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CMS

Docket No. 01-0707
ICC Staff Exhibit. 5.00

Additional Direct / Rebuttal Testimony

of

Steven R. Knepler

Accounting Department

Financial Analysis Division

Illinois Commerce Commission

Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.

The Peoples Gas Light and Coke Company

Docket No. 01-0707

January 7, 2005

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WITNESS IDENTIFICATION

Q. Please state your name and business address.

A. My name is Steven R. Knepler. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Have you previously filed testimony in this proceeding?

A. Yes. My Direct testimony was filed in August 2003 as ICC Staff Exhibit 1.00.

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

A. The purpose of my additional direct / rebuttal testimony is to present the Staff position on The Peoples Gas Light and Coke Company's ("Company" or "Peoples" or "Peoples Gas") Purchased Gas Adjustment Clause ("PGA") Reconciliation for the year ending September 30, 2001, to address the accounting and applicability of transactions subject to Part 525, the Purchased Gas Adjustment Clause ("PGA rule"), and to comment on Staff's recommendations for a management audit, additional internal audits, and the update of the operating agreement.

STATUS OF STAFF'S DIRECT CASE PGA ADJUSTMENTS

Q. Please summarize the status of Staff's direct case adjustments.

A. In its direct case, Staff proposed 7 adjustments to reduce the Company's commodity gas charge by $30,769,580.[1] Staff is maintaining all 7 direct case adjustments, two of which have been accepted by the Company. The two Staff adjustments accepted by the Company are the $4,628,267 maintenance gas adjustment appearing in column (B) and the $538,225 adjustment for off-system transactions 16 and 22 in column (D) of my direct Schedule 1.03. Thus, the Company has accepted $5,166,492 of the $30,769,580 commodity cost reductions quantified in Staff's direct case.[2] Additionally, the seventh adjustment[3] has been reformatted into its two components and is now shown as separate adjustments in columns (H) and (I) on page 1 of my Schedule 5.03. Thus, page 1 of Schedule 5.03 now shows 8 adjustments (instead of 7 shown on my direct Schedule 1.03) in columns (B) thru (I).

Furthermore, and based upon new information, Staff is revising the amount for five of its direct adjustments: the Enron GPAA Imprudence, Off-system Transaction 19, Park and Loan transactions, Third Party Storage Exchanges, and Imprudent Use of Manlove Storage Field (which is now two separate adjustments). These adjustments appear in columns (C), (E), (F), (G) and (H) of my direct Schedule 1.03 and in columns (C), (E), (F), (G), (H) and (I) for my additional direct/rebuttal 5.03. Also, the "FERC Park and Loan Transactions"

[1] Staff proposed adjustments to one of Peoples' three-PGA components, the Commodity Gas Charge. Staff did not propose adjustments to either the Non-Commodity & Demand Gas Charge or to the Transition Surcharge components.

[2] Note: Dr. Rearden has revised his adjustment for transactions 16 and 22 from $538,225 in direct to $535,554 in additional direct / rebuttal. Based on the revised adjustment amount, the Company has accepted $5,163,821 in adjustments.

[3] ICC Staff Exhibit 1.00, Schedule 1.03, column (H).

adjustment appearing in column (F) is now referred to as "FERC Operating Statement Transactions" in my additional direct/rebuttal to better reflect the nature of the transactions.

Q. In addition to Staff's direct adjustments previously discussed (and identified on page 1 of your direct Schedule 1.03)[4], is Staff proposing any additional adjustments based on new information obtained during the reopening of the discovery phase of this proceeding?

A. Yes. Staff is proposing seven additional adjustments to the Commodity Gas Charge Reconciliation. These additional adjustments are for (1) Off-system Transaction #103, (2) Refinery Gas Purchases, (3) PEC Storage Optimization Contract, (4) Enron Storage Optimization Contract, (5) Trunkline Deal, (6) enovate Income-PEC Income, and (7) enovate Income-Enron Income. These seven additional adjustments are summarized on page 2 of my Schedule 5.03, columns (K) thru (Q) respectively. Dr. Rearden provides support for the Off-system Transaction #103 adjustment and Staff witness Hathhorn provides the computation for the adjustments shown in columns (L) thru (Q).

Summary of Staff Additional Direct/Rebuttal PGA Adjustments

Q. Please provide a summary of Staff's PGA adjustments.

[4] Updated as Schedule 5.03, page 1 of 2.

A. Staff is proposing 15 adjustments totaling $91,987,033 for the Reconciliation of the Commodity Gas Charge to be refunded to PGA customers. These adjustments are as follows:

- The first adjustment is for $4,628,267 to correct the accounting for the cost of maintenance gas. Peoples has accepted this adjustment.[5]

- Adjustment two is Staff's imprudence disallowance for entering into a gas supply contract with Enron North America (Enron). As noted in my direct testimony Staff conducted a two-part analysis to determine imprudence. First, Staff determined that the contract was imprudent (based on a lack of economic analysis).[6] Staff witness Andersen discusses the lack of an economic analysis (ICC Staff Exhibit 6.00). While Staff believes this is sufficient reason to declare the GPAA imprudent, Staff witness Rearden conducted a detailed, before-the-fact, numerical analysis to show that Peoples Gas and North Shore should have seen that the GPAA was, in fact, imprudent. Second, Staff measured the impact (i.e., harm) on customers of the imprudent actions (of entering into the Enron contract). Staff witness Rearden quantifies the imprudent action of $13,304,910 in his testimony (ICC Staff Exhibit 7.00).[7] The Company is disputing this adjustment.

- Adjustment three is for off-system transactions found to be imprudent by Staff. As noted in my direct testimony, Off-system transactions are not regulated by the Commission. Adjustment three relates to a contract Peoples entered into with Enron Midwest, whereby Enron Midwest could purchase certain quantities of gas on (up to) any 10 days of each month during November and December 2000 (commonly referred to as a "call option"). Deliveries of gas under this call option in November 2000 and December 2000 have been designated as "Transaction 16" and "Transaction 22" respectively. The Company has accepted this adjustment. Dr. Rearden has quantified this adjustment as a $535,554 reduction to recoverable gas cost.

- Adjustment four relates to another imprudent off-system transaction with Enron Midwest whereby Peoples agreed in November 2000 to resell base load gas to Enron Midwest in December 2000. Staff believes Peoples has not demonstrated prudence since it did not explore all of its alternatives or provide sufficient detail about the effect of the resell. In his direct testimony

[5] See Respondent's Exhibit F, Rebuttal Testimony of David Wear, p.55, lines 1221-1228.
[6] Note; if in step 1 of Staff's analysis, Peoples decision to enter into the contract was found to be "prudent", then no adjustment would be proposed – even if the results turned out to be negative (harm ratepayers).
[7] Note: Revised from $8,977,229 in direct (ICC Staff Ex. 3.10) to $13,304,910 in additional direct/rebuttal (ICC Staff Ex. 7.00).

Staff witness Rearden stated that the imprudence of Transaction 19 caused PGA customers to overpay for gas. This adjustment remains disputed; the Company believes it acted prudently, however, the Company further believes that Staff's direct adjustment is miscalculated.[8] Dr. Rearden maintains his belief that Peoples acted imprudently and his revised calculation states that the PGA customers overpaid gas charges by $5,661,703.

- Staff adjustments 5 and 6 relate to Non-tariff Service Revenues. Staff is proposing adjustments to reduce recoverable gas costs by $4,378,466 for revenues received under the FERC Operating Statement Agreement and by $2,250,165 for revenues received for Third Party Storage Exchanges. Section 525.40(d) of the Purchased Gas Adjustment Clause requires gas utilities to offset recoverable gas cost for revenues received from transactions "that are not subject to the Gas Charge(s) if any of the associated costs are recoverable gas cost…" The two Non-tariff Revenue adjustments are summarized in columns (F) and (G) of my Schedule 5.03. The Non-tariff revenue adjustments are further discussed in the testimony of Staff witness Rearden (ICC Staff Exhibit 7.00). This adjustment is in dispute.

- Staff Adjustments 7 and 8 relate to Peoples' imprudent use of the Manlove Storage Field. During the high volume periods, Peoples did not interrupt sales to its third party-interruptible customers. Staff believes this decision was imprudent because it increased gas prices for the Company's PGA customers by (1) requiring Peoples to purchase additional gas supplies (on the open or spot market) to meet the demand of its PGA customers; and (2) requiring Peoples to borrow from the gas in storage to supply third parties (because the third parties had depleted their bank of gas). Staff witness Rearden sponsors this adjustment and has determined that the imprudent use of the Manlove Storage Field increased gas prices by $10,268,171 for the value of gas loaned to third parties and by $25,920,181 for storage imprudence (ICC Staff Exhibit 7.00).

Staff adjustments 9 thru 15 are based on information obtained since the February 2004 reopening of discovery and are summarized in columns (K) thru (Q) on page 2 of Schedule 5.03.

- Staff Adjustment 9 is to offset recoverable gas cost for the revenues received from Off-system transaction #103. Dr. Rearden states that the cost of commodity gas was overstated by $1,411,031.

[8] Respondent's Exhibit F, Rebuttal Testimony of David Wear, pp. 49-54, lines 1101-1207.

- The tenth Staff Adjustment recognizes the imprudence related to purchases of Refinery Fuel Gas (RFG). Staff witness Hathhorn[9] has determined that Peoples Gas was imprudent by $2,232,490 in its purchase of refinery fuel gas purchases from PERC (Peoples Energy Resources Corporation). In previous fiscal years, Peoples made direct purchases of refinery fuel gas. In this reconciliation period Peoples obtained the refinery fuel gas from PERC at prices higher than previous periods. The refinery fuel gas purchase adjustment is shown in my Schedule 5.03, column (J).

- Staff Adjustments 11 and 12 relate to the profit received by and recorded on the books of PEC (Peoples Energy Corporation)[10] and Enron/EMW for the Storage Optimization Contract ("SOC"). Peoples Gas was charged monthly management fees and surrendered revenues to Enron via Enron Midwest for optimizing its leased storage. Staff adjustment 11 identifies $623,000 in management fees and revenues from the Storage Optimization Contract that was funneled to PEC, rather than Peoples Gas and the PGA; and Staff Adjustment 12 is for $717,455, the amount Enron received under the contract. The Storage Optimization Contract adjustments are calculated in Schedules 9.02 and 9.03 to the testimony of Staff witness Dianna Hathhorn. Ms. Hathhorn addresses the PEC adjustment primarily, and Dr. Rearden further supports why the Enron revenues should offset gas cost as well. The impact of Staff's SOC adjustments is shown on my Schedule 5.03, page 2, columns (M) and (N).

- Staff's Adjustment 13 also relates to revenues received by the parent company, PEC, and the non-utility subsidiary PERC through the deal. The Trunkline deal could not have been accomplished without the use of Peoples' facilities. The parent company PEC (Peoples Energy Corporation) and PERC should not be permitted to structure contracts which can only be accomplished by use of Peoples' facilities, and that structure the transactions so that Peoples is not a party to the contract and thus, any revenues received pass directly to PEC in order to avoid compliance with Part 525.40(d). Staff witness Hathhorn testifies recoverable PGA gas costs should be offset by $372,000 of Trunkline Deal revenues. The impact of the Trunkline Deal Revenue on the Commodity Gas Charge is shown on my Schedule 5.03, page 2, column (O).

- Staff Adjustments 14 and 15 relate to the "enovate income adjustment" that increases PGA recoveries (or revenues) for income received by PEC and Enron from revenue sharing arrangements with enovate. "enovate LLC" was a gas trading company that was owned 50% by Peoples MW and 50% by Enron MW (EMW). Peoples MW is a 100% owned subsidiary of PEC

[9] ICC Staff Exhibit 9.00.
[10] Peoples Energy Corporation (PEC) is a holding company and parent company of the operating utilities Peoples Gas Light & Coke Company and North Shore Gas Company.

(Peoples Energy Corporation, the holding company and parent of Peoples Gas Light and Coke Company). Enron Midwest (EMW) was owned by Enron North America (ENA), which was owned by Enron, the failed energy trading company. Staff witness Hathhorn testifies that enovate income could not have been accomplished without the use of Peoples facilities, and that Peoples has not explained, documented, or supported enovate transactions that directly impact the PGA. Therefore, Ms. Hathhorn testifies that the revenue received by PEC from the partnership, $9,052,809 (Schedule 9.05), should accrue to Peoples Gas and the PGA. Dr. Rearden further supports that Enron's income of $10,630,817 from enovate, calculated in Ms. Hathhorn's Schedule 9.06 should be credited to the PGA ratepayers. My Schedule 5.03, page 2, columns (P) and (Q) show the impact of the enovate income adjustment on the Commodity Gas Cost reconciliation.

All of Staff's adjustments described above are identified and summarized on my Schedule 5.03.

Schedule Identification

Q. Are you sponsoring any schedules as part of ICC Staff Exhibit 5.00?

A. Yes, I prepared the following schedules for the Company that show data for the reconciliation year ending September 30, 2001:

Schedule 5.01	PGA Reconciliation Summary
Schedule 5.02	Reconciliation of Commodity Gas Charge
Schedule 5.03	Adjustments to Commodity Gas Charge
Schedule 5.04	Reconciliation of Non-Commodity Gas Charge and Demand Gas Charge
Schedule 5.05	Reconciliation of Transition Surcharge
~~Schedule 5.06~~	~~Adjustments to Recognize Non-tariff Revenues~~

STAFF RECONCILIATION SCHEDULES

Q. Please describe Schedule 5.01, PGA Reconciliation Summary.

A. Schedule 5.01 is the same as Schedule 1.01 described on page 5 of my direct testimony, except that it reflects Staff's additional direct/rebuttal position. Schedule 5.01 represents Staff's reconciliation of the three individual PGA cost recovery components (the Commodity Gas Charge, the Non-commodity Gas Charge & Demand Gas Charge, and the Transitions Surcharge) and the total company reconciliation.

Q. Describe Schedule 5.02, Reconciliation of Commodity Gas Charge.

A. Schedule 5.02 is an update of my direct Schedule 1.01 and presents Staff's reconciliation of the Commodity Gas Charge. Column (B) reflects the Company's CGC reconciliation as presented on Company Exhibit 1. Column (C) summarizes Staff's additional direct/rebuttal adjustments to the Company's reconciliation. Column (D) is the net of columns (B) and (C) and represents Staff's reconciliation of Commodity Gas Charge. Column (D) is carried forward to my Schedule 5.01, column (B).

Q. Describe Schedule 5.03, Adjustments to Commodity Gas Charge.

A. Schedule 5.03 identifies individual Staff adjustments to the various components of the Company's presentation of the Commodity Gas Charge Reconciliation. The source of each adjustment is shown in the heading of each column. The total of all Staff adjustments are shown in column (I) and are carried forward to Schedule 5.02, column (C). Schedule 5.03 is an update of Schedule 1.03 filed with my direct testimony.

Q. Please explain Schedule 5.04, Reconciliation of Non-commodity Gas Charge and Demand Gas Charge, the second cost component of Peoples' PGA Charge.

A. Schedule 5.04 is Staff's reconciliation of the Non-commodity Gas Charge and Demand Gas Charge and except for the identifying header it is the same as Schedule 1.04 presented with my direct testimony. Staff is not proposing any adjustments to the Company's reconciliation of the Non-commodity Gas Charge and Demand Gas Charge and it is included as a convenience for the parties.

Q. Please explain Schedule 5.05, Reconciliation of Transition Surcharge.

A. Schedule 5.05 presents Staff's reconciliation of the third cost component of Peoples' PGA Charge, the Transition Surcharge. Except for the identifying header, Schedule 5.05 is the same as Schedule 1.05 filed with my direct testimony. Staff is not proposing any adjustments to the Company's reconciliation of the Transition Surcharge and it is included as a convenience for the parties.

ADJUSTMENTS TO RECOGNIZE NON-TARIFF REVENUES

Q. In direct testimony, Staff proposed two adjustments to reduce the cost of gas recoverable from the PGA customers for revenues received from Non-tariff services. Has there been any change to your adjustments to recognize non-tariff revenues since your direct testimony?

A. Yes. Based upon Peoples' responses to Staff Data Request ACC 6.002, Staff is revising the amounts of the two non-tariff service revenue adjustments. Additionally, Staff has changed the description of the first non-tariff revenue adjustment in column (F) from, "Park and Loan Transactions" to "FERC Operating Statement Transactions" in order to more accurately describe the nature of these transactions. Staff's non-tariff revenue adjustments reduce recoverable gas cost by $4,378,466 for FERC Operating Statement Transactions and $2,250,165 for Storage Exchange Transactions. These two adjustments are summarized in columns (F) and (G) respectively of Schedule 5.03.

ADJUSTMENT FOR MANLOVE STORAGE

Q. Have you read Mr. Anderson's discussion of Peoples' use of the Manlove storage field during the winter of the reconciliation period?

A. Yes.

Q. Would you please describe what Mr. Anderson says about the operation of the Manlove storage field during this time period?

A. Mr. Anderson asserts that Peoples used Manlove to not only provide storage services for PGA customers but also provided park and loan and exchange transactions for third parties (non-tariffed services). To accomplish this, Mr. Anderson states that Peoples utilized resources that included PGA recoverable gas costs. He also concludes that Peoples gave these third party storage transactions priority to the detriment of PGA customers.

Q. Has the Commission expressed concern about these types of transactions?

A. Yes. This is a perfect example of the type of transaction the Commission was referring to when they stated in their Order in the PGA rulemaking docket : "The Commission is concerned that revenue sharing would create incentives for utilities to subsidize off-system transactions with on-system transactions and could therefore result in PGA gas charge increases." (ICC Docket No. 94-0403, Order at 8). In order to address this concern, the Commission determined that all the revenues from such transactions should be flowed through the PGA.

Q. Does the PGA rule require the revenues from the Manlove third party storage services of the nature described in Mr. Anderson's testimony to be flowed through the PGA?

A. Yes. Section 525.40(d) of the PGA rule states that:

> Recoverable gas costs shall 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) of this Section. This Subsection shall not apply to transactions subject to rates contained in tariffs on file with the Commission, or in contracts entered into pursuant to such tariffs, unless otherwise specifically provided for in the tariff. Taking into account the level of additional recoverable gas costs that must be incurred to engage in a given transaction, the utility shall refrain from entering into any such transaction that would raise the Gas Charge(s).

The above rule does not expressly state that <u>all costs</u> associated with a non-tariff transaction must be PGA recoverable gas costs in order for all revenues received from the transaction to be credited to the PGA. Section 525.40(d) states that "recoverable gas costs shall be offset by the revenues derived... **<u>if any</u>** of the associated costs are recoverable gas costs as prescribed by subsection (a) of this Section". Peoples argues that only rate base assets that have no recoverable gas costs (i.e., the Manlove Storage Field and its transmission pipeline system) are used to perform non-tariff services (Peoples Exhibit C, pp. 32-35, lines 705-767). However, as noted by Staff witness Anderson, other resources, that include PGA recoverable gas costs, are required to support these transactions (ICC Staff Exhibit 6.00). Accordingly, Staff determines that these non-tariff service revenues should be flowed through the PGA.

MANAGEMENT AUDIT / INTERNAL AUDIT

Q. In his rebuttal testimony Company witness Zack states that your management audit and internal control recommendations are not needed. Please comment.

A. The reasons for Staff's management audit and internal audit recommendations extend beyond what Mr. Zack refers to as a mishandled off-system transaction, Transaction 16/22. Some of the documents reviewed by Staff that supports Staff's audit recommendations are:

(1) Internal audit report which states that PEC gave enovate control over the gas supply and storage functions (ICC Staff Exhibit 9, Attachment E);

(2) The unexplained consulting contract between PERC and EMW (ICC Staff Exhibit 9, Attachment A-1);

(3) The disclosure of oral agreements (the RFG contract, the Revenue Sharing Agreements PEC and Enron, and the arbitrary credits to PGA recoverable gas), (ICC Staff Exhibit 9.00); and

(4) Staff witness Anderson's testimony that third parties were permitted to make additional storage withdrawals even though they had depleted their bank of storage gas. (ICC Staff Exhibit 6.00).

Therefore, I am maintaining my direct recommendation that a management audit of Peoples' gas purchasing practices, gas storage operations and storage activities be performed by a firm independent to the Company and the parties to this docket. Additionally, I maintain the recommendation stated in my direct testimony that Peoples perform annual internal audits of its gas purchasing function and report the results of those audits to the Manager of the Commission's Accounting Department until the Commission determines that such internal audits are no longer necessary upon approval of a formal request by the Company. Peoples Gas should submit the internal audit reports by May 1 after each year of an audit.

Q. Mr. Zack also states that "(G)iven the scope of the Sarbanes-Oxley project, the Company believes that a second audit by the Commission may unnecessarily duplicate and add to the costs to the work being done for Sarbanes-Oxley compliance" (Respondent's Ex. G, p.28, lines 604-606). Mr. Zack further states that the Company is proposing to submit a report to Staff addressing its concerns. Do you have any comments?

A. Yes. Mr. Zack's concern that a requirement for an audit of the internal controls concerning the Company's gas purchasing practices, gas storage operations, and gas storage activities would be duplicative of work being done for the Sarbanes-Oxley Act is misplaced.

The Sarbanes-Oxley Act requires many publicly traded companies to comply with rules of the Securities and Exchange Commission by reporting on the effectiveness of the company's internal control systems to indicate the following:

- A statement of management's responsibilities for establishing and maintaining an adequate system of internal controls;

- The identification of the framework used to evaluate the internal controls;
- A statement as to whether or not the internal control system is effective as of yearend;
- The disclosure of any material weaknesses in the system; and
- A statement that the company's auditor's have issued an audit report on management's assessment of the internal controls.

Through the review of gas costs recovered through the PGA during this reconciliation period, Staff is alarmed by the apparent weaknesses of internal controls in the Company's gas purchasing practices, gas storage operations, and gas storage activities. This concern necessitates that the Company do an extensive analysis of its system of internal controls in this area that is reported back to the Commission.

If an analysis of these internal controls will already be included within the work that will be done by the Company in regard to compliance with the Sarbanes-Oxley Act, the only extra effort and cost to be incurred by the Company will be that which is associated with preparing the special report to the Commission on the Company's gas purchasing practices, gas storage operations, and gas storage activities. Preparing a report to the Commission on the findings of an internal audit would not be duplicative of the work being done by Sarbanes-Oxley.

Q. Do you have any further recommendations regarding an internal audit?

A. I recommend that the audit be conducted by a firm independent of the Company, parties to this docket, and Peoples' consultant Davison or her firm "Investment Training and Consulting Institute".

Furthermore, I recommend that the management audit be conducted under the management and control of the independent directors of Peoples Energy Corporation's audit committee. The firm selected to perform the audit must receive Commission approval. Furthermore, the management audit report should be submitted to the Commission prior to filing of direct testimony by Staff and the Interveners in the 2002, 2003, and 2004 PGA reconciliations.

Q. Company witness Zack states that Staff's concerns about the Hub should not be the basis for an audit. Mr. Zack further states that Staff is proposing inconsistent treatment for the Company from prior cases. Do you have any comments?

A. Yes, Staff's failure or omission to investigate the Hub or any issues in prior reconciliations should not prevent Staff from taking issues in the current or future reconciliations. In the 2001 Illinois Power PGA reconciliation the Commission stated that:

> **"(f)urthermore, the fact that the Commission allowed recovery of $230 in interest charges in Docket No. 99-0477 does not require the same outcome in this proceeding since nothing prohibits the Commission from correcting a prior oversight of this nature on a prospective basis. More importantly, whether Staff asked about the late payment interest charges in Docket No. 99-0477 is of little consequences since this question was not brought to the Commissions for resolution in that proceeding. (Illinois Commerce**

Commission, On Its Own Motion, vs Illinois Power Company, Docket No. 01-0701, Order Date February 19, 2004, p. 27).

INTERCOMPANY SERVICES AGREEMENT

Q. In your direct testimony, you recommended that Peoples Gas Light and Coke Company update its operating agreements approved by the Commission in Docket No. 55071 (ICC Staff Exhibit 1.00, p. 33). What is the status of that recommendation?

A. I am maintaining the recommendation for Peoples to update its operating agreements.

Q. When did the Commission approve Peoples' operating agreements?

A. As stated in my direct testimony, the Commission approved the operating agreements on September 10, 1969, in Docket No. 55071. Since 1969, the conditions that Peoples Gas operates under have changed dramatically. For example, no Hub existed during 1969, the relationship with EMW/enovate did not exist, and FERC regulations have changed since that time. Also, the operating agreement approved in Docket No. 55071 does not specify how revenues are assigned or the basis for allocating joint costs, two basic conditions that are always included in recent operating statements approved by the Commission.

Q. How did Peoples Gas respond to your statement that transactions with enovate did not receive Commission approval?

A. Company witness Zack stated that Peoples Gas would address in briefs the issue of whether enovate was an affiliate requiring Commission approval (Respondent's Ex. G, p. 28, lines 614-615). However, prior to addressing that issue in its brief, the Company may wish to respond in rebuttal to the following concerns: (1) is "enovate" a *de facto* affiliate of Peoples Gas Light and Coke since it shares some revenues with Peoples that are recorded as an offset to recoverable gas cost; and (2) why it is appropriate under Section 525.40(d) of the PGA rule to flow some of the gas revenues to the parent company (PEC) and some to the utility (Peoples Gas)?

Reopening of Docket No. 00-0720

Q. Should the Commission should consider reopening Docket No. 00-0720, Peoples Gas' 2000 PGA reconciliation?

A. Staff has reviewed the GPAA for the FY 2001 reconciliation and found that the GPAA was imprudent. The Commission should reopen Docket No. 00-0720 because Staff has reviewed the GPAA for FY 2001 and found it imprudent. The first year the GPAA was in effect was the 2000 reconciliation year. In order for the Commission to consider the impact of the GPAA on the FY 2000 reconciliation year it would be appropriate to reopen Docket No. 00-0720.

SUMMARY OF PGA RECONCILIATION

Q. Please summarize Staff's PGA reconciliation.

A. Staff is proposing 15 adjustments totaling $91,987,033 to reduce recoverable gas cost for the Reconciliation of Commodity Gas Charge (CGC):

1. To correct the accounting for the cost of maintenance gas, $4,628,267;
2. To disallow the imprudence of the Enron GPAA contract, $13,304,910;
3. To disallow the imprudence of off-system Transactions #16 and #22, $535,554;
4. To disallow the imprudence of off-system Transaction #19, $5,661,703;
5. To offset gas cost for revenues from FERC operating statement transactions; $4,378,466;
6. To offset gas cost for third party storage exchange revenues, $2,250,165;
7. To disallow the imprudent use of the Manlove Storage Field for the value of gas loaned to third parties, $10,268,171;
8. To disallow the imprudent use of the Manlove Storage Field for the costs of gas purchased to supply PGA customers, $25,920,181;
9. To disallow the imprudence of off-system Transaction #103, $1,411,031;
10. To disallow the imprudent cost of refinery gas purchased, $2,232,490;
11. To disallow the PEC profit on gas purchase through the Storage Optimization Contract, $623,000;

12. To disallow the Enron profit on the Storage Optimization Contract, $717,455;

13. To disallow the profit on gas purchase through the Trunkline Deal, $372,000;

14. To disallow the PEC profit on gas purchased from the affiliate "enovate, L.C.C", $9,052,823; and

15. To disallow the Enron profit on gas purchased from the affiliate "enovate, L.C.C", $10,630,817.

These adjustments are identified and summarized on Schedule 5.03, pages 1 and 2.

Staff is not proposing adjustments to the Reconciliation of the Non-Commodity Gas Charge and Demand Gas Charge nor to the Reconciliation of the Transition Surcharge.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Q. In your direct testimony you made several recommendations. Please summarize the current status of each recommendation.

A. The Company has agreed to account for maintenance gas as recommended by Staff. Thus, Recommendations 3, 4, 5, 6, and 8 are agreed to by the Company. It should be noted that the reporting period for Recommendation 8 has been revised from the quarter ending September 30, 2004 to the quarter ending September 30, 2007. Recommendations 1, 2, 7 and 9 are disputed and await a Commission ruling. My conclusions and recommendations are the following:

- Recommendation 1:
  I recommend that the Commission adopt Staff's proposed PGA reconciliation as reflected on ICC Staff Exhibit 5.00, Schedule 5.01. Staff's reconciliation shows that $91,987,033 is to be refunded to Peoples' PGA customers via the Commodity Gas Charge (CGC) through an Ordered Reconciliation Factor (Factor O) to be reflected in the Company's first monthly PGA filing submitted after the date a final order is entered in this proceeding;

- Recommendation 2:
  I share Staff witness Hathhorn's recommendation that the Company immediately update its operating agreement approved by the Commission in Docket No. 55071;

- Recommendation 3:
  I recommend that the Commission direct Peoples to account for all gas physically injected into the Manlove Storage Field by including the cost associated with maintenance gas in the amount transferred from purchased gas expense to the gas stored underground account (Account 164.1);

- Recommendation 4:
  I recommend that the Commission direct Peoples to account for the portion of gas injected into the Manlove Storage Field in order to maintain pressure (i.e., maintenance gas) as credits from Account 164.1, Gas Stored Underground and as charges to Account 117, Gas Stored Underground (for the recoverable portion of cushion gas) or to Account 101, Gas Plant (for the nonrecoverable portion of cushion gas);

- Recommendation 5:
  I recommend that Peoples be ordered to revise its maintenance gas accounting procedures related to gas injected for the benefit of the North Shore Gas Company and third parties to require those entities to bear the cost of maintenance gas;

- Recommendation 6:
  I recommend that Peoples Gas be ordered to submit its revised maintenance gas accounting procedures to the Commission's Chief Clerk with a copy to the Manager of the Accounting Department within 30 days after the date a final order is entered in this proceeding;

- Recommendation 7:
  I recommend that Peoples perform an annual internal audit of gas purchasing and submit a copy of the audit report to the Manager of the Commission's Accounting Department by May 1 of the year following the audit until the Commission finds that an internal audit in no longer necessary upon a formal request by the Company;

- Recommendation 8:
  I recommend that Peoples submit quarterly reports reflecting its use of journal entries regarding maintenance gas to the Manager of the Commission's Accounting Department within 45 days of the end of each quarter after the date a final order is entered in this proceeding through the quarter ending September 30, 2007;

- Recommendation 9:
  I share Staff witnesses Anderson's, and Rearden's recommendation that Peoples Gas should engage outside consultants to perform a management audit of its gas purchasing practices, gas storage operations and storage activities. The firm selected to perform the management audit is to be independent of the Company, Staff and Interveners to Docket Nos. 01-0706 and 01-0707, and approved by the Commission. The management audit should be managed by the independent directors of Peoples Energy Corporation's audit committee. Monthly reporting of the progress of the conduct of the management audit should be submitted to the Bureau Chief of the Commission's Public Utilities Bureau, with a copy to the Manager of the Commission's Accounting Department, until the management audit report has been submitted. Upon completion, which shall occur no later than 12 months after the date a final order is entered in this proceeding, copies of the management audit report are to be submitted to the Public Utilities Bureau Chief and the Manager of the Accounting Department.

- Recommendation 10:
  I recommend that the Commission reopen Docket No. 00-0720, Peoples Gas' PGA 2000 reconciliation.

CONCLUSION

Q. Does this question end your prepared additional direct/rebuttal testimony?

A. Yes, it does.

The Peoples Gas Light and Coke Company
PGA Reconciliation Summary
for the Year Ended September 30, 2001

Line No.	Description	Commodity Gas Charge (CGC)	Non-Commodity Gas Charge & Demand Gas Charge (NCGC and DGC)	Transition Surcharge (TS)	Total Company (B+C+D)
	(A)	(B)	(C)	(D)	(E)
	FISCAL 2000				
1.	Unamortized Balance at September 30, 2000 (Refund) / Recovery	$ 31,416,105.68	$ (936,949.00)	$ (12,375.53)	$ 30,466,781.15
2.	Factor A Adjustments Amortized to Schedule I at September 30, 2000	13,388,581.16	(221,497.41)	(13,502.24)	13,153,581.51
3.	Factor O (Refunded) / Recovered	-	-	-	-
4.	Balance (Refundable) / Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	$ 44,804,686.84	$ (1,158,446.41)	$ (25,877.77)	$ 43,620,362.66
	Fiscal 2001				
5.	Costs Recoverable through the Gas Charge	$ 755,562,294.77	$ 57,348,585.98	$ -	$ 812,910,880.75
6.	Revenues Arising through Application of the Gas Charge	928,986,583.08	50,989,557.66	927.69	979,977,068.43
7.	Separately Reported Pipeline Refunds or Surcharges	-	(614,882.34)	-	(614,882.34)
8.	Separately Reported Other Adjustments	-	-	-	
9.	Interest	903,534.14	(101,519.94)	(998.84)	801,015.36
10.	(Over) / Under Recovery for Reconciliation Year (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	$ (172,520,754.17)	$ 5,642,626.04	$ (1,926.53)	(166,880,054.66)
		-	-	-	
11.	(Over) / Under Recovery Balance at September 30, 2001 (Line 4 + Line 10)	(127,716,067.33)	4,484,179.63	(27,804.30)	(123,259,692.00)
12.	Factor A Adjustments Amortized to Schedule I at September 30, 2001	(11,852,706.48)	1,514,897.62	(4,223.70)	(10,342,032.56)
13.	Unamortized Balance at September 30, 2001 (Refund) / Recovery	(23,876,327.85)	2,969,282.01	(23,580.60)	(20,930,626.44)
14.	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$ (91,987,033.00)	$ -	$ -	$ (91,987,033.00)

Sources:
Column (B): ICC Staff Ex. 5.00, Schedule 5.02, Column (D)
Column (C): ICC Staff Ex. 5.00, Schedule 5.04, Column (D)
Column (D): ICC Staff Ex. 5.00, Schedule 5.05, Column (D)

The Peoples Gas Light and Coke Company
Reconciliation of Commodity Gas Charge (CGC)
For the Year Ended September 30, 2001

Line No.	Description	Commodity Gas Charge (CGC) As Filed	Staff Adjustments	Staff Revised (B+C)
	(A)	(B)	(C)	(D)
	FISCAL 2000			
1.	Unamortized Balance at September 30, 2000 (Refund) / Recovery	$ 31,416,105.68	$ -	$ 31,416,105.68
2.	Factor A Adjustments Amortized to Schedule I at September 30, 2000	13,388,581.16	-	13,388,581.16
3.	Factor O (Refunded) / Recovered	-	-	-
4.	Balance (Refundable) / Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	$ 44,804,686.84	$ -	$ 44,804,686.84
	Fiscal 2001			
5.	Costs Recoverable through the Gas Charge	$ 826,153,232.77	$ (70,590,938.00)	$ 755,562,294.77
6.	Revenues Arising through Application of the Gas Charge	907,590,488.08	21,396,095.00	928,986,583.08
7.	Separately Reported Pipeline Refunds or Surcharges	-		-
8.	Separately Reported Other Adjustments	-		-
9.	Interest	903,534.14	-	903,534.14
10.	(Over) / Under Recovery for Reconciliation Year (Line 5 - Line 6 + Line 7+ line 8 + Line 9)	$ (80,533,721.17)	$ (91,987,033.00)	$ (172,520,754.17)
11.	(Over) / Under Recovery Balance at September 30, 2001 (Line 4 + Line 10)	(35,729,034.33)	(91,987,033.00)	(127,716,067.33)
12.	Factor A Adjustments Amortized to Schedule I at September 30, 2001	(11,852,706.48)	-	(11,852,706.48)
13.	Unamortized Balance at September 30, 2001 (Refund) / Recovery	(23,876,327.85)	-	(23,876,327.85)
14.	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$ -	$ (91,987,033.00)	$ (91,987,033.00)

Source:
Column (B): Company Exhibit 1
Column (C): ICC Staff Exhibit 5.00, Schedule 5.03, Col. I

The Peoples Gas Light and Coke Company
Adjustments to Commodity Gas Charge
For the Year Ended September 30, 2001

<========== Direct Testimony Adjustments ==========>

Line No.	Description (A)	Maintenance Gas ICC Staff Ex 1.00 Schedule 1.06 (B)	Enron GPAA Imprudence Staff Ex. 3.10 (C)	Off-System Transactions: #16 and # 22 Imprudence Staff Ex. 3.06 (D)	Off-System Transactions: #19 Imprudence Staff Ex. 3.06 (E)	Non-tariff Services Revenue: FERC Operating Statement Transactions Staff Ex. 7.00 (F)	Non-tariff Services Revenue: Storage Exchange Transactions Staff Ex. 7.00 (G)	Imprudent Use of Manlove S. Field: Value of Gas Loaned to 3rd Parties Staff Ex. 7.00 (H)	Imprudent Use of Manlove S. Field: Imprudent Storage Usage Staff Ex. 7.06 (I)	Subtotal Commodity Gas Adjustments (J)
	FISCAL 2000									
1.	Unamortized Balance at September 30, 2000	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2.	Factor A Adjustments Amortized to Schedule I at 9-30-00	-	-	-	-	-	-	-	-	-
3.	Factor O (Refunded) / Recovered	-	-	-	-	-	-	-	-	-
4.	Balance (Refundable) / Recoverable from Prior Periods	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
	Fiscal 2001									
5.	Costs Recoverable through the Gas Charge	$ (4,628,267)	$ (13,304,910)	$ (535,554)	$ (5,661,703)	$ (4,378,466)	$ (2,250,165)	$ (10,268,171)	$ (25,920,181)	$ (66,947,417)
6.	Revenues Arising through Application of the Gas Charge									
7.	Separately Reported Pipeline Refunds or Surcharges									
8.	Separately Reported Other Adjustments									
9.	Interest	-	-	-	-	-	-	-	-	-
10.	(Over) / Under Recovery for Reconciliation Year	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
11.	(Over) / Under Recovery Balance at 9-30-01 (Line 4 + Line 10)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
12.	Factor A Adjustments Amortized to Schedule I at 9-30-01	-	-	-	-	-	-	-	-	-
13.	Unamortized Balance at September 30, 2001	-	-	-	-	-	-	-	-	-
14.	Requested Factor O (Line 11 - Line 12 - Line 13)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -

15. Column (F): Derived from Information Presented on Company Response ACC 6.002: Line 56 (Totals) - (sum of lines 43 thru 54) - (line 26) [Re: $6,870,216 - 2,250,165 - 241,605 = $4,378,466]

16. Column (G): Derived from Information Presented on Company Response ACC 6.002: Sum of lines 43 thru 54 (Manlove Storage Exchanges) [Re: $2,250,165]

17.

18.	Column (I):			
19.	Imprudent Storage Usage			$ 32,548,812
20.	Less: FERC Operating Statement Transactions	(Col. F)	$ (4,378,466)	
21.	Less: Storage Exchange Transactions	(Col. G)	(2,250,165)	
22.	Subtotal (Non-tariff Service Revenues in Line 19)			$ (6,628,631)
23.	Imprudent Storage Usage Adjustment			$ 25,920,181

24. Adjustments Accepted by the Company:
25. (1)...Rebuttal Testimony of David Wear (Respondent's Exhibit F), p. 55, lines 1225-1228.
26. (2)...Rebuttal Testimony of David Wear (Respondent's Exhibit F), p. 54, lines 1211-1214, ($538,225); Amount Revised by Staff witness Rearden to $535,554.

27.	Increased Cost of Gas Purchased on Open Market	$ 296,949
28.	Imprudent Transaction #16 and #22	241,605
29.	Total Adjustment	$ 538,554

The Peoples Gas Light and Coke Company
Adjustments to Commodity Gas Charge
For the Year Ended September 30, 2001

<========================== Aditional Direct / Rebuttal Testimony Adjustments ==========================>

Line No.	Description (A)	Subtotal Commodity Gas Adjustments (J)	Off-System Transaction # 103 Staff Ex. 7.00 (K)	Refinery Fuel Gas Purchases Staff Ex. 9.01 (L)	Storage Optimization Contract (SOC) Adjustment: PEC Income Staff Ex. 9.02 (M)	Storage Optimization Contract (SOC) Adjustment: Enron Income Staff Ex. 9.03 (N)	Trunkline Deal Staff Ex. 9.04 (O)	enovate Income Adjustment: PEC Income Staff Ex. 9.05 (P)	enovate Income Adjustment: Enron Income Staff Ex. 9.06 (Q)	Total Commodity Gas Adjustments (R)
	FISCAL 2000									
1.	Unamortized Balance at September 30, 2000	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2.	Factor A Adjustments Amortized to Schedule I at 9-30-00	-	-	-	-	-	-	-	-	-
3.	Factor O (Refunded) / Recovered	-	-	-	-	-	-	-	-	-
4.	Balance (Refundable) / Recoverable from Prior Periods	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
	Fiscal 2001									
5.	Costs Recoverable through the Gas Charge	$ (66,947,417)	$ (1,411,031)	$ (2,232,490)						$ (70,590,938)
6.	Revenues Arising through Application of the Gas Charge	-			$ 623,000	$ 717,455	$ 372,000	$ 9,052,823	$ 10,630,817	21,396,095
7.	Separately Reported Pipeline Refunds or Surcharges	-								
8.	Separately Reported Other Adjustments	-								
9.	Interest	-	-	-	-	-	-	-	-	-
10.	(Over) / Under Recovery for Reconciliation Year	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (91,987,033)
11.	(Over) / Under Recovery Balance at 9-30-01 (Line 4 + Line 10)	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -	(91,987,033)
12.	Factor A Adjustments Amortized to Schedule I at 9-30-01	-	-	-	-	-	-	-	-	
13.	Unamortized Balance at September 30, 2001	-	-	-	-	-	-	-	-	-
14.	Requested Factor O (Line 11 - Line 12 - Line 13)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (91,987,033)

Docket 01-0707
ICC Staff Exhibit 5.00
Schedule 5.04

The Peoples Gas Light and Coke Company
Reconciliation of Non-Commodity Gas Charge and Demand Gas Charge
For the Year Ended September 30, 2001

Line No.	Description	Non-Commodity Gas Charge & Demand Gas Charge (NCGC and DGC) As Filed	Staff Adjustments	Staff Revised (B+C)
	(A)	(B)	(C)	(D)
	FISCAL 2000			
1.	Unamortized Balance at September 30, 2000 (Refund) / Recovery	$ (936,949.00)		$ (936,949.00)
2.	Factor A Adjustments Amortized to Schedule I at September 30, 2000	(221,497.41)		(221,497.41)
3.	Factor O (Refunded) / Recovered	-		-
4.	Balance (Refundable) / Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	$ (1,158,446.41)		$ (1,158,446.41)
	Fiscal 2001			
5.	Costs Recoverable through the Gas Charge	$ 57,348,585.98		$ 57,348,585.98
6.	Revenues Arising through Application of the Gas Charge	50,989,557.66		50,989,557.66
7.	Separately Reported Pipeline Refunds or Surcharges	(614,882.34)		(614,882.34)
8.	Separately Reported Other Adjustments			-
9.	Interest	(101,519.94)		(101,519.94)
10.	(Over) / Under Recovery for Reconciliation Year (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	$ 5,642,626.04	$ -	$ 5,642,626.04
11.	(Over) / Under Recovery Balance at September 30, 2001 (Line 4 + Line 10)	4,484,179.63	-	4,484,179.63
12.	Factor A Adjustments Amortized to Schedule I at September 30, 2001	1,514,897.62		1,514,897.62
13.	Unamortized Balance at September 30, 2001 (Refund) / Recovery	2,969,282.01	-	2,969,282.01
14.	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$ -	$ -	$ -

Source:
Column (B): Company Exhibit 1

The Peoples Gas Light and Coke Company
Reconciliation of Transition Surcharge
For the Year Ended September 30, 2001

Line No.	Description	Transition Surcharge (TS) As Filed	Staff Adjustments	Staff Revised (B+C)
	(A)	(B)	(C)	(D)
	FISCAL 2000			
1.	Unamortized Balance at September 30, 2000 (Refund) / Recovery	$ (12,375.53)	$ -	$ (12,375.53)
2.	Factor A Adjustments Amortized to Schedule I at September 30, 2000	(13,502.24)	-	(13,502.24)
3.	Factor O (Refunded) / Recovered	-	-	-
4.	Balance (Refundable) / Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	$ (25,877.77)	$ -	$ (25,877.77)
	Fiscal 2001			
5.	Costs Recoverable through the Gas Charge	$ -	$ -	$ -
6.	Revenues Arising through Application of the Gas Charge	927.69	-	927.69
7.	Separately Reported Pipeline Refunds or Surcharges	-	-	-
8.	Separately Reported Other Adjustments	-		-
9.	Interest	(998.84)	-	(998.84)
10.	(Over) / Under Recovery for Reconciliation Year (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	$ (1,926.53)	$ -	$ (1,926.53)
11.	(Over) / Under Recovery Balance at September 30, 2001 (Line 4 + Line 10)	(27,804.30)	-	(27,804.30)
12.	Factor A Adjustments Amortized to Schedule I at September 30, 2001	(4,223.70)	-	(4,223.70)
13.	Unamortized Balance at September 30, 2001 (Refund) / Recovery	(23,580.60)	-	(23,580.60)
14.	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$ -	$ -	$ -

Source:
Column (B): Company Exhibit 1