STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

The Illinois Commerce Commission On its own motion, v. The Peoples Gas Light and Coke Company Reconciliation of revenues collected under the gas adjustment charges with actual costs prudently incurred.	)))))))))))	Docket No. 01-0707

JOINT PRETRIAL MEMORANDUM OF THE CITY OF CHICAGO AND THE CITIZENS UTILITY BOARD REGARDING SECTION 525.40 OF THE ILLINOIS COMMERCE COMMISSION RULES

Dated: March 4, 2005

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Pursuant to the direction of the Administrative Law Judge ("ALJ") in this proceeding, the City of Chicago ("City"), and the Citizens Utility Board ("CUB") jointly submit the following Pretrial Memorandum ("Memo") addressing the applicability of Section 525.40 of the Rules of the Illinois Commerce Commission ("Commission" or "ICC").

The Language

1. The legal construction of the language of Section 525.40 is straightforward. It provides that a natural gas utility may recover pursuant to the Purchased Gas Adjustment ("PGA") clause its actual, reasonable, and prudent costs in the following categories: commodity cost of natural gas; cost of transportation; cost of storage services; and "other out-of-pocket direct non-commodity costs related to hydrocarbon procurement, transportation, supply management, or price management, net of any associated proceeds". 83 Ill. Adm. Code

525.40(a)(1-4), implementing 220 ILCS 5/9-220. These are the "Recoverable Gas Costs" the utility passes on to ratepayers through the Gas Charge.

2. The Recoverable Gas Costs that the natural gas utility is permitted to recover through the Gas Charge must, however, be offset "by the revenues derived from transactions at rates that are not subject to the Gas Charge(s) if any of the associated costs are recoverable gas costs as prescribed by subsection (a)". 83 Ill. Adm. Code 525.40(d). That is, if (1) the rates at which the transaction is completed are non-PGA rates and (2) any of the costs associated with the transaction are Recoverable Gas Costs, then the revenues from the transaction must be credited to ratepayers as an offset to the costs recovered through the Gas Charge. The only exceptions are transactions that are subject to ICC tariff regulation. *Id*. (For ease of reference, transactions that ***are*** subject to Section 525.40 and that are ***not*** subject to ICC tariff regulation are referred to herein as "non-tariff" transactions.)

3. Further, Section 525.40(d) expressly requires gas utilities to refrain from "entering into any such transaction that would raise the Gas Charge(s)."[1] *Id*. This determination is made after "taking into account the level of additional recoverable gas costs that must be incurred to engage in a given transaction." *Id*.

4. In sum, if a natural gas public utility conducts non-tariff transactions for which any of the associated costs are recoverable through the Gas Charge then the revenues from those transactions shall be used to offset the Gas Charge. If the Gas Charge would be raised by a non-tariff transaction, the transaction itself is prohibited.

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[1] This language does not– as Peoples seems to assume – authorize a gas utility to behave as it wishes as long as it does not act affirmatively to increase the Gas Charge. A utility may not freely divert or decline revenues and revenue opportunities to evade regulatory treatment respecting the revenues earned. Diversions of revenues that a reasonable business would pursue, and that (if taken) would lower the Gas Charge, are not prudent. From the perspective of the ratepayers protected by Section 525.40, such transactions violate the revenue offset and no rate increase requirements of the PGA clause.

5. The PGA clause protects ratepayers from the unfair imposition of non-tariff transaction costs, by requiring that when costs recovered from ratepayers support a non-tariff transaction, the revenues from that transaction must be credited to the benefit of ratepayers. Thus, a gas utility may not deny or neglect to give ratepayers the economic benefit of revenue opportunities provided by the costs they bear. Further, the PGA clause expressly forbids the greater inequity of a gas utility engaging in non-tariff activities that have the effect of actually increasing the Gas Charge to rate payers.

6. In the present proceeding, the main dispute is about the application of Section 525.40 -- not its meaning. The issue is whether the facts concerning various novel transactions The Peoples Gas Light and Coke Company ("Peoples" or the "Company") engaged in and that used Company assets and operations compel application of the offset provision of Section 525.40. That is, whether (1) "any of" the costs associated with those transactions or arrangements are recoverable through the Gas Charge, thus requiring that the revenues derived from the non-tariff transactions and services supported by those costs be used to offset the Gas Charge or (2) the transactions had the effect of raising the Gas Charge and are thus prohibited.

The Transactions

7. Peoples provides what are known as hub services pursuant to a Federal Energy Regulatory Commission ("FERC") Operating Statement. These services are not subject to ICC tariff regulation and, therefore, are subject to the provisions of Section 525.40. Peoples' hub services include firm and interruptible transportation and storage services as well as park and loan services. Parks and loans refer to short-term storage (parking) and short-term withdrawals

(loaning) of natural gas. The Company uses its Manlove storage field and Mahomet pipeline – and the operation of those facilities -- to support its hub services.[2]

8. Peoples also engaged in other non-tariff activity that it maintains "optimized" excess PGA gas assets, storage capacity, and operations, or that the Company argues used ordinary utility operations and PGA gas without impairing the reliability of service to ratepayers.[3] Peoples Pre-Trial Brief at LL 278,1337. For instance, the Company participated in the optimization of contract no-notice storage known as NSS pursuant to its Storage Optimization Contract. And, the Company used physically available PGA gas when needed to complete hub transactions.

9. The costs of the Company's optimization arrangements are recovered through the Gas Charge. Staff Ex. 7.0, Reardon Add. Direct at LL 1358-1360; Peoples Second Pretrial Memo at LL 576-577; 591-594. The Company's gas transportation and storage costs, including the category of costs related to unaccounted for gas (also referred to as "GLU"), are recovered through the Gas Charge. See City-CUB Ex. 1.0, Decker Add. Direct at LL 603-630. The Company has also acknowledged that it uses PGA gas in displacement transactions. Peoples Ex. F, Wear Rebuttal at LL 912-914. (For a discussion of "displacement transactions, *see e.g.*, Staff witness Anderson's Direct Testimony at LL 675-781; Anderson Additional Direct at LL 529-700; Knepler Direct at LL 209-306; Knepler Additional Direct at LL 239-284.) Further, the Company's hub services were supported by the availability of stored PGA gas, which gas was sometimes used to complete hub transactions. Finally, the Company has not denied that its stored gas withdrawals and injections to complete midstream transactions can affect the LIFO-

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[2] The Manlove storage field is located within Champaign County in central Illinois, and the Mahomet pipeline runs from there to PGLC's distribution system in the City of Chicago.

[3] The Company's arguments do not address the economic effect on ratepayers of costs added or not offset in the Gas Charge calculation.

based gas costs passed through to ratepayers in the Gas Charge. The above categories of Recoverable Gas Costs encompass nearly all of the costs at issue in this case. Under Section 525.40, "any" PGA costs used to support a midstream transaction brings the associated revenues into the PGA.

11. Despite the acknowledged involvement of PGA costs, the Company argues that its "hub transactions are fully supported through the use of assets, such as Manlove Field and the Mahomet transmission pipeline, for which the associated costs are recovered in Peoples Gas' base rates and not through the Gas Charge." Peoples Second Pre-hearing Memo at LL 219-223 (emphasis added). Without addressing any economic effects on the Gas Charge, the Company argues that the availability and use of PGA gas (and related transport and storage activity) to support midstream transactions does not require Section 525.40 treatment – because ratepayers were never denied gas and because it did not always need to purchase replacement gas to meet immediate customer demands.

12. The crux of this case lies in the factual determinations needed to ascertain whether the provisions of Section 525.40 must be applied to particular transaction revenues and associated costs identified in the testimony of various witnesses. If "any costs" supporting particular transactions are recoverable through the Gas Charge, then Section 525.40 clearly requires that the revenues derived from the transactions must be "passed through" the PGA as an offset to costs collected through the Gas Charge.

WHEREFORE, the City of Chicago and the Citizens Utility Board respectfully submit the foregoing Pretrial Memorandum.

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Respectfully submitted,

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