

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

Purchased Gas Adjustment Clause Reconciliation

North Shore Gas Company

Docket No. 01-0706

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 North Shore Gas Company's ("North Shore" or "Company") witness Thomas  
8 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, and I provide an overall  
15 perspective regarding North Shore's decision to enter into the GPAA.

16 **Review Time for the GPAA Agreement**

17 Q. Mr. Zack noted on page 14 of his rebuttal testimony, Respondent's Ex. E, that in  
18 the fall of 1999, Staff requested and the Company provided a copy of the GPAA  
19 to Staff. Do you agree with that statement?

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

27 Q. Mr. Zack, again on page 14 of his rebuttal testimony, noted that, if Staff's review  
28 of the GPAA indicated a need for additional information, it was free to request it  
29 at any time, do you agree with that statement?

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

34 Q. Why did Staff make this request?

35 A. Staff, after reviewing the GPAA contract in late 1999, did not understand how the  
36 contract operated or how the Company was making use of the contract.  
37 Therefore, Staff requested the Company provide a presentation so that Staff  
38 could achieve a greater understanding of the contract as well as to ask clarifying  
39 questions regarding the contract.

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

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

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

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

49 Q. Mr. Zack, on pages 14 through 15 of his rebuttal testimony, noted that Staff was  
50 not precluded from requesting additional time if it believed more time was needed  
51 to complete its review in Docket No. 00-0719 (North Shore prior PGA  
52 reconciliation). How do you respond?

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

58 Q. Mr. Zack also notes that Staff's testimony in Docket No. 00-0719 was submitted  
59 in late May of 2001 which meant that Staff had in excess of 1.5 years to review  
60 the contract before filing testimony. Do you agree with that statement?

61 A. Yes, I agree with Mr. Zack's time calculation. However, Mr. Zack does not  
62 provide the whole story. As I noted above, Staff had a copy of the GPAA  
63 contract, but Staff did not fully understand how the contract operated or how the  
64 Company made use of the contract. Therefore, Staff's testimony in Docket No.  
65 00-0719 relied upon the Company's testimony and the Company's responses to  
66 Staff's data requests in that proceeding. Company testimony was filed on March  
67 12, 2001. The Company's responses to Staff's generic data request were  
68 provided from mid-March through late March 2001. Therefore, Staff had  
69 approximately 2 months after receiving the Company's responses to Staff's  
70 generic PGA data request to conduct its review, issue follow-up data requests,  
71 and write its direct testimony.

72 Q. Was 2 months an adequate amount of time for Staff to conduct its review in  
73 Docket No. 00-0719?

74 A. No, I do not believe so. Given that Staff and the other parties took approximately  
75 18 months<sup>1</sup> to review the Company's actions and its use of the GPAA prior to  
76 filing direct testimony in the instant proceeding, Staff's review time in Docket No.  
77 00-0719 was likely too short.

78 Q. Do you have any other reasons for believing that the amount of time Staff had to  
79 review the GPAA contract in Docket No. 00-0719 was inadequate?

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

80 A. Yes. The Company itself, through Mr. Wear's rebuttal testimony, Respondent's  
81 Exhibit D, page 2, admits: "The GPAA is a multifaceted, large-scale supply  
82 agreement. To thoroughly, and completely, prepare a quantitative analysis over  
83 all possible outcomes is next to impossible." In essence, the Company agrees  
84 GPAA is a large contract that is hard to analyze.

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

86 Q. Mr. Zack noted on page 11 of his rebuttal testimony that Staff had not requested  
87 the sort of study advocated by Dr. Rearden in Docket No. 00-0719 and that the  
88 Company has generally supported its portfolio of supply and capacity contracts in  
89 much the same manner as it has done in this case. Do you agree with that  
90 statement?

91 A. I would agree that a data request asking for the type of study advocated by Dr.  
92 Rearden was not specifically requested in Docket No. 00-0719. However, Staff's  
93 generic PGA data request does include a question that asks the utility to provide  
94 its analysis used to select each new or renegotiated firm supply contract entered  
95 into during the reconciliation period. Therefore, Staff did ask and expected the  
96 Company to have documentation to support its decision to sign the GPAA.

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

99 A. The determination of a supply and capacity portfolio is a multi-step process and  
100 is the same for North Shore as it is for any other gas utility. In general, the utility

101 must first determine the demand requirements for its customers under varying  
102 temperature assumptions throughout the year. This is accomplished from the  
103 use of econometric models that forecast customers' demand by comparing  
104 historical usage patterns to various variables, most notably temperature.

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

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

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

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

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

129 A. Not usually. Most supply contracts are normally limited to one or two year terms  
130 and have very similar pricing schemes, which makes it easy to compare the  
131 various offers. For example, a utility may determine it requires a baseload<sup>2</sup>  
132 contract of 5,000 units on Pipeline X for the following supply year. Every  
133 response the utility receives from the bid request process that meets those  
134 requirements could be reviewed to determine the most prudent alternative to the  
135 utility.

136 In a PGA reconciliation, the utility, in support of its selected bid or bids from the  
137 bid request process, provides Staff with a listing showing all of the various bids  
138 that it received, the prices quoted for each bid, and bid(s) selected. If the  
139 contract selected was not the lowest cost bid, then additional explanation is  
140 either provided or requested from the utility. Because of the straightforward and

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<sup>2</sup> 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.

141 easily comparable analysis that results from the bid request process, no formal  
142 studies are usually necessary.

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

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

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

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

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

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

162 Q. Did North Shore Gas Company provide analyses or studies to Staff in Docket No.  
163 03-0551 to support its request?

164 A. Yes.

165 Q. What is the basis for your historical knowledge for North Shore's PGA  
166 proceedings and the Illinois utilities in general?

167 A. I was assigned to review North Shore's PGA in Docket Nos. 91-0581, 92-0340,  
168 93-0378, 94-0265, 95-0128, 96-0041, and 97-0023. In addition to the specific  
169 North Shore proceedings, I have also been assigned to numerous other PGA  
170 proceedings during my tenure at the Commission. Further, at the end of 1997 I  
171 assumed my current responsibilities as the Supervisor of the Gas Section of the  
172 Engineering Program. Among the responsibilities of the Gas Section is the  
173 annual review of the prudence of PGA costs for all 14 natural gas utilities under  
174 the Commission's authority.

175 Q. Do you believe that North Shore should have conducted a study prior to signing  
176 the GPAA agreement?

177 A. Yes.

178 Q. Why do you believe North Shore should have conducted a study prior to signing  
179 the GPAA agreement?

180 A. There are four reasons. First, Section 9-220 of the Public Utilities Act ("PUA"),  
181 220 ILCS 5/ 9-220, places the burden of proof upon the utility to establish the

182 prudence of its gas costs. The Company's prior reliance on the bid request  
183 process that allowed for a straightforward and easily discernable selection of  
184 contracts is not an excuse for not performing a study or having any  
185 documentation to support the signing of the GPAA agreement.

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

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

196 Finally, the GPAA is a unique and extremely complex contract whose various  
197 conditions, size, and scope went far beyond anything previously signed by North  
198 Shore or any other gas utility in Illinois. The term of the contract, five years, was  
199 unique among most gas utilities that normally limit the gas purchasing contracts  
200 to terms of not more than two years. The fact that the Staff and the Commission  
201 have never seen a contract like the GPAA agreement and given the potential  
202 impact the contract would have on North Shore's PGA customers, North Shore  
203 should have been aware that it would need to provide support for its decision to

204 enter into the agreement. Further, the review conducted by Staff witnesses  
205 Anderson and Rearden demonstrates the signing of the GPAA was not in the  
206 best interests of North Shore's ratepayers.

207 **North Shore's Actions Versus Other Illinois Utilities**

208 Q. Was North Shore's decision to enter into the GPAA a major departure from how it  
209 and other Illinois gas utilities configure their natural gas supply contracts?

210 A. Yes. Since FERC passed its Order 636<sup>3</sup>, no other utility, aside from North  
211 Shore's and Peoples Gas Light and Coke Company's (North Shore's sister  
212 company) decisions to enter into the GPAA, has made a major deviation in the  
213 manner that it purchases the gas whose cost is flowed through the PGA for  
214 ratepayers.

215 As I discussed above, most utilities send out a bid request to a group of gas  
216 suppliers when they need to replace an expiring supply contract or contract for  
217 additional supply. The bid request indicates the type of supply contract the utility  
218 is seeking, the amount of gas requested for each contract, its delivery location(s),  
219 and the time period the contract should be in force. The utility will then take the  
220 responses to its bid request and perform a comparison of all of the offers and  
221 then select the most prudent choices.

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

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<sup>3</sup> 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.

223 A. Yes.