mr. Graves and Mr. Mudge's view is not supported by independent market participants such as S&P and Value Line. *Id.* at 107-108. IIEC/CUB maintain that the book value and market value financial risks for the same company are interconnected to one another and produce a single level of financial risk for the company. *Id.* at 108.

IIEC/CUB opine that in past cases, the Commission has ruled that the book value capital structure, reflecting the investment required for providing utility service (i.e., net original cost rate base for Illinois jurisdictional utilities) should be the basis for establishing the cost of capital for ratemaking purposes. *N. Shore Gas Co. / The Peoples Gas Light and Coke Co.*, Docket Nos. 14-0224/14-0225 (Consol.), Order at 126-27, 132-33 (Jan. 21, 2015). IIEC/CUB further point out that Staff has also taken a position on the reasonableness of adding a financial leverage return on equity adder to the results of the common equity analyses in this case – Staff witness Phipps suggested that these adjustments as proposed by Mr. Graves and Mr. Mudge:

. . . are based on the flawed argument that a market-driven required rate of return does not produce a 'fair' return when applied to a book value rate base if the market to book value ratio differs from one.

Staff Ex. 4.0 at 56. Ms. Phipps suggests that the flaw in such an argument “. . . is that it equates secondary investing (i.e., the purchase of existing shares of stock from other investors) with a primary investing (i.e., the purchase of new shares of stock directly from the company or the retention of earnings for reinvestment).” *Id.* at 56. According to Ms. Phipps the primary investing and secondary investing are different:

The former does not affect the amount of money available to the company to buy assets because the proceeds from the sale go to the previous stockholder, not to the company. Thus, a rise in the price of existing common stock traded in secondary markets does not increase the amount of capital actually serving customers. It only reveals that investors' expectations for the future cash flows of the company have risen or that their required rate of return has fallen. In contrast, primary investment directly contributes capital to the company that is available to buy assets to serve customers. Under original cost ratemaking, ratepayers provide a return only on

the amount of capital that is invested in assets that serve ratepayers. Inflating that return to compensate investors for capital not invested in plant and equipment is not cost-based ratemaking and, therefore, is neither fair nor appropriate, moreover, such an adjustment would render the establishment of original cost rate base a pointless exercise.

Staff Ex. 4.0 at 56.

IIEC/CUB reason that in traditional Commission ratemaking, the required rate of return for the investor is one determined by the market price investors are willing to pay. The Commission has stated:

The Commission, in authorizing a rate of return, makes an estimate the investor is demanding. It is the Commission that reacts to investors, not vice versa.

*III. Bell Tel. Co.*, Docket No. 92-0244/93-0239 (Cons.), Order at 172 (October 11, 1994).

It is IIEC/CUB's position that the ATWACC adder and its use in a ROE estimate is poor regulatory policy. IIEC/CUB witness Mr. Gorman offered the many reasons for its rejection:

1. It does not produce clear and transparent objectives for management to use that will accomplish the objective of minimizing its overall rate of return while preserving its financial integrity. Therefore, a regulatory commission cannot oversee the reasonableness and prudence of management decisions in managing its capital structure. Under the ATWACC theory, management's decisions to manage its capital structure can be skewed by changes in market value which change the market value capitalization mix. Management simply has no control over the market value capital structure, but it does have control over the book value capital structure. As such, setting the rate of return and measuring risk based on book value capital structure creates a more transparent and clear path for regulatory oversight of management's effort to maintain a balanced and reasonable capital structure.
2. The ATWACC introduces significant additional instability and unreliability into the utility's cost of service and tariff rates. Book value capital structure weights permit the utility to hedge or lock-in a large portion of capital market costs in arriving at the rate of return used to set rates. This rate of return cost hedge stabilizes the utility's cost of service, which in turn helps stabilize utility rates. A stable method of setting rates also allows investors to more accurately assess the future earnings and cash flow outlooks for the utility, which will reduce the business risk of the utility. The ATWACC, on the other hand, will produce an overall rate of return which will change based on both changes to market value capital structure weights and also based on changes to market capital costs. Hence, a major component of the cost structure of the utility (i.e., the overall rate of return) will vary based on market forces from rate case to rate case. This rate of return variability will

introduce significant instability in the utility's cost of service (via rate of return changes) and hence instability in tariff rates. Introducing additional instability and unreliability in the utility's cost structure and rates will not benefit either investors or ratepayers.

3. The ATWACC artificially increases rates to produce an excessive return on equity opportunity for utility investors. Inflating utility's rates to provide this excessive earnings opportunity is unjust and unreasonable and should be rejected.

IIEC/CUB Ex. 1.0, Vol. II at 108-109. IIEC/CUB also observe that Mr. Gorman identified several regulatory decisions in California, Arizona, Ohio and Wisconsin that found the ATWACC methodology to be poor regulatory practice, and where it was affirmatively rejected. IIEC/CUB Ex.1.0, Vol. II at 109-110.

IIEC/CUB aver that furthermore, in many past cases, the Commission has refused to adopt adjustments similar to the adjustment proposed by the Company and its witnesses. It is the position of IIEC/CUB that the substantial evidence in this record justifies rejecting the use of the ATWACC adder, which has been rejected by other regulators as well. IIEC/CUB maintain that the ATWACC adder cannot be, in any form, used or considered when evaluating the proper return on common equity for a utility company. IIEC/CUB conclude that the Commission should affirmatively and clearly reject its use in this case and any others to come.

In the opinion of IIEC/CUB, the evidence does not support the averaging approach adopted in the Stipulation for the ROE. While the Commission has adopted rate of return and return on equity recommendations resulting from averaging the recommended rate of returns on equity in the case to produce an authorized return, IIEC and CUB have criticized this approach in circumstances where the averaging methodology inappropriately included the adders discussed above. See, i.e., 2017 Rate Case at 80-92. However, in this case, if the Commission were to adopt an averaging approach of the three parties presenting cost of capital testimony, (Nicor Gas, Staff, and IIEC/CUB), IIEC/CUB argue that the Commission should use the DCF and CAPM estimates produced by Nicor Gas, and Staff and IIEC/CUB DCF and CAPM estimates to develop an average. IIEC/CUB aver that, if the Commission were to do so, it would produce an average return on equity in the range of 9.38% to 9.66%. IIEC/CUB Ex. 2.0 at 18. In the opinion of IIEC/CUB, Nicor Gas' proposed return should only be reflected if the financial risk adder (ATWACC) is removed.

IIEC/CUB state that if the Commission removes the financial leverage adder known as the ATWACC, as they recommend, the averaging approach using the DCF and CAPM results would support a return on equity of 9.10% to 9.12%. *Id.* at 19. In other words, IIEC/CUB state that, if the Commission takes the averaging approach and uses the methodologies that are most frequently used in Illinois to establish the appropriate return on equity for the utility, (the CAPM and DCF) and excludes the financial leverage adjustments proposed by the Company, as it has in prior cases, it would produce an authorized return on common equity for Nicor Gas of not less than 9.10% and not more than 9.12%. This result is close to the actual recommendations of Staff and IIEC/CUB,

and that is because the results of the DCF and CAPM studies performed by all the witnesses in this case, including the Company witnesses, demonstrate that Nicor Gas' cost of equity falls within that range.

IIEC/CUB point out that the Nicor Gas-Staff stipulated rate of return, which includes a 9.86% ROE and 54.2% common equity ratio exceed the industry average authorized return on equity of 9.6% and the industry average common equity ratio of 52.0%. See IIEC/CUB Ex. 2.0 at 14; IIEC/CUB Ex. 2.3. IIEC/CUB show that the authorized returns on equity for the regulated natural gas industry were less than 9.6% for the first four months of 2019 and in 2018. IIEC/CUB Ex. 2.0 at 14. IIEC/CUB explain that while the industry authorized return on equity in 2017 was 9.65%, this was only because of an exceptionally high return on equity of 11.8% awarded to Enstar Natural Gas Company by the Regulatory Commission of Alaska. In 2016, say IIEC/CUB, the regulated natural gas company's industry average authorized return on equity was 9.35%. *Id.* at 14. In fact, in 2019, only one natural gas company received an authorized return on equity of about 9.8% and only seven of the 45 authorized returns on equity were 9.86% or higher, observe IIEC/CUB. While in 2017, only three natural gas companies received an authorized return on equity in excess of 9.8% out of 21 rate decisions. *Id.* at 15. Thus, IIEC/CUB conclude that the frequency of distributions of authorized returns on equity shows that the 9.86% return on equity is excessive and toward the high-end outlier for regulated natural gas companies in large part because of the ATWACC. *Id.*

Furthermore, continue IIEC/CUB, a comparison of authorized returns on equity and bond ratings for natural gas utilities demonstrates that a higher return on equity does not equate to a higher bond rating. IIEC/CUB Exhibit 2.3 shows that authorized returns on equity that fall within the general range of about 9.6% down to 9.4% are associated with companies with bond ratings in the range of BBB to A-. IIEC/CUB explain that, currently Nicor Gas has a bond rating of A-, which falls within this industry range, which demonstrates that a return on equity of substantially less than 9.8% and a common equity ratio of 52% or less would comfortably support Nicor Gas' current bond rating of A-. IIEC/CUB Ex. 2.0 at 15.

IIEC/CUB state that, prior to the settlement with Nicor Gas, Staff offered testimony that estimates the Nicor Gas required return on common equity to be 9.115% (9.12% rounded), based on a DCF analysis that suggested Nicor Gas' ROE was 8.95% and a CAPM analysis that suggested Nicor Gas' ROE was 9.28%. IIEC/CUB point out that Staff used the DCF and CAPM methods and the results of those methods. However, IIEC/CUB note that in just four lines Staff simply states that it has stipulated to a 9.86% ROE for Nicor Gas, well above the Nicor Gas cost of equity capital as calculated by its own expert witness. Staff states in those four lines that the 9.86% is supported by the Stipulation and Nicor Gas' testimony. Nicor Gas-Staff Joint Ex. 1.0 at 2-3. However, IIEC/CUB observe that Staff did not present any testimony from its own expert witness, Ms. Phipps, supporting or explaining Staff's support for the stipulated ROE or stating that it is reasonable and reflective of Nicor Gas' cost of equity capital. IIEC/CUB argue that there is no independent evidentiary record support for Staff's support of the stipulated ROE.

In fact, say IIEC/CUB, Staff's Initial Brief ignores its own expert testimony in this record, testimony that does not support the stipulated ROE but does support the IIEC/CUB recommended ROE. IIEC/CUB argue that Staff did not address the propriety

of the ECAPM and Risk Premium methods and the ATWACC in its Initial Brief because Staff's expert's position on these financial/leverage adjustments is contrary to the methodology used to establish the stipulated ROE. It is important to identify this void in Staff's Initial Brief, claim IIEC/CUB, as Staff's own expert analysis undercuts the evidentiary basis for the stipulated ROE. IIEC/CUB point out that Ms. Phipps' testimony criticized Nicor Gas' leverage adjustments to its DCF, CAPM, and ECAPM estimates, which produced an overall ROE estimate of 10.50%, which was then adjusted for flotation costs to produce a recommended ROE of 10.60%. In her judgment, state IIEC/CUB, the 10.60% was substantially higher than the investor-required rate of return. Staff Ex. 4.0 at 35-37.

IIEC/CUB aver that Ms. Phipps disagreed with Nicor Gas witnesses Graves and Mudge, who suggested that authorized ROEs for Illinois gas utilities have been below the national average of authorized ROE. *Id.* at 39. According to IIEC/CUB, Ms. Phipps explained there has been a period of declining ROEs nationally, consistent with a decline in interest rates and the development of automatic adjustment and investment recovery mechanisms that reduce utility business risk. *Id.*

Like Nicor Gas and IIEC/CUB's experts, Ms. Phipps employed the DCF and CAPM models and relied on those results to compute her recommended ROE, (see Staff Ex. 4.0 at 12), as IIEC/CUB explain is standard Commission practice in rate proceedings. Nicor Gas, on the other hand, suggests that the Commission should instead use "multiple frameworks" and "diverse models" to determine the appropriate ROE. See Nicor Gas Init. Br. at 94. IIEC/CUB claim that these "diverse models" reference by Nicor Gas include the ECAPM analysis, the expected earnings analysis, and the bond yield plus risk premium models used by Mr. Graves and Mr. Mudge, as well as leverage adjustments, which can reference collectively as financial/risk adders. *Id.* at 96. Like IIEC/CUB witness Gorman, Ms. Phipps excluded these financial/risk adders from consideration because they lack merit and had not been adopted in previous proceedings. Staff Ex. 4.0 at 38-40.

IIEC/CUB point out that Ms. Phipps testified that, of the ten Illinois gas utility rate cases since 2012, four of the cases were the subject of stipulated ROEs that were a function of a compromise and settlement of disputed issues reached in those cases and that pursuant to those agreements, the ROEs approved were not to be relied upon in any future proceeding. *Id.* at 40. In the remaining six cases, Ms. Phipps testified that the Commission relied exclusively on ROE estimates derived from DCF and CAPM analyses as is traditionally done. *Id.* at 40. IIEC/CUB point out that Ms. Phipps recognized that the financial/risk adders in those models has been fully litigated numerous times and that Staff has repeatedly explained why they should be rejected by the Commission. *Id.* at 42. IIEC/CUB observe that Ms. Phipps identified at least seven separate cases between 2010 and 1995 where the Commission has declined to adopt leverage adjustments, such as the one Nicor Gas included in its initially-proposed ROE. See *id.* at 60. IIEC/CUB point to her testimony that the "inclusion of the flawed models Messrs. Graves and Mudge propose, . . . would result in an inflated ROE estimate, does not improve the result and is not without consequence. To the contrary, an authorized ROE that exceeds investor-required rate of return would result in a windfall for Company shareholders to the detriment of utility customers." *Id.* at 43.

IIEC/CUB point to Ms. Phipps' testimony that a 9.12% ROE for Nicor Gas would produce \$176 million annually for Nicor Gas' common stockholder (i.e., Southern Company) and that adopting Nicor Gas' initially-proposed ROE of 10.60% would effectively grant Southern Company an additional \$29 million, which would be collected through Nicor Gas' rates. *Id.* at 43-44.

In sum, IIEC/CUB maintain that Ms. Phipps' testimony, which is largely ignored in Staff's and Nicor Gas' Initial Briefs, very clearly demonstrates why the Commission should reject the stipulated ROE. That ROE is based, in part, on Nicor Gas' use of "alternative methodologies," like the ATWACC risk adder, that have consistently been rejected by this Commission, according to IIEC/CUB. As a result, to the extent the Commission relies on the evidence and analyses supporting the stipulated ROE, IIEC/CUB argue that it would be approving a ROE above the reasonable cost of equity for Nicor Gas, as Staff witness Phipps and IIEC/CUB witness Gorman each testified.

#### **d) Commission Analysis and Conclusion**

In determining an appropriate ROE, the Commission must keep in mind various, and, at times, competing interests. The Commission engages in "a balancing of investors and customers interests." *Fed. Power Com. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). The Commission is, however "not merely an arbitrator between the utility and parties opposing a rate change[;] it is an investigator and regulator of utilities[,] responsible for the setting of just rates for all affected by the rates." *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 2018 IL App (1st) 170527, ¶ 25 citing *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 276 Ill. App. 3d 730, 740 (1st Dist. 1995). Furthermore, ratemaking decisions require the Commission to exercise "sound business judgment" rather than the routine application of a legal formula. *People ex rel. Madigan*, 2015 IL 116005, ¶ 23 ("determining rates is a matter of sound business judgment, which the legislature has entrusted to the Commission"); *Iowa-Illinois Gas & Elec. Co. v. Ill. Commerce Comm'n*, 19 Ill. 2d 436, 442 (1960); *Amax Zinc Co. v. Ill. Commerce Comm'n*, 124 Ill. App. 3d 4, 11 (5th Dist. 1984) ("[r]atemaking is not an exact science").

To ensure the safe, effective, reliable, and the least-cost public utility service, the Commission is tasked with setting just and reasonable rates that both reflect the cost of utility service and provide utilities a sufficient return on investment to attract capital in financial markets at competitive rates. 220 ILCS 5/1-102, 102 (a)(iii)-(iv). In doing so, the Commission must ensure that there is enough revenue not only for operating expenses but also for the capital costs of the business. *Hope Natural Gas Co.*, 320 U.S. 591, 603. A sufficient return is one that assures confidence in the financial soundness of the utility and allows the utility to maintain and support its credit and to raise needed capital to run its business. *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 693 (1923). Rates that are insufficient to yield a reasonable return are unjust and unreasonable. *Id.* at 690.

Two parties of record, Nicor Gas and Staff, reached an agreement on their recommended ROE. After careful consideration, the Commission rejects the Stipulation presented by Nicor Gas and Staff and their agreement on a ROE of 9.86%. The Illinois Supreme Court has held that the Commission may consider "a settlement proposal not agreed to by all of the parties and the intervenors" as "a decision on the merits," as long

as the provisions of such settlement do not violate the Act, and “are independently supported by substantial evidence in the whole record.” *Bus. and Prof'l People for the Pub. Interest*, 136 Ill.2d 192, 216-217 (1989). The Commission finds that the stipulated ROE of 9.86% is not supported by substantial evidence in the record. See e.g. IIEC/CUB Ex. 2.0 at 14; IIEC/CUB Ex. 2.3. While the stipulated ROE of 9.86% appears to average the ROEs proposed by Nicor Gas and Staff, Nicor Gas’ proposed ROE of 10.6% is inflated as it includes adjustments for financial risk, including the ATWACC (aka market-to-book (“M/B”) adjustment) as well as the flotation cost adjustment. See e.g. IIEC/CUB Ex. 1.0, Vol. II at 103-108; Staff Ex. 4.0 (Public) at 61.

Regarding the ATWACC, this Commission has consistently rejected similar leverage adjustments in the past. See e.g. *Central Ill. Light Co. d/b/a AmerenCILCO*, *Central Ill. Public Service Co. d/b/a AmerenCIPS* and *Ill. Power Co. d/b/a AmerenIP*, Docket Nos. 09-0306 through 09-0311, Order at 216-17 (April 29, 2010); *North Shore*, Docket Nos. 09-0166/09-0167 (Cons.), Order at 128-29 (Jan. 21, 2010); *North Shore*, Docket Nos. 07-0241/07-0242 (Cons.), Order at 95-96, 99 (Feb. 5, 2008); *Central Ill. Light Co.*, Docket Nos. 06-0070/06-0071/06-0072 (Cons.), Order at 141 (Nov. 21, 2006); *Consumer Ill. Water Co.*, Docket No. 03-0403, Order at 42 (April 3, 2004); *Central Ill. Public Service Co. (AmerenCIPS) and Union Electric Co.*, Docket Nos. 02-0798/ 03-0008/ 03-0009 (Cons.), Order at 87 (Oct. 22, 2003); and *Commonwealth Edison Co.*, Docket No. 94-0065, Order at 92-93 (Jan. 9, 1995). The Commission agrees with Staff witness Phipps that the leverage adjustment Nicor Gas applies in this proceeding is based on the “faulty premise that an adjustment to the cost of equity estimate derived from market values of equity is necessary when that estimate is to be applied to book values of equity to determine utility rates.” Staff Ex. 4.0 (Public) at 61. The Commission observes that Nicor Gas does not have market traded common stock and thus does not have observable market-to-book ratios. Removing the ATWACC adjustment results in a CAPM ROE estimate of 8.7% and a DCF ROE estimate of 9.5%.

Regarding the flotation cost adjustment, the Commission rejects a 10-basis point flotation cost adjustment from 10.5% to 10.6%, as discussed further in this order, and finds that it should not be included in its consideration regarding the appropriate ROE.

By accepting the Stipulation, the Commission could be construed as implicitly “accepting” or “adopting” these adjustments. Therefore, to avoid uncertainty and ambiguity in our rulings, the Commission does not accept the Stipulation as it contains adjustments that unreasonably inflate the rate of return. Having found the ROE recommended by the Stipulation flawed and not fully supported by the evidence in the record, the Commission must fill the gap and exercise sound business judgement in determining a reasonable rate of return on equity. *Commonwealth Edison Co.*, 405 Ill. App. 3d at 402 (the Commission has wide latitude to exercise its business judgment to implement pragmatic solutions by filling gaps in the record).

The Commission’s findings must be supported by substantial evidence within the Commission’s scope of statutory authority, they must be reached in a manner, or through proceedings, that were not unconstitutional or clearly unreasonable. 220 ILCS 5/10-201(e)(iv)(A); see also *Citizens Util. Bd.*, 2018 IL App (1st) 170527, ¶ 25 citing *Monarch Gas Co. v. Ill. Commerce Comm’n*, 261 Ill. App. 3d 94, 101 (5<sup>th</sup> Dist. 1994). Substantial evidence “can support multiple possible findings.” *Citizens Util. Bd.*, 2018 IL App (1st)

170527, ¶ 36 citing *Cent. Ill. Pub. Serv. Co. v. Ill. Commerce Comm'n*, 268 Ill. App. 3d 471, 479 (4th Dist. 1994). The Act “requires ‘substantial evidence,’ not conclusive evidence.” *Citizens Util. Bd.*, 2018 IL App (1st) 170527, ¶ 36 citing *Commonwealth Edison Co. v. Ill. Commerce Comm'n*, 398 Ill. App. 3d 510, 514 (2d Dist. 2009). Substantial evidence requires “more than a mere scintilla but less than a preponderance of evidence” and requires “evidence that a reasoning mind would find to be sufficient support for a particular conclusion.” *Id.*

In determining the reasonable cost of equity, the Commission traditionally analyzes the values derived from several financial analysis tools. Nicor Gas, Staff, and IIEC/CUB presented witnesses who testified concerning their recommendations for the Company’s cost of common equity. While all the witnesses performed their analyses using the DCF and CAPM analyses, their recommendations differ considerably. In addition, Nicor Gas proposed ROEs using two additional models, Risk Premium and Expected Earnings. The Commission notes that the record presents the following range of unadjusted proposed values, provided in the Table below:

	<b>Nicor Gas<sup>1</sup></b>	<b>Staff<sup>2</sup></b>	<b>IIEC/CUB<sup>3</sup></b>
<b>CAPM</b>	8.7	9.28	9.5
<b>DCF</b>	9.5	8.95	8.9
<b>Risk Premium</b>	10.2	N/A	N/A
<b>Expected Earnings</b>	11.2	N/A	N/A

The Commission finds that the entire range of the values that the parties’ DCF, CAPM, Risk Premium, and Expected Earnings calculations produced, without averaging them first, is the most complete range of ROEs in the record evidence.

The Commission notes that each of the proposed models has arguable flaws. CAPM measures systemic risk, *beta*, for which the cost of equity must compensate investors, but parameters are measured against historical data. This creates a model that adjusts slowly to changes in the industry. In contrast, DCF models incorporate current market prices in the most recent dividends and growth outlook, thereby making DCF modeling, arguably, too sensitive to short-term market phenomena, which may not be representative of capital market conditions and the required investor returns that will prevail in the future. The bond yield plus risk premium models contain proxy sample flaws and can use outdated data. The expected earnings method incorrectly posits that earned returns on book common equity are the same as investor-required returns on common

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<sup>1</sup> Traditional CAPM & DCF, IIEC/CUB Exhibit 1.0, Vol. II at 103; Risk Premium, Nicor Gas Ex.14.0 at 61, Expected Earnings, Nicor Gas Ex.14.0 at 63.

<sup>2</sup> CAPM, Staff Ex. 4.0 at 33 and Schedule 4.12; DCF, Staff Ex. 4.0 at 21 and Schedule 4.12.

<sup>3</sup> CAPM & DCF, IIEC/CUB Exhibit 1.0, Vol. II at 97.

equity. The Commission has in the past rejected the use of bond yield plus risk premium models as well as the expected earnings analysis. See e.g. *North Shore*, Docket Nos. 14-0224/14-0225 (Cons.), Order at 134 (Feb. 5, 2015) (for risk premium); *Commonwealth Edison Co.*, Docket No. 10-0467, Order at 152 (May 24, 2011); *Central Ill. Company*, Docket Nos. 06-0070/06-0071/06-0072 (Cons.), Order at 141-42 (Nov. 21, 2006) (for expected earnings). While historically the Commission has focused on the DCF and CAPM models, the Commission acknowledges that there may be a value in exploring additional models presented by the parties, specifically the Risk Premium and Expected Earnings, to bring our methodology into closer alignment with how investors inform their investment decisions. The Commission is cognizant that other regulatory agencies are also considering this approach to ensure that the chosen return on equity is based on substantial evidence and does not overvalue any one model. See e.g. 165 FERC ¶ 61,118 at 11.

Within this more complete range of ROEs in the record, the Commission looks at the trends among these values to determine consistencies and anomalies. At the outset, it is evident that the Expected Earnings model produces an anomalous result of 11.2%, that is substantially higher than the ROE of 10.6% initially requested by Nicor Gas, is also 100 basis points higher than the next closest number and exceeds recent historical awards by 145 basis points. Nicor Gas Ex. 2.0 at 8:169-9:172; Nicor Gas Reply Br. at 87, Figure 1; Nicor Gas Ex. 29.0 at 5:91–94 (showing an average Commission ROE award in recent years (2015-2018) of 9.75%). The Commission is, thus, not persuaded that it should consider this value and rejects the 11.2% ROE produced by the Nicor Gas' Expected Earnings calculations as unreasonable. See e.g. IIEC/CUB Ex. 1.0, Vol. II at 102:1261-62, 103; Nicor Gas Ex. 14.0 at 64:1199-1201; Staff Ex. 4.0 at 37:673-74.

The Commission also rejects ROEs of 8.7%, 8.9%, 8.95% and 9.28%. An authorized rate of return that is not competitive will deter continued investment in the State of Illinois. A reasonable ROE helps ensure that the company can attract capital in order to meet the Commission required infrastructure needs. While the Commission is not bound, as Nicor Gas alleges, by the 9.80% ROE issued 19 months ago, we do note that a significant reduction in ROE from the previous Order would provide regulatory instability given that market conditions are not that drastically different from our most recent determination. Nicor Gas Rep. Br. on Exc. at 2. The Commission believes that the ROEs at such a low end of the range are not “reasonably sufficient to assure confidence in the financial soundness” of Nicor Gas and would potentially reduce the utility’s competitive access to capital markets. *Bluefield*, 262 U.S. at 693; *Hope*, 320 U.S. at 603 (“return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks”). Moreover, the Commission does not believe these proposed ROEs are appropriately reflective of market conditions. Therefore, the Commission rejects 8.7%, 8.9%, 8.95% and 9.28% as unreasonable ROEs. For the same reasons, the Commission also rejects the ROE of 9.13% recommended by the Administrative Law Judges in the Proposed Order.

The Commission finds that the resultant range of reasonable ROEs based on the record evidence is: 9.5%, 9.5% and 10.2%. These numbers are reflective of CAPM, DCF and Risk Premium models and are fully supported by the record. See e.g. Nicor Gas Ex. 14.0 at 61:1127–29, 64:1199-1201; Staff Ex. 4.0 at 37:673-74, 40:725-26; IIEC/CUB Ex.

1.0, Vol. II at 97:1162-63, 102:1261-62. In averaging this range of numbers, the Commission arrives at a ROE of 9.73%. Averaging is a reasonable approach that has been traditionally both used by the Commission and upheld by the courts. *Ill.-Amer. Water Co.*, Docket No. 16-0093, Order at 66-67 (Dec. 13, 2016); *Aqua Ill., Inc.*, Docket No. 14-0419, Order at 43 (Mar. 25, 2015); *Citizens Util. Bd.*, 2018 IL App (1st) 170527, ¶ 33. The Commission finds that a ROE of 9.73% is reasonable and supported by substantial evidence.

In support of its conclusion that a ROE of 9.73% is just and reasonable, the Commission finds that 9.73% is consistent with the average award in recent years (of 9.75%, as noted by Nicor Gas) and is also within the 12-year historical range of 9.05% to 10.15%. Nicor Gas Ex. 29.0 at 5-6; see also Nicor Gas Reply Br. at 87, Figure 1. Moreover, the awarded ROE of 9.73% in this case is consistent with the national average award of 9.73%. *Id.* It is also consistent with the general downward trend in ROE awards evident from the record. Staff witness Phipps, for example, explains that there is a “generally downward trend in authorized ROE over the past several years...consistent with the declining interest rate environment.” Staff Ex. 4.0 at 39:711-20 (citing February 20, 2019 S&P Global Market Intelligence, RRA Regulatory Focus, and noting that “the average authorized ROE for gas utilities averaged 9.59% in 2018, declining from 9.72% in 2017”). IIEC/CUB witness Gorman notes as well that “[o]bservable market evidence is quite clear that capital market costs are near historically low levels. IIEC/CUB Ex. 1.0, Vol. II at 40:142-48. He adds that “[w]hile authorized returns on equity have fallen to the mid-9% range, utilities continue to have access to large amounts of external capital even as they are funding large capital programs.” *Id.*; see also IIEC/CUB Ex. 1.0, Vol. II at 35:61-36:64 (showing a decline from 2017 to 2018). The Commission also observes that ROEs produced by the parties’ calculations in this docket follow a similar trend as compared to Nicor Gas’ previous rate case and are approximately 10 basis points lower than parties’ proposed ROEs in the last rate case.

A ROE of 9.73% derives from Commission review of various models, without utilizing adjusted CAPMs or DCFs modeling, that has been consistently rejected by the Commission in the past. The Commission finds this balanced approach appropriate in the instant case. It is neither a specific endorsement or rejection of any one particular model or methodology but rather is intended to represent the Commission’s careful review of the substantial record evidence before it in this particular case.

Consistent with its decision in other rate cases, this analysis “is not indicative of how the Commission will review and decide upon ROE in future rate cases, nor shall this decision obligate the Commission to apply the same or similar analysis in future proceedings.” *2017 Rate Case*, Order at 102 (Jan. 31, 2018). The Commission has the authority to address each situation before it despite how the Commission may have previously addressed a similar situation. *Citizens Util. Bd. v. Ill. Commerce Comm’n*, 291 Ill. App. 3d 300, 307 (1997).

For the reasons stated above, the Commission adopts Nicor Gas’ cost of common equity of 9.73%. This number reflects an average of the 9.5%, 9.5% and 10.2% proposed ROEs. The Commission finds that this ROE is reasonable, supported by the record, and consistent with the governing legal standard. The Commission’s analysis in this case is not indicative of how the Commission will review and decide upon ROE in future rate

cases, nor shall this decision obligate the Commission to apply the same or similar analysis in future proceedings.

### **3. Flotation Costs**

#### **a) Nicor Gas' Position**

As part of the Stipulation, Nicor Gas has agreed not to seek recovery of its unrecovered historical flotation costs in this proceeding. Nicor Gas states the Stipulation was entered into for the purposes of reducing the uncertainties of litigation, conserving resources, reducing the scope and complexity of contested matters, and simplifying the resolution of issues in the rate case.

Nicor Gas states that utilities have a legal right to the opportunity to recovery flotation costs just as they do with respect to any other type of cost, and that the evidence supports recovery of these long-unrecovered costs. To the extent that flotation costs are still disputed by IIEC/CUB, Nicor Gas maintains that it provided sufficient evidence establishing that it has incurred costs of issuing equity that have not previously been recovered in rates. Nicor Gas Ex. 2.0 at 14-15.

#### **b) IIEC/CUB's Position**

IIEC/CUB point out that Mr. Graves and Mr. Mudge estimated that a 10-basis point adder represents a reasonable adjustment to account for flotation costs, which increases Nicor Gas' proposed ROE from 10.5% to 10.6%. IIEC/CUB Ex. 1.0, Vol. II at 129.

In the opinion of IIEC/CUB, flotation costs are ordinarily a legitimate cost of doing business but should only be included in the development of cost of service under two conditions. First, say IIEC/CUB, the Company must demonstrate what its actual flotation costs are, and then prove they are reasonable. IIEC/CUB aver that it is not appropriate to approximate flotation costs and build those approximated costs into a utility's cost of service: costs should be known and measurable and should be verifiable and most importantly, should be shown to be reasonable before they are included in cost of service, which is not possible if a utility's flotation costs are approximated, as Mr. Graves and Mr. Mudge have done. IIEC/CUB Ex. 1.0, Vol. II at 129-30.

Second, IIEC/CUB aver that Nicor Gas is not a publicly traded company. It is a wholly owned subsidiary of Southern Company. IIEC/CUB point out that, at the time the subject flotation costs were incurred in 1979, Nicor Gas was a subsidiary of Nicor Inc. Therefore, all common stock issuance expense shown on Nicor Gas' Schedule D-5 were for Nicor Inc. common stock, which is now completely owned by Southern Company. IIEC/CUB state that the subject stock is no longer an outstanding publicly traded common stock and is 100% owned by Southern Company Gas, which in turn is owned by Southern Company. IIEC/CUB Ex. 1.0, Vol. II at 130.

IIEC/CUB confirm that the flotation cost expenses shown on Schedule D-5 relate to the sale of stock to the public. IIEC/CUB state that these shares no longer exist because they have been acquired by Southern Company. According to IIEC/CUB, the record cannot demonstrate that Southern Company did not already recover the flotation costs when it acquired these publicly traded shares. IIEC/CUB argue that simply reciting the historic flotation costs associated with these shares is not proof of the justness and reasonableness of including the flotation cost adjustment in rates in this case. IIEC/CUB

observe there is no evidence that the Company has incurred any flotation costs that should be included in its cost of service in this proceeding. Because the Company no longer has publicly traded shares, say IIEC/CUB, it cannot show that it incurs costs in selling common stock to the market. IIEC/CUB argue that neither source of Nicor Gas' equity capital, retained earnings and equity infusion from its parent company, Southern Company, results in the incurrence of flotation costs. IIEC/CUB aver that under the circumstances, Mr. Graves and Mr. Mudge's estimate of a 10 basis point adjustment to account for the flotation costs should be disregarded and excluded from the cost of equity determination in this case.

Third, IIEC/CUB note the Commission has considered Nicor Gas' recovery flotation costs through its cost of common equity in past cases. See *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 04-0779, Order at 94 (Sep. 20, 2005); *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 95-0219, Order at 98 (Apr. 3, 1996). IIEC/CUB point out that in Nicor Gas' last rate case, the Commission found that Nicor Gas failed to prove that issuance costs were not previously recovered through rates and rejected the Company's proposal for a flotation cost adjustment. 2017 Rate Case, Order at 109. Likewise, in this proceeding, Nicor Gas has not provided evidence that the subject costs have not been previously recovered.

IIEC/CUB state that the Company has suggested in this case, pursuant to 83 Ill. Adm. Code 285.4050, that it has had \$478,277 in stock issuance expense since 1978. Staff Ex. 4.0 at 68, Fn. 101. However, as Staff witness Phipps noted and IIEC/CUB agree, the simple entry of that expense on Nicor Gas' books does not mean the expense has not been recovered. Therefore, in the opinion of IIEC/CUB, the flotation cost adjustment proposed by Nicor Gas should be rejected.

In sum, it is the position of IIEC/CUB the flotation cost should only be recovered in rates if the costs are known and measurable, not approximated. IIEC/CUB explain that the flotation costs in this case are associated with the floating stock sold to the market in 1979 and do not reflect the cost of stock outstanding and reflective of Nicor Gas' current ownership or Nicor Gas' cost of public stock issuance incurred by its parent company. The cost, in essence, is not known and measurable and is not associated with Nicor Gas' current parent company and public traded stock related to Nicor Gas cost of common equity, the adjustment should be rejected as it has been in the past, according to IIEC/CUB.

### **c) Commission Analysis and Conclusion**

Historically, the Commission rejects flotation cost adjustments unless the utility can show that (1) it incurred the specific amount of flotation costs for which it seeks recovery and (2) the specific flotation costs have not previously been recovered through rates. Nicor Gas states it withdrew its proposal to seek recovery of its historical flotation costs in the Stipulation. Therefore, the Commission finds that flotation costs shall not be recovered.

## **D. Recommended Rate of Return on Rate Base**

### **1. Nicor Gas' Position**

Nicor Gas states that the 7.2675% ROR recommended in the Stipulation is reasonable and appropriate and is supported by the evidentiary record. Nicor Gas further states that each of the individual components of the rate of return is itself reasonable and supported by the evidence, including the testimony of its experienced and well-qualified witnesses. Nicor Gas argues that the record evidence shows that its recommended 7.2675% ROR is within industry standards and fairly reflects the Company's costs of providing safe, reliable utility service. Nicor Gas further argues that its proposed ROR takes into account factors specific to Nicor Gas as well as properly accounts for recent tax changes and Nicor Gas' continuing need for a strong capital structure.

Nicor Gas argues that the reasonableness of its proposal is supported by the fact that it is nearly identical to its current approved ROR of 7.256%, approved in the 2017 Rate Case. Nicor Gas notes that, while the individual components of the rate of return are significant, the resulting rate of return is the number that ultimately affects customers' rates, and Nicor Gas and Staff's recommendation for the components of cost of capital results in an input to the calculation of customers' rates is substantially similar to that approved in the 2017 Rate Case.

### **2. Staff's Position**

It is Staff's view that as set forth in the Stipulation (Nicor Gas-Staff Joint Ex. 1.0 at 3) and supported by the Company's witnesses' rebuttal and surrebuttal testimony (Nicor Gas Ex. 18.0 at 3- 6, 14; Nicor Gas Ex. 29.0 at 2- 6.; Nicor Gas Ex. 32.0 at 3-5; Nicor Gas Ex. 42.0 at 1-10), Nicor Gas' overall cost of capital should be 7.2675%. Nicor Gas-Staff Joint Ex. 1.0 at 3, ¶ 8.

### **3. IIEC/CUB's Position**

IIEC/CUB recommend an overall rate of return of 7.0%. IIEC/CUB Ex. 1.1. IIEC/CUB's recommended rate of return on rate base is based on Mr. Gorman's recommended 9.2% ROE and a capital structure including a common equity ratio of 52.0%, long-term debt of 45.581%, and short-term debt of 2.419%. IIEC/CUB Ex. 1.0, Vol. II at 64. In stark contrast, say IIEC/CUB, the Stipulation ROE of 9.86% and common equity ratio of 54% are far more than necessary to ensure a decent bond rating.

IIEC/CUB note that while Nicor Gas claims the Stipulation's overall ROR of 7.2675% is reasonable, Staff on the other hand simply says the Stipulation ROR is supported by the rebuttal and surrebuttal testimony of Company witnesses Graves and Mudge and the Stipulation itself. IIEC/CUB show several reasons why this settlement ROR is excessive and unreasonable.

First, IIEC/CUB point out that in this case, IIEC/CUB witness Mr. Gorman, and Staff witness Ms. Phipps were very close in their recommended overall ROR for Nicor Gas. Ms. Phipps recommended 6.92% and Mr. Gorman recommended 7.00%. Staff Ex. 4.0 at 35; Gorman, IIEC/CUB Ex. 2.0 at 62; IIEC/CUB Ex. 1.1. Mr. Gorman explained that, based on a comparison of key financial ratios for Nicor Gas at his proposed return on common equity of 9.2% and his proposed capital structure (with 52% common equity to S&P's benchmark financial ratios, using S&P new credit metrics), his recommended

overall rate of return would support an investment grade bond rating for Nicor Gas. IIEC/CUB Ex. 1.0, Vol. II at 97-101. Thus, contrary to Nicor Gas' suggestions, IIEC/CUB believe Mr. Gorman's recommended overall rate of return for Nicor Gas is reasonable and will ensure Nicor Gas financial integrity.

Second, IIEC/CUB point out the settlement overall rate of return is not reasonable, as claimed by Nicor Gas. It is excessive because it includes a common equity ratio of over 54.2%, along with an excessive return on common equity of 9.86%. IIEC/CUB Ex. 2.0 at 15-16.

Third, IIEC/CUB argue the stipulated overall rate of return of 7.2675% has been inflated by an excessive amount of common equity that will require customers to pay rates higher than necessary to support Nicor Gas' current A- investment grade bond rating. Thus, customers will not receive a benefit from paying an inflated ROR as reflected in the settlement. The rates necessary to support such an excessive overall rate of return, produce rates that are not just and reasonable and do not provide the necessary balance between protecting the interests of investors and customers. IIEC/CUB Ex. 2.0 at 16. IIEC/CUB cite to the reasoning of Illinois Courts in support of the tenets that (1) the Commission is responsible for balancing the right of utility investors (in this case, Southern Company), to a fair rate of return and the right of members of the public to pay no more than reasonable for the value of utility services and rates can never be so low as to be confiscatory; and (2) that when the "...rightful expectations of the investor are not compatible with those of the consuming public, it is the latter that must prevail." *Camelot Utilities Inc., v. Ill. Commerce Comm'n*, 51 Ill. App. 3d 5, 10 (1995), citing *State Public Utilities Comm'n, ex rel., City of Springfield v. Springfield Gas & Electric Co.*, 291 Ill. 209. In this case, IIEC/CUB's recommended ROR of 7% will actually allow Nicor Gas to maintain its current bond rating and financial integrity, and thus the interest of Nicor Gas investors (Southern Company) in achieving a higher rate of return is not compatible with those of the consuming public. Under the circumstances, IIEC/CUB argue that the interest of the consuming public in ensuring a lower cost rate of return that will allow Nicor Gas to maintain its current bond rating should prevail and the Commission should approve the IIEC/CUB overall rate of return of 7%, together with its recommended 52% common equity ratio and its 9.2% ROE.

#### **4. Commission Analysis and Conclusion**

Based on the findings in this Order concerning Nicor Gas' capital structure and costs of debt and equity, the Commission adopts a ROR of 7.197% as calculated below. This rate of return on rate base includes a ROE of 9.73% and a capital structure including a common equity ratio of 54.20%, long-term debt of 40.90%, and short-term debt of 4.90%.

<b>CAPITAL COMPONENT</b>	<b>Weight</b>	<b>Cost</b>	<b>Weighted Cost</b>
Short-term Debt	4.90%	2.494%	0.122%
Long-term Debt	40.90%	4.350%	1.779%
Common Equity	54.20%	9.73%	5.274%
Credit Facility Cost			0.022%
<b>Total</b>	100.00%		7.197%

## **VIII. COST OF SERVICE AND ALLOCATION ISSUES**

### **A. Overview**

Nicor Gas states that its embedded cost of service study (“ECOSS”) employs sound allocation methods that reflect principles of cost causation and is consistent with the Commission’s decision in the 2017 Rate Case. Staff and Nicor Gas are in agreement concerning the ECOSS methodology. A dispute remains between the Company and the AG with respect to two allocation issues.

Staff states that the Company proposed the average and peak (“A&P”) allocation factors in its Cost of Service Study (“COSS”). The Company’s COSS is consistent with the COSS approved in the Company’s 2017 Rate Case. Staff Ex. 5.0 at 5. Staff witness Harden supports the A&P allocator as long as the Commission continues to find that the modified distribution main (“MDM”) approach is reasonable for Nicor Gas. As discussed in the below in Section IX., the Company’s proposal to implement Rider Volume Balancing Adjustment (“VBA”) will have an additional impact on rate design that is not considered in the Company’s use of the MDM approach in its COSS. *Id.* at 9.

### **B. Uncontested Issues**

#### **1. Average and Peak Allocator**

Nicor Gas explains that cost allocation is the apportionment of individual elements of the Company’s cost of service among the rate classes, based on the responsibility of each class for the cost being incurred. Nicor Gas notes that the process of cost allocation requires the development of numerous cost allocation factors that reflect the causation of the different types of costs included in the revenue requirement.

Nicor Gas further explains that one of the most significant cost allocation factors is the factor used to allocate fixed demand costs among customers. In turn, the Company notes that the most significant driver of demand-related costs is design day demand, due to the weather patterns in the service area.

Nicor Gas used a A&P allocator for general demand which, the Company states, uses the contribution to design day demand and the proportion of annual use. No party disputes this decision. As a result, this issue is uncontested, and the use of the A&P allocator is approved.

## **2. Modified Distribution Main Study**

Nicor Gas explains that fixed demand-related distribution main costs are allocated to rate classes on the basis of a blended allocation factor derived from a MDM study. Nicor Gas states that it applied that blended MDM and average allocation factor to the customer component of distribution mains, in order to preserve the underlying allocation approach that the Commission adopted in past Nicor Gas rate cases. 2017 Rate Case, Order at 115. Nicor Gas states that the MDM study examines the side of the mains that connect individual customers to the Company's system, and the aggregated day load for each rate class is used to allocate the book cost of each diameter of main.

No party disputes Nicor Gas' MDM study methodology or the resulting allocation of costs. Staff witness Harden requested that Nicor Gas perform a different study that does not incorporate MDM results to examine the impact of the Company's proposed Rider VBA on rate design. When the Company provided that study, Ms. Harden recommended two modifications that reduce the monthly customer costs for Residential Rate 1 customers by \$2.89, compared to the Nicor Gas proposal. Nicor Gas is in agreement with Staff concerning the residential customer charge. As a result, there is no dispute among the parties concerning the MDM study or the resulting allocation of costs, and it is approved.

### **C. Contested Issues**

#### **1. Residential Customer Charge**

##### **a) Nicor Gas' Position**

All Nicor Gas residential customers, which the Company attests comprise 90% of its customer base, are served under Rate 1. The Company explains that the rate design that applies to these customers includes two types of charges: a fixed monthly customer charge and a distribution charge applied on a per-therm basis. In this case, Nicor Gas proposes to increase the fixed monthly customer charge from \$16.06 per month to \$20.69 per month. The Company states that the monthly customer charge was derived using the methodology approved by the Commission in the 2017 Rate Case. Under this methodology, the Company would recover 75% of the residential class' allocated base revenue through the Rate 1 customer charge. The Company also proposes to increase the per-therm distribution charge from \$0.0471 to \$0.0754 per therm to recover the revenue requirement not recovered through the monthly customer charge.

Nicor Gas initially proposed that its Rider VBA apply to all residential Rate 1 customers. Staff witness Harden recommended that, if Rider VBA is adopted, the monthly customer charge should recover 70% rather than 75% of base revenues allocated to residential customers. The Company agreed with Staff's proposal. In the event the Commission does not approve Rider VBA, Staff agreed with the Company that the monthly customer charge should recover 75% of the revenues allocated to residential customers. As a result, Staff and Nicor Gas are in agreement regarding this issue.

In addition, AG witness Rubin argued that only 65% of residential-allocated revenues should be recovered through the monthly customer charge. Mr. Rubin later responded, in agreement with Staff, that recovering 70% of residential-allocated revenues through the monthly customer charge would be reasonable. However, Mr. Rubin does not support the adoption of Rider VBA and his rebuttal testimony does not appear to recognize the terms of agreement between Staff and the Company, proposing the 70% recovery rate only if Rider VBA is approved. The Company maintains that if Rider VBA is not approved, which is Mr. Rubin's preference, then 75% of residential-allocated revenues should be recovered through the monthly charge.

Accordingly, the Company takes the position that the Commission should approve a monthly customer charge that recovers 70% of the residential class revenues if Rider VBA is approved. If Rider VBA is not approved, the Company argues that the Commission should approve a monthly customer charge that recovers 75% of the residential class revenues. The Company avers that these proposals are in alignment with the results of the ECOSS, and they recognize the relationship between fixed monthly charges and the Company's ability to recover its fixed costs.

**b) AG's Position**

The AG's position is discussed in detail below in Section IX.B.1.

**c) Commission Analysis and Conclusion**

Nicor Gas and Staff reached an agreement that, if Rider VBA is adopted, the Commission should approve a monthly customer charge that recovers 70% of the residential class revenues. Nicor Gas states that the recommendation is in alignment with results of the ECOSS. The AG also accepts Nicor Gas' and Staff's compromise position to collect 70% of residential class revenues should Rider VBA be approved. Because the Commission is adopting Rider VBA, the Commission therefore approves the uncontested proposal for a monthly customer charge that recovers 70% of the residential class revenues.

**2. Class Revenue Allocation**

**a) Nicor Gas' Position**

Nicor Gas proposes to allocate revenues among the customer classes to mitigate the level of increase in rates applicable to the Residential Rate 1 and Large Volume Transportation Rate 77 classes by increasing rates for Rate 4, Rate 74, Rate 5, and Rate 75 customers. AG witness Rubin proposes an alternative revenue allocation, which would result in Rate 1, Rate 74, and Rate 77 classes each receiving a 23.7% increase in revenues. The Company asserts that Mr. Rubin's proposal would fail to treat Rate 74 the same as its companion, Rate 4. As a result, the AG's proposal would result in higher base rates for transportation service than would apply to a similarly-situated sales service customer and create an inappropriate economic incentive for transportation customers to return to sales service.

Mr. Rubin revised his proposal to recommend deriving new rates at the higher revenue allocation that would result from combining the Rate 4 and Rate 74 allocations that he initially recommended. Nicor Gas argues that this proposal would continue to impose an unreasonable subsidy on Rate 4 and Rate 74 customers. As a result, the

Company avers that the Commission should approve Nicor Gas' proposed revenue allocation methodology, including the Company's proposed method for mitigating the revenue increase allocated to Residential Rate 1 customers.

**b) AG's Position**

Nicor Gas proposes to increase rates to its various customer classes at various rates. Nicor Gas Ex. 12.5. However, the AG notes that rather than move customers toward cost of service consistently, Nicor Gas deviates from this concept of mitigation by lumping Rate 74 with other non-residential rates. This masks the fact that revenues from Rate 74 should be increased by \$10.5 million, from \$40.5 million to \$51.0 million, or a 25.9% increase, according to the AG. AG Ex. 4.0 at 9. That level of increase is almost as large as the unconstrained increase to the Residential class (27.4%). AG Ex. 4.3.

AG witness Rubin recommends that Rate 74 should be treated separately from other non-residential rates for purposes of this case, and that "revenues available for mitigation should be used to achieve the same percentage increase for the three classes that the ECOSS indicates require significant revenue increases, the Residential, Rate 74, and Rate 77 classes. This results in the Residential, Rate 74, and Rate 77 classes each receiving a 23.7% increase (or approximately 1.15 times the system-average increase of 20.7% including QIP changes)," as shown on AG Exhibit 4.4. Given that the rate increase requested in this docket will be less than originally requested, Mr. Rubin suggests that the percentages in the last column on AG Exhibit 4.4 should be reduced by the same proportion to achieve the overall revenue requirement. *Id.* at 10.

The AG urges the Commission to adopt Mr. Rubin's rate mitigation approach to fairly treat residential and non-residential customer classes. Nicor Gas witness Yardley's concern that Rates 4 and 74 should be treated the same can be accommodated, "by having the total revenues from the two classes equal the amounts [Mr. Rubin] showed on AG Exhibit 4.4 (as adjusted for differences in the revenue requirement)." AG Ex. 11.0 at 12. However, customer classes that have different costs, and produce different rates of return clearly impose different costs on the system, and the rates and rate increases applicable to these customer classes should reflect those different costs, the AG notes. In the AG's opinion, it is inappropriate to mask those differences and perpetuate the problems with cost, while increasing rates for residential customers.

In response to AG witness Rubin's testimony that its class revenue allocation under-allocates costs to Rate 74, Nicor Gas asserts that it wants to treat customers who receive service through sales rates and through transportation rates the same, even though the revenues from the transportation customers (Rate 74) do not cover costs. Mr. Rubin modified his recommendation to allow these two rates (Rate 74 and Rate 4) to remain the same (despite the fact that the costs are different) while still sharing the effect of rate mitigation with the residential class.

Nicor Gas recognizes that Mr. Rubin's final proposal would allow Rates 74 and 4 to remain the same, but still opposed a fair sharing of the mitigation of rate increases by asserting that there would still be "an unreasonable subsidy on those customers." The reason that Nicor Gas proposed to mitigate rate increases is because the revenues from certain classes do not cover their costs as determined by the COSS. Both Residential customers and Rate 74 and Rate 4 face subsidy issues and denying mitigation to

residential customers based on a claim of “unreasonable subsidy” does not address the key question, which is how to allocate the requested revenue increase in light of these subsidies, according to the AG. Nicor Gas chooses to favor Rates 4 and 74. The AG maintains that the COSS justifies increasing Rates 4 and 74, as recommended by Mr. Rubin.

### **c) Commission Analysis and Conclusion**

The ECOSS assesses the reasonableness of prices among the different customer classes and is used to determine the appropriate cost responsibility for each customer class. Based on the results of the ECOSS, the Residential Rate 1 and Large Volume Transportation Rate 77 classes would experience the largest revenue increase. Nicor Gas asserts an adjustment is needed to Rate 4, Rate 74, Rate 5 and Rate 75 to mitigate the level of increase in rates applicable to the Residential Rate 1 and Rate 77 classes. No party contests that an adjustment is needed. However, Nicor Gas and the AG disagree on the appropriate revenue allocation.

The Commission finds that Nicor Gas presented a sufficient basis for its proposed allocation methodology. Nicor Gas’ proposal increases rates for Rate 4, Rate 74, Rate 5, and Rate 75 customers by approximately one-half of the increase that would otherwise have been applied to Rate 1 and Rate 77 customers. The Commission notes that Nicor Gas asserts that the AG’s proposal would impose an unreasonable subsidy on Rate 4 and Rate 74 customers. The Commission is not persuaded by the AG’s contention that a larger increase to Rate 4 and Rate 74 is needed beyond what Nicor Gas already proposes. Accordingly, the Commission adopts Nicor Gas’ proposed class revenue allocation.

## **IX. RATE DESIGN**

### **A. Uncontested Issues**

#### **1. SBS Charge Increase**

Nicor Gas proposes to increase the charge associated with the Storage Banking Service (“SBS”) from \$0.0052 to \$0.0065. Nicor Gas Ex. 7.0 at 4. The increased charge is based on the Company’s calculation of its storage revenue requirement, and the results of the ECOSS presented in this case. *Id.* at 5; see also Nicor Gas Ex. 12.3 (ECOSS results), Nicor Gas Ex. 12.6 (storage-related rate components). This adjustment is uncontested and is approved.

#### **2. Administrative Charge Adjustment for Transportation Rates**

Nicor Gas proposed an adjustment to the monthly Administrative Charge applied to accounts on Rate 74, Rate 75, and Rider 25. Currently, individual accounts on Rate 74, Rate 75, and Rider 25, pay a monthly Administrative Charge of \$39.00. Nicor Gas Ex. 7.0 at 5. Group accounts on those rates are charged \$8.00 per month per account within the group, with a minimum group charge of \$47.00. *Id.* Under the Company’s proposal, the Administrative Charge for individual accounts would increase to \$56.00 per account, while the Administrative Charge for group accounts would be \$7.00 per month per account with a minimum group charge of \$63.00. *Id.*

Nicor Gas explains these adjustments are appropriate because there has been a decrease in the number of individual accounts, relative to the cost of serving them, driving the increase in the Administrative Charge for individual and group accounts. This adjustment is uncontested and is approved.

### **3. Companion Rates**

Nicor Gas' existing rate schedules are segregated by sector, customer size, and nature of service. Residential customers are served under the Rate 1 rate schedule, while commercial and industrial ("C&I") customers are served under eight different rate schedules. The eight C&I rate schedules include four pairs of rate schedules, and each pair includes a sales service rate schedule and transportation service rate schedule. The C&I parties schedules are: (1) Rate 4 (General Service) and Rate 74 (General Transportation Service); (2) Rate 5 (Seasonal Use Service) and Rate 75 (Seasonal Use Transportation Service); (3) Rate 6 (Large General Service) and Rate 76 (Large General Transportation); (4) Rate 7 (Large Volume Service) and Rate 77 (Large Volume Transportation Service).

Staff notes the C&I rate schedules employ the same type of rate design as residential customer rates, that is, there are customer charges and distribution charges. Staff Ex. 5.0 at 19. However, some of the companion rate schedules have three different meter class-based customer charges as compared to the single customer charge for Residential Rate 1 customers. In addition, Rate 7 and Rate 77 schedules incorporate demand charges added to the customer charge and distribution charge. The demand charges are applied monthly to the peak consumption billing determinant for the customer. *Id.* Company witness Yardley explained that sales customers on these companion rates who purchase their gas supply from Nicor Gas pay a volumetric gas charge for gas supply through Rider 6. Many customers are transportation-only customers and pay Nicor Gas to deliver gas supply that they have purchased from various third-party suppliers that may offer competitive pricing. Nicor Gas Ex. 12.0 at 20-21. This issue is uncontested and is approved.

#### **a) Rates 4 and 74**

Nicor Gas' proposed rates for Rate 4 (General Service) and Rate 74 (General Transportation Service) were derived on a combined basis, taking into account the revised cost of storage. Nicor Gas Ex. 12.0 at 27. The change in base revenue is reflected proportionally in the fixed monthly customer and variable distribution charges. This approach maintains the percentage of fixed cost recovery through fixed charges. *Id.* Once the fixed monthly customer charges are determined, the distribution charge adjusts to recover the remaining base revenue requirement. *Id.* The updated unit cost of storage is deducted from the Rate 74 charge. *Id.*; see also Nicor Gas Ex. 12.7 at 2, 6.

Staff witness Harden recommended that the Company's original proposals from its direct testimony be approved as the companion rates are not affected by Rider VBA and stated that the final rates should be adjusted based upon the revenue requirement ultimately approved by the Commission. Staff Ex. 5.0 at 20, 22. This adjustment is uncontested and is approved.

**b) Rates 5 and 75**

Nicor Gas' proposed rates for Rate 5 (Seasonal Use Service) and Rate 75 (Seasonal Use Transportation Service) incorporate an increase in base revenues to reflect the elimination of QIP revenues. Nicor Gas Ex. 12.0 at 27. The monthly fixed customer charge component of these rates was increased to a level that corresponds with the fixed monthly charges under Rate 4 and Rate 74. *Id.* The distribution rate for the winter period was set equal to the tail block rate for Rate 74, and all remaining revenue requirements will be recovered through the summer period distribution rate. *Id.*; see also Nicor Gas Ex. 12.7 at 3, 7.

Staff notes Ms. Harden recommended that the Company's original proposals from its direct testimony be approved as the companion rates are not affected by Rider VBA and stated that the final rates should be adjusted based upon the revenue requirement ultimately approved by the Commission. Staff Ex. 5.0. This adjustment is uncontested and is approved.

**c) Rates 6 and 76**

Nicor Gas set rates for Rate 76 (Large General Transportation Service) according to the ECOSS and used those rates as the basis to derive rates for Rate 6 (Large General Service). Nicor Gas Ex. 12.0 at 28. Currently, no customers take service under Rate 6. Nicor Gas proposes to increase the customer charge for Rate 76 to \$2,500 to reflect the results of the ECOSS and derived a delivery charge necessary to yield the target level of base revenues. *Id.* Rates to be charged under Rate 6 were set equal to those derived for Rate 76, except that the delivery charge was increased to reflect the unit cost of storage for Rate 76. *Id.*; see also Nicor Gas Ex. 12.7 at 4, 8.

Staff notes Ms. Harden recommended that the Company's original proposals from its direct testimony be approved as the companion rates are not affected by Rider VBA and stated that the final rates should be adjusted based upon the revenue requirement ultimately approved by the Commission. Staff Ex. 5.0. This adjustment is uncontested and is approved.

**d) Rates 7 and 77**

Nicor Gas set rates for Rate 77 (Large Volume Transportation Service) based on the target revenue requirement, by increasing the monthly fixed customer and demand charges to increase the proportion of fixed costs recovered through fixed charges, and by deriving a distribution charge to yield the target level of revenues. Nicor Gas Ex. 12.0 at 28. Currently, no customers take service under Rate 7 (Large Volume Service). Rates for Rate 7 were set equal to those for Rate 77, except that the delivery charge was increased to reflect the unit cost of storage for Rate 77. *Id.*; see also Nicor Gas Ex. 12.7 at 5, 9.

Staff notes Ms. Harden recommended that the Company's original proposals from its direct testimony be approved as the companion rates are not affected by Rider VBA and stated that the final rates should be adjusted based upon the revenue requirement ultimately approved by the Commission. Staff Ex. 5.0. This adjustment is uncontested and is approved.

#### **4. Existing Riders**

##### **a) Rider 26 – Uncollectible Expense Adjustment**

Nicor Gas proposes to modify Rider 26 to update the amount of uncollectable recovery to reflect the bad-debt forecast amount of \$8,100,000 for the Test Year. Nicor Gas Ex. 7.0 at 6, 8. Nicor Gas uses Rider 26 to recover or refund the difference between its actual annual uncollectable expense and the uncollectable amount included in the Company's delivery and supply service rates.

Staff witness Trost recommended that language in Section E-Annual Internal Audit in Rider 26 be revised to direct the Company to submit the audit report to the Commission's Director of the Financial Analysis Division, rather than the Manager of the Accounting Department. Staff Ex. 1.0 at 31-32. Nicor Gas does not contest this recommendation and agrees with Ms. Trost's recommendation. Nicor Gas Ex. 22.0 at 3. This adjustment is uncontested and is approved.

##### **b) Rider 3 – Variable Tax Cost Adjustment**

Nicor Gas explained that Rider 3 is a mechanism that provides for more accurate recovery of the Invested Capital Tax ("ICT") imposed on the Company under Section 2a.1 of the Gas Revenue Tax Act. Staff witness Trost recommended that Nicor Gas include in a compliance filing an exhibit setting forth the ICT amount included in the Company's base rates and recovered through Rider 3. Staff Ex. 1.0 at 27. Nicor Gas does not contest that recommendation and plans to include the information in a compliance filing.

In addition, Nicor Gas agrees with Staff's recommendation to note the ICT Base Rate Allowance included in base rates is \$28,820,000. This issue is uncontested and is approved.

#### **5. Proposed Riders**

##### **a) Rider 35 – Bill Payment Options**

Nicor Gas initially proposed Rider 35, which the Company states would have eliminated the need for customers to pay a third-party fee when using certain payment channels to pay a Nicor Gas bill. The Company subsequently agreed to withdraw its proposed Rider 35 but reserved its right to propose a similar rider or otherwise address the recovery of these costs in a future proceeding. Because the Company withdrew its proposed Rider 35, it is no longer a contested issue in this proceeding.

##### **b) Rider 37 – Compressor Fuel Cost Recovery**

Nicor Gas initially proposed Rider 37, which the Company states would have annually reconciled actual compressor fuel costs, rather than recovering a fixed amount through Operations and Maintenance expense. The Company subsequently agreed to withdraw its proposed Rider 37 but reserved its right to propose a similar rider or otherwise address the recovery of these costs in a future proceeding. Because the Company withdrew its proposed Rider 37, it is no longer a contested issue in this proceeding.

## **6. Terms and Conditions**

### **a) Service Reconnection Charge**

Nicor Gas initially proposed to increase the Service Reconnection Charge set forth in its Terms of Service. Nicor Gas and Staff subsequently agreed by stipulation to maintain the current service reconnection fee of \$74. Nicor Gas–Staff Joint Ex. 1.0 at 5-6. No other party addressed this issue and it is approved as stipulated.

### **b) Recording Device Charge**

Nicor Gas proposes to add new language to its Terms and Conditions to clarify that the monthly Recording Device Charge paid by transportation customers will expire for each customer upon their transition to an AMI device. The Company explained that transportation customers currently pay a monthly Recording Device Charge to recover the cost of the device used to obtain monthly meter readings, but once the customer transitions to an AMI device, that cost will be recovered through base rates. This issue is uncontested and is approved.

### **c) Third Party Damage Fee**

Nicor Gas proposes to change the calculation of the Third Party Damage Fee in its Terms and Conditions: rather than charging customers a flat fee of \$408.50 for any damage to non-steel service pipes sized 1.125 inches or less, the Company proposes to base damage fees on the time and material spent to repair the damages. The Company's rationale for the change was to ensure that damage fees are assessed as accurately and fairly as possible, to prevent situations in which third parties are billed for a minor repair, and to ensure that Nicor Gas' customers are not subsidizing third parties that create the need for a major repair. Nicor Gas Ex. 7.0 at 14. This issue is uncontested and is approved.

### **d) Excess Service Pipe Installations**

Nicor Gas proposes to revise the charges for excess service pipe installations, as described in its Terms and Conditions. The proposed revisions would split the 1-inch polyethylene category to distinguish between Residential and Non-Residential installations, and apply the charges to all ½-inch, 1-inch Residential, 1-inch Non-Residential, and 2-inch installations. This issue is uncontested and is approved.

### **e) Equipment Furnished and Maintained by Customer**

Nicor Gas proposes to revise the Conditions of Service for Equipment Furnished and Maintained by the Customer, within its Terms and Conditions. The proposed revision clarifies the duties of the Company with respect to equipment owned or controlled by the customer in situations where death or injury to persons or property occurs in the absence of the Company's sole negligence. The Company notes that the revision would align its tariffs with those of another Illinois local distribution company. This issue is uncontested and is approved.

### **f) Access to Premises**

Nicor Gas proposes to revise the Access to Premises portion of its Terms and Conditions by adding language stating a customer's failure to provide access to premises

may lead to disconnection and other legal action. This issue is uncontested and is approved.

**g) Limitations of Service**

Nicor Gas proposes to revise the Limitations of Service for Continuous Service portion of its Terms and Conditions by clarifying through examples that liability shall not attach to the Company. The Company explained that this language is consistent with the tariffs of another Illinois local distribution company and will reduce ambiguity. This issue is uncontested and is approved.

**7. Housekeeping Revisions**

Nicor Gas proposes a variety of revisions intended to correct typographical errors, clarify definitions, and clean up outdated references. The Company also proposes to add the City of West Galena to the list of “Municipalities and The Unincorporated Contiguous Territory To Which This Schedule Is Applicable.” Staff witness Harden also recommends additional housekeeping changes to which Nicor Gas agreed to in rebuttal testimony. Nicor Ex. 22.0 at 5. This issue is uncontested and is approved.

**B. Contested Issues**

**1. Rate 1 – Residential Class**

**a) Nicor Gas’ Position**

Nicor Gas’ position is discussed in detail above in Section VIII.C.1.a.

**b) Staff’s Position**

Staff witness Harden testified that the appropriate rate design for Rate 1 – residential class of customers depends upon whether the Commission approves the Company’s proposal for Rider VBA, or some version thereof. Ms. Harden adds Mr. Yardley’s proposed rate design, based on the Company’s COSS, which includes minimum distribution mains, produces a rate design that assigns 74.89% of the Rate 1 revenue requirement to the customer charge and 25.11% to the distribution charge. Ms. Harden notes this reflects a high degree of recovery through the fixed customer charge compared to recovery through the volumetric distribution charge. Ms. Harden states the Commission has repeatedly expressed concern about combining this kind of rate design with another decoupling mechanism that promotes revenue stability like Rider VBA or a formula rate. Staff Ex. 5.0 at 12.

Staff explains that if the Commission approves Rider VBA, Ms. Harden recommends that the Residential Rate 1 be based upon her proposal that would recover 70% of the residential revenue requirement through the customer charge and the remaining 30% through the distribution charge. *Id.* at 18. Staff adds that if the Commission does not approve Rider VBA, then Ms. Harden recommends approval of the Company’s proposal which recovers almost 75% of the revenue requirement through the customer charge.

Staff and the Company stipulated that if Rider VBA is approved by the Commission, Staff witness Harden’s residential customer charge should be approved. Nicor Gas-Staff Joint Ex. 1.0 at 5.

### **c) AG's Position**

The AG explains that Nicor Gas confuses the analysis provided by AG witness Rubin on the residential customer charge. Mr. Rubin's rebuttal testimony accepted as a compromise the agreement made between the Company and Staff to collect 70% of residential class revenues through the customer charge if the Commission decides to approve Rider VBA. The AG adds that Nicor Gas dismisses Mr. Rubin's willingness to accept this compromise on the customer charge when it states Mr. Rubin does not support the adoption of Rider VBA. While Mr. Rubin did not reject the high customer charge that Nicor Gas and Staff propose in the Stipulation, his testimony showed how the per-customer Rider 38 decoupling proposal is flawed. The AG believes the per-customer Rider 38 decoupling proposal will result in an over-collection of revenues and should be rejected or modified to class-based revenue decoupling, consistent with the decoupling or volume balancing adjustment riders of other Illinois utilities.

The AG notes that if the Commission approves decoupling, it must recognize the decoupling's guarantee of revenues for the residential class serves the same purpose as high customer charges. The AG states high customer charges and surcharge mechanisms such as decoupling are both designed to guarantee that the utility collects its authorized revenues regardless of consumption trends. The AG adds that adopting both a high monthly customer charge and a decoupling surcharge based on per-customer usage will not result in revenue protection, but revenue over-recovery, which is particularly unfair to low-usage, non-space-heating customers whose bills are primarily driven by high customer and fixed charges (about 100,000 Nicor customers use less than 38 therms per year). AG Ex. 4.0 at 12.

The AG explains the purpose of both a high customer charge and decoupling is to ensure that the utility receives a pre-determined level of revenues, despite the amount of gas ratepayers consume. AG Ex. 4.0 at 22. As discussed below, per-customer decoupling is not needed when a utility recovers 70% of its residential revenues from the customer charge in addition to multiple riders that also collect revenues from those customers independent of the per-therm delivery charge. The AG adds per-customer decoupling would do more than guarantee class revenues, potentially resulting in a windfall by charging existing customers more to compensate for lost revenue from new customers who use gas more efficiently. AG Ex. 4.0 at 26-27. The AG contends that while it does not oppose the high customer charge recommended by Staff and Nicor Gas, the effect of this high customer charge is one factor that justifies rejecting Nicor's per-customer decoupling proposal.

### **d) Commission Analysis and Conclusion**

Nicor Gas asserts that if Rider VBA is not adopted then the monthly customer charge should recover 75% of the revenues allocated to residential customers. Staff asserts that if Rider VBA is adopted in some form then Residential Rate 1 should recover 70% of the residential revenue requirement through the customer charge and the remaining 30% through the distribution charge. Nicor Gas agreed with Staff's recommendation if Rider VBA is adopted as Nicor Gas proposes. The AG accepts this agreement between Staff and Nicor Gas. The Commission adopts Rider VBA, as discussed in Section IX.B.3.a. Because the Commission is adopting Rider VBA in some

form, the Commission accepts Staff's recommendation to recover 70% of the residential revenue requirement through the customer charge and the remaining 30% through the distribution charge.

## **2. Existing Riders**

### **a) Rider 32 – Qualified Infrastructure Plant (Rider QIP)**

#### **i. Nicor Gas' Position**

Nicor Gas explains that its Rider QIP allows the Company to recover a return on, and depreciation expense related to, its investment in QIP. QIP includes certain types of facilities that are not included in the rate base used to establish the Company's base rates, installed in the ordinary course of business, or revenue producing. Nicor Gas is required by law to file a petition initiating a reconciliation of the amounts collected under Rider QIP against the actual prudently incurred costs for QIP in the year.

The Company notes that its Rider QIP calculated charges to customers using a variety of factors to adjust for differences between the QIP in a rate case order and the Company's actual investment in QIP. The difference is used as an adjustment of the monthly QIP charge assessed to customers. The Company is required to file a public document in each rate case that compares actual costs with QIP costs included in base rates.

AG witness Selvaggio recommends that the Company revise its Rider QIP tariff to state that, when the Company makes its annual reconciliation filing, it must explain the variances between actual and forecasted QIP investment, in order to facilitate investigation of those costs. The Company argues that this proposal should be rejected because it blurs the clear statutory and regulatory line between a general rate proceeding and the annual QIP reconciliation proceeding. Nicor Gas points out that Ms. Selvaggio states that her proposal is intended to avoid the issuance of discovery requests in the annual reconciliation proceeding. The Company also argues that the AG fails to point to any facts indicating that Nicor Gas should be subjected to this reporting requirement. Nicor Gas avers that the information the AG seeks is not relevant to the instant rate case, and that the proper forum for any investigation of this issue is the annual QIP reconciliation proceeding.

#### **ii. AG's Position**

The AG explains that under Section 9-220.3 of the Act, Nicor Gas can move certain investment costs into rate base and recover the costs as part of base rates in a rate case. 220 ILCS 5/9-220.3(g). In this case, Nicor Gas is requesting to move \$65,168,000 in QIP revenues to base rates which include revenues for QIP investment from January 1, 2018 through September 30, 2019 that have not yet been reconciled.

The AG states that in order to enable the Commission to assess the reasons for divergence between the projected QIP investment included in base rates and the actual QIP investment that would be recovered through the QIP surcharge, the Commission should revise Section F of the Company's Rider QIP tariffs to require that the Company to explain each component in the calculation of AdjNetQIP and AdjNetDep that has a variation in excess of 10% of the amount included in base rates. AG witness Selvaggio

recommends that the Commission direct the Company to revise its Rider QIP tariff to require that the Company's annual reconciliation filing explain each component in the calculation of AdjNetQIP and AdjNetDep that differs by more than 10% from the project amount included in base rates. AG Ex. 1.0 at 34.

The AG further explains the reasoning for the recommendation is that in some cases, such as in Aqua Illinois Inc.'s recent rate case and QIP reconciliation, the difference between the rate base projection and the actual QIP spending was significant. *Aqua Ill., Inc.*, Docket No. 17-0259, Compliance Report (Mar. 6, 2019). The AG adds that when there is a significant variation between the actual QIP costs and the QIP costs included in base rates, the variation should be investigated, and having the explanation for the variation facilitates the investigation of cost differences and promotes transparency. AG Ex. 1.0 at 34. In addition, providing the reasons for the variations upon filing would only be necessary if the differences are greater than 10%. The AG contends the reporting of significant variations should be unusual and would naturally be an issue both the Commission and the parties would want explained.

In response to Nicor Gas' argument that this recommendation is unnecessary and overly broad, the AG states that Ms. Selvaggio's proposal is made primarily to enhance the efficiency of the reconciliation process, by providing the Commission and interested stakeholders with information relevant to reconcile the annual spending and cost recovery as well as to the plant-in-service in base rates. The AG notes that by having this information upon the filing of the QIP proceeding ensures that the Company tracks the level of QIP spending relative to investment amounts already in rate base and that any discrepancies can be investigated and understood. The AG also believes it will enable Staff and interested parties to conduct discovery more expeditiously.

## ii. Commission Analysis and Conclusion

The Commission adopts the Company's Rider QIP proposal. The Commission notes the Act mandates the Commission hold annual proceedings for the purpose of reviewing the accuracy and prudence of the investments in QIP. 220 ILCS 5/9-220.3(e). The Commission agrees with the Company that the proper forum to address variances between the actual and forecasted QIP investment is the annual QIP reconciliation proceeding. As the AG contends, if there is reporting of a significant variant that would be an issue for both the Commission and other parties, it is appropriate that the parties involved identify and further investigate those variances at that time.

### b) Rider 36 – Variable Income Tax Adjustment

#### i. Nicor Gas' Position

Nicor Gas explains that Rider 36 – Variable Income Tax Adjustment ("Rider VITA") is used to recover and refund changes in tax expenses resulting from changes in income tax rates and amortization of deferred taxes. Nicor Gas did not contest Staff's recommendation and plans to include such information in a compliance filing.

The Company also does not object to the AG's recommendation to supplement its compliance filing with further detail concerning the final excess ADIT amounts, and details related to the amortization of excess ADIT. Nicor Gas agrees to provide that information in its compliance filing.

Nicor Gas states the state income tax rate used in the determination of base rates in this proceeding was 9.50%. The federal income tax rate used in the determination of base rates in this proceeding was 21.00%. The amount represented as amortization of deferred tax excess and deficiencies, as used in the calculation of income taxes used to set base rates in this proceeding, was \$8,716,000.

## **ii. Staff's Position**

Staff notes Nicor Gas does not contest its recommendation to include an exhibit in its compliance filing to the Final Order to explicitly state the final amounts for the amortization of the excess ADIT baseline and state and federal income tax rates included in the Order in this proceeding so that there is not an issue with those values in future Rider VITA proceedings. Ms. Trost explains that while most of the components necessary for calculating the VITA Percentage will be readily apparent in the revenue requirement approved in this proceeding, other components are not as obvious from the revenue requirement schedules. Ms. Trost further testifies the compliance filing should include workpapers in the same or similar format to Company Schedule C-5.2 with additional workpapers reflecting calculations of the final EDT amounts. Staff Ex. 1.0 at 27-28.

## **iii. AG's Position**

The AG notes Nicor Gas agrees and does not contest its recommendation that the Company supplement its compliance filing showing the final amounts for the amortization of the excess ADIT baseline to be considered in the Company's Rider VITA proceedings, as set forth in AG Ex. 8.0 at 30-31.

The AG supports Staff's recommendation but recommends that it be supplemented with an additional public schedule setting forth the detail of the final excess ADIT amounts in a format similar to the schedule included with the Company's response to data request AG 24.03. AG Ex. AG 2.01 Ex. 8.2, Att. G at 2. In addition, the AG recommends the additional public schedule also reflect the detail of the Federal Tax Reform EDIT Amortization (Unprotected), broken out between amounts related to the five-year amortization period starting January 1, 2018, and the new five-year amortization period starting when the new rates go into effect, as discussed in Nicor Gas Ex. 19.0R at 2, the amortization method and period of amortization for each type of excess ADIT. AG Ex. 8.0 at 30.

The AG notes the Company accepted its recommendations and ask the Commission to adopt these unopposed recommendations.

## **iii. Commission Analysis and Conclusion**

The Commission finds that these issues are uncontested and are hereby approved.

### **3. Proposed Riders**

#### **a) Rider 38 – Volume Balancing Adjustment**

##### **i. Nicor Gas' Position**

Nicor Gas proposes a revenue decoupling mechanism applicable to all Residential Rate 1 customers, Rider 38 – Volume Balancing Adjustment ("Rider VBA"). The

Company's proposal implements revenue-per-customer decoupling, meaning that it includes a monthly benchmark level of revenue per residential customer, which will be compared against actual revenue per customer to determine the impact of changes in customer use on revenue recovery. The Company notes that neither CUB nor Staff objects to the form or operation of proposed Rider VBA. Meanwhile, although the AG proposes a modification to the operation of Rider VBA, Nicor Gas believes it does not argue that Rider VBA should be rejected in total.

The Company explains that revenue decoupling is a common rate design approach, which breaks the link between utility revenue and customer consumption. Nicor Gas states that under the methodology it proposes, any difference between the Commission-approved revenues and the actual revenues in each year is credited to, or recovered from, customers. The Company argues that revenue-per-customer decoupling is appropriate because the Company is pursuing opportunities to add customers to its distribution system, resulting in costs to serve those new customers. The Company states that the revenue-per-customer approach would allow the Company to receive a commensurate level of additional base revenues as residential customers are added to its system.

Nicor Gas argues that the AG's opposition to the revenue-per-customer component of proposed Rider VBA provides no basis to reject the rider. The Company points out that the overwhelming majority of natural gas decoupling riders nationwide utilize per-customer revenue decoupling. The Company also argues that the per-customer decoupling approach is reasonable and supported by evidence because it preserves the incentive for the utility to add new customers between rate cases. The Company explains that per-customer revenue decoupling would allow the Company to offset the incremental revenue requirement associated with capital investments in new meters, services, and mains used to serve new customers. Meanwhile, Nicor Gas asserts that the AG's claims about incentivizing increased customer usage is without merit. The Company explained that, under its proposal, it would receive the established level of revenue, regardless of how much gas any individual customer consumes. Nicor Gas adds the Company has no incentive to increase the consumption of any customer. Nicor Gas pointed to the testimony of its witness, Mr. Yardley, who testified that the fact that per-customer decoupling preserves an incentive for the utility to add customers to its system does not undermine the policy goals typically associated with decoupling mechanisms. Rather, Mr. Yardley noted that all customers benefit from rate stability when fixed utility costs can be spread over a greater number of customers.

The Company also argued that the AG's claims concerning how new customers would be treated under proposed Rider VBA are unfounded. Nicor Gas explained that the AG's data concerning gas usage in newer homes is inconclusive. For example, Mr. Rubin's data shows that homes constructed in the decade between 2000 and 2009 use more natural gas than homes constructed in the two decades between 1980 and 1999. Also, Nicor Gas witness Yardley testified that of the data the AG provided, homes constructed after 2010 comprise less than 1% of the total homes in the assessment.

Meanwhile, the Company argues that the AG failed to demonstrate any inequity that arises specific to the per-customer decoupling component of proposed Rider VBA. The Company stated that if any inequity exists between new and old customers, it is not

unique to per-customer decoupling. In general, whether a decoupling mechanism is present or not, rates are designed to recover the average cost to serve the members of each class, primarily via volumetric charges based on forecasts of average usage in each customer class. As such, the Company notes that any new customer added between rate cases will pay rates based on the last rate case, even if their cost of service differs. Therefore, Nicor Gas asserts that the AG's inequity claims are misplaced.

The Company also argues that the AG's assertions that proposed Rider VBA departs from established practice are unavailing. Nicor Gas asserts that there is no Illinois law or precedent that requires decoupling on a class basis. Nicor Gas adds that there is no Illinois precedent that considers and rejects a proposal for per-customer decoupling. The method simply has not yet been presented to the Commission. Furthermore, the Company stated that Illinois law makes clear that prior Commission orders do not bind the Commission in future proceedings; instead, the Commission must evaluate each case based on the evidence presented in the record. See *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 166 Ill. 2d 111, 125-126 (1995). Consequently, Nicor Gas avers that it would be inappropriate to overlook the substantial evidence in the record to adopt a different method simply because it has not been approved before in other circumstances.

Nicor Gas also notes the AG's proposal to include certain tariff language in the reporting requirements. Nicor Gas' proposed Rider VBA currently requires the Company to submit a report on its rate of return with and without the effect of proposed Rider VBA. The AG recommends that, in any period in which Rider VBA results in a surcharge to customers, Nicor Gas be required to submit to Staff and other entities various disclosures and workpapers. Nicor Gas maintains that this proposal should be rejected, arguing that it calls for an unprecedented and onerous reporting burden when the facts do not support the need for it. The Company avers that the proposed Rider VBA would still require the Company to initiate an annual reconciliation of the Rider VBA, and to include with its petition a statement of the reconciliation adjustment with supporting workpapers and a report providing the rate of return with and without Rider VBA. Nicor Gas claims this is a sufficient level of detail, submitted in the appropriate forum, and that the AG's proposals concerning reporting should not be adopted.

## **ii. Staff's Position**

Staff points to the testimony of Ms. Trost, who testified that while not offering an opinion on whether proposed Rider VBA should be approved, four recommendations should be considered in the event the Commission approves proposed Rider VBA. Ms. Trost's first recommendation is that the language in Section D – Annual Internal Audit, be revised to indicate that the audit report should be provided to the Commission's Director of the Financial Analysis Division. Staff Ex. 1.0 at 29. Ms. Trost's second recommendation also concerned internal audits. Ms. Trost recommends that the tariff language precisely describe the specific audit test to be performed. See Staff Ex. 1.0 at 29-30.

Ms. Trost's third recommendation is to add an annual reporting requirement of the Company's rate of return with and without the effect of the proposed Rider VBA. *Id.* at 30-31. Ms. Trost's fourth recommendation is to add a compliance filing requirement for the final inputs approved by the Commission. The compliance filing will aid in Staff's

review in the annual reconciliation proceeding. See *Id.* at 31. Ms. Trost explains that other utilities with a Rider VBA have similar reporting requirements. Staff Ex. 1.0 at 30. Staff notes the Company agrees with all four of Ms. Trost's recommendations. Nicor Gas-Staff Joint Ex. 1.0 at 5.

Staff witness Harden adds that if the Commission approves the proposed Rider VBA, then the tariff should state how the charge will be shown on a customer's bill. Staff Ex. 5.0 at 34. In response to Staff DR DLT 8.05, the Company agrees to have a separate line item on a customer bill for this rider. *Id.*

### iii. AG's Position

The AG requests that if the Commission approves a revenue decoupling rider in this proceeding, that the Commission require Nicor Gas to achieve revenue decoupling on a total rate class revenue basis, and not on a per-customer revenue basis. The AG states that under traditional ratemaking, the Commission would approve a rate per therm rather than a revenue amount, resulting in utility revenues that would vary depending on the customer usage volume. The AG explains that under revenue decoupling, the Commission determines Nicor Gas' revenue requirement. Here, the utility's rate, not its revenues, varies with customer usage volume by annually crediting or surcharging residential customers' accounts to reconcile any revenue discrepancy caused by changes in customer use between the approved Residential Service class revenues and the revenues residential customers actually paid. Nicor Gas Ex. 12.0 at 29.

The AG notes that the purpose of revenue decoupling is to ensure that the utility has no financial incentive to promote increased usage by customers or prevent conservation. However, unlike other Illinois gas utilities, Nicor Gas seeks to be the only regulated gas utility in Illinois permitted to "decouple" revenues on a "per-customer" basis. The AG argue that per-customer "decoupling" would not in fact decouple revenues from customer usage or maintain an approved revenue requirement because Nicor Gas' proposed Rider VBA would automatically increase Nicor Gas' revenue as it adds new customers, giving Nicor Gas a financial incentive to add more customers and thereby increase customer usage.

Further, the AG contends that per-customer decoupling would violate cost causation because the addition of new customers would increase charges to Nicor Gas' existing customers in the predictable circumstance that new customers' usage is lower than existing customers' usage. The AG requests that any decoupling rider maintain consistent treatment of customers across all Illinois regulated gas utilities, ensure fair treatment of new and existing customers, and prevent unwarranted windfall profits at ratepayers' expense by setting Nicor Gas' revenues from the residential rate class on a total rate class basis rather than on a per-customer basis as Nicor Gas proposes. AG Ex. 4.0 at 27.

The AG adds that under traditional ratemaking, a utility's revenue depends on the volume of usage by its customers. If a utility's customers increase usage or more customers use the service, the utility receives more revenue. If customer gas usage declines, so do the utility's revenues. The AG notes that without decoupling, utilities would have a financial incentive to maximize customers' usage. Efforts to conserve resources, such as energy efficiency measures, would diminish the utility's revenues and

counter-act the utility's interest in increasing sales. The AG states that by linking utility revenues to customer usage volumes, traditional ratemaking places a utility's financial interests at odds with resource conservation objectives. Revenue decoupling is intended to harmonize these interests by severing the link between customer usage and utility revenues. To decouple revenues, the Commission sets the utility's revenue independent of its sales volumes, freeing utilities to promote demand-side management and other conservation programs without undermining their own profitability.

The AG refers to decoupling on a total-revenue basis for a rate class as the established gas and water utility practice in Illinois. The AG notes every other regulated gas utility in Illinois – Ameren Illinois Company d/b/a Ameren Illinois gas (“Ameren Illinois”), North Shore Gas Company (“North shore”), and Peoples Gas Light and Coke Company (“Peoples”) – decouples revenues on a total customer class basis. AG Ex. 11.0 at 8; AG Ex. 11.1. The AG adds the Rider VBA of every major regulated water utility in Illinois also decouples based on total rate class revenues. *Ill.-Am. Water Co.*, Docket No. 16-0093, Order at 72-73 (Dec. 12, 2016); *Aqua Ill., Inc.*, Docket No. 17-0259, Order at 44-45 (Mar. 7, 2018). The AG maintains that nothing in the record in this proceeding provides any basis for treating Nicor and its customers differently.

The AG observes that Peoples and North Shore were the first Illinois gas utilities to propose a residential customer class revenue decoupling rider, similar to Nicor Gas' proposed Rider VBA. *Peoples Gas Light and Coke Co. / N. Shore Gas Co.*, Docket Nos. 07-0241/07-0242 (Cons.), Order at 138 (Feb. 5, 2008). There, the Commission approved the utilities' revenue decoupling riders (also called “Rider VBA”) as a four-year pilot in their 2007 consolidated rate case. *Id.* at 97. The pilot riders decoupled revenues per customer. *Id.* at 126. However, the Commission changed to total class decoupling when it approved the Peoples and North Shore permanent decoupling riders in their consolidated 2011 rate case. In the 2011 rate case, Peoples and North Shore initially proposed to decouple revenues on a per-customer basis but Staff called for decoupling revenues on a total customer class basis, and the utilities adopted this position. *Peoples Gas Light and Coke Co. / N. Shore Gas Co.*, Docket Nos. 11-0280/11-0281 (Cons.), Order at 164 (Jan. 10, 2012). The Commission approved the total rate class approach. *Id.* at 236. The AG states the Rider VBA from that proceeding, for both Peoples and North Shore, has reflected a total rate class decoupling since the proceeding. AG Ex. 11.1 at 6-11.

The AG also notes Ameren sought its own residential revenue decoupling rider (also named “Rider VBA”) in its 2007 rate case, but the Commission rejected the proposal in light of the Peoples / North Shore's pilot revenue decoupling riders. *Ameren Ill. Co. d/b/a Ameren Ill.*, Docket Nos. 07-0588/07-0589/07-0590 (Cons.), Order at 236 (Sep. 24, 2008). The AG states the Commission went on to approve Ameren's revenue decoupling rider in the utility's 2015 rate case. *Ameren Ill.*, Docket No. 15-0142, Order at 115 (Dec. 9, 2015). The AG points out that Ameren rider is consistent with the Peoples and North Shore rider, decoupling revenues on a total residential customer rate class revenues basis. AG Ex. 11.1 at 1-5.

The AG argues that the Commission should adopt Mr. Rubin's proposal that Rider VBA treat Nicor Gas and its customers the same as Peoples, North Shore, and Ameren's' VBA riders by decoupling total rate class revenues. The AG asserts that if adopted, Nicor

Gas' proposed per customer decoupling scheme would allow Nicor Gas to automatically increase its revenues, including charges to existing customers, without filing a rate case whenever it adds new customers. AG Ex. 4.0 at 23.

In support of their position that per-class decoupling is truer to the goals of decoupling and that per-customer decoupling would result in increased revenues between rate cases, the AG cites Mr. Rubin's testimony showing that new residential customers are more likely to live in newer housing and as a result have lower average monthly gas usage than existing residential customers. *Id.* at 24; AG Ex. 11.0 at 9. The AG assert that newer housing stock reflects advances in space heating efficiency, water heating efficiency, water efficiency of appliances that use hot water, different types of insulation, and smart thermostats, to name a few, resulting in lower total natural gas usage.

The AG contends that by wrongly assuming that average new customer use will not differ from existing customer use, Nicor Gas can expect to experience a purported revenue shortage if new customers use, on average, less than existing customers. The AG asserts that the result of Nicor Gas' proposed per-customer decoupling would be to impose a surcharge on all customers when new customers' lower usage drives down the residential per customer average consumption. To illustrate this problem, AG witness Rubin applied Nicor Gas' proposed per-customer approach to revenue decoupling in a hypothetical scenario wherein the 9,000 new customers Nicor Gas added in the twelve months ending in September 2018 used gas at a rate typical for a new customer (lowest 20th percentile). The AG explains that under this scenario, Nicor Gas could expect \$2,700,000 in additional revenue from new customers, or \$300 per new customer. However, these additional revenues would not be applied to the revenue requirement. Under Nicor Gas' proposal, it would claim a shortfall of over \$20 for each customer because its proposed decoupling method would establish a benchmark of \$320 per customer, based on usage by existing customers. The AG concludes that as a result, Nicor Gas would receive \$2,700,000 from these new customers and surcharge existing customers for another \$180,000 (9,000 customers, \$20 per customer) for supposedly lost revenues that result from the failure of per-customer decoupling approach to count new revenues and to ignore the differences between new and existing residential customers' usage. AG Ex. 4.0 at 24.

In response to Nicor Gas' suggestion that the consumer data the AG cites does not demonstrate that customers in new housing have lower average gas consumption, the AG cites that the oldest houses had the highest average gas usage and, more importantly, housing built since 2010 had the lowest average gas usage of any housing age cohort studied. The AG argues that the data therefore establishes a reasonable expectation that customers living in newly constructed housing will have lower average monthly gas usage than customers in existing housing. Based on these findings, the AG concludes that Nicor Gas witness Yardley's assumption that residential customer usage is homogeneous is incorrect. Nicor Gas Ex. 12.0 at 32.

The AG notes Nicor Gas made one cost-based argument for its per-customer decoupling proposal when explaining Nicor Gas incurs costs to connect new customers to the system, which necessitates per-customer decoupling to collect additional revenues for each additional customer. Nicor Gas Ex. 12.0 at 32. The AG contends that Nicor Gas

ignored the fact that the utility receives revenue from many charges other than usage charges. For example, under Nicor Gas' proposed rates, Nicor Gas would collect about 70% of residential base revenues through the fixed customer charge. Nicor Gas Ex. 40.0 at 5. The AG contends that for each new residential customer, Nicor Gas is already guaranteed 70% of its residential revenues through fixed charges, unrelated to usage. The AG also notes that Nicor Gas has several riders and sources of revenue that are available to cover costs associated with new customers and are not part of the per-customer revenue decoupling tariff, such as the QIP under section 9-220.3 of the Act, an energy efficiency rider under section 8-104 of the Act, and an uncollectible charge under section 19-145(c) of the Act. 220 ILCS 9-220.3; 220 ILCS 5/19-145(c). Given the ratio of fixed to variable charges and numerous riders, the AG asserts that it is simply wrong to suggest that per-customer decoupling is needed to supplement new customer revenues.

The AG references multiple provisions of Nicor Gas' tariff that already allow Nicor Gas to collect revenues between rate cases to cover new customer costs. For example, the Extension of Distribution System portion of the Nicor Gas tariff's Terms and Conditions allows the Company to cover the cost of a gas main extension by collecting a deposit of an amount of money equal to the Company's estimated cost of the required extension, with certain adjustments. *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Ill.C.C. No. 16 – Gas, 5th Rev. Tariff Sheet No. 40, Terms and Conditions – Extension of Distribution System. The AG adds that after the completion of the required extension, the Company has 120 months to refund the deposit. *Id.* Therefore, the AG concludes that under Nicor Gas' current tariff, the Company can collect a deposit to cover the estimated cost of extending a gas main, complete the gas main extension, determine its costs, and hold the deposits to cover new costs for a decade before the Company must return the deposit.

Moreover, the AG also cites Rider 33 (Designated Extension Service Area, or "DESA"), which allows Nicor to recover a non-refundable DESA Connection Charge from new customers served by a gas main extension the Company undertook to serve the DESA. *N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Ill.C.C. No. 16 – Gas, Sheet Nos. 86-86.2, Rider 33 – Designated Extension Service Area. The AG notes the DESA Connection Charge equals the customer's required contribution to the costs of the main extension and apply to every new customer within the DESA who connected within 10 years after service first became available in the DESA. This charge applies only where the above-referenced deposit for gas main extensions costs is not provided and is calculated similarly to the aforementioned deposit. The amount of the customer's required contribution is the customer's share of the estimated cost of the required main extension, with certain enumerated deductions. *Id.* at Sheet No. 86.1. The AG adds Rider 33 allows Nicor Gas to determine which portions of its service territory constitute designated extension service areas. *Id.* at Sheet No. 86.1. Therefore, the AG asserts, Nicor may invoke Rider 33 to recover revenue for new customers at its discretion.

The AG contends that allowing a utility to increase its revenues automatically through customer surcharges whenever it adds new customers defeats the purpose of revenue decoupling, which is to guarantee the approved revenue level associated with usage. The AG asserts that if the utility alleges, as Nicor Gas has, that it needs additional revenues to cover the expense of adding new customers, a revenue decoupling rider is

not the appropriate mechanism because it was never designed to add revenues for ordinary operations such as adding new customers. Moreover, the AG maintains that cost causation principles dictate that any rate increase sought to cover costs incurred to add new customers to the system ought to be borne by new customers, as many Nicor Gas tariffs already provide.

The AG states that decoupling on a total residential class revenue basis, like every other regulated gas utility in Illinois, would achieve the goals of decoupling to provide Nicor Gas with a steady revenue level from usage charges, and protect it from revenue fluctuations associated with weather and energy efficiency efforts. The AG argues that under the uniform approach in Illinois, Nicor Gas would not receive a windfall from a decoupling rider when it adds new, lower usage customers, because the utility would not charge existing customers more to cover illusory lost revenues as average per customer usage declines so long as total levels remain constant.

The AG further requests that if the Commission approves Nicor Gas' proposed revised Rider VBA, the Commission should also approve the AG's recommended changes to Section C of the proposed tariffs. The recommended changes require that: (1) the report providing Nicor Gas' rate of return with and without the effect of Rider VBA be public; and (2) additional information be provided if (i) Nicor earns in excess of its authorized ROR with and without the effect of Rider VBA and (ii) the VBA rate for the period results in a collection from ratepayers in the subsequent annual VBA rate period. See AG Ex. 8.0 at 29.

The AG also requests that the supplemental report be publicly provided to facilitate the ease of access to the information. The AG believes the information should be publicly available for other utilities having a Rider VBA. The earned ROR and ROE with and without Rider VBA is provided publicly in the filed testimony of the proceeding to reconcile Rider VBA for Ameren and is publicly reported in orders approving the reconciliations of Rider VBA for North Shore and Peoples. The AG also maintains that requiring that the supplemental report be publicly filed is consistent with the Commission's Order in Docket No. 17-1106, the water and sewer service rate case for Utility Services of Illinois, in which the Commission concluded that such a report should be publicly provided. The Order states:

The Commission agrees with the AG that for ease of access for the parties, a public filing is appropriate and it should be made in the docket of that year's annual reconciliation.

*Util. Svcs. of Ill.*, Docket No. 17-1106, Order at 62 (Sep. 24, 2018); AG Ex. 1.0 at 36.

The AG notes Nicor Gas has numerous independent riders that ensure Nicor Gas recovers the actual costs of certain categories of expenses that include the following:

- Rider 3 Variable Tax Cost Adjustment,
- Rider 5 Storage Service Cost Recovery,
- Rider 6 Gas Supply Cost,
- Rider 7 Governmental Agency Compensation Adjustment,
- Rider 12 Environmental Cost Recovery, Rider 26 Uncollectible Expense Adjustment,
- Rider 30 Energy Efficiency Plan Cost Recovery,

- Rider 32 Rider QIP, and
- Rider 36 Variable Income Tax Adjustment.

The AG contends Nicor Gas' proposed Rider VBA would be the only rider that requires the submission of a report that provides Nicor Gas' earned annual rate of return for the preceding year and thus, would represent the Commission's only opportunity to assess whether Nicor Gas' collection of rates and riders in aggregate are just and reasonable as required by Section 9-101 of the Act. AG Ex. 1.0 at 37. In sum, the AG avers Nicor Gas failed to justify its request that the Commission adopt per customer revenue as the measure of decoupling. The AG requests that if the Commission approves the proposed Rider VBA or any alternative method of revenue decoupling, the Commission reject Nicor Gas' proposed per-customer decoupling rider and order Nicor Gas to decouple revenues on a residential class total revenue basis.

#### **iv. Commission Analysis and Conclusion**

The Company's proposed Rider VBA introduces a revenue decoupling mechanism that would be applicable to all of Nicor Gas' Residential Rate 1 customers (over 90% of the Company's customer base). The Company notes Rider VBA will stabilize the recovery of variable distribution revenues through distribution charges due to variances in volumes of gas service used by customers. The Company adds these variances may be caused by a number of external factors, including, but not limited to, weather patterns, customer behavior, and declining use per customer caused by increased appliance efficiencies. The Company asserts Rider VBA will not change the underlying base rate structure that incorporates variable revenue recovery but will employ an adjustment mechanism to recover or credit customers the base revenue or margin impact associated with changes in customer use.

As the AG points out, the Commission has approved the use of a decoupling mechanism on a per class basis by every other regulated gas utility in Illinois. The Commission notes no party currently avers that Rider VBA should be rejected in whole.

At issue here is whether the operation of Rider VBA should be modified to implement the revenue decoupling on a class revenue basis rather than a per-customer revenue basis. The Commission notes the purpose of decoupling is to remove both the incentive utilities have to increase sales, and the disincentives that utilities have to encourage energy efficiency for their customers. If approved, the Company's proposed per-customer decoupling would differentiate Nicor Gas' decoupling mechanism from all other gas utilities across the state, who currently implement decoupling on a per-class basis.

The Commission finds the evidence presented by the Company does not support a deviation from decoupling on a per-class basis. The decoupling mechanism as proposed fails to identify a problem in which per-customer decoupling aims to correct. The Commission agrees with the AG that decoupling on a per-customer basis contradicts the purpose of Rider VBA as it provides Nicor Gas with a financial incentive to add more customers to the system so as to increase customer usage.

Furthermore, as evident with the recent passage of the Future Energy Jobs Act, the Commission recognizes the State's commitment towards the promotion of energy

efficiency measures and programs. The Commission agrees with the AG that due to energy efficiency efforts, new customers' usage, on average, will be lower than existing customers. As a result, implementation of a per-customer decoupling mechanism would in effect require ratepayers who use more gas to unreasonably subsidize those who use less.

Therefore, the Commission adopts Rider VBA and finds the revenue decoupling mechanism shall be based on a per-class basis. The Commission also adopts Staff's unopposed recommended revisions to Section D – Annual Internal Audit, Section C – Annual Reports and Reconciliation, and Section E – Compliance Filing. Additionally, as agreed by the Company, Nicor Gas shall include a separate line item on customer bills that identifies this rider.

#### **4. Third-Party Billing Service Tariff**

##### **a) Nicor Gas' Position**

Nicor Gas explains that tariffs allow the Company to provide billing services to third-parties, as well as the ability to contract with third parties regarding specific terms for providing such billing services. The Company currently provides billing services to three types of customers: PHS (pursuant to contract); Customer Select Suppliers ("CSS") (pursuant to tariff); and Illinois Energy Solutions ("IES").

The Company argues that the AG raises a series of claims against PHS that should be rejected. First, Nicor Gas states that there is no basis to initiate an investigation into whether it is following its tariff regarding the billing service charge to PHS. While the Company's charges to CSS are tariffed and were approved by the Commission in Docket Nos. 00-0620/00-0621 (Cons.), the contract between the Company and PHS provide that charges to PHS must be based on a fully-distributed cost study, which ensures the charges to PHS fully compensate the Company for the cost of the services provided to PHS. As explained in Section VI.C.3, the methodology to calculate the PHS charge was approved in Docket No. 08-0363, and the Company cites to the testimony from Ms. Hotchkiss explaining that the Company updated its cost study in 2018, so that it is current. Moreover, Ms. Hotchkiss explained the unique nature of the billing service to PHS, as opposed to CSS or IES. As a result, Nicor Gas states that there is a reasonable explanation for the difference in the manner in which PHS is charged for billing service.

The Company also argues that there is no basis to adopt the AG's proposal to preclude the Company from providing billing services to PHS. Nicor Gas states that the AG's effort to impugn PHS' actions are undermined by the Better Business Bureau's A+ rating. Further, the Company asserts that the AG offers no standards as to what the Commission should consider prior to precluding such billing.

Finally, Nicor Gas urges the rejection of the AG's proposal to include in its bills a disclaimer specifying that gas service cannot be shut off for nonpayment of any amount billed by the third party. On this point, the Company argues that no AG witness offered testimony suggesting such an approach, and the AG cites to no evidence in the record. As such, the Company states that it was not afforded an opportunity to present evidence to respond to this proposal. Given the absence of any evidentiary support for this proposal, as well as due process concerns resulting from the AG's failure to present this

proposal during the evidentiary phase of this proceeding, Nicor Gas concludes that the Commission should reject the AG's disclaimer proposal.

**b) AG's Position**

The AG states Nicor Gas provides third-party billing services for PHS, an unaffiliated company that sells warranty services products. The AG adds that under an agreement between the two companies, customers who owe payments to both Nicor Gas and PHS receive a single bill from Nicor Gas, in which both companies' charges are included as line items that contribute to the total bill amount listed. Nicor Gas Ex. 26.0 at 3. The AG notes PHS's record of customer dissatisfaction and detailed allegations of misconduct, including a class-action lawsuit, and requests that the Commission order Nicor Gas to cease providing billing services on behalf of PHS. AG Ex. 4.0 at 32. The AG maintains that the dollars collected for PHS, marketed as Nicor Home Solutions, are significant. The AG further notes that during 2018, Nicor Gas collected \$45,863,000 from its customers that was assessed on Nicor Gas utility bills for charges from Nicor Home Solutions. AG Ex. 8.2, Attachment E.

The AG notes PHS customer complaints allege lack of response to customer inquiries, inability to cancel the service, customers stating that they never signed up for the service, PHS inability to provide the repair services promised, failure to respond to service calls, and more. The AG notes PHS customer complaints allege lack of response to customer inquiries, inability to cancel the service, customers stating that they never signed up for the service, PHS's inability to provide the repair services promised, failure to respond to service calls, and more. AG Ex. 4.0 at 30. The AG further cites that Nicor Gas recently settled a class-action lawsuit in Indiana related to a class of customers who purchased products from PHS and alleged fraud in the marketing, sale, and billing of the products in violation of the Indiana Consumer Fraud and Deceptive Business Practices Act, as well as a second class action suit filed in the State Court of Ohio asserting nearly identical allegations and legal claims. Tr. at 126-27. The AG maintains that Nicor Gas has provided no evidence or reason why it should continue to operate as a billing agent for a company that: (1) does not provide essential utility services; (2) is no longer affiliated with it; and (3) is a subject of several consumer fraud lawsuits and numerous customer complaints.

The AG contends that in light of the complaints from current and former PHS customers, AG witness Rubin testifies that he had concerns about Nicor Gas operating as the billing agent for a company like PHS with what he characterizes as a very poor history of customer service, including allegations that it is abusing the privilege of appearing on utility bills. The AG notes Nicor Gas does not dispute Mr. Rubin's characterization of the customer reviews, and Nicor has offered no comment on PHS' settlement of the class-action lawsuit. Nicor Gas Ex. 26.0 at 9. The AG asserts that while the Commission does not regulate PHS, it does regulate Nicor Gas' use of the utility bill. Accordingly, the AG requests that the Commission prohibit Nicor Gas from including PHS charges on customer bills. AG Ex. 4.0 at 32.

In response to Nicor Gas' claim that the AG did not articulate an objective standard for determining which third parties should be excluded and a system for reinstating banned third parties, the AG clarifies that its analysis is focused on PHS because there

is evidence in the record illustrating alleged misconduct by PHS. Nicor Gas Ex. 26.0 at 8. The AG also notes that Nicor Gas did not challenge Mr. Rubin's assessment of PHS. The AG further claims it referenced their request that third parties' eligibility for billing service be conditioned on compliance with a code of conduct as articulating an objective standard. AG Ex. 4.0 at 32.

The AG also requests that if the Commission decides to allow Nicor Gas to continue including PHS charges on customers' bills, the Commission should require Nicor Gas to apply to all third parties for which it provides billing service a code of conduct at least as protective as its standards for third-party suppliers. The AG argues that despite the numerous complaints Nicor Gas received from customers alleging unprofessional and potentially exploitative practices by PHS, Nicor Gas does not condition its third-party billing relationship with PHS on PHS' adherence to any code of conduct, contrary to Nicor Gas' tariff requirements for third-party suppliers. The AG avers the lack of an accountability mechanism for PHS and other non-suppliers leaves Nicor Gas' customers vulnerable to abuse.

The AG asks that the Commission require Nicor Gas to hold all third parties for which it provides billing service to a code of conduct equivalent to the standards Nicor Gas applies to third party gas suppliers in Rider 16, the Company's Supplier Aggregation Service tariff. AG Ex. 4.0 at 32. The terms of this tariff provide that failure to comply with the Rider 16 code of conduct is a basis to remove a third-party supplier from Nicor Gas' "Customer Select" program. AG Ex. 4.15 at 3.

The AG represents that such a code of conduct requires an entity using Nicor Gas' bill to follow certain consumer protections, such as customer notice requirements, telemarketing restrictions, and other mandates that protect Nicor Gas customers from unethical business behavior. The AG further asserts that Nicor Gas' practice of applying only some of these standards to non-suppliers like PHS is not enough. Nicor Gas Ex. 26.0 at 9. The AG contends that a robust code of conduct spelled out in Nicor Gas' tariff is not only necessary for third-party suppliers but for all third parties for which Nicor Gas provide billing services.

The AG further requests that if the Commission decides to allow Nicor Gas to continue including PHS charges on customers' bills, the Commission should require Nicor Gas to disclose certain material information to ensure customers are aware of the implications of nonpayment, including a disclaimer on the customer bills specifying that that gas service cannot be shut off for nonpayment of any amount billed by the third party. The AG argues that this information is critical to customers who may be behind on their payments and wish to prioritize payments and avoid utility late fees and gas service shutoff. The AG maintains that such a message would clearly inform customers of their rights under Nicor Gas' tariff and the Commission's regulations.

### **c) Commission Analysis and Conclusion**

The Commission takes note of the AG's position regarding PHS's alleged record of customer dissatisfaction and detailed allegations of misconduct, including a class-action lawsuit. This information, as presented in the record, does not warrant a Commission action prohibiting Nicor Gas from including PHS charges on customer bills

at this time. The Commission therefore adopts the Company's third-party billing tariff as presented.

However, in an attempt to appropriately examine the claims presented by the AG, the Commission directs Staff to file a Staff Report within 120 days recommending whether the Commission should open a formal investigation addressing Nicor Gas' Third Party Billing Tariff, as it pertains to PHS. Staff's Report shall also consider the AG's proposal to add additional language, including a code of conduct and disclaimer to customer bills.

## **X. GROSS REVENUE CONVERSION FACTOR**

### **A. Overview**

The gross revenue conversion factor ("GRCF") is applied to the operating income deficiency to derive the change in revenue requirement. It is based upon the applicable federal income tax rate, state income tax rate, and uncollectible rate. The Company's revised GRCF is 1.410405. The Company and Staff stipulated to the GRCF methodology in Staff Schedule 7.01, and it is now uncontested. Nicor Gas-Staff Joint Ex. 1.0 at 4.

### **B. Uncontested Issues**

#### **1. Uncollectibles Rate**

Nicor Gas states the Test Year operating revenues were adjusted using an Adjustment for Uncollectible Accounts of -0.008300. Revised Schedule A-2.1; Nicor Gas Ex. 19.1 at 2. The uncollectibles rate is 0.83%. Staff Ex. 1.0, Schedule 1.07. This rate is uncontested and is approved.

#### **2. State Income Tax Rate**

Nicor Gas states the state income tax rate used in the determination of base rates in this proceeding is 9.50%. Revised Schedule A-2.1; Nicor Gas Ex. 19.1 at 2; Staff Ex. 1.0, Schedule 1.07. This rate is uncontested and is approved.

#### **3. Federal Income Tax Rate**

Nicor Gas states the federal income tax rate used in the determination of base rates in this proceeding is 21.00%. Revised Schedule A-2.1; Nicor Gas Ex. 19.1 at 2; Staff Ex. 1.0, Schedule 1.07. This rate is uncontested and is approved.

## **XI. OTHER ISSUES**

### **A. Overview**

The parties presented testimony on several additional issues, including the Company's storage study, its study analyzing the impact, if any, of Nicor Gas' affiliation with Southern Company and its other subsidiaries on the cost of capital of Nicor Gas, the priority in which customers' partial payments are applied, and the amounts paid by the Company for customer payment processing.

### **B. Uncontested Issues**

#### **1. Storage Study**

In the 2017 Rate Case, the Commission directed the Company to prepare a study assessing the implications of how Traditional Transportation customers and Customer

Select suppliers use the Company's on-system storage under the current terms and conditions of service, and to present the results of the study in its next rate case. Nicor Gas reports that it prepared that study, which concluded that Customer Select and Transportation customers currently use Nicor Gas' eight aquifer storage facilities in a manner that does not support the short- and long-term reliability of those facilities. The Company explained that, even though these customers comply with current tariffs and practices, their patterns of storage utilization conflict with optimal storage cycling needed to sustain the operational integrity of the aquifer storage fields, and that action is needed to preserve the reliability and integrity of the storage facilities. Nicor Gas states that it continues to analyze methods for resolving these issues.

While IIEC does not agree with the Company assessment regarding the use of the storage system by the Traditional Transportation customers and Customer Select suppliers, IIEC does agree with addressing these issues in a separate proceeding before the Commission where interested parties can address the merits and conclusions of the study. IIEC Ex. 1.0 at 2. RESA states that Nicor Gas correctly notes that, as required in its last rate case, it prepared and filed a Storage Study addressing the manner in which large-volume transportation customers and Customer Select suppliers utilize Nicor Gas' on-system storage.

AG witness Rubin recommends that the Company initiate a proceeding to consider proposals to remedy the problem identified in the storage study within six months of the Final Order in this case. The Company agrees with this recommendation but proposes to extend the window to initiate a future proceeding to consider the issues arising from the storage study until June 30, 2020. The parties did not contest this proposal, and as a result, the Commission approves this recommendation.

## **2. Satisfaction of Merger Conditions**

Condition 8 of the Final Order in Docket No. 15-0558 requires Nicor Gas to file a study analyzing the impact, if any, of Nicor Gas' affiliation with Southern Company and its other subsidiaries on the cost of capital of Nicor Gas. Nicor Gas states that it has satisfied this condition by providing such a study in the testimony of Frank Graves and Robert Mudge. No party has contested this study, or the satisfaction of the merger conditions. As a result, this matter is uncontested.

### **C. Contested Issues**

#### **1. Third-Party Partial Payment Priority**

##### **a) Nicor Gas' Position**

The Company explains that when customers make partial payments of their utility bills, Nicor Gas applies a priority protocol to determine which components of the customer's bill will be fulfilled using the partial payment. The Company states that if the customer is subject to disconnection, the Company first applies the partial payment to fulfill any of the customer's obligations to the Company that will defer or avoid the disconnection process. This practice supports customers in maintaining continued service.

Nicor Gas states that if the customer is not subject to disconnection, or if disconnection can be deferred or avoided, the Company applies the partial payment to

the customer's obligations in the following order: first to fulfill any obligation to maintain a deposit with Nicor Gas; second, to any obligations under a Deferred Payment Arrangement or a Medical Payment Arrangement; third, on a pro rata basis to Nicor Gas and warranty charges that are past-due; fourth, on a pro rata basis to third-party supplier charges that are past-due; fifth, on a pro rata basis to Nicor Gas and warranty charges that are not past-due; and finally, on a pro rata basis to third-party supplier charges that are not past-due. The Company states that it has used this priority protocol for at least 20 years with no issues or complaints, and that the AG presented no evidence demonstrating that customers are experiencing an actual problem with this arrangement. The Company also notes that no other party supports the AG's proposal to reconfigure the priority of payments.

The Company opposes AG witness Rubin's recommendations that the Commission require Nicor Gas to allocate partial payments between charges for utility service and for energy supplied by third parties, and only allocate any remainder to charges for third-party non-utility service providers. Nicor Gas initially notes that, contrary to the AG's claim, it does not impose late fees related to third-party charges.

The Company argues that the AG's proposed priority protocol does not acknowledge the fact that charges within each category of payment are of varying ages. The Company maintains that its priority protocol is in line with other states in granting higher priority to older-aged receivables. Nicor Gas notes that the Commission has recognized the importance of relieving the oldest receivables first. See *Citizens Util. Bd.*, Docket Nos. 00-0620/00-0621 (Cons.), Order at 80 (Jul. 5, 2001) ("CUB Order"). The Company argues that this approach accomplishes this objective, while Mr. Rubin's proposal does not account for it.

Nicor Gas also disagrees with the AG's assertion that the manner in which Nicor Gas applies partial payments contradicts the CUB Order and exposes customers to late fees and disconnection, in violation of 83 Ill. Adm. Code Part 280 of the Commission's rules. Nicor Gas maintains that the AG misinterprets the CUB Order when it contends that Nicor Gas' payment prioritization violates the conclusion in that order. The Company states that the AG erroneously claims that the CUB Order addressed how Nicor Gas should apply partial payments to amounts owed to third-party non-supply service providers before amounts owed to Customer Select suppliers. The Company explains that the Commission made findings concerning how partial payments should be applied, as between the utility and the Customer Select supplier, but the docket did not address third-party providers of non-supply services. Nicor Gas avers that the AG incorrectly interprets the CUB Order to place such providers in third priority in all circumstances, even though that conclusion does not appear in the CUB Order. The Company notes that neither Staff nor CUB, both of whom participated in the referenced docket, supports the AG's interpretation of the CUB Order.

Nicor Gas further argues that the AG is incorrect in claiming that Nicor Gas' prioritization methodology would leave ratepayers who make partial payments subject to disconnection. The Company explained that partial payments are applied first to any obligations that will defer to eliminate the disconnection process, and that Nicor Gas applies any partial payment customers make in a manner that reduces the likelihood of disconnection. The Company also points out that the AG's proposed payment protocol

does not put disconnection balances first, and would therefore make disconnection more likely, undermining the AG's stated goal. Finally, Nicor Gas asserts that the AG did not present its proposed payment priority in any witness testimony in this proceeding. As such, this proposal should be rejected as unsupported and contrary to law.

**b) AG's Position**

AG witness Rubin highlighted several deficiencies in the Company's current application of customer partial payments that leave Nicor Gas customers vulnerable to unlawful late fees and potential disconnection. Most notably, Nicor Gas' current practice of prioritizing payments for warranty services on equal footing with current Nicor Gas charges on a pro rata basis, and above third-party past-due and current supplier charges (1) contradicts a prior Commission order; and (2) exposes customers to late fees, collection action and potential gas service shut-off, in violation of 83 Ill. Adm. Code Part 280. The AG urges the Commission to order Nicor Gas to correct these prohibited practices and file a new Customer Select tariff that adheres to the Commission's prior directive relating to the prioritization of customer payments.

The AG argues that Nicor Gas' current partial payment prioritization violates Commission-established policy. The AG points out that Section 280.130 of the Commission's rules prohibits service disconnections for non-payment of "charges for non-utility services, unless otherwise authorized by Illinois statute." AG Ex. 4.0 at 29; 83 Ill. Adm. Code 280.130. The regulations also prohibit a utility from charging a late payment fee on unpaid charges for non-utility service: "Late fees shall not be assessed on any amount billed that is not for utility service unless otherwise authorized by statute." AG Ex. 4.0 at 29. The AG further notes that Nicor Gas' tariff similarly provides that unpaid charges for non-utility services will not incur late payment fees. Specifically, the tariff states: "Unless authorized by statute, *late payment charges shall not be assessed on any amount billed which is not for utility service.*" *Id.* at 29 (emphasis added); Nicor Gas Co. – Ill.C.C. No. 16- Gas, 2nd Revised Sheet No. 37.2 (eff. 4/18/2016). No Illinois statutory provision provides an exception to these requirements for the types of services sold by PHS.

In addition to this Commission rule, the AG points out that Commission precedent makes clear that when a customer makes a payment to the utility, the utility must prioritize regulated past due and current charges over unregulated charges owed. In the CUB Order, the Commission concluded:

The Commission finds that partial payments should be allocated consistent with our decision regarding the dispersion of third-party payments in Section IV.C of this Order. *Payments should be applied first to any overdue regulated charges, then to overdue supplier charges, next, to current regulated charges, and finally, to any current supplier charges.* We agree that payment of overdue regulated charges is paramount to insure continued service to customers. However, it is of equal importance that suppliers remain in the market to allow competition to flourish. We believe that this can only be accomplished if suppliers are

assured of payment. Further, since suppliers are not subject to regulation by the Commission, penalties and late fees charged by suppliers may exceed those of Nicor Gas if bills become overdue. *The Commission concludes that Nicor Gas' Customer Select tariffs should include language describing this approved allocation of partial payments.*

CUB Order at 80 (emphasis added).

The AG asserts that Nicor Gas' current partial bill payment practices clearly violate Section 280.130 and the CUB Order. Moreover, despite the Commission's specific instruction to the Company to include the language in its Customer Select tariff prioritizing regulated service charges over unregulated charges when applying customer payments, the AG points out that Nicor Gas failed to do so. See AG Cross Ex. 19; Tr. at 222-25.

The AG demonstrates that, currently, the Company applies partial payments to outstanding amounts due in the following order, from highest priority to lowest priority, with older past-due balances given priority over newer past-due balances within the same category:

1. If the customer is eligible for disconnection, any amount owed to Nicor Gas to prevent disconnection;
2. Any obligation the customer has to maintain a deposit with Nicor Gas;
3. The balance on any existing Deferred Payment Arrangement or Medical Payment Arrangement with Nicor Gas;
4. On a pro rata basis to Nicor Gas and PHS warranty past due charges (with priority given to older past-due balances);
5. On a pro rata basis to third-party supplier past due charges;
6. On a pro rata basis to current Nicor Gas and warranty charges not past due; and
7. On a pro rata basis to current third-party supplier charges not past due.

Nicor Gas Ex. 39.0 at 4; Tr. at 193-195. This pro rata approach to customers' partial bill payments not only puts PHS warranty charges on equal footing as current Nicor Gas charges, but also triggers separate late charges for PHS warranty service, the AG notes. Ultimately, potential disconnection can occur, the AG points out, when payments that fail to cover both their Nicor Gas service, including default energy supply, and the amount owed for the PHS warranty service accumulate.

Thus, the AG argues that by preventing customers from satisfying their Nicor Gas balances without also paying off their balances with non-supplier third parties like PHS, Nicor Gas is violating its own Billing Services Tariff by imposing late fees based on

nonpayment of third-party charges. Indeed, the AG avers, the customer cannot avoid a late payment charge without paying the balance it owes to both Nicor and the third-party non-supplier under the Company's current partial payment, pro rata methodology. Nicor Gas Ex. 39.0 at 4.

The result of this payment allocation method equates to Nicor Gas having an explicit policy of imposing a late fee on behalf of the third-party non-supplier for nonpayment of the third party's charges, according to the AG. Assuming that these customers continue to make partial payments, Nicor Gas' partial payment pro rata application procedure leaves these ratepayers subject to eventual disconnection - a fact that Ms. Hotchkiss confirmed on cross-examination. Tr. at 206, 217-18, 221-22.

As noted above, the plain language of the Commission's CUB Order makes clear that partial payments shall be allocated according the following priority, from highest to lowest:

1. Overdue regulated charges;
2. Overdue supplier charges;
3. Current regulated charges;
4. Current supplier charges.

AG Ex. 11.0 at 4-5. As Ms. Hotchkiss conceded, charges from third parties like PHS (as well as third-party suppliers) are not regulated by the Commission. Tr. at 214-15. Yet, the Company treats PHS on equal footing with Nicor Gas regulated charges. While Ms. Hotchkiss claimed in testimony that Nicor Gas is in compliance with all current Commission Rules and orders (Nicor Gas Ex. 39.0 at 5-6), she later conceded on cross examination that she had not reviewed the CUB Order before making this assertion. Tr.at 208.

The AG states that when applying customer payments to a utility bill, payments to providers of services essential to utility service (the distribution utility and, if separate, the supplier) must take priority over payments to providers of non-essential services, such as PHS. The AG emphasizes that the services provided by non-supplier third parties like PHS are not essential for a customer to receive utility service. AG Ex. 11.0 at 5.

AG witness Rubin observed that, in his experience, "most utility regulators require partial payments to be applied first to the utility's charges for basic service, with any remainder applied to third-party charges for unregulated service." AG Ex. 11.0 at 5. He cited decisions of the Colorado Public Utilities Commission, the Public Utilities Commission of Ohio, and the Pennsylvania Public Service Commission to illustrate the norm among state utility regulators of allocating partial payments to basic utility service, overdue or current, before any third-party providers of other services. *Id.* (citing 4 Code of Colo. Regs. 723-4, Rule 4401(b); Ohio Admin. Code 4901:1-13-11(G); 52 Pa. Code § 56.23). Nicor Gas' only excuse for not following Commission rules, precedent and other states' typical payment practices is an alleged contractual relationship between Nicor Gas and PHS, now owned by American Water Enterprises. Tr. at 220. The AG argues that a contractual agreement, however, cannot trump Commission rules and precedent.

The AG notes Nicor Gas collected \$45.86 million from its customers in 2018 on behalf of PHS, while receiving less than \$1 million from PHS for billing and collection services. The AG argues that given the substantial charges for some PHS services (see Nicor Gas Ex. 26.1 showing a monthly \$84.75 “service plan charge” and \$178.84 past due), it is not surprising that some customers make a partial payment rather than pay their full Nicor Gas bill.

The AG states that Nicor Gas’ pro rata partial payment process in fact increases the likelihood that customers’ Nicor Gas arrearages will grow, late fees will be applied to both regulated and unregulated services, contrary to Commission rule, and disconnection will occur. Accordingly, Nicor Gas’ partial payment policy contradicts the CUB Order.

The AG states that Nicor Gas ignores the fact that the Commission’s regulations prohibit a utility from charging a late payment fee on unpaid charges for non-utility service, stating: “Late fees shall not be assessed on any amount billed that is not for utility service unless otherwise authorized by statute.” Ill. Adm. Code 280.60(d)(5). Nicor Gas’ own Billing Services tariff, the AG points out, similarly provides that unpaid charges for non-utility services will not incur late payment fees. Specifically, the tariff states: “Unless authorized by statute, *late payment charges shall not be assessed on any amount billed which is not for utility service.*” In response to Nicor Gas’ view that its partial payment pro rata application process should be maintained because it grants higher priority to older receivables, the AG points out that its payment prioritization process violates Section 280.130 of the Commission’s regulations, which prohibits service disconnections for non-payment of “charges for non-utility services, unless otherwise authorized by Illinois statute.” AG Ex. 4.0 at 29; 83 Ill. Adm. Code 280.130(c)(1).

In light of these clear violations of Commission rule and precedent, the AG requests that the Commission order Nicor Gas to:

- cease its current pro rata payment application procedure and apply partial payments to past and current regulated charges first, past and current third-party supply charges next and finally, any remaining payment dollars to third-party warranty service charges last (should the Commission allow Nicor to continue providing billing services to PHS);
- end the application of late fees on Nicor Gas bills for third-party supply and warranty services; and
- revise its Customer Select tariff to include language that requires the Company to apply partial payments first to any overdue regulated charges, then to overdue supplier charges, next to current regulated charges, then to any current supplier charges, and finally, to amounts owed to non-regulated warranty service providers, who should be prioritized last, consistent with the Commission’s directive in its 2001 Customer Select Order and with the non-utility nature of these services.

If, however, the Commission permits Nicor Gas to continue as the PHS billing agent (and it should not), the AG requests that the Commission order Nicor Gas to provide additional information on customer bills, in addition to correcting its flawed partial payment application procedure as outlined above. The AG notes that if Nicor Gas customers were

clearly informed that PHS charges were not utility charges and could be cancelled, or that partial payments would cover utility charges first, the customer would have the knowledge and incentive to better manage both payment and the selection of services to fit within a budget. The fact that unregulated charges for non-utility service are on customer bills should be disclosed as a consumer protection measure, and partial payments should be used first to pay for essential, regulated utility services, according to the AG.

### **c) Commission Analysis and Conclusion**

The Commission agrees with the AG that the CUB Order prioritizes utility service charges over non-utility service charges. The plain language of the Order is clear that payments to gas suppliers must be prioritized with past due charges from the utility otherwise the market will not remain competitive. CUB Order at 80. The Commission directs Nicor Gas to modify its Customer Choice tariff language to prioritize partial payments as follows: (1) overdue regulated charges; (2) overdue supplier charges; (3) current regulated charges; and (4) current supplier charges. This priority structure ensures that the optimal goal of avoiding disconnection is met, as well as maintaining consistency with 83 Ill. Adm. Code Part 280. The Commission directs Nicor Gas to implement these changes within 120 days of the date of this Order. See Nicor Br. on Exc. at 36; Nicor Gas Ex. 39.0, 6:101-103.

## **2. Repair Allowance**

### **a) Nicor Gas' Position**

Nicor Gas argues that the AG's proposal to have the Commission direct Nicor Gas to implement a change in its tax accounting to take advantage of a capital repairs income tax deduction that is available to electrical utilities is unreasonable and should not be adopted. The Company asserts that there is no specific guidance from the Internal Revenue Service ("IRS") on whether that deduction is appropriate for gas utilities, and that the AG could not prove otherwise.

The Company maintains that the AG's proposal fails to acknowledge that the IRS guidelines issued in September 2013 state that the applicability of such regulations is more appropriately determined through guidance tailored through individual industries under the IRS' Industry Issue Resolution program. The Company observes that the safe harbor guidelines referenced therein apply to additional repairs deduction on electric transmission and distribution property. The Company further observes that while the American Gas Association is working with the IRS to develop analogous "safe harbor" guidance applicable to natural gas transmission, such guidance has not yet been released.

With regard to the AG's claim that other gas utilities are taking the tax deduction in the absence of IRS guidance, the Company asserts that point is anecdotal and does not change the fact that the IRS has not established a safe harbor for gas utilities on this issue. The Company posits that it is in compliance with IRS regulations for repair and maintenance expense, and that once the IRS releases guidance for a permissible methodology for the Company to take tax repair deductions, Nicor Gas will analyze that guidance and take appropriate action as soon as possible. However, the Nicor Gas avers that the AG's proposal to have the Commission order Nicor Gas to adopt such tax

treatment in the absence of applicable IRS guidance is not prudent or appropriate and should be rejected.

**b) AG's Position**

The AG requests that the Commission order Nicor Gas to take all reasonable steps to take advantage of the capital repairs tax deductions as soon as possible. The AG further requests that if Nicor Gas does not implement the steps necessary, the Commission should hold Nicor Gas' customers harmless for the Company's failure to take advantage of the repairs tax deduction by imputing the effect of the capital repairs deduction in determining the revenue requirement.

The AG observes that Nicor Gas has failed to avail itself of certain tax accounting changes that would allow it to take advantage of a capital repairs income tax deduction that would lower its revenue requirement. AG Ex. 2.0 at 20. The AG states that this particular change in tax accounting would decrease Nicor Gas' income taxes currently payable and provide significant cash flow benefits that would be reflected as reductions to Nicor Gas' rate base, thereby lowering its revenue requirement. *Id.*

The AG notes that in March 2008, the IRS issued proposed regulations expanding the current deductibility of certain expenditures as repairs. In September 2009, the IRS issued Revenue Procedure 2009-39, clarifying the procedures for taxpayers to obtain consent for changes in the method of accounting for which expenditures are currently deductible under Internal Revenue Code Section 162 and which expenditures must be capitalized under Internal Revenue Code Section 263. The AG asserts that Revenue Procedure 2009-39 clarified that consent to implement such changes in accounting would be automatic. *Id.* at 20.

In September 2013, the IRS adopted final regulations providing guidance regarding the deduction and capitalization of expenditures related to tangible property. The effect of the final regulations issued in 2013 was to formalize the expansion of the treatment of certain expenditures, which are capitalized on taxpayers' books of account, as current deductions for income tax purposes. The AG maintains that these repair allowance deductions are available to Nicor Gas, but the utility has not claimed these deductions. *Id.*

AG witness Effron testified that many other gas distribution companies have taken advantage of the available benefits of the capital repairs deductions. Mr. Rubin posited that prior to 2019, there was no particular urgency to implement the capital repairs deductions, as Nicor Gas was in a net operating loss ("NOL") position, and any increase to ADIT would be offset by an increase to the NOL, resulting in no net effect on rate base. However, Mr. Rubin asserted that now with the expiration of bonus depreciation, the NOL has been absorbed, and there are significant benefits available from implementation of the capital repairs deductions. Therefore, Mr. Rubin concluded, it is not reasonable for the Company to ignore the availability of these deductions in determining its revenue requirements. *Id.* at 23.

The Company attempted to explain its failure to act on the repair allowance deduction by claiming that it is awaiting IRS development of a "safe harbor" guidance for an additional repairs deduction specific to natural gas transmission and distribution

property. *Id.* at 21. The AG contends that there is no excuse to delay, pointing to numerous gas distribution companies in Maryland, Massachusetts, Pennsylvania, and Rhode Island that have implemented changes in accounting for the repair allowance in recent years. The AG observes that these gas distribution utilities have been availing themselves of the capital repairs income tax deductions under current regulations, notwithstanding any absence of a “safe harbor” IRS guidance specific to gas utilities. Many of these utilities implemented the changes in 2011 or earlier, according to Mr. Effron. *Id.* at 21.

To illustrate the potential impact on Nicor Gas’ revenue requirement of the effect of the increased repair allowance deductions, Mr. Effron provided an example. If the fiscal year (“FY”) 2020 repair allowance were 20% of gas transmission and distribution plant additions, the increase to the balance of FY 2020 ADIT would be approximately \$19.9 million (Schedule DJE-5). In addition, the balance of ADIT would be affected by the Section 481(a) adjustment. Assuming that the Section 481(a) deduction would be equal to 5% of the gross transmission and distribution plant in service as of the end of FY 2019, the increase to the balance of ADIT would be \$63.9 million. With these assumptions, the total reduction to Nicor Gas’ revenue requirement, from the going forward increase to the repair allowance deduction plus the effect of the Section 481(a) adjustment, would be approximately \$8.5 million. *Id.* at 22-23.

Moreover, the AG asserts that cross-examination revealed that contrary to Mr. Morley’s original claim, the IRS guidance on repairs disallowance was not specifically limited to the electric utility distribution and transmission industry. *Tr.* at 23-27. Mr. Morley further acknowledged that if the Company waited until an IRS safe harbor guidance was issued in the future, and even if applied retrospectively through amended tax returns for prior years, *today’s* ratepayers that would pay the rates set in this rate case would not benefit. *Tr.* at 28-30. He also agreed that by not taking the repairs deduction in this case, Nicor Gas’ present revenue requirement is higher than it would be if Nicor had implemented the repairs deduction allowance in this case. *Tr.* at 31.

### **c) Commission Analysis and Conclusion**

The Commission declines to adopt the AG’s recommendation to order Nicor Gas to use the capital repairs tax deductions. The Commission agrees with the Company that it is appropriate to wait until safe harbor provisions pertaining to gas utilities are released. The Commission orders Nicor Gas to address this issue in its next rate case.

## **3. Payment Processing Fees**

### **a) Nicor Gas’ Position**

Nicor Gas argues that the AG’s proposal to increase rates by \$8.5 million in order to roll third-party convenience fees into base rates as an operating expense should not be considered independent of the tariff package that the Company originally proposed. The Company noted that prior to filing its rebuttal testimony in this proceeding, Nicor Gas withdrew its proposed Rider 35 proposal, which addressed these convenience fees, in order to narrow issues with Staff. On this point, the Company observes that the AG opposed Rider 35 before it was withdrawn. Nicor Gas also argues that the AG’s attempt to socialize these convenience fees among all ratepayers without a rider mechanism does

not find support in the record and notes that neither Staff nor CUB support the proposal. Given the foregoing, Nicor Gas asserts that it would be unreasonable to adopt the AG's proposal without proper consideration of all relevant issues.

Meanwhile, the Company asserts that the issue of the reasonableness of third-party payment processing fees is not properly before the Commission in this docket. Nicor Gas points to evidence that the third-party fees in question are charged directly to customers who select a particular bill payment channel when paying a Nicor Gas bill. Given that Nicor Gas neither imposes the charge nor collects the charge on behalf of the third-party, the Commission does not have jurisdiction over these third-party charges. See, e.g., *Zahn v. N. Am. Power & Gas, LLC*, 2016 IL 120526 (finding the Commission was without exclusive jurisdiction with respect to rates charged by alternative suppliers, since "the prices they are permitted to charge are not established by the Commerce Commission through the conventional rate-making process and do not have to be submitted to the Commerce Commission for approval under the 'just and reasonable' standard."). Accordingly, the Company argues that the Commission should reject the AG's proposal to have the Commission exceed its jurisdiction.

#### **b) Staff's Position**

Staff witness Trost proposed an adjustment for fee-free customer payments. Her adjustment eliminates \$8,516,000 proposed by the Company for customer payment fees. Staff Ex. 1.0 at 19. Ms. Trost testified that the Commission agreed in the 2017 Rate Case that these costs are not necessary to provide utility service. *Id.* Ms. Trost further testified that the Company is under no obligation to customers by statute or otherwise to provide alternative bill payment options to customers without associated fees. *Id.* at 19-20. As discussed in Ms. Trost's testimony, the Commission accepted a similar adjustment in the 2017 Rate Case. In it, the Commission stated:

It is fundamental that the Commission should disallow recovery of any cost of capital in excess of that reasonably necessary for provision of services. *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 276 Ill.App.3d 730 (1<sup>st</sup> Dist. 1995). The Commission agrees with Staff that providing fee-free payments are not necessary to provide utility service, and Nicor Gas is under no obligation, statutory or otherwise, to provide alternative bill payment options to customers without associated fees.

2017 Rate Case, Order at 50.

Staff and the Company stipulated to the withdrawal of these fee-free customer payments costs from the revenue requirement as well as the withdrawal of Nicor Gas' Proposed Rider 35 – Bill Payment Options. Nicor Gas-Staff Joint Ex. 1.0 at 5, ¶ 20.

Staff opines that the Commission should reject the AG's attempt to increase customer rates by over \$8.5 million for a number of reasons. First, the AG failed to present a single witness to support its position that fee free customer payments/convenience fees are necessary to provide utility service. Instead, the AG argues that convenience fees are a "cost of doing business." These are the same fees that the AG

argued against in the 2017 Rate Case. 2017 Rate Case, Order at 49 (“businesses are not expected to provide fee-free payment programs for its customers.”). As discussed above, the Commission addressed this issue less than 17 months ago. 2017 Rate Case, Order at 50. Third, charging all customers for convenience fees violates cost causation principles. Putting aside that convenience fees are not necessary to provide utility service, the AG’s proposal is inconsistent with the findings and intent of Section 1-102 of the Act. Under Section 1-102, “the costs of supplying utility services is allocated to those who cause the costs to be incurred.” 220 ILCS 5/1-102(d)(iii). Customers who choose to pay their bills by credit card cause those fees to be incurred and therefore those same customers who pay by credit card should not be allowed to have their costs charged, or “socialized”, to all customers as the AG proposes.

Lastly, the AG’s own witness calls into question the reasonableness of Nicor Gas’ current contract costs with the third-party vendor. AG Ex. 5.0 at 9, 11-12. The AG then presents the unworkable recommendation for the Commission to require the Company to submit a report justifying the amount of the payment processing costs borne by Nicor Gas customers. The purpose of this report is unclear. The \$8.5 million in costs the AG seeks to increase rates by is either reasonable in amount or it is not, since the Commission can only approve rates which are just and reasonable. 220 ILCS 5/9-201(c).

### **c) AG’s Position**

The AG requests that the Commission order Nicor Gas to eliminate payment processing fees assessed to customers (\$2.95 to pay online or by phone; \$2.00 to pay via walk-in agent) and to instead recover payment processing costs through base rates. The AG notes that Nicor Gas initially proposed to eliminate payment processing fees in this proceeding, citing significant customer dissatisfaction and a barrier to convenient and accessible payment options, before agreeing to drop its proposal via a Stipulation with Staff. AG Cross Ex. 8 at 2, 9; Nicor Gas Ex. 7.0 at 13-14; Nicor Gas-Staff Joint Ex. 1.0 at ¶ 20.

The AG contends that eliminating these fees would simplify customers’ online bill payment experience and put all customers on equal footing regardless of what means of payment they have available and use. AG Ex. 4.0 at 16-17. In support of this position, the AG cited Nicor Gas data showing that its customers have moved away from payment methods Nicor Gas processes in-house in favor of modern payment methods that vendors handle. For example, the AG references data showing that from 2010 to 2017, the share of Nicor Gas customer bill payments made by paper check decreased from 52% to 33%. AG Cross Ex. 6 at 2-3; AG Cross Ex. 8 at 4. Further, the AG notes that roughly two-thirds of Nicor Gas bill payments in 2017 were made online or by phone. AG Cross Ex. 6 at 2-3. The AG argues that this data demonstrated that a substantial and growing portion of Nicor Gas customers have adopted modern payment methods, making the additional fees Nicor Gas charges customers who utilize these payment methods a barrier to facilitating bill payment efficiently.

The AG argues that treating payment processing costs as an operating expense would give Nicor a financial incentive to manage these expenses. If Nicor Gas treats these costs as an operating expense the way businesses typical do, Nicor Gas could increase its earnings by decreasing its payment processing costs. The AG argues that

this would encourage Nicor Gas to manage payment processing costs to promote cost savings, such as negotiating lower prices with its processors, pushing other processors to compete for Nicor Gas' business with better offers, adopting cost-saving technologies, and running all bill payment-related processes within its control as efficiently as possible. AG Ex. 4.0 at 19.

The AG maintains that Nicor Gas currently has no such incentive to manage this cost because as a regulated public utility, Nicor Gas has the unique ability to require its customers to cover payment processing costs because they have no options to take service from another provider. The AG argues that these payment processing fees are especially problematic for certain Nicor Gas customers – for example, those who do not have a bank account who cannot pay their bills through any channel that does not utilize a third-party payment processing vendor. The AG posits that these fees are inescapable for people whose income is received on a debit card (i.e., Social Security or Veterans Administration disability benefits).

The AG adds that socializing payment processing costs also could create savings for customers by facilitating more customer switching to paperless billing, which Nicor Gas has found reduces its cost to bill the average customer by \$4.25 per year. AG Cross Ex. 6 at 9. The AG asserts that eliminating payment processing fees would remove a barrier to customers adopting electronic billing, encouraging more customers to migrate to paperless billing and thereby reduce paper billing costs.

The AG further notes that Nicor Gas witness Rendos called for the elimination of payment processing fees and the socialization of payment processing costs, citing thousands of Nicor Gas customer complaints regarding these fees. AG Cross Ex. 8 at 7-8. The AG also cites Ms. Rendos' statements that these payment processing fees were established at a time when electronic and walk-in payment methods were "unique" and a "convenience" and that payment methods processed by vendors are now a widely adopted practice that should not be treated as a special convenience with an associated fee. AG Cross Ex. 8 at 5.

The AG argues that it is ordinary business practice to include payment processing costs in the price of the product. AG witness Rubin testified that the cost of processing payments, like the cost of sending bills, should be considered part of Nicor Gas' cost of doing business. AG Ex. 4.0 at 16. The AG asserts that Nicor Gas treats several such expenses this way. For example, Nicor Gas does not assess an additional fee to send customers paper bills despite the additional expense of doing so. AG Cross Ex. 6 at 9. The AG characterizes billing costs as a necessary expense of any company transacting business with its customers and contended that it should be included as a cost of doing business. Competitive retailers, the AG notes, typically treat such expenses, including payment processes fees owed to third-party vendors, as part of overhead costs and do not charge customers separate fees or surcharges associated with them. AG Ex. 4.0 at 16-17. The AG references Ms. Rendos' statement that "bill payment convenience fees are analogous to Nicor Gas' other customer service functions," in which she offered Nicor Gas' recovery of website costs from all customers – not just those who use the website – as an example. AG Cross Ex. 8 at 6.

Regardless of whether payment processing costs are to be recovered through fees or rates, the AG also requests that the Commission require Nicor Gas to demonstrate that the amount these processors charge under their contract with Nicor Gas is reasonable. The AG references Nicor Gas' statement that it "is able to participate in and influence vendor negotiations to lower the cost per transaction" in arguing that Nicor Gas is responsible for negotiating these charges on behalf of ratepayers. AG Cross Ex. 7 at 5. However, the AG asserts, Nicor Gas has no financial incentive to negotiate for lower charges because customers pay these charges directly to the vendors through fees. The AG contends that Nicor Gas' representation that it does not receive processing statements from its vendors detailing the actual costs of processing customer bill payments shows that Nicor Gas is, in fact, not monitoring these costs.

The AG characterizes this practice as a lack of diligence by Nicor Gas in exerting its influence on ratepayers' behalf. The AG notes that Nicor Gas maintains up-to-date cost remittance studies recording Nicor Gas' exact costs to process payments it handles in-house. AG Cross Ex. 6 at 4-5. The AG contends that third-party payment processing vendors are aware of their costs to process payments as well and regularly provide this information to a client on request in the form of itemized processing statements. AG Ex. 5.0 at 10-11. The AG cites the finding of witness Dwyer, who has been advising businesses on the use and cost of payment processing for thirteen years, that "it is highly unusual not to receive a statement justifying processing costs." AG Ex. 5.0 at 1. The AG also quotes Mr. Dwyer's testimony in asserting that it would be "relatively easy" with these processing statements to determine whether Nicor Gas had negotiated reasonable charges and that Nicor is "flying blind" in negotiating terms without them. *Id.* at 2-3.

AG witness Dwyer finds that Nicor Gas' estimated \$1.95 per bill charge, let alone the \$2.95 and \$2.00 fees Nicor now proposes to continue assessing, represents "a significant markup over several interchange categories that likely have a high transaction volume." As an example, the AG points to regulated debit categories producing a markup of more than triple base cost. AG Ex. 5.0 at 11; AG Ex. 5.4. Mr. Dwyer's analysis illustrates that even at the lower \$1.95 per customer charge under Nicor Gas' since-withdrawn proposal, markups on each transaction would account for 12% to 75% of the total payment processing fee the customer pays. AG Ex. 5.0 at 9-10. The mark-up is even larger, the AG points out, when the per-transaction cost is \$2.95. The AG suggests that these mark-ups were potentially excessive, necessitating a review of the vendors' actual costs to process Nicor Gas customer payments to determine the propriety of the vendors' charges.

The AG contends that the per-transaction markups Mr. Dwyer calculated are consistent with the processors charging an excessive price under the contract. Accordingly, the AG posits that regardless of how these charges reach customers – convenience fees, base rate charges, or otherwise – the Commission should order Nicor Gas to demonstrate that it has negotiated a reasonable and competitive rate with its processors. To ensure that Nicor Gas prudently manages payment processing costs borne by its customers, the AG requests that the Commission order Nicor Gas to submit within 90 days after the issuance of the Final Order in this case a report justifying the amount of the payment processing costs borne by Nicor Gas customers. The AG maintains that at a minimum, this report should include itemized processing statements

demonstrating that the amounts of the payment processing fees Nicor Gas imposes on its customers are reasonable and an investigation by Nicor Gas of how its payment processing costs compare to those of its peer utilities. AG Ex. 5.0 at 9-12.

After it withdrew its request to include processing costs in rates, Nicor Gas claimed that the Commission lacked authority to address these costs. In response, the AG cites the Commission's authority under several provisions of the Act as providing jurisdiction to provide the remedies they seek regarding payment processing costs. The AG cites first to Section 9-104, which authorizes the Commission to review charges, rules, and regulations "relating" to utility service, including "rates and other charges." 220 ILCS 5/9-104 (emphasis added). Further, the AG contends that Section 4-101 grants the Commission authority over all aspects of the utility's interaction with the public. 220 ILCS 5/4-101. Moreover, the AG notes that Section 8-101, which requires that utilities provide service in a non-discriminatory manner, explicitly states, "Nothing in this Section shall be construed to prevent a public utility from accepting payment electronically or by the use of a customer-preferred financially accredited credit or debit methodology." 220 ILCS 5/8-101.

The AG responds to Nicor Gas' suggestion that payment processing vendor fees are outside of the Commission's jurisdiction by distinguishing payment processing vendor contracts from the third-party supplier contracts to which Nicor Gas analogizes. The AG agrees with Nicor Gas that the Commission has no jurisdiction over third-party supplier charges, as the *Zahn* decision holds. *Zahn v. N. Am. Power & Gas*, 72 N.E.3d 333 (Dec. 1, 2016). However, the AG contends that *Zahn* does not prevent the Commission from reviewing the utility's diligence in negotiating contract terms with third parties which consumers are obligated to pay as a feature of doing business with the utility. The AG argues that the operative distinction between the supplier charges at issue in *Zahn* and the payment processing vendor charges of concern in this proceeding is that in *Zahn*, the Commission was asked to regulate a third party whereas here, the AG asks the Commission to review *the utility's* contracting practices. The Commission has jurisdiction over Illinois public utilities, including Nicor Gas, but cannot order a third party to change its rates. The AG maintains that they do not seek any remedy from the third-party vendors and instead seek only for the Commission to approve Nicor Gas' contracting practice.

#### **d) Commission Analysis and Conclusion**

Consistent with the Commission's findings in the 2017 Rate Case, it declines to adopt the AG's recommendation to increase rates by \$8.5 million in order to roll third-party convenience fees into base rates as an operating expense. The Commission agrees with Staff that these costs are not necessary to provide utility service and Nicor Gas is under no obligation to provide alternative bill payment options to customers without associated fees. However, the Commission agrees with the AG that the Company should ensure that its contracts with vendors that provide payment services to customers are just and reasonable. Therefore, the Commission orders the Company to present evidence in its next rate case on those costs. The *Zahn* holding does not prohibit the Commission from examining a utility's contracts with third parties.

## XII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Northern Illinois Gas Company d/b/a Nicor Gas Company is an Illinois corporation engaged in the storage, transmission, distribution, and sale of natural gas to the public in the State of Illinois and, as such, is a “public utility” as defined in Section 3-105 of the Public Utilities Act;
- (2) the Commission has jurisdiction over the parties hereto and the subject matter herein;
- (3) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record, and are hereby adopted as findings of fact and conclusions of law; the Appendix attached hereto provides supporting calculations;
- (4) the Test Year for the determination of the rates herein found to be just and reasonable should be the 12 months ending September 30, 2020; such Test Year is appropriate for purposes of this proceeding;
- (5) for the Test Year ending September 30, 2020, and for the purposes of this proceeding, the Company’s rate base is \$3,446,880,000;
- (6) the \$6,995,028,000 original cost of plant for Nicor Gas at September 30, 2018, as presented in Staff Exhibit 2.0, is unconditionally approved as the original cost of plant;
- (7) a just and reasonable return which Nicor Gas should be allowed to earn on its net original cost rate base is 7.197%; this rate of return incorporates a return on common equity of 9.73%, on long-term debt of 4.350%, and on short-term debt of 2.494%, and includes a 0.022% adder to overall cost of capital to account for credit facility fees;
- (8) the rate of return set forth in Finding (7) results in base rate operating revenues of \$918,447,000 and net annual operating income of \$248,075,000 based on the Test Year approved herein;
- (9) the Commission has considered the costs expended by Nicor Gas to compensate attorneys and technical experts to prepare and litigate this rate case proceeding and assesses that such costs as reflected in the evidence are just and reasonable pursuant to Section 9-229 of the Act (220 ILCS 5/9-229), and together with the unamortized balance of rate case expenses previously approved in Docket No. 17-0124, is amortized over two years;
- (10) Nicor Gas’ rates which are presently in effect are insufficient to generate the operating income necessary to permit Nicor Gas the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;
- (11) the specific rates proposed by Nicor Gas in its initial filing on November 9, 2018 do not reflect various determinations made in this Order; Nicor Gas’

proposed rates should be permanently canceled and annulled consistent with the findings herein;

- (12) Nicor Gas should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of \$899,135,000, which represents a gross increase of \$167,739,000; such revenues will provide Nicor Gas with an opportunity to earn the rate of return set forth in Finding (7) above; based on the record in this proceeding, this return is just and reasonable;
- (13) the determinations regarding cost of service, rate design, and tariff terms and conditions contained in the prefatory portion of this Order are just and reasonable for purposes of this proceeding; the tariffs filed by Nicor Gas should incorporate the rates, rate design, and terms and conditions set forth and referred to herein;
- (14) Rider VBA, as modified above in Section IX.3.a., is just and reasonable and is hereby approved;
- (15) new tariff sheets authorized to be filed by this Order should reflect an effective date not less than four days after the date of filing, with the tariff sheets to be corrected, if necessary, within that time period;
- (16) the Invested Capital Tax Base Rate Allowance included in base rates is \$28.820 million;
- (17) the state income tax rate used in the determination of base rates in this proceeding was 9.50%; the federal income tax rate used in the determination of base rates in this proceeding was 21.00%; the amount represented as amortization of deferred tax excess and deficiencies, as used in the calculation of income taxes used to set base rates in this proceeding, was \$8.716 million;
- (18) the September 30, 2019, QIP amounts included in base rates are comprised of Gross Plant of \$567,060,418, related accumulated depreciation of \$98,541,039, related accumulated deferred income taxes of \$(29,190,117), and \$9,584,110 for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired;
- (19) the QIP costs related to the 2018 and 2019 QIP costs included in the revenue requirement are subject to review for prudence and reasonableness adjustments in the applicable annual QIP reconciliations and future base rate proceedings;
- (20) Nicor Gas shall prepare an updated cost study specific to analyzing the cost of third-party billing service and present its results in the Company's next rate case proceeding;
- (21) Nicor Gas has satisfied Condition 8 of the Commission's Final Order in Docket No. 15-0558 by filing a study analyzing the impact, if any, of Nicor Gas' affiliation with The Southern Company and its other subsidiaries on the cost of capital of Nicor Gas;

- (22) Nicor Gas has satisfied Finding (16) of the Commission's Final Order in Docket No. 17-0124 by preparing a study to assess the implications of how Transportation customers use the Company's storage assets under current terms and conditions of service and presenting its results in this proceeding as set forth in Nicor Gas Exhibit 8.1; and
- (23) Nicor Gas shall make a revenue-neutral tariff filing by June 30, 2020 in which to consider the issues arising from the storage study presented in this proceeding.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets presently in effect rendered by Northern Illinois Gas Company d/b/a Nicor Gas Company are hereby permanently canceled and annulled, effective at such time as the new tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the proposed tariffs seeking a general rate increase, filed by Northern Illinois Gas Company d/b/a Nicor Gas Company on November 9, 2018, are permanently canceled and annulled.

IT IS FURTHER ORDERED that Northern Illinois Gas Company d/b/a Nicor Gas Company is authorized to file new tariff sheets with supporting workpapers in accordance with Findings (12), (13), (14) and (15) of this Order, including Rider VBA set forth therein, applicable to service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that the \$6,995,028,000 original cost of plant for Northern Illinois Gas Company d/b/a Nicor Gas Company at September 30, 2018, as presented in Staff Exhibit 2.0, is approved as the original cost of plant.

IT IS FURTHER ORDERED that the September 30, 2019 QIP amounts included in base rates are comprised of Gross Plant of \$567,060,418, related accumulated depreciation of \$98,541,039, related accumulated deferred income taxes of \$(29,190,117), and \$9,584,110, for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired.

IT IS FURTHER ORDERED that the QIP costs related to the 2018 and 2019 QIP costs included in the revenue requirement are subject to review for prudence and reasonableness adjustments in the applicable annual QIP reconciliations and future base rate proceedings.

IT IS FURTHER ORDERED that Northern Illinois Gas Company d/b/a Nicor Gas Company is directed to prepare an updated cost study specific to analyzing the cost of third-party billing service and present its results in the Company's next rate case proceeding.

IT IS FURTHER ORDERED that Northern Illinois Gas Company d/b/a Nicor Gas Company is directed to make a revenue-neutral tariff filing by June 30, 2020 in which to consider the issues arising from the storage study presented in this proceeding.

IT IS FURTHER ORDERED that Northern Illinois Gas Company d/b/a Nicor Gas Company is directed to implement the changes to its third-party partial payment structure as described above within 120 days of this Order.

IT IS FURTHER ORDERED that any motions, petitions, objections, and other matters in this proceeding that remain unresolved are disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED that pursuant to Section 10-113(a) of the Public Utilities Act and 83 Ill. Adm. Code 200.880, any application for rehearing shall be filed within 30 days after service of the Order on the party.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 2<sup>nd</sup> day of October 2019.

Commissioners Sheahan and Oliva dissent.

(SIGNED) CARRIE ZALEWSKI  
Chairman