

STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION

*Admitted*  
*4/19/05*  
*[Signature]*

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

**REDACTED**

**DIRECT TESTIMONY**

**OF**

**JEROME D. MIERZWA**

**ON BEHALF OF THE**

OFFICIAL FILE

**CITIZENS UTILITY BOARD**

ILLINOIS COMMERCE COMMISSION DOCKET NO. *01-0707*  
*Ad* Exhibit No. *2.0*  
Witness: *Mierzwa*  
Date: *4/19/05* Reporter: *TR*

AUGUST 2003

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Date  
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Witness  
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EXHIBIT NO.  
\_\_\_\_\_  
ILLINOIS COMMERCE COMMISSION DOCKET NO.

OFFICIAL FILE

**EXETER**

ASSOCIATES, INC.  
5565 Sterrett Place  
Suite 310  
Columbia, Maryland 21044



1 state regulatory affairs. In April 1987, as part of a corporate reorganization, I was  
2 transferred to National Fuel Gas Supply Corporation's ("NFG Supply's") rate department  
3 where my responsibilities included utility cost of service and rate design analysis, expense  
4 and revenue requirement forecasting and activities related to federal regulation. I was  
5 also responsible for preparing NFG Supply's Purchased Gas Adjustment ("PGA") filings  
6 and developing interstate pipeline and spot market supply gas price projections. These  
7 forecasts were utilized for internal planning purposes as well as in NFGD's purchased gas  
8 cost rate proceedings.

9 In April 1990, I accepted a position as a Utility Analyst with Exeter Associates, Inc.  
10 In December 1992, I was promoted to Senior Regulatory Analyst. Effective April 1,  
11 1996, I became a principal of Exeter Associates. Since joining Exeter Associates, I have  
12 specialized in evaluating the gas purchasing practices and policies of natural gas utilities,  
13 utility class cost of service and rate design analysis, sales and rate forecasting,  
14 performance-based incentive regulation, revenue requirement analysis, the unbundling of  
15 utility services and evaluation of customer choice natural gas transportation programs.

16 Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS ON  
17 UTILITY RATES?

18 A. Yes. I have provided testimony on more than 85 occasions in proceedings before the  
19 Federal Energy Regulatory Commission ("FERC"), utility regulatory commissions in  
20 Delaware, Georgia, Indiana, Louisiana, Montana, Nevada, New Jersey, Ohio,  
21 Pennsylvania, Rhode Island, Texas and Virginia, as well as before this Commission.

22 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

23 A. Exeter Associates, Inc. was retained by the Citizen's Utility Board ("CUB") to review the  
24 Peoples Gas Light and Coke Company's ("Peoples Gas" or "the Company") 2001

1 reconciliation period purchased gas cost filing. My testimony presents the results of my  
2 review.

3 Q. HAVE YOU PREPARED EXHIBITS TO ACCOMPANY YOUR TESTIMONY?

4 A. Yes, I have. Schedules JDM-1 through JDM-5 are attached to my direct testimony.  
5 Schedule JDM-1 summarizes my adjustments to the Company's 2001 reconciliation  
6 period purchased gas costs that total \$56,361,655. I recommend that this amount be  
7 flowed back to ratepayers during the December through February winter period.

8 Q. PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS.

9 A. My findings and recommendations are as follows:

- 10
- 11 • The call option service provided by the Company to its affiliate Enron Midwest had  
12 an adverse impact on sales customers and reconciliation period gas costs should be  
13 adjusted to remove the adverse impact of this service (\$434,800);
  - 14
  - 15 • The Company's exchange and storage activities had an adverse impact on sales  
16 customers and reconciliation period gas costs should be adjusted to remove the  
17 adverse impact of these activities (\$51,206,708);
  - 18
  - 19 • The Company's practice of recovering the costs associated with maintenance gas  
20 solely from sales customers is unreasonable. The costs associated with maintenance  
21 gas should be recovered from all customers (\$1,886,281); and
  - 22
  - 23 • The provisions of the Company's gas supply contract with Enron Midwest which  
24 allow Enron Midwest to determine the daily summer injection quantity is  
25 unreasonable and had an adverse impact on sales customers. Reconciliation period  
26 gas costs should be adjusted accordingly (\$2,833,867).
- 27

1 **II. CALL OPTION SERVICE**

2 Q. WHO IS ENRON MIDWEST?

3 A. Enron Midwest is an affiliate of Enron North America Corporation (“ENA”). As  
4 subsequently discussed, Peoples Gas has a gas supply contract with ENA which provides  
5 a substantial percentage of Peoples Gas’ annual natural gas supply requirements. Peoples  
6 Gas’ corporate parent, Peoples Energy Corporation, and Enron Midwest each have a one-  
7 half membership interest in enovate, a limited liability company.

8 Q. PLEASE DESCRIBE THE CALL OPTION SERVICE AT ISSUE.

9 A. Peoples Gas initially thought that it had negotiated an arrangement with Enron Midwest  
10 (“EMW”) to provide an exchange service. [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED] EMW was to pay

14 Peoples Gas a fixed demand charge of \$241,600 for providing the exchange service.

15 However, due to the Company’s failure to properly document the transaction it thought it  
16 had negotiated, the service actually provided was [REDACTED] call option to EMW.

17 [REDACTED]

18 [REDACTED]

19 [REDACTED] In return for this service, Peoples Gas  
20 received \$241,600.

21 Q. WHAT DO YOU MEAN BY FIRST-OF-THE-MONTH CHICAGO CITYGATE  
22 INDEX PRICE?

23 A. There are various natural gas journals that publish average prices paid by market  
24 participants for the purchase of gas supplies at various locations and times. These index  
25 prices reflect the market price of gas. One of the locations for which prices are published

1 is for gas delivered to the Chicago area, often referred to as the Chicago citygate. First-  
2 of-the-month index prices are applicable for purchases that flow at the beginning of the  
3 month, for the entire month. The same quantity of gas flows on each day during the  
4 month under these arrangements.

5 Also published are daily index prices. These prices are applicable for purchases  
6 made on days after the first-of-the-month. These purchases can be for periods as short as  
7 one day, or from the date of purchase until the end of the month.

8 Q. HOW WERE THE REVENUES DERIVED FROM THE CALL OPTION SERVICE  
9 TREATED BY THE COMPANY?

10 A. Initially, Peoples Gas had proposed to retain the fixed demand credit of \$241,600.  
11 However, since then, in its additional direct testimony, the Company has indicated that it  
12 intends to credit sales customers with the fixed demand credit.

13 Q. IS THERE ANYTHING ELSE CONCERNING THE PAYMENT OF THE FIXED  
14 DEMAND CHARGE WORTH NOTING?

15 A. Yes. The payment came from enovate, a company that is owned equally by Peoples  
16 Energy Corporation, Peoples Gas' corporate parent, and EMW. The Company has no  
17 idea why the payment was received from enovate (POL 2.055).

18 Q. WHAT IS YOUR CONCERN WITH RESPECT TO THE CALL OPTION  
19 SERVICE NOW THAT THE FIXED DEMAND CREDIT WILL BE FLOWED  
20 THROUGH THE GAS CHARGE?

21 A. In order to provide the call option service, Peoples Gas would have been required to  
22 purchase incremental gas supplies on the days EMW elected to exercise its call service  
23 option. During November and December 2000, when EMW exercised its option rights,  
24 the daily market price of gas was well in excess of the applicable first-of-the-month  
25 published index price. As a result, Peoples Gas was required to purchase higher cost gas

1 and sales customers were adversely affected since they paid for the higher cost  
2 incremental supplies. It was unreasonable for Peoples Gas to expose sales customers to  
3 this speculative price risk.

4 Q. HAVE YOU PREPARED A SCHEDULE QUANTIFYING THE ADVERSE  
5 IMPACT OF THE CALL OPTION SERVICE ON SALES CUSTOMERS?

6 A. Yes. Confidential Schedule JDM-2 reveals that the adverse impact on sales customers  
7 was \$434,800.

8  
9 **III. EXCHANGE SERVICES**

10 Q. PLEASE DESCRIBE THE EXCHANGE SERVICES AT ISSUE.

11 A. Peoples Gas provided exchange and storage services using its Manlove storage facilities  
12 to certain third-parties (generally marketers) pursuant to what it refers to as its FERC  
13 Operating Statement. Under these exchange transactions, Peoples Gas either accepts gas  
14 from a third-party and returns it at a later point in time, or loans gas to a third party who  
15 returns it at a later point in time. Peoples Gas claims that revenues derived from these  
16 transactions are properly retained by the Company as base rate revenues (ENG 2.119,  
17 2.121). During the reconciliation period, Peoples Gas realized more than ██████████ from  
18 the provision of exchange and storage services.

19 Q. WHAT IS YOUR CONCERN WITH THE PROVISION OF EXCHANGE AND  
20 STORAGE SERVICES BY PEOPLES GAS?

21 A. To serve its sales customers during the winter, the Company can purchase gas that is  
22 delivered directly to its system, or withdraw gas from storage. While prices soared during  
23 the winter of 2000-2001, the Company withdrew gas from Manlove storage to  
24 accommodate its third-party exchange and storage activities. That is, instead of relying  
25 more heavily on gas from storage to serve its sales customers, Peoples Gas had to

1 purchase more high cost gas during the winter of 2000-2001 because gas in storage was  
2 utilized to provide third-party exchange and storage services. Peoples Gas withdrew  
3 more than ██████████ during the winter of 2000-2001 to accommodate its  
4 exchange and storage services. Included in the amount was nearly ██████████ that was  
5 advanced to third-parties and repaid at a point in the future. That is, Peoples Gas injected  
6 ██████ of gas into storage on behalf of third-parties prior to the winter of 2000-2001,  
7 withdrew and returned that gas to third-parties during the winter of 2000-2001, and  
8 withdrew an additional ██████ of gas from storage during the winter and delivered it to  
9 third-parties who returned that gas at a later point in time.

10 The costs associated with the Manlove storage facilities are paid for by ratepayers  
11 through base rates and, therefore, ratepayers are entitled to the benefits of storage  
12 operations. In this instance, storage gas should have been utilized to displace high cost  
13 purchases, not to serve third-parties. It is not unreasonable for Peoples Gas to utilize its  
14 storage facilities to generate base rate revenues as long as those storage activities do not  
15 increase costs for ratepayers. It is unreasonable and improper for the Company to engage  
16 in activities that increase gas costs for ratepayers.

17 Q. HAVE YOU PREPARED A SCHEDULE SHOWING THE ADVERSE IMPACT  
18 OF THE COMPANY'S EXCHANGE ACTIVITIES ON SALES CUSTOMERS?

19 A. Yes. As shown in Schedule JDM-3, I have calculated the adverse impact on sales  
20 customers to be \$51,206,708.

#### 22 IV. MAINTENANCE GAS

23 Q. WHAT IS MAINTENANCE GAS?

24 A. Maintenance gas is gas the Company injects into its on-system storage facilities to replace  
25 gas that has been lost.

1 Q. HOW MUCH MAINTENANCE GAS DID PEOPLES GAS INJECT INTO  
2 STORAGE DURING THE RECONCILIATION PERIOD?

3 A. Maintenance gas totaled 742,900 Dth during the reconciliation period.

4 Q. HOW ARE THE COSTS ASSOCIATED WITH MAINTENANCE GAS  
5 RECOVERED?

6 A. The costs associated with maintenance gas are recovered entirely from sales customers.

7 Q. IS THIS REASONABLE?

8 A. No. All customers that utilize the Company's on-system storage facilities should be  
9 responsible for the costs associated with maintenance gas. This includes end-user  
10 transportation customers, exchange customers and North Shore Gas Company.

11 Q. WHAT IS YOUR RECOMMENDATION CONCERNING THE RECOVERY OF  
12 THE COSTS ASSOCIATED WITH MAINTENANCE GAS?

13 A. I recommend that the costs associated with maintenance gas be recovered from all  
14 customers who utilize the Company's on-system storage facilities. An adjustment to the  
15 Company's reconciliation period gas costs reflecting my recommendation is presented on  
16 Schedule JDM-4.

17

18 **V. ENRON NORTH AMERICA GAS SUPPLY CONTRACT**

19 Q. PLEASE DESCRIBE THE COMPANY'S GAS SUPPLY CONTRACT WITH  
20 ENRON NORTH AMERICAN CORPORATION.

21 A. Peoples Gas has a contract to purchase approximately █ percent of its annual gas  
22 supplies from Enron. That contract has a provision that allows Enron to determine the  
23 amount of gas to deliver to Peoples Gas for injection into storage on each day in the  
24 summer. This quantity is referred to as the Summer Injection Quantity ("SIQ"). The

1 price Enron receives for this gas is the published Chicago citygate first-of-the-month  
2 index price, [REDACTED]

3 Q. WHAT IS YOUR CONCERN WITH THE ENRON CONTRACT?

4 A. It is unreasonable to agree to pay first-of-the-month prices while giving the supplier the  
5 right to determine how much gas it will deliver on a daily basis. This is because when  
6 daily market prices for gas decline from the first-of-the-month price, Enron can increase  
7 the quantity of gas delivered to Peoples Gas for storage injection. Under these  
8 circumstances, Enron profits on the difference between the first-of-the-month price and  
9 daily prices. Sales customers' gas costs are increased by the amount by which Enron  
10 profits.

11 When daily prices increase from first-of-the-month prices, Enron can minimize  
12 deliveries to Peoples Gas, selling gas initially destined for Peoples Gas to others at a profit.  
13 Again, sales customers experience higher gas costs under these circumstances since the  
14 Company must purchase replacement supplies from other suppliers at the higher price  
15 levels.

16 Q. WHAT IS YOUR RECOMMENDATION CONCERNING THE ENRON  
17 CONTRACT?

18 A. Peoples Gas has an obligation to minimize gas costs for its ratepayers and should have  
19 attempted to renegotiate this unfavorable provision. It failed to do so. Therefore, I  
20 recommend that reconciliation period gas costs be adjusted as if the unfavorable SIQ  
21 provisions had been eliminated. As shown on Schedule JDM-5, this results in an  
22 adjustment of \$2,833,867 to reconciliation period gas costs.

23 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

24 A. Yes, it does.



**THE PEOPLES GAS LIGHT AND COKE COMPANY**

## Summary of Reconciliation Period Adjustments

No.	Adjustment	Amount	Source
1.	Call Option Service	\$434,800	Schedule JDM-2
2.	Exchange Transactions	\$51,206,708	Schedule JDM-3
3.	Maintenance Gas	\$1,886,281	Schedule JDM-4
4.	SIQ Provisions	\$2,833,867	Schedule JDM-5
	Total	\$56,361,655	

**CONFIDENTIAL**

Citizens Utility Board

Docket No. 01-0707

Exhibit JDM 2

**CONFIDENTIAL**

Citizens Utility Board

Docket No. 01-0707

Exhibit JDM 3

**CONFIDENTIAL**

Citizens Utility Board

Docket No. 01-0707

Exhibit JDM 4

**THE PEOPLES GAS LIGHT AND COKE COMPANY**

Adjustment to SIQ Gas Costs  
October 2000 - September 2001

Month	Adjustment
October 2000	\$53,312
November	\$1,990,941
April 2001	\$8,686
May	(\$70,258)
June	\$342,041
July	\$23,203
August	\$504,799
September	\$34,455
Total	\$2,833,867