STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company d/b/a Nicor Gas Company	**:**	
Proposed general increase in rates and revisions to other terms and conditions of service. (tariffs filed January 14, 2021)	**:**	**21-0098**

ORDER

November 18, 2021

Table of Contents

I. INTRODUCTION 1

II. OVERALL REVENUE REQUIREMENT AND REVENUE DEFICIENCY 3

III. TEST YEAR 3

IV. RATE BASE 3

A. Uncontested Issues 3

1. 2021 Qualified Infrastructure Plant Amounts 3

2. Technology Capitalization 4

3. Request for a Depreciation Study 4

B. Contested Issues 4

1. Original Cost of Gross Plant Balance 4

2. Pension Asset 4

3. RNG Pilot Program (Rate 81) 14

4. Capital Additions 15

5. Cash Working Capital 25

V. OPERATING EXPENSES 26

A. Uncontested Issues 26

1. Interest Expense on Customer Deposits 26

2. Income Tax Expense – Meals and Entertainment 26

3. Shared Services – Divestitures and Back Billings 26

4. Teleworking Stipend 27

B. Contested Issues 27

1. Incentive Compensation 27

2. Rate Case Expense 36

3. Shared Services 39

4. Enterprise Foundations 46

5. Pension/OPEB costs 47

6. Incremental Charitable Contributions 51

7. Smart Neighborhood Project 55

8. Customer Payment Fees 61

9. Employee Level and Payroll Costs 63

10. Interest Synchronization 66

VI. RATE OF RETURN 67

A. Uncontested Issues 67

1. Remaining Construction Work-In-Progress ("CWIP") Accruing Allowance for Funds Used During Construction ("AFUDC") Adjustment 67

2. Cost of Long-Term Debt 67

3. Credit Facility Fees 67

B. Contested Issues 67

1. Capital Structure 67

2. Cost of Short-Term Debt 71

3. Cost of Common Equity 73

4. Flotation Costs 95

C. Recommended Rate of Return on Rate Base 97

VII. COST OF SERVICE AND ALLOCATION ISSUES 99

A. Overview 99

B. Contested Issues 99

1. Embedded Cost of Service Study 99

2. Class Revenue Allocation 105

VIII. RATE DESIGN 109

A. Uncontested Issues 109

1. Companion Rates 109

2. Existing Riders 111

3. Proposed Riders 111

4. Terms and Conditions 111

5. Housekeeping Revisions 111

6. Other 111

B. Contested Issues 112

1. Rate 1 – Residential Class 112

2. Existing Riders 115

3. Proposed Riders 118

IX. GROSS REVENUE CONVERSION FACTOR ("GRCF") 126

X. OTHER ISSUES 127
A. Contested Issues 127
1. Third-Party Billing Service 127
2. Transportation Tariffs Approved in Docket No. 20-0606 131
XI. FINDINGS AND ORDERING PARAGRAPHS 133

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company d/b/a Nicor Gas Company	:	
Proposed general increase in rates and revisions to other terms and conditions of service. (tariffs filed January 14, 2021)	:	**21-0098**

ORDER

By the Commission:

I. INTRODUCTION

On January 14, 2021, Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" or the "Company"), filed with the Illinois Commerce Commission (the "Commission") pursuant to Section 9-201 of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 *et seq*., the following tariff sheets: 25th Revised Sheet No. 1, 20th Revised Sheet No. 1.5, 8th Revised Sheet No. 4, 13th Revised Sheet No. 10, 12th Revised Sheet No. 11, 9th Revised Sheet No. 11.5, 13th Revised Sheet No. 12, 13th Revised Sheet No. 13, 6th Revised Sheet No. 14, 14th Revised Sheet No. 19, 10th Revised Sheet No. 21, 11th Revised Sheet No. 21.4, 5th Revised Sheet No. 21.6, 16th Revised Sheet No. 22, 13th Revised Sheet No. 24, 5th Revised Sheet No. 24.5, 15th Revised Sheet No. 25, 14th Revised Sheet No. 26, 13th Revised Sheet No. 27, 10th Revised Sheet No. 28, 8th Revised Sheet No. 35, Original Sheet No. 35.1, 10th Revised Sheet No. 35.5, 7th Revised Sheet No. 38.1, 12th Revised Sheet No. 39, 13th Revised Sheet No. 41, 5th Revised Sheet No. 42.2, 8th Revised Sheet No. 52.5, 18th Revised Sheet No. 54, 20th Revised Sheet No. 55, 1st Revised Sheet No. 55.2, 12th Revised Sheet No. 56, 11th Revised Sheet No. 57, 10th Revised Sheet No. 62, 7th Revised Sheet No. 85, 3rd Revised Sheet No. 88, 2nd Revised Sheet No. 88.1, 2nd Revised Sheet No. 88.2, 2nd Revised Sheet No. 91.1, Original Sheet No. 96, Original Sheet No. 97, Original Sheet No. 98, and Original Sheet No. 99.

This rate filing embodied 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 255. The Commission issued an Order on February 4, 2021 suspending the tariffs up to and including June 12, 2021 and initiating this proceeding. Subsequently, the Commission issued a resuspension order on May 27, 2021, resuspending the tariffs and an amendatory resuspension order on

September 2, 2021, indicating that the tariff suspension date runs through December 12, 2021.

Staff of the Commission ("Staff") participated in this proceeding and the Illinois Attorney General's office ("AG") filed an appearance. The following parties were given leave to intervene in this proceeding: International Brotherhood of Electrical Workers Local 19, ALF-CIO ("Local 19"); Illinois Energy, USA, LLC; Citizens Utility Board ("CUB"); the Retail Energy Supply Association ("RESA"); Nucor Steel Kankakee, Inc. ("Nucor"); Illinois Propane Gas Association ("IPGA"); the Environmental Defense Fund ("EDF"); ExxonMobil Power & Gas Services, Inc., Cleveland-Cliffs Riverdale LLC, Caterpillar Inc., and Ingredion Inc. (collectively, "Illinois Industrial Energy Consumers" or "IIEC"); and the Illinois Competitive Energy Association ("ICEA").

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 on February 25, 2021. An evidentiary hearing was held July 21, 2021, at which time the written testimony and exhibits of Nicor Gas, Staff, the AG, EDF and CUB (jointly "EDF/CUB"), ICEA and RESA (jointly "ICEA/RESA"), IIEC, IIEC and CUB (jointly "IIEC/CUB"), and IPGA were admitted into the record. The record was marked "Heard and Taken" on August 5, 2021.

The following witnesses testified on behalf of Nicor Gas: John O. Hudson, III, President and Chief Executive Officer, Nicor Gas; Gregory MacLeod, Finance Director & Assistant Treasurer, Southern Company Gas; 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; Patrick E. Whiteside, Senior Vice President for Operations, Nicor Gas; Meena Beyers, Vice President for Business and Community Development, Nicor Gas; Anne M. Hizon, Manager of Rates, Nicor Gas; Ellen K. Rendos, Director of Credit, Collections and Remittance, Southern Company Gas; James M. Garvie, Senior Vice President of Human Resources Total Rewards & Information Systems, Southern Company Services, Inc.; Robin Lanier, Director of Renewable Natural Gas, Southern Company Gas; Daniel P. Yardley, Principal, Yardley Associates; Todd J. Jirovec, Principal, Strategy&; Dr. Bente Villadsen, Principal, The Brattle Group; John Quackenbush, President, JQ Resources, LLC; John Hengtgen, Consultant, Hengtgen Consulting LLC; David Kopsch, Principal, Mercer (US) Inc; and Vida Hotchkiss, Director of Strategic Billing and Solution, Southern Company Gas.

The following witnesses testified on behalf of Staff: Bonita A. Pearce, Accountant, Financial Analysis Division; Michael Alan, Accountant, Financial Analysis Division; Sheena Kight-Garlisch, Senior Financial Analyst, Financial Analysis Division; Rochelle Phipps, Senior Financial Analyst, Financial Analysis Division; Cheri Harden, Rate Analyst, Rates Department, Financial Analysis Division; Mark Maple, Senior Gas Engineer, Energy Engineering Program of the Safety & Reliability Division; and David Brightwell, Economic Analyst, Policy Division.

The following witnesses testified on behalf of the AG: Mary E. Selvaggio, a regulatory consultant and certified public accountant; Brendan Larkin-Connolly, Principal, DHInfrastructure LLC; and Scott J. Rubin, an independent consultant and attorney.

IIEC/CUB jointly presented the following witnesses: Michael P. Gorman, Managing Principal, Brubaker and Associates, Inc. ("BAI"); and Christopher C. Walters, Associate, BAI. IIEC separately presented the following witnesses: Jessica A. York, Associate, BAI; and Brian Collins, Principal, BAI.

EDF/CUB jointly presented witness David G. Hill, Ph.D., Managing Consultant, Energy Futures Group, Inc.

ICEA/RESA presented witnesses Kevin Wright, President of ICEA, and John Mehling, Senior Regional Operations Manager at NRG Energy.

IPGA presented witness John Tibbs, the Director of Education for IPGA.

On August 17, 2021, Nicor Gas, Staff, the AG, EDF/CUB, IIEC, IIEC/CUB, and ICEA/RESA filed Initial Briefs ("IB"). On August 31, 2021, Nicor Gas, Staff, the AG, EDF/CUB, IIEC, IIEC/CUB, ICEA/RESA, IPGA, and Nucor filed Reply Briefs ("RB"). On September 22, 2021, Staff filed a Supplemental Brief. A Proposed Order was issued on September 30, 2021. Nicor Gas, Staff, the AG, IIEC, IIEC/CUB, ICEA/RESA, and Nucor filed Briefs on Exceptions on October 13, 2021. Nicor Gas, Staff, the AG, IIEC/CUB, ICEA/RESA, and EDF/CUB filed Reply Briefs on Exceptions on October 20, 2021.

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 proposed the use of a forecasted calendar year 2022 as the Test Year, which is permissible under the Commission's Rules. No party objected to the proposed Test Year and it is adopted.

IV. RATE BASE

A. Uncontested Issues

1. 2021 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 Qualified Infrastructure Plant ("QIP"). The Company proposed to transfer all Rider QIP investments made through December 31, 2021 to the Gross Plant component of the Company's Test Year base rate. Staff witness Alan suggested, and Nicor Gas agreed, that the Order should include certain language regarding the December 31, 2021 QIP plant. As such, the Commission memorializes that the December 31, 2021 QIP amounts included in base rates are comprised of gross plant of $722,904,161, related accumulated depreciation of $124,370,304 (increase to gross plant), related accumulated deferred income taxes of ($39,671,090), and $13,017,333 for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired.

In addition, based on the recommendation of Mr. Alan, with agreement by the Company, the Commission finds that the QIP costs related to the 2020 and 2021 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.

2. Technology Capitalization

Based on mutual agreement between Staff witness Alan and the Company, the Advanced Metering Infrastructure ("AMI") Project and updates and support for the Customer Care and Billing System Upgrade Project, which were capitalized rather than expensed, will be removed from the rate base amounts. However, as agreed by Staff and the Company, software licenses for testing the Customer Care and Billing System, which were capitalized rather than expensed in accordance with the Company's Accounting Policy Manual, will remain in the base rate amounts.

3. Request for a Depreciation Study

Nicor Gas agreed to the AG's proposal, which Staff supported, to prepare an updated depreciation study and present it in the Company's next rate case.

B. Contested Issues

1. Original Cost of Gross Plant Balance

Nicor Gas presented evidence that its Gross Plant balance for the period ending December 31, 2020, was $8,707,524,000. Staff agrees with this amount. Staff Ex. 2.0 at 24. AG witness Larkin-Connolly proposed various disallowances related to the Company's capital additions (see Section IV.B.4 of this Order). Based on the findings in this Order, Original Cost of Gross Plant Balance is $8,707,524,000.

2. Pension Asset

a. Nicor Gas' Position

Nicor Gas explains that the net pension asset, which is estimated to be $83 million in the Test Year, should be included in rate base because it was created by the Company and its shareholders rather than ratepayers. The Company points out that significant portions of Staff and intervenors' arguments in opposition rely solely on previous Commission decisions, which are not binding.

The Company begins by explaining that it established a defined-benefit retirement plan for its employees in 1954. The Company notes that under the plan, it is required to make minimum contributions, but there is no upper bound. The Company states that there are three sources of funding for the pension fund—the Company, ratepayers, and market appreciation. The Company notes that under Illinois rate design principles, ratepayers fund the pension costs, but not more.

According to the Company, a pension asset exists when pension contributions exceed costs; a pension liability exists under the opposite circumstance. The Company states that a pension asset cannot be created by ratepayers because ratepayers pay only for pension costs. The Company states that if only ratepayer funds were considered, the pension asset would be roughly $0, because there would be no surplus. The Company also provides that the pension asset cannot be created by market appreciation under the Generally Accepted Accounting Principles ("GAAP"). Rather, market appreciation must be returned to customers or deferred as a credit on the balance sheet until recognized. Therefore, the Company concludes that shareholders are the only logical source of the pension asset.

Nicor Gas highlights several bases in support of its conclusion that shareholders and not ratepayers are responsible for the pension asset. First, the Company reiterates that it is a principle of Illinois rate design that customers pay only the pension cost and that market returns do not count toward the calculation of the pension asset. Second, the Company notes that as of 1990, the cumulative prepaid pension balance was negative. Third, the Company observes that ratepayers received pension credits in each year during the 1990s and large credits in the early 2000s, and emphasizes that during this time, the pension asset grew from a negative figure to over $150 million. And fourth, the Company highlights that cumulatively, since 1954, customers have paid a net total of just $9 million, so even if there was any incidental customer contribution to the pension asset, it has been returned. Given these facts, the Company states that the net pension asset must have come from shareholders.

Nicor Gas also argues that its proposal to include the net pension asset in rate base is consistent with the Commission's treatment of Other Post-Employment Benefits ("OPEB"). The Company states that it reduced its rate base request, consistent with Commission precedent, based on its OPEB liability. Because OPEB and pension asset share accounting rules, the Company concludes that it would be reasonable for the Commission to increase its rate base by the net pension asset.

The Company observes that Staff and the AG rely primarily on past rate case decisions in their arguments against including the net pension asset in rate base. The Company responds that prior Commission decisions are not binding, and that with the benefit of hindsight and the evidence presented in this docket, it would be proper for the Commission to include the net pension asset in rate base.

b. Staff's Position

Staff witness Alan recommended an adjustment to reduce rate base by a net $82.704 million. The adjustment excludes the Company's net pension asset from rate base since it was funded by ratepayers and not shareholders. Mr. Alan's testimony that the pension asset is funded by ratepayers is significant because, for ratemaking purposes under Illinois law, a public utility may not receive a return on investment from ratepayers for ratepayer supplied funds. *City of Alton v. Ill. Commerce Comm'n*, 19 Ill. 2d 76, 85-6, 91 (1960); *DuPage Utility Co. v. Ill. Commerce Comm'n*, 47 Ill. 2d 550, 554 (1971); *see Bus. & Prof. People for the Pub. Int. v. Ill. Commerce Comm'n*, 146 Ill. 2d 175, 258 (1991) ("BPI II").

Staff explains that both the net pension asset and OPEB liability are ratepayer funded. Staff Ex. 2.0 at 5, 16. The Commission has made this same determination in the following Nicor Gas rate cases: Docket No. 95-0219, Docket No. 04-0779, Docket No. 08-0363, and Docket No. 17-0124. The facts have not changed since the prior Commission Orders in Docket Nos. 95-0219, 04-0779, 08-0363, and 17-0124. Staff states that the Company has presented no new evidence to support inclusion of the pension asset in rate base; thus, there is no reasonable basis to support the Company's position that shareholders are now entitled to a return on the pension asset.

Nicor Gas witness Kim states that "[h]istorically, other parties have claimed that customers have funded the Prepaid Pension" and Mr. Kim argues the assertion that customers have funded the prepaid pension asset is incorrect. Nicor Gas Ex. 4.0 at 17.

Mr. Kim goes on to discuss the pension asset as if it were funded by shareholders. *Id*. However, Staff states, the Company's description of the pension asset in this case does not comport with the Commission's Orders in Docket Nos. 17-0124, 08-0363, 04-0779 and 95-0219. In those past Nicor Gas dockets, the Commission rejected the same argument made by Mr. Kim based on the same basic facts as the Company presents in the instant proceeding. *See N. Ill. Gas Co*. *d/b/a Nicor Gas Co*., Docket No. 95-0219, Order at 9 (Apr. 3, 1996); *N. Ill. Gas Co*. *d/b/a Nicor Gas Co*., Docket No. 04-0779, Order at 23 (Sept. 20, 2005) ("*04-0779 Order*"); *N. Ill. Gas Co*. *d/b/a Nicor Gas Co.,* Docket No. 08-0363, Order at 18 (Mar. 25, 2009) ("*08-0363 Order*"); *N. Ill. Gas Co*. *d/b/a Nicor Gas Co.,* Docket No. 17-0124, Order at 29 (Jan. 31, 2018) ("*17-0124 Order*").

Furthermore, Staff points out that the Commission's decisions are entitled to less deference when the Commission drastically departs from past practice. *Bus. & Prof. People for the Pub. Int. v. Ill. Commerce Comm'n*, 136 Ill.2d 192, 228 (1989) ("BPI I").

Staff witness Alan testified that the pension asset is a cumulative balance from many past years. Staff Ex. 2.0 at 7. The pension asset that Nicor Gas seeks to include in rate base in this case includes the cumulative transactions that took place since its pension plan began in 1954. The Company makes the same assertions in this proceeding as it did in the four Commission Orders discussed above and presents no new evidence that the funds contributed in the past were not provided by ratepayers. There have been no additional contributions required of or provided to the pension fund by the Company since 1995 (Staff Ex. 2.0 at 12), which is well before the *17-0124 Order*. Staff states that nothing has changed about how the pension was previously funded. Further, the Company's pension contributions for 2018, 2019, and 2020 were zero given the overfunded status of its pension trust fund and the projected pension contributions for 2021 and 2022 are projected to be zero as well. *Id*. at 7.

Nicor Gas witness Kim stated that the pension asset represents the Company's contributions in excess of pension costs recorded over time by the Company, which is essentially the amount paid by customers through rates. Nicor Gas Ex. 4.0 at 16-17. Mr. Kim, then argued that "[n]o witness has disputed my testimony that 'since 1990 the Company recorded large pension credits as a result of market returns on pension assets, meaning ratepayers were refunded their previous contributions." Nicor Gas Ex. 3.0 at 10. Staff asserts that Mr. Kim's argument is a red herring. Mr. Kim ignored the fact that the negative pension expense, which gave rise to large pension credits that he refers to, was due to returns on a pension fund paid for by ratepayers, not shareholders. Staff Ex. 2.0 at 10-11.

Staff further explains that Attachment C to Staff Ex. 2.0 shows that for the period 1999 through 2020, "the pension credit was a result of the 'Expected Return on Plan Assets' and not from Shareholder funding of the pension plan." Staff Ex. 2.0 at 11. The Company has made no contributions since 1995. *Id*. at 12. Mr. Alan's charts further show that whenever the Company made contributions to the pension fund, the pension costs essentially matched those contributions. *Id*. at 9-11. Charts 1, 2, and 3 show that from 1955 through 1978 contributions to the pension fund approximately matched pension cost. According to Staff, that means that the contributions going to the pension fund were funded by ratepayers, not by shareholders. Similarly, from 1979 through 1990, with the exception of 1985, pension contributions to the pension fund continued to

approximately equal pension cost. *Id*. at 10 (Chart 2). From 1991 through 2020, except for a $1.1 million contribution in 1995, there were no contributions to the pension fund. Also, from 1991 through 2008, pension costs were negative. The pension expense then switched from negative to positive in 2009. *Id*. at 11 (Chart 3). So, despite Nicor Gas' claim to the contrary, Mr. Alan's charts show that the pension asset is not the result of Company's contributions. Nicor Gas Ex. 34.0 at 11. Staff states that the pension asset is due to negative pension expense, which, in turn, was due to expected returns on the pension plan fund, which was funded by ratepayers and not shareholders. Staff Ex. 2.0 at 11.

Finally, Staff states that Mr. Kim's testimony gives the impression that Staff's position is based solely upon the outcome of past rate cases for Nicor Gas and other utilities and nothing else. Nicor Gas Ex. 34.0 at 9. Staff notes that Mr. Kim fails to acknowledge Staff witness Alan did his own analysis in this proceeding. Staff's position is based on Mr. Alan's analysis, which is in evidence in this proceeding, and not just the prior orders he refers to in testimony.

Staff further notes that the Commission has previously denied inclusion of a pension asset in rate base for other utilities on the basis that it was not reasonable to allow shareholders a return on ratepayer supplied funds. In Docket Nos. 09-0166/0167(cons.), the Commission denied inclusion of The Peoples Gas Light and Coke Company's ("Peoples Gas") pension asset in rate base, since there was no evidence in the record that it was created with shareholder funds. *N. Shore Gas Co. and Peoples Gas Light and Coke Co*., Docket Nos. 09-0166/0167 (cons.), Order at 36 (Jan. 21, 2010). The Commission's ruling on this issue was upheld by the Illinois First District. *People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654 ¶¶ 69, 71.

Staff also points out that the Commission again denied inclusion of the pension asset in the subsequent three North Shore Gas Company ("North Shore")/Peoples Gas rate cases. *See N. Shore Gas Co. and Peoples Gas Light and Coke Co.*, Docket Nos. 11-0280/0281 (cons.), Order at 33 (Jan. 10, 2012); *N. Shore Gas Co. and Peoples Gas Light and Coke Co.*, Docket Nos. 12-0511/0512 (cons.), Order at 90 (June 18, 2013); *N. Shore Gas Co. and Peoples Gas Light and Coke Co.*, Docket Nos. 14-0224/0225 (cons.), Order at 49 (Jan. 21, 2015).

Staff further points out that the Commission has also twice declined to include a pension asset in rate base for Illinois-American Water Company ("IAWC"). In Docket No. 11-0767, the Commission ruled that IAWC's proposal to include a pension asset in rate base was not substantively different than those the Commission considered, and rejected, in past rate case decisions. *Ill.-Am. Water Co.*, Docket No. 11-0767, Order at 8 (Sept. 19, 2012). In Docket No. 16-0093, IAWC attempted to receive a debt return on its pension asset. The Commission denied the adjustment, citing not only IAWC's past case history and the fact that no new facts were provided in Docket No. 16-0093, but also noting that while the Commission is not bound by precedent, when the Commission deviates from past practices it must articulate a reasoned basis to do so. *Ill.-Am. Water Co*., Docket No. 16-0093, Order at 12-13 (Dec. 13, 2016).

Further, in Docket No. 14-0066, the Commission ruled against MidAmerican Energy Company when it proposed to include a pension asset in rate base, because the

company failed to show the pension asset was funded by anything other than ratepayer funds. *MidAmerican Energy Co*., Docket No. 14-0066, Order at 12 (Nov. 6, 2014). Again, Staff states that Nicor Gas presents no new evidence regarding the pension asset in this proceeding and therefore, there is no basis to warrant an abrupt departure from past Commission practice. Staff Ex. 2.0 at 7-12.

Staff notes that the Company's "symmetry" argument has been considered and rejected multiple times by the Commission. The Company states that, to be consistent with its treatment of the accrued OPEB liability, the Commission should include the prepaid pension asset, which is funded by shareholders, in the Company's rate base. Nicor Gas Ex. 4.0 at 20. According to Staff, this symmetry argument has no bearing on the proper exclusion of an OPEB liability from rate base. Staff explains that OPEB liabilities represent other post-employment benefits that had not been paid out to the OPEB trust by the end of the year but for which the utility has already received recovery from rates. Rate base is properly reduced by these OPEB liabilities to recognize that such costs are already recovered from ratepayers by their inclusion as an operating expense. Staff states that it would not be reasonable to allow shareholders a return on this cost-free source of capital to the Company. The Commission has also rejected the Company's symmetry argument in the past for other utilities besides Nicor Gas. Staff Ex. 2.0 at 16.

In Docket Nos. 07-0241/0242 (cons.), both Peoples Gas and North Shore excluded their OPEB liabilities from rate base, i.e., neither utility reduced rate base for the OPEB liabilities. Peoples Gas also had a pension asset, which it did not include in rate base. Peoples Gas similarly argued for symmetrical treatment; that is, excluding both its pension asset and OPEB liability from rate base. The Commission instead found that the pension asset should be excluded from rate base, and that the OPEB liabilities should be reflected as a reduction to rate base. *N. Shore Gas Co. and Peoples Gas Light and Coke Co*., Docket Nos. 07-0241/0242 (cons.), Order at 36 (Feb. 5, 2008).

The Company continued to assert its symmetry argument in rebuttal testimony. Mr. Kim testified that because the accounting rules for pension assets and OPEB are the same, and they are mirror images of each other, the pension asset should be included in rate base. Nicor Gas Ex. 20.0 at 15. As Staff witness Alan testified in rebuttal, the pension asset and OPEB liability are not the same. They are not mirror images. Mr. Alan testified that the pension asset has not been funded by shareholders but rather ratepayers have funded it. Staff Ex. 8.0 at 7. He further added that the consistent position is (1) if the liability has been funded by ratepayers then rate base must be reduced and (2) if the pension asset is not due to shareholder funding then it must not be included in rate base. *Id*. at 7.

c. AG's Position

The AG asks the Commission to adopt AG witness Selvaggio's proposed adjustment to remove the prepaid pension asset from rate base on the grounds that the Company offered no new arguments since the last four times it asked the Commission to require consumers to provide shareholders a return on funds shareholders have not provided. Each time, the AG notes, the Commission denied the asset's inclusion in rate base because it was found to be funded by ratepayers, not shareholders. The AG points

out that in Nicor Gas' most recent rate case and fifth attempt to include the asset in rate base, Docket No. 18-1775, the Commission approved a stipulation between Nicor Gas and Staff to exclude the pension asset from rate base. *N. Ill. Gas Co. d/b/a Nicor Gas Co*., Docket No. 18-1775, Order at 4 (Oct. 2, 2019) ("*18-1775 Order*"). The AG asserts that in this docket, Staff witness Alan and IIEC/CUB witness Gorman made the same adjustment as Ms. Selvaggio on the same basis adopted in Nicor Gas' prior rate cases. Staff Ex. 2.0 at 5-19; 8.0 at 4-7; IIEC/CUB Ex 1.0 at 6-11; and IIEC/CUB Ex. 3.0 at 2-7.

Ms. Selvaggio explained that the "Retirement Benefits, Net" proposed by Nicor Gas consist of two components: a liability for future health care referred to as OPEB and an offsetting net pension asset. Nicor Gas Ex. 4.1, 4.2; AG Ex. 1.0 at 5. OPEB is unfunded, meaning Nicor Gas funds its obligations by paying the benefits as they become due rather than in advance to a third-party administrator. *Id*. Under the Company's pension plan rules, pension funds used to pay OPEB are maintained by a pension trust, a third-party administrator, and the funds are invested in the market and earn a market return. When the value of the pension plan is greater than the projected benefit obligation, there is a pension asset. Currently pension funds exceed obligations, resulting in an average pension asset of $121,465,000. AG Ex. 1.1, Sch. A2. The AG argues that Nicor Gas has not made any payments to this fund since 1995, but claims it is entitled to a return on the excess funds, raising the question of whether it should be included in rate base, generating a return for shareholders. AG Ex. 1.0 at 5.

Nicor Gas witness Kim argued that this pension asset is the result of shareholder funds and not ratepayer funds, and that the Company should be able to earn a return on the funds it provided in the past. Nicor Gas. Ex. 4.0 at 20. This, he argued, is because ratepayers do not contribute directly to the fund but rather pay any OPEB obligation as an expense in the event an obligation comes due, and any market returns are "either (a) given back to the customers through a reduction in pension expense (or pension credit if the reduction exceeds the cost) if recognized, or (b) deferred as a credit on the balance sheet that offsets the pension asset…" *Id*. at 17. Therefore, he argued, the asset was not funded by ratepayers.

The AG asserts that these arguments ultimately fail because they attempt to charge consumers for the increase in the value of the pension trust that are independent of shareholder funding. The AG also notes that these are exactly the same arguments the Commission rejected in Nicor Gas' previous rate cases, Docket Nos. 95-0219, 04-0779, 08-0363, and 17-0124, where the Commission analyzed Company and ratepayer pension contributions since the fund's inception in 1954 and concluded that ratepayers funded the asset. AG Ex. 1.0 at 6; Staff Ex. 2.0 at 7. The Commission did not have to analyze the issue to reach the same conclusion again in the Company's last rate case, Docket No. 18-1775, because it approved the stipulation between Nicor Gas and Staff to exclude the net pension asset from rate base. Docket No. 18-1775, Order at 4. The AG also points out, that for nearly identical reasons, the Commission rejected the inclusion of a pension asset in rate base in a North Shore/Peoples Gas rate case, Docket Nos. 14-0224/14-0225 (cons.), Illinois-American Water Company's recent rate case, Docket No. 16-0093, and Ameren Illinois Company d/b/a Ameren Illinois' ("Ameren") last gas rate case, Docket No. 20-0308. The AG notes that this list is not exhaustive.

The AG asserts that Nicor Gas presented no new evidence or compelling reasons for the Commission to change the treatment of the pension asset that has been consistently applied in Nicor Gas' previous rate cases as well as other Illinois utilities' rate cases over the last 25-plus years. The AG argues that the Commission should reach the same conclusion here as it did in those many prior cases and reject Nicor Gas' attempt to unfairly charge consumers a return on funds that were not supplied by shareholders.

Ms. Selvaggio's adjustment is presented on Sch. A2, AG Ex. 1.1, 4.1, and the AG IB Attachment 1. The net effect of this adjustment is to reduce Retirement Benefits, Net by $121.465 million, related ADIT by $33.011 million, and Excess ADIT by $5.75 million for a net reduction to the Company's rate base of $82.704 million.

d. IIEC/CUB's Position

IIEC/CUB point out the Commission-established standard with regard to including a prepaid pension asset in rates is clear and comports with regulatory law and policy: in order to be included as an asset in rate base, the utility must show that shareholders funded the pension asset. *See 17-0124 Order* at 29. IIEC/CUB note this standard has existed for decades, and as stated by Staff witness Alan, "the basic facts in this case remain the same as in the 95, 04, 08, and 17 Nicor Rate cases. The basic facts are also the same as in the most recent rate case, Docket No. 18-1775, where Staff and the Company resolved the issue by stipulation. The Company has presented no new evidence to support including the pension asset in rate base." Staff Ex. 8.0 at 4 (internal citations omitted).

IIEC/CUB assert the Company's own evidence proves that investor capital did not fund the prepaid pension asset. IIEC/CUB maintain that the prepaid pension asset's funding came from either (1) Company contributions that were ultimately recovered or reimbursed by collections from customers, or (2) resulted from pension trust fund earnings. Therefore, IIEC/CUB conclude, consistent with prior Commission decisions, the prepaid pension asset should be excluded from Nicor Gas' cost of service. IIEC/CUB Ex. 1.0 at 4.

IIEC/CUB explain that Company witness Kim, in support of Nicor Gas' repeatedly-rejected attempt to reverse the Commission's consistent conclusions on this issue, incorrectly obfuscates this straightforward determination not by demonstrating that the pension asset was funded by shareholders, but rather by suggesting that the Company's customers could not have funded the prepaid pension asset. *See* Nicor Gas Ex. 20.0 at 13-14. IIEC/CUB argue Mr. Kim's attempt to prove a negative does nothing to further the Company's position.

IIEC/CUB contend utility investments that are fully recovered by collections from customers (for example, contributions in aid of construction and/or investments funded by accumulated deferred income taxes ("ADIT")) should not be used to increase the utility's cost of service. IIEC/CUB Ex. 1.0 at 4. IIEC/CUB note in this case, and in each previous case where Nicor Gas has made the same proposal, IIEC/CUB, the AG, and Staff reached consensus that the Company's proposal is unsupported. IIEC/CUB believe the Commission should therefore once again reject Nicor Gas' proposal to include a prepaid pension asset in its cost of service in this proceeding. IIEC/CUB calculate that

removing the prepaid pension asset from rate base reduces Nicor Gas' revenue requirement by approximately $7.1 million. IIEC/CUB Ex. 1.0 at 12.

IIEC/CUB note the Commission, in the *17-0124 Order*, where Nicor Gas made the same arguments under nearly identical facts, outlined a standard that if a prepaid pension asset is not funded by shareholders then it should not be included in cost of service. *17-0124 Order* at 29. IIEC/CUB state in the current case, Nicor Gas was unable to show the pension asset was funded by shareholder funds. To the contrary, the Company's evidence proves that the asset was not created by shareholder capital. Mr. Kim asserts that the asset is funded by shareholders because customers only pay Nicor Gas' GAAP pension costs through base rates and he defines the prepaid pension asset as the contributions in excess of GAAP pension cost. Nicor Gas Ex. 4.0 at 17. Therefore, in Mr. Kim's deduction through the process of elimination, customers could not have funded the prepaid pension asset which leaves shareholders as the source of the asset funding. Nicor Gas Ex. 4.0 at 17. IIEC/CUB contend the record confirms the opposite: that the prepaid asset was not created by contributions from Nicor Gas to its pension trust that were funded by shareholder capital. IIEC/CUB Ex. 1.0 at 8. Rather, IIEC/CUB assert the record shows that the prepaid asset was created by excess pension trust fund returns in excess of annual pension costs, or pension actuarial accounting – not from shareholder contributions. *Id*. at 9.

IIEC/CUB state it is undisputed that the Company has fully recovered all of its pension cost and pension trust fund contributions from customers via recovery of its annual pension expense in ratemaking cost of service. IIEC/CUB do not oppose Nicor Gas' recovery of pension expense, but note customers are entitled to the benefits created by the pension trust earned returns if the Company has fully recovered all contribution via collections from customers. This trust earnings benefits includes either reductions or increases to the annual pension expense. IIEC/CUB reason Nicor Gas' request to earn a return on the prepaid pension asset, which is not funded by shareholder capital, should be denied again in this case.

IIEC/CUB argue Mr. Kim's unsupported assertion that customers could not have paid more than the contributions the Company relied on to fund the prepaid pension asset, because customers only pay the GAAP pension expense, is also without merit. IIEC/CUB assert Mr. Kim did not fully consider the fact that customers can pay pension expense in the development of rates that may exceed the GAAP pension expense that can vary from year to year when the rates are actually in effect. IIEC/CUB Ex. 3.0 at 5. Hence, IIEC/CUB reason the amount of pension expense recovered from customers can be in excess of recorded GAAP expense and can be adequate to compensate the Company for all contributions it has made to its pension trust. *Id*.

IIEC/CUB note that according to Mr. Kim, Nicor Gas has not contributed any funds to the pension trust since 1995, (Nicor Gas Ex. 20 at 13), so the Company certainly has not made any contributions since the Commission's decision in Nicor Gas' last rate case. IIEC/CUB further note that Nicor Gas' prepaid pension asset has grown by over $72 million since the Company's last cash contribution to its pension trust in 1995, comprising approximately 60% of the test year gross prepaid pension asset. IIEC/CUB Ex. 1.1. IIEC/CUB found during this time, the growth in the prepaid pension asset was caused by pension trust investment returns that were in excess of annual pension costs. IIEC/CUB

Ex. 3.0 at 5-6. IIEC/CUB reason the prepaid pension asset was not created by the Company contributing to the pension trust in excess of the pension expense, and thus the prepaid pension asset was not funded by shareholder capital. *Id*. Meanwhile, Nicor Gas has continued to recover its ratemaking pension expense from customers in its cost of service. IIEC/CUB argue this evidence demonstrates that Nicor Gas has fully recovered all its pension trust contributions from customers in rates.

IIEC/CUB note Mr. Kim argues in his direct and rebuttal testimonies that customer contributions did not create the pension asset and instead the pension asset was created by shareholder funds. Nicor Gas Ex. 20 at 13. IIEC/CUB point out Mr. Kim's primary argument is that the prepaid pension asset was recorded under a GAAP accounting transaction, and, therefore, the asset was created from shareholder capital. *Id*. IIEC/CUB contend this argument fails to provide any ratepayer protections and shifts the rate-setting standard away from the Commission and to Nicor Gas' GAAP accounting auditors. Further, IIEC/CUB argue under the Company's logic, any asset recorded on Nicor Gas' balance sheet under GAAP could be allowed to be included its rate base regardless of the asset's prudence and/or the cost of the asset. IIEC/CUB reason this logic is not consistent with the requirement under the Act that all actual and reasonable costs of providing service be included in Nicor Gas' regulated rates. 220 ILCS 5/9-101.

IIEC/CUB note Mr. Kim acknowledges Nicor Gas has not made a pension contribution in over 20 years, which is the same time period during which a significant amount of the prepaid pension asset was created. Nicor Gas Ex. 20 at 13. IIEC/CUB explain that this is clear evidence that investor capital did not fund contributions to the trust. IIEC/CUB Ex. 1.0 at 8. IIEC/CUB maintain the question is not whether a prepaid pension asset will have the effect of reducing pension expense or whether an expense reduction occurred, but rather whether the Company incurred a cost to reduce the pension expense. *Id*. IIEC/CUB note if the utility did not make contributions to the pension trust, then investor capital was not used to fund the creation of a prepaid pension asset. *Id*. Instead, IIEC/CUB show that accounting returns and GAAP accounting surrounding the protection of the pension trust, not shareholder funds, funded the pension asset. *Id*.

IIEC/CUB assert there is no dispute that the prepaid pension asset was created by the pension accounting of the trust fund's earnings. IIEC/CUB Ex. 1.0 at 9. Rather, IIEC/CUB maintain the dispute in this case is whether the accounting returns were created from shareholder-invested money. IIEC/CUB point out Mr. Kim argues that "the Company seeks a return on its prepaid pension asset, which by definition under the GAAP, must come from the *Company*, not ratepayers." Nicor Gas Ex. 20.0 at 13 (emphasis in original). IIEC/CUB assert Mr. Kim's argument is incomplete and untrue. IIEC/CUB reason Mr. Kim assumes, but cannot demonstrate with record evidence, that the amount of pension expense built into rates has always equaled its GAAP pension expense. IIEC/CUB point out Mr. Gorman investigated this very question in his rebuttal testimony, challenging the underlying basis for Mr. Kim's assumptions, and concluded that "Mr. Kim has not provided any evidence to prove his claim that customers have only contributed pension expense in rates equal to the amount of GAAP pension expense." IIEC/CUB Ex. 3.0 at 5. IIEC/CUB emphasize Nicor Gas was unable to identify the amount of pension expense Nicor Gas actually recovered from customers in rates, and this

information is necessary for Mr. Kim's theory to hold water. IIEC/CUB point out no data presented in this record verifies whether or not the amount of pension expense built into rates was equal to or exceeded the amount of GAAP pension expense, nor whether Nicor Gas has fully recovered from customers its contributions to the pension trust. *Id*. IIEC/CUB argue Mr. Kim's assertions and claims are not supported by evidence in the record.

IIEC/CUB note Mr. Gorman goes on to describe how the amount of pension expense built into rates could exceed the annual GAAP pension expense because the GAAP pension expense will change year to year due to various pension actuarial factors, whereas the amount of pension expense built into rates is based on a test year concept and does not change until the utility files another rate case. *Id*. at 5. IIEC/CUB contend if Nicor Gas fully recovered its pension GAAP expense, and fully recovered all contributions it made to the pension trust, then customers are entitled to the full benefits created by the excess returns on the pension trust. These benefits include the reduced or negative pension expense as a result of the pension trust returns that are in excess of annual pension costs. Mr. Gorman concludes in his rebuttal testimony, "No further costs should be included in the test year cost of service for pension-related expense other than the Company's GAAP pension expense in the test year." IIEC/CUB Ex. 3.0 at 5

e. Nucor's Position

Nucor states that the Commission should reject Nicor Gas' proposal to include its net pension asset in rate base. As explained by Staff, the AG, and IIEC/CUB, the Commission has consistently denied Nicor Gas' request to include the asset in rate base because it was funded by ratepayers, not shareholders. Because the Commission has consistently denied including the pension asset in rate base, and because Nicor Gas has not put forth compelling evidence to change course, Nucor agrees that the pension asset should be excluded from rate base.

f. Commission Analysis and Conclusion

As in previous Nicor Gas rate cases, the Company again seeks to include a pension asset in rate base under the theory that it was supplied by shareholder – and not ratepayer – funds. Staff, the AG, IIEC/CUB, and Nucor all point out that the Commission rejected this argument in previous Nicor Gas rate cases, as well as numerous other Article IX rate cases with similar facts. In the previous Nicor Gas rate cases, as Staff and intervenors point out, the Commission analyzed Company and ratepayer pension contributions since the fund's inception in 1954 and definitively concluded that ratepayers funded the asset. No facts have changed to warrant a different finding in this docket.

Nicor Gas attempts to use accounting returns to claim that these returns, by process of elimination, had to have been created from shareholder-invested money. However, the record shows that Nicor Gas did not use shareholder capital to fund the pension trust, rather ratepayers supplied the pension trust. Because the prepaid pension asset was created by pension trust fund returns, the pension asset was effectively based on funding by ratepayers.

The Company further argues that the Commission should not treat previous decisions as precedential. However, if the Commission deviates from its past rulings, it

must explain and give reasons for its departure from an established practice. Furthermore, Commission decisions are entitled to less deference where they depart from past practices. *City of Naperville*, Docket No. 03-0799, Order at 38 (Sept. 9, 2004); *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 683 N.E. 2d 938 (1st Dist. 1997). Nicor Gas has not demonstrated sufficient evidence to show that the pension asset is comprised of any shareholder funds, therefore no deviation from the Commission's past practice is necessary. The Commission declines to include the Company's pension asset in rate base.

3. RNG Pilot Program (Rate 81)

a. Nicor Gas' Position

Consistent with its proposed Renewable Natural Gas ("RNG") Interconnection Pilot (Rate 81) ("Rate 81" or "RNG Pilot Program"), which the Commission recently approved in Docket No. 20-0722, the Company included $5 million ($2.5 million in the average 2022 rate base) in its 2022 Test Year capital budget for RNG interconnection facilities. The Company notes that no party suggested that the forecasted investment was imprudent or unreasonable. Instead, the AG proposes to disallow the investment because a Proposed Order in Docket No. 20-0722 recommended denying the Rate 81 proposal. Nicor Gas states that such a disallowance is inappropriate because the Commission approved Rate 81 and presented evidence in rebuttal testimony affirming the Test Year level of investment even with the Commission's adjustment to Rate 81. In particular, Nicor Gas explained that the Commission's changes to the aggregate investment cap allowed under the RNG Pilot Program, as well as the project specific allowance cap, does not alter the Company's forecasted Test Year investment for the program, and as a result no disallowance is appropriate. Further, Nicor Gas argues that there is no legal basis for Ms. Selvaggio's proposal to disallow costs based on possible appeal of a Commission order.

b. AG's Position

The Company included $2.5 million in its 2022 test year capital budget associated with the construction of the RNG Pilot Program interconnection facilities in the event the Commission approved its request in Docket No. 20-0722. AG Ex. 1.2 at 3-4; AG Ex. 1.0 at 9. In her direct testimony, Ms. Selvaggio recommended removing the cost of Rate 81 because the Proposed Order in Docket No. 20-0722, dated June 27, 2021, did not recommend Commission approval of Rate 81. AG Ex. 1.0 at 9. During this proceeding, the Commission approved Rate 81; however, the approval reduced the spending cap from $20 million to $16 million and adopted a $3.2 million per-project limit. *N. Ill. Gas Co. d/b/a Nicor Gas Co*., Docket No. 20-0722, Order at 35 (June 24, 2021); AG Ex. 4.0R at 11.

The AG's adjustment is presented on Sch. A3 of AG Ex. 1.1, 4.1, and AG IB Attachment 1 and reduces rate base $2.461 million (a reduction of gross utility plant by $2.5 million offset by reductions in the depreciation reserve of $0.017 million and ADIT of $0.022 million) and reduces depreciation expense by $0.033 million.

c. Commission Analysis and Conclusion

The AG's proposed adjustment assumed that the Commission would reject the RNG Pilot Program in Docket No. 20-0722. The Commission approved the RNG Pilot Program and therefore inclusion of forecasted Test Year investment for Rate 81 is appropriate. There is no evidence in the record that the amount of Nicor Gas' forecasted investment is imprudent or unreasonable. Accordingly, the Commission does not adopt the AG's proposed adjustment.

4. Capital Additions

a. Project Cost Variances – October 2018 to December 2020

(i) Nicor Gas' Position

The Company maintains that AG witness Larkin-Connolly's proposal to reduce the Company's rate base by $50.7 million, claiming that 48 capital projects lack support for project cost variances where actual costs exceeded planned costs, is without merit and contrary to the facts. The Company asserts that Mr. Larkin-Connolly's proposed adjustment is not based on a substantive analysis of the actual projects, but is instead premised only on a simplistic, out of context, and distorted presentation of a small part of a single data request response, to which no objection or request for additional information was made. Nicor Gas avers that Mr. Larkin-Connolly's position lacks merit and notes that this conclusion is supported by Staff witness Maple who testified that, based on his review of the testimony and relevant data request responses, he does not support Mr. Larkin-Connolly's recommendations. Despite substantial and comprehensive information presented about Nicor Gas' budgeting and project management process, Mr. Larkin-Connolly focuses exclusively on a single part of a single data request response to lodge his proposed adjustments.

Mr. Larkin-Connolly's cost variance analysis supporting his proposed disallowance is based on the Company's response to Data Request AG 5.01, including data provided in AG 5.01 Ex. 2. The Company maintains that Mr. Larkin-Connolly is providing an incomplete and distorted view of the record and is presenting the data out of context by disregarding projects with cost underages. The Company explained that when taken together, the 166 projects with costs over $1 million reviewed by Mr. Larkin-Connolly are, in the aggregate, under budget by approximately $54 million or 6%. The Company avers that it has demonstrated that its implementation and management of the projects for which Mr. Larkin-Connolly proposes disallowances were prudent and reasonable. The Company asserts that the single discovery response relied upon by Mr. Larkin-Connolly speaks only to what data the AG sought in its request, not to whether the project costs were prudently incurred by Nicor Gas. Notably, the AG did not express concern about the Company's response or issue any follow-up data request.

The Company also disputes the assumption and assertion that cost variances are somehow indicative of imprudence. Rather, the Company maintains that the project cost variances were warranted by the facts, and that such costs were vetted and supported by the Company's processes for managing its capital investments. The Company explains that it manages its capital investments utilizing both bottom-up and top-down processes. Under this approach, it anticipates that some individual projects will incur costs higher or

lower than estimated based on the presence or absence of various field conditions which are anticipated generally, and are accounted for in the top-down budgeting process, but cannot reasonably be predicted or estimated on a project-specific basis.

The Company explains in detail why Mr. Larkin-Connolly's proposed adjustments are without merit. The Company maintains that the cost variances at issue here were prudently incurred under the facts presented. According to the Company, cost variances are not unusual for utility construction projects and reflect real world conditions in which the Company must operate. The Company notes that the vast majority of the facilities being worked on are buried underground, often under roads, sidewalks, vaults, and other appurtenances, and must cross or run along facilities owned by other entities which were installed many decades ago. The Company maintains that cost variances are inherent in utility construction due to these difficult underground work environments and the fact that certain work is driven by requests from customers and governmental entities. As a result, the Company is subject to factors which are wholly out of its control, yet manages a project budget which, on an overall basis, was under budget by approximately $54 million or 6% of the Company's overall capital investments. The Company also explained that it diligently plans for each specific project, gathering all available information to minimize conflicts and issues. The Company has established that the costs were prudently incurred and reasonable.

In addition to being contrary to the facts, the Company maintains that Mr. Larkin-Connolly's proposed disallowance is contrary to law. As explained above, the Company has supported the prudence and reasonableness of its capital investments, including by providing detailed analyses of the Schedule F-4 projects and detailed information regarding how it manages its investments to ensure that the investments are needed and the costs incurred are reasonable. Mr. Larkin-Connolly's variance analysis does not raise specific substantive issues regarding these projects. Instead, his analysis focuses only on a single data request response to inaccurately and wrongly assert the Company has not supported the prudence of its investments. This is contrary to law. Once a utility presents sufficient evidence of the prudence and reasonableness of its test year costs of service, the burden shifts to the parties proposing adjustments to support their positions with evidence that the costs incurred are imprudent or unreasonable. *City of Chicago*, 133 Ill. App. 3d at 442-443. It is not for a witness to assert that he is unconvinced by the Company's evidence. That is the province of the Commission.

The Company maintains that it has demonstrated good results in its project costs estimates as evidenced by its distribution rates being among the lowest in the state. Mr. Larkin-Connolly has implied that because some projects costs evolve over time, they must have been imprudently incurred or unreasonable in amount. This is incorrect and contrary to sound regulatory policy. According to the Company, Mr. Larkin-Connolly's position would only reward overestimating project costs to avoid being subject to subsequent disallowances of actual investment costs. The Company submits that it has provided ample evidence of its prudence, including that the additional costs were prudently incurred in each case to address new information not available at the time the original estimate was prepared, such as discovering the presence of rock in a bore path, encountering abandoned or additional foreign utilities, experiencing unusually heavy rainfall at the time of construction causing wet soil conditions, being subject to new

directives from governmental entities regarding the timing or running line for their projects, and other similar developments beyond the Company's control as described in Nicor Gas Ex. 21.1. In sum, the Company can face unexpected physical and natural conditions at any and every phase of a project. The Company undertakes reasonable and prudent actions to address these conditions.

The Company maintains that Mr. Larkin-Connolly's suggestion that a utility engage in full subsurface engineering for distribution projects would be inefficient and uneconomical, unnecessarily increasing customer costs since field adjustments can reasonably accommodate unexpected conflicts for distribution work. The Company's current approach, which is characterized by diligent planning based on available information and subsequent modification based on new information as projects develop, reflects prudent utility management. The Company explains that it appropriately plans for possible subsurface conflicts for distribution work, including by conducting site inspections, locating existing utilities by requests to all known utility entities for design locates or utility facility maps, and having its drawings and designs for such work include a two-dimensional depiction of all above ground features and the horizontal location of underground utilities such as storm sewers, sanitary sewers, water main, gas main, telephone lines, overhead electric lines, road signs, manholes, trees, right-of-way limits, sidewalks, curb lines, centerlines, underground conduit for electrical, cable TV, and fiber optic.

Mr. Larkin-Connolly challenged the Company's partnership with NPL Construction Company ("NPL") on the basis that NPL worked on many of the projects on Mr. Larkin-Connolly's list of projects he characterizes as showing poor due diligence. The Company maintains that NPL has delivered significant measurable value to the Company and supports its assertion with a third-party vendor performance audit report. Mr. Larkin-Connolly did not appropriately consider the quantity, complexity, and difficulty of the types of projects that NPL predominantly performs for the Company. The full context demonstrates NPL's value.

Mr. Larkin-Connolly also challenges the Company's use of contractor resources for performing certain new business installations and claims this is inconsistent with the Company's use of contractor resources to install copper serviced in the 2018 QIP reconciliation proceeding. The Company asserts that its use of contractor crews under the circumstances presented was prudent and reasonable, and that Mr. Larkin-Connolly's assertion is without merit. The Company maintains that it uses contractors for new services for new business installations, a type of work largely driven by customer requests over which the Company lacks control. When demand exceeds the capacity of Company crews, it prudently and reasonably meets its obligation to timely serve customers through contractors. Further, the use of contractors for copper services reflects unique demands faced by the Company in 2018. The Company also experienced increased levels of code compliance work for items such as same-day emergencies, code compliance repairs, and expedited leak repairs in 2018, alongside increased crew vacancies which drove the need for contractor work. The Company explained that while an average level of employee turnover can be anticipated, job vacancies are subject to unexpected variability based on factors beyond the Company's control, such as employee decisions to relocate, retire early, or otherwise end their employment with the Company.

In response to Mr. Larkin-Connolly's focus on variances, the Company analyzed two projects in greater detail and provided a thorough explanation of the types of new information or developments that caused actual costs to exceed original estimates. Based on the processes utilized for managing projects identified in the Company's testimony and the project-specific information reviewed in testimony and in Nicor Gas Ex. 21.1, the Company submits it has demonstrated that the costs for the projects identified by Mr. Larkin-Connolly were, contrary to his assertions, prudently incurred and reasonable based on the new or additional information encountered for those projects.

(ii) Staff's Position

Staff explains that, due to the large number of capital projects undertaken since Nicor Gas' last rate case, the Company provided a list of the thirteen largest capital projects by cost that it proposed to include in its rate base, summarized in Nicor Gas Schedule F-4, Additions to Plant in Service Since the Last Rate Case. Staff Ex. 6.0 at 2. Schedule F-4 was based on actual costs through the end of September or October of 2020 for several of the projects, but since that time, Nicor Gas has updated the costs of several projects based on the most recent expenditures and forecasts. Staff Ex. 6.0 at 2-3. On March 18, 2021, in response to Staff data request MEM 3.01, the Company provided an updated Schedule F-4, reflecting the most recent forecasted costs for five capital projects. Staff determined, after reviewing the workpapers corresponding to each updated project cost, that the new forecasts were more reliable than the original forecasts from September and October of 2020. Staff Ex. 6.0 at 3. Staff notes that it is common practice for the Commission to use the most recent data when establishing rates to the extent that data exists and is reliable. Staff Ex. 6.0 at 4. Staff proposes that the Commission adopt the Company's updated Schedule F-4, which uses the most recent data for the five capital projects. Staff Ex. 6.0 at 4. This has a net effect of lowering the Company's capital additions by $5.1 million compared to the forecasts in Nicor Gas' original Schedule F-4. Staff Ex. 6.0 at 4. Company witness Whiteside stated in rebuttal testimony that, in the interest of reducing contested issues, the Company would not contest Staff's adjustment. Nicor Gas Ex. 21.0 at 36. Therefore, Staff's adjustment is uncontested and should be adopted by the Commission.

The AG recommended a disallowance of $54,845,120 in plant additions and proposed that Nicor Gas be required to submit a comprehensive capital strategy in future rate base proceedings. AG Ex. 2.0 at 5; Staff Ex. 12.0 at 2. Staff reviewed the AG's testimony, Nicor Gas' responses to the AG's data requests regarding capital additions, and also sent Staff data requests on the subject. Staff Ex. 12.0 at 2. Staff does not support the AG's recommendations (Staff Ex. 12.0 at 2) and the Commission should reject the AG's proposals.

(iii) AG's Position

The Act requires Nicor Gas to provide substantial evidence to demonstrate that its capital spending was reasonable and prudent. 220 ILCS 5/9-201(c). However, the AG points out that Nicor Gas' schedules and testimony did not explain this drastic increase in spending, nor did they provide sufficient fact-specific evidence to justify the reasonableness and prudence of the increased costs Nicor Gas sought to pass to ratepayers in this proceeding.

AG witness Larkin-Connolly's testimony focused on non-QIP projects that cost over $1 million and had cost overruns above 20% of the budgeted cost. AG Ex. 2.0 (Rev.) at 19-20. He focused on non-QIP projects because the prudence and reasonableness of QIP projects are reviewed during Nicor Gas' annual QIP proceedings under Section 9-220.3 of the Act. *Id*. at 20. He focused on projects with costs over $1 million, because "[w]hen projects of this magnitude go well over budget ratepayers are left to cover *hundreds of thousands* to *millions* of dollars in additional costs"—not trivial amounts. *Id*. at 20 (emphasis in original). He focused on projects with cost variances of 20% or greater, because such high discrepancies indicate a problem with how Nicor Gas planned and managed its plant additions and require explanation and reasonable justification. *See Id*. at 20-22. And he focused on projects that were already in-service because these were projects where the costs were already incurred, and the overruns were readily apparent. As a result, there were millions of dollars in QIP and future test year non-QIP projects that Mr. Larkin-Connolly did not review, but that the AG requests the Commission consider when conducting its own assessment of the reasonableness and prudence of these projects and Nicor Gas' proposed rate base.

The AG asserts that Nicor Gas increased its non-QIP spending fourfold in recent years without a comprehensive investment plan or "clear relationship to [Nicor Gas'] and its customers' needs." AG Ex. 2.0 (Rev.) at 7-8. In addition to this drastic increase in spending, Nicor Gas consistently spent more than it budgeted for a substantial portion of its projects and failed to support the prudence of its cost overages with substantial evidence. *E.g., id*. at 22-23. Attachment 2 to the AG's Initial Brief is a demonstrative exhibit that includes all of the projects for which the AG recommends disallowances (taken from AG Ex. 5.01 confidential) and the explanations provided by Nicor Gas for the cost overages identified for each project (taken from Nicor Gas' Responses to AG DR 5.01 and 17.01-17.59; and Nicor Gas' supplemental explanations in Nicor Gas Ex. 21.1). These projects demonstrate Nicor Gas' failure to prudently implement its projects and to perform proper due diligence during the planning phase of its projects to ensure that spending was reasonable and remained within budget. *Id*. at 5.

Nicor Gas claimed it established the prudence of its projects by providing "substantial evidence regarding its capital development process." Nicor Gas IB at 16. According to Nicor Gas witness Whiteside, this process included a five-step Asset Development Process ("ADP") and was based on the Company's "extensive experience, track record, and expertise in planning, developing, and implementing capital projects." Nicor Gas Ex. 21.0 at 22. However, Mr. Larkin-Connolly pointed out "[w]hile the Company may have confidence in its project management practices, it essentially asks the Commission and intervenors to take its word that projects were carried out prudently." AG Ex. 5.0 (Rev.) at 20.

The AG asserts that it would be unreasonable for the Commission to rely on Nicor Gas' word that its internal processes ensure prudent management, because the Company incurred unreasonable cost overruns of $50,681,933, despite these processes. As a result, "the procedures themselves need to be evaluated based on the success of the projects implemented," not by their mere existence. The Commission must reject Nicor Gas' argument that its capital development processes ensured prudent management, because the Company failed to explain why these processes did not

prevent the Company from regularly and substantially exceeding its budget, at ratepayer expense. AG Ex. 5.0 (Rev.) at 21.

The AG requests that the Commission disallow $50,681,933 in cost over-runs, resulting from Nicor Gas' failure to prudently manage 45 of its 166 in-service, non-QIP projects. AG Ex. 5.0 (Rev.) at 38. In his testimony, Mr. Larkin-Connolly pointed out that when a company spends significantly more than budgeted "[a] complete explanation from the Company on what did not go according to plan is a critical piece of information needed to determine whether the project was implemented prudently." AG Ex. 5.0 (Rev.) at 27. The AG argues that Nicor Gas failed to provide adequate or relevant explanations for the substantial cost overruns stemming from its 2018-2020 investments in its schedules, responses to discovery requests, direct, rebuttal or surrebuttal testimony. *See id*. at 5. Instead, Nicor Gas' witnesses provided unsupported assurances, incomplete information, and specious arguments. *Id*.

Nicor Gas claims that the Commission should reject the AG's proposed disallowances, because Mr. Larkin-Connolly focused only on cost overruns, and ignored instances where the Company completed projects under budget. Nicor Gas IB at 22. In response, the AG points out that their focus on cost overruns was intentional. As ratepayers, the AG is concerned with instances where investor-owned utilities imprudently managed projects and overcharged consumers. In contrast, cost underages merely indicate occasions where the Company apparently met its duty to prudently manage specific projects. Simply because Nicor Gas may have prudently managed some projects does not mean that it prudently managed all projects. The AG is concerned with those projects that were not prudently managed, and the resulting transfer of costs to ratepayers.

Nicor Gas also argues that Mr. Larkin-Connolly's analysis was based on an "assumption and assertion that cost variances are… indicative of imprudence." Nicor Gas IB at 23. However, this mischaracterizes Mr. Larkin-Connolly's argument and ignores the actual scope of his analysis. Mr. Larkin-Connolly proposed disallowances for 45 of 61 in-service non-QIP projects with cost variances greater than 20%, because these were projects where the cost overruns were unreasonable, imprudent, and not supported by sufficient explanations. In other words, Mr. Larkin-Connolly did not automatically reject Nicor Gas' explanations for every cost overrun, but instead recommended disallowances where Nicor Gas clearly failed to provide evidence to support its spending or managed its projects imprudently.

Mr. Larkin-Connolly split Nicor Gas' attempted justifications into four categories: (i) Poor Due Diligence; (ii) Weather-Related Overages; (iii) Outsourced New Service Projects; and (iv) Redundant Explanations. The AG asserts that the testimony and briefs the AG provided demonstrate how each of Nicor Gas' explanations was insufficient to justify Nicor Gas' budgeted-to-actual-cost disparities, which ranged from 23% to 986% over budget. In the AG's opinion, Nicor Gas did not provide adequate fact-specific evidence to demonstrate that it prudently managed these projects or that its costs were reasonable. For these reasons, the AG requests the Commission disallow $50,681,933 in cost overruns for in-service, non-QIP, plant.

(iv) Commission Analysis and Conclusion

The AG recommends the Commission disallow $50,681,933 in cost overruns for in-service, non-QIP plant related to 45 plant projects that had a cost variance greater than 20%. The Commission understands the AG's concern with arguably excessive cost overruns because cost overruns negatively affect ratepayers. The Commission notes that the AG does not dispute Nicor Gas' explanations for the cost overruns, but rather argues that Nicor Gas failed to provide sufficient evidence to support its spending or otherwise mismanaged the projects. The Commission finds that the record demonstrates Nicor Gas presented sufficient explanations to justify the disputed capital projects. Upon review of the Company's explanations for the overages on the various capital projects, the Commission finds that the Company's actions were not unreasonable or imprudent. Many factors may contribute to cost overages. Most facilities being worked on were underground, which can and did lead to changes in the project design, scope or equipment needed. Other real-world factors led to cost overruns such as weather issues, and requests from customers or governmental entities.

While no party indicates otherwise, the Commission notes that project planning and management does not require perfection. As Nicor Gas points out, of the 166 projects with costs over $1 million reviewed in this proceeding, Nicor Gas was under budget by approximately $54 million, which in the aggregate comprises only 6% of the Company's overall capital investments. The AG highlights that costs reached as high as 986% over budget. In reviewing the one project that was 986% over budget, Nicor Gas shows that the overage was due to a system error that allocates material dollars to new installations or replacements. Nicor Gas Ex. 21.1; AG IB, Attachment 2. Nicor Gas states it corrected the system error on a going forward bases. *Id*. The next highest cost overrun of 898% was due to county and state design changes after project start and increased costs due to environmental regulations of wetlands. Nicor Gas also explains that Nicor Gas will be reimbursed for part of the work. *Id*. The Commission is cognizant that certain factors may be outside the Company's control and can lead to cost overages. Based on the record, the Commission does not find that Nicor Gas' actions rise to the level of imprudence.

Staff's adjustment to capital additions was not contested. Accordingly, the Commission finds that Nicor Gas' planned costs, as adjusted by Staff, are sufficiently supported as prudent and reasonable, and are recoverable.

b. Proposed Capital Plan Requirement

(i) Nicor Gas' Position

Nicor Gas states that AG witness Larkin-Connolly's assertions regarding the level of capital additions lack perspective and merit and do not warrant the AG's proposed filing requirements. Mr. Larkin-Connolly criticized the level and rate of growth in plant over the October 2018 to December 2020 time period. He does not propose any disallowances from this analysis, but recommends the Commission require Nicor Gas to file a capital plan in subsequent rate increase requests. The Company maintains that this proposal should be rejected. The Company has continued to invest in plant to meet its obligation to provide safe and reliable gas service and to fulfill its obligation to serve all customers during the September 30, 2018 through December 2020 time period. The Company

avers that whether investments have been prudently incurred and are reasonable is the primary consideration for the Commission regarding continued capital investments.

The Company maintains that Mr. Larkin-Connolly's analysis fails to appropriately acknowledge that a significant portion of the Company's capital investments over the October 1, 2018 to December 31, 2020 time period were for unique and one-time investments. These investments included $244.7 million for the Company's Commission-approved deployment of AMI; $39.7 million for AMI-related meter rebuilds; $15.7 million for the Galena Territory Main Extension; and $33.3 million for pressure improvement projects. Combined, these projects account for $333.5 million or 31.9% of the rate base plant additions over this time period. In addition, the Company explained that it was also making increased safety and reliability investments during this time period pursuant to its QIP program. The Company has demonstrated that the increase in its capital investments were driven by unique goals and projects which are not ongoing. The increase in investment represents the implementation of the Company's previously planned and Commission approved investment strategy. Mr. Larkin-Connolly is seeking to contest issues which have previously been resolved by this Commission.

Nicor Gas explains that the capital investments challenged by Mr. Larkin-Connolly were intended to support the safe and reliable natural gas delivery service to the Company's customers. Investments to ensure the provision of safe and reliable natural gas service to end-use customers are critical capital investments for a natural gas local distribution company. Such investments have helped Nicor Gas safely and reliably deliver natural gas during extreme winter conditions that resulted in record-high natural gas demand. The Company has demonstrated that its investments benefit its customers as well as economic development in northern Illinois.

The Company has sufficiently demonstrated that its investments are part of a comprehensive investment plan. Mr. Larkin-Connolly is incorrect in his assertion that this is not the case. The recurring capital investments made to continue to provide safe and reliable service to the Company's customers, the unique non-ongoing capital investments described above, and the unavoidable increases in the cost of doing business are all key contributors to the increase in capital investments. The Company also provided detailed information regarding its Distribution Integrity Management Program and Transmission Integrity Management Program, including comprehensive risk analyses which drive its investments. Contrary to Mr. Larkin-Connolly's assertion, the Company asserts it provided ample evidence that its investments were carefully planned, developed, and implemented.

The Company maintains that Mr. Larkin-Connolly's leak data analysis fails to support his alleged concerns, and his analysis and conclusions are not reasonable or appropriate. Nicor Gas explains that the prudent and standard industry practice that the Company follows is to rely on facility-specific information, not general leak data and trends, to assess whether components of its natural gas transmission, distribution, and storage systems need to be upgraded or replaced from a safety or reliability perspective. Stable or improving leak data and trends are not consistent with the need to replace or upgrade aging facilities on the basis of otherwise identified safety or reliability issues. Further, Mr. Larkin-Connolly's leak data analysis does not properly account for the fact that the Company revised its grading criteria for certain leaks at the end of 2017, which

resulted in an increase in reported Grade 3 leaks. Finally, while leaks can be an indicator of safety issues or concerns, they are not the only indicator of a safety or reliability concern. Observed anomalies in pipe walls, corrosion condition, materials identified as presenting an increased risk of catastrophic failure, and other conditions are factors which do not necessarily correlate to increased leaks, but are reliable and reasonable indicators of safety or reliability issues which need to be addressed. The Company's processes for managing its capital investments include forming risk profiles for each potential investment project and investing as appropriate.

The Company maintains that the AG's attempt to call into question bill impact data similarly fails to support its proposal. The Company notes that even with the additional capital investment proposed to be placed in rate base in this case, Nicor Gas' distribution rates will remain one of the lowest of any major natural gas distribution utility in Illinois. The Company asserts that the AG's analysis purporting to support the recommendation by Mr. Larkin-Connolly is neither reasonable nor appropriate. The Company already includes explanations for its investments in its testimony consistent with applicable rate case filing requirements, further negating the need for Mr. Larkin-Connolly's recommendation.

(ii) Staff's Position

See Section IV.B.4.a.ii of this Order.

(iii) AG's Position

The AG requests that the Commission direct Nicor Gas to file a comprehensive investment plan in this docket, within six months of the Commission's Order, and in future rate case proceedings. In this docket, Nicor Gas asked the Commission to approve its original cost finding of $8,707,527,000 for in-service plant through December 31, 2020—$1.71 billion or 24% more than the original cost finding through September 30, 2018 in Nicor Gas' most recent rate case. AG Ex. 5.0 (Rev.) at 2-3. This extraordinary increase in slightly more than two years was largely the result of Nicor Gas' unprecedented acceleration in investment and questionable spending, planning, and management practices.

The AG points out Nicor Gas' recent acceleration of investment was a change in company investment strategy after acquisition by The Southern Company ("Southern Company") in 2016. *The Southern Company, AGL Resources Inc., and N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 15-0558, Order (June 7, 2016). "The record in a base rate proceeding…. [should] clearly explain these changes and address not just the general category of plant investment, but why the portfolio of investments was pursued at that time." AG Ex. 5.0 (Rev.) at 3. This would require the Company to not only identify the category of spending, but also its strategy for selecting, planning, and budgeting its investments at a particular time. AG Ex. 5.0 (Rev.) at 3.

To support this assertion, Mr. Larkin-Connolly cited five specific projects where Nicor Gas planned to complete or inspect projects with internal crews but had to hire third parties because internal crews and inspectors were unavailable. The higher costs incurred to hire these third parties was "directly the result of the high volume of work [Nicor Gas] was pursuing." AG Ex. 5.0 (Rev.) at 6. The AG shows that Nicor Gas failed to

provide adequate evidence to support its acceleration in spending and instead continually provided broad citations to "safety and reliability" concerns and "system improvements," without connecting its accelerated investments to actual Company and customer needs. *E.g*. AG Ex. 2.0 (Rev.) at 15. The AG requests that the Commission require Nicor Gas to provide its investment plan so that anomalies like these are addressed in a comprehensive manner.

Nicor Gas argued that its recent increase in capital spending was the result of investments that were "unique" and of a "one-time nature." Nicor Gas IB at 33. However, the AG points out that if this were true, it would support the need for a capital spending plan, because the plan could describe the unique nature of specific investments and their relation to overall spending goals. AG Ex. 5.0 (Rev.) at 5. Whether Nicor Gas' spending increased from unique projects or a general expansion of ordinary maintenance and replacement, the Commission should have the opportunity to review Nicor Gas' plan both to assess the overall plan for reasonableness and to ensure that the Company does not overspend ratepayer funds in the future.

In an attempt to discern the premises for Nicor Gas' extensive and accelerated investment, Mr. Larkin-Connolly considered Nicor Gas' annual reports to the federal Pipeline and Hazardous Materials Safety Administration ("PHMSA") to determine whether there was an indication that additional or accelerated work was required to address reported safety concerns. His analysis of Nicor Gas' leak rates reported to PHMSA demonstrates that Nicor Gas' distribution main leaks have remained relatively stable over the past ten years—indicating no noticeable deterioration; Nicor Gas' service leak rates have increased —indicating a deterioration of some class of services; and despite a marginal increase, Nicor Gas' transmission leak rates have remained mostly stable—indicating no noticeable deterioration. AG Ex. 2.0 (Rev.) at 12-13.

Nicor Gas argued that Mr. Larkin-Connolly's use of leak data was improper because: (1) the Company relied on "facility information, not general leak data and trends, to assess whether components of its transmission, distribution, and storage systems need to be upgraded or replaced from a safety and reliability perspective[;]" (2) "the Company revised its grading criteria for certain leaks at the end of 2017… [resulting] in an increase in reported Grade 3 leaks[;]" and (3) "while leaks can be an indicator of safety issues or concerns, they are not the only indicator of a safety or reliability concern." Nicor Gas IB at 36. The AG points out that Nicor Gas ignored the fact that Mr. Larkin-Connolly used this data because the Company did not provide any other quantitative evidence or metrics to support its recently accelerated pace of investment in its direct testimony. AG Ex. 5.0 (Rev.) at 7-8.

The AG's use of leak data was not to meant to be all-inclusive but was instead meant to be used as one indicator of system safety and reliability. AG Ex. 5.0 (Rev.) at 8. Instead of discrediting Mr. Larkin-Connolly's analysis, the Company simply claimed that it was improper because leak data is not the only means of analyzing system safety. *See* Nicor Gas IB at 36. The AG asserts that Nicor Gas' argument highlights the need to require Nicor Gas to file a comprehensive investment plan that would include considerations in addition to the PHMSA leak data. Filing a comprehensive investment plan would provide Nicor Gas with the opportunity to identify the factors other than PHMSA leak data that are driving its accelerated investment.

The AG further states that such unexplained spending patterns have had a direct impact on ratepayers through higher distribution rates, without "a clear relationship to [Nicor Gas'] and its customers' needs." AG Ex. 2.0 (Rev.) at 8-9. For example, Nicor Gas' average customer's delivery charges have increased 54% since 2015 and increased by 20.3% in 2020 and 9.5% in 2019, in-part due to the capital additions such as those being considered in this docket. *Id*. at 9. If the Commission approves Nicor Gas' proposed increases in this proceeding, "it will represent a 40% increase in the delivery-only portion" of customer bills, since 2014. *Id*. at 9.

Nicor Gas, according to the AG, attempted to mask its distribution rate increases by claiming that the total average customer bill decreased in recent years. Nicor Ex. 1.0 at 4-5. However, the AG shows that this claim ignores the fact that overall bills have declined because the price of gas supply has decreased in recent years—not because Nicor Gas' own operational decisions. AG Ex. 2.0 (Rev.) at 10. In fact, Nicor Gas' customers have instead experienced substantial increases in delivery rates since 2014. *Id*. at 9. As a result, Nicor Gas' "increased capital spending has negated the benefits of the drop in gas prices for consumers" and "the Company and its investors have benefitted by essentially capturing a good portion of the gas cost savings in increased delivery revenues." *Id*. at 11.

The AG demonstrates that Nicor Gas' argument that its rate increase would have a minimal effect on consumers is misleading and should not be given any weight by the Commission. Nicor Gas is not "entitled" to rates as high as other companies with different customer mixes and different operational conditions, particularly in the absence of any evidence (such as in the Peoples Gas situation) that the utility requires extraordinary spending to address safety concerns. Nicor Gas' lack of explanation and plan for its increasingly large capital additions demonstrates the need for the Commission to direct Nicor Gas to file a comprehensive capital plan to provide the Commission and public with "greater insight into [Nicor Gas'] investment decisions." AG Ex. 2.0 (Rev.) at 17. The AG requests that, in order to give the Commission time to review and assess the plan, it should require Nicor Gas to file a five-year construction plan within six months of the Order in these proceeding, and updated plans in future rate case proceedings.

(iv) Commission Analysis and Conclusion

The AG takes exception to the level and rate of growth in plant. All parties agree that, over the time period in question, Nicor Gas' capital investments have increased significantly. Nicor Gas explains that this is due to unique goals and projects that are not ongoing, as well as general maintenance/replacement and safety and reliability projects. No other party supports the AG's recommendation to require Nicor Gas to provide a comprehensive capital plan. The Commission finds that Nicor Gas provided sufficient explanations for its capital investments and does not find it necessary at this time to require Nicor Gas to provide a comprehensive capital plan, and incur the associated costs in doing so, as proposed by the AG.

5. Cash Working Capital

The parties agree on the methodology to calculate the cash working capital; however, the amount of cash working capital will depend on the revenue requirement, which is contested. Therefore, there is no contested issue for the Commission to resolve

regarding calculation of cash working capital, and the cash working capital shall be calculated using the revenue requirement set forth in this Order.

V. OPERATING EXPENSES

A. Uncontested Issues

1. Interest Expense on Customer Deposits

The AG proposed an adjustment to the interest rate applied to the forecasted average 2022 balance for customer deposits based on the Commission's rate of 0.0% for 2021. Nicor Gas accepted this adjustment. The Commission finds that this issue is uncontested and approves the agreed interest rate.

2. Income Tax Expense – Meals and Entertainment

The AG proposed an adjustment to Income Tax Expense related to meals and entertainment costs based on an Internal Revenue Service Notice. Nicor Gas accepted this adjustment. The Commission finds that this issue is uncontested and approves the agreed adjustment.

3. Shared Services – Divestitures and Back Billings

Nicor Gas explains that it operates under a shared services model by which its affiliate – AGL Services Company ("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 explains that, through the shared services model, it incurs costs for services provided by AGSC, as well as costs for certain corporate-level services undertaken by Southern Company Services, Inc. ("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.

AG witness Selvaggio proposed a $1 million reduction to the Company's Test Year shared services cost, reflecting an increase in Customer Operations billings costs that was associated with divestitures of certain smaller utilities by Southern Company. In support of this adjustment, Ms. Selvaggio asserted that Nicor Gas should have identified cost savings to offset the increases. Ms. Selvaggio withdrew her proposed adjustment after the Company explained in rebuttal that it had decreased expenses related to Customer Operations billings and that divestitures were not the only reason for increasing shared services costs.

Ms. Selvaggio also proposed that the Company increase the back billings to SCS from AGSC for gas facilities management in the Test Year to the projected 2021 amount of $0.849 million on the basis that there was inadequate support for a reduction between 2021 and the Test Year. Nicor Gas explained in rebuttal that the Company's allocated share of back billings was estimated to be $0.340 million in 2021 and $0 in 2022 because of a reorganization of employees between AGSC and SCS which eliminated back billings. Ms. Selvaggio withdrew the proposed adjustment in response to the Company's explanation.

As a result of Ms. Selvaggio withdrawing her proposed adjustments, the shared services costs related to divestitures and back billings are uncontested and are approved. Other shared services costs are contested and discussed in Section V.B.3 of this Order.

4. Teleworking Stipend

In response to an objection from the AG, Nicor Gas removed the $379,000 forecasted teleworking reimbursement expense from the Test Year. This adjustment reduces the Company's cash working capital component of rate base by $45,000. This issue is now uncontested.

B. Contested Issues

1. Incentive Compensation

a. Nicor Gas' Position

Nicor Gas asserts that its total compensation program, which includes both competitive base salary and incentive compensation, is reasonable, appropriate, and consistent with market best practices. No party contested the Company's total rewards compensation philosophy or the evidence showing that the Company's compensation approach is consistent with the market, nor does any party claim that the amount of incentive compensation costs is inappropriate.

Nicor Gas argues that the disallowances proposed by Staff, the AG, and IIEC/CUB are based on a 15-year-old Commission Order which is inconsistent with recent Commission Orders.

First, Nicor Gas maintains that its incentive compensation policy is based on financial metrics and provides direct benefits to customers and should be recoverable. Nicor Gas explains that its overall compensation policies, practices, and strategies are competitive, cost-effective, and serve to attract and maintain a highly qualified and diverse workforce. The Company maintains that each element of its compensation policies creates a competitive "total rewards package" that is critical to attract and retain talented employees. Under Nicor Gas' total rewards package, compensation for professional employees consists of fixed base pay, plus variable at-risk pay in the form of annual cash opportunities. Nicor Gas notes that other elements of the total rewards package cannot be quantified, as intangible benefits of employment include work/life balance, support of community involvement, and continual training and personal development opportunities. The Company explains that the annual cash incentives offered to employees—or at-risk compensation costs—are based on the achievement of goals designed to benefit customers by balancing the operational and financial health of the Company. This balance ensures that the Company can continue to provide efficient, safe, and reliable service while keeping costs low.

Nicor Gas argues that goals based on financial metrics provide benefits to customers by reducing expenses, creating greater efficiencies in operations, ensuring a financially strong company, and allowing access to the capital markets at a low cost. Nicor Gas further argues that financial performance goals of Nicor Gas' parent company also benefit customers because Nicor Gas is dependent on the ability of its parent company to access the capital markets for equity capital. All of Nicor Gas' customers depend on the Company to make investments that are necessary and required to provide

all aspects of service. Therefore, financial goals that measure the parent company's financial integrity will attract investors and allow for access to the capital markets where the Company can raise funds at a lower cost than otherwise and pass these cost savings along to customers. The Company states that it presented evidence supporting specific, dollar-value cost increases that it saves by including portions of employees' pay as incentive compensation rather than incorporating those same costs into base pay. Nicor Gas explains that if the Company were to stop including these costs as incentive compensation, it would need to increase base pay in order to continue to be competitive in the market. And, since the Company determines a number of benefits using the base pay amount, such as the matching contribution to retirement plans and the amount of coverage for life insurance and long-term disability insurance, the Company explains that the costs of these benefits also would increase with an increase in base pay. The Company states that, contrary to Staff, AG, and IIEC/CUB's contentions, the record demonstrates that incentives based on financial goals provide tangible benefits to customers and promote the long-term financial strength of the Company.

Second, Nicor Gas argues that Staff and intervenors' reliance on a 15-year old Commission Order to support the proposed disallowance is contrary to the law, the facts, and sound regulatory policy. The Company maintains that no provision of the Act precludes it from recovering reasonably incurred employee incentive compensation costs based upon financial metrics. Nicor Gas points out that Staff and intervenors do not contradict this, but instead point to the *04-0779 Order* in Nicor Gas' 2004 rate case as evidence that incentive compensation must be disallowed. However, Nicor Gas asserts that relying on the 15-year-old order as a bar on incentive compensation is inconsistent with Commission findings since then. The Company states that Staff's position that the 2004 Order prohibits Nicor Gas from recovering any incentive compensation costs unless the Company can "demonstrat[e] tangible benefits to ratepayers" is a historical conclusion that is without precedential value in the present matter. Nicor Gas argues that the Commission can and should change its course when required by the facts of each individual case before it.

Nicor Gas argues that beyond the fact that the Commission is not bound by prior determinations, there are factual reasons that make the 2004 case inapplicable to the present case. Nicor Gas states that it presented evidence showing that over the past 10-15 years, permanent employment has become much less permanent thereby increasing competition for top talent in the workforce. The Company asserts that retaining highly skilled employees, who change jobs far more frequently than before, increases the need for a highly competitive total rewards package including incentive compensation.

Nicor Gas further argues that if the Commission were to apply the same standard used in its 2004 Order, the record shows, with substantial evidence, that the incentive compensation plan confers tangible benefits on ratepayers and is prudent and reasonable. Nicor Gas points out that the Commission previously held 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." *18-1775 Order* at 82. In response to the AG's argument that the Company is required by law to present a study or analysis supporting the net benefits provided to ratepayers, Nicor Gas argues that Illinois law requires only that the utility demonstrate a sufficient nexus to

support recovery of these costs. The Company argues that it has demonstrated that incentive compensation based on financial metrics promotes employee longevity and has overall provided detailed and specific evidence of the tangible benefits that incentive compensation would provide to all of its stakeholders, particularly ratepayers.

Nicor Gas argues that, contrary to IIEC/CUB witness Gorman's position, its restricted stock units ("RSUs") are not based on financial metrics and are recoverable as part of the Company's approved revenue requirement. Nicor Gas maintains that, like the RSUs approved in its last two rate cases, the RSUs at issue here are not based on financial metrics and that Mr. Gorman has not provided any evidence to suggest otherwise.

b. Staff's Position

Staff states that the Commission should approve Staff's adjustments to remove the cost of incentive compensation that is based on financial metrics and do not provide ratepayer benefits, just as it has done in numerous prior cases. Staff Ex. 1.0 at 7-9. According to Staff, the Company has provided no new evidence, apart from that which it provided in its prior rate cases that this portion of incentive compensation provides ratepayer benefits in the form of specific dollar savings or other tangible benefits. *Id*. at 7. In a 2007 general rate case involving IAWC, the Commission summarized its practice on incentive compensation as follows:

> The Commission has consistently disallowed recovery of payouts that are tied to overall company financial goals. As is apparent from previous rate orders, the Commission has generally disallowed such expenses except where the utility has demonstrated that its incentive compensation plan has reduced expenses and created greater efficiencies in operations which provide net benefits to ratepayers. In this case, no such showing has been made by IAWC.

Ill.-Am. Water Co., Docket No. 07-0507, Order at 25 (Jul. 30, 2008). The Commission denied rate recovery of 100% of IAWC's annual incentive plan, which was dependent on IAWC's corporate parent reaching its financial earnings goals. *Id*. at 26.

Moreover, Staff explains, it is well-established in many prior Commission orders that incentive compensation based on financial metrics actually benefits shareholders, not ratepayers. The Commission has followed this practice for decades. It creates a circular effect where rates are increased to cover the cost of the incentive compensation, thereby making it easier for the Company to meet the financial metrics required to achieve the associated incentive compensation metrics. *See e.g.* Docket Nos. 09-0166/0167 (cons.), Order at 58-59; *Ill. Power Co*., Docket No. 93-0183, Order at 52 (Apr. 6, 1994); *MidAmerican Energy Co*., Docket No. 99-0534, Order at 9 (Jul. 11, 2000).

In this proceeding, the financial metrics relate to Southern Company's earnings per share and Southern Company Gas' net income, as well as the total shareholder return. The financial success of these entities is favorably impacted by Nicor Gas rate increases. The Company has made no showing that Southern Company and Southern Company Gas' financial and operational success directly benefit Nicor Gas ratepayers.

Accordingly, these costs should be removed from the revenue requirement (Staff Ex. 1.0 at 9), as reflected in the attachment to Staff's Initial Brief.

Staff states that the Company failed to provide evidence sufficient to justify a different conclusion than the Commission has reached in several prior orders, based on a similar fact pattern. Staff witness Pearce testified that the Company argues that incentive compensation based upon financial metrics helps to attract and retain a stable work force, and that stable workforce benefits customers. Staff Ex. 1.0 at 11. In a previous Nicor Gas proceeding, the Company put forth the same argument and the Commission rejected it. Staff Ex. 1.0 at 11. In the *04-0779 Order*, the Commission concluded that incentive compensation costs are recoverable in rates only if the utility demonstrates tangible benefits to ratepayers.

Staff notes that the Commission also disallowed recovery of incentive compensation costs based on financial metrics in the following cases. In the *17-0124 Order*, the Commission reflected the Company's acceptance of AG-recommended disallowances to operating expenses and taxes other than income of $6,710,000 and $156,000, respectively, which were based on the assertion that the incentive compensation costs were based on underlying financial goals. *17-0124 Order* at 37-38.

In the *08-0363 Order*, Nicor Gas' 2008 rate case, the Commission reflected the Company's acceptance of Staff-recommended disallowances to operating expenses and rate base totaling $2,393,000 and $55,000, respectively. *08-0363 Order* at 24-25. Staff's adjustments reduced the Company's operating expenses and rate base for incentive compensation expenses for amounts which were driven by shareholder-oriented goals, and incentive compensation expenses that were unlikely to be incurred.

In a Commonwealth Edison Company ("ComEd") appeal of the Commission's order in Docket No. 05-0597, the court found that with respect to salary related expense "there is ample precedent making a benefit to ratepayers a condition upon which the recovery of salary-related expense depends." *Commonwealth Edison Co. v. Ill. Commerce Comm'n*, 398 Ill. App. 3d 510, 517 (2d Dist. 2009).

Finally, the Commission has expressed concern about the uncertainty inherent in incentive compensation plans. Staff Ex. 1.0 at 21. For example, the Commission has expressed concern that incentive compensation expenses subject to financial goals will be funded by ratepayers regardless of whether the metrics are actually met. *Ill. Power Co*., Docket Nos. 99-0120/99-0134 (cons.), Order at 44 (Aug. 25, 1999); *Central Ill. Light Co*., Docket Nos. 99-0119/99-0131 (cons.), Order at 38 (Aug. 25, 1999).

Staff concludes that, because the Company has failed to meet its burden and has not demonstrated ratepayer benefits from the proposed incentive compensation costs based on financial metrics in the instant proceeding (Staff Ex. 7.0 at 9), the Commission should remove these costs from the revenue requirement, consistent with longstanding Commission practice. Staff IB, Appendix A, Sch. 9, at 1-2.

c. AG's Position

The AG opposes Nicor Gas' request to include incentive compensation costs based on financial targets pointing out that for more than 16 years, the Commission has determined – and the courts have upheld – that incentive compensation costs based on

financial targets are not recoverable from ratepayers because they do not provide any net tangible benefits to ratepayers, only to shareholders. The AG also notes that Staff and IIEC/CUB make similar recommendations to remove incentive compensation based on financial targets from the revenue requirement on similar grounds. Staff Ex. 1.0 at 7-23; IIEC/CUB Ex. 1.0 at 17-24.

In this proceeding Nicor Gas seeks to recover the full cost of its projected 2022 incentive compensation program, $30 million. Nicor Gas Ex. 10.0 at 8. Nicor Gas states, however, that of this amount $20.082 million or 67% of the total is earmarked to fund incentive compensation programs based on financial metrics, i.e., corporate earnings per share or financial targets. *Id*. at 7-8; AG Ex. 1.2 at 1-2. Nicor Gas witness Garvie described these programs as a Performance Pay Program ("PPP"), and a Long-Term Incentive Program ("LTI"). Nicor Gas Ex. 10.0 at 7-8. The PPP is a short-term program that offers employees the opportunity to receive cash awards for their performance in a calendar year, while the LTI Program is a long-term, target based, variable pay program that grants employees awards that are paid in shares of common stock. *Id*.; AG Ex. 1.0 at 3. The AG asserts that payouts in both programs are heavily dependent upon whether the Company hits its financial targets and are designed to benefit shareholders rather than customers. Nicor Gas Ex. 25 at 9; AG Ex. 4.0 (Rev.) at 5.

In response to Nicor Gas' assertion that Staff and intervenors relied solely on a 15-year old Commission order for this disallowance, the AG cites Commission orders denying the recovery of incentive compensation based on financial metrics – and the appellate court decisions upholding those orders that were challenged – spanning from 1994 to 2020. AG IB at 32; IIEC/CUB IB at 13; and Staff IB at 21-26. The AG continues, it was not just one 15-year-old Commission order but 27 years of sound Commission reasoning, supported by the courts, that the AG, Staff, and IIEC/CUB rely upon for this disallowance. In addition, the AG argues that the General Assembly adopted this policy in Section 16-108.5(c)(4), providing that formula rate electric utilities cannot recover "[i]ncentive compensation expense that is based on net income or an affiliate's earnings per share," and that rule excluding incentive compensation costs based on financial metrics is well-established in Illinois. *Id*.

With respect to Nicor Gas' allegation that the AG misapplied the law, the AG asserts that the Commission has held, "if a utility is seeking to recover such projected [incentive compensation] expenses from ratepayers, the utility should demonstrate that its plan can reasonably be expected to provide net benefits to ratepayers… [such as] specific dollar savings or other tangible benefits." *04-0779 Order* at 45. "[T]he Commission has generally disallowed such expenses except where the utility had demonstrated that its incentive compensation plan has reduced expenses and created greater efficiencies in operations which provide net benefits to ratepayers." Docket No. 07-0507, Order at 25. Based on this authority, the AG argues that the Commission requires more than bald assertions of customer benefit to charge consumers for a program designed to increase shareholder profits. As the Illinois Court has stated, when expenses are incurred "to achieve goals that primarily benefit shareholders, then it is reasonable to require that shareholders bear the cost of that [expense]." *See People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654, ¶54.

The Company argues that incentive payments based on financial targets provide benefits to customers by "reducing expenses, creating greater efficiencies in operations …and attracting and retaining top talent employees," Nicor Gas Ex. 25.0 at 7-8; 10, and that "Staff and Intervenors' reliance on a 15-year old Commission order to support the proposed disallowance is contrary to law, the facts, and sound regulatory policy." Nicor Gas IB at 44. The AG responds that the Company did not articulate these alleged benefits beyond the assertions themselves and explains that the Company did not provide a study, analysis, or other evidence supporting the proposition that incentive payments based on corporate financial performance translate into quantifiable dollar savings, time savings, or other net benefits to ratepayers as required by law. AG Ex. 4.0 (Rev.) at 5-7; Nicor Gas Ex. 25 at 7-10.

Moreover, the AG notes that the utility must "demonstrate a sufficient nexus between the earnings-per-share portion of the employee incentive compensation plan and a benefit to ratepayers" to recover their costs from ratepayers. *People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654. at ¶52. "[A]ttracting good employees [is] too remote a benefit to support recovery from ratepayers." Docket Nos. 09-0166/09-0167 (cons.), Order at 58-59 (citation omitted). Finally, "[t]he utility carries the burden of proving costs it seeks to recover in rates are reasonable and prudently incurred." *BPI II* at 196; 220 ILCS 5/9-201(c). The AG concludes that Nicor Gas provided nothing more than previously rejected arguments to support its claim that its incentive compensation programs based on financial targets provide the requisite benefits to ratepayers, and that the Company has not and cannot provide specific evidence of dollar savings and other tangible benefits because it is not possible to objectively articulate, measure, and attribute such benefits allegedly resulting from efficiencies spurred on by employees' actions that increase shareholder wealth. AG RB at 23.

In addressing Nicor Gas' policy contention, AG witness Selvaggio testified that incentive compensation based on financial goals, such as maximizing profitability and growth, and that increase earnings per share or the return on equity, primarily benefit shareholders. AG Ex. 1.0 at 4. For example, all else being equal, higher rates generate higher revenues, which in turn generate higher earnings for the Company. Therefore, she concluded, including such costs in the revenue requirement would effectively require ratepayers to reward utility management for charging them higher rates, an absurd result. *Id*. Consumers also lose if service quality declines in an effort to increase shareholder earnings. *Id*. The AG notes that equally absurd is the fact that these incentive costs would be built into rates and collected from ratepayers regardless of whether Nicor Gas or its parent company actually hit their targets and were required to pay the reward. AG RB at 24. Neither of these results, the AG posits, reflect sound policy which independently support the adjustment proposed by the AG, Staff, and IIEC/CUB to remove incentive compensation based on financial goals from the revenue requirement. *Id*.; IIEC/CUB Ex. 3.0 at 9. The AG concludes that it would be bad policy and a misapplication of the law to hold such a result is reasonable.

The impact of Ms. Selvaggio's adjustment, as presented on Sch. A1 of AG Ex. 4.1 and AG IB Attachment 1, is to reduce administrative and general ("A&G") expenses by $16.347 million, depreciation expense by $0.059 million, and reduce rate base by $1.831 million (reduction of plant in service by $1.868 million offset by reductions to the

depreciation reserve of $0.029 million and accumulated deferred income taxes ("ADIT") of $0.008 million). The AG's adjustment is based on the Company's response to Data Request AG 4.13 provided as AG Ex. 1.2, pp. 1-2.

d. IIEC/CUB's Position

IIEC/CUB note the Commission articulated its standard on allowable incentive compensation costs in the *04-0779 Order*. There, the Commission made clear that incentive compensation costs should be borne by shareholders rather than ratepayers when the payment of incentives is dependent upon, or triggered by, the achievement of financial goals. *04-0779 Order* at 45. IIEC/CUB find this standard has been upheld repeatedly since the 2004 proceeding, not just for Nicor Gas, but also other Illinois gas, electric, and water utilities. IIEC/CUB argue the Company provides no information that differentiates its request in this proceeding from each of these Commission determinations.

IIEC/CUB argue rates should not include incentive compensation costs related to financial goals, for several reasons. First, shareholders can pay for the incentive compensation using the higher earnings achieved as a result of meeting the financial goals. Second, including these costs in rates exposes customers to the risk of paying for incentive compensation without knowing if the financial goals will be achieved. Third, incentive compensation costs relating to financial goals do not provide any additional benefit to customers. IIEC/CUB maintain the Commission has therefore rightly excluded these costs from rates. IIEC/CUB note, consistent with both Commission standards and fair and balanced regulatory practices, the Commission disallows incentive compensation costs based on financial goals because incentive compensation programs primarily designed to align the interests of executives with shareholders should be paid for by shareholders. IIEC/CUB find, as Staff witness Pearce succinctly stated: "[t]he Commission, in order to support recovery of incentive compensation from ratepayers, has long required a clear demonstration of ratepayer benefits. Staff Ex. 7.0 at 9.

IIEC/CUB argue, in addition to excluding these costs because they are designed to primarily benefit shareholders, including such costs in rates is asymmetrical by creating risk to ratepayers but not shareholders, and therefore cannot meet the just and reasonable standard in the Act. IIEC/CUB Ex. 1.0 at 19; 220 ILCS 6/9-201. IIEC/CUB note, for example, if incentive compensation costs are borne by shareholders and excluded from cost of service, then shareholders will pay these incentive compensation costs only if the incentive targets are achieved. IIEC/CUB Ex. 1.0 at 19. IIEC/CUB maintain if the incentive targets are achieved, then the Company's earnings and dividend-paying ability will be enhanced. *Id*. IIEC/CUB explain in this instance, shareholders can pay for the incentive compensation costs out of the higher earnings created by the employees achieving the incentive financial goals. *Id*. IIEC/CUB note if the goals are not achieved, shareholders will not incur the incentive compensation costs. On the other hand, IIEC/CUB find if the incentive compensation costs were included in cost of service, customers would be obligated to compensate for incentive compensation costs regardless of whether or not the incentive financial goals were actually achieved. *Id*. In this instance, IIEC/CUB argue customers would compensate Nicor Gas for incentive compensation expenses, but customers would not benefit from the achievement of the financial goals.

IIEC/CUB contend Nicor Gas' incentive compensation plan descriptions prove certain costs associated with these programs should be rejected by the Commission. Nicor Gas has two incentive compensation programs, PPP and LTI. IIEC/CUB Ex. 1.2 at 6-31. IIEC/CUB point out the description of PPP shows that a portion of the program's incentive compensation is awarded based on financial goals, such as earnings per share. For incentive compensation awarded based on an earnings per share goal, shareholders can pay for these costs out of the higher earning achieved by hitting the earnings goal. On the other hand, IIEC/CUB maintain Nicor Gas has not shown what benefit customers receive if Nicor Gas achieves a particular earnings per share goal. Contrast this to operational goals such as safety which have a clear customer benefit and are appropriate to include in Nicor Gas' cost of service. IIEC/CUB argue Nicor Gas' other incentive compensation program, LTI, is also partially or entirely based on financial goals.

IIEC/CUB argue allowing incentive compensation costs based on financial metrics to be included in rates creates a conflict between the utility achieving its financial goals and its obligation to keep tariff rates as low as possible. For example, IIEC/CUB point out Nicor Gas will benefit from enhancing the awarded return on equity in this case because it increases profit, which will benefit both Nicor Gas shareholders and employees under Nicor Gas' incentive compensation goals that are tied to profits. IIEC/CUB Ex. 1.0 at 22. On the other hand, IIEC/CUB note customers could be harmed if the enhanced profits are attributable to Nicor Gas convincing the Commission to award an inflated return on equity in setting rates. *Id*. That is, IIEC/CUB explain, if the return is set above a just and reasonable level in this case, it would unreasonably inflate tariff rate charges to customers. *Id*.

IIEC/CUB argue it is appropriate, for ratemaking purposes, to separate incentive compensation costs between (i) incentives tied to customer benefits (including employee safety, service reliability and quality, and customer service components) and (ii) performance incentives tied to financial performance of the Company which benefits shareholders (including operating income management, various financial targets, and employee retentions related to RSU awards). IIEC/CUB Ex. 3.0 at 7.

IIEC/CUB note Nicor Gas rejects the recommendation of IIEC/CUB, Staff, and the AG partially on the basis that these recommendations challenge the Company's compensation design. IIEC/CUB point out Nicor Gas witness Garvie claims that, if Nicor Gas is unable to recover the costs of rewarding employees for achieving these important financial goals, it would challenge the Company to rethink its compensation design by removing or reducing goals based on financial metrics. Nicor Gas Ex. 25 at 10. IIEC/CUB observe Mr. Garvie asserts that this would imbalance the Company's incentive compensation plan and may result in employees using more financial resources than necessary, resulting in higher costs to customers. *Id*.

IIEC/CUB assert Nicor Gas' argument is flawed. IIEC/CUB argue the design of the Company's incentive compensation benefits the Company and its employees well beyond whether these costs are recovered from customers. IIEC/CUB maintain, again, Nicor Gas' executives and shareholders will benefit regardless of the ratemaking treatment of these costs because if the targets are achieved they benefit via achieving exceptional financial performance whereas customers do not benefit. IIEC/CUB find employees therefore are incented to work hard and efficiently to reach those financial

goals and get their compensation rewards whether or not these amounts are recovered in rates. IIEC/CUB point out the Commission has made clear that utility customers should only be obligated to compensate the Company for executive and employee compensation programs that benefit them via Nicor Gas achieving exceptional reliability and/or service quality. *04-0779 Order* at 44-45.

IIEC/CUB witness Gorman further recommended the Commission also exclude from Nicor Gas' cost of service the incentive compensation costs tied to RSUs. IIEC/CUB Ex. 1.0 at 23. IIEC/CUB point out Mr. Garvie argues in his rebuttal testimony that RSU awards are stock units that vest over a defined period of time based solely on continued employment and that these awards are not subject to corporate performance measures and are not based on financial metrics. IIEC/CUB note Mr. Garvie further argues that RSUs should be included in Nicor Gas' cost of service because RSUs retain and attract employees by rewarding longevity, which benefits customers. IIEC/CUB Ex. 3.0 at 10.

IIEC/CUB argue Nicor Gas' position should be rejected. IIEC/CUB contend the LTI planning documents show that RSUs awarded to executives are based on financial goals. IIEC/CUB assert these costs should be excluded. IIEC/CUB Ex. 3.0 at 11. IIIEC/CUB witness Gorman describes in his direct testimony how RSUs are a component of Nicor Gas' long-term incentive award, and while remaining at Nicor Gas through a vesting period is part of receiving the RSU award, the award is part of an overall incentive program that is a performance-based compensation plan. IIEC/CUB Ex. 1.0 at 24. IIEC/CUB note the LTI description also states the value of the RSUs can increase or decrease depending on the change in the Common Stock price from the date of grant to the time of vesting. *Id*. at 24.

IIEC/CUB assert the record in this case demonstrates that RSUs awarded to executives are based on financial goals and RSUs for other employees are a part of an incentive compensation program that is performance-based. *Id*. at 24. IIEC/CUB argue as a result, these costs should be excluded from Nicor Gas' cost of service and not be recovered in rates.

e. Commission Analysis and Conclusion

Staff, the AG, and IIEC/CUB recommend adjustments to eliminate portions of Nicor Gas' proposed incentive compensation expense because the costs are based on underlying financial goals and therefore should not be recoverable in rates. As these parties note, the Commission has long held that incentive compensation costs based on financial performance that primarily benefit shareholders are not recoverable in rates.

Nicor Gas does not dispute that the incentive compensation opposed by Staff and the AG is based on financial goals. Nicor Gas requests that the Commission reverse its long-held policy arguing that the Commission should look at the total compensation program as a whole in determining benefits to ratepayers. Nicor Gas then uses the same arguments it made in the 2004 rate case here – namely that an incentive compensation package including awards based on financial goals is necessary to maintain a stable workforce and to provide efficient, safe, and reliable service.

The Commission does not find Nicor Gas' argument persuasive, especially considering the well-established treatment of incentive compensation benefits related to

financial goals. Nothing in the record demonstrates that Nicor Gas' incentive compensation programs based on financial goals do not primarily benefit shareholders rather than ratepayers. Nicor Gas has not met its burden of proof to include these costs and therefore the adjustment to remove these incentive compensation costs supported by Staff and the AG is approved.

IIEC/CUB agree with Staff and the AG, but IIEC/CUB also contend that incentive compensation costs tied to RSUs are based on financial goals and therefore should not be recoverable. The Commission finds again, as it did in the last Nicor Gas rate case, 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 also determined in the *18-1775 Order* that the RSU awards to executive officers are subject to an additional safeguard that ensures the award is not issued in the event the Company's financial situation would not support the issuance of the award. That safeguard is still in place. Nicor Gas Ex. 25.0 at 13. Accordingly, the Commission rejects IIEC/CUB's adjustment related to RSUs.

Nicor Gas' uncontested incentive compensation costs are approved.

2. Rate Case Expense

a. Nicor Gas' Position

In accordance with Section 9-229 of the Act and the Commission's Rules, 83 Ill. Adm. Code 288, Nicor Gas presented evidence that its rate case expense of $4,713,000 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 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).

Nicor Gas explains that the sole disputed issue is the AG's proposed disallowance of certain identified activities of outside counsel that AG witness Selvaggio claimed should not be billed to this rate case. In response, the Company provided the declaration of Elizabeth Wade, Chief Counsel – Regulatory Affairs for Southern Company Gas, who reviewed the invoices supporting Nicor Gas' Rate Case Expense and concluded, based on her substantial experience as regulatory counsel, that all of the activities of the Company's outside counsel, as reflected on its invoices, properly are related to the preparation and litigation of this rate case. Additionally, based on a prior Commission decision, the Company argues that Ms. Selvaggio is not qualified to opine on what tasks billed by lawyers are necessary to the rate proceeding. In particular, the Company disagrees that such a review is a "typical audit function" and points out that the Commission has previously observed "accountants do not necessarily know what lawyers do or should be doing on behalf of their clients[]" and "may not be able to determine

whether this work is necessary[.]" *Commonwealth Edison Co*., Docket No. 12-0321, Order at 53 (Dec. 19, 2012); *see also Commonwealth Edison Co*., Docket No. 10-0467, Order at 84 (May 24, 2011). Accordingly, Nicor Gas asserts that the AG's proposed adjustment should be rejected.

b. Staff's Position

The Commission should approve Nicor Gas' projected rate case expense of $4,713,000, to be amortized over two years. The Company estimates the cost of legal fees, external consultants, customer notices, travel costs and other miscellaneous costs amortized over a two-year period will result in test-year amortization expense of $2,356,500. Accordingly, Staff recommends that the Order in this proceeding include the following Commission conclusion:

> The Commission has considered the estimated costs to be expended by Nicor Gas to compensate attorneys and technical experts to prepare and litigate rate case proceedings and assesses that the amount included as rate case expense in the revenue requirement of $2,356,500 is just and reasonable pursuant to Section 9-229 of the Act. This amount represents total rate case expense of $4,713,000 amortized over a two-year period.

Staff Ex. 7.0 at 20.

c. AG's Position

AG witness Selvaggio reviewed the invoices Nicor provided in support of the requested rate case expense and stated that she identified $0.049 million in Jenner and Block legal fees unrelated to this proceeding. She posited that the activities identified include but are not limited to: (1) updating rate tracking worksheets for Ameren Electric, Ameren Gas, and ComEd; (2) summarizing Staff and Intervenor testimony for an Ameren Gas rate case; (3) uploading and analyzing Ameren Gas rate case documents; (4) assembling Ameren reply briefs for attorney review; (5) assembling testimony filed in a North Shore/Peoples Gas rate case; and (6) summarizing a proposed order from an Ameren Gas rate case for use in a "Coordinating Committee" meeting. AG Ex. 1.0 at 24; Nicor Gas Ex. 3.5; Nicor Gas Ex. 19.4.

Regarding Ms. Selvaggio's qualifications, the AG argues that her four-plus decades of accounting and auditing experience, including 33 years with the Commission, many of which involved reviewing the inclusion of rate case expenses such as these, qualifies her to propose this disallowance. AG IB at 36; AG RB at 26. The AG posits that identifying costs related to other rate cases and judging whether those costs bear a relationship to the current proceeding based on the task descriptions on the invoices provided by the Company is a basic audit function, the execution of which Ms. Selvaggio has performed for decades. *Id*.

The AG further argues that the Act itself affirms that an assessment and finding of the justness and reasonableness of rate case expense entails more than simply approving an item simply because the Company's counsel says it is rightly included in rates. 220 ILCS 5/9-229; Nicor Gas IB at 52. The Act states that "[t]he Commission shall

specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing." 220 ILCS 5/9-229. The idea, the AG asserts, that only attorneys can opine on the justness and reasonableness of a rate case expense would render Section 9-229 meaningless and undermine the authority and ability of the Commission to render a valid decision, as not all Commissioners are attorneys. The AG concludes that AG witness Selvaggio appropriately identified an unusual and unreasonable expense – related to the firm's review of other utility proceedings – for the Commission to remove from rates and not meeting the just and reasonable legal standard.

As to the billed activities at issue, the AG argues that tracking party positions and the procedural posture of other utility rate case proceedings, either through participation or observation, are the very activities that contribute to the collective knowledge and expertise of the firm, which benefit all of the firm's current and prospective clients. AG IB at 37; AG RB at 26. The AG asserts that costs associated with such activities are part of the firm's overhead and general legal work, are presumably reflected through the hourly rates charged by its attorneys and paralegals and should not be included in rate case expense. *Id*.

This basic principle, the AG notes, is further reinforced by the fact that Jenner and Block represents other utilities in Illinois, who selected the firm because of its expertise and experience. Jenner and Block represents North Shore and ComEd. AG Ex. 4.0 (Rev.) at 26. Ms. Selvaggio stated that Jenner and Block was last retained by North Shore due to the "firm's background and experience and recent experience litigating both electric and natural gas rate cases before the Commission." *Id*. (citing *N. Shore Gas Co*., Docket No. 20-0810, AG Ex. 3.2 at 2). She noted that ComEd, in Docket No. 21-0367, selected Jenner and Block due to "their expertise in the utility industry in Illinois." *Id*. (citing *Commonwealth Edison Co*., Docket No. 21-0367, ComEd Ex. 1.12 at 4).

The AG argues that just as Nicor Gas did, these utilities selected Jenner and Block because of the firm's expertise and experience gained through previous utility proceedings before the Commission and agreed to pay a fee for that experience. The AG posits that it is entirely unreasonable for the firm to charge Nicor Gas – and therefore ratepayers – a second time for the same or similar work conducted for previous clients or that contribute to the firm's expertise and experience. *See e.g*. AG Ex. 1.0 at 24-25.

In regard to Staff's position, the AG contends that the fact that Staff did not object to any of the rate case charges does not bind the Commission. The AG argues that it provides ample factual or legal bases on which the Commission can conclude that the unrelated activities Ms. Selvaggio identified bear no relationship to the preparation and litigation of this rate proceeding.

Ms. Selvaggio's adjustment removes $0.049 million of actual costs incurred through February 28, 2021 for outside legal services from the projected rate case expense of $4.713 million. Since rate case expense is amortized over two years, Ms. Selvaggio's adjustment reduces rate case expense included in the test year operating expenses by $0.025 million. This is reflected on Sch. 7 of AG Ex. 4.1 and AG IB Attachment 1 and is based on the invoices provided in Nicor Gas Exs. 3.5 and 19.3.

d. Commission Analysis and Conclusion

Section 9-229 of the Act allows utilities to recover costs incurred to prepare and present a rate case. 220 ILCS 5/9-229. To recover rate case expense, the Commission must determine that those costs are just and reasonable. In this proceeding, the dispute regarding rate case expense concerns the AG's proposed disallowance of costs related to certain activities of Nicor Gas' outside counsel. In the AG's opinion, the disputed costs are not related to the preparation and litigation of this rate case proceeding.

The AG takes exception to costs related to researching, assembling and analyzing data, testimony, and briefs regarding other utilities' cases before the Commission. As an initial matter, it is apparent by this proceeding alone that the Commission's treatment of issues arising in other utilities' rate cases may be beneficial and useful when presenting a rate case.

The AG then asserts that these activities contribute to the firm's (outside counsel) collective knowledge and expertise, and therefore, because the firm represents other utilities, these costs should not be included in rate case expense and should instead be attributed to the firm's overhead and general legal work. This argument seems to misunderstand the benefits of hiring a firm with experience and expertise. Information and analysis may be needed in this rate case that will be used, or has been used, in other utilities' rate cases. This information will presumably be needed whether Nicor Gas uses Jenner and Block or another firm that does not represent other utilities. Part of the savings in using a firm with experience and expertise is due to billable hours. A firm with experience and expertise should not need as much time to compile and analyze needed information for a utility's rate case, thus resulting in savings to ratepayers.

The AG's proposed adjustment to rate case expense is rejected, and the Commission approves Nicor Gas' rate case expense.

3. Shared Services

a. Supply Chain Integration

(i) Nicor Gas' Position

Nicor Gas states that following the 2016 merger with Southern Company, Southern Company Gas began consolidating operations with SCS. The Company explains that this consolidation included redundant functions, like treasury, investor relations, internal audit, information services, and supply chain services. The Company provided evidence that integrating supply chain services, in particular, will save money for ratepayers in the long run, even though the process resulted in some upfront costs. These savings will come from increased buying leverage, deeper category management (i.e., bundling), and improved efficiency. According to the Company, the full benefit of the savings does not appear immediately because procurement contracts are typically cyclical. Notwithstanding this, the Company reports that it has already achieved $313,000 in procurement savings.

(ii) Staff's Position

Staff states that the Commission should approve the Company's cost of Shared Services in the Test Year revenue requirement, as set forth in the attachment to Staff's

Initial Brief. As the Company explained, the consolidation of the supply chain functions of SCS and AGSC may provide benefits over a longer term than the window recommended by the AG. Staff Ex. 7.0 at 27. The Company further explained that there is no occupancy credit related to the test year, due to the fact that SCS has no commitment to occupy space for its personnel in AGSC facilities during the 2022 test year. *Id*. at 28. Therefore, Staff asserts, no occupancy credit should be imputed for the Test Year. Finally, the Company explained the allocations of air travel charges are based on a combination of actual flight hours and fixed availability costs, as well as the benefits of reduced travel time, ability to work during the flight, and avoidance of overnight costs (hotels and meals) and increased flexibility. *Id*. at 26. For these reasons, Staff does not support the AG's proposed adjustment to reduce the cost of Shared Services in the 2022 Test Year.

(iii) AG's Position

In June 2020, SCS and Southern Company Gas completed the consolidation of their supply chains into a "One Supply Chain" model, "designed to drive efficiencies across the enterprise by centralizing responsibilities, [] matching skillsets with needs…and improv[ing] supply chain purchasing economies." Nicor Gas Ex. 13.0 at 42-43. The Company included $0.9 million in the test year for increased costs primarily related to ongoing One Supply Chain model. *Id*.; AG Ex. 1.0 at 19. However, Ms. Selvaggio pointed out that this increase is only offset by $0.33 million in projected cost reductions in the 2022 test year. AG DR 6.02 (AG Ex. 1.3 at 6). Given that the stated purpose of the One Supply Chain model is to increase efficiencies and reduce costs, Ms. Selvaggio recommended removing the incremental increase of $0.57 million in the Company's test year. AG Ex. 1.0 at 19-20.

Nicor Gas argues that "additional savings will be realized and exceed the incremental costs to integrate the supply chain functions," and that the "timing of these savings depends upon factors such as contract expirations across the Southern Company Gas operating companies, future anticipated volumes, and sourcing events to secure vendor commitments." Nicor Gas Ex. 29 at 3-4. The Company also argues that $0.313 million in procurement-related savings at Nicor Gas was realized in 2021 and that Ms. Selvaggio's adjustment is merely based on a point in time, not contemplating the evidence suggesting that the increase in shared services costs is expected to be mitigated by further spend consolidation. Nicor Gas Ex. 29.0 at 4.

The AG contends that the fact remains that the Company is requesting a $0.9 million increase in ongoing supply chain costs related to the "One Supply Chain" model, the intent of which is to reduce costs and streamline purchasing functions. This cost increase is only offset by $0.33 million in projected cost reductions in the 2022 test year, causing an incremental $0.57 million increased cost in the Company's Test Year. *Id*. The AG contends that the Company had already realized $0.313 million in procurement-related savings during 2021 when the Company filed its rebuttal testimony on June 8, 2021, and that Nicor Gas itself asserted that additional savings beyond the $0.313 million will be realized over the remainder of 2021, and continue into 2022. AG Ex. 4.0 (Rev.) at 17; Nicor Gas Ex. 29.0 at 4. The AG concludes that the Company's projection attempt to include $0.9 million in costs while ignoring that savings are expected to increase beyond the $0.33 million of savings identified in the 2022 Test Year should be rejected. The AG

argues that Ms. Selvaggio's adjustment compensates ratepayers for those savings that should be realized in 2022 but are not currently reflected as a reduction to the Test Year's expenses, and that it is unreasonable to charge ratepayers an additional cost for a supply chain model designed to reduce costs and increase efficiencies, and to ignore savings associated with this additional cost. AG Ex. 4.0 (Rev.) at 17.

Ms. Selvaggio's adjustment reduces the test year shared services costs by $0.57 million as reflected on AG Ex. 4.1, Sch. A6, line 1.

(iv) Commission Analysis and Conclusion

The Commission agrees with Nicor Gas that the integration of supply chain services will save money for ratepayers in the long run. It is reasonable that the consolidation of supply chain services would have initial upfront costs. The benefits of the integrated supply chain will allow the Company to leverage the buying power of its parent company, benefit from improved bundling and sourcing of materials and services, and lead to improved efficiency and lead times on purchased items. The Commission rejects the AG's adjustment to shared services regarding the supply chain integration and approves the Company's costs.

b. Occupancy Credit

(i) Nicor Gas' Position

Nicor Gas states that the AG's proposal to apply an occupancy credit for the Test Year is unreasonable, and notes that no other party supports this adjustment. The credit relates to when SCS personnel have worked from Nicor Gas' headquarters. The Company explained in testimony that it did not include an occupancy credit in its Test Year budget because it is uncertain whether SCS will use Nicor Gas office space at all, or, if so, the extent to which it might be utilized. The Company asserts that SCS has not given any estimate about whether it will need space in 2022. Further, Nicor Gas notes that exacerbating this uncertainty is the ongoing pandemic, as employers continue to reevaluate the role of in-person activities at office locations. Finally, the Company pointed to evidence explaining that the level of an annual occupancy credit has varied by as much as 28%. Consequently, it would be entirely speculative to assume what the credit may be, if one even occurs.

(ii) Staff's Position

See Section V.B.3.a.(ii).

(iii) AG's Position

The AG explains that the Company included $0.628 million in its Test Year revenue requirement resulting from an SCS occupancy credit it did not include in its Test Year budget. Nicor Gas Ex. 13.0 at 46. From 2018 through 2020, this annual credit has served to compensate Nicor Gas for the 152 SCS Technology Organization employees currently occupying 7,425 square feet of floor space in Nicor Gas' Naperville, Illinois facilities. *Id*. Nicor Gas excluded this credit from its Test Year budget because "AGSC and Nicor [Gas] do not budget for items that are unknown or cannot be quantified…" Nicor Gas Ex. 29 at 5. The AG contends that this argument is without merit and should be rejected.

Ms. Selvaggio pointed out that "there has been an occupancy credit issued to Nicor [Gas] each year since at least 2018 …ranging from $0.484 million in 2018 to $0.628 million in 2020," and that the Company presented no evidence suggesting SCS intends to reduce its required floor space or pull its 152 employees from Nicor Gas' facility in 2021 or 2022. AG Ex. 1.3 at 7 (Company response to AG DR 6.04); AG Ex. 1.0 at 20; AG Ex. 4.0 (Rev.) at 18. The AG argues that the Company has presented no evidence suggesting it intends to relocate the 152 employees and/or vacate or replace the 7,425 square feet of office space, which would be a large undertaking and require extensive planning and notice. The AG notes that as of this writing only four months of 2021 remain, making any potential move highly unlikely, the occupancy credit proposed by Ms. Selvaggio should be applied.

In response to Nicor Gas' assertion that this credit is unknown and speculative, the AG argues that the Company's entire Test Year is forecasted, not historical; it is based solely on projected costs and revenues. The AG asserts that the revenues from SCS are no more speculative than any other projected cost or revenue source in the future Test Year, and that it is, therefore, disingenuous for Nicor Gas to argue that it cannot budget for future Test Year items that benefit consumers because they are unknown. Moreover, the AG adds, the amount of space occupied by SCS is known as well as the amount of the credit Nicor Gas received in 2020. The AG concludes that, in the absence of evidence to the contrary, it is reasonable for the Commission to conclude that Nicor Gas will receive an occupancy credit in the Test Year like the occupancy credit it received last year and has received for the last five years.

Ms. Selvaggio's adjustment reduces the Test Year shared services costs by $0.628 million to reflect the issuance of an occupancy credit in the test year based on the most recent actual credit received. The adjustment is reflected on Sch. A6 of AG Ex. 1.1, 4.1, and the AG IB Attachment.

(iv) Commission Analysis and Conclusion

The Commission finds Nicor Gas' reasons for not including an occupancy credit reasonable. Considering the lack of any estimate by SCS as to the need of office space coupled with the ongoing pandemic – and the resulting reevaluation many entities are considering regarding the need for work space – it is perhaps more speculative than normal whether and to what extent SCS may need office space. Accordingly, the AG's proposed reduction to the Test Year shared services related to the occupancy credit is rejected and Nicor Gas' costs are approved.

c. System Air Services

(i) Nicor Gas' Position

Nicor Gas states that the AG's proposed adjustment to reduce System Air Services ("System Air") costs is unreasonable, and notes that neither Staff nor any other party supports the AG's position. Nicor Gas explains that System Air is a charter aircraft program provided for participating affiliates of The Southern Company. The Company states that there are three primary benefits of System Air: (1) enabling executives to fly anywhere in the country on short notice regardless of whether that destination has a commercial airport; (2) increasing efficiency by reducing travel times and allowing teams

to work while in transit; and (3) allowing the Company to avoid travel costs like lodging and food.

Nicor Gas explains that System Air recovers its costs in two ways. First, it assesses a "utilization" charge, which covers the incremental cost of each flight. Second, System Air assesses an "availability" charge, which covers fixed costs of the operation, such as aircraft leases, hangar space, and maintenance. The availability charge is allocated to participating affiliates using a combination of financial metrics and utilization data. The Company says that this mix is a fair representation of the value of availability because availability is a separate benefit from the flights itself, and the size of each affiliate is a reasonable barometer for the availability benefit. The Company also points out that in 2019, the last year with data prior to the pandemic, Southern Company Gas' allocation of availability charges was on par with its utilization.

In response to the AG, Nicor Gas first notes that using only the availability charge is improper because it omits the vast majority of System Air costs. Nicor Gas observes that there is no legal or factual basis upon which to disallow these costs. According to the Company, the AG's position is also based upon incorrect and unsupported facts, such as the assertion that the undiscounted commercial fare is calculated using a first-class ticket. Second, as to the AG's claim that System Air only benefits executives, the Company notes that the AG's position is unsupported by any record evidence, and that the Company's testimony is uncontradicted. Third, with respect to the AG's allocation argument, Nicor Gas states that the current methodology, which includes financial metrics, fairly represents the value of System Air, and that it is improper to look to data during the pandemic when travel was dramatically curtailed. During that time, the statistics were skewed and unrepresentative of what can be expected in the Test Year. Fourth, as to the AG's argument about improper uses of System Air, the Company responds that there are strict policies in place, ratepayers do not pay for personal travel, and it is unaware of any audit discrepancies.

(ii) Staff's Position

See Section V.B.3.a.(ii).

(iii) AG's Position

AG witness Selvaggio explained that the SCS System Air costs allocated to AGSC (and thus to Nicor Gas) are made up of two components: (1) a utilization charge based on comparable first class undiscounted commercial fare for the itinerary flown; and (2) an availability charge. AG Ex. 1.0 at 21. The availability charge, which is the premium charged to ensure a plane is available when called, is based on a series of factors, including flight hour usage and a financial rate. AG Ex. 1.3 at 10-12 (Company response to AG DR 10.20). The financial rate is not based on an affiliate's use of System Air, but rather is based on various financial aspects of the affiliate company, such as net fixed assets, operating expenses, revenues, etc., and is "intended to represent the scale of an affiliate company relative to other affiliate companies…" *Id*. at 13. In 2020, "SCS modified aspects of the financial rate …", which increased the availability percentage allocator for AGSC from 7.1% to 15.4% – a 117% increase. AG IB at 43.

Nicor Gas argues that its "availability charge allocation is actually more fair than a use only-method because it reflects the value of System Air's availability to all companies. It also prevents spikes in the availability charge based on years of high use." Nicor Gas Ex. 20.0 at 6. In the AG's opinion, Nicor Gas also places a significant amount of emphasis on the benefits of System Air, such as "travel on short notice anywhere in the country – regardless of whether that place is served by a commercial airport…[the] avoid[ance] of certain travel costs, including food and lodging…and [the ability to] work privately with each other en route…", to justify its costs. *Id*. at 3; Nicor Gas Ex. 29.0 at 8-9. The AG contends that these responses do not justify doubling the allocation to Nicor Gas and ignore the several reasons Ms. Selvaggio raised as support for the disallowance.

The AG first asserts that it is not challenging the cost of flights at the undiscounted commercial fare for the itinerary flown, which represent first class tickets and are already a premium rate. The AG notes that premium air travel already includes privacy, free food, and convenience and that the Company did not demonstrate that the benefits it alleges System Air provides vary from the benefits available on first class commercial flights. The AG argues that the additional charges for a private jet and the identified luxuries benefit the executives utilizing them, not ratepayers; therefore, consumers should not pay more than the undiscounted commercial fare for executive travel. Any alleged benefit to ratepayers from the availability and use of private jets, they posited, has not been substantiated by the Company.

Second, the AG points out that in 2020 Southern Company revised its financial rate so that "the entity with 40.38% of the flight hours [was] allocated only 20.49% of the costs while other entities, such as [Southern Company Gas], are allocated a greater percentage of the costs." AG Ex. 1.0 at 21. The AG contends that the Company's availability charge allocation method allocates more costs to Nicor Gas than its use of System Air justifies. The AG concludes that it is not fair to allocate to Illinois ratepayers a cost disproportionate to aircraft usage while affiliates that utilize the service more than Nicor Gas are under-allocated private air availability charges.

Nicor Gas witness Kim stated that "because a significant benefit of System Air is its availability – which exists for all companies regardless of their actual use of the service – it would be unfair to assign the full cost of the availability charge based only on use." Nicor Gas Ex. 20.0 at 5. The AG responds that if a significant benefit exists for all companies, then all companies should be contributing to the availability charge, regardless of their actual use of the service. The AG also notes that not all affiliates contribute to the costs of System Air, even though the Company claimed all affiliates benefit from the system. AG Ex. 4.0R at 22. The AG concludes that in addition to the availability charge being disproportionate to the utilization of System Air by Nicor Gas, the failure to allocate the availability charge to all affiliates further disproportionately increases the allocation to Nicor Gas' Illinois customers.

Finally, the AG argues that the heavy reliance on availability charges to allocate the Company's System Air charges results in ratepayers paying generally for a service that have personal and political benefits unrelated to utility service. For example, the AG notes that "[e]lected or appointed government officials or their staff (federal, state, or local) or candidates for elective office may be transported on System Air if approved by both the applicable company's Chief Executive Officer and the Southern Company General

Counsel or his designee." *Id*. The AG argues that the general impropriety of such use has given rise to strict federal regulations. *See generally* 14 C.F.R. § 91.321 (Carriage of Candidates in Elections); 2 U.S.C.A. § 1613 (Prohibition on provision of gifts or travel by registered lobbyists to Members of Congress and to congressional employees).

The AG explains that Southern Company also authorizes the use of System Air services by not-for-profits, which increases their loyalty to Southern Company and may be used to advance Southern Company objectives. *Id*. Finally, the AG points out that executives using System Air services are able to bring "immediate family members or other guest, if there is available capacity with the fair market value of the transportation added to the primary employee's gross income as a taxable benefit that the Company may be unable to deduce for tax purposes." AG Ex. 1.0 at 20 (citing AG Ex. 4.6R, Company response to AG DR 16.01 Ex. 1 at 2).

The AG concludes that these are political, social, and personal benefits enabling the Southern Company to lobby and benefit third parties by offering private jet travel on short notice anywhere in the country, and that these services do not benefit Nicor Gas ratepayers and does not affect Nicor Gas' service to customers. Yet, the AG argues, the large allocation of availability charges to Nicor Gas – in excess of its proportionate use – results in a subsidy of System Air services to out-of-state executives, politicians and public officials, and not-for-profits by Illinois ratepayers. Ms. Selvaggio's adjustment removes the availability charges of $1.893 million from the Test Year.

In the Company's rebuttal, Nicor Gas witness Kim stated that "if the Commission agreed with Ms. Selvaggio that the allocation should be based entirely on use, her complete disallowance of this cost is disproportionate to the actual variance in the allocation of flight hours." Nicor Gas Ex. 20.0 at 6. He argued that "in 2019, [Southern Company Gas] made up 12.68% of flights hours and its allocation was 15.44%—a three percentage point difference." *Id*. The AG argues that the Commission should reject this argument.

Ms. Selvaggio indicated that the 12.68% allocator was based on flight hours from April 2019 through March 2020. AG Ex. 4.0R at 22. In the following 12 months ending March 2021, Southern Company Gas had only 7.09% of the flights, and from January 2021 through May 2021, Southern Company Gas had only 3.99% of the flights. *Id*. (citing AG Ex. 4.5 at 5, Company response to AG DR 16.03). She noted that Southern Company Gas personnel did not use System Air in April or December 2020, or in February, March, or June of 2021. Nicor Gas Ex. 34 at 7-8. The Company argues that this lower usage was the result of the pandemic. *Id*. The AG responds that this is the most recent usage information available, and it demonstrates that Southern Company Gas personnel did not utilize System Air in the most recent time period, which includes the period after vaccinations became available (January 2021-May 2021). Further, the AG adds, as the Delta variant of COVID-19 spreads, it is premature to assume that Southern Company Gas travel will return to pre-pandemic levels. The AG concludes that the 2021 travel for Southern Company Gas as well as for other Southern Company affiliates is most representative of current and near future (2022) conditions.

The AG also notes that Southern Company Gas usage is a percentage of total usage, so clearly other affiliates utilized System Air more during the reported months

notwithstanding the pandemic, and those entities should be allocated an availability charge that is proportionate to their usage. *Id*. at 47. Therefore, the AG concludes that the actual recent Southern Company Gas usage shows that an availability charge of 12.68% overstates the benefit Illinois consumers receive from System Air and under-allocates availability charges to Southern Company's other affiliates.

Ms. Selvaggio stated that if the Commission concludes that ratepayers should pay an allocated portion of the System Air availability charge, it should direct Nicor Gas to use the most recent use percentage allocator of 3.99% which is the use most representative of current conditions based upon the methodology indicated in the Company's response to Data Request AG 16.03 Ex. 1 provided as AG Ex. 4.5 at 7.

(iv) Commission Analysis and Conclusion

The point of shared services is to save money. System Air costs are allocated to Nicor Gas via AGSC as part of shared services costs. Nicor Gas asserts that System Air is more fair than commercial travel because it reflects the value of availability to all companies. The benefit of sharing in a resource such as System Air is that the alternative would be more expensive. While the AG questions the reasonableness and fairness of using a service such as System Air versus commercial travel, the AG's proposed adjustment applies to the availability charge of System Air. The AG only proposes to eliminate the availability charges of $1.893 million and not other related costs.

The availability charge covers fixed costs of maintaining System Air's fleet. If allowed to recover System Air costs in general, the fixed costs of maintaining the fleet and access to that fleet is reasonable. The question remains as to what amount of availability costs should be attributed to Illinois ratepayers. According to the record, Nicor Gas' explanation of costs, which uses a combination of flight-use data as well as company financial metrics, appears reasonable as presented. Therefore, these costs are approved.

4. Enterprise Foundations

a. Nicor Gas' Position

The Enterprise Foundations Program is a multi-year initiative whereby the Company and other affiliates of The Southern Company are implementing a suite of new upgraded solutions to replace varying dated applications, such as for accounting, human resources, and supply chain functions. The Company explained, for example, that the program is replacing Southern Company Gas' primary accounting, human resources, and supply chain program, PeopleSoft, which was deployed between 1998 and 2001, and is now at the end of life. The Company maintains that Enterprise Foundations will bring the Company up to modern standards and, as a cloud-based platform, continue to evolve with the pace of technological change. The program would also bring all participating affiliates of The Southern Company into closer alignment, which will promote future efficiencies. The Company notes that the AG found the costs associated with the program, including the correction to the gross plant, to be reasonable.

Nicor Gas noted that IIEC/CUB witness Gorman proposed a $9.6 million adjustment related to Enterprise Foundations in direct testimony, asserting that the Commission should not allow an increase in AGSC costs until the Company proves that

the obsolete costs have been removed from the Test Year. In rebuttal testimony, Nicor Gas witness Kim explained that the IIEC/CUB proposal was inappropriate, as AGSC and Nicor Gas have fully depreciated or retired these applications prior to the Test Year. Consequently, there is no net asset value or depreciation expense related to the retiring applications in the Company's Test Year. Nicor Gas also noted that IIEC/CUB witness Gorman never addressed Mr. Kim's rebuttal testimony, nor did IIEC/CUB support this suggested disallowance in briefs. The Company asserts that there is no basis to adopt the adjustment suggested in IIEC/CUB's direct testimony, as the proposal was subsequently abandoned.

b. IIEC/CUB's Position

IIEC/CUB witness Gorman testified that the Company did not show that the increase in AGSC costs of $9.6 million based on the Enterprise Foundation program for information technology ("IT") is offset by a decrease in AGSC costs associated with the legacy or obsolete IT being replaced. IIEC/CUB Ex. 1.0 at 25. Mr. Gorman recommended that the Commission not allow the increase in AGSC costs until the Company proves the obsolete costs have been removed from its test year cost of service." *Id*. at 26.

c. Commission Analysis and Conclusion

The Commission notes that IIEC/CUB does not address this issue beyond direct testimony. Nicor Gas explains that AGSC and Nicor Gas have fully depreciated or retired these applications prior to the Test Year. Accordingly, the Commission finds there is no basis to adopt any adjustment to the increase in AGSC costs based on the Enterprise Foundation program.

5. Pension/OPEB Costs

a. Nicor Gas' Position

Nicor Gas opposes the AG's and Staff's proposed adjustment to the Company's Pension and OPEB expense based on an actuarial study released in May 2021 ("May 2021 Study"). The Company provides two reasons why the Commission should not adopt the adjustment. First, Nicor Gas witness Kim stated that the May 2021 Study does not represent a more refined or better estimate of final 2022 pension and OPEB costs. The Company explains that its benefits costs for both its pension plan and OPEB are comprised of four components: "(1) a service cost, which represents how employees 'earn' their pension as they provide service; (2) an interest cost, which represents the increase in pension obligation due to the passage of time; (3) an expected return on plan assets, which assumes a certain level of asset appreciation that reduces benefit cost and is adjusted for contributions and benefit payments; and (4) amortization of any gains/losses that are allowed to be deferred and recognized over time." Nicor Gas Ex. 4.0 at 58. Mr. Kim further explained that because the underlying cost factors constantly fluctuate, it will not be possible to determine the final 2022 pension and OPEB costs until March or April 2022, when a comprehensive actuarial valuation is performed. As such, interim changes in the underlying figures between when this rate case was filed and the final comprehensive actuarial valuation lack value because they lack predictive power as to what the final costs will be. Consequently, taking one data point in isolation is unreasonable.

Nicor Gas also avers that adopting the proposed adjustment violates the prohibition against single-issue ratemaking. Here, the Company cites to the Illinois Supreme Court decision in *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 166 Ill. 2nd 111, 137 (1995) ("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."). The Company points to the fact that while the AG and Staff seek to reduce pension and OPEB expense based on data from May 2021, they fail to make other adjustments where expenses have increased since Nicor Gas filed this case on January 14, 2021. Nicor Gas witness Kim pointed to the fact that the Consumer Price Index increased each month between January and May 2021, and that gas prices rose nearly 30% during the same period. Yet, neither the AG nor Staff seek to recalculate the Test Year revenue requirement to account for these fluctuating costs. The Company argues that this is precisely the reason why there is a prohibition against single-issue ratemaking - the Commission should not look at variations in cost for one component of the revenue requirement and ignore other variations absent, of course, exigent changes in circumstances. On this point, Nicor Gas 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 released during the pendency of a rate case is antithetical to the purpose of a future test year, which identifies forecasted costs at the time of the Company's filing. Reliance on such contemporaneous data as it is published would result in an endless rate case process. Accordingly, the Company argues that the AG's and Staff's recommendations should be rejected.

b. Staff's Position

Staff recommends that the Commission adjust Nicor Gas' Pension and OPEB Expense, Net Retirement Benefits, and Capitalized Pension and OPEB balances to reflect the accounting impacts of the most recent actuarial study on the revenue requirement. An estimate derived from more recent information is likely to be more accurate than an older estimate used by the Company, because it considers changes in circumstances that may have occurred since the previous estimate was performed. The updated actuarial estimate at issue is likely to produce a more accurate cost of service for the Company's 2022 test year because it considers 2020 information, whereas the previous actuarial report was based on information through 2019.

Staff states that using the most recent actuarial report is also consistent with the Commission's rules. 83 Ill. Adm. Code 285.305(g) requires the most recent actuarial report supporting post-employment benefits as a general information requirement. The actuarial study that accompanied Nicor Gas' filing was dated October 2, 2020, and contained projections to reflect actual experience through December 31, 2019, along with future expectations. Thus, the Company's revenue requirement was based on data provided within the prior year's experience and future expectations at the time.

Staff explains that, consistent with 83 Ill. Adm. Code 285.305(g), in response to AG DR 12.04, the Company provided an updated actuarial study, which contained projections to reflect actual experience through December 31, 2020 along with current expectations about the future. This updated study was distributed to the service list via email on Friday, May 7, 2021, at 4:43 pm. Because Staff and Intervenor direct testimony

was due on May 11, 2021, Staff and Intervenor witnesses had extremely limited time to review the most recent study. Despite the Commission rule requiring Nicor Gas to provide the most recent study in its filing (83 Ill Adm. Code 285.305(g)), the Company wants the Commission to just ignore it. Nicor Gas Ex. 20.0 at 16.

Staff explains that, using the updated study shows that A&G expenses should be reduced by $3,057,000 to reflect updated pension and OPEB costs, and depreciation expense should be reduced by $26,000. The update also resulted in a net decrease to rate base of $788,000 ($815,000 reduction to Plant in Service minus $26,000 reduction to Depreciation Reserve minus $1,000 reduction to Accumulated Deferred Income Taxes). In its rebuttal testimony, Staff agreed with the AG's initial adjustments, made in AG witness Selvaggio's direct testimony, to reflect the updated actuarial study. Staff Ex. 8.0 at 9 and Schedule 8.02. Staff's adjustment was revised to adopt the AG's proposed adjustment, as reflected in the AG's rebuttal testimony. AG Ex. 4.1, Schedule A11.

Staff concludes that the Commission should reduce pension and OPEB expenses by the amounts reflected on AG Ex. 4.1, Schedule A11 and Staff Initial Brief, Appendix A, Schedule 12. All are based upon the most recent actuarial study.

Finally, Staff is well aware of the Commission's past practice of reflecting the most current information for pension and OPEB costs in the test year revenue requirement. For instance, in Docket No. 20-0308, a very recent Ameren Gas rate case, even though the most current actuarial study ended up benefiting Ameren Gas and increasing rates, Staff did not object to Ameren Gas' proposal to reflect the most recent actuarial study in its rates. Staff did express concern in that case that future updates might be made too late in a proceeding to evaluate the new information. *Ameren Ill. Co. d/b/a Ameren Ill*., Docket No. 20-0308, Order at 31 (Jan. 13, 2021). However, Staff notes, timing is not an issue here, where the study was made available shortly before direct testimony was due and well before rebuttal testimony was due. AG Ex. 1.0 at 28.

c. AG's Position

In compliance with 83 Ill. Adm. Code 285.305(g), the Company based its projected 2021 and 2022 Pension and OPEB costs on an October 2, 2020, actuarial study, included in the Company's initial filing. AG Cross Ex. 2. In response to AG DR 12.04, the Company provided an updated actuarial study, received by the AG on May 7, 2021. AG Ex. 4.0 (Rev.) at 29. The AG contends that the updated study demonstrates that the Company's projected 2021 and 2022 pension and OPEB costs are overstated, requiring a three-part adjustment to A&G Expense, Retirement Benefits Net, and the Company's capitalized 2021 and 2022 pension and OPEB costs.

Nicor Gas argues that the Commission should ignore this update because it "is simply a data point [and] does not represent a more refined or more likely estimate of the final 2022 pension and OPEB costs." Nicor Gas Ex. 20.0 at 16. The Company suggests that "mere [cost] fluctuations, whatever they turn out to be and particularly in isolation, should not affect the Test Year calculations." *Id*. Nicor also argued that "by proposing an adjustment to discrete items based on just one new data point, Ms. Selvaggio runs afoul of the rule against single-issue ratemaking." Nicor Gas IB at 59.

The AG argues that, in addition to the fact that the same arguments could apply to the 2020 actuarial study, 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 notes that clearly this requirement is intended to assure that the most recent pension and OPEB expense is included in rates; otherwise, this requirement would be pointless, and 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, 967, 755 N.E.2d 98, 103 (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 further cites the Commission's decision in Nicor Gas' last rate case that rejected the Company's argument that it should ignore an adjustment based on an updated actuarial study. The Commission stated:

> 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.

18-1775 Order at 69-70. The AG concludes that Nicor Gas has provided no viable reason to deviate from this reasonable and well-supported conclusion.

With respect to the Company's allegation of single-issue ratemaking, the AG responds that this argument is entirely without merit. The AG states that 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." *See, e.g., Citizens Util. Board v. Ill. Commerce Comm'n*, 166 Ill.2d 111, 209 Ill. Dec. 641, 651 N.E.2d 1089 (1995); *People ex rel. Madigan v. Ill. Commerce Comm'n*, 2011 IL App (1st) 100654, para 27; *Commonwealth Edison Co. v. Ill. Commerce Comm'n*, 405 Ill. App. 3d at 411 (Mar. 30, 2011). This, the AG asserts, most generally arises when a single expense item, such as investment in a particular project, i.e., cast iron mains or smart meters, is separated from the total revenue requirement and collected independent of other costs or expenses over several years are combined into a single test year. *BPI II* at 230-231, 244-245 (deferring charges over several years for recovery in rates requires consideration of all costs).

The AG explains that the premise underlying the prohibition against single-issue ratemaking is that a utility's revenue requirement is based on the totality of expenses, investments, cost of capital and revenues, and that changes in one expense may be offset by changes in other expenses. A rate case is the forum where all the factors that go into a revenue requirement are considered, and single-issue ratemaking does not ordinarily arise in that circumstance. In this docket, the pension and OPEB expense is one factor that goes into the revenue requirement. The AG argues that Ms. Selvaggio's adjustment does not remove the expense from the revenue requirement or the Test Year or suggest special recovery of this expense. Rather, the AG's adjustment to the pension and OPEB expense is an ordinary adjustment to a test year expense that is appropriate because it reflects the most accurate and recent information available for the future test year. *See* AG Ex. 1.1, Schs. A11-A13, Staff IB Append. A, Schs. 12-14.

d. Commission Analysis and Conclusion

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 May 7, 2021. It is reasonable for the Commission to use the most recent study in determining rates. The Commission finds the Company's argument that this constitutes single-issue ratemaking is without merit. In this case, a just and reasonable rate would be one based on the updated actuarial estimate because the updated study contains actual experience through December 31, 2020, consistent with the intent of the Act.

6. Incremental Charitable Contributions

a. Nicor Gas' Position

Nicor Gas proposes a $500,000 incremental increase in charitable contributions expense in order to help address the growing needs of customers and citizens in the Company's service territory, which have been driven, in part, by the pandemic. The focus of the Company's charitable giving includes Basic Human Needs and Energy Assistance, Education, Environmental Stewardship, and Diversity. The Company states that it has presented evidence to support this increase, in conformance with 83 Ill. Adm. Code 325 and 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. The Company notes that no party has presented evidence suggesting otherwise.

The Company observes that the AG is the only party opposed to the Company's proposal and asserts that the AG offers no legal basis to support its adjustment to remove the incremental $500,000 increase. In response to the AG's claim that it is unreasonable to increase the level of charitable expense, Nicor Gas also points to the testimony of Staff witness Pearce, who noted that the current situation underscores the need for more assistance, not less. In the absence of a legal prohibition and given the challenging circumstances that the AG did not dispute, the Company asserts that the Commission should reject the AG's proposed disallowance.

b. Staff's Position

The Commission should accept the Company's proposed increase of $500,000 in charitable contributions from $2.2 million to $2.7 million for the 2022 Test Year. Staff accepts the Company's assertion that Nicor Gas will receive increasing requests for assistance to customers in its service territory. The reasons for Staff's acceptance of the expected increase are: (1) the impact of Covid-19 and the attendant financial hardships it imposed on individuals, businesses and institutions is on-going; and (2) Staff's acceptance of the Company's assertions that the additional $0.5 million that was approved in the most recent prior rate case, Docket No. 18-1775, will eventually be distributed. Staff Ex. 7.0 at 22.

Although the AG worries that Nicor Gas customers are already having difficulty paying their gas utility bills, AG witness Selvaggio attributes this to increasing rates, partly due to the QIP surcharge and partly due to higher costs of gas supply. AG Ex. 1.0 at 12-14. In Staff's opinion, this supports the need for more assistance, not less. Staff Ex. 7.0 at 22. Accordingly, Staff does not support the AG's proposal to reduce the cost of charitable contributions proposed by the Company for the 2022 Test Year.

c. AG's Position

The Company seeks to increase its level of charitable contributions included in base rates by $0.5 million, from $2.2 million approved in the 2018 rate case to $2.7 million. Nicor Gas Ex. 3.0 at 29; 7.0 at 3; AG Ex. 1.0 at 10.

Nicor Gas witness Beyers argued that this increase is needed to meet the "increased needs of the community in light of the current pandemic and the State of Illinois' fiscal situation." Nicor Gas Ex. 7.0 at 3. The AG responds that Nicor Gas customers have limited resources constrained by their own increasing financial needs and are already making significant contributions to "meet the needs of the communit[ies] in light of the pandemic." AG IB at 50-51. The AG argues that Nicor Gas has not justified a further 22% increase in charitable charges to consumers for contributions to the organizations that Nicor Gas – not consumers – deems appropriate. The AG notes that of course Nicor Gas can make unlimited charitable contributions at shareholder expense without Commission approval, as is the practice in other states where Southern Company's subsidiaries operate electric or gas utilities but are not allowed to make charitable contributions using ratepayer funds.

In the Company's last rate case, Docket No. 18-1775, the Commission approved a $0.5 million (a close to 30% increase) in charitable contributions for energy assistance initiatives and programs to address "increased needs of the community." The AG argues that since then and as a result of the COVID-19 pandemic, utilities, including Nicor Gas, created bill payment assistance programs, funded by consumers, that provide eligible residential customers with relief from high arrearages incurred as a result of financial hardship caused by pandemic. AG Ex. 1.0 at 10-11. The stated intent of those programs is to assist customers affected by the current economic and health crises, slow the growth and minimize the total amount of arrearages, and reduce the uncollectible costs recovered from residential customers through rates. *Id*.

The AG states that Nicor Gas ratepayers have provided $7.5 million for the Bill Payment Assistance Program through the Company's Rider 39 Special Purpose Charge ("SPC"), and another approximately $9 million for customer assistance in the Spring of 2021 from revenue that had been over-collected from customers under its Rider 26 Uncollectible Expense Adjustment during 2020 and which was redirected to fund SPC.

AG witness Selvaggio pointed out that this $16.5 million ($7.5 million + $9 million) in incremental funding provided by ratepayers is in addition to the recovery of the Company's actual costs of uncollectible expense surcharge under the Rider 26 Uncollectible Expense Adjustment. Further, she argued, the Company's uncollectible expense was $17.451 million in 2019 and is projected to increase $5.6 million or 32.1% to $23.049 million in 2022. The AG concludes that these ratepayer contributions toward community welfare are already significant, and that while the AG supports Nicor Gas expanding its charitable giving, that expansion should be at shareholder expense.

The AG also argues that the financial pressure facing Nicor Gas customers is evident in the fact that, in March 2021, 20% of the Company's residential customers were assessed late payment fees or charges, meaning that they were not able to pay their bill in full the prior month. And this percentage does not include the Nicor Gas customers who received Low Income Home Energy Assistance Program ("LIHEAP") and Percentage of Income Payment Plan ("PIPP") in March 2021 and customers on deferred payment agreements ("DPAs"). The AG contends that these DPAs, arrearages, late fees, and number of LIHEAP/PIPP participants show that while ratepayers are already funding significant charitable assistance, the $26.9 million in energy assistance funding that was received by Nicor Gas customers in 2020 has still left many customers struggling to pay their bills. The AG argues that Nicor Gas' approach of attempting to increase customer charges by 58% since 2018 (from $1.7 million identified in Nicor Gas' 2018 rate case to $2.7 million) for additional charitable contributions that Nicor Gas selects, does not help energy affordability but makes it worse, by burdening all ratepayers with Nicor Gas' discretionary expenditures. Given the substantial revenue increases Nicor Gas has received from ratepayers for charitable assistance and community welfare, further Nicor Gas charitable giving should be funded by Nicor Gas shareholders.

The AG asserts that if Nicor Gas is granted its requested increase, rates will include approximately $267.223 million in profit for its shareholders, giving the Commission confidence that if Nicor Gas chooses to incrementally increase its charitable giving, there are sufficient shareholder funds and it is reasonable to expect Nicor Gas to use shareholder funds for this purpose. Ms. Selvaggio also pointed out that for a typical residential customer Nicor Gas is requesting an astounding 29.7% increase in delivery rates. AG Ex. 1.0 at 12-13. Further, the AG adds, its ongoing and increasing QIP charge further contributes to ratepayers' increasing financial burden. Company witness Hudson testified that a typical residential customer will experience an average annual increase of 8.37% in their annual natural gas bill – including gas supply charges – compared to current rates. Nicor Gas Ex. 1.0R at 4. And although significant, this percentage markedly understates the 32% revenue increase being requested by Nicor Gas. The AG notes that Mr. Hudson's percentage masks the increase in revenues for Nicor Gas delivery service by incorrectly assuming a continued low cost of gas supply recovered

through its Rider 6 – Gas Supply Costs and ignoring the continued substantial levels of QIP spend and other rider charges.

Ms. Selvaggio also stated that her support for an increase in charitable contributions in the Company's last rate case, Docket No. 18-1775, was conditioned on the Company using that increase to specifically fund energy assistance grants. AG Ex. 1.0 at 14. Record evidence demonstrates that Nicor Gas customers did not begin receiving assistance in the payment of their gas bills until July of 2020, and less than half of the $0.5 million was actually applied to customers' bills in 2020 despite the pandemic and increased residential arrearages. *Id*.; AG Ex. 1.2 at 8-9. This, the AG argues, means that more than half of the funding provided in 2020 is still available to be applied to customers' bills in 2021, in addition to the $0.5 million in new funding in 2021. The AG states that the Commission should not require consumers to fund more charitable giving when the Company has not fully spent the funds already provided by consumers. The AG also asserts that the Company's "confidence" that customers will "ultimately receive all allocated assistance payments" is insufficient evidence to guarantee Nicor Gas' compliance with the Commission's directive in Docket No. 18-1775.

The AG concludes that Nicor Gas ratepayers are burdened enough with their own financial obligations and Nicor Gas' continuously increasing rates. The AG asserts that it is not Nicor Gas' responsibility to increase this burden by imposing additional ratepayer-funded philanthropy, and that if Nicor Gas wishes to increase its influence on "Illinois' fiscal situation" or its contributions to the "needs of the community," it can do so with shareholder funds and with the funds it already collects from ratepayers that are designated for energy assistance and charitable giving. The AG asks that the Commission find that the increase in ratepayer-funded charitable giving to be unreasonable given both that the 30% increase allowed last year was not spent in a timely manner and that ratepayers are already funding significant charitable and welfare giving despite the burdens of steadily increasing Nicor Gas base, QIP, and other charges.

Finally, the AG concludes that an additional reporting is required to ensure the Commission that the funds it approved in the last rate case were used, and will continue to be used, to reduce the energy bills of Nicor Gas customers. The AG requests that the Commission supplement its annual reporting requirements set forth in its *18-1775 Order* to include the following information as articulated by Ms. Selvaggio's in AG Ex. 1.0 at15 and AG Ex. 4.0 (Rev.) at 13:

(1) name of each organization receiving funds from the incremental $0.5 million funding for customer energy assistance;

(2) amount donated to each organization;

(3) number of customers that received energy assistance from each organization each month;

(4) the name of the program used to distribute the assistance; and

(5) the amount of energy assistance received by customers from each organization.

d. Commission Analysis and Conclusion

Nicor Gas proposes to include an increase of $500,000 in general charitable giving, resulting in $2.7 million of charitable contributions in the 2020 Test Year. Section 9-227 of the Act allows recovery of these funds if they are for the public welfare or for charitable scientific, religious, or educational purposes. The Commission notes that no party presented evidence demonstrating that the proposed general charitable contributions do not comply with the Act or Commission rules. Moreover, the Commission agrees with Staff that more charity is needed in current times. Accordingly, Nicor Gas' request for a $500,000 increase in general charitable contributions is approved, which results in $2.7 million of charitable contributions in the 2020 Test Year.

The Commission further finds that the AG's proposed additional reporting requirements on the remaining funds approved in the last rate case is not necessary. Nicor Gas made assurances that those funds will be distributed.

7. Smart Neighborhood Project

a. Nicor Gas' Position

Nicor Gas maintains that the Smart Neighborhood Project ("SNP" or "program") presents the Commission with the opportunity to engage lower-income households in a renewable technology revolution that has largely been open only to more affluent customers. In particular, Nicor Gas asserts that the research and development program will explore the role that natural gas can play in expanding affordability and access to renewables while ensuring energy reliability and reliance. The Company will work with the National Renewable Energy Laboratory ("NREL") and Habitat for Humanity to create a smart neighborhood consisting of 40 to 50 single-family homes in the southern suburbs of Chicago. Nicor Gas will not be involved in the construction of the homes. Rather, the SNP will focus on leveraging a variety of energy sources to expand the adoption and resilience of renewables. In particular, Nicor Gas will provide energy-related components for the homes, including home energy management systems that rely on photovoltaic panels as a primary energy source, energy efficient natural gas appliances, and a natural gas generator as a backup to maintain resilient and reliable operations. In addition, these homes will also be retrofitted or built with high levels of insulation, various connected and energy-efficient technologies, and other sustainability features Unlike past efforts that look at these components in isolation, the SNP will show how the suite of technologies work in concert and can be used to reduce gas and electricity consumption.

The Company has explained in detail the learnings this program will generate and the benefits such learnings will have. Nicor Gas maintains that these benefits outweigh the estimated costs of $2.3 million in the Test Year ($2 million Operations & Maintenance ("O&M"), and $300,000 capital costs) and $5.25 million total. The Company's ultimate goal is to understand better how a smart community can be created in a setting that is accessible to more customers. Nicor Gas has demonstrated that this concept is worthy of exploration.

Staff and intervenors do not challenge the program or its stated goal as a whole, but rather critique individual components. Nicor Gas maintains that this ignores the holistic nature of the program and its potential benefits and learnings which depend on

the way in which each of the components work together to reach net zero while remaining affordable. EDF/CUB witness Hill acknowledged the value of the program's back-up power source, focus on low-income customers, and valuable potential learnings. Despite this, the Company maintains that Dr. Hill focused on each program component individually in his criticism.

The Company asserts that it has provided evidence that Staff and Intervenor opposition is reflective of preconceived notions about the needs of low-income customers and outdated views of utility innovation. The Company also explained how the program could be scalable and help promote learnings about the optimal energy mix for all customers as our energy culture changes in light of the climate concerns. In sum, the SNP will assess whether the right combination of components for a residential structure can create an affordable net-zero community that delivers reliable and resilient energy.

b. Staff's Position

Staff recommends that the Commission reject the SNP. The proposed goal of the SNP is to provide "meaningful information about how the existing natural gas distribution system enables and supports an affordable net-zero community while meeting the needs of low-income customers." Nicor Gas Ex. 34.0 at 2.

EDF/CUB note that while this goal of learning more about how to use the gas distribution system appears laudable, the details about what is going to be learned make this program unnecessary and costly. Staff states that most of the supposed learnings are widely known. EDF/CUB Ex. 1.0 at 4. The addition of gas-powered backup generators seems to be the only new aspect of this program that might provide incremental knowledge over what has been gained from previous research. Staff points out that much of the technology that is included in the SNP relates to technology that is installed to electric distribution systems and many pilots have already studied these technologies and would be available to Nicor Gas through the Gas Technology Institute ("GTI"). Staff Ex. 13.0 at 15-16.

Staff recommends that the Commission reject the Company's SNP and remove the program's $2.3 million cost (Nicor Gas Ex. 7.0 at 24) from the Company's rate base.

c. AG's Position

The AG contends that the Commission should reject the inclusion of this expense in base rates because Nicor Gas ratepayers should not be fully funding a project that focuses on electricity and natural gas efficiency and that benefits only a handful of customers without a comprehensive energy efficiency analysis.

The AG argues that the Company did not explain why this project was not included as an energy efficiency program under Section 8-104 of the Act. Further, the AG notes, that the project would unlikely be subject to an energy efficiency cost effectiveness standard given it is targeted towards low-income customers.

The AG also asserts that the Stakeholder Advisory Group ("SAG") was established by the Commission for the sole purpose of facilitating the design, implementation, and measurement of potential and actual successes and failures of energy efficiency measures and programs. The AG argues that this group has the expertise to properly analyze and weigh a proposed program cost against any alleged energy savings and

associated carbon reductions, has experience with various energy efficiency projects, and is in the best position to evaluate any identified learnings. Further, the AG notes that the issues raised by EDF/CUB witness Hill with respect to the "key principles that should be applied to the design and consideration of pilots" are part of the energy efficiency measurement and program vetting process. EDF/CUB IB at 11. The AG states that the SAG, along with its plethora of expert subcommittees, is the appropriate forum to discuss and critique a proposed energy efficiency program, not a general rate case. The AG concludes that the record is incomplete, and it is unreasonable to charge Nicor Gas ratepayers for a project that focuses on carbon reduction, electricity and natural gas efficiency, and that benefits only a handful or customers without a comprehensive and well-informed energy efficiency analysis. *Id*.

Finally, the AG argues that entities that have not funded the project will benefit at the expense of Nicor Gas ratepayers, which is unreasonable and imprudent. Ms. Selvaggio pointed out that the NREL, Nicor Gas' primary research partner, and the GTI, a secondary research partner, providing the modeling of the technology, advising, and consulting on the design of the project, are not providing any funds to support the costs associated with the program. AG Ex. 1.0 at 16. Yet, Ms. Selvaggio noted, the learnings and experience gained through the program will be enjoyed by NREL and GTE, as well as its members and clients. Ms. Selvaggio stated that Nicor Gas has also agreed to share non-confidential information with interested stakeholders, including other utility companies. *Id*. Nicor Gas argues that these other utilities and stakeholders are not funding the project either but will likely seek to capitalize on the learnings and experience gained through it. Ms. Selvaggio asserted, if the SNP is deemed worthwhile, the capital costs and expenses should be funded by external collaborative R&D entities, such as the GTI, the American Gas Foundation, or Nicor Gas' shareholders.

The AG notes that Staff witness Brightwell agreed with Ms. Selvaggio's reasoning and her conclusion that this program be rejected by the Commission; however, the Staff revenue requirement schedules do not remove the costs of the program from the Staff proposed revenue requirement. Staff Ex. 13.0 at 15-16. The AG further notes that EDF/CUB witness Hill also recommended that the Commission deny the inclusion of the SNP's costs in the proceeding, and that they are more appropriately considered in the context of Nicor Gas' energy efficiency portfolio. EDF/CUB Ex. 2.0 at 2-14.

Ms. Selvaggio's adjustment reduces distribution expense by $2.0 million, depreciation expense by $0.005 million, and rate base by $0.148 million.

d. EDF/CUB's Position

As a threshold matter in considering both the SNP and TotalGreen, EDF/CUB explain that proposals like these are not unique – across the country, states and commissions are considering how to best manage the natural gas transition to a decarbonized energy system of the future. EDF/CUB note that methane's outsized impact on climate change, state and local climate commitments, increasing access to and decreasing costs of clean energy alternatives, and the likely trade-off of continued emissions or costly stranded assets are all being discussed today nationwide through state public utility commission processes. EDF/CUB further suggest that, while natural gas utilities should test and implement alternative fuel pilots and innovative demand-side

alternatives to existing natural gas use, such alternatives should include careful guardrails to guarantee emissions reductions and protect vulnerable customers from cost increases. EDF/CUB assert that the pilot programs proposed in this case demonstrate several things: one-off utility proposals in varied tariff proceedings are neither judicially efficient nor necessarily effective at achieving cost-effective, equitable decarbonization; pilots intended to serve community needs should include meaningful community input; and holistic, inclusive, transparent gas system planning is urgently needed in Illinois.

EDF/CUB continue that the SNP and TotalGreen proposals are part of a growing trend within the natural gas and utility regulation industries. While natural gas use was once considered by some to be an inexpensive form of "clean" energy, EDF/CUB explain that science has now shown that natural gas use has an outsized impact among greenhouse gases as a contributor to climate change. A molecule of methane contributes much more to the rate of climate change than a molecule of carbon dioxide. It is therefore particularly important to reduce the amount of methane escaping into the atmosphere in order to rapidly slow the rate of global warming. EDF/CUB aver that emissions, particularly methane emissions from natural gas, are not just from its on-site combustion by end use customers. In fact, say EDF/CUB, upstream emissions of methane (source to end-use) are significantly higher than previously understood, and new tools empower utilities and regulators to calculate the true emissions impacts of natural gas from extraction to end use. In light of this reality, EDF/CUB point out that states and cities across the United States (including in Illinois) have implemented ambitious but achievable climate goals that will require substantial reductions in emissions from buildings in order to meet targets – with some states even moving to ban new natural gas hookups. EDF/CUB contend that the movement toward equitable solutions for reducing emissions from natural gas is hastening, and for good reason.

EDF/CUB argue that Nicor Gas has not met its burden of proof to demonstrate that SNP is prudent and reasonable. EDF/CUB provided evidence to demonstrate that SNP would subsidize the cost of a number of existing clean energy technologies, plus a natural gas backup generator, for Habitat for Humanity homes. While EDF/CUB acknowledge that it has several positive characteristics and commendable goals of improving affordability, reliability, and clean energy access for underserved communities, EDF/CUB assert that the costs of SNP are excessive relative to the individual components, most interventions are well understood, and the costs do not justify the purported benefits. EDF/CUB witness Hill closely examined the SNP and concluded that it does not meet critical principles for approval of a pilot program and does not demonstrate a level of new learnings to justify the proposed costs and associated ratepayer funding request. He explained that the "new learnings" of this pilot are primarily attributable to the use of on-site natural gas electric generators. EDF/CUB respond to Nicor Gas' complaints about their focus on the gas generator by explaining that the gas generator is the most unique aspect of the program. Other elements of the program, including energy efficiency measures, roof-top photovoltaics, and, to a somewhat lesser degree, smart home energy management systems, say EDF/CUB, are well understood and increasingly widely deployed all over the country. Furthermore, Dr. Hill testified that the costs of the equipment and labor for the program ($50,000 to $70,000 per household), and for the additional operations, management, and natural gas system expenditures ($35,000 to $106,000 per household) are much greater than other equivalent projects around the

country that produce similar benefits. Dr. Hill concluded that, if the potential benefit to be tested is simply use of an on-site natural gas electric generator as a resilience or demand response resource, that may be better suited as an electric utility pilot rather than a natural gas utility program. EDF/CUB maintain that expanding utility services and sales is primarily in the Company's interest, not its ratepayers, and therefore it is more appropriate for the Company's shareholders to fund this project. EDF/CUB continue that while Nicor Gas may be interested in testing this new business model, it should instead engage with the customers to be served and determine their priorities. EDF/CUB recommend that, in the context of a transparent, inclusive, comprehensive system planning proceeding, Nicor Gas, stakeholders and the Commission could design a pilot program that achieves community goals and aligns with long-term natural gas plans and climate goals.

EDF/CUB further assert that the exceedingly high costs of the program as proposed relative to existing programs that provide similar benefits at lower cost belie the Company's arguments regarding scalability as "new learning." Moreover, say EDF/CUB, this program is unique in that Habitat for Humanity is building the homes and thus the efficient furnaces, windows and insulation are additional costs that Nicor Gas or another third-party would have to take on in the future. EDF/CUB aver that this would be prohibitively expensive, particularly on top of the already high costs of the other program elements. EDF/CUB conclude that the program is not likely to result in learnings on scalability, other than demonstrating that replicating the current design would be too expensive in the future. EDF/CUB aver that with limited resources, the Company should leverage funds to strategically support incremental efficiency gains that will cost-effectively benefit customers.

EDF/CUB argue that Nicor Gas' reasoning throughout is speculative and circular. The Company argues that the program should be approved because there may be benefits and new learnings, but Nicor Gas will not know if there are benefits or new learnings unless the Company does the pilot. According to Nicor Gas, the costs of the program should be approved because they may be reasonable, but Nicor Gas will not know whether the costs are in fact reasonable at-scale without the program. EDF/CUB question that learnings from SNP will help the Company better understand what the community wants when community input was not included in the program design. EDF/CUB argue that the burden is on the Company to demonstrate that the program meets priority needs and that it meets four important criteria for pilots: accountability, scalability, equity and inclusivity, and reduction of greenhouse gas emissions. This program does not.

EDF/CUB contend that, given the limited resources available to support high-performance affordable housing, it is incumbent on the Company to tailor proposed pilot and technical solutions to match the priorities of participants and to test strategies that are scalable and replicable. EDF/CUB maintain that the best way for Nicor Gas to design a pilot that supports and demonstrates high-performance affordable housing is for pilot design and development to proactively seek community input and design the pilot in the context of a broader future of gas planning study. Rather than a "battle of the experts" in a utility rate case, EDF/CUB conclude that a holistic, inclusive planning process that empowers communities to robustly participate and speak for themselves should be used to design pilots like SNP. EDF/CUB propose that the Commission take an active

leadership role in addressing these issues in a comprehensive way by initiating that process.

e. IPGA's Position

IPGA opposes implementation of Nicor Gas' SNP pilot program, but if the Commission permits its implementation, IPGA recommends that none of the $5.25 million associated with the SNP be recovered from Nicor Gas' customers. IPGA agrees with the AG and EDF/CUB witnesses who criticize Nicor Gas' claims of benefits and valuable "learnings" to be gained under the SNP. IPGA supports the recommendations of the AG, EDF/CUB, and Staff concerning the SNP.

When the Commission evaluates the benefits of the SNP alleged by Nicor Gas, IPGA specifically encourages the Commission to recognize Nicor Gas' history of making exaggerated claims to obtain desired regulatory outcomes. IPGA points out to the Commission that in order to receive regulatory approval to spend approximately $17.6 million to extend its gas distribution system in Jo Daviess County, Nicor Gas represented in Docket No. 18-0285 that 1,320 prospective customers would connect to Nicor Gas' system in the first five years after construction of new distribution facilities. After only roughly a year, however, only 10% of the 1,320 prospective customers became Nicor Gas customers. IPGA cites Nicor Gas' most recent annual report submitted under its Rider 33-Designated Extension Service Area (IPGA Ex. 1.1), which indicates that only 138 of the subject customers are taking service from Nicor Gas as of December 31, 2020. IPGA Ex. 1.0. Nicor Gas does not deny or dispute IPGA's point that Nicor Gas' past claims failed to materialize. IPGA encourages the Commission to bear in mind Nicor Gas' history of overplaying the success of its proposals in order to achieve its desired regulatory results. Had Nicor Gas' past projections come to fruition, IPGA asserts that Nicor Gas' claims of broad benefits from the SNP would be easier to accept.

Considering Nicor Gas' tendency to exaggerate and Ms. Selvaggio and Dr. Hill's well-reasoned criticism of the SNP, IPGA avers that the SNP does not merit approval, or at the least, recovery of related costs from ratepayers is not warranted. Rather than endorse a program aimed at maintaining and increasing gas sales at the expense of existing customers, IPGA urges the Commission to reject the SNP.

f. Commission Analysis and Conclusion

The Commission finds that Nicor Gas has not met its burden of proof that the $2.3 million in customer costs is prudent and reasonable.

The Commission agrees with Staff and intervenors that, while the goal of SNP appears commendable, the potential benefits and values are questionable thus making the program unnecessary and costly. Substantive testimony demonstrates that the supposed "learnings" are already known in the industry. For instance, as Staff notes, much of the technology included in SNP relates to technology installed in electric distribution systems that has already been the subject of studies. Therefore, Nicor Gas could obtain the information from other resources, such as GTI, without incurring needless costs for Nicor Gas' customers.

The Commission further agrees with EDF/CUB that the best way for Nicor Gas to achieve its goal to support an affordable net-zero community is to seek community input

and potentially be part of a broader and more comprehensive gas planning study, rather than be the subject of a "battle of the experts" in the limited confines of a rate case. The SAG would be a more appropriate forum to first discuss and critique an energy efficiency program such as SNP. The SAG can help the Company develop a more comprehensive energy efficiency analysis prior to bringing the project before the Commission for approval, especially considering the costs associated with such a program.

Accordingly, the Commission approves the adjustment to remove the approximately $2.3 million in expense related to SNP.

8. Customer Payment Fees

a. Nicor Gas' Position

To address customer concerns, improve satisfaction, and satisfy public policy goals, Nicor Gas seeks to eliminate added third-party transaction fees imposed on customers who pay their bills with debit/credit cards, or when using an authorized bill-payment agent. In support of this proposal, the Company points to evidence showing that eliminating these surcharges is both in line with standard industry practice across the country and preferred and expected by customers. On this point, Nicor Gas presented evidence showing that more than 40 utilities around the country now process debit/credit card bill payments without a surcharge, and instead include such costs in base rates. In further support of this proposal, Nicor Gas also points to evidence showing that the proposal would benefit customers with household incomes below $50,000 who pay with electronic bank transfer or debit/credit card at higher rates than other customers. In addition, Nicor Gas explains that this proposal aligns with the Governor's stated policy of eliminating third-party surcharges assessed to individual customers when they pay a utility bill. The Company observes that no party contested any of these facts.

The Company explains that the estimated annual cost of third-party payment processing charges in the 2022 Test Year is $6.8 million. No party contested that estimate, and Nicor Gas notes that the AG supports including this cost in base rates, while CUB did not object to this proposal. However, Staff does oppose the Company's proposal.

Nicor Gas disagrees with the two points that serve as the foundation to Staff's opposition. The first point concerns the definition of what constitutes a utility service. The Company asserts that Staff's view is too narrow, and that it does not reflect the evolving nature of customers' views on what constitutes a utility service. Nicor Gas points to the evidence showing that technological advancements have made electronic bill payments much easier as compared to just a few years ago. Further, based on surveys, customers do not want to have a separate surcharge imposed when they pay a bill electronically or when using an authorized payment agent. As such, the Company asserts that customer expectations of utility service include the ability to pay a bill without incurring an additional charge.

The Company also disagrees with Staff's second point regarding the notion of cost causation. Nicor Gas notes that no party disputes the fact that its proposal expands the list of bill payment options that do not impose a direct third-party surcharge and compares this offering to the inclusion of call center costs in base rates. The Company explains

that all customers are allocated a portion of the call center costs even though they may never use the call center. Similarly, Nicor Gas states that under its proposal, any customer has the opportunity to use the services that are currently associated with a third-party transaction fee. Given the availability of this surcharge free service to all residential customers, the Company's proposal does not conflict with cost causation principles.

b. Staff's Position

Initially, Staff witness Pearce recommended an adjustment to remove from the revenue requirement in this proceeding $6.8 million of third-party customer payment fees. Staff contests the Company's proposal to include, for the first time, fees charged by third-parties to a select portion of customers who pay their bills with debit/credit cards instead of cash or a check. These transaction fees are not currently reflected in the utility's rates. Instead, they are paid by the customers who incur them when making payment using debit/credit cards or walk-in payments. Staff Ex. 7.0 at 24. The Company proposed to include an estimated cost of $6.8 million in the revenue requirement to cover the cost of these transaction fees. *Id*. Staff opposes this treatment because it violates the foundational concept of cost-causation that underlies the Act. *Id*. at 27. This concept requires that costs should be borne by those who cause the costs to be incurred. Based on the concept of cost-causation, Staff argues, there is no need to include the cost of third-party payment fees in the revenue requirement because they are already being paid by the cost-causers at the time of the transaction. Moreover, including these costs in the revenue requirement will force customers who never use these services to subsidize the costs for those customers who do. *Id*. at 25. This is unreasonable and unnecessary for the provision of utility service.

Staff points out that the Commission has already considered a similar proposal from Nicor Gas in its 2017 Rate Case, Docket No. 17-0124. In that proceeding, the Commission found that fee-free payments are not necessary to provide utility service, and that the Company is under no obligation, statutory or otherwise, to provide alternative bill payment options to customers without associated fees. *17-0124 Order* at 50.

In Staff's Supplemental Brief, Staff revised its position on this issue. Staff notes that, on September 15, 2021, after passage by the Illinois General Assembly, Governor Pritzker signed Senate Bill 2408, P.A. 102-0662, into law. Staff states that P.A. 102-0662 became effective immediately and includes a prohibition on credit card convenience fees. Based on the plain language of the new provision in Section 8-201.9(a) of the Act, Nicor Gas may no longer "assess any convenience fee, surcharge, or other fee to any customer who elects to pay for service using a credit card." 220 ILCS 5/8-201.9. Therefore, Staff withdraws the adjustment proposed in its Initial and Reply Briefs to remove $6.822 million in third-party customer payment fees from the revenue requirement.

Staff notes, however, that it did not present any testimony in this proceeding on the prudence, justness, or reasonableness of Nicor Gas' proposal to include third-party payment fees in its revenue requirement. Staff therefore takes no position on whether third-party payment fees should be approved by the Commission as an operating expense pursuant to Section 8-201.9(a).

c. Commission Analysis and Conclusion

Staff is the only party that recommended an adjustment to customer payment fees. Due to very recent changes in the Act, Staff withdraws its recommended adjustment to remove from the revenue requirement in this proceeding $6.822 million of third-party customer payment fees. Because Staff's adjustment is withdrawn and there are no further objections, the Company's proposal is adopted.

9. Employee Level and Payroll Costs

a. Nicor Gas' Position

Nicor Gas included 2,153 full-time equivalent employees ("FTE") in its Test Year projection of payroll expense. The Company maintains that this proposal is reasonable and reflects the forecasted payroll expense for the Test Year. IIEC/CUB propose to reduce the payroll expense based on a proposed headcount reduction of 87 positions to reflect historical vacancies. In response, the Company explains that the proposed adjustment wrongly isolates and adjusts for FTEs in a vacuum, when the number of budgeted FTEs is just one of multiple factors used to develop budgeted payroll expense.

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 disagrees with Mr. Gorman's assertion that basing revenue on budgeted FTE headcount is likely to result in over-recovery. In fact, the Company's data shows that average actual payroll expense tends to slightly exceed budgeted average payroll, and that the correlation between headcount and payroll expense is not sufficiently reliable to support an adjustment based on headcount levels alone. The Company maintains that the impact of vacancies is analyzed and appropriately addressed in the development of its payroll budget. 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.

IIEC/CUB attempt to call into question the Company's budgeted payroll expense based on Mr. Gorman's assertion that the Company is forecasting a significant increase in the base O&M payroll in the 2022 Test Year which is not offset by a corresponding decrease in O&M overtime and premium time. Mr. Whiteside explained that the increase in projected Test Year payroll cost was attributable to: (1) additional FTEs for the Company's proposed Leak Priority Response Program; and (2) the Company's projected annual wage increase of 3 percent. When 2022 budgeted payroll expense is adjusted for those two factors, budgeted payroll expense for 2022 actually decreased from 2021 levels. Therefore, IIEC/CUB's argument lacks merit and does not support their proposed adjustment.

IIEC/CUB argue that the Company does not take into account vacant positions in developing budgeted payroll expense based on Mr. Gorman's interpretation of a data request response addressing a different question. Nicor Gas witness Whiteside confirmed that Mr. Gorman's speculation about the Company's budgeted payroll expense was factually incorrect. Mr. Whiteside also explained that Mr. Gorman's assertion was contrary to the demonstrated accuracy of the Company's budgeted payroll expense over

an extended period of time and ignored that it is payroll expense, rather than headcount, which is relevant for revenue requirement purposes. Finally, the Company maintains that Mr. Gorman's interpretation of the Company's data request response was incorrect and unreasonable given prior testimony by Mr. Whiteside that Nicor Gas does not directly adjust its reported budgeted headcount for vacancies, but does incorporate the impact of vacancies by directly reducing estimated payroll expense. Given this explanation in the testimony, the Company's response that it "does not maintain a count of vacancies contained within the budget" is consistent with Mr. Whiteside's testimony that it does not directly adjust its reported budgeted headcount, and is not contrary to Mr. Whiteside's testimony that the "impact of vacancies" is incorporated "by directly reducing estimated payroll expenses computed in step one above." Nicor Gas Ex. 21.0 at 32-33.

b. Staff's Position

The Commission should approve the Company's proposed level of payroll expense in the 2022 test year. Although IIEC/CUB assert that the employee level supports a lower level of payroll cost, the Company explains that headcount is not the only factor in the determination of payroll expense. Other factors include assumptions around vacancies, levels of overtime, utilization of contractors to supplement or supplant employees and changes in the mix of work between operating expense and capital. Staff Ex. 7.0 at 30. The Company supports this contention with data showing that Nicor Gas' actual payroll expense has been within 0.97% of budget during the three-year period ended December 31, 2020, and within 0.66% of budget during the five-year period ended December 31, 2020. Finally, the Company argues that although Nicor Gas' headcount has been below budget, payroll expense has not. *Id*. For these reasons, Staff does not support the adjustment proposed by IIEC/CUB to reduce payroll costs.

c. IIEC/CUB's Position

IIEC/CUB propose a disallowance to Nicor Gas' projected employee level because Nicor Gas has not demonstrated that it will meet its projected number of FTEs, and its historical hiring practices cast serious doubt on its likelihood of hiring its full budgeted amount of employees. IIEC/CUB note the Company plans to increase its workforce by 277 employees to address ongoing operational needs. *Id*. at 12. IIEC/CUB witness Gorman's investigation found Nicor Gas failed to support its employee level forecasts and that only a portion of the proposed employees are required to maintain high quality, reliable service in the forecasted Test Year. As a result, Mr. Gorman recommended an adjustment to Nicor Gas' proposed employee costs to remove costs associated with the proposed employees where Nicor Gas was unable to provide justification to include their cost in the Test Year. Mr. Gorman recommended the Commission adjust Nicor Gas' Test Year employee expense to reflect a normal level of unfilled or vacant employee positions given Nicor Gas was unable to provide justification for the additional employees. *Id*. at 16. IIEC/CUB note this reduces Nicor Gas' test year operating expenses by approximately $8,841,000. *Id*. at 17.

IIEC/CUB assert Nicor Gas only provided justification for a portion of the 277 employees it proposes to hire between now and the end of the forecasted test year. IIEC/CUB note Nicor Gas' data responses provide a short description of the purpose of the 277 employees, which Mr. Gorman analyzed to determine whether the proposed

increase in employee positions is justified. IIEC/CUB Ex. 1.0 at 14. IIEC/CUB witness Gorman does not take issue with the employees where Nicor Gas was able to provide a clear purpose, such as the 133 employees Nicor Gas plans to hire for its Leak Priority Response program, but notes the evidence does not support the justness and reasonableness of the other 87 projected employees Nicor Gas proposes to hire to fill vacancies. *Id*. at 14.

IIEC/CUB explain that an accurate, balanced employee count forecast would be expected to overestimate headcount some years and underestimate headcount other years, with these annual residuals cancelling out over the long term. *Id*. at 12. IIEC/CUB note when comparing Nicor Gas' FTE historical forecast headcounts to its actual headcounts shows this has not been the case. *Id*. IIEC/CUB's concern is that Nicor Gas' test year employee expense, which relies on a budgeted amount of employees, does not account for the fact that Nicor Gas is unlikely to hire its full budgeted amount of employees given the historical hiring practices. As a result, IIEC/CUB argue, not reflecting a normalized level of vacant positions in its test year forecast will allow Nicor Gas to recover more than its actual employee costs when the rates in this proceeding are in effect. *Id*. at 13.

IIEC/CUB emphasize that Nicor Gas admits that it incorrectly forecasted the number of employees and that actual headcount has been below budget, but focuses instead on the fact that it did accurately forecast the overall payroll expense. Nicor Ex. 21.0 at 31-32. In response, IIEC/CUB witness Gorman recreated the budgeted versus actual payroll expense comparison that was developed by Nicor Gas witness Whiteside. IIEC/CUB Ex. 1.0 at 12-13. While Mr. Gorman acknowledges that the Company's evidence shows the 3-year and 5-year actual payroll is comparable to budgeted payroll for the same time period when including overtime expenses, IIEC/CUB note the Company does not address the demonstrated pattern that it has not and likely will not meet its projections in the test year. *Id*. While the three- and five-year average variance between actual and budgeted O&M fixed compensation is consistently lower than the total budgeted O&M compensation, IIEC/CUB note the Company is forecasting a significant increase in the base O&M payroll in the 2022 Test Year, increasing to $137 million from $111 million and $112 million in 2019 and 2020, respectively. *Id*. IIEC/CUB point out this increase is not offset by a corresponding decrease in O&M overtime and premium pay in the Test Year.

IIEC/CUB explain Nicor Gas' historical data shows that the significant increase in its budgeted base payroll expense, which is partially due to filling vacant positions, is not offset by a corresponding decrease in budgeted overtime expense in Nicor Gas' Test Year forecast. *Id*. at 15. Thus, Mr. Gorman concluded that Mr. Whiteside's claim that the Company's increased budgeted payroll costs reflect offsets in other compensation factors is unsupported. IIEC/CUB find the Company's budgeting process does not reflect a normalized level of employee vacancies or costs and must be adjusted to reflect a reasonable cost level and prevent over-recovery.

IIEC/CUB argue the record does not support Mr. Whiteside's assertion that Nicor Gas' Test Year payroll budget incorporates the impact of employee vacancies due to workforce attrition by directly reducing the estimated payroll expense in the forecasted budget. Nicor Gas Ex. 21 at 32. IIEC/CUB note Mr. Whiteside concludes from this

assertion that Mr. Gorman's employee vacancy adjustment is not needed because Nicor Gas' forecast already accounts for a certain level of vacant employee positions. *Id*. at 34. But IIEC/CUB point out Mr. Whiteside's claim that the budgeted payroll expense is adjusted to remove vacant positions is belied by the Company's responses to data requests, which show that Nicor did not account for this attrition in its budgeting process. IIEC/CUB Ex. 3.0 at 14. Therefore, Mr. Gorman concluded that Nicor Gas' proposal to set rates based on its budgeted expense will allow the Company to over-recover its actual employee costs when the rates in this proceeding are in effect. *Id*.

IIEC/CUB argue the Company has failed to show that filling the vacant positions in its forecast will benefit Nicor Gas or its customers with a reduction in ancillary costs like overtime and hiring contractors. IIEC/CUB assert the Company has not demonstrated that its forecasted Test Year costs reflect contractor, overtime and other savings associated with filling vacant positions. Thus, IIEC/CUB suggest the Company's proposed payroll expense should be adjusted to reflect a normalized level of FTEs, as proposed by IIEC/CUB witness Gorman.

d. Commission Analysis and Conclusion

Nicor Gas and Staff oppose the reduction FTEs that is proposed by IIEC/CUB. The Company points out that its actual payroll expense has been within 0.97% of budget during the three-year period ended December 31, 2020, and within 0.66% of budget during the five-year period ended December 31, 2020. Also, the Company provided testimony that headcount is only one factor in the determination of payroll expense, other factors include assumptions around vacancies, levels of overtime, utilization of contractors to supplement or supplant employees and changes in the mix of work between operating expense and capital. Nicor Gas also points out that it needs to hire additional FTEs for the Company's proposed Leak Priority Response Program and a projected annual wage increase of 3%.

IIEC/CUB base their argument on information that Nicor Gas incorrectly forecasted the number of FTEs and that actual headcount of current FTEs has been below budget. However, the Company states that focus should instead be on the fact that it did accurately forecast the overall payroll expense. IIEC/CUB also argue that the Company filling the vacant positions will not benefit Nicor Gas or its customers.

The Commission notes that the Company is in the best position to determine the impact of vacancies and payroll expense. The Company has shown that its headcount may have been below projected levels, however, its payroll expense has not. The Company maintains that the impact of vacancies is analyzed and appropriately addressed in the development of its payroll budget. Nicor Gas has demonstrated that it has provided sufficient evidence showing that its payroll expenses included in the Test Year are reasonable and prudent. The Commission agrees with Nicor Gas and denies IIEC/CUB's proposed reduction in FTE.

10. Interest Synchronization

a. Nicor Gas' Position

The AG proposes interest synchronization adjustments to account for its other proposed adjustments in this proceeding, namely to the Company's rate base and change

in the weight cost of debt. Nicor Gas states that, while it does not dispute AG witness Selvaggio's methodology in computing these proposed adjustments, the Company does not agree with many of the underlying proposed adjustments to rate base and the AG's proposed cost of capital. Consequently, Nicor Gas disagrees with the AG's proposed interest synchronization adjustments and avers that such adjustments should be based on the conclusions set forth in this Order.

b. Commission Analysis and Conclusion

Other than Nicor Gas, no party addressed the interest synchronization in briefs. The Company does not oppose the AG's methodology. Accordingly, the interest synchronization will be calculated based on the non-disputed methodology and the conclusions in this Order.

VI. RATE OF RETURN

A. Uncontested Issues

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

Staff witness Kight-Garlisch recommended 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 Allowance for Funds Used During Construction ("AFUDC"). For purposes of this case, Nicor Gas did not contest this adjustment. This issue is no longer contested and this adjustment is adopted by the Commission.

2. Cost of Long-Term Debt

Staff witness Kight-Garlisch recommended calculation adjustments to the cost of long-term debt related to utilizing weighted average long-term debt and amortization balances in the Test Year, which result in a cost of long-term debt of 3.685%. For purposes of this case, Nicor Gas accepted these adjustments. No other party addressed Nicor Gas' long-term debt costs.

3. Credit Facility Fees

Staff witness Kight-Garlisch recommended removing credit facility fees from the calculation of short-term debt cost and instead utilizing a 2.4 basis point adder to Nicor Gas' overall cost of capital to account for these fees. For purposes of this case, Nicor Gas accepted these adjustments. No other party addressed the credit facility fees.

B. Contested Issues

1. Capital Structure

a. Nicor Gas' Position

Nicor Gas states that its proposed capital structure for test year 2022 is reasonable and appropriate, and no party has provided a legitimate reason for it to be rejected. After accepting Staff's minor adjustments to its calculations, Nicor Gas proposes a Test Year capital structure of 54.459% common equity, 43.965% long-term debt, and 1.576% short-

term debt. Nicor Gas states that its proposed capital structure is substantially similar to its current Commission-approved ratemaking capital structure, which the Company has maintained since before its 2018 rate case. Nicor Gas points out that Staff agrees that this capital structure is reasonable, and Staff witness Kight-Garlisch opines that it is "commensurate with a strong, but not excessive, degree of financial strength." Staff Ex. 3.0 (Cor.) at 10. Nicor Gas argues that there is no evidence that it lies outside the range of reasonable capital structures or represents imprudent financial management. Nicor Gas disagrees with IIEC/CUB witness Walters' opinion, based on a generic analysis not specific to Nicor Gas, that his proposed 52.00% common equity ratio is "fair and balanced," and argues that Mr. Walters does not establish that Nicor Gas' actual capital structure is unjust or unreasonable. No other party presented evidence contesting any component of Nicor Gas' capital structure.

Nicor Gas avers that its proposed capital structure is well supported and appropriately takes into account the Company's need for stable and assured access to capital markets at reasonable costs and terms for financial stability and security and to balance the costs and benefits of leverage. Nicor Gas further states that the proposed capital structure will support the Company's investments and cash flow needs, while maintaining the strong credit ratings the Company has long enjoyed, and further will support its continued financial strength and its continued ready access to the capital markets at reasonable costs. Nicor Gas states that no party disputes the need for a strong capital structure.

Nicor Gas points out that although consistency with other similar utilities is not a requirement, it is useful as an indicia of the proposed capital structure's reasonableness. Nicor Gas points to Staff witness Kight-Garlisch's opinion, based on an analysis specific to Nicor Gas, that the proposed common equity ratio "is consistent with the common equity ratios of other similar companies in the gas distribution industry." Staff Ex. 3.0 (Cor.) at 9. Nicor Gas explains that Staff's analysis looked to the most recent 3-year average common equity ratio for the sample upon which Staff's return on equity ("ROE") estimate was derived and the most recent 3-year average common equity ratio for Atmos Energy Corp., the only company in the Gas Sample that, like Nicor Gas, has credit ratings in the A range from both Moody's and S&P. Nicor Gas argues that this analysis provides a benchmark of similar utilities, while the two analyses performed by IIEC/CUB witness Walters are backward-looking and do not address the specific characteristics of Nicor Gas or of the current interest rates, tax laws (which are critical to capital structure), and demands on the various utilities included.

Nicor Gas states that with Staff and Nicor Gas in agreement that the proposed capital structure is just and reasonable, and the primary capital structure dispute centers on Mr. Walters' opinion that a 52.00% common equity ratio is "fair and balanced." IIEC/CUB Ex. 2.0 at 24. Nicor Gas asserts that Mr. Walters' proposed common equity ratio is based solely on a generic analysis of "average" common equity ratios that fails to consider the details of each company's financial stability, business mix, capital needs, investment plans, or market conditions relative to Nicor Gas. Nicor Gas argues that Mr. Walters' flawed analysis, in addition to other errors identified by Nicor Gas witness MacLeod, uses a proxy group of holding companies (including holding companies with international or electric business) that has a lower average credit rating than Nicor Gas.

Nicor Gas further argues that Mr. Walters' analysis of what common equity ratio will support Nicor Gas' current credit rating also suffered from significant errors, and that despite the fact that correction of these errors materially changed Mr. Walters' analysis—for example his initial calculation that his recommended capital structure would result in a Funds From Operations ("FFO") to debt ratio of 38.1% was, after correction, revised to 23.7%—Mr. Walters' recommendation did not change. Nicor Gas argues that Mr. Walters' refusal to reconsider his recommendations in the face of that change, even where he agreed that the errors should be corrected, cast further doubt on its validity and his objectivity, a point of greater than even normal importance given his absence of any real world treasury experience. Nicor Gas argues that even though identifying an ideal capital structure is not an exact process, as Staff witness Kight-Garlisch acknowledges, Mr. Walters' analysis is particularly inexact.

Nicor Gas states that IIEC/CUB's claims that Nicor Gas' proposed common equity ratio is "excessive" as a benchmark historical average for dissimilar companies that are not relevant to Nicor Gas' needs in the Test Year. Nicor Gas points out that the analysis Mr. Walters performed looks to the average of 2010 through 2019 for gas utilities, as well as electric and water utilities, which have different capital needs than gas utilities, and covers a range of time with different interest rates and economic conditions. In addition, Nicor Gas points out that only two of the nine years of data he reviewed reflect the tax changes implemented by Public Law 115-97, commonly known as the Tax Cuts and Jobs Act ("TCJA"), which went into effect in 2018 and resulted in lower cash flow and a lower FFO to debt ratio for utilities and excluded public utility property from bonus depreciation eligibility, amongst other changes. Nicor Gas explains that these changes warranted greater use of equity to properly fund operations and meet credit metrics. Nicor Gas argues that as conditions change, so should capital structures, and to hold Nicor Gas' proposed capital structure to a ruler of all utility capital structures under historical economic conditions is illogical.

Nicor Gas argues that it has established that its proposed capital structure, which is essentially its current actual capital structure, is just and reasonable, supports the Company's financial integrity and credit standing, and ensures access to capital under reasonable terms and prices, and no party has established otherwise. Nicor Gas points out that the Commission has recognized that "a hypothetical capital structure should only be used when the utility's actual capital structure is found to be unreasonable, imprudent or unduly affected by such circumstances as double leverage as so to unfairly burden the utility's customers." *People ex rel. Hartigan v. Ill. Commerce Comm'n*, 214 Ill. App. 3d 222, 228 (3rd Dist. 1991). Further, Nicor Gas states that the Commission recently re-articulated this standard, stating that "[i]f the utility's actual capital structure is found to be unreasonable, imprudent or unfairly burdensome, then an imputed capital structure […] may be adopted." *18-1775 Order* at 102. Nicor Gas disagrees with IIEC/CUB's characterization of this Commission-approved practice as "deference Nicor seeks[,]" and further disagrees with IIEC/CUB's argument that this practice requires the Commission to "abdicate its role […] as an independent investigator and decider of just and reasonable rates" and would "reduce the Commission to a rubber stamp." IIEC/CUB IB. at 32.

b. Staff's Position

Ms. Kight-Garlisch recommended several adjustments and corrections to the Company's forecasted capital structure. She recommended that the long-term debt and common equity balances be adjusted to recognize the Commission's formula for calculating an AFUDC. Additionally, she observed that in response to Staff data requests, the Company corrected errors in the unamortized discount or premium balances for several debt issuances and reflected the cost associated with each new issuance separately. (Company response to Staff Data Requests SK 1.01, SK 1.05, SK 1.06, and SK 1.07.) Ms. Kight-Garlisch also corrected four other errors in the Company's updated long-term debt schedule. Reflecting these adjustments results in a forecasted average 2022 capital structure that contains 1.576% short-term debt, 43.965% long-term debt, and 54.459% common equity. Staff Ex. 3.0 (Cor.) at 4-5. Nicor Gas accepted Staff's recommended capital structure. Nicor Gas Ex. 18.0 at 1.

Ms. Kight-Garlisch did not address IIEC/CUB witness Walters recommendation.

The Commission should adopt Staff's recommended capital structure, which was agreed to by the Company in this proceeding.

c. IIEC/CUB's Position

IIEC/CUB recommend a ratemaking capital structure that consists of 52.0% common equity. IIEC/CUB Ex. 2.0 at 24. This ratio is higher than the typical 51.85% average across gas utilities in comparable states over the last 6 years. *Id.* at 6, 7: Table 2. IIEC/CUB argue up-to-date actual capital market data demonstrates that a 52.0% common equity ratio is more than sufficient to support Nicor Gas' financial health and continued ability to attract capital. *Id.* at 7-20; IIEC/CUB Ex. 4.0 at 14-17.

IIEC/CUB emphasize Nicor Gas' requested 54.549% common equity ratio is excessive. IIEC/CUB argue a common equity ratio of this magnitude unfairly inflates Nicor Gas' rates and exacerbates the inflated rate of return when considered alongside the Company's requested 10.35% ROE. IIEC/CUB stress adopting Nicor Gas' requested equity ratio would result in a rate of return that exceeds what is reasonably required to attract capital, and therefore the Company's customers would be paying inflated rates.

d. Commission Analysis and Conclusion

IIEC/CUB disagree with the capital structure proposed by Staff and accepted by the Company. IIEC/CUB argue that based on their calculations their proposed capital structure is sufficient to support Nicor Gas' financial strength and ability to attract capital. IIEC/CUB claim to have used up-to-date actual ratios that used an average of the common equity ratios of similarly situated companies. However, IIEC/CUB's analysis fails to consider important details about each company's financial stability, business mix, capital needs, investment plans or market conditions compared to Nicor Gas. The Commission notes that IIEC/CUB's analysis is based on artificial considerations and not necessarily based on factors related to the needs of Nicor Gas.

The Commission agrees with Staff's recommended capital structure. Staff reviewed the most recent 3-year average common equity ratio for the sample group upon which its ROE estimate was based. Staff corrected some errors in the Company's calculations and Nicor Gas also corrected some errors in response to Staff data requests.

The Commission notes that the capital structure recommended by Staff is the Company's current capital structure and is accepted by Nicor Gas. The Commission finds that the analysis by Staff used the many factors related to identifying a reasonable capital structure. The Commission prefers the use of actual data as opposed to IIEC/CUB's hypothetical capitalization. The Commission finds that the forecasted average 2022 capital structure that contains 1.576% short-term debt, 43.965% long-term debt, and 54.459% common equity as proposed by Staff is reasonable and is hereby adopted.

2. Cost of Short-Term Debt

a. Nicor Gas' Position

Nicor Gas asserts that it used reliable forecasts of short-term interest rates during the period when that debt would be outstanding to determine its cost of short-term debt for the Test Year, including interest costs and the costs of the credit facility that supports the debt. Staff proposed two adjustments to Nicor Gas' cost of short-term debt: (1) bifurcating bank facility fees and (2) use of "current day" spot prices to establish the debt cost for the Test Year. Nicor Gas has accepted the bifurcation of bank facility fees, addressed above, so the remaining contested issue related to short-term debt costs is whether to use forecasted debt costs or "current" spot interest rates. No other party contested Nicor Gas' short-term debt costs.

Nicor Gas recommends the use of forecasted debt rates for the Test Year, which after the adjustment described above, results in a recommended short-term debt cost for the Test Year of 0.75%. Nicor Gas argues that the use of forecasted debt rates is particularly important now, given how atypical current conditions are. Nicor Gas points out that short-term borrowing rates are at all-time lows, and very close to the 0% floor, as a result of the Federal Reserve's emergency actions in March 2020. Nicor Gas explains that these emergency actions cut the federal funds rate by 1.5 percentage points, the largest emergency reduction in the Federal Reserve's more than 100-year history. Nicor Gas further explains that these significant emergency actions were intended to be temporary, and Federal Reserve Chair Jerome Powell stated that the Federal Reserve's goal was to help the Unites States "weather this difficult period" and "foster a more vigorous return to normal once the disruptions from the coronavirus abate." Nicor Gas Ex. 32.0 at 17. Nicor Gas states that since those March 2020 actions, the Federal Reserve has held the Federal Funds Rate steady, but in recent months many members of the Federal Open Market Committee have accelerated their projected timelines for when interest rates will rise. Nicor Gas argues that the future rate pressure is much more likely upward than flat or downward, and to argue otherwise intentionally ignores the information we have available. While Nicor Gas does not dispute Staff's statement that no one can predict interest rates with certainty, it points out that assuming current rates is itself an implicit forecast that those rates will not change and an assumption that we cannot do better than to act is if rates will not change.

Nicor Gas argues that the Commission need not adopt general rules accepting or rejecting forecasts in all circumstances and times, but should base its determination on the specific facts in the record and the current market conditions. Nicor Gas argues that the Commission and Staff often rely on forecast data in other scenarios, despite the fact that no economic predictions are guaranteed to be accurate, and that the analysts'

forecasts relied upon by Nicor Gas are reliable, reasonable, and should be adopted by the Commission.

b. Staff's Position

Ms. Kight-Garlisch disagreed with Nicor Gas' use of forecasts in determining its costs of short-term debt. Nicor Gas issues short-term debt in the form of commercial paper rated A-1/P-1/F1 by Standard & Poor's ("S&P"), Moody's Investors Service ("Moody's"), and Fitch Ratings ("Fitch"), respectively. Nicor Gas' actual average weighted cost of short-term debt for March 1, 2021 was 0.13%. Thus, she recommended using the Company's actual cost of short-term debt of 0.13%. Although Mr. MacLeod noted that Nicor Gas' cost of commercial paper increased between March 1, 2021, and March 31, 2021, Nicor Gas Ex. 18.0 at 17, the Company's daily average cost of commercial paper this year from March 1 through June 30 is 0.13%. Further, the Company's average monthly cost of commercial paper for May and June 2021 was 0.12%. Staff Ex. 9.0 at 4-5.

Staff's recommended cost of short-term debt is consistent with the Company's actual cost of short-term debt. The Company forecasted a cost of short-term debt of 0.50% for January through June 2020, which was about three to five times higher than the Company's actual costs over the same period. Forecasting interest rates is problematic. No one can predict with certainty when interest rates will begin to rise, the rate at which they will rise, how long they will rise before falling again, the rate at which they will fall, or even whether they will rise before they fall further. Staff Ex. 9.0 at 3. The Commission has concluded that:

> [P]redicting the direction, magnitude, or timing of future interest rate changes with accuracy is not possible. The Commission observes that the record demonstrates that professional forecasting services relied on by the Companies have consistently over estimated future rates in recent years. Current interest rates have proven to be better predictors of future interest rates than professional forecasters.

Docket Nos. 14-0224/14-0225 (cons.), Order at 111.

Staff explains that, for this reason, the Commission has repeatedly rejected the use of forecasted interest rates and, instead, has relied on current, observable market interest rates. Staff Ex. 9.0 at 3. The problem with accurately forecasting interest rates is evident in the over 0.30% difference between the Company's forecasted rate and its actual rate for the same period. The Company's forecast for the 2022 Test Year is even higher at 0.751%, over 0.60% higher than the Company's current cost of short-term debt and more than five times the Company's current actual cost of 0.13%.

Mr. MacLeod attempts to support his higher forecasted cost of short-term debt by noting that "several members of the Federal Open Market Committee ("FOMC"), which regularly reviews the economic and financial conditions of the US Federal Reserve, indicated that they expect the Fed Funds Rate to increase by 2022." Nicor Gas Ex. 18 at 18. Mr. MacLeod's statement is misleading. The March 2021 report from the FOMC shows that zero members expect the Fed Funds Rate to increase in 2021. Staff Ex. 9.0

at 6-7; Attachment D. Further, that report shows that only four of the eighteen members of the FOMC expect the Fed Funds Rate to increase in 2022. Of those four members who expect an increase in 2022, three expect a Fed Funds Rate of 0.375% and one expects a Fed Funds Rate of 0.625%. In the June 2021 FOMC report, the majority (11) of the FOMC members still are not expecting an increase in 2022. Staff Ex. 9.0 at 6-7; Attachment E. Thus, the Commission should accept Staff's recommended cost of short-term debt of 0.13% instead of the Company's forecasted cost of short-term debt of 0.751%. Staff Ex. 9.0 at 5-6.

c. Commission Analysis and Conclusion

The Commission finds the forecasted averages for the cost of short-term debt provided by the Company troubling and that they over estimate future rates. The Commission has consistently relied on the current market rates when setting the cost of short-term debt. Nicor Gas' attempt to justify the increase based on the statements of several members of the FOMC is not supported by the record and fails to convince the Commission that such a large increase in short-term debt is justified. The Commission agrees with Staff that the Company's actual cost of short-term debt will more accurately reflect the costs than Nicor Gas' forecasted rates. The Commission adopts Staff's recommended cost of short-term debt of 0.13%.

3. Cost of Common Equity

a. Nicor Gas' Position

Nicor Gas explains that a regulated utility's cost of equity, like that of any company, is determined by the demands of equity investors in the capital markets. Nicor Gas further explains that in those markets, utilities must compete with alternative investments with varying financial and operating characteristics and risks, including other gas distribution utilities. For that reason, Nicor Gas argues that it is entitled to a reasonable opportunity to earn a rate of return on its rate base comparable to that investors can expect to earn on investments in equivalently risky firms. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989); *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 622 (1944); *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va*., 262 U.S. 679, 693 (1923).

Nicor Gas states that it presented evidence that, based on market data and investor expectations, its total authorized ROE should be 10.35%, based on robust measures of investor requirements. Nicor Gas explains that total proposed ROE includes 10 basis points to recover unrecovered flotation costs. Nicor Gas' estimate was compiled by Dr. Bente Villadsen, an independent consultant with extraordinary experience in evaluating both utility and other regulated company capital costs in jurisdictions around the world, as well as estimating the cost of capital for valuation purposes. Nicor Gas argues that the record shows that this ROE is fair and reasonable and should be accepted.

Nicor Gas explains that Dr. Villadsen calculated her ROE estimate using methodologies accepted in modern corporate finance and input data, including interest rate and equity risk premium data matched to the future Test Year costs being measured, and to the particulars of Nicor Gas, including its operating and financial characteristics

and sample data from comparable publicly-traded natural gas utilities subject to rate regulation. Nicor Gas explains that Dr. Villadsen took care to utilize multiple calculation methods and to analyze Nicor Gas' particular activities and risks to ensure that the recommended ROE fairly represents Nicor Gas' situation. Nicor Gas argues that it is important for the Commission to consider different models, as they provide different insights into the required return, and the Commission has regularly considered the results from several methodologies in determining the allowed ROE. *See, e.g*., *Ill.-Am. Water Co.*, Docket No. 16-0093, Order at 48-67 (Dec. 13, 2016); *Liberty Utils. (Midstates Natural Gas) Corp. d/b/a Liberty Utils.*, Docket No. 14-0371, Order at 66 (Feb. 11, 2015); *Ameren Ill. Co. d/b/a Ameren Ill*., Docket No. 13-0192, Order at 166 (Dec. 18, 2013); *Ameren Ill. Co. d/b/a Ameren Ill.*, Docket No. 11-0282, Order at 127 (Jan. 10, 2012); *Aqua Ill., Inc.*, Docket No. 10-0194, Order at 22 (Dec. 2, 2010). Nicor Gas further explains that Dr. Villadsen also utilized an expanded sample that includes both gas utilities and regulated water utilities. Nicor Gas Ex. 14.0 at 36, 38. Her recommendation is reinforced by, but not reliant on, the consideration of the broader sample. *Id.* at 38.

Nicor Gas explains that the models Dr. Villadsen considered in formulating her recommendation included the Capital Asset Pricing Model ("CAPM") and Empirical CAPM ("ECAPM"), the Discounted Cash Flow ("DCF") model, and a specific type of general risk premium model. Nicor Gas notes that, in particular:

- Dr. Villadsen presented a CAPM and ECAPM analysis that calculates Nicor Gas' cost of equity based on risk free rates matched to the future test year during which Nicor Gas capital costs will be incurred. Dr. Villadsen's CAPM analysis considered Nicor Gas' risk, and also considered differences in the financial leverage of Nicor Gas and the publicly traded companies on whose market stock returns the other CAPM inputs are based. The techniques she employed to do this include a correction to beta values (a measure of relative risk) called the "Hamada adjustment" that is an established point of financial theory and is uncontroversially recognized in academic finance and by financial practitioners as being essential to arriving at unbiased results. Dr. Villadsen's CAPM models produce an ROE for Nicor Gas of between 9.25% and 9.75%, while the inclusion of the full sample results in a range of 9.0%-10.0%.
- Dr. Villadsen presented a DCF analysis that calculates Nicor Gas' cost of equity based on the value of its estimated future cash flows and the growth of those flows. As with Dr. Villadsen's CAPM analysis, this methodology is forward looking and reflects forecasts of future Nicor Gas and market performance. Dr. Villadsen's DCF analyses produced an ROE range of 8.5%-11.0%, while the inclusion of the full sample results in a range of 8.25%-11.75%.
- Dr. Villadsen presented a risk premium model that calculates Nicor Gas' required return based on equity returns allowed and, thus, expected for other gas distribution companies which compete for capital with Nicor Gas. Such models are frequently used by analysts, and Dr. Villadsen's model should be considered here for several reasons. It gives added insight into the competing equity returns with which investors will require Nicor Gas to

remain competitive. Dr. Villadsen's risk premium models yielded a range of 9.4% to 9.6%.

Considering these models and the insight they each provide, Nicor Gas proposed a base ROE (excluding flotation costs) of 10.25%, 25 basis points above the midpoint (10.00%) of the reasonable range of estimates (9.0% - 11.0%). Nicor Gas explains that Dr. Villadsen placed Nicor Gas' required return on equity toward the upper end of the range in order to reflect Nicor Gas' increased risk relative to the proxy group because it is smaller, has a higher capital intensity, and is located in a state that has experienced a more severe impact of COVID-19 than the country in general. Dr. Villadsen also notes that the cost of equity today is higher than when Nicor Gas' cost of equity was last determined, which also supports Nicor Gas' placement in the upper portion of the range.

Nicor Gas states that in contrast, Staff recommends an ROE of 9.75% and IIEC/CUB recommend an ROE of 9.40%, but IIEC/CUB recommend that should the Commission approve Nicor Gas' recommended common equity ratio, the ROE should be set in the range of 9.0-9.4%. Nicor Gas explains that the Company has modest methodological disagreements with Staff and takes issue with certain of Staff's inputs and its failure to properly account for risk. These issues are not as significant as those raised by IIEC/CUB's analysis. For example, while Staff witness Phipps accounts for, although only indirectly, the effect of financial leverage, IIEC/CUB witness Walters fails entirely to take financial leverage into account. Nicor Gas further notes that Mr. Walters recommends a CAPM result that is not supported by his 12 CAPM analyses and makes no attempt to justify this deviation.

Nicor Gas argues that, in addition to failing to adjust for the effect of financial leverage on betas and cash flows available to investors, Staff and IIEC/CUB entirely fail to consider ECAPM analyses. Nicor Gas explains that the ECAPM analysis corrects for a well-known and documented bias in the CAPM that results in a tendency to under predict required returns for stocks with betas lower than 1. Nicor Gas further explains since the betas for the proxy companies are less than 1, failing to consider the ECAPM biases Staff and IIEC/CUB's results and recommendations downward by approximately half a percent. Nicor Gas argues that while Staff and IIEC/CUB contend that ECAPM is redundant when using adjusted beta estimates from Value Line betas, that assertion is incorrect, unsupported by the academic evidence, and founded on flawed reasoning by the Staff and IIEC/CUB witnesses. Dr. Villadsen explains that the ECAPM analysis and using adjusted beta estimates from Value Line are two fundamentally different and complementary adjustments.

Nicor Gas argues that Staff and IIEC/CUB also fail to consider relevant information about other highly regulated utility companies, such as water utilities, that would provide a reasonable comparison in a proxy sample. Nicor Gas explains that investors can and do compare returns across highly regulated utilities and require a return for Nicor Gas that is comparable to that of other highly regulated utility companies with similar business risk profiles. Nicor Gas states that in the current environment, where there has been considerable consolidation of the natural gas industry and regulatory initiatives to switch from natural gas to alternative sources of energy, it is beneficial to confirm the estimates by additional companies, such as a sample of highly regulated water utilities that are the closest to a natural gas utility sample. Importantly, the natural gas distribution industry

and the water utility industry share many characteristics, such as the fact that both are highly regulated and commonly by the same regulatory body, based on a network of pipes and mains, capital intensive, and serving residential, commercial, and industrial customers. Nicor Gas further explains that, in addition, investors make comparisons across regulated companies, so it becomes important to consider whether the returns awarded Nicor Gas are comparable not only to other natural gas utilities but also to other similar risk benchmarks. Nicor Gas explains that, in the current environment, when the natural gas distribution industry is expected to undergo substantial changes as customers, regulators, and the legislature focus on carbon reductions, and as a result stock prices and analysts' evaluations may be influenced by initiatives in a specific state, a group of water utilities, which have none of these carbon considerations, it is useful to assess whether the estimates from the gas local distribution companies are reasonable. Dr. Villadsen explains that her analysis of a group of similar water utilities supports her recommended range of results for Nicor Gas.

Finally, Nicor Gas argues that, besides the methodological issues, the Commission should consider the Staff and IIEC/CUB recommendations in context. Nicor Gas states that the record shows that current market conditions are unprecedented and have led to heightened perceptions of risk among investors. Nicor Gas argues that Staff and IIEC/CUB recommendations fail to properly account for how the heightened uncertainty of the market impacts the appropriate recommended ROE. Nicor Gas states that in order to set an ROE that appropriately reflects market expectations, the Commission should utilize the information in the record related to current market conditions.

b. Staff's Position

Staff witness Phipps recommends a 9.75% cost of common equity for Nicor Gas based on her application of DCF and CAPM analyses. *Id.* at 2. She applied those models to a sample of gas utilities comparable in risk to the natural gas distribution operations of Nicor Gas ("Gas Sample") to estimate the cost of common equity for the Company. *Id.*

To select a Gas Sample that reflected the operating and financial characteristics of Nicor Gas, Ms. Phipps only included companies categorized as natural gas utilities by Value Line, that derive at least 60 percent of operating income from regulated natural gas utility operations, have investment grade credit ratings, pay quarterly dividends, have analyst growth rate estimates from S&P Global Market Intelligence ("Market Intelligence") or Zacks Research Wizard ("Zacks"), and are not a party to a merger or other significant transaction. *Id.* at 2-3. The following seven companies composed Staff's Gas Sample: Atmos Energy Corp., New Jersey Resources Corp., Northwest Natural Gas Holding Co., ONE Gas Inc., South Jersey Industries Inc., Southwest Gas Holdings Inc., and Spire Inc. *Id.* at 3.

Staff explains that to attract common equity capital, a utility must provide a rate of return on common equity sufficient to meet investors' requirements. *Id.* A DCF analysis establishes a rate of return directly from investor requirements since the market price of a utility's stock embodies the market consensus of a utility's operating and financial risks. *Id.* According to DCF theory, a security price equals the present value of the cash flow investors expect it to generate. Specifically, 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.*

Since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that stock prices embody. *Id.* at 4. Ms. Phipps measured the annual required rate of return on common equity by applying a quarterly constant-growth DCF model because the companies in the Gas Sample pay dividends quarterly. *Id.* The quarterly DCF model assumes that dividends will grow at a constant rate and the market value of common stock (i.e., stock price) equals the sum of the discounted value of each dividend. *Id.*

Ms. Phipps explained that the DCF methodology requires a growth rate that reflects the expectations of investors. *Id.* at 5. Since market-consensus expected growth rates cannot be measured directly, Ms. Phipps measured expected growth indirectly with 3-5 year growth rates forecasted by securities analysts, which are compiled and disseminated to investors by Zacks and Market Intelligence. *Id.*

Ms. Phipps also measured each company's current stock price with its closing market price from April 21, 2021, because a current stock price reflects all information that is available and relevant to the market. *Id.* at 9. Thus, a current stock price represents the market's assessment of the common stock's current value. *Id.*

Ms. Phipps explained that stock prices reflect the market's concurrent expectations of the cash flows the securities will produce and the rate at which those cash flows are discounted. *Id*. Therefore, an observed change in the market price does not necessarily indicate a change in the required rate of return on common equity. *Id*. Rather, a price change may reflect investors' re-evaluation of the expected dividend growth rate. In addition, stock prices change with the approach of dividend payment dates; as such, one should measure the expected dividend yield and the corresponding growth rate concurrently when using the DCF model to estimate the required return on common equity. *Id.* Using a historical stock price along with current growth expectations would likely produce an inaccurate estimate of the market-required rate of return on common equity. *Id.*

Ms. Phipps applied the average expected growth rate to the current declared dividend rate to estimate the expected dividend rate. *Id.* at 10. Since most utilities declare and pay the same dividend per share for four consecutive quarters before adjusting the rate, Ms. Phipps assumed the current declared dividend rate will remain in effect for a minimum of four quarters and then adjust during the same quarter it changed during the preceding year. *Id.* If the utility did not change its dividend during the last year, she assumed the rate would change during the next quarter. *Id*.

The quarterly constant growth DCF analysis performed by Ms. Phipps estimated that the required rate of return on common equity for the Gas Sample is 9.70%. *Id*.

In addition to DCF analysis, Ms. Phipps used the CAPM, a one-factor risk premium model, to estimate ROE. The CAPM 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. *Id.* at 12. The risk premium methodology is consistent with the theory that investors are risk averse (i.e., investors require higher returns to accept

greater exposure to risk). Put plainly, if investors had an opportunity to purchase one of two securities with equal expected returns, they would purchase the security with less risk. Conversely, if investors had an opportunity to purchase one of two securities with equal risk, they would purchase the security with the higher expected return. Thus, in equilibrium, two securities with equal quantities of risk have equal required rates of return. *Id*.

Staff notes that implementing the CAPM requires one to 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. *Id.* at 11.

To estimate the risk-free rate of return, Ms. Phipps examined the suitability of the yields on four-week U.S. Treasury bills and thirty-year U.S. Treasury bonds. *Id.* at 12. She explained 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 13. The yields of fixed income securities include premiums for default and interest rate risk. U.S. Treasury securities are virtually free of default risk (which pertains to the possibility of default on principal or interest payments) by virtue of the federal government's fiscal and monetary authority. Interest rate risk pertains to the effect of unexpected interest rate fluctuations on the value of securities. *Id.* She noted further that, due to relatively long terms to maturity, U.S. Treasury bond yields contain an interest rate risk premium that diminishes their usefulness as measures of the risk-free rate. *Id.*

On April 21, 2021, four-week U.S. Treasury bills were yielding 0.00% and thirty-year U.S. Treasury bonds were yielding 2.27%. *Id.* at 15. Ms. Phipps explained that forecasts of inflation and real gross domestic product ("GDP") growth from Energy Information Administration ("EIA") and the Survey of Professional Forecasters imply a long-term, nominal risk-free rate between 4.4% and 4.5%. Therefore, the current U.S. Treasury bond yield of 2.27% more closely approximates the long-term risk-free rate. Staff notes, however, 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.* at 15-16.

Ms. Phipps estimated the expected rate of return on the market by conducting a DCF analysis on the firms composing the S&P 500 Index as of March 31, 2021. *Id.* at 17. She explained 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 12.35%. *Id.*

Ms. Phipps explained that beta measures risk in a portfolio context. *Id.* at 17. When multiplied by the market risk premium, a security's beta produces a market risk premium specific to that security. Ms. Phipps estimated beta for the Gas Sample using a combination of weekly betas (i.e., Value Line betas) and monthly betas (i.e., Zacks betas and regression analysis). *Id*. Ms. Phipps explained that she used multiple beta estimates for her Gas Sample because true betas are unobservable, forward-looking measures of investors' expectations of market risk. *Id.* at 20. Like all proxies, beta estimates are subject to measurement error. *Id.* at 20-21. Thus, using multiple

approaches to estimate beta mitigates the effect on her cost of equity estimate of measurement error in her Gas Sample beta estimates. *Id.* at 21.

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 over-weighting the monthly return-based betas. She then averaged that result with the Value Line beta to obtain a single beta estimate for the Gas Sample. *Id.* Averaging this monthly beta with the weekly Value Line beta (0.89) produces a beta for the Gas Sample of 0.76. *Id.* at 22.

Using the CAPM model and the inputs discussed above, the risk premium model employed by Ms. Phipps estimates a required rate of return on common equity of 9.90%. *Id.*

Staff explains that 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. *Id*. In Staff's opinion, an estimate of the required rate of return on common equity based solely on judgment is inappropriate. *Id.* at 22-23. Nevertheless, because techniques to measure the required rate of return on common equity necessarily employ proxies for investor expectations, judgment remains necessary to evaluate the results of such analyses. Along with DCF and risk premium analyses, Ms. Phipps considered the observable 3.24% 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 9.75%. *Id.* at 23.

Ms. Phipps arrived at her 9.75% recommended rate of return on common equity for Nicor Gas in the following steps. She explained that the average investor-required rate of return on common equity for the Gas Sample of 9.80% is based on the average of her recommended DCF-derived results (9.70%) and risk premium-derived results (9.90%). Next, she deducted five (5) basis points (i.e., 5/100th of a percent, or 0.05%) to reflect the lower level of risk of Nicor Gas relative to the Gas Sample. This results in Ms. Phipps recommending a 9.75% cost of common equity for Nicor Gas. *Id*.

Ms. Phipps explained 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, and through the use of multiple models. *Id*. The models from which the individual company estimates were derived are correctly specified and thus contain no source of bias. *Id.* at 23-24. Moreover, except for the use of U.S. Treasury bond yield as a proxy for the long-term risk-free rate and the use of 3-5 year analysts' growth estimates as proxies for the long-term growth estimates in the market rate of return, Ms. Phipps is unaware of bias in the proxies she employed for investor expectations. *Id.* at 24.

Ms. Phipps explained that the Gas Sample serves as a proxy for the target company, Nicor Gas, and should therefore reflect the risk of Nicor Gas. If, however, the proxy does not accurately reflect the risk level of the target company, then an adjustment should be made. Since issuer credit ratings reflect a company's overall risk (i.e., business and financial risk), Ms. Phipps compared the average issuer credit rating of the Gas Sample (A3/A- from Moody's and S&P) to those of Nicor Gas (A2/A from Moody's and S&P). Since the current credit ratings indicate that the Company (rated A2/A) has less

risk than the Gas Sample (average rating of A3/A-), Ms. Phipps concluded that the cost of common equity for the Company should be adjusted downward to reflect that relatively lower level of risk. *Id.*

Company witness Quackenbush testified against the Commission making pre-judgments about models and data. Nicor Gas Ex. 15.0 at 46. In response, Ms. Phipps explained that the Commission has considered the merits of the type of leverage adjustments, ECAPM analyses, and bond yield plus risk premium models that Dr. Villadsen used to estimate the investor-required return on common equity for Nicor Gas numerous times and rejected them. Staff Ex. 4.0 (Cor.) at 26-27.

In the instant case, Staff argues, Dr. Villadsen recommended an ROE that is derived from flawed methodologies, which have been repeatedly rejected by the Commission, without offering any remedies to the shortcomings identified by the Commission in the past. *Id.* at 27. Therefore, Ms. Phipps recommended the Commission avoid adopting an ROE for Nicor Gas that is derived from models, inputs, and adjustments that have been reviewed and repeatedly rejected by the Commission, because relying on these methods would result in an inflated ROE estimate. *Id.* Ms. Phipps explained that the consequence of an authorized ROE that exceeds the investor-required rate of return is a windfall for Company shareholders that is funded by Nicor Gas customers. *Id.* at 28. In dollar terms, according to Staff, adopting the Company's proposed ROE of 10.35% instead of Staff's recommended ROE of 9.75% would effectively grant an additional $16 million of profit to the Company's common stock shareholder (i.e., The Southern Company) annually, which would be collected through utility rates. *Id.*

Mr. Quackenbush also suggested that Dr. Villadsen's gas sample, which is comprised of nine natural gas utilities, is a relatively small sample. Nicor Gas Ex. 15.0 at 49. To the contrary, in the last two Nicor Gas rate cases, Company and Staff ROE witnesses have relied on comparable samples that were composed of nine companies or less to estimate ROE for Nicor Gas. Staff Ex. 4.0 (Cor.) at 28-29. Specifically, in the Company's last rate case, the Company's ROE witnesses relied on the same nine natural gas utilities as Dr. Villadsen does in the instant case to estimate the return on common equity for Nicor Gas, as well as a subsample consisting of only five of those companies. In Docket No. 17-0124, Dr. Villadsen's comparable sample consisted of seven natural gas utilities that she viewed as "broadly representative of the regulated gas distribution industry from a business risk perspective;" in that case, she also considered a subsample, which excluded two of the natural gas companies. Thus, Mr. Quackenbush's assertion that a gas sample composed of nine natural gas utilities is too small is unfounded and should not be given any weight in this proceeding. *Id.* at 29.

Dr. Villadsen recommended a 10.25% ROE for the gas delivery services of Nicor Gas (before any flotation cost adjustment), which she derived from constant growth DCF analysis, multi-stage DCF (also referred to as non-constant DCF or "NCDCF") analysis, CAPM analysis, ECAPM analysis, and bond yield plus risk premium analysis. Nicor Gas Ex. 14.0 at 30. Based on her analysis, Dr. Villadsen concluded that the Company's cost of equity is in the range of 9.0% to 11.0% prior to any adjustment for equity flotation costs. *Id.* at 4.

Ms. Phipps testified that the Company's ROE recommendation for Nicor Gas is substantially higher than the investor-required rate of return due to errors in Dr. Villadsen's ROE analysis. In Ms. Phipps' judgment, those errors, each described more fully below, led Dr. Villadsen to overestimate the Company's cost of common equity. *Id.* at 31.

Ms. Phipps testified that Dr. Villadsen added unnecessary measurement error into her analysis by including three companies in her proxy group that do not meet her own selection criteria. *Id.* at 33. Specifically, Dr. Villadsen admitted that her proxy groups include gas and water companies that fail to meet her own defined selection criteria, which she established for the purpose of selecting companies comparable in risk to Nicor Gas. Id. For example, she claimed that her proxy group companies are required to have an investment grade credit rating. Nicor Gas Ex. 14.0 at 39. Yet, Chesapeake Utilities does not have a credit rating from any of the major rating agencies. Staff Ex. 4.0 (Cor.) at 33. She also claimed that, to be included in her proxy groups, a company must have more than $300 million in annual revenues for liquidity purposes. Nicor Gas Ex. 14.0 at 39. Yet, two of the six water companies in her proxy group – Middlesex Water and York Water Company – fail to meet this criterion. Middlesex Water has annual revenues of $130 million and York Water Company has annual revenues of $50 million. *Id.* As Ms. Phipps noted, this runs counter to her claim that "very small water companies may have limited trading or very volatile financials." Not only are the annual revenues of those companies far below the threshold that Dr. Villadsen established, but they are also far below the $1.8 billion of annual revenues generated by Nicor Gas in 2020. Staff Ex. 4.0 (Cor.) at 34. This raises doubt regarding the comparability of Dr. Villadsen's proxy groups to the target company, Nicor Gas.

Furthermore, Dr. Villadsen does not show that the water companies she uses to estimate the ROE for Nicor Gas are comparable in risk to Nicor Gas. *Id.* Ms. Phipps cited several characteristics that suggest the water companies are less risky than the gas utilities and Nicor Gas; specifically, the water utilities have higher common equity ratios, higher credit ratings, and lower betas than the gas utilities. *Id.* Staff states that all of these factors diminish the usefulness of the water companies as a useful benchmark for evaluating the cost of equity for Nicor Gas, as Dr. Villadsen has done.

Dr. Villadsen's DCF, CAPM and ECAPM estimates also include leverage adjustments, which lack any basis in financial theory. Specifically, Dr. Villadsen made market-to-book based leverage adjustments to her DCF, CAPM, and ECAPM analyses to account for the difference in the market value capital structures of the gas sample companies and the book value capital structure of Nicor Gas, which she contended is a source of financial risk to Nicor Gas. Nicor Gas Ex. 14.0 at 7.

To accomplish this, Dr. Villadsen relied on two separate leverage adjustments. The first leverage adjustment, which she applied to her DCF, CAPM, and ECAPM models, involved calculating the after-tax cost of capital for each sample company in combination with market value-based capital structure ratios. Nicor Gas Ex. 14.5 at 23-24, 36. While holding the overall after-tax cost of capital for the sample companies constant, she re-arranged the overall cost of capital formula to estimate the implied cost of equity for Nicor Gas using Nicor Gas's book value capital structure ratios. *Id*. at 25, 43. This approach, the after-tax weighted average cost of capital ("ATWACC") adjustment, assumes that the

ATWACC is constant for a range that spans the capital structures used to estimate the cost of equity (i.e., the market value capital structures of the proxy group) and the regulatory capital structure (i.e., the book value capital structure of Nicor Gas). Nicor Gas Ex. 14.0 at 12-13.

Dr. Villadsen also applied another leverage adjustment, referred to as a "Hamada adjustment," to the betas used in her CAPM and ECAPM models. To apply this leverage adjustment, Dr. Villadsen adjusted the individual Value Line betas for each company in her proxy group to reflect the market risk of the company assuming it were financed with 100% equity. Next, she re-calculated, or "re-levered," each of the all-equity betas using a regulatory capital structure. *Id*. at 13.

Staff states that these leverage adjustments raised the Company's DCF, CAPM, and ECAPM-based ROE estimates for the gas utilities by 10 to 125 basis points. The leverage adjustments have an even greater effect on the ROE estimates for the water utilities. For the Company's water sample, the leverage adjustments raised the DCF-based ROE estimates by 210 basis points, raised the CAPM-based ROE estimates by 155 to 190 basis points, and raised the ECAPM-based ROE estimates by 120 to 200 basis points. Staff Ex. 4.0 (Cor.) at 38.

The leverage adjustments proposed by Dr. Villadsen, according to Staff, are based on the flawed argument that a market-derived 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 (i.e., if the market value does not equal book value). Nicor Gas Ex. 14.0 at 12, 21-22. Ms. Phipps explained that the crucial flaw in that argument is that it erroneously equates secondary investing (i.e., the purchase of existing shares of stock from other investors) with primary investing (i.e., the purchase of new shares of stock directly from the company or the retention of earnings for reinvestment). Staff Ex. 4.0 (Cor.) at 40. Secondary investing 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. Moreover, such an adjustment would render the establishment of original cost rate base a pointless exercise. *Id*. at 41.

Staff asserts that the erroneous equation of primary and secondary investing also leads to Dr. Villadsen's incorrect comparison of book values and market values. *Id.* As indicated above, the amount of money contributed to a company for the purchase of assets that serve ratepayers is not necessarily equal to the market value of that company's stock because the market value of a company's stock is based on the cash flows expected to be generated by all of its assets discounted by the investor-required rate of return. *Id*.

Finally, allowing upward adjustments to the allowed rate of return based on a market to book value ratio greater than one, when taken to its logical conclusion, would result in a never-ending upward movement in the allowed rate of return. To establish utility rates, regulators generally apply a market-based rate of return to a book value rate base. If that process provided a return that did not meet investor requirements, market prices would fall towards book value. Yet, the market prices of utility stocks continue to exceed book value. *Id*. at 42.

Staff argues that Dr. Villadsen mischaracterized the differences that result from measuring a capital structure using market values versus book values as differences in financial leverage. Nicor Gas Ex. 14.0 at 11-12. That is, she confused a measurement tool (i.e., common equity ratio) with the phenomenon to be measured (i.e., financial risk). Staff Ex. 4.0 (Cor.) at 42. Ms. Phipps testified that, contrary to Dr. Villadsen's assertion, capital structure ratios are merely indicators of financial risk; they are not sources of financial risk. *Id*. Importantly, switching measurement tools does not affect the phenomenon to be measured. Staff states that financial risk arises from contractually required debt service payments, not from the way the debt is measured. Changing the measure of capital structure ratios from a market to book value basis does not affect a company's debt service requirements and, thus, it does not change a company's risk. *Id.*

It is Staff's position that the Commission has expressed its view that the basis for establishing the cost of capital for ratemaking purpose should be book value capital structure, which reflects the investment required for providing utility service (i.e., net original cost rate base for Illinois jurisdictional utilities). (*See, e.g*., Docket Nos. 14-0224/14-0225 (con.), Order at 126-127 and 132-133 (Jan. 21, 2015). The Commission has also declined to adopt leverage adjustments in numerous past rate case proceedings.

In summary, Staff contends that both of the leverage adjustments used by Dr. Villadsen are based on the faulty premise that an adjustment to the cost of equity estimate derived from market values of equity is necessary when that ROE estimate is to be applied to the book value of equity to determine utility rates for Nicor Gas. Staff Ex. 4.0 (Cor.) at 45. The Commission has determined that the market-required rate of return on common equity should be applied to common equity ratio derived from the book value capital structure of the Illinois utility; moreover, the Commission has used this approach in establishing utility rates for decades and the results have consistently provided Illinois utilities with adequate access to capital at reasonable costs. *Id.* at 45. For the foregoing reasons, Staff recommends that the Commission reject the leverage adjustments proposed by Dr. Villadsen in this proceeding.

Ms. Phipps explained that Dr. Villadsen's CAPM analysis should not be relied upon to determine an allowed ROE for Nicor Gas because: (1) her CAPM analysis relied exclusively on betas calculated using weekly returns, and (2) her CAPM used a forecasted risk-free rate estimate.

Dr. Villadsen's CAPM analyses relied exclusively on Value Line betas, which are estimated using weekly data. Nicor Gas Ex. 14.0 at 47. Ms. Phipps found this problematic because the major reason for observed variation among published betas is the interval effect (monthly returns versus weekly returns) due to nonsynchronous trading, which is greater for weekly data than monthly data. By relying exclusively upon betas calculated using weekly data, Dr. Villadsen has introduced bias into her CAPM analysis that could have been mitigated using a beta estimate derived from monthly return intervals in combination with their weekly beta estimate. Staff Ex. 4.0 (Cor.) at 46. Staff notes that the Commission has expressed its preference for using a combination of weekly and monthly beta estimates in CAPM analysis to avoid unnecessary bias that results from exclusive reliance on either weekly or monthly beta estimates. *Id.*

Finally, Ms. Phipps testified that averaging the Company's Value Line (weekly) beta estimate with a monthly beta estimate would lower the ROE estimates derived from CAPM analysis by 110 basis points (from 8.5% to 7.4%). Staff Ex. 4.0 (Cor.) at 47.

In addition, Dr. Villadsen relied on two estimates of the risk-free rate for her CAPM analyses: a 2.05% risk-free rate estimate and a 2.25% risk-free rate estimate. Nicor Gas Ex. 14.0 at 44. The 2.05% risk-free rate estimate equals a forecasted 10-year Treasury bond yield, plus 50 basis points. Staff Ex. 4.0 (Cor.) at 48. The 50 basis points adder represents Dr. Villadsen's estimate of a maturity premium that equals the average historical excess yield on 20-year versus 10-year Treasury bonds over the past thirty years (i.e., 1990-2020). *Id.* To derive her 2.25% risk-free rate estimate, Dr. Villadsen added 20 basis points to her initial 2.05% risk-free rate. *Id.* The 20 basis points adder reflected her view that the spread between yields on utility bonds and U.S. Treasury bonds is approximately 30 basis points higher than it was prior to the 2008 financial crisis. Id.

Ms. Phipps found Dr. Villadsen's reliance on forecasted Treasury yields problematic because, as the Commission has recognized, accurately forecasting the movement of interest rates is problematic. *Id*. at 49. Given the difficulty of accurately forecasting interest rates, Ms. Phipps testified that the Commission should, instead, continue to rely on current, observable market interest rates. Staff Ex. 4.0 (Cor.) at 49. In fact, the use of current, observable market interest rates renders the use of forecasted interest rates unnecessary because U.S. Treasury bond yields reflect all relevant, available information, including investor appraisals of the value of current expectations for the future. *Id*. Importantly, as Ms. Phipps testified, using current market interest rates also obviates the need to adjust a 10-year forecasted yield to manufacture a synthetic 20-year forecasted yield, as Dr. Villadsen proposed, since a 20-year U.S. Treasury yield is directly observable.

Further, Ms. Phipps noted that U.S. Treasury bond yields reflect market forces, while forecasts do not. *Id.* at 50. The risk-free rate is reflected in the return that investors are willing to accept in the market. *Id.* At the time Dr. Villadsen performed her ROE analysis, investors were willing to accept a 1.37% return on 20-year U.S. Treasury bonds, which includes an interest rate risk premium associated with its relatively long term to maturity. *Id.*

Ms. Phipps showed that, all else equal, substituting the current, observable, 20-year U.S. Treasury bond yield of 1.37% on November 30, 2020 (the date of Dr. Villadsen's ROE analysis), for the Company's forecasted risk-free estimates of 2.05% and 2.25% would lower the CAPM- and ECAPM-derived ROE estimates for the sample composed of natural gas utilities by 80 basis points. *Id.*

Staff observes that the Commission has previously declined to adopt analyses that use projected Treasury bond yields as a proxy for the risk-free rate of return and has repeatedly stated its preference for using current, observable U.S. Treasury bond yields to estimate the risk-free rate because it is impossible to accurately predict future interest rates.

Ms. Phipps explained in testimony that Dr. Villadsen's ECAPM analysis suffers the same infirmities as her CAPM analysis and inappropriately employs adjusted beta

estimates. Staff Ex. 4.0 (Cor.) at 32. Dr. Villadsen's ECAPM ostensibly attempted to adjust the CAPM for the flatness of the empirically measured security market line ("SML") relative to the predicted SML. Nicor Gas Ex. 14.0 at 48. Staff witness Phipps testified that since the adjustments to the CAPM that result in the ECAPM are based on empirical testing rather than financial theory, the ECAPM should be applied in a manner that is consistent with the conditions under which it was developed. Staff Ex. 4.0 (Cor.) at 51. Moreover, the ECAPM is unnecessary, given that Litzenberger, *et al*. suggests that globally adjusted betas, such as those which Value Line publishes, are a solution to the discrepancy between the theoretically predicted and empirically observed relationship between risk and return. In other words, by using adjusted betas in her traditional CAPM, Dr. Villadsen has already effectively transformed the traditional CAPM into an ECAPM. Therefore, including an additional adjustment in the ECAPM results in an upwardly biased estimate of the cost of common equity. Hence, Staff recommends that the Commission reject her ECAPM results.

Staff notes that the Commission has rejected such application of the ECAPM in several prior proceedings. *Ill.-Am. Water Co*., Docket No. 11-0767, Order at 109 (July 31, 2012); *Consumers Ill. Water Co*., Docket No. 03-0403, Order at 41-42 (April 13, 2004); *MidAmerican Energy Co*., Docket No. 01-0696, Order at 22 (Sept. 11, 2002) and Docket No. 01-0444, Order at 14-17 (March 27, 2002).

Staff states that Dr. Villadsen improperly used historical data to estimate the dividend yields in her DCF analysis. Staff Ex. 4.0 (Cor.) at 55. Specifically, Dr. Villadsen used an average of the last 15 days of stock prices ending November 30, 2020, to calculate the dividend yield for her DCF analysis. Nicor Gas Ex. 14.5 at 17. Dr. Villadsen, however, stated that she used an average dividend yield in order to "avoid the bias caused by any one day." Nicor Gas Ex. 14.0 at 54. In other words, she implied that she used historical data to estimate the dividend yield in an attempt to reduce measurement error. Staff Ex. 4.0 (Cor.) at 56. Staff explains that, while stock prices can be influenced by temporary imbalances in supply and demand, any distortions such imbalances might have on the measured cost of common equity can be reduced through the use of samples, which is a technique that Dr. Villadsen already applied. *Id.*

Importantly, Staff opines that the use of historical data is problematic because historical data favors outdated information that the market no longer considers relevant over the most-recently available information. *Id*. at 55. In addition, historical data reflects conditions that may not continue into the future. In other words, use of average historical data implies that securities data will revert to a mean. *Id.* Even if securities data were mean-reverting, there is no method for determining the true value of that mean let alone the length of time over which mean reversion will occur. Consequently, sample means, which depend upon the selected measurement period, are used. Thus, any measurement period chosen is arbitrary, rendering the results uninformative. *Id.*

Staff argues that the Commission has rejected DCF analyses that use historical dividend yields previously, stating that it found the use of spot common stock prices in the DCF model to be superior to the use of average prices when estimating a forward-looking cost of common equity. *Consumers Ill. Water Co*., Docket No. 03-0403, Order at 42 (Apr. 13, 2004). For this reason, Staff states that Dr. Villadsen's use of historical data in her cost of equity analysis should also be rejected in this proceeding.

Staff points out that Dr. Villadsen performed a regression analysis in which the observed equity risk premium represents the historical spread between authorized returns for natural gas utility companies and long-term U.S. Treasury bond yields over the 1990 – September 2020 measurement period. Staff Ex. 4.0 (Cor.) at 57. Dr. Villadsen used the same U.S. Treasury bond yields that she uses in her CAPM and ECAPM analyses, which are flawed for the reasons set forth previously herein in the CAPM discussion. *Id.*

In addition, as Ms. Phipps explained, Dr. Villadsen's bond yield plus risk premium analysis relied heavily on historical data over the 1990-2020 measurement period, which wrongly implies that market risk premiums revert to a mean that is observable. To the contrary, security returns approximate a random walk. That is, research has found that the last observed security price is the best estimator of future security prices. Staff Ex. 10.0 (Cor.) at 20. Therefore, the selection of a measurement period will necessarily be arbitrary. Staff Ex. 4.0 (Cor.) at 57. Furthermore, returns authorized by regulatory bodies are not necessarily market-based investor-required returns, but rather are legal determinations. Thus, it cannot be assumed that those authorized returns are representative of the concurrent investor-required returns, as Dr. Villadsen's analysis assumes. *Id.* Moreover, based on the limited information that is available, the average allowed common equity ratio in the rates cases relied upon by Dr. Villadsen (where such data is provided) is a much lower common equity ratio than the 54.5% that Nicor Gas Requests in the instant case. *Id.* at 58. All else equal, based on the limited information that is available the common equity ratio denotes more financial risk that the Company's 54.5% common equity ratio. *Id.* On this basis, the bond yield plus risk premium model appears to overestimate the return on equity that would be appropriate for Nicor Gas, given its lower degree of financial risk.

Staff notes that the Commission has routinely rejected bond yield plus risk premium analysis as a valid basis for determining ROE. In rejecting the risk premium model in a prior case, the Commission stated:

> The Commission understands that the CAPM is similar to a risk premium model. However, the risk premium model that the Utilities use in addition to their CAPM is unhelpful. The primary reason that the Commission has repeatedly rejected that type of risk premium analysis the difficulty in establishing the "correct" risk premium. The risk premium for common equity relative to debt changes over time and, in the Commission's view, there is not objective mechanism [to] establish that risk premium. While all cost of equity analyses require the application of judgment, this particular approach is primarily a matter of judgment and we are unwilling to rely on a such a subjective analysis.

Docket No. 07-0241/07-0242 (cons.), Order at 93-94 (Feb. 5, 2008).

The Company claims that the use of multiple models will result in an allowed ROE that better reflects reality. Staff asserts that to the contrary, the cases cited by the Company to support this assertion show that the Commission has authorized ROEs derived exclusively from DCF and CAPM analyses that are similar to the models and

inputs that Staff used to estimate the investor-required ROE for Nicor Gas. Specifically, the Company relies on the following five Commission Orders to support its claim that using multiple models will result in an allowed ROE that better reflects reality: Docket No. 16-0093, Docket No. 14-0371, Docket No. 13-0192, Docket No. 11-0282, and Docket No. 10-0194. *Id.* at 83. A review of these decisions reveals that the Company's claim is inaccurate. Notwithstanding Docket No. 10-0194, an Aqua Illinois water rate case in which Aqua and Staff stipulated to using Staff's ROE analysis (which was based on DCF and CAPM analyses), in each of the cases Nicor Gas references above, the Commission relied upon only DCF and CAPM methodologies to determine an allowed ROE for Illinois utilities.

In each of the cases referenced by Nicor Gas, Staff notes, the Commission also did not rely upon a bond yield plus risk premium analysis. *Id.* Therefore, Staff contends that the Commission should reject the Company's claim and adopt Staff's recommended ROE of 9.75%.

c. IIEC/CUB's Position

Consistent with the Commission's historical practice, IIEC/CUB witness Walters used several models based on financial theory to estimate Nicor Gas' cost of common equity. Those models are (1) a DCF model, using the consensus of analysts' growth rate projections; (2) a Multi-Stage DCF model; (3) a risk premium model; and (4) a CAPM. Mr. Walters applied these models to a group of publicly traded utilities with investment risks similar to Nicor Gas, referred to as the "Proxy Group." IIEC/CUB Ex. 2.0 at 21.

IIEC/CUB point out the Proxy Group utilized by Mr. Walters is the same Proxy Group relied upon by Nicor Gas' cost of equity witness Villadsen with the exception of Chesapeake Utilities, which he excluded, because it is not rated by the major ratings agencies. IIEC/CUB Ex. 2.0 at 25. The Proxy Group (identified in IIEC/CUB Ex. 2.3), has an average corporate rating from Moody's of A3, which is one notch lower than Nicor Gas' A2 rating from Moody's and an average corporate rating from S&P of A-, which is one notch below Nicor Gas' rating of A. *Id.* at 24.

The Proxy Group, as reported in Market Intelligence, has an average and median common equity ratio (including short term debt) of 44.9% and 46.2%, respectively. As also reported by Value Line, the Proxy Group has an average and median common equity ratio (excluding short-term debt) of 51.4% and 52.0% respectively. *Id.* at 25-26.

IIEC/CUB maintain, in sum, Nicor Gas' investment risk is reasonably represented by the Proxy Group when taking into consideration the 52% common equity ratio recommended by IIEC/CUB. Furthermore, should the Commission adopt Nicor Gas' requested common equity ratio, an ROE in the lower half of Mr. Walters' recommended cost of equity range of 9.0% to 9.8% is warranted. *Id.* at 26.

IIEC/CUB note Mr. Walters used several versions of the DCF model in his analysis of the cost of equity for Nicor Gas. The DCF model posits that the 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. The DCF model requires a current stock price, expected dividend, and expected growth rate in dividends as described in full in Mr. Walters' testimony. IIEC/CUB Ex. 2.0 at 26-27.

IIEC/CUB also note Mr. Walters included a quarterly compounding adjustment to his DCF return estimate based on his understanding that it is the Commission's current preference to use the quarterly compounding form of the Constant Growth DCF model. *Id.* at 27.

IIEC/CUB show for the current stock price in the Constant Growth DCF model analyses, Mr. Walters used the average of the weekly high and low stock prices for the proxy group over a 13-week period and 26-week period ending March 26, 2021. IIEC/CUB note he did so because an average stock price is less susceptible to market price variations than a price at a single point in time. IIEC/CUB Ex. 2.0 at 27-28. Mr. Walters used the most recently paid quarterly dividend reported in the Value Line Investment Survey of February 26, 2021 for the expected dividend. *Id.* at 28.

IIEC/CUB note for the expected growth rate in dividends, in his Constant Growth DCF analysis, Mr. Walters relied on a consensus of professional securities analysts' 3 to 5 year earnings growth estimates as a proxy for dividend growth expectations. He used the average of three sources of analysts' growth rate estimates, Zacks, Market Intelligence, and Yahoo! Finance. The growth rate estimates he used are shown in IIEC/CUB Ex. 2.4. The average rate for his Proxy Group was 5.56%. *Id.* at 29.

IIEC/CUB point out the results of Mr. Walters' average and median Constant Growth DCF returns for his Proxy Group for the 13-week analysis were 9.57% and 9.66% respectively. *Id.* at 29. Mr. Walters noted that the growth rate of 5.56% assumed in his constant growth DCF model exceeds the long-term expected growth rate of the U.S. GDP of 4.10%. IIEC/CUB explain that no company can grow faster than the economy in which it sells goods and services in perpetuity, which is the time period assumed by the constant growth model. *Id.* at 30. IIEC/CUB note, however, within the "perpetuity" time period there will be times when growth will be different than the perpetuity time frame. *Id.* at 32-33. As such, IIEC/CUB witness Walters incorporated a multi-stage DCF model which recognizes the potential for changing growth expectations over time. *Id.* at 33.

IIEC/CUB witness Walters performed a Multi-Stage DCF analysis to reflect the outlook of changing growth expectations. IIEC/CUB Ex. 2.0 at 32. IIEC/CUB explain that the Constant Growth DCF model is based on analyst growth rate projections. Therefore, IIEC/CUB maintain it is a reasonable reflection of rational investment expectations over the next three to five years. However, the Constant Growth model cannot reflect a rational expectation that a period of high or low short-term growth can be followed by a change in growth to a rate that is more reflective of long-term sustainable growth. *Id.* at 32. Thus, IIEC/CUB witness Walters performed a Multi-Stage DCF analysis as indicated above.

IIEC/CUB point out the Multi-Stage DCF model reflects the possibility of non-constant growth for a company over time. It reflects three growth periods: (1) a short-term period consisting of the first five years; (2) a transition period, consisting of the next five years (years 6 through 10); and (3) a long-term growth period starting in year 11 and extending into perpetuity. *Id.* at 33.

For the short-term growth period, IIEC/CUB witness Walters relied on the consensus of analysts' growth projections used in his Constant Growth DCF model. For the transition period, growth rates were reduced or increased by an equal factor reflecting the difference between the analysts' growth rates and the long-term sustainable growth

rate. For the long-term period, IIEC/CUB witness Walters assumed each company's growth would converge to the maximum sustainable long-term growth rate. *Id.* at 33.

IIEC/CUB witness Walters developed his long-term sustainable growth rate based on the consensus of long-term GDP growth rate projections by independent economists. Mr. Walters observed that the Blue Chip Economic Indicators publishes the consensus for GDP growth projections twice a year. *Id.* at 34. Mr. Walters also observed that these projections reflect current outlooks for GDP and are likely to have an influence on investor expectations of future growth outlooks. *Id.* at 36-37. Mr. Walters also considered other sources of projected long-term GDP growth. IIEC/CUB note these other sources included EIA-Annual Earnings Outlook, Congressional Budget Office, Moody's Analytics, Social Security Administration, and the Economist Intelligence Unit. *Id.* at 37. IIEC/CUB argue the nominal GDP growth and the real GDP growth projections made by these sources supported the use of the consensus for 5-year and 10-year projected GDP growth outlooks as a reasonable estimate of market participants' long-term GDP growth. *Id* at 39. For the stock price, dividend, and growth rates in his Multi-Stage DCF analysis, IIEC/CUB witness Walters relied on the same 13-week average stock prices and most recent quarterly dividend payment data referenced in his constant growth DCF analysis. *Id*. at 39. IIEC/CUB point out for the first stage of Mr. Walters' Multi-Stage DCF analysis, he used the same consensus of analysts' growth rate projections he used in his Constant Growth DCF model. For the second stage (transition stage), he transitioned the growth rate from the first stage to the third stage using a straight linear trend. IIEC/CUB note that for the third stage of his Multi-Stage DCF analysis, Mr. Walters transitions the growth rate from the first stage to the third stage using a straight linear trend. For this third stage the long-term sustainable growth stage is 4.10% and is based on the consensus of economists' long-term projected nominal GDP growth rate. *Id.* at 39.

Under the IIEC/CUB Multi-Stage DCF Model, the average and median DCF returns on equity for the proxy group, using the 13-week average stock price, are 8.43% and 8.32% respectively. *Id.* at 39; IIEC/CUB Ex. 2.7.

IIEC/CUB witness Walters used a Bond Yield plus risk premium model to estimate Nicor Gas' cost of equity. This model is based on the principle that investors require a higher return to assume greater risk. IIEC/CUB Ex. 2.0 at 40. IIEC/CUB note generally, common equity investments are riskier than investments in bonds because bonds have more security of payment in case of bankruptcy than common equity and coupon payments on bonds represent contractual obligations. *Id.* IIEC/CUB point out, on the other hand, companies are not required to pay dividends or guarantee returns on equity investments. *Id*.

IIEC/CUB witness Walters' risk premium model was based on two estimates of equity risk premium. The first estimate is based on and quantified as the difference between regulatory commission authorized returns on equity and U.S. Treasury Bond yields. That difference is the risk premium. *Id.* at 40. The second estimate is based on and quantified as the difference between authorized returns on equity and contemporary "A" rated utility bond yields by Moody's for the period 1986-2020. IIEC/CUB Ex. 2.0 at 41.

IIEC/CUB witness Walters estimated the first equity risk premium by measuring the average authorized ROE for gas utilities over prevailing Treasury Bonds and utility

bonds since 1986. *Id.* at 41; IIEC/CUB Exs. 2.9 and 2.10. Based on his analysis, IIEC/CUB witness Walters established that the average indicated risk premium over U.S. Treasury Bond yields has been 5.56%. *Id.* at 41, IIEC/CUB Ex. 2.9, Col. 3, Ln. 36. IIEC/CUB witness Walters calculated the equity risk premium over contemporary "A" rated Moody utility bond yield was 4.20%. *Id.* at 42.

Based on Mr. Walters analysis of the information in IIEC/CUB Exs. 2.9 and 2.10, and because of the current low interest rates and uncertainty revolving around forecasted interest rates, Mr. Walters recommended that more weight be given to the high-end risk premium estimates than the low-end in order to be conservative. IIEC/CUB Ex. 2.0 at 45. Therefore, IIEC/CUB recommend that the most recent 5-year average risk premiums be used in determining a fair ROE for Nicor Gas. *Id.* at 45.

Based on the information discussed above, and because of current low interest rates and uncertainty revolving around forecasted interest rates, IIEC/CUB witness Walters recommended that in the context of his risk premium model, more weight be given to the high-end risk premium estimates than the low-end risk premium estimates in order to be conservative. Mr. Walters recommended the most recent 5-year average risk premiums be used in determining a fair ROE for Nicor Gas. The most recent 5-year average risk premium over Treasury yields is 7.05% which exceeds the 35-year average of 5.65% by 1.40 percentage points. IIEC/CUB Ex. 2.0 at 45; IIEC/CUB Ex. 2.9. Similarly, the most recent 5-year allowed risk premium over utility bonds is 5.80%. IIEC/CUB emphasize this is well above the 35-year historical average risk premium of 4.20%. IIEC/CUB Ex. 2.0 at 45; IIEC/CUB Ex. 2.10.

Under IIEC/CUB witness Walters' risk premium analysis, adding the 7.05% risk premium to the projected Treasury yield of 2.40% produces an ROE of 9.45% (which rounds to 9.50%), adding the 5.80% risk premium to the "A" rated utility bond yield of 3.14% and 3.00% produce an estimated cost of equity of approximately 8.94% and 8.80%. *Id.* at 45.

IIEC/CUB note, similarly, the Baa-rated utility bond yields have averaged 3.42% and 3.30% over the same 13-week and 26-week periods. Adding the 5.80% premium to the average Baa-rated utility bond yields of 3.42% and 3.30% produce an estimated cost of equity of 9.22% and 9.10%. Id. at 45. The estimated cost of equity using risk premium over utility bond yields is in the range of 8.8% to 9.2%. *Id.* at 45. Based on his risk premium analysis, IIEC/CUB witness Walters concluded that a reasonable ROE for Nicor Gas is 9.1%. *Id.* at 46.

IIEC/CUB point out 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. IIEC/CUB Ex. 2.0 at 46. IIEC/CUB assert the CAPM theory suggests that the market will not compensate investors for assuming risks that can be diversified away. *Id.* Therefore, the only risk that investors will be compensated for is systematic or non-diversifiable risks. The beta is a measure of the systematic or non-diversifiable risks. *Id.* at 47. The CAPM requires an estimate of the risk-free rate, the Company's beta, and a market risk premium. *Id.*

For the risk-free rate, IIEC/CUB witness Walters used Blue Chip Financial Forecasts' projected 30-year Treasury bond yield of 2.4%, for his CAPM analysis,

because long-term Treasury bonds are considered to have negligible credit risk. *Id.* at 48.

For the beta, IIEC/CUB witness Walters relied on multiple estimates of the proxy group beta including the recently reported estimates from Value Line, the long-term historical average beta from Value Line, and estimates from Market Intelligence. *Id.* at 49.

For his market risk premium estimate, IIEC/CUB witness Walters developed three market risk premium estimates. These included an estimate using a risk premium estimate based on the historical real return and projected inflation, as well as two forward-looking estimates based on the DCF methodology. *Id.* at 49. In addition, Mr. Walters incorporated the normalized risk premium estimates by Duff & Phelps. *Id.*

IIEC/CUB note the market risk premium 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. IIEC/CUB Ex. 2.0 at 50. IIEC/CUB witness Walters estimated the expected market return to be 11.4%. *Id.* IIEC/CUB note the market risk premium is the difference between the 11.4% market return and the projected risk-free rate of 2.4% or 9.0%. *Id.* at 50.

IIEC/CUB witness Walters also derived market risk premium estimates using the DCF methodology. Mr. Walters used two different versions of the DCF methodology to develop estimates of the market risk premium. First, Mr. Walters employed the constant growth DCF model in the traditional sense by adding a projected 3- to 5-year growth rate to a projected dividend yield. *Id.* at 50. Mr. Walters second DCF-based market risk premium estimate was derived by estimating the expected return using FERC's two-step DCF methodology. *Id.* at 50-51. Using the constant growth DCF model, Mr. Walters produced a market risk premium estimate of 13.97%. *Id*. at 52. Using the second version, Mr. Walters produced a market risk premium of 11.60%. *Id.*

IIEC/CUB witness Walters employed the two-step method because the constant growth model assumes the input growth rate to be a growth rate in perpetuity and no Company, regulated or not, can grow at a higher rate than the economy in perpetuity. *Id.* at 52. IIEC/CUB note, furthermore, actual earnings estimates for the underlying holdings are used to calculate a mean 3 to 5 year earnings growth rate estimate for the index, and individual growth rates for underlying holdings must be taken into consideration in evaluating the reasonableness of the sustainability of growth rate for the index as a whole. IIEC/CUB witness Walters pointed out as an example, that S&P 500 member company Amazon (NYSE: AMZN) has a projected growth rate of 38.5%, which is approximately 9.0 times higher than the consensus expected growth rate of 4.10% for the U.S. economy. *Id.* at 52. Mr. Walters concludes that for those reasons, employing the two-step DCF based on a blended growth rate gives some weight to projected GDP growth and is a reasonable approach. *Id.*

IIEC/CUB witness Walters also observed that his forward-looking estimates of market risk premium of 9.0%, 11.60%, and 13.70% exceed the historical market risk premium of 6.1%. IIEC-CUB Ex. 2.0 at 53. Mr. Walters relied on the Duff & Phelps normalized equity risk premium of 5.5% and normalized risk-free rate of 2.5%. *See id.* at 56-57.

As shown in IIEC/CUB Ex. 2.14, IIEC/CUB witness Walters provided the results of multiple different applications of the CAPM. Based on the results of his various applications of the CAPM, Mr. Walters concluded that a CAPM return of 9.80% was reasonable. *Id.* at 57.

IIEC/CUB witness Walters' DCF estimate is 9.0%, his Risk Premium estimate is 9.1% and his CAPM estimate is 9.8%. *Id*. Based on these analyses, IIEC/CUB witness Walters estimates Nicor Gas' current market cost of equity be in the range of 9.0% to 9.8%, with a midpoint estimate of 9.4%. *Id*. Thus, IIEC/CUB recommend Nicor Gas be awarded a return on common equity of 9.4%.

IIEC/CUB argue the recommended overall rate of return and return on common equity of 9.4% will support an investment grade bond rating for Nicor Gas. IIEC/CUB witness Walters 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. IIEC/CUB Ex. 2.0 at 59.

IIEC/CUB witness Walters described the S&P credit methodology and its use of financial benchmark ratios in his direct testimony. *Id.* at 59-60. IIEC/CUB note S&P publishes ranges for primary financial ratios that it uses as guidance in its credit review for utility companies. *Id.* at 60. IIEC/CUB point out the two core financial ratio benchmarks it relies on in its credit rating process include: (1) Debt to Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA"); and (2) FFO to Total Debt. *Id.* at 60. IIEC/CUB witness Walters applied these ratios to test the reasonableness of the IIEC/CUB ROE of 9.4%. *Id.* at 61. IIEC/CUB argue, based on an equity return of 9.4% and a 52% common equity ratio, Nicor Gas will be provided an opportunity to produce a debt to EBITDA multiple of 3.3x in S&P's Intermediate range of 2.5x to 3.5x and supports a credit rating of A. *Id.* at 62. IIEC/CUB point out Nicor Gas' gas distribution operations FFO to total debt ratio, at a 9.4% equity return, is 23.9%, which is within S&P's "Intermediate" metric guideline range of 23% to 35%. IIEC/CUB assert each of these ratios supports an investment grade bond rating of A-. IIEC/CUB Ex. 4.0 at 19; IIEC/CUB Ex. 4.4 at 1. IIEC/CUB note the Commission has previously determined an investment grade bond rating is a guideline for financial integrity for a public utility and "this criterion is consistent with the pronouncement of the US Supreme Court in *Bluefield Waterworks & Improvement Co. v Public Service Comm'n* 262 US 679 (1923)." Revised Order on Remand Commonwealth Edison Company, 1993 Ill. PUC Lexis 84 at *144 Docket No. 90-0169 (cons.).

IIEC/CUB note Nicor Gas is requesting a return on common equity of 10.35%, which includes a 0.10% premium for unrecovered flotation costs, based on a recommended range of 9.0% to 11.0%. *See* Nicor Gas Ex. 30.0 at 1, 4. IIEC/CUB state the recommended return on common equity of 10.35% proposed by Nicor Gas is over-stated and unreasonable. IIEC/CUB witness Walters expresses concern with multiple aspects of Dr. Villadsen's analyses supporting her recommended ROE.

IIEC/CUB argue that Dr. Villadsen's ATWACC adjustment is unnecessary and is not a well-recognized methodology in setting a fair ROE for regulated utilities in the United States. IIEC/CUB point out that Dr. Villadsen's upper-end of her recommended range and her recommended point estimate rests on her ATWACC adjustments, inclusion of

flotation costs, and a faulty assumption that Nicor Gas is of higher risk relative to her sample companies. IIEC/CUB note that for Dr. Villadsen's CAPM analysis, she includes both an ATWACC adjustment and alternatively a leveraged beta adjustment to the CAPM results. IIEC/CUB claim that Dr. Villadsen also relies on an ECAPM analysis and includes adjustments for her ATWACC and leveraged beta methods. In addition to IIEC/CUB concerns for these two adjustments, Dr. Villadsen's ECAPM analysis is miscalculated because she uses adjusted betas in her ECAPM. IIEC/CUB argue this is inappropriate because an adjusted beta accomplishes the same thing as an ECAPM analysis. Both flatten the slope of the security market line. IIEC/CUB assert that Dr. Villadsen's risk premium analysis is based on a regression analysis that provides equal weight to the relationship between interest rates and equity risk premiums from the relatively distant past which may not be appropriate in today's market. IIEC/CUB argue that Dr. Villadsen's assertion that Nicor Gas is of higher risk than her sample companies is incomplete, inaccurate, and should be ignored.

In conclusion, at the IIEC/CUB recommended return on equity of 9.4%, and proposed capital structure with 52% common equity, Nicor Gas' financial credit metrics are supportive of an investment grade bond rating of A, ensuring the Company's financial integrity.

d. Commission Analysis and Conclusion

The Commission reviewed the different proposals of the parties as well as the testimony and reasoning of the parties. Nicor Gas, Staff, and IIEC/CUB each recommend an ROE for Nicor Gas based on various financial models.

Nicor Gas recommends a 10.25% ROE, before any flotation cost adjustment. The Commission's conclusion regarding the flotation cost adjustment is discussed below in Section VI.B.4. Nicor Gas based its recommended ROE on a constant growth DCF analysis, multi-stage DCF analysis, CAPM analysis, ECAPM analysis, and bond yield risk premium analysis. The Commission finds that the Company's sample group includes companies that are not comparable in risk to Nicor Gas. One of the companies included in the gas utility sample group does not have an investment grade rating from any credit agency. Moreover, the Company included both gas and water companies in its full utility sample group which is problematic because the Company failed to show the water companies are comparable in risk to Nicor Gas. The Commission notes that two of the water companies have much smaller annual revenues when compared to Nicor Gas. The water companies included in Nicor Gas' full utility sample group also appear to have higher common equity ratios and higher credit ratings. Additionally, the Company's leverage adjustments improperly inflated the Company's ROE recommendation, especially for the water companies. Further, the leverage adjustments are based on the flawed argument that a market-derived ROE does not produce a fair rate of return when applied to a book value rate base. In the Commission's view, an ROE derived from market-based models should be applied to the book value common equity ratio of the Illinois utility because the book value capital structure reflects the amount of capital a utility actually uses to finance the acquisition of assets for providing utility service, which are included in rate base. In contrast, market value typically includes appreciated value, which is not used in establishing the overall or weighted average cost of capital in ratemaking proceedings for Illinois utilities. The Commission has used this approach to

establish utility rates for decades and the results have consistently provided Illinois utilities with adequate access to capital at reasonable costs. In contrast, allowing upward adjustments to the allowed ROE to reflect leverage adjustments would result in a never-ending upward movement in the allowed rate of return, which would not properly balance the interests of customers and the utility.

IIEC/CUB used several models to estimate Nicor Gas' ROE, including the DCF, multi-stage DCF, risk premium, and CAPM models. IIEC/CUB used the same gas utility sample group as Nicor Gas, except for the company that is not rated by any major rating agency. Based on their analyses, IIEC/CUB recommend Nicor Gas be awarded an ROE of 9.4%.

The Commission concludes that the Company's ROE recommendations should not be adopted primarily because the Company's DCF and CAPM estimates include leverage adjustments, which the Commission has routinely rejected. The Company also used ECAPM analyses and bond yield plus risk premium models to determine an ROE, which the Commission has also historically rejected. In addition, the use of water companies in the Company's and ROE analyses is unnecessary and inappropriate. It appears that the inclusion of water companies distorted their ROE estimates, since the size, risks and exposure of these companies were not comparable to Nicor Gas'. IIEC/CUB's analyses did not include water companies, leverage adjustments, or the ECAPM. The analyses presented by IIEC/CUB did, however, include a bond yield plus risk premium model, in addition to DCF and CAPM analyses. Like the DCF and CAPM analyses presented by the Company, the DCF and CAPM analyses presented by IIEC/CUB also used historical stock prices, a forecasted risk-free rate, and relied exclusively on weekly beta estimates. The Commission finds that IIEC/CUB's ROE recommendation is flawed for many of the same reasons as the Company's recommendation, including the use of a forecast to estimate the risk-free rate in their CAPM analysis, the use of historical stock prices in their DCF analyses and their application of a bond yield plus risk premium analysis, all of which the Commission has routinely rejected. Therefore, IIEC/CUB's ROE recommendation is rejected.

Unlike the Company, Staff did not include water utilities in its utility sample group. Staff recommends a 9.75% ROE based on its DCF and CAPM analyses. Staff used a utility sample group of seven similarly situated gas companies that reflect the operating and financial characteristics of Nicor Gas. Staff determined that the average investor-required rate of return on common equity for the Gas Sample is 9.80% based on the average of Staff witness Phipps' recommended DCF-derived results (9.70%) and risk premium-derived results (9.90%). Next, Staff deducted five (5) basis points (i.e., 5/100th of a percent, or 0.05%) to reflect the lower level of risk of Nicor Gas relative to the Gas Sample. This results in Staff's recommended 9.75% ROE for Nicor Gas.

Staff's analysis is based on a utility sample group that consists of gas companies that bear financial risks and operating risks similar to Nicor Gas. Additionally, Staff's CAPM analysis was based on a combination of weekly and monthly beta estimates to avoid unnecessary bias that results from using only one or the other. Staff also relies on U.S. Treasury securities to estimate the risk-free rate. in contrast, the Company relies only on weekly beta estimates in its CAPM and uses a forecasted risk-free rate. Based on the record in this case, the Commission finds it is more appropriate to rely on weekly

and monthly beta estimates and current observable U.S. Treasury bond yields to estimate the risk-free rate than the projected Treasury yields relied on by the Company.

Having considered all three proposals that are in the record, the Commission finds that Staff's recommended ROE is supported by the record and its ROE estimate of 9.75% is adopted.

4. Flotation Costs

a. Nicor's Position

Nicor Gas states that it has incurred costs of issuing common stock that have not previously been recovered in rates, and that it has identified and substantiated those costs in Nicor Gas Exs. 2.4 and 2.5. Nicor Gas explains that the Commission has previously held that where issuance costs have been incurred but not recovered, an adjustment to cost of equity is necessary to provide a fair return on issuance costs because "if these costs are not recovered in the Company's allowed rate of return, its investors will not have a fair opportunity to earn their required rate of return." *Iowa-Ill. Gas & Elec. Co*., Docket No. 92-0292 (cons.), 1993 Ill. PUC Lexis 245 Order at *126 (July 21, 1993). Nicor Gas argues that this is not a matter of policy alone—flotation costs are a cost of capital and utilities have a legal right to the opportunity to recover such costs just as they do with respect to any other type of cost. Nicor Gas argues that it is legally entitled to recover at least a substantial portion of these costs and that the evidence, on balance, supports recovery of them all.

Nicor Gas explains that the history of Nicor Gas flotation costs and the Company's efforts to recover them dates back years. Nicor Gas further explains that it sought to recover these costs in its 2004 rate case, but the Commission held that Nicor Gas had not provided sufficient evidence to justify their recovery. *04-0779 Order* at 94. The Company explains that it sought recovery of these costs again in its 2008 rate case, and ultimately agreed to withdraw its request but preserved its right to recover such costs in the future. Docket No. 08-0363, Nicor Gas Ex. 24.0. Nicor further explains that in the 2004 case, the data provided by Nicor Gas was substantially similar to the data available now, but not all that data was admitted into evidence. In its 2017 rate case, Nicor Gas provided all of the data required by Part 285 (in addition to its sworn testimony) and the data supporting these costs was moved into evidence. The Commission held in that case that "Nicor Gas' evidence is still lacking and fails to establish that these costs were not previously recovered through rates." *17-0124 Order* at 109.

Nicor Gas explains that the documentary evidence it provided in this proceeding includes contemporaneous securities instruments and issuance documents confirming the equity issuances and their flotation costs. In addition, Nicor Gas has provided evidence of the flotation cost entries in its Form 21 documents from 1960 to present, which are records that are accepted both by the Company in the course of its business and by professional accounts and the Commission and other regulators as persuasive evidence of the existence and amount of the Company's costs.

Nicor Gas points out that while the Commission has determined that this evidence is "lacking," neither Staff nor the Commission in previous decisions has articulated what additional evidence would be sufficient to establish that these costs have not been

recovered. Nicor Gas further points out that no party has identified any reason to doubt the accuracy or veracity of any of the testimonial or documentary evidence Nicor Gas provided, nor has the Commission found any of that evidence to be inaccurate or otherwise inadmissible. Nicor Gas has provided the Commission with sworn testimony based on the witnesses' review of Nicor Gas' audited books and records, original equity issuance documents, rate filings made with the Commission, annual reports to the Commission, and the Commission's own rate orders demonstrating that Nicor Gas has incurred issuance costs and that those costs have not been recovered. Nicor Gas states that, although Staff argues that this evidence is insufficient, this evidence is unrefuted.

Nicor Gas states that, in essence, Staff's argument is that because Nicor Gas did not recover these costs previously, it should not be allowed to recover these costs now. Nicor Gas states that there are several reasons why this argument should be rejected. First, Nicor Gas explains that the Commission's decisions are not res judicata. Nicor Gas states that there are numerous examples where the Commission's thinking has evolved and led to different results, even where the evidence was identical and there was no change in the law. It is with utmost respect that Nicor Gas asks the Commission to look again at these costs because the Company sincerely believes that denying recovery to date has been an error. Nicor Gas states that the Commission is called upon to rule on the issues based on the record and to decide them in accordance with the preponderance of that evidence, and no one can reasonably deny that Nicor Gas has supplied detailed evidence of its flotation costs and the fact that they have not been recovered. The Company argues that there is not a shred of evidence to the contrary.

Nicor Gas states that the Commission has acknowledged that denying recovery of unrecovered flotation costs denies investors a fair opportunity to earn their required rate of return. *Iowa-Ill. Gas & Elec. Co*., 1993 Ill. PUC Lexis 245, Order at *127. Nicor Gas argues that it has provided ample, unrefuted evidence that these costs were incurred and remain unrecovered, and the Commission should properly consider the evidence Nicor Gas has provided to allow for recovery of these expenses.

b. Staff's Position

Staff explains that flotation costs are incurred by a company when it issues common equity to the public. Staff notes that Nicor Gas witness Villadsen recommends adding a flotation cost adjustment of ten (10) basis points to her 10.25% ROE estimate, resulting in a recommended ROE of 10.35% for Nicor Gas. Nicor Gas Ex. 14.0 at 70. The Company's proposed flotation cost adjustment is derived using a generalized approach that has been rejected by the Commission because it fails to reflect any actual issuance costs that may have been incurred but not recovered by Nicor Gas. Staff Ex. 4.0 (Cor.) at 53. Dr. Villadsen applied a modified DCF formula that accounts for flotation costs to her natural gas utility sample and compared the results of the modified DCF to the results of her standard DCF analysis. *Id.* The difference between the calculated ROE with flotation costs and without flotation costs equals 10 basis points, which she added to her 10.25% ROE estimate in order to arrive at her 10.35% ROE recommendation for ratemaking purposes. *Id.* at 53-54.

Staff witness Phipps testified that since Dr. Villadsen's calculation is not based on issuance costs that the Company has incurred but has not previously recovered through

rates, it should not be considered in setting the investor-required rate of return on common equity for Nicor Gas. *Id*. at 54. Staff notes that the Commission has repeatedly rejected generalized flotation cost adjustments in previous cases, most recently in Nicor Gas' rate case in Docket No. 17-0124. *17-0124 Order* at 109.

For all the foregoing reasons, Staff argues the Commission should reject the Company's proposal to add a flotation cost adjustment and adopt Staff's recommended ROE of 9.75% which does not include a flotation cost adjustment.

c. IIEC/CUB's Position

IIEC/CUB witness Walters did not include a flotation cost adjustment in his recommended ROE of 9.4%. IIEC/CUB agree, as Staff witness Phipps pointed out in her direct testimony, the Commission has routinely rejected generalized flotation cost adjustments as inappropriate. Staff Ex. 4.0 at 54. IIEC/CUB agree with Staff on this issue. IIEC/CUB argue the Commission should not allow a flotation cost adjustment to the Company's return on common equity approved in this case.

d. Commission Analysis and Conclusion

The Company claims that it is entitled to a flotation cost adjustment of 10 basis points to its proposed ROE for costs that Nicor Gas has incurred, but not recovered through rates. Nicor Gas argues that its evidence is sufficient to support recovery of this adjustment. Staff points out that the Company arrived at its figure by applying a modified DCF formula that accounts for flotation costs to its natural gas utility sample and compared the results of the modified DCF to the results of its standard DCF analysis. The difference between the calculated ROE with flotation costs and without flotation costs equals 10 basis points. The Commission finds that this calculation is not based on actual costs incurred by the Company that have not been recovered through rates but represents a generalized flotation cost. Nicor Gas did not provide any alternative numbers based on the amount claimed. The Commission has repeatedly rejected generalized flotation cost and rejects the Company's request for a flotation cost adjustment of 10 basis points.

C. Recommended Rate of Return on Rate Base

a. Nicor Gas' Position

Nicor Gas seeks a 7.29% overall rate of return on its net rate base. Nicor Gas explains that this weighted average cost of capital is derived mathematically from Nicor Gas' proposed embedded cost of debt, and its calculated annual rate of return on common equity. The Company states that its proposed overall rate of return is reasonable and within industry standards, and fairly reflects the Company's costs of providing safe, reliable utility service. The derivation of Nicor Gas' proposed rate of return is summarized in the following table (Nicor Gas Ex. 18.1 at 1):

PROJECTED COST OF CAPITAL SUMMARY

Line No.	Class of Capital	Amount ($000)	Percent of Total	Percent Cost	Weighted Cost
	(A)	(B)	(C)	(D)	(F) = (C X D)
	December 31, 2022				
1	Long-term Debt	2,126,690	43.965%	3.685%	1.62%
2	Short-term Debt	76,242	1.576%	0.751%	0.01%
3	Commercial Paper Fees				0.02%
4	Common Equity	2,634,322	54.459%	10.35%	5.64%
5	Total Capital	$ 4,837,255	100.000%		7.29%

Nicor Gas argues that the record evidence supports its proposed 7.29% overall rate of return. Nicor Gas states that this rate of return, which incorporates Nicor Gas' proposed capital structure, its proposed 10.35% ROE, and its proposed embedded cost of debt, fairly reflects the costs to provide safe, reliability utility service. Nicor Gas argues that Staff's and IIEC/CUB's proposed overall rates of return of 6.96% and 6.63%, respectively, are based on recommended costs of common equity that do not appropriately take into account market conditions, Nicor Gas' characteristics, and economically sound estimation methodologies and inputs. Nicor Gas argues that IIEC/CUB's recommendation is further reduced by a capital structure recommendation that is unsupported and does not take into consideration the evidence in the record. Nicor Gas argues that the Commission should reject Staff's and IIEC/CUB's proposals regarding the weighted average cost of capital.

b. Staff's Position

Staff states that Nicor Gas' overall cost of capital should be 6.96%. Staff IB, Appendix A, Schedule 1, column I, line 22. This incorporates a 9.75% cost of equity, a 3.69% cost of long term debt, a 0.13% cost of long term debt and a credit facility fee of 2.4 basis points for the gas delivery services of Nicor Gas. Staff Ex. 10.0 (Cor.) at 2.

c. IIEC/CUB's Position

IIEC/CUB's proposed capital structure, which includes 52% common equity and reflects a 9.4% return on common equity, will produce an overall rate of return for Nicor Gas of 6.63%. *See* IIEC Ex. 2.1. IIEC/CUB stress an overall rate of return of 6.63% will provide Nicor Gas with the opportunity to earn credit metrics that support an issue or credit rating of A, which is identical to Nicor Gas' current rate. IIEC/CUB Ex. 2.0 at 63.

d. Nucor's Position

Nucor asserts that the Commission should approve a ROE that both provides Nicor Gas a fair return and accounts for the impact of the approved ROE on Nicor Gas' customers. Nucor notes that Nicor Gas proposes an ROE of 10.35%, which includes a 10-basis point adder for unrecovered flotation costs. However, as explained by IIEC/CUB, Nicor Gas' proposed ROE is excessive and unreasonable and overstates the return on equity for Nicor Gas. Nucor states that the Commission should adopt IIEC/CUB's recommended ROE and capital structure because it mitigates ratepayer impacts while still providing Nicor Gas with an opportunity to realize a fair and reasonable return.

e. 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 6.96% as calculated below.

CAPITAL COMPONENT	Weight	Cost	Weighted Cost
Short-term Debt	1.576%	0.13%	0.00%
Long-term Debt	43.965%	3.69%	1.62%
Common Equity	54.459%	9.75%	5.31%
Credit Facility Cost			0.02%
Total	100.00%		6.96%

VII. 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 decisions in the 2017 and 2018 Rate Cases. Staff and Nicor Gas agree on the ECOSS methodology. The AG challenges the treatment of distribution main costs in the ECOSS, and IIEC proposes adjustments to the allocation of distribution and transmission main costs.

B. Contested Issues

1. Embedded Cost of Service Study

a. Application of Modified Distribution Main Study

(i) Nicor Gas' Position

The Company explains that consistent with its approach in earlier rate cases, it prepared a Modified Distribution Mains ("MDM") study, the results of which were incorporated into the Company's ECOSS. The MDM study examined the main size that connects individual customers to the Company's distribution system. The study also collects information about the customer's rate class and peak demand. This process is repeated for each main size. Ultimately, the MDM study serves to assign main costs to customers based on their relative utilization. Nicor Gas notes that Staff did not object to the Company's ECOSS or the use of the MDM study.

The Company states that the AG incorrectly claims that a significant portion of main costs appear in the ECOSS as being customer-related, and that the Company's methodology is contrary to what is approved for other Illinois utilities. The Company highlights that the MDM study has no bearing on the classification of distribution main costs as customer-related because the study is used to allocate costs among rate cases. Rather, the Company classifies distribution main costs between the demand and customer components using a completely separate analysis – a medium size study. This

approach is consistent with the Commission's determination in the *17-0124 Order*. In addition, Nicor Gas challenges the AG's claim that the Company's approach is inconsistent with that approved for other Illinois utilities. In fact, Nicor Gas witness Yardley explained that the language from the Ameren Gas rate case order upon which the AG relies expressly noted that the passage was not relevant to Nicor Gas. As such, the Company argues that the Commission should reject the AG's assertions with regard to the MDM study.

Meanwhile, Nicor Gas also opposes IIEC's suggested modifications to the MDM study. IIEC seeks to replace the demand component of distribution mains with a design-day allocation and the allocation of the customer component of distribution mains with a customer count allocation. The Company explains that the Commission previously considered and rejected proposals that deviated from its prior MDM study directives. Nicor Gas asserts that IIEC failed to show that its proposed methodology is superior to the approach that the Commission previously approved for Nicor Gas. Additionally, the Company pointed to the testimony of its witness, Yardley, who explained that IIEC's proposal, if adopted, would result in a $74.3 million increase in total revenue requirements allocated to residential customers. The Company maintains that this proposed adjustment should be rejected.

(ii) Staff's Position

Staff witness Harden did not object to the Company's use of the modified MDM in the ECOSS. Staff Ex. 5.0 at 8. Specifically, Ms. Harden testified that the results of the MDM have been reflected in the Company's ECOSS for the last six Nicor Gas rate cases. Ms. Harden explained that MDM divides the costs of the distribution mains between demand-related and customer-related components. MDM assumes that the system can be divided between a theoretical minimum-sized system, that would use only the smallest-sized mains in its entirety, and the remainder of the system, which provides additional capacity for those customers who need it. Staff Ex. 5.0 at 7. Under this approach, the costs associated with the theoretical minimum-sized system are treated as customer-related costs and the costs for the remainder of the system are treated as demand-related costs. The costs identified by MDM as customer-related are allocated among customer classes based on the number of customers and the costs identified by MDM as demand-related are allocated among customer classes based on usage. Then, the costs of the distribution mains that have been allocated to each customer class are distinguished within each class as customer-related or demand-related as indicated in MDM. Staff Ex. 5.0 at 7-8.

(iii) IIEC's Position

IIEC notes Nicor Gas allocated both the demand-related and customer-related components of distribution mains using the MDM and average allocation factor. While IIEC does not take issue with the development of the MDM study itself, IIEC does take issue with its application to the cost allocation process. Specifically, IIEC recommends allocating the demand-related distribution main costs using the MDM allocator without the average component. The MDM allocator is a variation of the design day demand allocator which reflects the fact that some large gas users do not take service from small distribution mains. Further, IIEC recommends allocating the customer component of

distribution mains using the number of customers in each class. IIEC states its recommended allocation of distribution main costs reflects cost causation and produces a more accurate measure of each class's cost of service than the Company's proposed cost allocation method.

With respect to the customer component of distribution mains, IIEC observes Nicor Gas witness Yardley noted that the classification of distribution mains should reflect the two distinct cost-causative factors that drive Nicor Gas' need to invest in these facilities: (1) distribution mains are designed to deliver the maximum quantities that are required during a peak period in order to maintain reliable operating pressures; and (2) to deliver supplies in reasonable proximity to customers in order to minimize the length of pipe used to serve all customers in an overall efficient fashion. IIEC Ex. 1.0 at 11. IIEC also points out that Mr. Yardley testified that the customer component of mains is supported by the system design criteria taken into consideration by the Company's distribution engineering staff. *Id*. at 11.

IIEC argues in order to tie cost allocation to cost causation, the customer component of distribution mains should be allocated using the number of customers in each customer class. IIEC states that as noted by Mr. Yardley, the customer component of distribution mains is typically allocated on the basis of the number of customers in each rate class. Nicor Gas Ex. 12.0 at 13.

IIEC notes Mr. Yardley's reason for opposing a customer allocation of the customer component of distribution mains was once again tied to prior Commission statements. Nicor Gas Ex. 28.0 at 8. According to IIEC, Mr. Yardley cited a prior comment from the Commission, stating that the Commission specifically noted that it was not convinced that the allocation of Nicor Gas distribution mains costs based on the number of customers would be beneficial to customers. *Id*. at 8. However, IIEC notes while Mr. Yardley used the Commission's prior statements to justify his opposition to Ms. York's recommended allocation of the customer component of distribution mains, he admitted that he did not understand the Commission's comment. IIEC Ex. 2.0 at 7.

IIEC points out Nicor Gas has confirmed a causal link between customers on the system and the cost of installing distribution mains. IIEC notes Nicor Gas admitted that when designing mains, it pursues the most efficient and economic route available to provide service to all customers. IIEC Ex. 2.0 at 8; IIEC Ex. 2.1 at 12. The most efficient and economical route (i.e. length) of mains depends on the location of the customers that need to be connected to the system. *Id*. at 8. As explained by Mr. Yardley, as a result, increases in the number of customers typically drive growth in the investment in distribution mains facilities. *Id*. at 8; Nicor Gas Ex. 1.0 at 10-11. Therefore, IIEC agues allocating the customer component of distribution mains on the basis of the number of customers in each class appropriately reflects cost causation and contributes to an accurate measure of Nicor Gas' cost of providing service to each class.

(iv) Commission Analysis and Conclusion

As an initial matter, Nicor Gas disputes statements made by AG witness Rubin regarding the MDM study. In testimony, AG witness Rubin challenges assumptions in Nicor Gas' ECOSS. However, the AG did not address this issue in briefs and does not

object to Nicor Gas' ECOSS. Staff also supports Nicor Gas ECOSS, including the modified MDM study.

The results of the MDM have been reflected in the Company's ECOSS for the last six Nicor Gas rate cases. The Commission has previously considered and rejected proposals that deviated from its prior MDM study directives. IIEC has not provide sufficient evidence for the Commission to revise its opinion in this proceeding.

b. Average Peak Allocator/Design Day Demand Allocator

(i) Nicor Gas' Position

Consistent with prior Commission directives, Nicor Gas utilized the peak and average general demand allocation factor ("A&P allocator") to prepare the ECOSS. The A&P allocator blends two factors to derive class responsibility for demand-related fixed costs: (1) the contribution to design-day demand, and (2) the proportion of annual use. The Company explains that the distinction between these factors is that the former reflects the design of the system, while the latter factor reflects the utilization of the system constructed to satisfy system design criteria. Staff witness Harden agrees that utilizing this allocator in the Company's ECOSS is appropriate for designing rates in this proceeding.

Nicor Gas opposes IIEC's suggestion to replace the A&P allocator for transmission mains with a design-day allocation stating that the IIEC's proposal is inconsistent with the Commission's general preference for using a peak and average demand allocation factor over a design-day demand allocation factor. The Company points out that the Commission considered and rejected alternative allocators to the MDM study in the Company's 2017 Rate Case, thereby ratifying Nicor Gas' use of the MDM study. Nicor Gas maintains that IIEC has failed to show that its proposed methodology warrants a departure from that previously adopted by the Commission and notes that Staff does not support IIEC's proposal.

(ii) Staff's Position

Staff witness Harden testified that the Company uses the A&P allocator based on the Commission's preference in past dockets. The A&P allocator blends two factors to derive each class responsibility for demand-related fixed costs. Staff Ex. 5.0 at 5; Nicor Gas Ex. 12.0 at 13.

Staff witness Harden supported the A&P allocator. Staff Ex. 5.0 at 6. Ms. Harden explained that the A&P method is a hybrid methodology that employs two allocators for system costs. The first allocator is based upon the class shares of average demand or usage levels. The second allocator is based upon the class contributions to system peak demands. The A&P method recognizes that two key factors drive investment in transmission and distribution plant: the demand factor and the system load factor. *Id*. The demand factor represents the need to meet peak demands, not just for individual classes, but for the system as a whole. Therefore, coincident peak demands are used as one component of the allocator. The demand allocator recognizes the role of year-round demands in shaping transmission and distribution investments through the average demand component. The investment associated with a distribution system could not be justified solely by demands on a peak day. Rather, it is dictated by year-round demands

by all ratepayers. *Id*. Ms. Harden explains that the system load factor, or how efficiently energy is used, provides a reasonable dividing point because it measures the relationship, through a ratio, between average usage and peak demand on an annual basis. The system load factor serves as a reflection of how average usage throughout the year compares with usage at the peak. Thus, Staff witness Harden determined that it provides a reasonable comparison between these two sets of demands for utility service and supported the A&P allocators use in the ECOSS. *Id*. at 7.

(iii) IIEC's Position

IIEC opines that Nicor Gas and Staff have pointed to prior rate cases as primary support for use of the A&P methodology in this case. However, IIEC observes prior Commission decisions are not *res judicata* or precedential and the Commission is free to reach different decision in a subsequent case based on the evidence in the record in that case. As a matter of law, past Commission decisions do not constitute binding precedent and the Commission may modify its prior determinations on the basis of new information or a reconsideration of evidence. *Mississippi River Fuel Corp. v. Ill. Commerce Comm'n*, 1 Ill. 2d 509 (1953); *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 291 Ill. App. 3d 300, 307 (1st Dist. 1997). IIEC argues the evidence in this case supports the rejection of the A&P methodology as a reasonable cost-based allocator of transmission and distribution capacity costs. There is no sound rationale or support for continued reliance on the A&P method.

IIEC notes in this docket, Nicor Gas advocated the use of the A&P class cost of service study, simply because it was how the Commission allocated fixed capacity cost in recent previous rate cases. Nicor Gas Ex. 12.0 at 13. However, IIEC points out Nicor Gas' witness Yardley could not and did not provide any technical, or theoretical cost-causation rationale for why the A&P methodology reasonably and accurately allocates capacity costs across rate classes based on cost causation. Indeed, IIEC observes Mr. Yardley acknowledged that the allocation of fixed capacity cost based on design day demand would be a superior and more reliable methodology compared to the A&P method for allocating fixed delivery capacity costs. *Id*. at 13. IIEC reasons Nicor Gas has provided a substantial amount of evidence showing that design day demand drives investment in transmission and distribution delivery main capacity, and that average demand or throughput, is not a load characteristic that drives the utility's need to invest in delivery capacity.

IIEC points out, for example, the Company stated in data responses that it does not design its system of mains to meet the average demand of its customers. IIEC Ex. 1.1 at 1. IIEC emphasizes that Nicor Gas agreed that if distribution main capacity was designed to meet average demand rather than peak day demand, then there would not be enough capacity available to provide reliable, uninterrupted service to firm service customers on the system peak day. *Id*. at 2. IIEC showed that Mr. Yardley confirmed that contribution to coincident peak day demand is most appropriate in developing a capacity allocation factor because demand-related costs are primarily incurred to meet the design day and design hour demands on the Local Distribution Company's system. IIEC Ex. 2.0 at 4; IIEC Ex. 2.1 at 1. Further, IIEC points out Mr. Yardley stated that allocation of demand-related costs on the basis of class contribution to design day is consistent with cost causation. IIEC Ex. 2.0 at 4; IIEC Ex. 2.1 at 1. Finally, IIEC points

out Mr. Yardley acknowledged that he does not agree that annual natural gas consumption is a cost-causative factor of a Local Distribution Company's demand-related costs. IIEC Ex. 2.0 at 4; IIEC Ex. 2.1 at 2.

IIEC also explains that Staff witness Harden attempted to justify her support for Nicor Gas' A&P ECOSS based on cost causation principles. Specifically, IIEC observes Ms. Harden claimed that the A&P method recognizes that two key factors drive investment in transmission and distribution plant: design day peak demand, and system load factor. Staff Ex. 5.0 at 6. However, IIEC points out Ms. Harden's claim that system load factor drives investment is erroneous, and contradicted by her responses to IIEC's discovery requests, as well as by the substantial amount of evidence produced by Nicor Gas as described above. IIEC notes a fundamental assumption by Ms. Harden to support her advocacy of the A&P method is wrong, contrary to the evidence in this case, and not based on cost causative principles.

IIEC notes that while Ms. Harden testified that system load factor drives investment in transmission and distribution plant, Nicor Gas confirmed that it does not. IIEC Ex. 3.0 at 4; IIEC Ex. 3.1 at 2. IIEC further points out that Ms. Harden then contradicted her own testimony by stating in response to a discovery request that she does not agree that load factor is one of the criteria generally considered by Nicor Gas to design facilities required to serve a customer class. IIEC Ex. 3.0 at 4; IIEC Ex. 3.1 at 7. In fact, in contradiction to her testimony assertions, IIEC notes Ms. Harden admitted that design day demand is the single load characteristic used to design the Company's transmission and distribution system delivery capacity. IIEC Ex. 3.0 at 5; IIEC Ex. 3.1 at 9.

IIEC asserts Ms. Harden also erroneously claimed that year-round demands shape transmission and distribution investments, and that the investment associated with a distribution system could not be justified solely by demands on a peak day. Staff Ex. 5.0 at 6. Presumably, "year-round" demands refer to daily usage on the system throughout the year. IIEC Ex. 3.0 at 5. However, IIEC notes Ms. Harden did not provided evidence demonstrating, in contradiction to the Company's admission and evidence in this case, how anything other than the system design day demand is used to design and develop Nicor Gas' transmission and distribution delivery system capacity. *Id*. at 5; IIEC Ex. 3.1 at 4-6.

IIEC explains while Ms. Harden agreed that design day demand drives investment in transmission and distribution capacity, she erroneously tried to caveat her agreement by suggesting that the utility cannot support its transmission and distribution infrastructure investments if it only operated one day per year, the peak day. IIEC Ex. 3.0 at 8-9; IIEC Ex. 3.1 at 9. According to IIEC, its witness Mr. Collins addressed this caveat by explaining that the design day demand "capacity needed by each rate class is used by every rate class on the system every day of the year, but the pressure in the delivery mains is modified in order to accommodate the variations in daily demands of the customer classes." IIEC Ex. 3.0 at 9-10.

IIEC points out that Ms. Harden further asserted that using design day demand implies that the utility will be paid for capacity investments on only one day per year, the peak day. IIEC says this is an assertion without merit. IIEC finds no such implication exists, nor is the existence of any such implication supported by any evidence in this case.

IIEC Ex. 3.0 at 11. IIEC notes no party other than Ms. Harden has made such an assertion. IIEC argues the design day demand allocator properly distributes the cost of capacity needed by the utility and used to provide service to all customer classes every day of the year, including the peak day, and customers pay for this capacity throughout the year. IIEC Ex. 3.0 at 11. IIEC says, this fact is supported by the testimony of Ms. York, Mr. Collins and Nicor Gas' own witnesses.

IIEC asserts a gas distribution utility incurs the fixed capital costs with mains designed to meet design day demand, but those fixed costs do not vary when the utility delivers less than its customers' design day demand in order to meet customer demand that varies throughout the year according to IIEC that is a point with which Ms. Harden agreed in her data responses. IIEC Ex. 3.0 at 10-11; IIEC Ex. 3.1 at 8.

IIEC notes that despite the admission, Ms. Harden claimed that a design day demand allocator can impair the ability of a utility's shareholders to realize a profit. IIEC Ex. 3.1 at 9; IIEC Ex. 3.0 at 11. IIEC states this claim is without merit. IIEC contends this appears to be an argument not made before by Staff to justify the use of the A&P allocator. IIEC Ex. 3.0 at 12.

(iv) Nucor's Position

Nucor states that the Commission should reject the A&P allocation methodology because it is not based on cost-causation principles. While the Commission has expressed a preference for the A&P methodology in the past, as IIEC illustrates, Nucor states that the record evidence in this case does not support the use of the A&P methodology in this instance. The A&P methodology does not reflect the status of Nicor Gas' system or the ways in which Nicor Gas invests in its transmission and distribution main capacity. Design day demand is the driver of such investments, not average demand or throughput. Therefore, Nucor argues, the A&P methodology should be rejected because it does not accurately reflect Nicor Gas' system planning and investments. Accordingly, Nucor states that the Commission should instead adopt the design day demand ECOSS as recommended by IIEC.

(v) Commission Analysis and Conclusion

The Commission finds that IIEC fails to show that its proposed allocation methodology warrants a departure from the allocation methodology previously adopted by the Commission. IIEC's proposal is inconsistent with the Commission's general preference for using an A&P demand allocation factor over a design-day demand allocation factor. The Company points out that the Commission considered and rejected alternative allocators to the MDM study in the *17-0124 Order*. Moreover, as IIEC acknowledges, there would be a significant rate impact on the residential class if IIEC's overall ECOSS recommendation is adopted. Accordingly, IIEC's proposal to use the design day demand allocator is rejected.

2. Class Revenue Allocation

a. Nicor Gas' Position

IIEC witness York proposed an alternative revenue allocation which would result in an equal increase to all rate classes. The Company responded that Ms. York's proposed allocation contradicts the results of Ms. York's ECOSS, and that IIEC provided

no new evidence to reject Nicor Gas' proposed ECOSS. The Company maintains that the proposed revenue allocation does not shift cost responsibility in a meaningful way and it does nothing to reduce the existing subsidies. Therefore, it offers no benefit to customers. Finally, the Company notes that neither Staff nor the AG agree with IIEC's proposal.

b. Staff's Position

Staff explains that the results of an ECOSS are summarized in rates of return for customer classes. Classes generating above-average returns are paying more than their share of the Company's revenue requirement, while classes with below-average returns are paying less than their share. In Staff's view, basing rates on cost is both efficient and equitable since the rates that consumers pay reflects the utility's cost of providing the service.

Company witness Yardley stated the Company's ECOSS assesses the reasonableness of its existing and proposed base rates while employing sound allocation methods reflecting principles of cost causation and is consistent with the requirements established by the Commission in the Company's last rate case (*18-1775 Order*). Nicor Gas Ex. 12.0 at 3, 5. The Company's ECOSS establishes the total investment and operating costs incurred and establishes the division of revenue requirements between customer classes. The revenue requirements are compared with class revenues in order to establish class income and rate of return on investment. The rates of return are used to guide the division of the base rate increase in the development of fair and reasonable proposed rates. Nicor Gas Ex. 12.0 at 6.

Staff witness Harden found that the Company's ECOSS and allocation of the revenue requirement among rate classes to be reasonable. Staff Ex. 5.0 at 2. Staff witness Harden noted in her rebuttal testimony that IIEC witness York recommended an equal percent increase for all non-contract customer classes. IIEC Ex. 1.0 at 15. Ms. Harden agreed with Company witness Yardley that there is not a clear basis set forth by Ms. York in her testimony to approve her recommendation. Nicor Gas Ex. 28.0 at 9. Staff witness Harden testified that the Commission has a longstanding objective of basing rates on costs. Occasional exceptions may occur such as a lack of accurate data from a Company to develop a cost-based alternative; the customers are unmetered; or a vast majority of customers served are similar type customers and therefore, the Company may claim it is not able to distinguish a difference in costs to serve. Staff Ex. 11.0 at 7-8. Staff witness Harden does not see conditions that would justify an across-the-board equal percentage increase. *Id*. at 8.

Additionally, Ms. Harden does not agree with IIEC witness York's preference for an allocation method based solely on the design of transmission and distribution mains. *Id*. Staff witness Harden explained that the design of the transmission and distribution mains must accommodate peak demand; however, the mains are not in use solely for the coldest day of the year, or the peak day, but rather for every day of the year. The demand each day throughout the year produces a sufficient revenue stream to make an investment viable. Ms. Harden testified that peak day demands alone cannot justify the expense of constructing a transmission and distribution system. *Id*. Therefore, average demands should also be considered. Staff witness Harden explained that the A&P

allocation method accounts for both the average demand and peak demand, giving greater weight to peak demand. *Id*. Thus, even though average demand may not be part of the design process, it is an appropriate factor in the allocation method.

Accordingly, Staff recommended that the Commission approve the ECOSS presented by the Company in this proceeding.

c. IIEC's Position

IIEC argues the evidence produced by Nicor Gas confirms that Nicor Gas' proposed A&P ECOSS does not reflect cost causation, and therefore does not produce an accurate measure of the Company's cost of providing service to each customer class. Instead, IIEC says the evidence supports the accuracy and reasonableness of IIEC's design day demand ECOSS.

IIEC indicates a comparison of the results of Nicor Gas' A&P ECOSS to IIEC's design day demand ECOSS was presented in Table 2 of IIEC witness York's direct testimony. IIEC Ex. 1.0 at 13. Under the A&P ECOSS, the Rate 76 class would require an increase of approximately 57% to reach cost of service, and the Rate 77 class would require nearly a 100% increase. IIEC Ex. 1.0 at 13. In comparison, the design day demand ECOSS shows that both of those classes would require less than the system average increase to reach cost of service. IIEC Ex. 1.0 at 13. For the residential (Rate 1) class, the A&P ECOSS shows a required increase of 33% to reach cost of service (including the roll-in of QIP), but the design day demand ECOSS shows that the Rate 1 class would require an increase of 44.7%, at the Company's requested revenue requirement. IIEC Ex. 1.0 at 13, Table 2.

IIEC notes that the results of both Nicor Gas' A&P ECOSS, and IIEC's design day demand ECOSS show that mitigation of customer class impacts is appropriate. As a result, IIEC proposes an equal percentage increase for all non-contract customer classes. IIEC shows this results in all non-contract customer classes receiving a 1.01 times system average increase, or 33.1%. IIEC Ex. 1.0 at 15. IIEC observes its proposed revenue spread is comparable to Nicor Gas' proposed revenue spread (which was based on its A&P ECOSS, with mitigation) for Rate 1, Rate 4, Rate 74, and the contract class. IIEC Ex. 1.0 at 15. IIEC's proposed increase for the Rate 77 class is 33.1%, which is less than Nicor Gas' proposed increase of 40% but is supported by the design day demand ECOSS results. IIEC Ex. 1.0 at 15. IIEC concludes that while Rate 76 should receive a decrease based on IIEC's design day demand ECOSS, this class would receive an increase under IIEC's proposed revenue spread. IIEC Ex. 1.0 at 15.

IIEC argues the impact of its proposed revenue allocation to the residential class is minimal. That is Nicor Gas proposed an increase of $208.721 million, including the roll-in to base rates of QIP, for the Rate 1 class. IIEC Ex. 1.0 at 16. IIEC's proposed increase for Rate 1 is $209.358 million, or about $637,000 more than Nicor Gas' proposed increase. IIEC Ex. 1.0 at 16. IIEC notes that spreading this difference over 2,062,124 Rate 1 customers equates to $0.03 per customer per month, assuming that Nicor Gas recovers 100% of its claimed revenue deficiency. IIEC Ex. 1.0 at 16.

IIEC indicates that Nicor Gas argues that Ms. York has not supported IIEC's proposed revenue allocation. Nicor Gas Ex. 28.0 at 9. IIEC disagrees with this

perspective. IIEC believes its proposed revenue allocation reflects a compromise between the results of Nicor Gas' A&P ECOSS, the design day demand ECOSS, and the Company's proposed revenue allocation. IIEC contends its revenue allocation provides a path for the Commission to transition to a revenue allocation based on the design day demand ECOSS, which has been shown to produce the most accurate measure of Nicor Gas' cost of providing service to each customer class, while mitigating the impact on the residential class.

IIEC explains under Nicor Gas' A&P ECOSS, the residential class would require an increase of 33.0% to reach cost of service. IIEC Ex. 1.0 at 3, Table 1. Under Nicor Gas' proposed revenue allocation, the residential class would receive an increase of 33.0%, bringing that class to parity based on the A&P ECOSS. IIEC Ex. 1.0 at 15, Table 3. IIEC points out its proposed revenue allocation would result in a 33.1% increase for the residential class. Therefore, IIEC maintains its proposed equal percent increase for all non-contract customer classes does not harm the residential class and is in fact consistent with the Company's A&P ECOSS results and proposed increase for this class.

IIEC notes the residential class is not harmed by its proposed revenue allocation. IIEC emphasizes however, not adopting its proposed revenue allocation will significantly harm the higher load factor customer classes. IIEC points out that the Company's proposed revenue allocation, based on the results of its non cost causative A&P ECOSS, would result in increases of about 40% for the Rate 76 and Rate 77 classes. IIEC asserts that increases of this magnitude would be unjust, unreasonable, and inequitable, given the evidence in this case, which clearly shows that the A&P ECOSS does not accurately assign costs to cost-causers.

IIEC contends the evidence in this case supports the accuracy and reliability of its proposed design day demand ECOSS. The design day demand ECOSS shows that Rate 76 would actually require a small decrease to reach cost of service, while Rate 77 would require a below-system average increase. IIEC Ex. 1.0 at 13, Table 2. IIEC's proposed equal percent increase for all non-contract customer classes brings both of these classes above cost of service, based on the design day demand ECOSS. In addition, IIEC argues its proposed revenue allocation provides no decrease to any rate class. IIEC further argues its approach mitigates the increase for the residential class and is consistent with the Company's proposed increase for this class.

IIEC notes AG witness Rubin did not propose any changes in Nicor Gas' proposed allocation of any rate increase among the customer classes. AG Ex. 3.0 at 4. He recommended that if the Commission determines that the overall revenue requirement is less than Nicor Gas requested, each class's multiple of the system-average increase should be kept approximately the same as Nicor Gas proposed. *Id*. at 4. Mr. Rubin also concluded that from the perspective of residential customers, he considered Nicor Gas' class revenue allocation to be reasonable and consistent with the results of the ECOSS. AG Ex. 3.0 at 8.

IIEC argues Nicor Gas' proposed revenue spread should be rejected, because it is based on an ECOSS that does not produce an accurate measure of each class's cost of service. IIEC notes the Company, AG witness Rubin, Staff, and IIEC are aligned with respect to the proposed increase for the residential class. IIEC Ex. 2.0 at 15. IIEC

believes its proposed revenue allocation reflects a compromise between the results of Nicor Gas' A&P ECOSS, the design day demand ECOSS, and the Company's proposed revenue allocation. IIEC contends its revenue allocation provides a path for the Commission to transition to a revenue allocation based on the design day demand ECOSS, which has been shown to produce the most accurate measure of Nicor Gas' cost of providing service to each customer class, while mitigating the impact on the residential class. IIEC states it is reasonable to support an equal percent increase for all non-contract customer classes, taking into account the undue impact to several customer classes, where the Company's proposed increases are not cost-based in the first instance.

d. Nucor's Position

Nucor asserts that the ECOSS proposed by IIEC based on design day demand should be adopted because it is more aligned with cost causation principles than Nicor Gas' ECOSS. While Nucor supports the design day demand ECOSS, Nucor also agrees with IIEC's proposal to mitigate the impact of a complete transition to design day demand allocation in this case. If the design day demand ECOSS were adopted without modification, the residential class would receive a 44.7% rate increase. To mitigate such an increase, IIEC proposes an equal 33.1% increase for all non-contract customer classes. Therefore, because IIEC's proposed revenue allocation is based on an ECOSS more aligned with cost causation principles than Nicor Gas' ECOSS, Nucor recommends that the Commission adopt IIEC's proposed revenue allocation.

e. Commission Analysis and Conclusion

The Commission believes that it is important to set rates based on costs whenever possible. The Commission agrees with Staff and the Company that there is no clear basis for IIEC's recommendation of an equal percent increase for non-contract customer classes. IIEC's recommendation does not shift cost responsibility in a meaningful way and does not reduce existing subsidies. IIEC's alternative revenue allocation is also based on the Commission's adoption of IIEC's design day demand ECOSS. As noted above, the Commission does not adopt IIEC's ECOSS and therefore it rejects IIEC's alternative class revenue allocation proposal.

VIII. RATE DESIGN

A. Uncontested Issues

1. 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 customer 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). No party has challenged Nicor Gas' companion rates, which are

consistent with the 2017 Rate Case. The Commission approves Nicor Gas' companion rates.

a. Rates 4 and 74

Nicor Gas' proposed Rate 4 (General Service) and Rate 74 (General Transportation Service) were derived on a combined basis, taking into account the revised unit cost of storage, which is deducted from the Rate 74 distribution charges. The Company proposes to increase the fixed monthly customer charges by a greater proportion than the variable distribution charges for Rate 4 and Rate 74 customers. Once the monthly customer charges are determined, existing distribution charges are increased to recover the remaining base revenue requirements, with an adjustment to reflect the updated unit cost of storage deducted from the Rate 74 charge. No party has challenged Nicor Gas' calculation of the proposed rates. The Commission approves the revisions to Rate Schedules 4 and 74 and the final rates shall be adjusted based on the revenue requirement approved in this Order.

b. Rates 5 and 75

Nicor Gas proposes to increase the base revenues rates for Rate 5 (Seasonal Use Service) and Rate 75 (Seasonal Use Transportation Service) to reflect the elimination of QIP revenues and a modest revenue increase. The proposed monthly customer charges are increased to the same levels as the corresponding Rate 4 and 74 charges. Nicor Gas also proposes to set the winter period distribution rate to equal to the tail block rate for Rate 74 with all remaining revenue requirements recovered through the summer period distribution rate. No party challenges these proposed revisions. The Commission approves Nicor Gas' proposed revisions to Rate Schedules 5 and 75 and the final rates shall be adjusted based on the revenue requirement approved in this Order.

c. Rates 6 and 76

Nicor Gas proposes to increase the customer charge for Rate 76 (Large General Transportation Service) to $2,765 to reflect the results of the ECOSS and derive a delivery charge necessary to yield the target level of base revenues. Nicor Gas currently has no customers taking service under Rate 6 (Large General Service), and proposes to set the Rate 6 rates equal to the Rate 76 rates, with the exception that the delivery charge was increased to reflect the unit cost of storage for Rate 76. No party challenges these proposed revisions. The Commission approves Nicor Gas' proposed revisions to Rate Schedules 6 and 76 and the final rates shall be adjusted based on the revenue requirement approved in this Order.

d. Rates 7 and 77

Nicor Gas proposes to set rates for Rate 77 (Large Volume Transportation Service) based on the target revenue requirement, by increasing the monthly fixed cost 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 currently has no customers taking service under Rate 7 (Large Volume Service), and proposes to set the Rate 7 rates equal to the Rate 77 rates, with the exception that the delivery charge was increased to reflect the unit cost of storage for Rate 77. No party challenges these proposed revisions. The Commission approves Nicor Gas' proposed

revisions to Rate Schedules 7 and 77 and the final rates shall be adjusted based on the revenue requirement approved in this Order.

2. Existing Riders

a. Rider 6 – Gas Supply Cost

Nicor Gas proposes a Residential Uncollectible Factor of 2.16% and a Non-residential Uncollectible Factor of 1.12% be applied to the monthly Gas Cost, which is the sum of the Commodity Gas Cost ("CGC") and the non-CGC rate. No party has challenged the proposed revision. Accordingly, the Commission approves Nicor Gas' proposed adjustment to Rider 6.

b. Rider 26 – Uncollectible Expense Adjustment

Nicor Gas proposes to modify Rider 26 – Uncollectible Expense Adjustment, to update the amount of uncollectible recovery embedded in the Company's base rate revenue requirement to reflect the delivery-based bad-debt forecast amount of $14.8 million for the Test Year. No party challenges Nicor Gas' proposal. The Commission approves this rate design proposal.

3. Proposed Riders

a. Rider 35 – Customer Payment Fee Rider

Nicor Gas withdrew 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 an issue in this proceeding.

4. Terms and Conditions

a. Landlord/Property Manager Agreement

Nicor Gas proposes to revise the Landlord/Property Manager Agreement, found on 1st Revised Sheet No. 55.2. Staff witness Harden initially objected to this proposal, but has withdrawn her objection following Nicor Gas' clarifications in rebuttal testimony and the modified tariff language as presented in Nicor Gas Ex. 23.3. No other party challenged Nicor Gas' proposal. The Commission approves this modified tariff language.

5. Housekeeping Revisions

Nicor Gas proposes a variety of Housekeeping changes to Sheet Nos. 11, 11.5, 12, 14, 21, 21.6, 25, 24.5, 28, 35.5, 38.1, and 39 that specify, clarify, or remove outdated content or language. The Company also proposed a variety of revisions intended to correct typographical errors, clean up outdated references, and clarify certain definitions. There is no dispute among the parties regarding these housekeeping revisions, and they are approved.

6. Other

Nicor Gas proposes several revisions to the Service Extension charges on Tariff Sheet 41. No party contests these proposed changes and they are approved.

B. Contested Issues

1. Rate 1 – Residential Class

a. Nicor Gas' Position

Nicor Gas states that absent an adjustment to its current Rider 38 – Volume Balance Adjustment ("Rider VBA"), it is reasonable to increase the percentage of fixed costs recovered through the monthly customer charge for residential customers from 70% to 75%. However, should the Commission adopt the Company's proposed adjustment to Rider VBA, Nicor Gas proposes to maintain the proportion of fixed costs recovered through the residential charge at 70%, which is the level the Commission approved in the Company's last two rate cases. In that scenario, Nicor Gas explains that its proposal would be in line with Staff witness Harden's recommended percentage of fixed costs to be recovered through the customer charge.

Meanwhile, Nicor Gas opposes the AG's proposal to limit the increase in the customer charge only to the extent that it incorporates the current QIP charges that will be rolled into base rates. The AG's proposal improperly excludes customer-related distribution mains costs. Nicor Gas also explains that the AG's proposal runs contrary to the Commission's Orders in the Company's last two rate cases regarding the determination of what is considered a customer-related cost. The Company acknowledges that Commission decisions are not precedential. However, Nicor Gas states that the AG has offered no reasonable basis for the Commission to abandon an approach it has recently applied to the Company.

b. Staff's Position

Staff witness Harden testified that Nicor Gas proposed to increase the Rate 1 customer charge for the residential class from $17.96 to $25.52. The Company's proposal would be a $7.56 increase, or 42%, which would set the customer charge at more than 100% of the Company's ECOSS for the monthly customer charge. The Company proposed that the remaining revenue requirement be collected in the flat, per therm, distribution charge (Nicor Gas Ex. 12.0 at 23) with a proposed change from 8.38 cents per therm to 9.34 cents, which is an 11% increase. Under the Company's proposal, the average monthly total residential bill for 100 therms of gas usage would increase from $66.96 to $72.40, which is $5.44 or just above 8%. Staff Ex. 5.0 at 10-11.

Staff witness Harden opposed the Company's proposal for Rate 1 because Nicor Gas witness Yardley's proposed residential customer charge of $25.52 is $1.75 more than the cost reflected in the ECOSS. In Ms. Harden's opinion, basing rates on costs is both efficient and equitable. She explained that it is efficient because the price that a customer pays reflects the cost of providing the service, and it is equitable because ratepayers are charged only for those costs that they cause the utility to incur for service. She further testified that cost-based rates also encourage conservation by providing balanced price signals rather than distorting the choice the customer makes when they use the commodity. Staff Ex. 5.0 at 11. Ms. Harden further testified that the Company's proposal increases the proportion of residential revenue requirement that is recovered through fixed charges from approximately 70% to approximately 75%. *Id*. at 12.

Staff witness Harden recommended a change in the current customer charge for residential customers but less than that proposed by Nicor Gas. She recommended the customer charge be set at $23.77 based on the ECOSS, which would be an increase of 32%, which is less than the 42% recommended by the Company. The Company identified the corresponding distribution charge for this recommendation in Nicor Gas Ex. 12.10, Alternate Residential Rate Design. The corresponding distribution charge would be 11.26 cents or a 34% increase. The Rate 1 customer charge and distribution charge would increase by a similar 32% and 34% under Ms. Harden's proposal. Staff Ex. 5.0 at 12.

Also under Ms. Harden's proposal, 30% of the Rate 1 revenue requirement is recovered through the distribution charge, and 70% of the Rate 1 revenue requirement is recovered through the customer charge. Ms. Harden's recommended charges are based on the cost of service and maintain the same percentage revenue recovery through the customer and distribution charges as the underlying current rates, which in her opinion, will moderate the potential impacts on residential customers. Staff Ex. 5.0 at 12.

At issue in this proceeding are some proposed changes to Rider VBA. Ms. Harden explained that regardless of the type of Rider VBA implemented by the Company, that would not affect her recommendation for Rate 1. *Id*. at 13.

With respect to customer impacts, Ms. Harden, in a data request, asked the Company to prepare the bill impacts for her recommendations. The data request response provided by the Company is Attachment A to Ms. Harden's direct testimony. Staff explains that Attachment A shows that a residential customer's average monthly total residential bill for 100 therms of gas usage would increase from $66.96 to $72.58, which is $5.61 or 8.4%, revealing a very small change from the Company's proposal while also maintaining the current revenue requirement split for Rate 1. A residential customer with low gas usage of 10 therms/month would have a 17.5% increase under Staff witness Harden's recommendation, which is lower than the Company's 21.3%, and is reflective of the Company's higher customer charge proposal. A customer with 200 therms/month usage would have an increase of 6.7%, which reflects Ms. Harden's recommendation to increase the distribution charge more than the Company's proposal. Staff Ex. 5.0, Attach. A.

Based upon the above, Staff urges the Commission to adopt Ms. Harden's Rate 1 proposal.

c. AG's Position

The AG argues for a $19.80 per customer per month customer charge, which is the current $17.96 charge plus the QIP roll-in. AG Ex. 3.0 at 9-12. The AG recommends that the Commission reject both Nicor Gas' proposed $25.52 monthly charge, which recovers 75% of its customer-related revenue requirement and Staff's $23.77 per month charge, which recovers 70% of the customer-related revenue requirement. AG Ex. 3.0 at 9-10; Staff Ex. 5.0 at 12.

AG witness Rubin explained that $19.80 is sufficient for Nicor Gas to collect residential customer-related costs. The AG notes that the Company's ECOSS overstates the customer-related costs because, unlike other Illinois regulated gas distribution utilities, Nicor Gas includes a portion of main costs in the customer-related cost calculation. *Id*.

at 10-11. Although the Commission has allowed a portion of main costs in the customer-related cost calculation, Mr. Rubin questioned its reasonableness as it results in low-use customers paying demand-related costs associated with mains. *Id*. at 11. In fact, as maintained by the AG, while a cost-allocation study in the last Nicor Gas rate case did include main costs; the agreed upon monthly customer charge was set after a study that excluded main costs. *18-1775 Order* at 126. In the instant case, the AG estimates the main-related costs to be $3.97. *Id*. at 11-12; AG Ex. 3.3. Reducing the ECOSS figure by $3.97 as suggested by the AG, results in $19.80 as the customer charge under the Company's proposed revenue requirement. AG Ex. 3.0 at 12.

The AG explains that high customer charges and surcharge mechanisms such as revenue decoupling guarantee the Company a level of revenue regardless of customers' usage. Increasing the customer charge to increase a company's guaranteed revenue recovery is contrary to the Commission's preference for cost-based customer charges, especially, as the AG argues, for companies such as Nicor Gas that have a revenue-decoupling mechanism such as Rider VBA.

The AG refers to the 2021 Social Security benefit increase to provide perspective on both the Company and the Staff proposed increases in the monthly customer charge. In 2021, Social Security retirees received a 1.3% cost of living adjustment, which increased the average retired worker benefit by $20 per month. If approved, the AG states, almost half of the customer's $20 will go to pay Nicor Gas' fixed monthly charge and potential Rider VBA charges, which are set to guarantee Nicor Gas' revenue.

The AG maintains that a fixed charge increase of this magnitude is neither reasonable nor justified by the cost of service. The AG argues that a reasonable increase is for Nicor Gas to set its current customer charge at $19.80, which covers the customer cost consistent with the ECOSS adjustments adopted in the *18-1775 Order* and includes the current QIP add-on.

d. Commission Analysis and Conclusion

The Commission approved Rider VBA in Nicor Gas' last rate case. In that proceeding the Commission determined that, since Rider VBA was approved, Rate 1 should recover 70% of the residential revenue requirement through the customer charge and the remaining 30% through the distribution charge. These charges are based on the cost of service and maintain the same percentage revenue recovery through the customer and distribution charges as the underlying current rates. The Commission does not find that Nicor Gas has sufficiently supported a modification allowing 75% of its customer-related revenue requirement to be recovered through fixed charges, especially considering the impact on ratepayers. Consistent with the *18-1775 Order*, the Commission finds that Rate 1 should recover 70% of the residential revenue requirement through the fixed customer charged and the remaining 30% through the distribution charge. Staff's proposal recovers 30% of Rate 1 revenue requirement through the distribution charge and 70% through the customer charge and is consistent with the Company's ECOSS, therefore Staff's Rate 1 proposal is adopted.

The Commission notes that the AG's proposal excludes customer-related main distribution costs, which runs contrary to the Commission's determination in previous rate

cases. The Commission finds the AG has not sufficiently supported its position to exclude these costs, and the AG's recommendation is rejected.

2. Existing Riders

a. Rider 38 – Volume Balancing Adjustment (Rider VBA)

(i) Nicor Gas' Position

Nicor Gas proposes a modification to Rider VBA to replace the per-class approach to revenue decoupling with a per-customer approach. 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. Under this proposal, the Company will receive revenues commensurate with the additional base revenues as Nicor Gas adds new customers to the system. Under this approach, Nicor Gas states 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 needed to serve new customers. Furthermore, the Company notes the benefits to customers under this approach, such as fixed utility costs being spread over a greater number of customers. The Company states that the modification will not result in a windfall. Rather, it removes a disincentive to add new customers. The Company notes that Staff does not object to the proposed modification to its Rider VBA.

Nicor Gas argues that the AG's claims in opposition to the modification are without merit. First, contrary to the AG's assertion, Nicor Gas states that it will not result in a windfall - a fact with which Staff agrees. The Company explained that it incurs costs between rate cases in order to deploy new facilities to serve new customers. On this point Nicor Gas pointed to the unrefuted evidence showing that in 2019 it invested $40.3 million to add 8,252 new residential customers to the system. However, the Company asserts that under the AG's approach, Nicor Gas would retain $0 through Rider VBA from these new customers despite the investment. Additionally, Nicor Gas explained that the cost to connect a new customer far exceeds the embedded costs of existing customers. Consequently, the Company cannot obtain a windfall that the AG claims.

The Company also argues that the AG's assumptions that new customers use the same amount of gas as existing customers are misguided. Nicor Gas explains that the AG used a period that was considerably warmer than normal, which skewed his results - and another point to which Staff agreed. Additionally, the Company clarifies that the AG relied on data that included usage for unoccupied dwellings with limited or no usage, which further skewed the results. Nicor Gas states that the AG's combined errors in attempting to analyze comparable usage between current and new customers was 150%-200% out of line with Staff's and the Company's analyses, thereby undermining the AG's claim on this point.

Finally, the Company argues that the AG's assertion that the Commission has resolved this question previously provides no basis to do so again here. Here, Nicor Gas points to Illinois case law noting the Commission decisions are not precedential – *City of Chicago*, 133 Ill. App. 3d at 440-441. Further, the Company also explains that the record

in this case contains facts not available when the Commission made its prior decision. Nicor Gas avers that the facts of this case demonstrate that its proposed modification to Rider VBA is reasonable, finds no opposition from Staff, and that the Commission should approve it.

(ii) Staff's Position

Staff explains that, in the Company's most recent rate case (Docket No. 18-1775), the Commission approved a volume balancing adjustment via Rider VBA that credits or refunds amounts to customers based on how much total actual residential sales deviate from total forecasted residential sales. In this proceeding, the AG supports maintaining this paradigm. However, Staff notes, the Company proposed to change its Rider VBA so that it credits or refunds amounts to customers based on the forecasted sales per residential customer compared to the actual sales per customer. Staff Ex. 13.0 at 1-2.

In support of maintaining the status quo, the AG argues in direct testimony that the per-customer forecasts do not account for new customers and that new customers across the Midwest tend to have about 13% lower average use than existing customers. If this lower average use continues in the Nicor Gas territory, then a per-customer Rider VBA inherently stacks the deck in favor of the Company. *Id*. at 4-5. In rebuttal, AG witness Rubin argues that the 13% lower use found in the Midwest significantly understates the case among Nicor Gas residential customers. Based on a Company data request response, Mr. Rubin believes that Nicor Gas' newer residential customers use about 30% less gas than existing customers. According to the AG, Nicor Gas' proposed change is inherently biased to be advantageous to the Company. AG Ex. 3.0 at 20-22; AG Ex. 6.0 at 6-7.

Staff witness Brightwell describes how the two proposed Rider VBA decoupling approaches differ. In simplest terms, the Company's proposal of a per-customer charge causes a slight disadvantage to customers because there is likely to be about a $0.06 per customer over-collection built in to the per-customer formula under the assumptions of (a) 13% lower use for new customers, (b) 9,000 new customers, (c) a $0.0934 delivery charge, and (d) reported average annual customers and reported average annual usage. *Id*. at 7.

Dr. Brightwell also showed that under the assumptions mentioned above, which is the best available information about the current state of Nicor Gas' residential rate class customers (i.e., 9,000 new customers, $0.0934 delivery charge, etc.) the current Rider VBA would cause the Company to refund about $799,700 to customers. *Id*. at 8. This refund is mostly due to the currently designed Rider VBA not accounting for customer growth or costs associated with the new customers. *Id*.

In general, Staff believes that both Rider VBA proposals serve the purpose of protecting the Company and customers from extreme weather conditions that may result in over- or under-collections of revenues, but that both have a slight bias under perfect conditions. The current paradigm, which the AG advocates for, is slightly biased against the Company, and the Company's proposed formula is slightly biased in favor of the Company. The degree of bias in both circumstances is small. Because the differences between the two proposals are small, Staff is indifferent as to which proposed formula the

Commission should adopt. Staff does not consider either proposal to be clearly better or worse than the other. *Id*. at 8-9.

(iii) AG's Position

When the Commission approved Nicor Gas' Rider VBA in its rate case not even two years ago, the Commission rejected the Company's proposal for per-customer decoupling; instead, it required class revenue-decoupling, which, the AG notes, is the decoupling method in place for other Illinois gas utilities. *18-1775 Order* at 146-147. Nicor Gas, by proposing per-customer revenue decoupling again, seeks to have the Commission authorize Nicor Gas to charge ratepayers differently from all other Illinois natural gas ratepayers in Illinois that are subject to a decoupling rider. The AG argues that the record does not support the reversal of Commission policy, which would be necessary to approve Nicor Gas' proposal for per-class revenue-decoupling.

The AG traced the history of Illinois' preference for class revenue-decoupling. The pilot project that introduced revenue decoupling to Illinois regulated gas companies in 2008 did utilize per-customer decoupling; however, rate class revenue decoupling replaced per-customer when the riders were made permanent. Docket Nos. 07-0241/07-0242 (cons.), Order at 153; Docket Nos. 11-0280/11-0281 (cons.), Order at 164. The Commission also approved revenue decoupling by rate class riders for Ameren in 2015 and rejected Nicor Gas proposed per customer decoupling in favor of per class decoupling in 2019. *Ameren Ill. Co. d/b/a Ameren Ill.*, Docket No. 15-0142, Order at 115 (Dec. 9, 2015); *18-1775 Order* at 146-147.

Nicor Gas attempts to justify its per-customer proposal by citing expenses incurred as it adds new customers to its distribution system. The AG asserts that such motivation for the modification is contrary to the Commission's decoupling policy. According to the AG, the Company not only attempts to use a decoupling recovery mechanism to incentivize customer growth, but, the AG cautions, Nicor Gas also discounts the relevance of energy efficiency as a factor in the revenue decoupling discussion, in favor of "the incremental cost of facilities." Nicor Gas IB at 101. Again, Nicor Gas ignores the Commission's findings from its prior rate case.

The AG points to Nicor Gas' motivation to incentivize customer growth and disinterest in including energy efficiency and customer usage as factors in setting revenue-decoupling policy, and concludes that the Commission correctly rejected per-customer decoupling in the *18-1775 Order* as inconsistent with the State's energy efficiency goals. The AG requests that, once again, the Commission apply existing Illinois law and policy to Nicor Gas and deny Nicor Gas' proposal to modify Rider VBA to per-customer revenue decoupling.

The AG notes that Staff finds the monetary value differences between the two methods of recovery to be small and "Staff is indifferent" to which decoupling mechanism the Commission adopts. Staff IB at 89; Staff Ex. 13.0 at 8-9. The AG questions Staff's indifference to recently confirmed Commission policy and to Staff's presumption to know what amount of money is insignificant to ratepayers. The AG points out that Staff's indifference to an unjustified increase in charges ignores its own witness who testified that per-customer decoupling places customers at a disadvantage because there is a per-customer built-in over-collection. *See* Staff Ex. 13.0 at 7.

The AG argues that a policy must be reasonable on its own merit and not rely on the policy-maker's opinion that the cost to the ratepayer is insignificant. The AG requests that the Commission deny Nicor Gas' proposal to modify Rider VBA to per-customer revenue decoupling.

(iv) Commission Analysis and Conclusion

After reviewing the record, the Commission is not persuaded by Nicor Gas' arguments in favor of adopting a per-customer revenue decoupling as opposed to the current per-class approach, which is the approved method for all regulated natural gas utilities with a decoupling rider in Illinois. Nicor Gas has not provided sufficient evidence to support a change to the decoupling method.

Staff points out that the monetary value between the decoupling mechanisms is small. Nicor Gas appears to agree that the overall impact on customers would be small and argues that the change would merely remove a disincentive to add new customers. One of the goals of revenue decoupling is to discourage a utility's financial incentive to promote increased customer usage or prevent conservation. The Commission agrees with the AG and the findings in the *18-1775 Order* 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. Additionally, as the AG points out, it is inconsistent with the State's energy efficiency goals. Nicor Gas' proposed modification to Rider VBA is rejected.

3. Proposed Riders

a. Rider 40 – TotalGreen

(i) Nicor Gas' Position

The Company asserts it provided sufficient evidence that proposed Rider 40 – TotalGreen ("TotalGreen" or "Rider 40") is an innovative service that will provide Nicor Gas, the Commission, and all stakeholders with valuable insights into customer interest in actively managing their carbon footprints. TotalGreen would provide Nicor Gas customers with a way to offset the environmental effects of their natural gas use through the acquisition of environmental commodities, including RNG environmental attributes. Given the nascent state of the Illinois RNG market, TotalGreen offers two primary blended options to customers: a product that includes a higher proportion of RNG credits (between 5% and 20%, with the remaining balance from carbon offsets), and one at a lower cost that is primarily comprised of carbon offsets (99%+ carbon offsets and <1% RNG). Nicor Gas maintains that the program will also raise customer awareness of the environmental consequences of their energy use and could also encourage them to improve their energy efficiency.

Nicor Gas believes that learnings from the program will help it provide better service while allowing the Company to better meet the needs of a transforming energy economy. The Company maintains that the voluntary nature of the program and the ability of customers to terminate service at any time (effective the following month) as well as the fact that only participating customers will bear the cost means the program is without downsides. The program would be the first of its kind in Illinois. The program is focused on increasing the proportion of RNG, a carbon neutral—and sometimes carbon

negative—energy source, in customer energy use and is structured such that this proportion will be able to increase as the RNG market in Illinois grows.

According to Nicor Gas, the TotalGreen service offering is just and reasonable. First, the TotalGreen program responds to the results of Nicor Gas customer surveys indicating that customers are interested in environmentally friendly natural gas service. Second, the initial administrative costs are very low (estimated to be under $1 million in total for its 5-year duration) and will be borne only by participants. Third, TotalGreen is structured as a pilot that will provide real world experience to help Nicor Gas, the Commission, and all stakeholders to better understand customer preferences, while also providing insight as to how RNG can be integrated into the Company's portfolio of services. Further, the Company explains that the pilot program will promote greater understanding of customer preferences, promote real-world learnings for the future, spur customers to engage in other environmentally friendly actions, and promote the development of a market for RNG. The Company has developed a list of metrics to measure the benefits and learnings of the program. The Company will also provide a report to the Commission each year during the pilot that would include an update on pilot metrics, including details regarding customer participation, the amount of RNG procured, carbon offsets purchased, and any cost changes under the tariff.

In Nicor Gas' opinion, no party has lodged justified objections. The Company maintains that TotalGreen does not impact its revenue requirement. The opposition to the program is without legal basis. No parties have provided evidence indicating that the program is unjust or unreasonable. ICEA/RESA witness Wright and Staff witness Brightwell expressed concern that the program would fail and cause other ratepayers to absorb the costs. However, the Company avers that the cost of the program is minimal and that in the unlikely event that it fails, the Company commits to not passing through the costs to non-participating members. The Company's commitment makes this issue moot.

The AG, ICEA/RESA, and Staff witnesses also expressed concerns that the TotalGreen program would affect the competitive market for this type of service. Nicor Gas asserts that these parties only offer conclusory statements about the state of competition; they do not offer empirical support or concrete examples of how the Company's offering would harm competition in Illinois. Nicor Gas asserts that the record offers no basis for the Commission to conclude that any significant competition for services similar to TotalGreen exists in Illinois. If these services were actually offered in Illinois, these parties would have presented evidence to that effect. Nicor Gas states that mere speculation that a market exists should not be enough to find that the tariff offering is unjust and unreasonable—especially given that there is no legal requirement that Nicor Gas refrain from offering a service already offered in the competitive market.

Further, the Company explains that comparisons to the availability of environmental offsets reflect a misunderstanding of the program's focus on RNG and blended energy options. The Company states that it demonstrated why the program is more than just environmental credits. Further, as the Company notes this program is a pilot, not a permanent offering. Thus, the Commission will be able to assess the program based on the information provided by the pilot.

The Company explained that EDF/CUB's testimony sought to improve the program. Nicor Gas has worked to address EDF/CUB's concerns. In response to concerns regarding the "additionality" of carbon offsets, Nicor Gas has committed to only acquire carbon offsets that are from trusted offset registries and that are additional, quantified, verified, and registered. In response to concerns about the transparency of the types of projects that will provide the carbon offsets and RNG credits, Nicor Gas agreed to add more specificity to customers once their services are initiated. In response to concerns about transparency related to "upstream emissions" associated with customer gas use, Nicor Gas is committed to transparency related to direct emissions but will not estimate and integrate upstream emissions which may confuse customers. In sum, Nicor Gas responded to EDF/CUB's concerns with fair, reasonable, and workable proposals that address each of the concerns to the greatest extent practical and prudent.

(ii) Staff's Position

Staff witnesses Harden and Brightwell offered testimony regarding Rider 40. Staff witness Harden did not offer an opinion on whether proposed Rider 40 should be approved. However, Ms. Harden stated that if the Commission approves the Company's proposal for Rider 40, then the rider should state in the tariff that the charge will be shown as a separate line item on a customer's monthly bill. Staff Ex. 5.0 at 24. In rebuttal testimony, Company witness Lanier stated that participating sales customers will have the charges for the TotalGreen pilot program listed as a separate line item on the customer's utility bill if Rider 40 is approved by the Commission. Nicor Gas Ex. 26.0 at 19. Therefore, Staff witness Harden recommends that if the Company's proposal for Rider 40 is approved, the rider should state in the tariff that the charge will be shown as a separate and distinct line item on a customer's monthly bill.

Staff witness Brightwell testified the TotalGreen pilot program would allow the Company to begin selling a product that consists of various percentages of renewable energy credits ("REC") and renewable natural gas commodity sales. The pilot program costs would go through Rider 40 where enrolled customers would be charged for incremental startup costs and monthly product costs.

Dr. Brightwell recommended rejecting the Company's proposed pilot program, for multiple reasons. Staff Ex. 13.0 at 15. The most overwhelming is that the pilot program is likely to create an unfair competitive advantage to Nicor Gas, and moreover, the new products offered through the pilot are not greatly different from existing products in the market. *Id*. at 10-12.

Multiple parties have pointed out these issues with the pilot. AG Ex 3.0 at 24; ICEA/RESA Ex. 1.0 at 4-6; ICEA/RESA Ex. 3.0 at 3-6. Overall, the pilot allows Nicor Gas to operate at cost when competition needs to earn a profit. Staff Ex. 13.0 at 10-11. In reality, the pilot may allow Nicor Gas to operate below cost because it appears that none of the labor, facility costs, etc. are included in Rider 40. Effectively, ratepayers are paying some of these costs in base rates as the cost of service studies do not account for or remove any costs for personnel, facilities, etc. that are being allocated to Rider 40 activities from base rates. AG Ex. 6.0 at 5.

Because of the inherent competitive disadvantage that the proposed pilot and Rider 40 create, and because the product is similar to other products already on the

market, Staff recommends that the Commission reject the TotalGreen pilot program and Rider 40. Staff Ex. 13.0 at 15.

(iii) AG's Position

The AG asserts that Nicor Gas' proposed Rider 40 is not just and reasonable under the Act. Under TotalGreen, Nicor Gas would sell customers natural gas delivery service paired with varying levels of carbon offsets and the environmental attributes of RNG to reduce the environmental impact of customers' natural gas usage. TotalGreen would offer two products: one with a higher proportion of the environmental attributes of RNG (between 5% and 20%, with the remaining balance from carbon offsets), and one at a lower cost that is primarily comprised of carbon offsets.

The AG states that the Commission's review of Rider 40 is governed by Section 9-201 of the Act. 220 ILCS 5/9-201. To approve the tariff, the Commission must find that Rider 40 is "just and reasonable." *Id*. at 5/9-201(c). The Act assigns Nicor Gas the burden to prove that Rider 40 is just and reasonable. *Id*. In deciding what is just and reasonable, the Commission balances "the interests of the utilities' stockholders and the utilities' consumers." *Abbott Laboratories, Inc. v. Ill. Commerce Comm'n*, 289 Ill. App. 3d 705, 716 (1997) (citing *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 276 Ill. App. 3d 730, 736–37 (1995)). When a tariff is optional, like Rider 40, the Commission is required to determine that the tariff is just and reasonable for both enrolled and non-enrolled ratepayers. *Commonwealth Edison Co*., Docket No. 19-1121, Order at 13 (Sept. 23, 2020) ("Community Supply"). If Nicor Gas fails to provide sufficient evidence demonstrating that Rider 40 benefits all ratepayers, the Company has failed to meet its burden under the Act and the Commission must reject the rider. *See id*. at 13–14.

The AG argues that Nicor Gas has failed to show that Rider 40 is just and reasonable because the Company will recover the costs of TotalGreen from all ratepayers, including non-subscribers, and the program will crowd out competitors who may sell carbon offsets and the environmental attributes of RNG. The AG first explains that the Company's failure to allocate any of TotalGreen's administrative costs in its cost-of-service study means that non-subscribers will pay for the costs to operate TotalGreen through base rates. The AG asserts that non-subscribers who receive no benefit from TotalGreen are forced to pay for the program through base rates.

The AG also responds to a statement by Nicor Gas witness Lanier wherein she appears to suggest that a proportionate fraction of TotalGreen's overhead costs will eventually be included in the price of TotalGreen, meaning that program participants will eventually bear a greater responsibility in funding TotalGreen. *See* Nicor Gas Ex. 40.0 at 17. The AG explains that if this cost shift happens before the Company's next rate case, Nicor Gas will double collect the costs of its overhead expenses from ratepayers and program participants. The Company would continue to receive revenue from all ratepayers to pay for the overhead expenses associated with TotalGreen through the rates approved in this docket until Nicor Gas' next rate case. If Nicor Gas adds the costs of overhead expenses into the costs of TotalGreen prior to its next rate case, subscribers will pay for overhead expenses that the Company will already receive funding for through base rates.

The AG next asserts that Nicor Gas' failure to allocate existing costs to TotalGreen in the Company's cost-of-service study also harms competition. Witnesses for both the AG and Staff maintain that Nicor Gas will be able to sell carbon offsets and the environmental attributes of RNG at cost because all customers will pay for TotalGreen's administrative costs through base rates, costs which private companies must recoup through sales. *See* AG Ex. 3.0 at 24; Staff Ex. 13.0 at 10−11. Competitors will thus not be able to compete with Nicor Gas on price. Moreover, Nicor Gas will also have a marketing advantage that competitors lack. Nicor Gas' status as a monopoly utility provider allows it to advertise TotalGreen much more effectively—for example, through targeted emails and pamphlets included with paper bills—than its competitors. Thus, TotalGreen undercuts the competitive market for carbon offsets and environmental attributes of RNG by giving Nicor Gas a price and advertising advantage.

The AG states that the Commission has previously held that riders are not just and reasonable if they damage market competition like Rider 40. The AG cites to the Community Supply order where the Commission rejected a rider submitted by ComEd that created three optional services to promote community solar projects and to offer "back office" functions in which community solar projects could choose to participate. *See Community Supply*, Order at 2–4 (Sept. 23, 2020). Throughout the proceeding, Staff asserted that there was a robust network of providers who could also offer these services and that ComEd's services were thus unnecessary. *See id*. at 11–13. The Commission found that ComEd's proposed rider was not just and reasonable, in part, because the services were not necessary and community solar projects could perform these services themselves or through contract with a non-utility third party. *Id*. at 13–14. The AG likens that rider to Rider 40 and maintains that Rider 40 is similarly unnecessary while also actively damaging the existing competitive market for carbon offsets and the environmental attributes of RNG.

The AG also rejects Nicor Gas' arguments which assert that Rider 40 provides a benefit to customers. Nicor Gas first contends that TotalGreen fills an existing demand because the Company's customers indicated in a survey that they would pay more to make natural gas delivery more environmentally friendly. The AG maintains that Nicor Gas presented no evidence to establish that its customers would purchase the specific products offered through TotalGreen. Nicor Gas' survey generally inquired as to whether customers would be willing to pay more to make natural gas delivery more environmentally friendly, but did not inquire as to whether respondents wanted to purchase carbon offsets and the environmental attributes of RNG. The AG states that without more granular data the Commission cannot conclude that TotalGreen provides a benefit to customers because there is no data concerning whether customers desire TotalGreen's specific products. The AG again cites to the Community Supply order where the Commission rejected ComEd's attempts to offer "back office" functions to community solar projects because, in part, ComEd did not show "that there is sufficient interest from [community solar projects] for these services." *Id*. at 13.

The AG also refutes Nicor Gas' assertion that customers will benefit from the potential customers learnings that could stem from Rider 40. The AG insists that this benefit is insufficient because every proposed rider offers the opportunity for potential learnings about how to execute programs and what programs customers want. Yet, the

Commission does not approve every rider that offers these potential benefits and has rejected riders when utilities have not presented supportable evidence of a concrete benefit to consumers.

The AG also questions the Company's argument that Rider 40 will benefit all ratepayers because TotalGreen may prompt Nicor Gas customers to take other environmentally friendly actions. The AG asserts that this benefit is wholly speculative and not supported by any evidence in the record. The AG analogizes this case to the Commission's order in Docket No. 12-0569, where the Commission rejected a Nicor Gas rider that would have established a new optional tariffed service for purchase of receivables and consolidated billing because Nicor Gas did not sufficiently prove that the potential benefits to customers, an increase in competition and lower customer costs, were likely to occur. *N. Ill. Gas Co. d/b/a Nicor Gas Co*., Docket No. 12-0569, Order at 18 (July 29, 2013). In that case, the Commission acknowledged that these benefits could arise under the proposed rider, but "other than stating that these are potential benefits, there is a distinct lack of evidence in the record that the Commission can rely on to support that these benefits would occur." *Id*.

Finally, the AG rejects Nicor Gas' argument that TotalGreen will benefit customers because it will promote awareness of the nascent RNG market. The AG maintains that this benefit is insufficiently supported because Nicor Gas provides no data concerning customers' current awareness of the RNG industry or their interest in purchasing RNG or associated environmental attributes when the market further develops. Consistent with their competition argument, the AG also asserts that ratepayers should not have to pay for the promotion of RNG and offsets. That is the responsibility of RNG developers and alternative retail gas suppliers who can easily switch their products to offer combined commodity and non-commodity packages.

The AG concludes that the Commission should reject Rider 40 and not require Nicor Gas consumers to subsidize the offering of RNG or other carbon offset programs.

(iv) EDF/CUB's Position

As a threshold matter, EDF/CUB maintain that it is not appropriate to consider the TotalGreen pilot in this rate case. EDF/CUB argue that it is premature to consider the merits of the proposal absent a broader investigation into and understanding of the future of Nicor Gas' gas system. That should, EDF/CUB say, include expected demand, climate goals, and adherence to criteria established for the design and consideration of pilots. Only then can the Commission evaluate whether TotalGreen and proposals like it are reasonably designed to achieve demonstrated new learnings and other benefits, such as meeting a demonstrated customer need, say EDF/CUB. EDF/CUB note that the pilot is proposed in the context of the shifting landscape for natural gas and energy usage in general, and Nicor Gas acknowledges the important "fight against [greenhouse gas ("GHG")] emissions." EDF/CUB maintain that fight cannot be won through a patchwork of pilot programs while utility investments remain otherwise business-as-usual. Instead, EDF/CUB say, the fight against GHG emissions requires transformative change through a comprehensive, transparent, and inclusive investigation into the future of the natural gas system and Illinois' energy goals. Those goals should then inform Nicor Gas' long-

term plans. EDF/CUB note that at least six other states and the District of Columbia have already initiated such investigations.

EDF/CUB argue that the TotalGreen pilot, as initially proposed, also suffers from numerous substantive fatal flaws. Nicor Gas witness Lanier agreed to modifications to the pilot in rebuttal, in response to Dr. Hill's direct testimony, and again in surrebuttal, in response to Dr. Hill's rebuttal testimony. Though Dr. Hill concluded that these revisions improved the program, he nonetheless maintained that additional changes are needed – if and only if the Commission sees value in the program in the context of the future of the gas system in Illinois. EDF/CUB argue that improvements made to the pilot in this case demonstrate the value of collaboration, but proposal remains premature at best. EDF/CUB's position is that without a foundation for how Illinois and Nicor Gas should plan for the future of the natural gas system, it is not possible to understand whether the pilot, even as revised, should be considered as part of that future – much less in the context of a rate case. EDF/CUB further point out that, less than two months ago, the Commission approved a separate alternative fuel pilot. EDF/CUB contend these piecemeal requests and approvals are not the right path forward for Illinois. Instead of perpetuating this ineffective process of piecemeal pilot proposals, EDF/CUB argue that the TotalGreen pilot should be considered in the context of a transparent, inclusive gas planning process.

EDF/CUB conclude that the TotalGreen proposal is premature and should be deferred until it is considered in the context of comprehensive, long-term natural gas system planning. If the Commission considers approving TotalGreen through this rate case, EDF/CUB contend that, at minimum, the following modifications are necessary to align the implementation of the pilot with its purported intent: (1) upstream emissions be accounted and included in the calculation of each customer's needed level of participation; (2) proactive and ongoing transparency about the source, type of project, and additionality of off-sets and RNG; and (3) planned and ongoing commitment to include offsets and RNG sources that have a tangible connection to Nicor Gas' system and local resources.

(v) ICEA/RESA's Position

ICEA/RESA argue that Nicor Gas' proposed Rider 40 should be rejected. ICEA/RESA state that they wholeheartedly agree with AG witness Rubin: "My recommendation was, and remains, that Nicor [Gas] should not be in this business." AG Ex. 6.0 at 4. ICEA/RESA note that Staff similarly argued that TotalGreen should be rejected. *See* Staff Ex. 13.0 at 15. According to ICEA/RESA, to support the existing (and growing) market for environmentally preferable products and services made available by alternative gas suppliers and other market participants, the Commission should reject Nicor Gas' proposed intrusion into the competitive retail market.

ICEA/RESA note that Docket No. 19-1121, cited by the AG, is a particularly apt comparison to the present docket. According to ICEA/RESA, in Docket No. 19-1121, ComEd proposed voluntary services and provided estimates of market uptake. However, ICEA/RESA continue, the Commission rejected ComEd's proposal in part because it found that ComEd did not establish that there would be any demand for their proposed voluntary services. ICEA/RESA argue that, as with ComEd, Nicor Gas has not established that there is any interest in the particular TotalGreen products it plans to offer.

ICEA/RESA further argue that Nicor Gas' estimates of market uptake are entirely speculative, just like ComEd's.

ICEA/RESA posit that there are several bases for rejecting the TotalGreen pilot program. First, the program has little value as a pilot other than allowing Nicor Gas to recover its start-up costs during the pilot period. According to ICEA/RESA, Nicor Gas also inadequately responded to questions regarding the potential risk that the pilot fails to acquire and maintain enough customers to bear the start-up costs of the program. Simultaneously, continue ICEA/RESA, Nicor Gas seeks to introduce a product offering into a preexisting market that directly competes with third parties (including alternative gas suppliers ("AGS")), yet the only justification Nicor Gas has provided in support of its proposed offering is the purported value of the pilot and the assertion that it should be entitled to bring the product to market because it is not prohibited by law from doing so. ICEA/RESA argue that Nicor Gas has failed to provide adequate justifications for its proposal. Therefore, conclude ICEA/RESA, because Nicor Gas cannot satisfy its burden of proof to establish that its proposed rates are just and reasonable, Nicor Gas' TotalGreen pilot proposal should be rejected.

ICEA/RESA argue that Nicor Gas cannot satisfy its burden of proof because it failed to demonstrate that the TotalGreen pilot has value. According to ICEA/RESA, Nicor Gas argued that the program will acquaint more customers with environmentally friendly gas products, but Nicor Gas witness Lanier offered no evidence to support that claim other than a bare statement that "to my knowledge, green gas services are not a well-known offering at this time." Nicor Gas Ex. 40.0 at 14 (citing Nicor Gas Ex. 26.0 at 15). ICEA/RESA argue that Nicor Gas witness Lanier cites no market studies, no survey results, or no information of any kind to form the basis of her opinion. ICEA/RESA juxtapose Nicor Gas' testimony with that of AG witness Rubin, who testified that "Nicor [Gas] offering carbon offsets is not likely to introduce its customers to the concepts of personal carbon footprints and carbon offsets." AG Ex. 6.0 at 3. ICEA/RESA contend that even if the Commission credits Ms. Lanier's unsupported contention that green products are not well known by consumers, it should also credit Mr. Rubin's testimony that Nicor Gas' pilot program is unlikely to address that knowledge gap.

Although Ms. Lanier does refer to a survey that allegedly supports the contention that "a majority of Nicor Gas customers may be willing to pay more to make their natural gas delivery more environmentally friendly[,]" her position cannot be verified because Nicor Gas failed to introduce the results of the survey into the record. Given that many of ICEA/RESA's members offer green energy products in Illinois and other states, it comes as no surprise that customers value green products. ICEA/RESA contend that Staff and the AG also highlight that the competitive market provides these products and services. ICEA/RESA highlight that Staff argued "moreover, the new products offered through the pilot are not greatly different from existing products in the market." According to ICEA/RESA, Ms. Lanier's statements fail to provide sufficient justification that green products should be offered by Nicor Gas.

ICEA/RESA contend that there is no evidence in the record that Nicor Gas performed even a basic study to determine whether customers would be interested in the particular products proposed at the particular pricing points to be offered. ICEA/RESA argue that among other risks, Nicor Gas is taking the risk that while a "majority" allegedly

"may be willing to pay more" for green products, there is no guarantee that customers would be willing to pay more for the particular product(s) that Nicor Gas seeks to offer.

ICEA/RESA highlight that their witness, Mr. Wright, pointed out that the pilot does provide a competitive advantage to Nicor Gas in the event that Nicor Gas continues to offer TotalGreen after the pilot period. ICEA/RESA argue that this benefit accrues exclusively to Nicor Gas and harms the competitive retail market. ICEA/RESA note that Staff and the AG also raise concerns that Nicor Gas' TotalGreen pilot would undermine the competitive market.

ICEA/RESA note that their witness Mr. Wright, along with AG witness Rubin and Staff witness Brightwell, raised additional questions and concerns regarding Nicor Gas' proposed TotalGreen pilot program, such as the absence of enrollment restrictions and the anti-competitive monthly price adjustment. ICEA/RESA contend that while these concerns provide further grounds for rejection, the Commission need not reach these issues because the overwhelming evidence supports rejection of Nicor Gas' proposed Rider 40.

(vi) Commission Analysis and Conclusion

As presented in this docket, the Commission finds TotalGreen just and reasonable. TotalGreen is a unique opportunity to offer an innovative service in Illinois. The service is entirely voluntary and only affects ratepayers who opt in.

Nicor Gas will gain essential learnings about customers' interest in environmental attributes, including renewable natural gas. These learnings, according to the Company, are key to its goal to expand the use of renewable natural gas in its system. The Commission rejects Staff's and intervenors' complaints about potential impact on the competitive market as they have failed to show: (1) there is a market for environmental attributes in Illinois and (2) how TotalGreen would adversely affect it.

TotalGreen provides no risk to ratepayers as the Company has committed not to pass on costs to non-participating customers and those who opt in can leave the program effective the next month. As such, the Commission approves Nicor Gas' proposal for Total Green.

IX. GROSS REVENUE CONVERSION FACTOR ("GRCF")

Nicor Gas presented evidence that the major factors in calculating its GRCF are uncollectible accounts and Federal and State income taxes. The Company's revised GRCF is 1.414684. No party contests the GRCF.

X. OTHER ISSUES

A. Contested Issues

1. Third-Party Billing Service

a. Commodity-Related Third-Party Billing Service Cost Study

(i) Nicor Gas' Position

Pursuant to the Commission's directive from the *18-1775 Order*, the Company conducted a fully distributed cost study to examine the current cost of providing commodity-related third-party billing services to Customer Select Suppliers. The study reflected that the current cost of providing the billing service, on a per-bill basis, is $0.28, which is an increase of $0.03 from the prior charge of $0.25. Staff witness Harden has no objection to the updated charge resulting from that study.

The Company opposes ICEA/RESA's proposal to adjust the per-bill charge to $0.27. Nicor Gas explains that $0.01 adjustment is founded on an incorrect premise. In particular, it rests on the notion that Customer Select Suppliers do not benefit from, or that benefits are limited, from space on a bill allocated to highlight the Company's Sharing Program. The Company detailed that the Sharing Program offers all customers an opportunity to make voluntary contributions as part of their bill payment, to a fund used to assist other customers who have difficulty paying their gas bill. Nicor Gas further stated that any customer, including customers who acquire gas from a Customer Select Supplier, can receive funds from the Sharing Program, so long as they meet eligibility requirements. The Company noted that the ICEA/RESA witness acknowledged this point. Nicor Gas also pointed to evidence showing that, in fact, customers of Customer Select Suppliers have benefitted from the Sharing Program: in 2020, 25 out of 424 customers receiving assistance were Customer Select Supplier customers. The Company dismissed ICEA/RESA's criticism that this number was small, noting that Customer Select Supplier customers comprise approximately 10% of the total number of customers, so approximately 6% receiving benefits from the Sharing Program in 2020 is in line with the overall proportion.

Nicor Gas also asserts that ICEA/RESA's claim that suppliers do not benefit from the Sharing Program is irrelevant. Rather, the question is whether customers of Customer Select Suppliers can benefit, and the unrefuted evidence shows that eligible customers can, and have, benefitted from the Sharing Program. Accordingly, the Company argues that there is no reasonable basis to alter the per bill charge determined in Nicor Gas' cost study.

(ii) Staff's Position

Staff witness Harden testified that the Company provided a cost study to examine the current cost of providing third-party billing services. Company witness Hizon provided a cost study, as Nicor Gas Ex. 8.5 Confidential, that analyzes the current cost to process and includes a third-party charge on the Company's monthly bill to customers. The Company referred to the *18-1775 Order* and a directive from the Commission to perform a cost study for a third-party charge. Nicor Gas Ex. 8.0 at 11. Specifically, the Commission found in the *18-1775 Order* that Nicor Gas' charge to Pivotal Home Solutions

based on an updated cost study, using a Commission-approved methodology, was reasonable and appropriate. Staff Ex. 5.0 at 9; *18-1775 Order* at 87-88. Company witness Hizon testified that "[t]he Company conducted a fully distributed cost study to examine the current cost of providing third-party billing services to Customer Select Suppliers. Various departments provided input as to the services provided and related costs incurred in the provision of billing services, as well as to identify the unique items related to this service. The resultant study incorporates the costs of generating and issuing bills, and processing remittance. … The cost study reflected that the current cost of providing the billing service, on a per-bill basis, is $0.28, which is an increase of $0.03 from the prior charge of $0.25." Nicor Gas Ex. 8.0 at 11.

Staff witness Harden does not object to the cost study, nor the resulting increase of $0.03 which results in a charge of $0.28 per bill because the Commission has previously approved this methodology in the *18-1775 Order*. Staff Ex. 5.0 at 10.

(iii) ICEA/RESA's Position

According to ICEA/RESA, the Commission should modify Nicor Gas' proposed third-party billing service cost study to allocate space related to the Sharing Program of Nicor Gas or, in the alternative, arrive at a more accurate allocation than evenly allocating the costs. ICEA/RESA provide alternatively that if the Commission accepts ICEA/RESA's primary proposal, the Commission should approve a $0.27/bill charge, as opposed to Nicor Gas' proposed $0.28/bill charge.

ICEA/RESA state that as a result of the *18-1775 Order*, Nicor Gas provided a service cost study for billing on behalf of AGS participating in the Customer Select Suppliers program that opt for utility-consolidated billing (also known as "third-party billing"). ICEA/RESA argue that the service cost study allocated costs by the space on the bill for Nicor Gas' purposes, for the supplier's purposes, and joint purposes. ICEA/RESA note that the allocation compared Nicor Gas space to supplier space, functionally ignoring the jointly-used space.

ICEA/RESA claim that their sole proposed modification to Nicor Gas' study was to make a modification to allocate space from the Sharing Program exclusively to Nicor Gas. ICEA/RESA argue that while Nicor Gas witness Hizon argued that AGS benefit because Customer Select Supplier customers may benefit and the AGS benefits if the customer's arrears are reduced, ICEA-RESA Cross Ex. 1 makes clear that: (1) AGS receive no direct payments under the Sharing Program; and (2) of the 424 customers receiving payments in 2020, only 25 had an AGS and Nicor Gas could not identify if even a single dollar went towards AGS arrears.

According to ICEA/RESA, Nicor Gas' suggestion that AGS benefit from the Sharing program is not supported by evidence and is at best speculation on the potential benefits that might accrue to AGS.

ICEA/RESA contend that Nicor Gas' sole argument against ICEA/RESA's allocation is that "[a]ny Nicor Gas customer, including customers who acquire gas from Customer Select suppliers, can receive funds from the Sharing Program." Nicor Gas Ex. 23.0 at 8. However, ICEA/RESA counter that (1) AGS do not receive direct payment under the Sharing Program, (2) according to the limited data Nicor Gas provided, the

overwhelming majority of participants are Sales customers, and (3) Nicor Gas did not establish that funds received by Customer Select customers even reached AGS arrears because the first payment priority is delivery arrears. As a result, conclude ICEA/RESA, the record does not reflect any quantifiable benefit to AGS. ICEA/RESA argue that in the absence of any quantifiable benefit to Customer Select customers or AGS, the Commission should either reduce the per-bill charge by $0.01 or provide a more accurate allocation based on actual benefits received by AGS.

For these reasons, ICEA/RESA conclude that the Commission should reject Nicor Gas' proposed $0.28/bill charge and adopt ICEA/RESA's proposed $0.27/bill charge for third-party commodity billing services—at least unless or until Nicor Gas provides better data to demonstrate benefits to AGS.

(iv) Commission Analysis and Conclusion

In the *18-1775 Order*, the Commission directed the Company to perform a cost of service study to analyze the current cost to process and includes a third-party charge on the Company's monthly bills to customers. The study provided by Nicor Gas, using Commission approved methodology, reflects the current cost of providing the billing service to Nicor Gas' customers is $0.28. The Commission concludes that the customers of Customer Select Suppliers can benefit, and the unrefuted evidence shows that eligible customers can, and have, benefitted from the Sharing Program. Therefore, the Commission approves a charge of $0.28 per bill.

b. Combined Cost Study for Third-Party Billing of Commodity and Non-Commodity Products and Services in Next Rate Case

(i) Nicor Gas' Position

Nicor Gas states that ICEA/RESA's proposal to abandon the Company's current Commission-approved process for considering the provision of non-commodity product billing services to third parties is unreasonable. The Company explains that it uses Commission-approved tariffs that set forth the terms and conditions upon which the Company offers gas commodity-related third-party billing service to Customer Select Suppliers, as well as the process by which Nicor Gas can consider a third-party billing service for non-commodity products. This protocol has been in place for nearly two decades and reflects the difference, both operationally and in cost, between providing commodity-related billing service and a one-off non-commodity billing service to Customer Select Suppliers. The Company states that this tariff structure is subject to specific Commission oversight, as Nicor Gas must submit to the Commission a contract for such a service to confirm the service and related charges are provided on a non-discriminatory basis.

The Company points to evidence showing that no party has ever alleged that Nicor Gas has administered the process for considering and offering a non-commodity billing service in an improper or discriminatory manner. Despite this, ICEA/RESA request that the Commission abandon its current process.

Nicor Gas presented three reasons why the Commission should reject the ICEA/RESA proposal. First, the Company explains that the proposal is in search of a

problem, as ICEA/RESA failed to present any evidence that Nicor Gas has administrated the current process in an improper or discriminatory fashion. Instead, the Company points to evidence showing that it separately evaluates each third-party request to provide a billing service for a non-commodity product, and that the Company engages in good faith negotiations regarding the fees. Further to that point, Nicor Gas reiterated that the Commission has full oversight of the process, contrary to ICEA/RESA's assertions.

Second, Nicor Gas states that the evidence shows why the provision of a non-commodity billing service is different from a commodity-related billing service. Here, the Company must evaluate each proposal and determine the necessary Information Technology and business process changes required. Nicor Gas further explains that it must recover the costs to implement such changes prior to implementing such changes to ensure proper cost recovery and avoid the requesting party being subsidized for the service. On this point, the Company argues that ICEA/RESA offer only speculation as to the products that might be offered. Moreover, Nicor Gas contends that ICEA/RESA's approach seeks to avoid payment of the upfront start-up costs, which is not reasonable.

In response to ICEA/RESA's claims about the Company's provision of non-commodity billing service to Pivotal Home Solutions ("PHS"), Nicor Gas explains that PHS went through the process and paid the Company, upfront, the costs associated with implementing the changes. Nicor Gas also points to evidence showing that PHS continues to pay the costs to update systems, as needed. The Company concludes that the manner in which it treats PHS is consistent with the current, Commission-approved tariffs, and that PHS offers no basis for the Commission to abandon that process.

Third, the Company explains that it is not in the business of providing billing services to third parties. In this light, Nicor Gas argues that ICEA/RESA never offered any evidence as to why its members cannot bill for their own non-commodity products and services.

(ii) ICEA/RESA's Position

ICEA/RESA request that the Commission compel Nicor Gas to undertake a cost study for combined commodity and non-commodity third-party billing and offer the combined offering as a tariffed service. ICEA/RESA aver that this combined commodity and non-commodity billing is the ideal way to increase consumer awareness of available products and services by offering a product such as a green product on the customer's utility bill, according to Nicor Gas witness Lanier (in the context of the TotalGreen product). According to ICEA/RESA, to combine the benefits of the competitive retail market identified by AG witness Rubin and Staff witness Brightwell while giving customers the convenience of having the products and services all on the utility bill, third parties such as retail suppliers need access to the utility bill at a fair price.

According to ICEA/RESA, the non-commodity service Nicor Gas offers to PHS is well-defined and it is being offered today at a rate disclosed in the record in this docket. ICEA/RESA argue that they presented a reasonable, specific, and definite request.

ICEA/RESA contend that currently, Nicor Gas will provide third-party billing for non-commodity service, but individual third parties have to negotiate pricing with Nicor Gas. ICEA/RESA further contend that under the current structure, a supplier interested

in offering a non-commodity service on the Nicor Gas bill must do so outside of a structure with Commission oversight or a docketed proceeding. ICEA/RESA argue that the supplier lacks the ability to verify or obtain third-party review of Nicor Gas' cost-related claims. According to ICEA/RESA, third-party billing for non-commodity providers currently takes place because Nicor Gas already offers this service from its former affiliate PHS non-commodity billing service. ICEA/RESA argue that based on confidential information provided in the docket, instead of negotiating individually--and effectively forcing a supplier to negotiate against itself—Nicor Gas should offer that non-commodity billing as a tariffed service.

ICEA/RESA respond to what they described as a red herring provided by Nicor Gas that "ICEA/RESA did not offer any evidence as to why they cannot bill for their own non-commodity products and services." Nicor Gas IB at 113. ICEA/RESA note they provided no evidence of that proposition because it is not correct. According to ICEA/RESA, while many AGS have the capacity to bill, ICEA/RESA witness Wright noted that he agreed with Nicor Gas witness Lanier that the gas bill is a logical and convenient place for these interests to converge.

ICEA/RESA also recommend that, as a tariffed service, Nicor Gas should study whether there are efficiencies to providing both commodity and non-commodity third-party billing service to suppliers. While ICEA/RESA reserve the right to review and object to cost allocations and estimates, ICEA/RESA state they had no objection to requiring suppliers to pay on a cost basis for prudent costs incurred. According to ICEA/RESA, identification of those costs and efficiencies, though, requires a study.

(iii) Commission Analysis and Conclusion

The Commission is not convinced that the proposal of ICEA/RESA to have Nicor Gas perform a study for a combined billing service, including both commodity and non-commodity services is necessary. Contrary to what ICEA/RESA allege, under the current tariffs, any agreement with a Customer Select Supplier must be submitted to the Commission for review.

2. Transportation Tariffs Approved in Docket No. 20-0606

a. Nicor Gas' Position

Nicor Gas did not propose any substantive language changes to its Transportation tariffs in this case. Instead, it proposed only changes in rates related to the proposed Test Year revenue requirement. Meanwhile, the Company points to the fact that the Commission considered and resolved substantive language changes to the Transportation tariffs on May 13, 2021, when it entered an Order approving substantive tariff changes to the terms and conditions governing the Company's Transportation program. *See N. Ill. Gas Co. d/b/a Nicor Gas Co.,* Docket No. 20-0606, Order (May 13, 2021) ("Transportation Tariff Docket"). The Company submitted its compliance tariff filing to the Commission on May 24, 2021, and the updated, Commission-approved Transportation tariffs became effective on May 28, 2021.

Nicor Gas points out that the Transportation Tariff Docket was fully litigated, and included discovery, testimony, briefing, and oral argument before the Commission. Nicor

Gas further states that ICEA/RESA participated fully in the proceeding and now are appealing the Transportation Tariff Order.

The Company opposes ICEA/RESA's attempt, in this case, to make further revisions to the Commission-approved language for the Transportation tariffs. Nicor Gas argues that ICEA/RESA's proposal is an improper collateral attack on an Order entered just three months ago. Further, the Company dismisses as disingenuous ICEA/RESA's claim that Nicor Gas somehow does not object to their proposed language changes. Here, Nicor Gas points to evidence showing that it has repeatedly rejected ICEA/RESA's proposals principally because these matters were resolved in the Transportation Tariff Docket. The Company also points out that ICEA/RESA's suggested changes are fully at odds with what Nicor Gas described as the time needed, and work necessary, to prepare for the implementation of the revised tariff language resulting from the Transportation Tariff Docket. Here, Nicor Gas points to language from the Order explaining why a May 1, 2022 implementation date was proposed – both to modify internal processes, but also to provide Transportation customers with time to prepare for the new operating parameters. As such, the Company asserts that there is no way that it would agree with the ICEA/RESA proposals, and urges the Commission to reject ICEA/RESA's attempt at a second bite at the apple to modify the Commission-approved tariff language.

b. ICEA/RESA's Position

ICEA/RESA witness Mehling testified that the proposed storage tariffs approved in Docket No. 20-0606 make it impossible to consistently meet daily storage parameters and harm suppliers' ability to offer products and services. ICEA/RESA note that they (and, separately, IIEC) have appealed the Commission's Order in the Transportation Tariff Docket. However, continue ICEA/RESA, pending the outcome of that appeal, Mr. Mehling proposed two changes to Nicor Gas' storage tariffs that would blunt the harm to the retail market: (1) the Commission should require Nicor Gas to provide Customer Select Suppliers with a daily demand requirement to fully utilize storage on a daily basis; and (2) the daily storage use cash-out for Customer Select should be limited to the city gate price rather than a discount (for sales) or premium (for purchases).

ICEA/RESA contend that with respect to the first recommendation, Mr. Mehling's approach seeks to promote transparency and collaboration between the supplier and the utility, and in doing so, equip the supplier with the tools necessary to remain within the narrow daily storage provisions currently at issue in ICEA/RESA appeal of Transportation Tariff Docket. ICEA/RESA further contend that Mr. Mehling's second recommendation is a targeted solution to address the nomination day behavior Nicor Gas raised in Transportation Tariff Docket in support of the proposed tariff changes.

ICEA/RESA argue that although Nicor Gas witness Hizon did address some of Mr. Mehling's proposals that may be litigated in the appeal of Transportation Tariff Docket, ICEA/RESA were unable to identify any response of any kind to the two proposals above. ICEA/RESA highlight that Nicor Gas had ample opportunity to object to or disagree with Mr. Mehling's proposals from his direct testimony, but did not conduct any discovery, address the issues in rebuttal or surrebuttal testimony, or cross-examine Mr. Mehling. ICEA/RESA aver that upon review of Nicor Gas' testimony and Initial Brief, it appears that Nicor Gas chose not to oppose or substantively engage ICEA/RESA witness Mehling's

proposals identified above. ICEA/RESA conclude that without opposition from Nicor Gas or any other party (at least that ICEA/RESA identified in their review of testimony), the Commission should direct Nicor Gas to make these modifications to Nicor Gas' storage tariffs.

As a result, ICEA/RESA recommend that the Commission should draw an inference that Nicor Gas does not object and should approve Mr. Mehling's proposals.

c. Commission Analysis and Conclusion

The Commission finds that despite ICEA/RESA's assertion, Nicor Gas does object to the changes to the tariff language approved in the Transportation Tariff Docket. The Commission agrees with Nicor Gas that these issues were addressed in the Transportation Tariff Docket. ICEA/RESA's proposal is rejected.

XI. 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 December 31, 2022; such Test Year is appropriate for purposes of this proceeding;

(5) for the Test Year ending December 31, 2022, and for the purposes of this proceeding, the Company's rate base is $4,652,130,000;

(6) the $8,707,524,000 original cost of plant for Nicor Gas at December 31, 2020, as presented in Staff Ex. 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 6.96%; this rate of return incorporates a return on common equity of 9.75%, on long-term debt of 3.69%, and on short-term debt of 0.13%, and includes a 0.023% 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 $1,133,027,000 and net annual operating income of $323,788,000 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 and 18-1775, 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 January 14, 2021 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 $1,133,027,000, which represents a gross increase of $240,224,000; 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) Nicor Gas' adjustments to Rider VBA are not approved;

(15) Nicor Gas' proposed Rider 40 – TotalGreen as presented in this docket is just and reasonable and is approved;

(16) 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;

(17) the December 31, 2021 QIP amounts included in base rates are comprised of Gross Plant of $722,904,161 related accumulated depreciation of $124,370,304, related accumulated deferred income taxes of $(39,671,090), and $13,017,333, for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired;

(18) the QIP costs related to the 2020 and 2021 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; and

(19) Nicor Gas shall prepare an updated depreciation study and present its results in the Company's next rate case 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 January 14, 2020, 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), and (16) of this Order applicable to service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that the $8,707,524,000 original cost of plant for Northern Illinois Gas Company d/b/a Nicor Gas Company at December 31, 2020, as presented in Staff Ex. 2.0, is approved as the original cost of plant.

IT IS FURTHER ORDERED that the December 31, 2021 QIP amounts included in base rates are comprised of Gross Plant of $722,904,161 related accumulated depreciation of $124,370,304, related accumulated deferred income taxes of $(39,671,090), and $13,017,333, 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 2020 and 2021 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’s proposed Rider 40 – TotalGreen as presented in this docket is just and reasonable and is approved.

IT IS FURTHER ORDERED that Northern Illinois Gas Company d/b/a Nicor Gas Company is directed to prepare an updated depreciation study and present its results in the Company’s next rate case proceeding.

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 18th day of November, 2021.

(SIGNED) CARRIE ZALEWSKI
Chairman