

The Peoples Gas Light and Coke Company Gas Main Replacement Program

A Historical Narrative

Introduction

The ICC's mission is to balance the interests of consumers and utilities to ensure adequate, efficient, reliable, safe and least-cost public utility services. Peoples Gas, with increasing regulatory oversight from the Illinois Commerce Commission, is pursuing a System Modernization Program (“SMP,” formerly known as the Accelerated Main Replacement Program or “AMRP”).

Peoples Gas, now owned by WEC Energy Group,¹ has served the city of Chicago since 1850, when it became the city’s first utility. The natural gas delivery system in Chicago consists of tens of thousands of segments of aging natural gas lines. Some segments are more than 100 years old and are made of obsolete, deteriorating materials.

While Peoples Gas began replacing at-risk gas mains at a moderate pace beginning in the early- to mid-1980s, tragic explosions involving aging natural gas main across the country prompted the Federal Government to issue a directive urging utilities to pursue replacement on an accelerated basis.

Consistent with its mission to ensure safety, the ICC continues to work to find the best path forward for the complex upgrade and replacement project that is the SMP. Whether working with the Company to develop and approve cost recovery mechanisms; audit or investigate the project; or, more recently, to engage all stakeholders in comprehensive workshops and litigated proceedings, the ICC is committed to utilizing its quasi-judicial resources to set SMP on a course that will ensure that the necessary work is completed while mitigating rate impacts, minimizing disruption to Chicago residents and businesses, and holding Peoples Gas accountable for results.

Origin of the Peoples Gas Main Replacement /Modernization Program

Peoples Gas began its accelerated main replacement efforts with the goal of replacing over 2,000 miles of cast iron mains, upgrading 300,000 customer service lines, and relocating gas meters from inside customer premises to outside, over a 20-year period. Cast iron mains and

¹ Detail as to ownership: Integrys Energy Group, the parent of Peoples Gas, was formed in 2007, and acquired by Wisconsin Energy Corporation in June 2015.

ductile iron mains, installed as much as 100 years ago, are made of obsolete, deteriorating materials.²

Peoples Gas was not alone in moving to address the issue of failing natural gas mains. Utilities in 35 states across the country, in other major, densely-populated cities like New York, Baltimore, Washington DC and Philadelphia, are replacing cast and ductile iron mains.

In its 2009 general rate case (Docket No. 09-0167), Peoples Gas's proposed Infrastructure Cost Recovery ("ICR") Rider was approved, which incentivized the Company to invest in infrastructure by allowing it to recover a surcharge for projected costs of system upgrades without filing for a general rate increase.

On January 21, 2010, the Commission approved Peoples Gas's proposal to recover SMP/AMRP costs through Rider ICR. The Commission's Order in that case required that the main replacement program be completed by 2030. In April 2011, Peoples Gas began to work on the SMP/AMRP and began to recover costs associated with that work through Rider ICR. In September 2011, however, the Illinois Appellate Court reversed the Commission's decision approving Rider ICR; consequently, Peoples Gas was no longer allowed to recover the SMP/AMRP costs through the Rider.

San Bruno Disaster and Federal Response

On September 9, 2010, a 30-inch steel gas pipeline located in San Bruno, California exploded, killing eight people and injuring over 50, destroying 38 homes and causing billions of dollars in damage. Similar incidents involving aging cast iron main in cities such as Allentown, Pennsylvania; Austin, Texas; Philadelphia, Pennsylvania; and East Harlem, New York killed dozens of people and injured many more.

In March 2011, U.S. Secretary of Transportation Ray LaHood announced a "Call to Action" through the Pipeline and Hazardous Materials Safety Administration ("PHMSA") urging utilities to accelerate the repair or replacement of high-risk pipelines.³ The Call to Action "engage[d] all the state pipeline regulatory agencies, technical and subject matter experts, and pipeline operators in accelerating the repair, rehabilitation, and replacement of the highest-risk pipeline infrastructure."

The PHMSA Call to Action heightened the sense of urgency for both the Commission and Peoples Gas to address aging natural gas mains.

² Since 2011, Peoples Gas has installed nearly 720 miles of distribution pipe and installed 16 miles of high-pressure transmission pipeline. Through the SMP, Peoples Gas and its crews will replace more than 40 percent of the company's system.

³ https://opsweb.phmsa.dot.gov/pipeline_replacement/action.asp

SMP/AMRP Proposal in 2012 General Rate Case

After the Illinois Appellate Court overturned Rider ICR, Peoples Gas pursued a different approach to cost recovery for work on natural gas mains. In its 2012 rate case (Docket No. 12-0512), Peoples Gas sought to recover costs for the SMP/AMRP program in general natural gas delivery rates. The Commission granted Peoples Gas's request to recover costs for SMP/AMRP through rates. Recognizing the critical importance of accelerated gas main replacement, the Commission noted in its Order that the Peoples Gas "distribution system . . . [was] approaching the point that further aging and deterioration will eventually cause replacement to maintain public safety to become an emergency matter."

However, the Commission also expressed concern that the project "lacked detail." In order to protect ratepayers and keep the company on schedule with the gas main replacement program's target 2030 end date, the Commission ordered a two-phase investigation of the SMP/AMRP program. This investigation became known as the Liberty Audit, as discussed further below.

Qualifying Infrastructure Plant ("QIP") Legislation

In May 2013, through legislation introduced as SB2266, the Illinois General Assembly responded to PHMSA's Call to Action and passed legislation that authorized gas utilities to use a Qualifying Infrastructure Plant ("QIP") Rider to recover the costs of replacing mains made of cast and ductile iron and other at-risk materials. The General Assembly specifically tied such work to the critical need to ensure the safety and reliability of natural gas delivery systems.⁴

The newly enacted legislation (Public Act 98-57), signed into law by Governor Pat Quinn on July 8, 2013, added Section 9-220.3 to the Illinois Public Utilities Act. Under Section 9-220.3, natural gas utilities are authorized to implement a rider to recover the costs of replacing qualified infrastructure, which includes such things as mains constructed of cast iron, ductile iron, bare or mechanically coupled steel, and certain types of obsolete plastic. Importantly, gas utilities could also recover the costs of upgrading systems to medium pressure, which reduces outages due to water infiltration and allows the utilities to install excess flow valves to shut off gas to a customer's premises if service lines are compromised. It also allows companies to recover costs associated with moving customer meters outside, which facilitates inspections to ensure system safety and provides additional reliability. The Commission approved Peoples Gas's Rider QIP, effective January 1, 2014.

Peoples Gas's first Rider QIP reconciliation case, for calendar year 2014, is currently fully briefed and awaits decision from the Commission, while reconciliation cases for calendar years 2015 and 2016 have also been filed. The key issue in the 2014 case, as in all other QIP cases, is

⁴ Another goal of the QIP legislation was incentivizing economic development and job creation. Peoples Gas and its contractors directly employ over a thousand people on the SMP/AMRP each construction season.

whether the QIP costs are reasonable and prudent. These reconciliation cases give the Commission the opportunity to scrutinize QIP costs on an ongoing, annual basis.

The Commission Audit of SMP/AMRP – the Liberty Audit

On June 18, 2013, in its final order in Docket No. 12-0512, the ICC ordered an audit of the Company's gas main replacement program. The ICC was concerned with the pace of the main replacement program and agreed with Commission Staff that an audit of the program was necessary to minimize construction delays and ensure costs did not exceed projections.

The Commission selected Liberty Consulting Group ("Liberty") to conduct an independent investigation of the SMP/AMRP (the "Liberty Audit"). The Commission asked Liberty to take a two-phase approach to the audit.

- Phase I – Review and audit Peoples Gas's planning, implementation and management of SMP/AMRP, and offer recommendations to improve processes and reduce costs.
- Phase II – Oversee implementation of Phase I recommendations.

In May, 2015, Liberty's Phase I report to the Commission included 95⁵ recommendations for improving SMP/AMRP planning and execution. The report was a comprehensive examination of the way that Peoples Gas had approached the SMP/AMRP, and resulted in recommended changes to essentially all of the processes and procedures underlying the work. Peoples Gas accepted and implemented the vast majority of these recommendations.

Phase II consisted of a structured, two-year program to monitor Peoples Gas's effectiveness in implementing the Phase I recommendations. In December 2017, Liberty submitted the eighth and final Phase II quarterly report. Throughout this process, Peoples Gas worked very closely with the Commission and Commission Staff to comply with and implement the Phase I Liberty recommendations.

Acquisition / Merger of Peoples by Wisconsin Energy Corporation

In June 2015, the Commission issued its final order in Docket No. 14-0486 (the "Merger Docket"). Following an extensive review, the Commission's order approved Wisconsin Energy Corporation's petition to acquire Integrys Energy Group, making Peoples Gas a subsidiary of the newly-formed WEC Energy Group.⁶

As a condition of approval, the Commission required Peoples Gas to file a Cost Plan Model and Scheduling Master Plan for the AMRP. These documents are discussed further below.

⁵ Originally, Liberty's report contained 95 recommendations, but that number was reduced to 88 with seven recommendations either deleted or merged.

⁶ The Commission approved the application on June 24, 2015 in Docket No. 14-0496. The acquisition of Integrys closed on June 29, 2015.

After finalizing the acquisition, the Company's new management undertook a review of the AMRP and agreed with the concerns of the Commission and consumer advocates, recognizing there was a significant need to improve the project through better project management practices. New management also acknowledged it would be possible to extend the program from its original 2030 end date to a target end date of 2035-2040, a change that would mitigate bill impacts while allowing Peoples Gas to continue to replace deteriorating main at an accelerated pace.

Investigation of Alleged Misrepresentations by Peoples/WEC during Merger Proceeding

At an ICC Open Meeting on May 20, 2015, executives of Peoples Gas and Integrys were questioned about the cost of the AMRP spiraling past original estimates of \$2.3 to \$4.5 billion, as well as Liberty's conclusion in the Liberty Audit that the Company could not accurately estimate the total cost of the AMRP. The executives claimed the project costs were unknown but assured the Commission that they were still working on a long-term cost model.

On July 27, 2015, following Commission approval of WEC's acquisition of Peoples Gas, Peoples Gas's new President, Charles R. Mathews, stated in a letter to the ICC's Chairman and Commissioners that "WEC Energy Group's management [was] provided, for the first time, after the close of the acquisition, with a preliminary cost estimate for the full 20-year AMRP. This projection," he noted, "exceeded \$8 billion."

On September 30, 2015, Liberty submitted its First Quarterly Report for Phase II of the AMRP Audit to the Commission. In this report, Liberty stated the \$8 billion cost estimate was disseminated within Peoples Gas on or about January 2015.

On November 18, 2015, in response to the allegations in the Liberty report, the Commission initiated Docket No. 15-0608 to investigate and determine whether Peoples Gas, Integrys Energy Group, Inc. or WEC knowingly misled or withheld material information from the Commission at its May 20, 2015 Open Meeting, in violation of Section 5-202.1 of the Public Utilities Act.

The Commission's investigative proceeding resulted in two settlement agreements, pursuant to which Peoples Gas agreed to pay a total \$18.5 million in penalties and refunds. The Company admitted the omitted information concerning cost estimates for SMP/AMRP was material to the Commission's oversight and regulation of the utility and the SMP/AMRP project. Under the terms of a \$7.5 million settlement between Peoples Gas, Commission Staff and the Office of the Illinois Attorney General, the company paid \$4 million into the Public Utilities Fund; \$500,000 into the State of Illinois General Revenue Fund, and \$3 million was dedicated to Peoples Gas's "Share the Warmth" fund, a program that provides heating grants to limited and fixed-income households. Under the terms of a second settlement, Peoples Gas paid \$10 million in rebates to Peoples Gas customers and another \$1 million to reconnect service and forgive outstanding debt of low-income customers whose gas had been disconnected.

Investigation into Anonymous Letters Alleging Misconduct and Improprieties Related to the SMP

Beginning in February 2015, the ICC received a total of seven anonymous letters, each of which contained accusations that Peoples Gas and its current and previous owners knowingly misled the Commission or withheld information regarding the total capital cost of the AMRP. On March 11, 2015, the Commission initiated Docket No. 15-0186 to examine the claims made in the anonymous letters, as well as address safety concerns regarding the Peoples Gas system.

As a result of a settlement with Staff in this docket, Peoples Gas modified its conflict of interest policy and agreed to provide quarterly conflict of interest reports, as well as semi-annual safety reports to Staff. These reporting commitments will continue for a period of four years.

Post-Merger Review of SMP/AMRP

Peoples Gas filed its Cost Plan Model and Scheduling Master Plan on November 30, 2015, in compliance with Condition 5 of the Commission's Final Order in the Merger Docket, Docket No. 14-0496. The Commission reviewed the plans, together with the Commission Staff's analysis of those plans and recommendations for future Commission action.

Staff recommended the Commission take several actions with regard to Peoples Gas's natural gas system modernization program, including convening a workshop/comment process open to all interested parties to address stakeholders' near-term and long-term recommendations for the program. In December 2015, the Commission issued an order adopting the Staff analyses and recommendations. The order directed Staff to convene a series of workshops and report back to the Commission with recommendations for a future proceeding.

Between January 14, 2016 and March 22, 2016, ICC Staff held a series of six workshops, during which Peoples Gas provided information to Staff and other workshop participants about its goals for the SMP/AMRP and progress to date. Other stakeholders, including the Attorney General and Citizens Utility Board (CUB), also presented information concerning all aspects of the project.

In May 2016, ICC Staff submitted a report to the Commission that summarized the workshop participants' positions on issues and recommended that the Commission initiate a formal proceeding to resolve the issues. To distinguish the Company's revised approach from previous iterations of the modernization program, the parties began to call the program the System Modernization Program ("SMP").

In July 2016, the Commission initiated Docket No. 16-0376 to investigate the SMP/AMRP's cost, schedule, scope and other issues. Peoples Gas submitted a written plan for proceeding with system modernization through a neighborhood approach and pursuant to rolling, three-year plans. In March, 2017, following a contested proceeding, the Commission ordered the parties to undertake a second phase of the docket, in order to address additional questions in the

interest of delivering a more complete record for Commission consideration. A Commission decision is expected in early 2018.

As a result of the proceeding, and in particular active participation from ICC Staff and other stakeholders, regulatory oversight for SMP will contain more rigorous performance metrics for the program. There is broad acceptance among the parties on several metrics, on most of which Peoples Gas has agreed to report to the Commission on a quarterly basis. These metrics will allow the Commission to monitor whether the SMP/AMRP is on pace and is being executed effectively. They will also allow the Commission to spot positive or negative trends in nearly real time and allow the Commission and Company to address them immediately.

Another possible outcome of the docketed proceeding is Commission authorization for ICC Staff to hire two additional consultants -- one to assist Staff with auditing the cost of infrastructure improvements in connection with annual Rider QIP reconciliation cases⁷, and a second to assist Staff in evaluating Peoples Gas's ongoing management of the SMP. These consultants will help the Commission and Staff ensure that the SMP operates in the most efficient, safe and cost-effective manner.

Also as a result of the proceeding, the Company, CUB and the Environmental Defense Fund (EDF) have agreed to work together to explore incorporating new technology for methane detection into the Company's neighborhood ranking process. The Company will conduct a pilot program through 2021 to determine the efficacy of advanced methane detection technology to enhance the SMP. As a part of this pilot program, Peoples Gas will submit annual reports to the Commission regarding program methodology, costs, benefits, results in terms of annual methane leak flow rate reduction, and other potential uses for the technology.

QIP and Long-Term Cost Modeling

Peoples Gas, Commission Staff and all the parties to Docket No. 16-0376 acknowledge the SMP will have an impact on customer bills, but the extent of the impact over the life of the project is subject to substantial uncertainty.

The QIP legislation that sets the maximum allowable annual expenditure, Section 9-220.3 of the Public Utilities Act, will be repealed by operation of law on December 31, 2023. Whether Section 9-220.3 is reenacted and, if it is, what levels of cost recovery will be allowed in the reenacted version, may significantly impact the amount Peoples Gas can spend annually on the SMP and, in turn, the level of rate increases for consumers.

The reporting and performance metrics that were imposed on Peoples Gas in the Docket No. 16-0376 Initiating Order, and the long-term reporting and performance metrics to which Peoples Gas has agreed and which Commission Staff recommends the Commission adopt in its final order, will provide the Commission with a complete picture of the SMP, including its

⁷ It is expected that the majority of the Peoples Gas's SMP costs will be recouped through QIP reconciliations.

success at targeting the highest risk pipe; the reduction to the risk of the system as a whole; and the program's cost. This information will further enable the Commission to provide the General Assembly with wide-ranging and detailed information about the SMP, which the General Assembly can and should consider when determining whether to reauthorize Section 9-220.3.

Conclusion

Faced with one of the most significant infrastructure challenges to face Chicago in many decades, the Commission conducted an extensive review of the SMP/AMRP to ensure that Peoples Gas's program prioritizes replacement of aging infrastructure that poses the most significant and immediate threat to safety and property. As the system modernization program progresses, long-term monitoring and reporting requirements will enable the Commission to make certain that the program continues to emphasize system safety, while proceeding in a cost-effective and efficient manner. The Commission is committed to ensuring Peoples Gas provides a safe, reliable and affordable natural gas main system for the benefit of all City residents and property owners.