Respondent's Exhibit B

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own Motion,	)	
	)	
v.	)	
	)	
North Shore Gas Company	)	03-0704
	)	
	)	
Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.	)	

DIRECT TESTIMONY
OF
<u>DAVID WEAR</u>

Q. Please state your name and business address.

A. David Wear. 150 N. Michigan Avenue, Chicago, Illinois 60601.

Q. By whom are you employed?

A. The Peoples Gas Light and Coke Company ("Peoples Gas").

Q. What position do you hold with Peoples Gas?

A. My current title is Manager of Gas Supply Administration.

Q. What are your responsibilities in that position?

A. I am responsible for negotiating, contracting, and dispatching the assets that make up the gas supply portfolio of Peoples Gas and Respondent, North Shore Gas Company (the "Company").

Q. Please summarize your educational background and experience.

A. I received a Bachelor of Science degree in Liberal Arts and Sciences (Geology) from the University of Illinois at Urbana-Champaign in 1981, and a Master in Business Administration from the University of Illinois at Chicago in 1989. I began my employment with Peoples Gas in July of 1989 in the Information Systems Division assisting in the design, acquisition, planning and implementation of various computer systems. I joined the Gas Supply Division in January of 1993 with responsibilities for managing term supply contracts, spot gas activities, and pipeline logistics. In my time in this division, I have held the titles of Gas Supply Contracts Analyst, Senior Gas Supply Contracts Analyst, Senior Gas Supply Trader, and Supervisor, before becoming Manager of Gas Supply Administration in April of 2000.

Q. What is the purpose of your direct testimony in this proceeding?

A. The purpose of my testimony is to describe Respondent's fiscal 2003 supply and capacity procurement practices, including negotiation of contracts and related accounting and auditing practices. In addition, I discuss steps taken by Respondent to reduce gas price volatility.

Q. Please describe Respondent's fiscal 2003 fuel procurement area and management control of the purchasing process.

A. Peoples Gas provides service for Respondent in these areas under an intercompany service agreement approved by the Commission. The President, to whom the Executive Vice President, Gas Supply, reported, had ultimate responsibility for determining Respondent's gas purchasing strategy in fiscal 2003. The Executive Vice President, in consultation with personnel in the Gas

Supply Administration and Gas Supply Planning Departments, and others, as appropriate, developed specific recommendations. The Gas Supply Division was responsible for entering into and administering contracts for the supply of natural gas and for purchases of transportation and storage services, and administering the contract for storage services that Peoples Gas provided to Respondent and would be responsible for formulating and administering contractual provisions for purchases of propane.

Q. What procedure did Respondent follow in fiscal 2003 on a monthly basis in order to select its monthly resource mix?

A. Each month, members of Peoples Gas' Gas Supply Administration and Gas Supply Planning Departments met to address Respondent's purchasing decisions for the upcoming month. On a daily basis during the course of the month, as changing requirements and the market dictated, these personnel addressed any changes necessary to accommodate the need for additional supply or capacity or the opportunity to release additional supply or capacity.

Q. Please describe the sources of firm gas supply contractually available to Respondent for system supply during the reconciliation period.

A. During fiscal 2003, Respondent had contracts in place with producer/marketers, principally for seasonal supplies for a period of less than one year. Also, Respondent was in the fourth year of a five-year contract, the Gas Purchase and Agency Agreement ("GPAA"), with Occidental Energy Marketing, Inc. ("OEMI") pursuant to which OEMI sold Respondent gas at the citygate to meet requirements throughout the year. The GPAA was initially with

Enron North America Corporation ("ENA"). ENA filed bankruptcy in fiscal 2002, and, during the course of the bankruptcy proceeding, OEMI acquired the contract. To facilitate that citygate supply relationship, Respondent released some of its pipeline transportation capacity to OEMI.

For the other supply contracts, Respondent purchased the gas in the field and transported it to the market using transportation contracts not released under the GPAA, or received gas from the suppliers at the citygate. Additionally, Respondent had storage contracts in place with two pipeline providers (Natural Gas Pipeline Company of America ("Natural") and ANR Pipeline Company ("ANR")). It continued to have a storage contract with Peoples Gas.

Q. Did Respondent have any other sources of gas available for system supply?

A. Yes. It had non-firm sources. It purchased supply on a monthly or daily basis from producer/marketers on the spot market. Also, a significant portion of Respondent's end use market opts for deliveries of customer-owned gas under Respondent's Schedule of Rates. This gas was another source available to Respondent for system supply.

Q. Please describe Respondent's contractual agreements for the purchase of supply and capacity recovered through Respondent's monthly Gas Charge filings.

A. During fiscal 2003, Respondent purchased a portion of its supply under firm contracts with producer/marketers. These purchases were made under the terms of the individual contracts that Respondent had with each producer/marketer. Generally, the nature of the service under the contracts was either “baseload” or “swing.” A baseload contract obligates Respondent to purchase the full contract quantity each day of the contract term. A swing contract permits Respondent to take any portion of its daily contract quantity on any day, subject to timely nominations to the seller and pipeline transporter. The GPAA includes both baseload requirements and the opportunity to purchase swing gas.

In fiscal 2003, Respondent purchased a portion of its total supply volumes as spot purchases from various producer/marketers. It made spot purchases from producer/marketers under the terms of the individual contracts that Respondent had with each seller. Respondent’s spot contracts with producer/marketers typically provided for purchasing gas on a short-term basis. Respondent made many spot purchases in fiscal 2003 on a day-to-day basis. Under the contracts, the seller was not required to offer supply and Respondent was not required to accept any offer.

Finally, Respondent had LP gas available had it been required to augment peak day deliverability when Respondent’s customer demand was in excess of deliveries available from other sources.

Capacity (both pipeline storage and transportation) transactions are subject to contracts with the pipelines and the pipelines’ FERC Gas Tariffs.

Q. Did any significant changes to Respondent’s transportation and storage capacity portfolio occur in fiscal 2003?

A. No.

Q. What was Respondent’s design day reserve margin in fiscal 2003?

A. In fiscal 2003, Respondent’s reserve margin was approximately 3 percent based on a design day defined as a January weekday with an average temperature of -20º F. This is generally consistent with Respondent’s actual reserve margins beginning in fiscal year 1996. The reserve margin is intended to ensure that Respondent will be able to serve its customers under extreme conditions. Because of the serious adverse impacts on public health and safety of a gas outage, in addition to the difficulties of restoring gas service, it is imperative that Respondent plan for extreme conditions. Firm gas supply and deliverability to Respondent’s distribution system were thus set at levels that provide a margin over Respondent’s projected peak day requirements. This reserve margin was necessary to accommodate, among other things, the fact that Respondent is located near the end of Natural’s and Northern Border Pipeline Company’s (“Northern Border”) facilities, the possibility of deliverability shortfalls in connection with storage and flow gas and the fact that requirements could exceed design day projections.

Q. Please describe the steps taken to address price volatility, including any hedging strategies.

A. The Company took several steps to address price volatility. During the year, the Company followed a price protection program, approved by the Company’s Risk Management Committee, which was specifically designed to mitigate the effects of gas price volatility. Under this program, a significant portion of the Company’s purchases were protected either at fixed prices or within fixed-price collars.

The Company’s supply portfolio also contained storage assets that allowed it to use the natural physical hedge that seasonal storage provides. The Company also purchased natural gas supplies from a variety of parties and from different producing regions to protect against regional price anomalies.

Q. Please describe the impact on the Gas Charge of the hedging strategies.

A. As a result of purchases made under the Company’s price protection programs, customers were partially insulated against price volatility. Analysis showed that by taking fixed price positions on a large portion of the anticipated baseload purchases, the Company could substantially dampen the effect that large swings in the price of natural gas would have on its total cost of gas. This, in turn, would lead to more stable prices for the Company’s customers. In the absence of this program, customers would be exposed to the full risk of market fluctuations. It must be emphasized that the price protection strategies employed by the Company were not aimed at guaranteeing the lowest possible price for gas, nor was that the result. The Company distinguishes between hedging and speculating, and believes that any strategy that aims to achieve or beat a given price is speculative and would not be prudent.

Q. Were Respondent’s incurred expenditures for fiscal 2003 gas supply prudent?

A. Yes. The incurred gas supply expenditures for fiscal 2003 reflected Respondent’s continuing efforts to minimize the cost of its gas supply consistent with operational and contractual constraints and the statutory obligation to provide adequate and reliable service to customers during all periods of the year.

Q. What other efforts has Respondent made to ensure that pipelines serving it provide reliable services on a best-cost basis?

A. Respondent made efforts to maintain adequate, reliable services from pipeline transporters and to keep gas costs to a minimum by active participation in its pipeline transporters' rate and certificate proceedings and other matters before the FERC. The Gas Supply Administration and Legal Departments monitored the filings of Respondent's principal pipeline suppliers of storage and transportation services -- Natural, Northern Border, and ANR. In addition, Respondent monitored FERC rulemaking and policy proceedings.

Based on analyses of pipeline filings, Respondent intervened in significant proceedings and sought to ensure that the pipelines provide services that allow Respondent to satisfy its obligations to provide adequate, safe and reliable service to its customers. Similarly, Respondent has participated in generic FERC proceedings. Also, Respondent continued to participate actively as a member of the American Gas Association in FERC rulemakings and other generic proceedings affecting our customers.

Q. Please describe the auditing procedures and monitoring related to contract enforcement for Respondent's pipeline purchases.

A. The auditing procedures and monitoring related to enforcement of contracts for natural gas delivered by pipelines interconnecting with Respondent were as follows:

1. Energy delivered by Natural to Respondent is registered by Respondent's electronic flow measurement ("EFM") equipment located at three locations, including Peoples Gas' Manlove Field. Peoples Gas' Gas Control Department, on behalf of Respondent, reviewed and monitored the accuracy of energy that was billed at all three meters. If the Gas Control Department's measurement audit indicated an energy discrepancy, the Gas Control Department would contact Natural to resolve the discrepancy. Peoples Gas' Gas Accounting Department, on behalf of Respondent, reviewed EFM data supplied by the Gas Control Department to independently compare these data to the amount billed by Natural.

2. Natural also recalibrates its billing meters once a month. Respondent's representative or a representative from Peoples Gas on behalf of Respondent may be present at these recalibrations. Respondent's representative or a representative from Peoples Gas on behalf of Respondent is present for physical changes (*e.g*., orifice plate inspection or replacement) involving a meter. Peoples Gas on behalf of Respondent, independently operates equipment verifying the accuracy of Natural's meters.

3. Respondent monitored the gas quality and heating value of all gas passing through the city gate by means of gas chromatographs that are recalibrated on a regularly scheduled basis. Natural determines gas quality and heating value at the Grayslake city gate station and uses Respondent's gas quality and heating value determination for deliveries at the Tonne Road city gate. Northern Illinois Gas Company ("NI-Gas") uses Respondent's gas quality

and heating value determination for deliveries at the Busse Road city gate. ANR determines the gas quality and heating value at the Somers Road Station from a chromatograph located on its system upstream of that point.

4. Respondent receives ANR deliveries at the Busse Road city gate. NI-Gas operates electronic measurement equipment at its Busse Road station. NI-Gas recalibrates its EFM equipment once a month. Respondent’s representatives may be present at these recalibrations. Peoples Gas’ Gas Control Department, on behalf of Respondent, reviews and monitors the accuracy of energy that is billed. Peoples Gas, on behalf of Respondent, independently operates equipment verifying the accuracy of the NI-Gas meters.

5. Respondent receives ANR deliveries directly from ANR at ANR’s Somers Road Station located in Wisconsin. Respondent also receives Northern Border deliveries, *via* ANR, at Somers Road. ANR owns and operates electronic gas measurement equipment at Somers Road. ANR recalibrates its electronic gas measurement equipment once a month. Respondent’s representative may be present at these recalibrations. Peoples Gas’ Gas Control Department, on behalf of Respondent, reviews and monitors the accuracy of energy that is billed. Peoples Gas, on behalf of Respondent, independently operates electronic equipment verifying the accuracy of ANR’s measurement.

6. Peoples Gas’ Auditing Department examines the Gas Accounting Department’s procedure once or twice each year to ensure that the proper procedure is being followed.

Q. Please describe the auditing procedures and monitoring programs related to enforcement of Respondent's contracts for purchases from producer/marketers, including ENA.

A. The gas purchased by Respondent from each producer/marketer was invoiced based on quantities delivered at the agreed delivery points. Each month the Gas Accounting Department verified that the appropriate unit prices have been used by each producer/marketer in the invoicing to Respondent.

Q. Please describe the auditing procedures and monitoring programs that Respondent uses with respect to its gas transportation contracts.

A. The auditing procedures and monitoring related to the enforcement of the transportation contracts with ANR, Natural and Northern Border were as follows:

1. Each of these pipelines renders monthly statements of the quantity of gas received on behalf of Respondent from each seller at each receipt point and the quantity of gas each transporter delivered to Respondent. The quantities of gas received and delivered by each transporter were measured in accordance with the General Terms and Conditions of its respective FERC Gas Tariff. Respondent has access to transporter's measurement equipment at the receipt and delivery points under the tariff provisions. The Gas Accounting Department verified the accuracy of each monthly statement based on records maintained by Peoples Gas' Gas Supply Administration Department in coordination with each transporting pipeline.

2. Transportation charges for each of the various receipt points also include a percentage retained by the transporter from gas received for

Respondent's account to compensate for the transporter's compressor fuel and lost-and-unaccounted-for gas. The quantities retained by the transporter, the transportation charges and the reservation fees were reviewed for accuracy by Peoples Gas' Gas Accounting Department, on behalf of Respondent, against either published tariffs, contracts or discount letters or agreements, as appropriate.

Q. Please describe the auditing procedures and monitoring programs that Respondent uses with respect to propane.

A. Respondent did not purchase propane during the reconciliation period.

Q. Does this conclude your direct testimony?

A. Yes, it does.