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ALJ

ADDITIONAL DIRECT/REBUTTAL TESTIMONY

OF

ERIC LOUNSBERRY

Engineering Department
Energy Division
Illinois Commerce Commission

Purchased Gas Adjustment Clause Reconciliation

North Shore Gas Company

Docket No. 01-0706

January 7, 2005

OFFICIAL FILE
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Staff Exhibit No. 8.0
Witness Lounsberry
Date 4/19/05 Reporter TR

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

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

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

A. My additional direct/rebuttal testimony responds to the rebuttal testimony filed by North Shore Gas Company's ("North Shore" or "Company") witness Thomas Zack.

Q. Are you making any recommendations in this proceeding?

A. No.

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

A. I address Mr. Zack's comments regarding the amount of time Staff had to review its GPAA contract in the prior proceeding, the manner that the Company has historically supported its supply and capacity portfolio, and I provide an overall perspective regarding North Shore's decision to enter into the GPAA.

Review Time for the GPAA Agreement

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

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

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

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

Q. Why did Staff make this request?

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

Q. Did the Company provide Staff with this presentation?

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

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

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

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

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

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

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

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

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

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

[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.

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

Historical Information Supporting Supply and Capacity Contracts

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

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

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

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

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

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

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

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

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

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

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

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

[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.

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

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

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

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

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

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

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

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

A. Yes.

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

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

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

A. Yes.

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

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

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

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

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

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

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

North Shore's Actions Versus Other Illinois Utilities

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

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

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

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

[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.

223 A. Yes.