

UNREDACTED
ADDITIONAL DIRECT/REBUTTAL TESTIMONY
OF
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Engineering Department
Energy Division
Illinois Commerce Commission

Purchased Gas Adjustment Clause Reconciliation

Peoples Gas Light and Coke Company

Docket No. 01-0707

January 7, 2005

1 Q. Are you the same Eric Lounsberry that previously submitted testimony in this
2 proceeding?

3 A. Yes. I previously submitted direct testimony in this proceeding, ICC Staff Exhibit
4 4.00.

5 Q. What is the purpose of your additional direct/rebuttal testimony?

6 A. My additional direct/rebuttal testimony responds to the rebuttal testimony filed by
7 People Gas Light and Coke Company's ("Peoples" or "Company") witness
8 Thomas Zack.

9 Q. Are you making any recommendations in this proceeding?

10 A. No.

11 Q. What topics is your additional direct/rebuttal testimony covering?

12 A. I address Mr. Zack's comments regarding the amount of time Staff had to review
13 its GPAA contract in the prior proceeding, the manner that the Company has
14 historically supported its supply and capacity portfolio, the Company's off-system
15 transactions, and I provide an overall perspective regarding Peoples' decision to
16 enter into the GPAA.

17 **Review Time for the GPAA Agreement**

18 Q. Mr. Zack noted on page 18 of his rebuttal testimony, Respondent's Ex. G, that in
19 the fall of 1999, Staff requested and the Company provided a copy of the GPAA
20 to Staff. Do you agree with that statement?

21 A. Yes. In particular, Staff received a copy of the GPAA from the Company in a
22 letter dated October 28, 1999. However, Staff only received the contract after
23 sending the Company a data request specifically requesting it. Prior to sending
24 the data request, various Staff, including myself, had a conversation with Peoples
25 personnel who indicated an unwillingness to provide Staff a copy of the contract
26 and instead suggested that Staff wait to review the contract during the next
27 reconciliation period when the contract would have been in force.

28 Q. Mr. Zack, again on page 18 of his rebuttal testimony, noted that, if Staff's review
29 of the GPAA indicated a need for additional information, it was free to request it
30 at any time, do you agree with that statement?

31 A. Yes. I agree that Staff was free to request additional information from the
32 Company. In fact, Staff, including myself, did contact the Company in early 2000
33 requesting that Company personnel provide a presentation to Staff on how the
34 Company was using the GPAA and on how the GPAA operated.

35 Q. Why did Staff make this request?

36 A. Staff, after reviewing the GPAA contract in late 1999, did not understand how the
37 contract operated or how the Company was making use of the contract.

38 Therefore, Staff requested the Company provide a presentation so that Staff
39 could achieve a greater understanding of the contract as well as to ask clarifying
40 questions regarding the contract.

41 Q. Did the Company provide Staff with this presentation?

42 A. No. When Staff made this request, Company personnel refused to provide a
43 presentation on the GPAA contract to Staff.

44 Q. What reason did the Company provide for refusing Staff's request for a
45 presentation on the GPAA contract?

46 A. The Company indicated that since the GPAA contract was not part of the Staff's
47 Purchased Gas Adjustment ("PGA") clause investigation that was occurring in
48 early 2000, Staff should wait until the Company's next PGA case to conduct its
49 review.

50 Q. Mr. Zack, on page 18 of his rebuttal testimony, noted that Staff was not
51 precluded from requesting additional time if it believed more time was needed to
52 complete its review in Docket No. 00-0720 (Peoples prior PGA reconciliation).
53 How do you respond?

54 A. The Administrative Law Judge directed that the cases be handled expeditiously.
55 In an attempt to get the cases done in a timely manner, the Commission
56 established deadlines for the review of PGA cases that in retrospect did not
57 provide sufficient time to analyze issues of such magnitude and complexity as
58 Staff has seen in this case.

59 Q. Mr. Zack also notes that Staff's testimony in Docket No. 00-0720 was submitted
60 in late May of 2001 which meant that Staff had in excess of 1.5 years to review
61 the contract before filing testimony. Do you agree with that statement?

62 A. Yes, I agree with Mr. Zack's time calculation. However, Mr. Zack does not
63 provide the whole story. As I noted above, Staff had a copy of the GPAA
64 contract, but Staff did not fully understand how the contract operated or how the
65 Company made use of the contract. Therefore, Staff's testimony in Docket No.
66 00-0720 relied upon the Company's testimony and the Company's responses to
67 Staff's data requests in that proceeding. Company testimony was filed on March
68 12, 2001. The Company's responses to Staff's generic data request were
69 provided from mid-March through late March 2001. Therefore, Staff had
70 approximately 2 months after receiving the Company's responses to Staff's
71 generic PGA data request to conduct its review, issue follow-up data requests,
72 and write its direct testimony.

73 Q. Was 2 months an adequate amount of time for Staff to conduct its review in
74 Docket No. 00-0720?

75 A. No, I do not believe so. Given that Staff and the other parties took approximately
76 18 months¹ to review the Company's actions and its use of the GPAA prior to
77 filing direct testimony in the instant proceeding, Staff's review time in Docket No.
78 00-0720 was likely too short.

¹ The Company filed its direct testimony in January 2002, additional direct testimony in October 2002, and Staff filed its direct testimony in August 2003.

79 Q. Do you have any other reasons for believing that the amount of time Staff had to
80 review the GPAA contract in Docket No. 00-0720 was inadequate?

81 A. Yes. The Company itself, through Mr. Wear's rebuttal testimony, Respondent's
82 Exhibit F, admits: "The GPAA is a multifaceted, large-scale supply agreement.
83 To thoroughly, and completely, prepare a quantitative analysis over all possible
84 outcomes is next to impossible." In essence, the Company agrees GPAA is a
85 large contract that is hard to analyze.

86 **Historical Information Supporting Supply and Capacity Contracts**

87 Q. Mr. Zack noted on page 15 of his rebuttal testimony that Staff had not requested
88 the sort of study advocated by Dr. Rearden in Docket No. 00-0720 and that the
89 Company has generally supported its portfolio of supply and capacity contracts in
90 much the same manner as it has done in this case. Do you agree with that
91 statement?

92 A. I would agree that a data request asking for the type of study advocated by Dr.
93 Rearden was not specifically requested in Docket No. 00-0720. However, Staff's
94 generic PGA data request does include a question that asks the utility to provide
95 its analysis used to select each new or renegotiated firm supply contract entered
96 into during the reconciliation period. Therefore, Staff did ask and expected the
97 Company to have documentation to support its decision to sign the GPAA.

98 Q. How do Illinois gas utilities normally determine their appropriate portfolio of
99 supply and capacity contracts?

100 A. The determination of a supply and capacity portfolio is a multi-step process and
101 is the same for Peoples as it is for any other gas utility. In general, the utility
102 must first determine the demand requirements for its customers under varying
103 temperature assumptions throughout the year. This is accomplished from the
104 use of econometric models that forecast customers' demand by comparing
105 historical usage patterns to various variables, most notably temperature.

106 Based on those demand assumptions, the utility then determines its physical
107 constraints in supplying that demand while taking into account any utility
108 resources, such as storage, and any existing supply or capacity contracts that
109 are in place. For example, a utility that is interconnected to multiple pipelines will
110 need to determine the minimum and maximum amounts of gas supply that it can
111 receive from each location. These physical constraints are based on engineering
112 calculations on the amount of gas the utilities' infrastructure at various locations
113 can transport over a given amount of time.

114 Once the constraints are determined, the utility performs an optimization of the
115 available resources to select the best capacity and supply portfolio available for
116 its customers. The utility's support for this optimization comes in several forms.
117 The capacity contracts correspond to the minimums dictated by the physical
118 constraints with the additional capacity selection based upon economics. The
119 supply contracts are also based upon the economics while conforming to the
120 constraints imposed upon the system.

121 Q. How do utilities normally support their gas supply portfolio?

122 A. The gas utilities usually send out a bid request to a group of gas suppliers. The
123 bid request indicates the type of supply contract the utility is seeking, the amount
124 of gas requested for each contract, its delivery location(s), and the time period
125 the contract should be in force. The utility will then take the responses to its bid
126 request and perform a comparison of all of the offers and then select the best
127 choices.

128 Q. Does the Staff's review of the bid request process require a formal study from the
129 gas utility?

130 A. Not usually. Most supply contracts are normally limited to one or two year terms
131 and have very similar pricing schemes, which makes it easy to compare the
132 various offers. For example, a utility may determine it requires a baseload²
133 contract of 5,000 units on Pipeline X for the following supply year. Every
134 response the utility receives from the bid request process that meets those
135 requirements could be reviewed to determine the most prudent alternative to the
136 utility.

137

² Baseload contracts refer to those contracts whose gas delivery does not vary from day to day. The same amount of gas is delivered every day for the term of the contract.

137 In a PGA reconciliation, the utility, in support of its selected bid or bids from the
138 bid request process, provides Staff with a listing showing all of the various bids
139 that it received, the prices quoted for each bid, and bid(s) selected. If the
140 contract selected was not the lowest cost bid, then additional explanation is
141 either provided or requested from the utility. Because of the straightforward and
142 easily comparable analysis that results from the bid request process, no formal
143 studies are usually necessary.

144 Q. Are there situations that cause utilities to perform formal studies to support their
145 decisions within a PGA proceeding?

146 A. Yes. In situations where a more complex situation exists, utilities normally
147 provide formal studies to support their decisions. For example, if a utility wanted
148 to determine whether to contract for more leased storage or to retain more
149 pipeline supply, then a more formal study or analysis is conducted.

150 Q. Are these studies or analyses normally part of the record within the PGA
151 proceedings?

152 A. No. If the utility supported all of its decisions and Staff had no issues in the
153 proceeding, then none of the documentation that supported the utility's decision
154 is included in the record.

155 Q. Are there other proceedings, aside from a PGA proceeding, where a gas utility
156 would provide analyses or studies to support a decision that could impact natural
157 gas costs in a PGA proceeding?

158 A. Yes. Whenever a utility enters into an agreement with an affiliate or if there are
159 contracts signed between two utilities, then formal Commission authority is
160 required prior to entering into those agreements. For example, North Shore Gas
161 Company, the sister company to Peoples, requested Commission approval in
162 Docket No. 03-0551 to enter into a firm transportation agreement with Northern
163 Illinois Gas Company.

164 Q. Did North Shore Gas Company provide analyses or studies to Staff in Docket No.
165 03-0551 to support its request?

166 A. Yes.

167 Q. What is the basis for your historical knowledge for Peoples' PGA proceedings
168 and the Illinois utilities in general?

169 A. I was assigned to review Peoples' PGA in Docket Nos. 92-0341, 93-0379, 94-
170 0266, 95-0129, 96-0042, and 97-0024. In addition to the specific Peoples'
171 proceedings, I have also been assigned to numerous other PGA proceedings
172 during my tenure at the Commission. Further, at the end of 1997 I assumed my
173 current responsibilities as the Supervisor of the Gas Section of the Engineering
174 Program. Among the responsibilities of the Gas Section is the annual review of
175 the prudence of PGA costs for all 14 natural gas utilities under the Commission's
176 authority.

177 Q. Do you believe that Peoples should have conducted a study prior to signing the
178 GPAA agreement?

179 A. Yes.

180 Q. Why do you believe Peoples should have conducted a study prior to signing the
181 GPAA agreement?

182 A. There are four reasons. First, Section 9-220 of the Public Utilities Act (“PUA”),
183 220 ILCS 5/ 9-220, places the burden of proof upon the utility to establish the
184 prudence of its gas costs. The Company’s prior reliance on the bid request
185 process that allowed for a straightforward and easily discernable selection of
186 contracts is not an excuse for not performing a study or having any
187 documentation to support the signing of the GPAA agreement.

188 Second, Section 1-102 (a)(ii), 220 ILCS 5/ 1-102 (a)(ii), of the PUA requires all
189 supply and demand options be considered and evaluated using comparable
190 terms and methods in order to determine how a utility meets its customer’s
191 demands for public utility service. The Company’s signing of the GPAA
192 agreement does not meet this requirement.

193 Third, Peoples’ decision to sign the GPAA agreement was a complete departure
194 from its historic purchasing practices that primarily made use of the
195 straightforward bid request process. Further, Peoples has provided no indication
196 that it thought its prior practices were deficient or produced any information that
197 supports its decision to make such a drastic change.

198 Finally, the GPAA is a unique and extremely complex contract whose various
199 conditions, size, and scope went far beyond anything previously signed by

200 Peoples or any other gas utility in Illinois. The term of the contract, five years,
201 was unique among most gas utilities that normally limit the gas purchasing
202 contracts to terms of not more than two years. The fact that the Staff and the
203 Commission have never seen a contract like the GPAA agreement and given the
204 potential impact the contract would have on Peoples' PGA customers, Peoples
205 should have been aware that it would need to provide support for its decision to
206 enter into the agreement. Further, the review conducted by Staff witnesses
207 Anderson and Rearden demonstrates the signing of the GPAA was not in the
208 best interests of Peoples' ratepayers.

209 **Non-tariff Transactions**

210 Q. What transactions are included in the non-tariff transaction grouping?

211 A. As was noted by Staff witness Rearden in his direct testimony, ICC Staff Exhibit
212 3.00, p. 45, there are two main groupings within the non-tariff services title. The
213 first is the FERC jurisdictional category that Peoples refers to as the Hub
214 transactions. The second is third party storage exchanges ("Exchanges") that
215 are conducted outside of the FERC Operating Statement.

216 Q. Do you agree with Mr. Zack's statement, from page 23 of his rebuttal testimony,
217 that the Commission has addressed how Nicor Gas should account for its Hub
218 costs and revenues addressed in a rate case?

219 A. Yes. Mr. Zack is correct that the Commission in its April 3, 1996 Order in Docket
220 No. 95-0219, pages 14 and 15, addressed Nicor's Chicago Hub Revenues and
221 ordered those revenues treated above the line.

222 Q. Mr. Zack also commented that he assumes that, had Peoples been operating its
223 Hub at the time of its last rate case, it would presumably have received similar
224 treatment. Do you agree?

225 A. No. I cannot speculate nor presume to know how the Commission would rule on
226 an issue without placing all of the facts before the Commission. However, I
227 would note that, while the Commission has ruled on how Nicor should treat Hub
228 costs and revenues, the circumstances surrounding the Peoples' Hub could be
229 different. Further, prior to the filing of Nicor rate case in Docket No. 95-0219,
230 Nicor had also filed an application before the Commission (Docket No. 93-0320)
231 to approve the accounting treatment related to its hub activities. The March 13,
232 1996, Order, page 1, notes that Nicor indicates it "...provides these services
233 pursuant to authorization by the Federal Energy Regulatory Commission
234 ("FERC") and subject to the operational constraints such that the Company's
235 utility customers are not and will not be adversely impacted."

236 Q. Has Staff determined that Peoples' actions regarding its non-tariff transactions,
237 which include Peoples' Hub activity, have adversely impacted Peoples'
238 ratepayers?

239 A. Yes. It is my understanding that Staff witness Rearden has determined that
240 there was a negative financial impact upon ratepayers as a result of Peoples'
241 actions through its non-tariff transaction activity.

242 Q. Has Peoples ever sought Commission approval for the manner that it accounts
243 for its non-tariff services revenues and costs?

244 A. No.

245 Q. Mr. Zack on page 23 of his rebuttal testimony voiced surprise that Staff was not
246 aware of Peoples' transactions prior to the instant proceeding, given Staff's
247 involvement in the Nicor cases, Staff's intervention at the FERC on the
248 proceedings where Peoples and Nicor obtained their FERC Operating Statement
249 to offer certain hub transactions, and Peoples filing of an annual transportation
250 report and a semi-annual storage report with the Commission. How do you
251 respond?

252 A. Peoples has never reported Exchange transactions to the Commission or FERC
253 in the past. This conclusion is supported by the Company's responses to Staff
254 data requests POL 13.002 and POL 13.003 in which Peoples indicates that it
255 does not issue any reports on its Exchange activity to the Commission or to the
256 FERC. In short, Mr. Zack should not be surprised about Staff's lack of
257 knowledge regarding the Exchange transactions since those have not been
258 previously reported.

259 As I noted in my direct testimony, the Company's prior responses to Staff data
260 requests regarding its activity in off-system transactions in the instant
261 proceeding, as well as prior PGA proceedings, did not provide any details
262 regarding the Company's various non-tariff transactions.

263 Q. Do you know why the Company's responses to Staff's data requests in the
264 instant proceeding or in prior PGA proceedings did not include this information?

265 A. Regarding the instant proceeding, yes I do. From discussions with Company
266 personnel regarding this matter, it appears that Peoples interpreted Staff's data
267 requests such that the Company only provided Staff with data that it believed
268 could be at issue in a PGA proceeding, irrespective of the language of the data
269 request. Since the Company did not believe the non-tariff transactions involved
270 the PGA, the Company did not provide Staff with the data. Further, Staff's
271 original assumption in the instant proceeding was that the Company had
272 provided it with a full and complete response as requested. Therefore, until
273 inquiries in the instant proceeding proved otherwise, Staff believed it had
274 received a full and complete response to its questions.

275 Regarding the Company's responses to Staff's data requests in prior PGA
276 proceedings, that topic was not specifically raised to the Company. However, I
277 would expect the reason why Staff was not provided the information via its
278 discovery process is similar to those provided by the Company in the instant
279 proceeding.

280 Q. Has any other information regarding non-tariff transactions recently come to your
281 attention?

282 A Yes. Nicor recently filed for a general increase in its gas rates with the
283 Commission, Docket No. 04-04779. In that proceeding, Nicor proposes to flow
284 all of its non-tariff revenue through its PGA. It is my understanding that proposal
285 is consistent with Staff's recommendations for the proper treatment of non-tariff
286 revenues in this proceeding.

287 **Peoples' Actions Versus Other Illinois Utilities**

288 Q. Was Peoples' decision to enter into the GPAA a major departure from how it and
289 other Illinois gas utilities configure their natural gas supply contracts?

290 A. Yes. Since FERC passed its Order 636³, no other utility, aside from Peoples'
291 and North Shore's (Peoples sister company) decisions to enter into the GPAA,
292 has made a major deviation in the manner that it purchases the gas whose cost
293 is flowed through the PGA for ratepayers.

294 As I discussed above, most utilities send out a bid request to a group of gas
295 suppliers when they need to replace an expiring supply contract or contract for
296 additional supply. The bid request indicates the type of supply contract the utility
297 is seeking, the amount of gas requested for each contract, its delivery location(s),
298 and the time period the contract should be in force. The utility will then take the

³ FERC Order 636, issued April 8, 1992, caused interstate pipelines to exit the bundled sales service function and caused them to only offer transportation service. Utilities then had the responsibility of contracting for their own gas supplies.

299 responses to its bid request and perform a comparison of all of the offers and
300 then select the most prudent choices.

301 Q. Does this conclude your additional direct/rebuttal testimony?

302 A. Yes.