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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own)
Motion)
)
v.)
)
The Peoples Gas Light and Coke Company)
)
Reconciliation of Revenues Collected Under)
Gas Adjustment Charges with Actual Costs)
Prudently Incurred)

Docket No. 01-0707

REBUTTAL TESTIMONY

OF

JEROME D. MIERZWA

ON BEHALF OF THE

CITIZENS UTILITY BOARD

FEBRUARY 2005

EXETER

ASSOCIATES, INC.
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REBUTTAL TESTIMONY OF JEROME D. MIERZWA

I. INTRODUCTION

- 1 Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?
- 2 A. My name is Jerome D. Mierzwa. I am a principal and Vice President with Exeter
3 Associates, Inc. My business address is 5565 Sterrett Place, Suite 310, Columbia,
4 Maryland 21044. Exeter specializes in providing public utility-related consulting
5 services.
- 6 Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN THIS
7 PROCEEDING?
- 8 A. Yes. My direct testimony was filed on behalf of the Citizens Utility Board (“CUB”) on
9 August 7, 2003.
- 10 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

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11 A. The purpose of my rebuttal testimony is to: (1) summarize the status of the adjustments
12 presented in my direct testimony in light of the evidence presented since the
13 Administrative Law Judge (“ALJ”) reopened this case to additional discovery; and (2)
14 respond to various aspects of the rebuttal and additional rebuttal testimony of Mr. David
15 Wear and Mr. Thomas Puracchio presented on behalf of the Peoples Gas Light and Coke
16 Company.

17

18 **II. STATUS OF DIRECT TESTIMONY RECOMMENDATIONS**

19 Q. PLEASE SUMMARIZE THE RECOMMENDATIONS CONTAINED IN YOUR
20 DIRECT TESTIMONY.

21 A. My direct testimony recommended four adjustments to the Company’s 2001
22 reconciliation period gas costs which totaled \$56,361,655. The specific CUB
23 adjustments were as follows:

24

- 25 (1) The call option service provided by the Company to its affiliate Enron Midwest,
26 had an adverse impact on sales customers, and reconciliation period gas costs
27 should be adjusted to remove the adverse impact of this service (\$434,800);
28
- 29 (2) The Company’s practice of recovering the costs associated with maintenance gas
30 solely from sales customers is unreasonable. The costs associated with
31 maintenance gas should be recovered from all customers (\$1,886,281);
32
- 33 (3) The provisions of the Company’s gas supply contract with Enron Midwest, which
34 allow Enron Midwest to determine the daily summer injection quantity, are
35 unreasonable and had an adverse impact on sales customers. Reconciliation period
36 gas costs should be adjusted accordingly (\$2,833,867); and
37
- 38 (4) The Company’s third party storage and exchange activities had an adverse impact
39 on sales customers and reconciliation period gas costs should be adjusted to remove
40 the adverse impact of these activities (\$51,206,708).

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42 Q. DO EACH OF THESE ADJUSTMENTS REMAIN CONTESTED ISSUES IN
43 THIS PROCEEDING?

44 A. No. In its rebuttal testimony, the Company accepted adjustments related to the call
45 option service and maintenance gas (CUB adjustment Nos. 1 and 2, above). More
46 specifically, the Company accepted the adjustments calculated by Staff. Staff's
47 adjustment for the call option service was \$535,554. Staff refers to this adjustment as a
48 disallowance for the imprudence of off-system Transaction Nos. 16 and 22. The
49 adjustment related to maintenance gas proposed by Staff and accepted by the Company
50 was \$4,628,267.

51 Q. WHAT IS THE STATUS OF CUB ADJUSTMENT NO. 3 RELATED TO THE
52 SUMMER INJECTION QUANTITY PROVISIONS OF THE COMPANY'S
53 GAS SUPPLY CONTRACT WITH ENRON MIDWEST?

54 A. CUB adjustment No. 3 relates to one provision of the Company's contract with Enron
55 Midwest. Staff and CUB witness Lindy Decker have challenged the prudence of this
56 contract in its entirety. Thus, if the Commission upholds either of these challenges, my
57 adjustment would be moot. However, if the Commission rejects these challenges, my
58 adjustment would remain.

59 Q. WHAT ABOUT CUB ADJUSTMENT NO. 4 RELATED TO THE
60 COMPANY'S THIRD PARTY STORAGE AND EXCHANGE ACTIVITIES?

61 A. My recommended adjustment with respect to storage and exchange activities remains a
62 contested issue in this proceeding. I would note that Staff has also proposed adjustments

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63 related to the Company's third party storage and exchange activities. I discuss Staff's
64 adjustments later in my testimony.

65 Q. HOW IS THE REMAINDER OF YOUR REBUTTAL TESTIMONY
66 ORGANIZED?

67 A. In the third section of my testimony, I first summarize my direct testimony with respect
68 to the Company's third party storage and exchange activities. I then address Staff's
69 adjustments related to these activities, and respond to the Company's rebuttal and
70 additional rebuttal testimony. In the final section of my testimony, I summarize my
71 direct testimony related to the Company's gas supply contract with Enron Midwest, and
72 respond to the Company's rebuttal and additional rebuttal testimony on this issue.

73

74 **III. THIRD PARTY STORAGE AND EXCHANGE ACTIVITIES**

75 Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY WITH RESPECT TO
76 THE PROVISION OF STORAGE AND EXCHANGE SERVICES FOR THIRD
77 PARTIES.

78 A. During the reconciliation period subject to review in this proceeding, Peoples Gas
79 provided storage and exchange services to certain third parties (generally marketers)
80 using its Manlove storage facilities pursuant to what it refers to as its FERC Operating
81 Statement. Under these transactions, Peoples Gas either accepted gas from a third party
82 and returned it at a later point in time, or loaned gas to a third party who returned it at a
83 later point in time. Peoples Gas claims that revenues derived from these transactions are

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84 properly retained by the Company as base rate revenues. My direct testimony noted that
85 Peoples Gas realized [REDACTED] from the provision of these storage and exchange
86 services during the reconciliation period.

87 While gas prices soared during the winter of 2000-2001, the Company withdrew
88 gas from its Manlove storage to accommodate its third party storage and exchange
89 activities. That is, instead of relying more heavily on gas from storage to serve its sales
90 customers, Peoples Gas had to purchase more high cost gas during the winter of 2000 -
91 2001 because gas in storage was instead utilized to provide third party storage and
92 exchange services. Peoples Gas withdrew more than [REDACTED] during the
93 period November 2000 - February 2001 to accommodate third party storage and
94 exchange activities. More specifically, Peoples Gas injected [REDACTED] of third party owned
95 gas into storage prior to the winter of 2000 - 2001, and withdrew and returned that gas to
96 third parties primarily during the months of November and December 2000. Peoples Gas
97 also loaned [REDACTED] of gas from storage, primarily during the months of January and
98 February 2001, and delivered it not to end-use sales customers, but to third parties who
99 returned that gas at a later point in time.

100 I agree with Staff that Manlove storage is an asset that is owned by the regulated
101 utility, and it should be used solely to the benefit of the ratepayer. In this instance,
102 storage gas should have been utilized to displace higher cost winter purchases of flowing
103 gas, not to serve third parties. It is not unreasonable for Peoples Gas to utilize its storage
104 facilities to generate base rate revenues as long as those storage activities do not increase

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105 costs for ratepayers. It is unreasonable and improper for the Company to engage in
106 activities which increase gas costs for ratepayers. My direct testimony recommended an
107 adjustment of \$51.2 million to eliminate the adverse impact of the Company's storage
108 and exchange activities on ratepayers.

109 Q. HOW WAS THE \$51.2 MILLION ADJUSTMENT CALCULATED?

110 A. Peoples purchases gas and injects it into storage during the summer. The \$51.2 million
111 adjustment assumed that the gas withdrawn from storage which was delivered to third
112 parties during the winter of 2000-2001 was instead delivered to sales customers. Thus,
113 the adjustment is based on the difference between gas prices during the summer of 2000
114 which averaged \$4.12 per Dth, and gas prices at the time gas was delivered to third
115 parties.

116 For example, as shown on Schedule JDM-3 of my direct testimony, in January
117 2001, the Company withdrew x x x x x x of gas from storage which was delivered to
118 third parties. During January 2001, Peoples paid an average of x x x per Dth for the gas
119 it purchased to serve sales customers. Thus, my adjustment for January 2001 reflects the
120 difference between the x x x per Dth cost of gas in January 2001 and the \$4.12 per Dth
121 cost of gas purchased during the summer of 2000, multiplied by the quantity of gas
122 delivered to third parties during that month. For January 2001 alone, the adjustment was
123 \$23.3 million. For the entire winter period, the adjustment is \$51.2 million.

124 Q. DID COMMISSION STAFF ADDRESS THE COMPANY'S STORAGE AND
125 EXCHANGE ACTIVITIES IN ITS DIRECT TESTIMONY?

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126 A. Yes.

127 Q. WHAT WAS STAFF'S DIRECT TESTIMONY POSITION WITH RESPECT
128 TO THE COMPANY'S STORAGE AND EXCHANGE ACTIVITIES?

129 A. Staff sponsored two adjustments to reconciliation period gas costs related to the
130 Company's storage and exchange activities. First, Staff recommended that the x x x x x
131 x in revenue received by Peoples Gas from the provision of storage and exchange
132 services be credited against recoverable gas costs. Second, Staff determined that the
133 Company's storage and exchange activities had a x x x x x x x adverse impact on the gas
134 costs of sales customers. This adjustment related to the x x x of gas which the Company
135 loaned to third parties. Staff offset the x x x x x x x adjustment related to the loaned gas
136 by the x x x x x x credit revenue adjustment, resulting in a proposed x x x x x x
137 adjustment for what Staff referred to as the imprudent use of Manlove storage. It is my
138 understanding that the loaned gas adjustment was reduced by the revenue credit
139 adjustment to eliminate what Staff perceived as double counting.

140 Q. WHAT IS STAFF'S POSITION IN ITS ADDITIONAL DIRECT REBUTTAL
141 TESTIMONY WITH RESPECT TO THE COMPANY'S STORAGE AND
142 EXCHANGE ACTIVITIES?

143 A. Staff is recommending three adjustments to reconciliation period gas costs related to the
144 Company's storage and exchange activities. First, Staff continues to recommend that the
145 revenues received by Peoples Gas from the provision of storage and exchange services be
146 credited against recoverable gas costs. However, based on information received since the

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147 filing of its direct case, Staff has increased the amount of the adjustment to x x x x x x
148 (identified as Staff adjustment Nos. 5 and 6). Second, Staff continues to support the x x
149 x x x x x adjustment presented in its direct testimony (identified as Staff adjustment
150 No. 7) related to the x x x loan of gas to third parties. Finally, Staff is proposing an
151 additional \$32.6 million adjustment for the Company's imprudent use of storage. This
152 additional adjustment largely relates to the Company's storage and exchange activities
153 which did not involve loaning gas to third parties (i.e., the x x x of gas injected into
154 storage in the summer of 2000 by third parties) which was withdrawn and returned
155 during the winter of 2000 - 2001. For purposes of totaling its adjustments, the \$32.6
156 million amount was reduced by the x x x x x x storage and exchange service revenue
157 credit for a net adjustment of x x x x x x x (rounded, identified as Staff adjustment No.
158 8). Thus, in summary, Staff is proposing a total adjustment of \$42.8 million associated
159 with the Company's storage and exchange activities x x x x x x x x x x .

160 Q. WHY DO THE ADJUSTMENTS PRESENTED BY CUB AND STAFF
161 RELATED TO THE ADVERSE IMPACT OF THE COMPANY'S STORAGE
162 AND EXCHANGE ACTIVITIES DIFFER?

163 A. The total adjustments presented by Staff and CUB both attempt to quantify the adverse
164 impact of the Company's storage and exchange activities on the Company's sales
165 customers. As just explained, the \$42.8 million adjustment proposed by Staff consists of
166 several separately calculated adjustments. However, the x x million revenue credit
167 (Staff adjustment Nos. 5 and 6) serves to reduce the adverse gas cost impact calculated

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168 under adjustment No. 8. Thus, to examine the differences between the CUB and Staff
169 adjustments related to the adverse impact of the Company's storage and exchange
170 activities, one need only to compare Staff adjustment Nos. 7 and 8 which total \$42.8
171 million, and CUB's \$51.2 million adjustment. To facilitate comparison, CUB's
172 adjustment can be separated into an adjustment for the x x x loaned to third parties which
173 corresponds to Staff adjustment No. 7, and an adjustment for the x x x which did not
174 involve loaning gas, which corresponds to Staff adjustment No. 8.

175 Q. PLEASE CONTINUE.

176 A. CUB's \$51.2 million adjustment related to the Company's third party storage and
177 exchange activities is based on the premise that the x x x of gas withdrawn from storage
178 during the winter of 2000-2001 to serve third parties could have instead been utilized to
179 displace x x x of high cost purchases made by Peoples Gas during the months of
180 November 2000-February 2001 (See Schedule JDM-3). Implicit in my adjustment is the
181 assumption that the x x x of gas loaned to third parties during the winter of 2000 - 2001
182 and repaid at a later date was placed in storage by the Company during the summer of
183 2000 in anticipation of providing services to third parties.

184 Staff, rather than calculating an adjustment based on the assumption that the x x x
185 loaned to third parties was purchased in the summer of 2000 and injected into storage,
186 based its adjustment No. 7 on the premise that the Company purchased gas on a current
187 basis when it loaned gas to the third parties. That is, for example, the x x x x x x
188 delivered to third parties in January 2001 was actually purchased in January 2001.

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189 Stated alternatively, CUB's adjustment related to the [REDACTED] loaned to third parties
190 is based on the difference between summer of 2000 and winter of 2000 - 2001 gas prices.
191 The rationale for this is that high cost purchases during the winter of 2000 - 2001 could
192 have been displaced by gas injected into storage during the summer. Staff's adjustment
193 related to the [REDACTED] loaned to third parties is based on the difference in gas prices which
194 existed at the time the [REDACTED] was loaned to third parties (January and February 2001) and
195 the time at which it was returned (March and April 2001).

196 Q. ON A STAND-ALONE BASIS, HOW DO STAFF'S ADJUSTMENT NO. 7
197 AND CUB'S ADJUSTMENT FOR THE 5 BCF LOANED TO THIRD PARTIES
198 COMPARE?

199 A. As explained above, Staff is proposing a [REDACTED] adjustment for the gas loaned to
200 third parties. CUB's adjustment for the [REDACTED] loaned to third parties on a stand-alone
201 basis is \$24.1 million (See Schedule JDM-6). Thus, by default and addressed later in my
202 testimony, CUB's adjustment for the Company's storage and exchange activities which
203 do not involve loaned gas is \$27.1 million (\$51.2 - \$24.1).

204 Q. WHICH IS THE MORE APPROPRIATE WAY TO CALCULATE AN
205 ADJUSTMENT FOR THE [REDACTED] LOANED TO THIRD PARTIES?

206 A. In my opinion, based on the Company's rebuttal testimony, I believe that an adjustment
207 for the [REDACTED] of gas loan to third parties should be calculated based on the approach set
208 forth in my direct testimony. This is because in its rebuttal testimony, the Company
209 claims the loans to third parties were not accommodated by incremental purchases, and

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210 that it engaged in storage and exchange activities with third parties to increase the storage
211 cycle (i.e., total amount of gas injected and withdrawn over an annual period). Buying
212 incremental gas on a current basis to loan to third parties would not increase the
213 Company's storage cycle.

214 Q. WHY WOULD BUYING GAS ON A CURRENT BASIS TO LOAN TO THIRD
215 PARTIES NOT INCREASE THE COMPANY'S STORAGE CYCLE?

216 A. When gas purchased on a current basis is delivered to a third party, the gas would flow
217 from the supplier or seller directly to the third party. It would not be injected into storage
218 and then withdrawn and delivered to the third party.

219 Q. WHY DOES STAFF'S \$32.1 MILLION ADJUSTMENT DIFFER FROM
220 CUB'S \$27.1 MILLION ADJUSTMENT FOR THE COMPANY'S STORAGE
221 AND EXCHANGE ACTIVITIES WHICH DID NOT INVOLVE LOANED
222 GAS?

223 A. There are many reasons for the calculated differences between Staff's and CUB's
224 adjustments. I will highlight some of the major differences. First, Staff's adjustment is
225 based on storage and exchange activity during December 2000 and January 2001. Thus,
226 Staff's adjustment does not consider activity during November 2000. This would tend to
227 decrease the amount of Staff's adjustment. Since the Company engaged in storage and
228 exchange activities in November 2000, I believe this activity should be included in an
229 adjustment.

230 Second, Staff's adjustment, as does CUB's, assumes that gas from storage is

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231 displacing higher cost purchases. I have utilized the Company's actual average cost of
232 gas to price the displaced higher cost gas. Staff has utilized a daily index to price the
233 displaced higher cost gas. The use of daily index prices would tend to increase the
234 amount of the adjustment since daily index prices during the period were higher than the
235 Company's average cost of gas. I have utilized the Company's average cost of gas to be
236 conservative.

237 Finally, the cost assigned to the gas being withdrawn from storage in Staff's
238 adjustment is based on the Company's annual LIFO (last-in, first-out) storage rate.
239 CUB's adjustment utilizes a proxy for summer period gas prices. Staff's use of the
240 Company's LIFO rate does not fully capture the adverse seasonal impact of the
241 Company's storage and exchange activities.

242 Q. PLEASE EXPLAIN WHY THE USE OF THE COMPANY'S ANNUAL LIFO
243 RATE DOES NOT FULLY CAPTURE THE ADVERSE IMPACT OF THE
244 COMPANY'S STORAGE AND EXCHANGE ACTIVITIES.

245 A. Under LIFO accounting, the price assigned to storage injections and withdrawals is based
246 on the average cost of all gas purchased by the Company during its fiscal year which
247 ends September 30. Because it was not purchased by the Company, the gas injected into
248 storage by third parties during the summer of 2000 would not have been included in the
249 determination of the Company's LIFO rate for either fiscal 2000 or 2001. If it were, the
250 Company's 2000 and 2001 LIFO rates would have been lower. Thus, Staff's use of the
251 LIFO rate understates the adverse impact on sales customers of the Company's storage

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252 and exchange activities. Because the Company eventually recovers its prudent gas costs
253 on a dollar-for-dollar basis, the fact that some of the third party injections incurred during
254 fiscal 2000 rather than 2001 does not affect CUB's adjustment, but represents a timing
255 difference.

256 Q. WHAT IS THE COMPANY'S RESPONSE WITH RESPECT TO CUB'S AND
257 STAFF'S PROPOSED ADJUSTMENTS RELATED TO THE PROVISION OF
258 STORAGE AND EXCHANGE SERVICES TO THIRD PARTIES?

259 A. In his rebuttal testimony, Company witness Thomas L. Puracchio claims that the seasonal
260 cycling capability of the Company's Manlove field is 35 Bcf, and that benefits are
261 realized by cycling this level of inventory. Of the 35 Bcf cycling capability, only 27 Bcf
262 is assigned to system supply (Peoples Gas is assigned 25.5 Bcf, North Shore Gas
263 Company is assigned 1.5 Bcf), and the remaining 8 Bcf is used to provide third party
264 storage and exchange services (rebuttal, at lines 145-167). Witness Puracchio claims that
265 the entire 35 Bcf seasonal cycling capability cannot be assigned to system supply because
266 during a warmer than normal winter there is a high probability that the Company's
267 objective of cycling 35 Bcf would not be met (rebuttal, at lines 261-271).

268 In his rebuttal testimony, witness David Wear claims that Peoples Gas typically
269 plans to have approximately 25.5 Bcf of Manlove storage available for system supply
270 (rebuttal, at lines 837-840). Witness Wear claims that experience has shown that 25.5
271 Bcf of storage is the amount that fits the Company's load profile. Any amount greater
272 than this could not be withdrawn under warmer than normal conditions, or would reduce

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273 or replace the need for baseload purchases throughout the year. He claims that baseload
274 purchases are necessary to achieve a mix of first-of-the-month and daily prices in the
275 supply portfolio. Without baseload purchases, he claims that the Company would
276 increase its exposure to daily price volatility (rebuttal, at lines 860-866). In his additional
277 rebuttal testimony, witness Wear further claims that the Company's sales customers
278 received the exact same access to storage as if no storage or exchange services were
279 provided to third parties (additional rebuttal, at lines 467-469). Finally, it appears that
280 witness Wear is implying that the adjustments proposed for the adverse impact of the
281 Company's storage and exchange activities are based on hindsight (additional rebuttal, at
282 lines 475-476).

283 Q. HOW SHOULD A UTILITY SUCH AS PEOPLES GAS DETERMINE HOW
284 MUCH STORAGE SHOULD BE USED TO SERVE SYSTEM SUPPLY?

285 A. Major gas utilities employ various computerized planning models which determine how
286 the Company's various gas supply and capacity resources should be utilized, or
287 dispatched, to minimize costs. Peoples Gas utilizes a Gas Dispatch Model to assist it in
288 the supply planning process. Peoples Gas should have used its planning model to
289 determine how much storage should be used for system supply.

290 Q. DID PEOPLES GAS RELY ON ITS GAS DISPATCH MODEL OR ANY
291 OTHER STUDIES OR ANALYSES TO SUPPORT ITS CLAIMS THAT IF THE
292 FULL 35 BCF OF MANLOVE STORAGE CAPACITY WERE AVAILABLE
293 FOR SYSTEM SUPPLY, THE COMPANY MAY BE UNABLE TO FULLY

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294 CYCLE STORAGE IF WARMER THAN NORMAL WEATHER WERE
295 EXPERIENCED?

296 A. No. In fact, the Company did not even prepare a gas supply plan for the winter of 2000-
297 2001 reflecting resource utilization under warmer than normal conditions (Peoples'
298 Response to CUB 8.005¹).

299 Q. WHAT GAS SUPPLY PLANS DID THE COMPANY PREPARE FOR THE
300 WINTER OF 2000-2001?

301 A. The Company prepared gas supply plans assuming normal and colder than normal
302 weather conditions. Those plans are attached to my testimony as Schedules JDM-7 and
303 JDM-8, respectively.

304 Q. HOW WAS THE AMOUNT OF MANLOVE STORAGE CAPACITY
305 AVAILABLE FOR SYSTEM SUPPLY DETERMINED IN THE GAS SUPPLY
306 PLANS PREPARED BY THE COMPANY?

307 A. The amount of Manlove storage capacity available for system supply was set at a
308 predetermined quantity by the Company, and this predetermined quantity was input into
309 the Company's model. As such, the Gas Dispatch Model, which developed the
310 Company's gas supply plans, could not optimize the amount of Manlove storage capacity
311 available for system supply.

312 Q. IS IT REASONABLE TO PREDETERMINE THE AMOUNT OF MANLOVE
313 STORAGE CAPACITY TO BE USED FOR SYSTEM SUPPLY?

¹ See Attachment 1.

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314 A. No. The Company's Gas Dispatch Model should be utilized to determine the amount of
315 Manlove storage capacity which should be used for system supply. This would provide
316 for the minimization of costs.

317 Q. WHAT WOULD THE COMPANY'S GAS DISPATCH MODEL HAVE
318 SHOWN IF THE COMPANY DID NOT PREDETERMINE THE QUANTITY
319 OF MANLOVE STORAGE FOR SYSTEM SUPPLY?

320 A. In my opinion, the Gas Dispatch Model would have utilized the full 35 Bcf of Manlove
321 storage for system supply (less that used to serve North Shore).

322 Q. BASED ON THE GAS SUPPLY PLANS PREPARED BY THE COMPANY,
323 COULD AN ADDITIONAL X X X OF STORAGE HAVE BEEN UTILIZED
324 TO MEET SYSTEM SUPPLY REQUIREMENTS?

325 A. Yes. Schedule JDM-9 summarizes the gas supply plans prepared by the Company for the
326 winter of 2000 - 2001. Under the normal weather scenario, the Company planned to
327 purchase x x x of baseload gas supplies during the months of December 2000 - February
328 2001, and x daily priced gas. Under this scenario baseload gas supplies could have been
329 displaced by additional gas from Manlove storage.

330 Under the colder normal weather scenario, the Company planned to purchase this
331 same x x x of baseload gas supplies and x x x x of daily priced gas. Under this scenario
332 gas from Manlove storage could have been used to displace baseload and daily priced
333 gas.

334 Q. WHAT IF WARMER THAN NORMAL WEATHER WERE EXPERIENCED?

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356 A. First, the Company has no formula for the mix of first-of-the-month and daily priced
357 purchases. In the Company's winter gas supply plans, under normal conditions, x daily
358 priced purchases are indicated during the months of December through February. Under
359 colder than normal conditions, x x x x of daily priced purchases are indicated. This
360 represents 15 percent of total purchases. Therefore, under warmer than normal
361 conditions, it is unlikely that significant quantities of daily priced gas would be
362 purchased. Moreover, under warmer than normal conditions, it is unlikely that gas prices
363 would increase significantly, exposing the Company to higher daily prices.

364 Q. IS SOME MIX OF FIRST-OF-THE-MONTH AND DAILY PRICED GAS
365 DESIRABLE IN A UTILITIES GAS SUPPLY PORTFOLIO?

366 A. Yes. However, there is no optimal mix. For example, Nicor Gas Company attempts to
367 purchase approximately 65 percent of gas requirements at first-of-the-month prices and
368 35 percent at daily prices.

369 Q. ARE THERE ANY OTHER TOOLS AVAILABLE TO THE COMPANY TO
370 ENSURE ITS ABILITY TO CYCLE 35 BCF UNDER WARMER THAN
371 NORMAL CONDITIONS IF THE ENTIRE 35 BCF WERE DEDICATED TO
372 SYSTEM SUPPLY?

373 A. Yes. Additional alternatives would include reducing withdrawals under the Company's
374 contract storage arrangement with its interstate pipelines.

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375 Q. WHAT IS YOUR RESPONSE TO WITNESS WEAR'S CLAIM THAT
376 HISTORICALLY, 25.5 BCF OF STORAGE IS THE AMOUNT THAT FITS
377 THE COMPANY'S LOAD PROFILE?

378 A. It was not until 1999 that the annual maximum withdrawal volume from Manlove storage
379 was increased from 28 Bcf to nearly 35 Bcf (Peoples' Response to POL 7.016²). Thus,
380 historically, only approximately 25.5 Bcf (plus 1.5 Bcf for North Shore) was used to
381 serve system supply because that was the amount available.

382 Q. WITNESS WEAR CLAIMS THAT SALES CUSTOMERS RECEIVED THE
383 EXACT SAME ACCESS TO STORAGE AS IF THE COMPANY PROVIDED
384 NO STORAGE OR EXCHANGE SERVICES TO THIRD PARTIES. DO YOU
385 HAVE ANY ADDITIONAL COMMENTS?

386 A. Although witness Wear makes this claim, I can find no evidence in his testimony to
387 support this claim. If this claim was valid, it could have been supported by the
388 Company's Gas Dispatch Model.

389 Q. WITNESS WEAR TESTIFIES THAT WHEN GAS IS LOANED, IT IS NOT
390 LOANED FROM A SPECIFIC SOURCE SUCH AS THIRD PARTY GAS,
391 SALES CUSTOMER GAS, TRANSPORTATION CUSTOMER GAS, OR
392 RECOVERABLE CUSHION GAS. DO YOU HAVE ANY COMMENTS?

393 A. Yes. Regardless of the source of the gas, the gas was available and the Company elected
394 to use the gas to serve third parties rather than sales customers. As such, the Company

² See Attachment 1.

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395 failed to minimize costs for its sales customers. Sales customers are required to pay for
396 storage through their base rates. Third parties are not required to pay for storage.

397 Q. ARE THE PROPOSED DISALLOWANCES FOR THE PROVISION OF
398 STORAGE AND EXCHANGE SERVICES BASED ON HINDSIGHT IN THAT
399 THEY PENALIZE THE COMPANY FOR EVENTS WHICH WERE
400 UNANTICIPATED BY THE COMPANY?

401 A. No. Gas supply planning is a dynamic, on-going process. Gas utilities routinely prepare
402 annual, seasonal, monthly and daily plans which are subject to constant revision due to
403 changes in gas prices, customer requirements, etc. Gas utilities use computer models to
404 determine how to best utilize their gas supply and capacity resources to minimize costs
405 for their customers. Gas utilities such as Peoples Gas reserve capacity resources
406 sufficient to serve their customers under extreme conditions. In the summer of 2000, the
407 Company did not know whether the winter of 2000 - 2001 would be warmer or colder
408 than normal, nor did it know how gas prices would react. However, the Company did
409 know that the winter of 2000-2001 would be either warmer or colder than normal, or
410 potentially even normal. In the summer of 2000, the Company entered into various
411 storage and exchange transactions which limited its flexibility to respond to its sales
412 customers' requirements under colder than normal conditions, presumably based on
413 winter requirements anticipated under normal conditions. Because it did so, resources
414 paid for by sales customers which would have been available (Manlove Storage) to serve
415 sales customers were not, and sales customers were adversely affect.

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416 Q. PLEASE CONTINUE WITH YOUR EXPLANATION AS TO WHY THE
417 PROPOSED DISALLOWANCES ARE NOT BASED ON HINDSIGHT.

418 A. The Company secures capacity sufficient to meet its customers' requirements on design
419 peak day, a day which may occur only once every 20-30 years or so. The Company's
420 actions during the reconciliation period were akin to using a portion of its capacity
421 resources to serve other purposes because design peak day conditions would not be
422 anticipated during most winters, but requiring sales customers to pay the addition costs
423 incurred because the capacity serving other purposes was not available when design peak
424 day occurred. This is not hindsight.

425 Q. WITNESS PURACCHIO CLAIMS THAT 8 BCF OF MANLOVE STORAGE IS
426 USED TO PROVIDE THIRD PARTY STORAGE AND EXCHANGE
427 SERVICES. DO YOU HAVE ANY COMMENTS?

428 A. Yes. As explained previously, 35 Bcf of Manlove storage should be assigned to system
429 supply. During the winter of 2000-2001, the Company used x x x to provide third party
430 storage and exchange service. As such, even by the Company's proposed standards,
431 which should be rejected, an additional x x x of gas from Manlove storage should have
432 been used to serve system supply. Under this approach, as shown on Schedule JDM-10,
433 the adverse impact of the Company's off-system storage and exchange transactions was
434 \$17.0 million.

435

436 **IV. ENRON GAS PURCHASE AND AGENCY AGREEMENT**

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437 Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY WITH RESPECT TO
438 THE ENRON GAS PURCHASE AND ASSIGNMENT AGREEMENT.

439 A. Peoples Gas had a contract to purchase approximately x x x x x of its annual gas
440 supplies from Enron. x
441 x
442 x
443 x
444 x x x x x x x

445 In my direct testimony I found it unreasonable for Peoples Gas to agree to pay
446 first-of-the-month prices while giving the supplier the right to determine how much gas it
447 will deliver on a daily basis. This is because when daily market prices for gas decline
448 from the first-of-the-month price, Enron can increase the quantity of gas delivered to
449 Peoples Gas for storage injection. Under these circumstances, Enron profits on the
450 difference between the first-of-the-month price and daily prices. Sales customers' gas
451 costs are increased by the amount by which Enron profits.

452 When daily prices increase from first-of-the-month prices, Enron can minimize
453 deliveries to Peoples Gas, selling gas initially destined for Peoples Gas to others. Again,
454 sales customers experience higher gas costs under these circumstances since the
455 Company must purchase replacement supplies from other suppliers at the higher price
456 levels.

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457 Since Peoples Gas has an obligation to minimize gas costs for its ratepayers, it
458 should have attempted to renegotiate this unfavorable provision. It failed to do so.
459 Therefore, I recommend that reconciliation period gas costs be adjusted as if the
460 unfavorable SIQ provisions had been eliminated, resulting in an adjustment of \$2.8
461 million to reconciliation period gas costs.

462 Q. WHAT WAS THE COMPANY'S RESPONSE TO YOUR
463 RECOMMENDATION WITH RESPECT TO THE SIQ PROVISION?

464 A. The Company claims that the SIQ provision was one of the negotiated sets of GPAA
465 contract provisions under which Peoples Gas is entitled to a discount from a delivered-to-
466 citygate price for gas supplies. The Company also claims that it was not particularly
467 concerned with which days gas is injected into storage, and was willing to accept varying
468 delivery quantities from day to day.

469 Q. HOW DO YOU RESPOND TO THE COMPANY?

470 A. Clearly, as described in my direct testimony, the SIQ provision had an adverse impact on
471 ratepayers. The Company had an obligation to seek relief from this provision. It did not.
472 I would note that the Company and Enron negotiated an amendment to the GPAA
473 effective December 1, 2000.

474 In addition, as explained in greater detail in the testimony of CUB witness Lindy
475 Decker, granting Enron unilateral power to set prices under the GPAA was not prudent.

476 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

477 A. Yes, it does.
478

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STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own)
Motion)
)
 v.)
)
The Peoples Gas Light and Coke Company)
)
Reconciliation of Revenues Collected Under)
Gas Adjustment Charges with Actual Costs)
Prudently Incurred)

Docket No. 01-0707

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SCHEDULES ACCOMPANYING THE
REBUTTAL TESTIMONY
OF
JEROME D. MIERZWA
ON BEHALF OF THE
CITIZENS UTILITY BOARD
FEBRUARY 2005