

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS COMMERCE COMMISSION,)	
On Its Own Motion)	
)	
-vs.-)	
)	DOCKET No. 01- 0707
PEOPLES GAS, LIGHT AND COKE COMPANY)	
)	
Reconciliation of revenues collected)	
under gas adjustment charges with)	
actual costs prudently incurred.)	

**REPLY BRIEF OF THE STAFF WITNESSES
OF THE ILLINOIS COMMERCE COMMISSION**

(PUBLIC VERSION)

Xxxx Redacted Text

James E. Weging
Sean R. Brady
Illinois Commerce Commission
Office of General Counsel
160 North LaSalle Street
Suite C-800
Chicago, Illinois 60601
(312) 793-2877
(312) 793-1556 (Fax)

Counsel for Staff Witnesses of the
Illinois Commerce Commission

Date: August 19, 2005

TABLE OF CONTENTS

I. ARGUMENT	2
1. RESPONSE TO ADMINISTRATIVE LAW JUDGE’S NOTICE	2
A. Standard of Proof.....	2
B. Any Determination of Interest is Made After an Order is Issued By Commission.....	4
2. ADJUSTMENTS.....	6
A. Enron’s Business Dealing and Accounting Procedures do not Absolve Peoples Gas of Imprudent and Inappropriate Business Dealings.....	6
B. Gas Purchase and Agency Agreement.....	7
(1) Peoples Gas Fundamentally Changed its Gas Supply Procurement Method	9
(2) The Commission’s Finding of the GPAA’s Prudence in Docket No. 00-0720 can be Revisited	14
(3) Peoples Gas Misconstrues the <i>Illinois Power Case</i>	17
(4) Collectively, Peoples Gas’ Evaluation of GPAA Fails to Demonstrate its Prudence.....	21
a. Five Objectives.....	21
b. Peoples Gas Cannot Support its Premise That the Discount or Credit is Sufficient to Make the GPAA Prudent	29
(5) Peoples Gas’ Criticisms of Staff’s Analysis are Baseless	30
a. Peoples Gas has not proven that Benefits that are Non-Quantifiable Support the Prudence of the GPAA	31
b. The Variety of Methods Used by Staff’s and GCI’s Experts to Analyze the GPAA Demonstrate that the GPAA Should be Analyzed Through a Quantitative Analysis.....	33
c. Peoples Gas’ Critique of Dr. Rearden’s Analysis of Cost Disallowance Casts Doubt Upon its own Data	35
C. Manlove Storage Field.....	38
(1) Hub Transactions Increased Gas Costs Because Peoples Gas Allocated Usage at Manlove Field Between Several Customers and Granted Third Parties Preferential Access to it	39
(2) Peoples Gas Failed to Demonstrate That Ratepayers Were not Harmed By its Imprudent Operations of Manlove Field or That Displacement is Dispositive of Staff’s Position.....	42
(3) Operational Factors Identified by Peoples Gas Are Not Unusual and Provided only Part of the Motivation for Manlove Field Storage Usage During 2001 Reconciliation Period	45
a. Operational Factors Experienced in Reconciliation Period Were not Unusual	45

	b.	Economic Considerations Impacted Peoples Gas Operation of Manlove Field	48
(4)		Peoples Gas Confounds Staff’s Adjustment Calculations With its Prudence Review	50
	a.	Peoples Gas Purchased Gas During the Winter to Maintain Operation of Manlove Field Into Late January	51
	b.	Staff did not Advocate the use of a “LIFO Rate” to Make Daily Withdrawal Decisions, but Gas in Storage can be Valued Using its LIFO Cost Calculate an Adjustment to the Gas Charge.....	53
(5)		Peoples Gas Mischaracterizes Staff Witness Anderson’s Testimony Regarding “Peak Winter Period”	54
D.		Revenue from Non-Tariff Services.....	56
	(1)	Recovery of Revenues through Base Rates is Not Dispositive of Requirements of Subsection 525.40(d).....	58
	(2)	Displacement Gas is Necessary to Complete Hub Service Transactions	61
	(3)	The 1996 Amendment of Part 525 Supersedes the Commission Finding in the <i>93-0320 Order</i> that Hub Services are Treated ‘Above-The-Line’	63
	(4)	The Transportation Contracts Approved in Docket Nos. 02-0779 and 03-0551 Are Not Analogous Because They are Contracts Approved by the Commission, Which is an Exception to a Recoverable Gas Cost.....	64
	(5)	Non-Tariff Revenues Should Be Included in the Gas Charge, and Not in Base Rates	67
E.		enovate Adjustment: The “enovate P&L” Statement Demonstrates the Nexus Between enovate’s Profits and Peoples Gas’ Gas Costs, and Peoples Gas Should Not be Rewarded for Failing to Maintain Sufficient Accounting Records.....	68
F.		Storage Optimization Contract.....	71
	(1)	There Were Superior Alternatives to the Storage Optimization Contract That Would Have Cost Ratepayers Less Money	72
	(2)	The SOC Resulted in Higher Gas Costs to Ratepayers Because TPC Would Have Received a Smaller Profit Share than Enron MW Did Under the SOC and Peoples Gas’ Management Fees and Revenue Sharing Would not Have Been Overstated due to Oral Sharing Agreements Between Peoples Energy and Enron .	73
G.		Transaction 19: Peoples Gas Does not Deny the Transaction was Imprudent and Staff’s Calculated Adjustment is Correct.....	74
	(1)	The Decision to Begin Withdrawals from Manlove Field Early was based on Economic Factors and Probably Affected by Peoples Gas’ Strategic Partnership with Enron.	75

(2)	Peoples Gas Ignored all Risks that Weather Might be Something Besides Warmer than Normal when it Began Withdrawals Early and Entered into Transaction 19.....	76
(3)	Peoples Gas did Not Evaluate Whether the Resale Term in the GPAA was Sufficient to Handle Oversupply	77
(4)	Staff is Not Imposing New Requirements upon Peoples Gas to Justify its Actions, but Does Believe that the Commission Must Insist that a Utility Explain its Decisions when It Changes its Strategy.....	78
(5)	Staff’s Method of Calculating the Adjustment is Reasonable.....	79
H.	Transaction 103: The Price Paid by Enron MW Was Imprudent Because it was Below the Future Price of Gas at Time Transaction was Entered Into.....	80
I.	The Trunkline Deal has the Appearance of an Ordinary Gas Purchase but it is an Imprudent Transaction Because it Improperly Cross-Subsidizes Peoples Energy	83
J.	RFG Deal: Peoples Gas Provides No Evidence That the Refinery Fuel Gas Deal is Prudent.....	86
3.	RECOMMENDATIONS	87
A.	Docket No. 00-0720 Should be Reopened Because Numerous Adjustments Proposed in the Instant Docket Were Not Considered.....	87
B.	Peoples Gas’ Alternative to Staff’s Recommended Internal and Management Audits Does Not Sufficiently Address the Concerns Raised in the Instant Proceeding	92
C.	Corrections to GCI’s Characterization of Staff’s Recommendations.....	95
II.	CALCULATION METHODOLOGIES	95
1.	Gas Purchase and Agency Agreement	96
2.	Manlove Storage Field	96
A.	Value of Gas Imprudently Loaned to Third Parties	96
B.	Cost of Gas Purchased by Peoples Gas to Support Hub Operations....	97
3.	Revenue from Non-Tariff Services	98
A.	Revenue from FERC Operating Statement Transactions	98
B.	Revenue from Storage Exchange Transactions	98
4.	enovate.....	99
A.	Profits Earned by Peoples Energy Corporation	99
B.	Profits Earned by Enron MW	99
5.	Transaction 19.....	100

6. Transaction 103.....	101
7. Trunkline Deal	101
8. Refinery Fuel Gas Deal	102
9. Storage Optimization Contract	102
A. Revenues received by Peoples Energy Corporation	103
B. Revenues received by Enron MW	104
10. Maintenance Gas	104
11. Transaction 16/22.....	104
III. CONCLUSION.....	105

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS COMMERCE COMMISSION,)	
On Its Own Motion)	
)	
-vs.-)	
)	DOCKET No. 01- 0707
PEOPLES GAS, LIGHT AND COKE COMPANY)	
)	
Reconciliation of revenues collected)	
under gas adjustment charges with)	
actual costs prudently incurred.)	

**REPLY BRIEF OF THE STAFF WITNESSES
OF THE ILLINOIS COMMERCE COMMISSION**

The Staff Witnesses of the Illinois Commerce Commission (the "Staff"), by and through its counsel, and pursuant to Section 200.800 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Reply Brief in the above-captioned matter in response to *Initial Brief of Peoples Gas, Light and Coke Company*, filed by Peoples Gas, Light and Coke Company ("Peoples Gas"), and *Joint Initial Brief of The City of Chicago, the Citizen's Utility Board and The People of the State of Illinois* filed by the City of Chicago ("City"), the Citizen's Utility Board ("CUB") and the People of the State of Illinois ("Attorney General"), hereafter collectively referred to as "Government and Consumer Intervenors" or "GCI").

In response to the Administrative Law Judges Notice of July 12, 2005, Staff will [a] address the pre-existing numbers relevant to this reconciliation, including interest

calculations, and any uncontested matters (*infra*, §1(1)(B) of this Reply Brief – “Any Determination of Interest is Made After Order Issued By Commission”), [b] explain the method it used to calculate its adjustments (*infra*, §II. Calculation Methodologies), and [c] address the burden of proof in terms of the applicable standard regarding the weight of the evidence (*infra*, §I(1)(A) “Standard of Proof”).

I. ARGUMENT

1. RESPONSE TO ADMINISTRATIVE LAW JUDGE’S NOTICE

A. Standard of Proof

Subsection 9-220(a) squarely places the burden of proof on the utility “to establish the prudence of its cost of fuel, power, gas, or coal transportation purchases and costs.” 220 ILCS 5/9-220(a). The Act, however, does not establish a standard of proof that they are to overcome. Section 10-15 of the Illinois Administrative Procedure Act (“IAPA”) provides that “[u]nless otherwise provided by law or stated in the agency’s rules, the standard of proof in any contested case hearing conducted under this Act by an agency shall be the preponderance of the evidence.” 5 ILCS 100/10-15. The Commission has observed that the IAPA standard appears to be “the appropriate standard in all contested cases[.]” (*Order, Illinois Commerce Commission on its Own Motion: Amendment of 83 Ill. Admin. Code Part 200*, Docket No. 92-0024, at 4 (April 29, 1992))¹.

The burden of proof places the burden upon the plaintiff to *produce* evidence and to *persuade* the trier of fact that certain facts are true. (*Ambrose v. Thornton Twp.*

¹ It is worthy of note that the Chicago Bar Association, which rarely participates in Commission proceedings, filed comments in Docket No. 92-0024 supporting the preponderance standard. (*92-0024 Order* at 1-2).

School Trustees, 274 Ill. App. 3d 676, 680 (1st Dist. 1995)). The burden of persuasion is to be distinguished from the burden of production, also called the burden of going forward. (*Board of Trade of The City of Chicago v. Dow Jones & Co., Inc.*, 108 Ill. App. 3d 681, 686 (1st Dist. 1982)). The burden of production is satisfied when the plaintiff presents sufficient evidence on each element of the cause of action to establish a prima facie case. (*Ambrose*, 274 Ill. App. 3d at 680). Once a prima facie case is established, the burden of production shifts to the opponent. (*Id.*; *Board of Trade of The City of Chicago*, 108 Ill. App. 3d at 686). The opponent then has the burden of going forward to present contrary evidence. (*Ambrose*, 274 Ill. App. 3d at 680). The burden of persuasion, however, never shifts during the course of the trial. (*Business & Professional People for Public Interest v. Illinois Commerce Commission*, 146 Ill. 2d 175, 196 (1991); *Ambrose*, 274 Ill. App. 3d at 680; *Board of Trade of The City of Chicago*, 108 Ill. App. 3d at 686)).

As these principles apply to the instant case, the Act establishes that the burden of proof is upon the utility. (§9-220). The burden of persuasion and production, in this case, is upon Peoples Gas; to show by a preponderance of the evidence that its purchases were prudent. The burden of production shifts to Staff or GCI only after Peoples Gas presents sufficient evidence on each element of the cause of action to establish that the cost of gas purchases were prudent. And the burden of persuasion remains upon Peoples Gas throughout the proceeding.

A preponderance of the evidence is that amount of evidence that leads a trier of fact to find that the fact at issue is more probable than not. (*In re K.O.*, 336 Ill. App. 3d 98, 107 (1st Dist. 2002)). A party need not establish a case or defense to an absolute

certainty. (See e.g., *Teter v. Spooner*, 305 Ill. 198, 211 (1922) (finding that it was error to give an instruction that imposes a burden upon the defendant that is greater than the standard, such as to convince the jury, or to satisfy the jury, or prove to the satisfaction of the jury)). In determining the preponderance of the evidence, the testimony of a single, credible witness is sufficient to sustain a finding even though the testimony is contradicted. (*In Interest of Johnson*, 48 Ill. App. 3d 370 (1st Dist. 1977)).

Applying the standard to the instant case, Peoples Gas asserts that some of the adjustments proposed by Staff are outside of the scope of this proceeding or do not have a nexus to Peoples Gas' gas purchases. For those adjustments (i.e. enovate, Storage Optimization Contract, and Trunkline), Staff must demonstrate a nexus to gas costs, as Staff has done, and since Subsection 9-220(a) of the Act, *supra*, imposes the burden of proof upon the utility, Peoples Gas bears the ultimate burden of persuasion and producing evidence demonstrating, by a preponderance of the evidence, that Staff's contentions are incorrect.

In addition, there are instances in which Peoples Gas fails to provide evidence within its control in response to Staff's claims. In those instances, a presumption arises in favor of Staff, because Peoples Gas' failure to produce evidence "strengthens the probative force of the evidence given to establish such claimed fact." (*Belding v. Belding*, 358 Ill. 216, 220-21, 192 N.E. 917 (1934)).

B. Any Determination of Interest is Made After an Order is Issued By Commission

Interest impacts the determination of the Gas Charge but is not determined until after a final adjustment – Factor O – is determined. Since Code Part 525 (83 Illinois Administrative Code Part 525) already addresses the issue of interest calculations on

Factor O, as will be discussed below, there is no need for the order in this proceeding to address the issue.

Subsection 525.60(b) sets forth the formula for the Gas Charge: estimated recoverable gas costs + prior year adjustments + (Commission ordered over or under recovery / estimated applicable therms) x 100. Interest is a component of the Commission ordered “over- or under-recovery,” known also as Factor O. The ‘over- or under-recovery’ proposed by Staff is identified in Staff’s Initial Brief, Appendix A, Schedule 5.03, line 14, and this amount does not include the interest. An interest rate will be established by the Commission under 83 Ill. Adm. Code 280.70(e)(1)² for the period from the end of the reconciliation year to the order date in the reconciliation proceeding.

The interest rate is applied to Factor O using the simple interest method at the Commission approved rate for each applicable year. Additional interest shall be charged, in the same manner as that prescribed in Subsection 525.50(b), if Factor O is amortized. At this time Peoples Gas has not requested that the ‘over- or under-recovery’ determined in this docket be amortized.

The payment of interest will commence with the first monthly filing after the issuance of the order by the Commission, and the interest calculations will be prepared at the time of that first monthly filing. Therefore, there is no need to perform any interest related calculations at this time.

² Interest shall be paid on all deposits held by the utility. The rate of interest will be the same as the rate existing for the average one-year yield on U.S. Treasury securities for the last full week in November. The interest rate will be rounded to the nearest .5%. In December of each year the Commission shall announce the rate of interest that shall be paid on all deposits held during all or part of the subsequent year. (83 Ill. Admin. Code §280.70(e)(1)).

2. ADJUSTMENTS

A. Enron's Business Dealing and Accounting Procedures do not Absolve Peoples Gas of Imprudent and Inappropriate Business Dealings

Peoples Gas emphasizes that "Enron's fraudulent business dealings and accounting procedures should not taint Peoples Gas' activities at a time when Enron's misdeeds not only were unknown but it was well-respected company and the largest natural gas marketer in the United States." (PG IB at 3). Peoples Gas goes on to state that that their decision to enter the Gas Purchase and Agency Agreement ("GPAA") with Enron North America Corporation ("Enron") was based on Enron's pedigree -- "Enron had proven capabilities, superior deal structuring ability, trading skills and logistic support, as well as excellent credit rating and a strong record of providing reliable supplies." (PG IB at 4). Enron's image did not affect Staff's review of the prudence of a contract or transaction, and it should not be determinative in the Commission's decision.

Staff's review has never focused on Enron's misdeeds, it has always focused on Peoples Gas' imprudent decisions as it relates to contracts, deals and transactions. The facts show, however, that Enron, and its affiliates who were involved with Peoples Gas, did not act contrary to Enron's current public image. There are a number of unorthodox business practices that occurred during the 2001 reconciliation period that impacted the Gas Charge, and they all seem to relate to Peoples Gas' dealings with Enron or its affiliates. Most of Staff's adjustments relate to an imprudent decision that involved Enron or its affiliate – GPAA, (Staff IB at 20-22, 32-53) Storage Optimization Contract (Staff IB at 88-89), Trunkline (Staff IB at 82-84), Transactions 19 and 103 (Staff IB at 78-80 and 80-81, respectively), RFG Deal (Staff IB at 85-86), enovate, LLC's ("enovate") use of Peoples Gas' facilities and profit sharing arrangements between

Enron MW, LLC (“Enron MW”) and Peoples Energy Corporation (“Peoples Energy”). (Staff IB at 11-14, 22, 88). The number and involvement of these business dealings lead Staff to conclude that they are part and parcel of the strategic partnership between the Peoples Energy and Enron corporate families. Moreover, this strategic partnership was more than just the GPAA and enovate, as Peoples Gas states in its brief. It included profit sharing between Peoples Energy and Enron affiliates. (Staff Ex. 7 at 5-12). Therefore, it impacted, to one extent or another, the decisions Peoples Gas exercised regarding transactions and contracts involving Enron or one of its affiliates.

Each of Staff’s recommended adjustments is based on the facts and not Enron’s image. Peoples Gas’ argument that Enron was well respected in the gas industry at the time and therefore Peoples Gas’ decisions involving Enron were prudent, is not persuasive. (PG IB at 4). In its testimony and briefs, Staff explains why each transaction is imprudent, and each adjustment is based on Peoples Gas performing unorthodox business practices that were imprudent. None of Staff’s arguments even raise the point that Enron has a tainted image in the public eye. Staff’s analysis of the facts surrounding each individual deal, contract and transaction support the finding of Peoples Gas’ imprudent decisions.

B. Gas Purchase and Agency Agreement

Peoples Gas did not meet its burden of proving that that the Gas Purchase and Agency Agreement (“GPAA”) was prudent. In addition, Peoples Gas’ reliance on the Commission’s decision in Docket No. 00-0720 is misplaced because there is evidence in this case shedding new light on the GPAA that was not produced by Peoples Gas in 00-0720. Any determination concerning the GPAA in Docket No. 00-0720 cannot be

given a presumptive effect in view of the annual reconciliation requirement of Subsection 9-220(a) of the Act, *supra*. Peoples Gas argues that Staff failed to account for non-quantifiable benefits of the GPAA, however, the existence of such benefits does not outweigh the need for an economic analysis. Peoples Gas counters Staff's seven factor evaluation of the GPAA with Mr. Graves' analysis of the CERA study. His incomplete analysis, however, only casts doubt upon that study's data, and the CERA study data does not prove what Peoples Gas claims it does. Moreover, Staff accords little weight to the use of the CERA data because it did not use basis differentials that are relevant to Peoples Gas' gas costs.

Peoples Gas claims that no economic analysis of the GPAA was conducted prior to entering into the agreement. This claim is not surprising (Group Ex. 1 at ST-PG 81, 96-98). Staff suspects that anyone at Peoples Gas with knowledge either knew or, at least, suspected that the GPAA was not a good deal for Peoples Gas' ratepayers.³ There was no point in producing such an analysis since an agreement with Enron was a foregone conclusion. Even Peoples Gas admits that in mid-1999 there was no other gas supplier that they were interested in reaching such a long-term and large-quantity contract (PG Ex. C, at 2, 6, and 9), no matter how many other suppliers were contacted concerning Peoples Gas' earlier fixed gas proposal (*Id.* at 3).

Peoples Energy sought an alliance with Enron and shared profits with Enron from various gas transactions involving various affiliates (Group Ex. 1, at ST-PG 118-134 and 207-209). North Shore and Peoples Gas, through their GPAA contracts, were to

³ This is borne out by the two economic studies done by Peoples Energy or North Shore personnel prior to the signing of the GPAA (Group Ex. 1 at ST-PG 50-74 and 135-161, and Wear Cross Exhibit 15) for unknown reasons (Group Ex. 1 at ST-PG 81 and 96-98). See *Belding v. Belding*, 358 Ill. 216, 220-21, 192 N.E. 917 (1934).

provide the incentive to Enron to enter into this alliance with Peoples Energy (*Id.*, Group Ex. 1, at ST-PG 78, 96-98, and 101-103). The prudence of the GPAA in a Section 9-220 of the Act, *infra* §I.2.B(4), sense was not a consideration in its signing. As shown in Staff's testimony, the GPAA was not prudent (*see generally*, Staff IB at 32-56).

(1) Peoples Gas Fundamentally Changed its Gas Supply Procurement Method

Peoples Gas has failed to meet its burden of proof. Peoples Gas attempts to prove the GPAA is prudent by asserting that it meets five objectives (See PG IB at 46-54), however, it fails to carry its burden of proving that a reasonable person would have found its decision to enter the GPAA to be prudent. A reasonable person would have performed an economic analysis of a contract of this type, and would not have disregarded economic analyses, performed at the time of the negotiations by personnel involved in negotiating the GPAA, that indicated that the GPAA would raise gas costs to ratepayers. Moreover, the five objectives, as well as the CERA studies, fail to demonstrate that the GPAA was prudent. Peoples Gas' review is a hindsight review because it presented no documentation that shows that their personnel considered the CERA information at the time they negotiated the GPAA. (See §I.2.B(4)(a)(iv) and §I.2.B(5)(c) in this Reply Brief, respectively, explaining the failure of Peoples Gas' after-the-fact reliance on these factors). Thus, Peoples Gas has not met its burden of proving the GPAA is prudent.

If the Commission, however, finds that Peoples Gas' arguments persuasively supports their initial burden, the Commission should still find that the contract was imprudent based on Staff's economic analysis. Staff's economic analysis evaluates seven factors that determine the value of the GPAA. This analysis shows that Peoples

Gas would spend more money purchasing gas under the GPAA than they would have spent purchasing gas from the field and transporting it to Chicago. (Staff IB at 48-53).

Several factors warrant that a contract like the GPAA be subject to an economic review. A reasonable person would have reviewed a contract of this type given that it was complex and unique, included three significant pricing structures in one contract, had an unusually long-term (*i.e.*, 5 years), and provided a not-unsubstantial (66%) amount of ratepayer gas from one source. Given the atypical nature and novelty of this contract, an analysis beyond a cursory review, based upon business experience, was merited.

Peoples Gas argues that this contract was not a significant departure from past practices. (PG IB at 43 and 51-52). Although the GPAA enables Peoples Gas to purchase gas, the fact is, the GPAA was much more than just a purchase contract. Its various elements made it a substantial risk and novel endeavor, such as the volume being purchased from a single supplier, and its long term. As a novel endeavor, a reasonable person acting on the ratepayers' behalf would give such a contract close scrutiny.

The signing of the GPAA is similar to a person failing to diversify his stock portfolio. A reasonable person knows that she runs a risk of losing or gaining a significant amount of money when a significant portion of her funds is placed in one stock. Similarly, buying 2/3 of the gas needed for ratepayers from one company left ratepayers subject to a substantial risk that the contract terms would lead to higher costs. A reasonable person would have performed an economic analysis to understand that risk. In addition, the contract had terms that were beneficial (3¢ discount/credit and

avoiding demand charges for swing purchases related to the DIQ term) as well as detrimental (i.e., the field-delivered price v. citygate price, SIQ pricing, re-pricing terms, and releasing control of leased transportation contracts which led to loss of demand credits (or buy-sell transactions)). Peoples Gas could not have known, *a priori*, that the contract, in aggregate, would be prudent without performing an economic analysis. The central question of the GPAA is why Peoples Gas believed that the citygate price was a good price without comparing it to the price of gas as it typically had been purchased by Peoples Gas. Staff did such an analysis, comparing the field-delivered price v. citygate price. (See Staff IB at 49-50, and 55). Therefore, the GPAA is not amenable to the sort of business experience rationale provided by Peoples Gas. A reasonable person would have looked at his cost option by performing some quantitative, mathematical analysis (such as were done in the Aruba analysis and Wear Cross Exhibit #15).

In addition, Subsection 9-220(a) of the Act, *supra* § I.1.A, gives Peoples Gas notice that it must prove that entering into the GPAA was a prudent decision. Such a requirement, in conjunction with the unique characteristics of the contract discussed above, would have led a reasonable person to perform an economic analysis to understand the potential downside the GPAA could have to itself and the harm it could cause to ratepayers.

Another reason why the decision to enter into the GPAA was imprudent is that a reasonable person would not have overlooked two economic analyses that were performed by personnel on the negotiation team. (Staff IB at 47-48). Moreover, failure to rely upon, and produce during discovery, existing economic analyses to support the

beneficial nature of the GPAA raises a presumption that, if analyses had been performed, the analyses are not favorable to the prudence in signing the GPAA.

Two employees -- Roy Rodriguez and David Wear – created or were in possession of economic analyses of the GPAA. Mr. Rodriguez acknowledged that he created the Aruba Analysis (Group Ex. 1 at ST-PG 103-104), and was involved in the team who negotiated the GPAA. (Group Exhibit 1 at ST-PG 101-02). Likewise, Mr. Wear was part of the negotiation team (Tr. 1045-46, 1081, 1097-98) and was found to have an economic analysis that contained terms from the GPAA (i.e. 3¢ credit) (Wear Cross Exh. #15). Although Peoples Gas argues that the economic analysis contained on Mr. Wear's computer (Cross Exhibit #15) shows that the contract was increasingly favorable over the four year period (PG IB at 59), Peoples Gas failed to produce either document after repeated requests by Staff for economic analyses of the GPAA. (Staff Ex. 7 at 6-7). Further, Mr. Wear expressly stated in testimony that the negotiation team did not perform an economic analysis similar to the one Dr. Rearden had performed (PG Ex. F at 12; *see also* Tr. 1009-10) and did not know of an economic analysis despite having received the Aruba Analysis in an email from Mr. Rodriguez (Group Ex. 1 at ST-PG 163). Moreover, Wear Cross Exhibit #15: (a) was stored on Mr. Wear's computer, which only he had access to, (b) the document identified him as the author, and (c) created by within two weeks of the signing of the GPAA. (Tr. 1021, 1024). His denial of these two documents, in light of these facts, cannot be believed.

The economic analyses discussed above were created at or before the time in which the GPAA was signed and contain terms related to the GPAA. Therefore, these economic analyses should have received close consideration by Peoples Gas, instead

of no consideration. The failure to consider them was imprudent. Because Peoples Gas chose not to rely upon them to demonstrate the prudence of its decision to enter into the GPAA, it raises the presumption that the documents do not show that the GPAA was prudent. (*Belding v. Belding*, 358 Ill. 216, 220-21, 192 N.E. 917 (1934) (holding that the failure to present evidence that is chiefly, if not entirely, in control of the adverse party, tends to strengthen the probative force of the evidence given to establish such claimed fact, and a presumption arises in favor of the adversary's claim of fact)). To the extent there is a factual dispute of whether or not the Aruba analysis supports a finding of imprudency in the GPAA, Staff and GCI's testimony is entitled to the greater weight, since the study was uncovered by Staff and GCI in 2004 (*Belding, supra*, 358 Ill. at 220-21).

Finally, the five objectives, as well as the CERA and PIRA studies are hindsight reviews and are without weight. (*Illinois Commerce Commission v. Commonwealth Edison Co., Reconciliation of FAC clause*, Docket No. 84-0395, Order at 17, 1987 Ill. PUC LEXIS 68 at *34 (Oct. 7, 1987), holding that the prudence of a decision to enter into the GPAA must be made on information and facts available at the time the utility made its decision, and hindsight review is impermissible). *Cf. Coney v. Rockford Life Insurance Co.*, 67 Ill. App. 2d 395, 400 (3rd Dist. 1966), finding that in contract construction, it is the contemporaneous construction which is entitled to great weight). Thus, Peoples Gas has not met its burden of proving that its decision to enter into the GPAA was prudent. A more thorough response on this point is provided *infra* Section I.2.B(4) – Collectively, Peoples Gas' Evaluation of GPAA Fails to Demonstrate its Prudence .

If the Commission, however, finds that Peoples Gas' arguments persuasively supports their initial burden of proof, the Commission should still find the decision to enter into the contract was imprudent based on Staff's economic analysis. Staff's economic analysis evaluates seven factors that constitute the GPAA's value relative to its alternatives. It also shows that Peoples Gas spent more money purchasing gas under the GPAA than it would have spent purchasing gas from the field and transporting it to Chicago. (Staff IB at 48-53).

(2) The Commission's Finding of the GPAAs Prudence in Docket No. 00-0720 can be Revisited

On pages 55 and 56 of its Initial Brief, Peoples Gas argues that Staff's and GCI's recommendation that the GPAA is imprudent is inconsistent with the review performed in Docket No. 00-0720. The Commission is not prohibited from reconsidering a prior decision. As Illinois Courts have held

A prior determination by an administrative body is not *res judicata* in subsequent proceedings before it. An administrative body has the power to deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar *or even the same situation in a previous proceeding*. (*Monat v. County of Cook*, 322 Ill. App. 3d 499, 506 (1ST Dist. 2001); *Hazelton v. Zoning Board of Appeals*, 48 Ill. App. 3d 348, 351-52, 363 N.E.2d 44, 6 Ill. Dec. 515 (1977)).

Subsection 9-220(a) of the Act, 220 ILCS 5/ 9-220(a), calls for annual reconciliation. A multi-year agreement cannot be given immunity from a prudence review for each year by presuming its prudence, or else the intent of Subsection 9-220(a) of the Act, *supra* § 1.1(A), will be defeated. The law is clear that the Commission can reexamine an issue no matter how often or how differently it has decided an issue in the past. (*Mississippi River Fuel Corp. v. Illinois Commerce Commission*, 1 Ill. 2d 509,

513 (1953)). The annual reconciliations under Subsection 9-220(a) of the Act, *supra*, are quite similar to the annual determination to tax liabilities. (*Cf. Rockford Life Insurance Co. v. Department of Revenue*, 112 Ill. 2d 174, 185-6 (1986), except in the cases of fraud or injustice, a public body will not be estopped from reexamining an issue and coming to do a different conclusion). A multi-year agreement cannot and should not be given a presumption of prudence under the statute, merely because it has been previously reviewed in an annual gas reconciliation case. (*Cf. Business & Professional People for Public Interest v. Illinois Commerce Commission*, (“BPI”) 136 Ill. 2d 192, 219-226 (1989), holding that Commission rules establishing a test year could not be avoided by allowing a multiple year approach). Unlike the Commission’s rules in the *BPI* case, *supra*, the Commission has no authority to alter the statute. (*Illini Coach Co. v. Illinois Greyhound Lines Co.*, 403 Ill. 21, 29-30 (1949), the Commission has no authority to alter statutory time limits). Instead, the utility has the statutory burden to reprove the agreement’s prudence for each year it is in effect.

In addition, Peoples Gas’ reliance on the Commission’s decision in Docket No. 00-0720 is misplaced because evidence was presented in this case that was not produced by Peoples Gas or considered by the Commission in Docket No. 00-0720. Such new evidence is significant enough to change the Commission’s findings and orders in Docket No. 00-0720 regarding the prudence of Peoples Gas’ decision to enter into the GPAA.

The most significant evidence admitted in the instant docket about the GPAA, but was not produced by Peoples Gas in Docket No. 00-0720, is the Aruba analysis and the GPAA analysis contained in Wear Cross Exhibit #15. Neither document was made

available to Staff in Docket No. 00-0720, despite the request for all analyses used to select each new or renegotiated firm supply contracts entered into in a reconciliation period (which would have included the GPAA agreement). The request was part of Staff's generic data request in 00-0720. (Staff Ex. 8 at 5). Another fact that was not known in the 00-0720 proceeding, and that also has a high potential for impacting the review of Peoples Gas' decision, was the strategic partnership between the Enron corporate family and the Peoples Energy corporate family. The strategic partnership between the Peoples and Enron corporate families, provides a reason why Peoples Gas placed little reliance on either of the two economic analyses⁴ of the GPAA that were performed prior to signing. The strategic partnership was entered into as part of a profit making venture for the two companies. It appears that the GPAA was a key part of that partnership, since it was signed on the same day as a Letter of Intent ("1999 LOI") that indicated its intent to enter into a joint venture with Enron. (Staff Ex. 7 at 7). See supra §I.2(A) -- Enron's Business Dealing and Accounting Procedures do not Absolve Peoples Gas of Imprudent and Inappropriate Business Dealings. The two families desire to have a strategic partnership is a strong motive to not consider two economic analyses of the GPAA (*i.e.*, Aruba analysis and Wear Cross Exhibit #15) when they negotiated the GPAA and denied their existence in the 2000 reconciliation case. Moreover, it is easy to conclude that little Peoples Gas gave little consideration to the impact the GPAA would have on ratepayers. This partnership, which also existed during the 2000 reconciliation period, is discussed extensively in Staff's Initial Brief, pages 3 through 6.

Accordingly, the finding of the GPAA's prudence in Docket No. 00-0720 should not preclude the reevaluation of it in this proceeding.

⁴ The Aruba analysis and Wear Cross Exhibit #15.

(3) Peoples Gas Misconstrues the *Illinois Power* Case

In addition, Peoples Gas incorrectly applies the *Illinois Power Company v. Illinois Commerce Commission* (“*Illinois Power*”), 339 Ill. App. 3d 425 (5th Dist. 2003) case to the instant matter. (PG IB at 32). Peoples Gas focuses on the Illinois Power Court’s decision that “the Commission cannot create a new standard and apply it retroactively in assessing the prudence of a utility’s gas purchases” (PG IB at 32), and seeks to truncate the Commission’s ability to revisit a previous decision since the Commission reviewed the GPAA in Docket No. 00-0720. In this proceeding, Staff is neither creating a new standard to assess prudence, nor is Staff applying its prudence review in a retroactive manner. Staff seeks to review the GPAA in light of new evidence. A closer review of the *Illinois Power* decision finds that the court held that the Commission’s “finding that a PVRR analysis was required in the instant [IP] case was not supported by substantial evidence.” *Illinois Power*, 339 Ill. App. 3d at 440. In the instant proceeding (Docket No. 01-0707), all of Staff’s recommendations and its reliance upon quantitative economic studies are supported by the evidence and in keeping with caselaw regarding the use of quantitative studies in determining prudence.

The *Illinois Power* case involved the denial of the costs of replacement gas in the PGA because the Freeburg propane plant should be retired. In its review, the Commission held that Illinois Power should have performed a present-value-of-future-revenue-requirements (“PVRR”) analysis to “compare the costs . . . of continuing to operate the Freeburg plant versus the costs . . . of retiring the facility and replacing its capacity with alternative sources” in determining whether to retire the plant. *Illinois Power*, 339 Ill. App. 3d at 433. The crux of the Court’s decision was that

Section 9-220(a) of the Act does not set forth any specific type of analysis that a utility must perform to show its costs are prudent . . . that the Commission did not point to any prior decisions or any other sources of a 'standard of care' that should have led a reasonable person to conclude that a PVRR analysis was a necessary component of prudent decision-making . . . and that Illinois Power had not performed a PVRR analysis for the previous four propane plants it had retired.

Illinois Power, 339 Ill. App. 3d at 439.

Other factors the Illinois Power Court considered were prior Commission orders in which the Commission had found a utility's actions prudent while not requiring an economic analysis be performed (*Illinois Power*, 339 Ill. App. 3d at 435-37), that the Commission had previously approved the retirement of four propane plants by Illinois Power without requiring an economic analysis (at 439), that Staff failed to show what relevant differences in circumstances existed between the first four propane plants and the Freeburg propane plant that necessitated an economic analysis be performed for the Freeburg plant (at 438), and that the Commission had committed an error in its review of other factors presented by Illinois Power to demonstrate the prudence of retiring the Freeport plant (at 440, finding that the Commission had looked at the other factors in isolation rather than collectively). Based on substantial evidence, the Illinois Power Court concluded that the Commission had not previously required a utility, acting as a reasonable person, to perform a PVRR analysis in evaluating whether to retire a plant, and that the change that required such a PVRR analysis was not supported by substantial evidence.

In comparing the *Illinois Power* decision to the instant case, it is evident that Peoples Gas has misconstrued the finding of the *Illinois Power* decision.

The enormous difference between the present cause and the *Illinois Power* case is evident. Propane plants have been around for many decades, and issues concerning their retirement had been examined before as the Court found in reversing the Commission. The multi-year GPAA is a novelty which Peoples Gas did in mid-1999.⁵ There are no claims that Peoples Gas' historical methods of purchasing gas were unsafe or obsolescent. Peoples Gas ignores that the prudence of its decision to enter into the GPAA arises for annual examination under Section 9-220 of the Act, *supra*, and that it bears the burden of proof for every year. (*Cf. Rockford Life Insurance Co. v. Department of Revenue*, 112 Ill. 2d 174, 185-6 (1986) except in the cases of fraud or injustice, a public body will not be estopped from reexamining an issue and coming to a different conclusion).

Peoples Gas seeks to turn *Illinois Power* on its head. *Illinois Power* forbade the requirement of a specific method of economic study. *Illinois Power* did not bar the use of all economic studies in PGA cases. Staff's position is that a prudent utility would have examined the economics of such a long-term, complicated contract in some rigorous way before entering into such an agreement (assuming the prudence of the agreement in a Section 9-220 of the Act, *supra*, sense was a consideration in negotiating the GPAA at all). Despite the late discovery of two contemporary economic studies by Peoples Energy or Peoples Gas, Peoples Gas according to its own testimony did not examine the economic prudence of the GPAA in any quantitative manner before entering into the agreement. There is no presumption in Section 9-220 reconciliation cases that any action taken by a public utility is prudent necessarily. Yet Peoples Gas argues as if the GPAA is presumed prudent.

⁵ June to September 1999 (PG Ex. C at 6-10); novelty (*Id.*, at 3).

Staff is not requiring Peoples Gas to perform a quantitative analysis of the GPAA, but does rely upon its own quantitative analysis in reaching its determination of imprudence and in determining the amount of the amount of recovery from the GPAA. Neither of which is a departure from past practice. The Illinois Supreme Court recognizes that quantitative analysis can be used to show prudence, (*Business & Professional People for Public Interest v. Illinois Commerce Commission*, 146 Ill. 2d 175, 202 (1991) (holding that a quantitative analysis of specific cost figures may be helpful in making a prudency determination, but it is only one of various factors that enter into that equation.) and quantitative analyses are routinely used to support decisions and determine adjustment amounts. Moreover, Peoples Gas has the discretion to choose the information it will present to show that its decisions were prudent and whether that information is quantitative in nature or not.

In addition, if the Commission were to adopt Peoples Gas' position, in effect it would estop the Commission's ability to revisit a previous decision. This would be contrary to Section 9-220, which requires annual reviews of gas purchases, and contrary to caselaw. (See e.g., *People ex rel. Brown v. Illinois State Troopers Lodge*, 7 Ill. App. 3d 98, 104-105 (4th Dist 1972); see also *Mississippi River Fuel Corp, supra*, 1 Ill. 2d at 513 and *Rockford Life Insurance Co. v. Department of Revenue*, 112 Ill. 2d at 185-6). When acting in its governmental capacity, there needs to be a compelling reason for estoppel to attach. (*Illinois State Troopers Lodge*, 7 Ill. App. 3d at 105). In explaining its rationale, the Court stated:

"There are sound bases for such policy. It is said that since the State cannot be sued without its consent, an inevitable consequence is that it cannot be bound by estoppel. More importantly, perhaps, is the possibility that application of *laches* or

estoppel doctrines may impair the functioning of the State in the discharge of its government functions, and that valuable public interests may be jeopardized or lost by the negligence, mistakes or inattention of public officials."

(Id.).

The court continued, stating that preventing the State from proceeding to remedy a continuing violation "would effectively curtail the power and the right of the State to enforce public rights when mistakes or errors in judgment of those acting in an official capacity appear." (Id.). Similarly, new evidence has been presented that changes the review of the GPAA, and therefore, the Commission should not be estopped from reviewing such information in light of new evidence and analysis, irrespective of the review in Docket No. 00-0720.

(4) Collectively, Peoples Gas' Evaluation of GPAA Fails to Demonstrate its Prudence

a. Five Objectives

The primary method, by which Peoples Gas attempts to demonstrate that its decision to enter into the GPAA was prudent, is that the GPAA met five objectives. (PG IB at 46). Staff extensively discussed these objectives in its Initial Brief at pages 34 through 41 and will reply below only to specific arguments in Peoples Gas' Initial Brief.

i. Market-Based Pricing Without Demand Charges

At page 46 of its Initial Brief, Peoples Gas argues that "The GPAA's market-based commodity pricing terms with no reservation or demand charges was a benefit to Respondent." Reducing or avoiding demand charges reduces costs and, in fact, it is one factor considered in Staff's GPAA analysis. (Staff Ex. 3 at 19 and 30-31). However, it is only one factor. By itself, this objective is not informative about the total cost of the

contract. More importantly, Peoples Gas misstates that it has no reservation or demand charges under the GPAA because Peoples Gas continued to pay the pipeline demand charges. Peoples Gas paid citygate prices for gas, while it also surrendered control of some of its pipeline capacity. Further, Peoples Gas never analyzed the GPAA's components in a way that allows the Commission to determine whether Peoples Gas is paying a demand charge. Therefore, those transportation demand charges are a "reservation or demand" charge under the GPAA. (Staff Ex. 2 at 20).

ii. Flexible Pricing

At page 47 of its Initial Brief, Peoples Gas notes that "[u]nder the GPAA, parties could agree to alternative pricing ... instead of the otherwise applicable index price." Article 4.2(a) of the GPAA allowed Peoples Gas to negotiate prices at other than those specified in the contract, however, Peoples Gas did not show that this represented a benefit beyond what it would have had absent the GPAA. That is, this in no way demonstrates that this term provided any more flexibility than the manner in which it used to purchase gas, using smaller volume and shorter term contracts. (Staff IB at 39). Further, the likelihood that this contract term provided benefits to Peoples Gas is limited by the fact that any change in pricing required the agreement of Enron.⁶ It is not reasonable to expect Enron to agree to any change that did not improve Enron's expected revenues or provide it more price protection. (Staff Ex. 3 at 15). Therefore, Peoples Gas did not receive the benefit it claims to have received under this objective.

⁶ See Article 4.2(a) stating that "...Buyer may, at any time and from time to time in accordance with the provision entitled "Flexible Pricing" in the Master Agreement, request different pricing for all or any portion of the quantities set forth in Section 2.1" (Staff Ex. 2, Attach 1 – GPAA Agreement – Art. 4.2(a)). Under the heading "Flexible Pricing" in Appendix f, it states "The price for all Gas for which a Flexible Price has not been agreed by the Parties shall be the original Contract Price applicable to the Transaction." (Staff Ex. 2, Attach 1 – GPAA Agreement – Appendix f).

iii. Operational Flexibility

Peoples Gas argues that the GPAA provided flexibility to meet changes in weather and fluctuation in day-to-day requirements. Peoples Gas supports this statement by discussing the flexibility provided by baseload, DIQ, and SIQ, and the sellback provision.

At page 49 of its Initial Brief, Peoples Gas states that the combination of baseload, SIQ, and DIQ gave it sufficient operational flexibility. Staff reiterates its position, expressed at page 39 of its Initial Brief, that Peoples Gas fails to demonstrate that the alleged flexibility of the GPAA reached the level Peoples Gas had previous to the GPAA (or could have had absent the contract). Prior to the GPAA, Peoples Gas had entered into multiple contracts with multiple vendors for various types of supply and transportation to obtain gas at the citygate. While the GPAA provided the three ways to purchase gas, and other different pricing arrangements, but the bottom line is that Peoples Gas was buying gas from only one source – Enron. (Staff IB at 39).

Peoples Gas also offers the sellback term as an example of flexibility. At page 50, Peoples Gas offers three reasons why sellbacks provide substantial benefits. First, resales are “...substantially affected by variables over which Respondent has little or no control.” Peoples Gas includes weather, customer usage and transport customers’ deliveries among these factors. The second reason is that an “...oversupply situation creates significant and serious business issues.” These include pipeline penalties. Third, “...an oversupply must be managed...to avoid overpressure situations...” and that “Disposing of or moving to an alternate market up to 150,000 MMBtu of gas on a day when the market is oversupplied is a formidable task” (PG IB at 51). Staff,

however, noted that Peoples Gas had to sell gas on the open market prior to signing the GPAA when it purchased excess supplies. (Staff Ex. 2 at 26). In testimony, Peoples Gas made no serious attempt to demonstrate that marketing excess gas supply on its own was inferior to the resale term. (Staff Ex. 3 at 29, lines 773-774).

In its Initial Brief, Staff notes that an alternative to the re-sale term is for Peoples Gas to dispose of gas on its own. The main reason that the re-sale term is useful is because other provisions of the GPAA, in particular the SIQ, raise the probability that Peoples Gas has to purchase more gas than it needs. (Staff Ex. 3 at 28-29). For example, “Only 3.6% of re-sales during the Summer Period were made on days that the maximum (or near maximum) SIQ was not chosen by Enron. Further, Peoples Gas made re-sales back to Enron on 93.9% of the days that Enron forced Peoples Gas to buy the maximum (or near maximum) SIQ. Thus, on days when Enron opted for the maximum SIQ, it almost always forced Peoples Gas to buy more gas than the Company could use.” (Staff Ex. 3 at 29). Thus, re-sales are highly correlated with the SIQ. That means that the re-sale term only has value because of other terms in the GPAA. The re-sale term is not independently valuable.

At page 51 of its Initial Brief, Peoples Gas defends the price structure for the sellbacks by noting that a “...slight discount [to the daily market indices] was not a penalty...” However, this statement is unsupported and is inconsistent with the pricing for the DIQ (*i.e.*, purchasing gas at the daily market index). Peoples Gas agreed to pay the full daily market index price, without a discount, when it purchases according to the DIQ, while simultaneously arguing that the discount reflects the lower value it would

receive by selling gas on short notice. See Staff Ex. 2, Attach. 1 – GPAA Agreement at 9 – Art. 4.1(c).

iv. Preserve Value of Transportation

On pages 47-48 of its Initial Brief, Peoples Gas argues that the GPAA met its objective to preserve the value of its transport capacity. In other words, Peoples Gas asserts that the GPAA serves as a hedge against a falling basis. First, as is true with all of its claimed objectives, it is not apparent that Peoples Gas really was pursuing this objective at the time of negotiations. (Staff Ex. 3 at 11). Second, its initial attempt to support this objective showed that the value preservation was not accomplished. (Staff Ex. 3 at 21-24).⁷ Third, Peoples Gas relies upon the CERA data, but it cannot substantiate that the CERA data was reviewed by Peoples Gas personnel or played a part in the GPAA negotiations. (Staff Ex. 3 at 20-21 and 24-26). Fourth, even if the GPAA “preserved the value of its transportation,” this objective does not address, by itself, all the effects that the GPAA had on gas costs. These include the effects of the SIQ and the re-pricing terms, as well as the lost revenue due to the release of pipeline capacity to Enron. (Staff Ex. 3 at 16-19).

Peoples Gas asserts that “...available information, such as analyses by the Cambridge Energy Research Associates (“CERA”) ...showed that basis likely would be declining.” (PG IB at 48). This statement reads as if Peoples Gas had relied upon the CERA studies at the time the GPAA was negotiated. That is not the case. Based on a data request response provided by Peoples Gas, Dr. Rearden drew the conclusion that “it appears the CERA report played no part in the negotiations with Enron.” (Staff Ex. 7 at 25). Peoples Gas did not respond to such a statement, therefore raising a

⁷ Revised calculations are presented in Staff Ex. 7.04.

presumption in Staff's favor. (*Belding v. Belding*, 358 Ill. 216, 220-21, 192 N.E. 917 (1934)). Further, if it did not rely upon the CERA data at the time, then Peoples Gas has failed to prove that it reviewed any data demonstrating that it evaluated the probability of the basis differential dropping over the term of the GPAA. As such, no weight can be accorded Peoples Gas' reliance on the CERA studies.

In addition, there are three reasons to accord little to no weight to the CERA study. First, in attempting to show that the basis differential for the GPAA was dropping, Peoples Gas only looks at the projected basis differential at the citygate and fails to look at what was happening to the projected basis differentials for the locations that supply Chicago. The second flaw in the Peoples Gas use of the CERA study is that the locations analyzed by Peoples Gas do not conform to the field locations applicable to the GPAA. (Staff Ex. 12 at 17). Third, little weight should be accorded the CERA data because it looks at basis differentials in regions and not at delivery points that are comparable to those used by Peoples Gas.

Addressing these flaws in turn, Peoples Gas fails to look at what was happening to the projected basis differentials for the locations that supply Chicago. In its testimony, Peoples Gas examined the scenarios in the CERA study. The scenarios charted the basis differentials between the Regional Markets (i.e., Alberta, Rocky Mountain, and Midcontinent, as they are identified in "At the Crossroads of Competition: A Future of Midwest Gas and Power Markets") and Chicago (PG Ex. H at 39-40, 44-45)). Based on its analysis of the CERA study Peoples Gas claims that the basis differential between Henry Hub⁸ and Chicago was known to be falling. The flaw in Peoples Gas analysis is that it failed to look at an alternative to the GPAA. To

⁸ Henry Hub is located in Louisiana. (PG Ex. C, Ex. #2).

determine the benefit of its decision Peoples Gas must compare the GPAA to an alternative, and the most obvious alternative being the manner in which Peoples Gas has historically purchased gas -- purchasing gas in the field and transporting it to Chicago. When looking at the CERA scenarios, Mr. Graves analysis fails to evaluate their different effects on the costs to purchase gas in the field. He simply uses the Aruba analysis data for the field prices for all the scenarios. To use each scenario correctly, Peoples Gas has to look at the projected basis differential at all locations where it could, would or has purchased gas if it was going to purchase gas in the field in each scenario. The CERA study contains information that might allow Peoples Gas to perform such an analysis but it failed to engage in the additional mathematical analysis to make the comparison apt. Peoples Gas used only the price differential for Henry Hub to Chicago, but did not analyze alternative regions from which Peoples Gas could receive gas, such as the price differential between Alberta, Canada and Chicago, or Midcontinent (Iowa) and Chicago.⁹ (Staff Ex. 12 at 17). Thus, Peoples Gas' analysis presented a skewed view of the CERA study data and, consequently, a skewed view of the likelihood that the basis differentials between Chicago and other supply basins would sharply decline. (Staff Ex. 12 at 16-17).

In addition, Peoples Gas uses the CERA study as a counter to Staff's analysis of the GPAA. Staff's analysis compares the citygate price to the price of purchasing gas in the field to determine the prudence of entering into the GPAA (Staff IB at 48-49; Staff Ex. 3 at 21-24; Staff Ex. 7 at 22-26). For the CERA study to properly respond, or be comparable to Staff's analysis of the GPAA, it should compare the citygate price to

⁹ Staff did not analyze these other regions because, as noted in the following paragraph, Staff does not believe the CERA study data is compatible with the parameters of the GPAA since it needs to be manipulated for there to be a relationship between regional markets and individual delivery points.

the price of purchasing gas in the field. Peoples Gas failed to make such a comparison, and should be accorded less weight, if not disregarded for the flaws discussed herein.

The second flaw relates to the actual data that was used. The scenarios contained in the CERA study were not delivery points, but were Regional Markets. Dr. Rearden explains that, since the scenarios are broad regions, and not individual locations, the model needed to be further developed to have any probative value. (Staff Ex. 12 at 15). Specifically, Peoples Gas needed to either modify the scenarios to match the field locations that apply to the GPAA, or to develop a relationship between the Regional Market and a delivery point on Peoples Gas' leased interstate pipeline service. (*Id.*). Moreover, the GPAA pre-determined the baseload quantity over the course of the contract, and those volumes varied by month. However, the CERA data were annual and could not contribute important information about gas costs. (Staff Ex. 7 at 25-26). Thus, the CERA study data is not sufficient, without additional analysis well beyond what Peoples Gas has performed, for a reasonable person to conclude that basis differentials would fall enough over the term of the GPAA to make the GPAA a prudent decision.

In discussing how likely that the "basis differential" to Chicago would precipitously fall, Peoples Gas states that "On net, it appeared there would be at least 1.0 Bcf per day increase in a market that already had concerns about excess capacity." (PG IB at 49). Even if one assumes that the effects that this has on markets is what Peoples Gas claims for it, it does not follow that Peoples Gas demonstrated that its response was prudent. The presentation that Peoples Gas has made simply does not consider its alternatives to the GPAA. In particular, Staff offered the idea that Peoples Gas could

have entered into shorter term transport contracts to take advantage of transportation's falling value. Indeed, Staff witness Anderson meticulously detailed the alternatives open to Peoples Gas to respond to a declining basis. Peoples Gas did not address them in its testimony, therefore raising a presumption in Staff's favor. (*Belding v. Belding*, 358 Ill. 216, 220-21, 192 N.E. 917 (1934)). It cannot claim it has demonstrated prudence for the GPAA when it did not consider alternatives to the GPAA to address its "objectives." (Staff Ex. 2 at 16-20).

b. Peoples Gas Cannot Support its Premise That the Discount or Credit is Sufficient to Make the GPAA Prudent

At the end of the first paragraph on page 20 of its Initial Brief, Peoples Gas states that the 3¢ discount (or credit) "...guaranteed value for its transportation assets and offset the expected decline in basis." Dr. Rearden's analysis demonstrated that this is not the case. In Dr. Rearden's analysis of the seven factors that comprise the value of the GPAA, he determined that the credit was too low, if all other things are held constant, because the GPAA raised gas costs, *i.e.*, a credit greater than 3¢ is needed to keep gas costs from rising (Staff Ex. 3 at 20-35; and Staff Ex. 7 at 2-36; see also PG Ex. E at 21 (PG Additional Rebuttal of Graves). Again, Staff strongly emphasizes that a discussion about whether the discount (or credit) is large enough to make the GPAA prudent only makes sense when all contract terms are aggregated and analyzed simultaneously. (Staff Ex. 3 at 13-15). Staff's analysis of the seven factors comprising the GPAA is a review of the contract in the aggregate and is based on the contracts terms. This analysis showed that the GPAA led to an increase in gas costs. (Staff Ex. 3 at 33-36; Staff Ex. 7 at 36). A higher credit, all else being held constant, could have changed this equation.

(5) Peoples Gas' Criticisms of Staff's Analysis are Baseless

The evidence Peoples Gas offers to show that its decision to enter into the GPAA was prudent fails to look at the whole contract. In contrast, Staff accounted for all factors in determining the relative value of the GPAA. Peoples Gas did not evaluate all factors; it did not even propose a competing value to all of Staff's values. In particular, the factors not empirically evaluated by Peoples Gas were the SIQ, the re-pricing terms, and the transportation capacity that was released to Enron. Peoples Gas' only serious response was to Staff's comparison of the field delivered price versus the citygate price. Mr. Graves proposed an alternative view of this comparison. In his comparison, Peoples Gas could legitimately suggest that there was potential for the field delivered price to fall below the Daily Midpoint Price for Citygate.¹⁰ Peoples Gas, however, cannot hold this projection out as an evaluation of the contract as a whole, since it never estimated the effect other factors of the contract would have on gas costs.

Peoples Gas attempts to undermine Staff's analysis in two ways. First, it tries to inject uncertainty about Staff's specific estimates for the value of individual contract elements. (Staff Ex. 7 at 22-36). Second, Peoples Gas tries to also sow uncertainty about the whole process that Staff used in estimating specific values and aggregating them to evaluate the contract as a whole. (Id. at 16-22; and Staff Ex. 12 at 221-22). This Brief will take these two points *in seriatim*.

¹⁰ Staff's position, of course, is that the data that Peoples Gas originally provided in this docket does not support that this is true. In addition, the second attempt of Peoples Gas to address the issue (the CERA data analyzed by Mr. Graves) had enough problems to undermine its conclusions there as well.

a. Peoples Gas has not proven that Benefits that are Non-Quantifiable Support the Prudence of the GPAA

With respect to the latter strategy, Peoples Gas makes a series of arguments in which it contends that the GPAA provides benefits that Staff's analysis did not address nor could be addressed (PG IB at 54-55). Staff confronted these alleged non-quantifiable benefits in its Initial Brief and responds to Peoples Gas' argument below. In most instances, the benefits Peoples Gas identifies do not possess characteristics that are easily quantified, which make them nearly impossible to truly evaluate.

Peoples Gas makes the following series of arguments on pages 54 and 55 of its Initial Brief -- (1) that the contract with Enron allowed "...discretionary daily purchase activity to remain hidden from the larger market" (PG IB at 54); (2) that the sellback provision allows Peoples Gas to ". . . turn to a single supplier for daily sales activity that may be required for operational reasons. . ." (PG IB at 55); (3) that the GPAA ". . . preserved reliability of Respondent's supply. . ." (*id.*); and (4) that the GPAA ". . . increased efficiency and information" (*id.*). For various reasons, it is difficult to place a value upon these items. Therefore, the Commission could value these items for purposes of this case as zero. Since market participants have not previously, and profitably, developed methods to deal with factors as nebulous as those listed above, it is possible that markets assign a small value to the factor. Similarly, Peoples Gas has not determined that these factors have any specific monetary benefit, such that they offset the very real and direct gas costs stemming from the GPAA (Staff Ex. 7 at 17-19), which is Peoples Gas' statutory burden. Accordingly, these factors should be given no weight in determining the benefits of the GPAA.

In another attempt to deny the ratepayers the benefits of a rigorous economic analysis, Peoples Gas states at page 55 of its Initial Brief that “The variety of these approaches [referring to Graves, Rearden, Decker and Efron], in and of themselves, demonstrate that the GPAA’s economic impact is incapable of mathematical precision.” Peoples Gas overlooks the self-acknowledged complexity of the GPAA in making this assertion. A complex contract can be analyzed a number of ways. In fact, Peoples Gas witness Graves engaged in a mathematical exercise to prove the prudence of the GPAA based on the CERA and PIRA studies, however unconvincing the presentation was ultimately. (PG Ex. F (Graves Rebuttal) at 38-41).

Experts are used for a reason, and their opinions are not always the same or based on similar analysis. When opinions of expert witnesses are in disagreement, the judge determines which is of greater weight by considering “the reasons given for the conclusion and the factual details marshaled to support it.” (*Mullen v. General Motors Corp.*, 32 Ill. App. 3d 122, 131 (1st Dist. 1975)). In weighing the testimony, the witnesses qualifications, the quality of their testimony, and their credibility are to be considered. *Hall v. National Freight, Inc.*, 264 Ill. App. 3d 412, 422-23 (1st Dist. 1994); *Rural Electric Convenience Cooperative Co. v. ICC*, 109 Ill. App. 3d 243, 246 (4th Dist. 1982). Therefore, the variety of the approaches is not determinative of whether the GPAA can be mathematically analyzed. If anything, the variety of mathematical approaches only confirms that the GPAA can be analyzed mathematically, and the only question that remains is which one is accorded greater weight based on the foregoing principles.

Whatever the claimed anomalous benefits, such benefits do not overcome the detriment to the ratepayers which arose from the gas purchases under the GPAA. The Commission could even find that, by striving for anomalous benefits, the GPAA is shown to be imprudent in the matters that are subject to this annual reconciliation of gas purchases. Although the GPAA has to be examined as a whole for purposes of this case, not every matter in the GPAA has an effect on the prudence of gas purchases.

b. The Variety of Methods Used by Staff's and GCI's Experts to Analyze the GPAA Demonstrate that the GPAA Should be Analyzed Through a Quantitative Analysis

Peoples Gas argues that the “wide range of recommended disallowances” by Staff, CUB and the Attorney General shows that prudence is subject to a variety of approaches and that honest differences of opinion are not evidence of imprudence. (PG IB at 56). What the differences in said testimony shows is a unanimity that the GPAA is imprudent. The differences that Peoples Gas is pointing out are only to the measurement of the ratepayers’ damages due to the imprudence of the GPAA.

As discussed in more detail below, Peoples Gas’ argument confuses the reasonableness of the amount of the adjustment with the determination of the prudence of the contract. The variety of analyses employed by the parties to analyze the GPAA demonstrates that a more rigorous analysis of the GPAA is needed than simply relying on the business expertise of Peoples Gas’ employees. In Staff’s view, that means that the GPAA should be analyzed quantitatively.

Peoples Gas’ argument confuses the determination of prudence with the reasonableness of the amount of the adjustment. Staff’s approach to analyzing the GPAA was a reasonable method because said analysis considered the contract as a

whole and performed a quantitative analysis by calculating values for seven factors. Staff chose the seven factors because they are the major drivers for the relative value of the GPAA. The calculations for each factor represent gas costs under the GPAA versus the costs if Peoples Gas had purchased the same volumes in its usual manner -- by buying the gas in the field and transporting it to Chicago. (Staff Ex. 3 at 16). The analysis of the most important factor (the field delivered price versus citygate price) used Peoples Gas' own numbers (Staff Ex. 7 at 21), therefore, Staff viewed the GPAA from essentially the same viewpoint as the Company. Staff's quantitative analysis shows that the gas costs under the GPAA were higher than gas that would have been purchased in the field and transported to Chicago (along with all the other contract elements), therefore the contract is imprudent. Similarly, CUB and the Attorney General conducted numerical analyses that prove the GPAA to have higher gas costs than if the GPAA were not entered into. As Peoples Gas points out, the additional cost due to the GPAA varied among the parties (see PG IB at 56) and that is due to each party's respective approach. Therefore, the difference in disallowances does not prove the GPAA is prudent, but merely raises the issue of which calculation methodology best reflects the additional imprudent cost of gas purchased under the GPAA.

As noted in the earlier section, Peoples Gas overlooks the self-acknowledged complexity of the GPAA. Logic dictates that a complex contract can be analyzed a number of ways. When opinions of expert witnesses are in disagreement, the judge determines which is of greater weight by considering "the reasons given for the conclusion and the factual details marshaled to support it." (*Mullen v. General Motors Corp.*, 32 Ill. App. 3d 122, 131 (1st Dist. 1975)). In weighing the testimony the trier of

fact is to consider the witnesses qualifications, the quality of their testimony, and their credibility. (*Hall v. National Freight, Inc.*, 264 Ill. App. 3d 412, 422-23 (1st Dist. 1994); *Rural Electric Convenience Cooperative Co. v. ICC*, 109 Ill. App. 3d 243, 246 (4th Dist. 1982). Since experts can analyze problems differently, and judges are called to weigh the expert's testimony, the variety of approaches presented in this proceeding could only be interpreted as proving that the GPAA can be mathematically analyzed. The only question that remains is which analysis is accorded the greater weight by the Commission.

Peoples Gas' also attempts to redirect the Commission's attention away from the existence of the Aruba analysis. The Aruba analysis confirms that Peoples Gas performed an analysis immediately prior to entering into the GPAA that showed the GPAA would raise gas costs. (Staff Ex. 7 at 12-15). The calculations in the Aruba analysis and in Staff's own numerical analysis are based on the same basis projections (Staff Ex. 7 at 22).¹¹ Both analyses show that the GPAA fails, by a large margin, to purchase gas at an amount equal to or lower than what Peoples Gas could purchase in the field. (Staff Ex. 7 at 12 and 35--36). The consistency of approach in both Staff's and the Aruba analyses confirms the validity of such a quantitative approach.

c. Peoples Gas' Critique of Dr. Rearden's Analysis of Cost Disallowance Casts Doubt Upon its own Data

In its attempt to show that Dr. Rearden's analysis was flawed, Peoples Gas tries to identify studies, other than an economic analysis, that would support its decision to enter into the GPAA, highlights that Dr. Rearden's analysis is a single scenario, and claims that the Aruba analysis supports its position. As discussed below, the other

¹¹ Staff's analysis of the GPAA predates Staff's finding of the Aruba Analysis in discovery.

studies Peoples Gas relies upon are not applicable to the GPAA, Dr. Rearden's analysis is based on data from Peoples Gas, and Peoples Gas' interpretation of the Aruba analysis misrepresents its results.

On page 60 of its Initial Brief, Peoples Gas states that "Mr. Graves testified that while the GPAA's benefit to Peoples Gas' customers could not have been a certainty, there was considerable evidence...suggesting the plausibility...of a steep decline in Chicago-area basis." While the Company produced documents that might lead some individuals to conclude that a fall in basis differential was possible, Peoples Gas cannot document that it viewed the likelihood for such a fall to be likely enough to warrant a contract, such as the GPAA, over some other strategy. (Staff Ex. 7 at 23-26). Further, it is telling that Peoples Gas did not present the data that Mr. Graves relies upon in its direct testimony, but only provided it in rebuttal to Dr. Rearden's analysis in his Exhibit 3. As discussed, *supra* § I.2.B(4)(a)(iv), if Peoples Gas did not rely upon Graves' CERA data at the time it negotiated the GPAA, then such testimony is merely a hindsight opinion, and Peoples Gas has failed to prove that it reviewed any data demonstrating a meaningful evaluation of the probability of the basis differential dropping over the term of the GPAA. As such, no weight can be accorded Peoples Gas' reliance on the CERA studies.

Peoples Gas further argues that "...to pass judgment on the GPAA's merits at the time it was negotiated and executed using only Dr. Rearden's single scenario would be unreasonable." (PG IB at 60). This statement ignores two important points. First, the scenario was developed by Peoples Gas and presented to the Commission in discovery responses and testimony as a demonstration of the prudence of the GPAA,

even though the data in fact shows the imprudence of the GPAA. (Staff Ex. 7 at 13 and 22-36; Staff Ex. 12 at 7-9; see also, *supra* §1.2.b(4(iv))). Peoples Gas documented this scenario by developing the data especially to evaluate the GPAA. (PG Ex. C at 7-8). Peoples Gas cannot now claim that this data set is neither relevant to this issue nor part of its thinking at the time.

In footnote 50, on page 60, Peoples Gas represents that it did not consider the Aruba analysis in making its decision to enter the GPAA, but that the results of the Aruba analysis are consistent with Peoples Gas witness Graves' analysis. This is a gross misrepresentation of the record evidence. The Aruba analysis shows the GPAA to raise gas costs to ratepayers, according to its author, Roy Rodriguez. He stated in his deposition that "It appears by looking at this based on a low case, it was showing that the proposed Chicago index minus three cents versus the straight weighted average delivered price -- ... -- it's coming up as a higher cost." (Staff Ex. 7 at 13, quoting the Deposition of Roy Rodriguez at 56). Again, this part of the Aruba analysis does not account for the deleterious effects of the SIQ and re-pricing terms.

In addressing the Company's rebuttal to Staff's testimony, Peoples Gas claims that "Dr. Rearden's analysis was very sensitive to assumptions of future basis projections." (PG IB at 61). As explained numerous times by Staff, Dr. Rearden's analysis simply used the only applicable data set known to have been considered by Peoples Gas before it signed the GPAA, and it was the data set used by Mr. Rodriguez in performing his Aruba analysis.

Thus, the same criticism could have been leveled at Peoples Gas before it signed the GPAA. Not only did it conduct an analysis that relied upon a single scenario,

but it even ignored that analysis, which was the only numerical analysis of the future conducted prior to the signing. It is the prudence of Peoples Gas in entering the GPAA, and not the prudence of Staff's quantitative analysis which is at issue in this cause.

C. Manlove Storage Field

In its brief, Peoples Gas makes three major arguments for the prudence of its operations of Manlove field – (1) Hub transactions did not increase gas costs, (2) Hub revenues were properly treated,¹² and (3) it prudently used Manlove field for its end users. In its brief, Peoples Gas asserts that it did not buy gas on the daily market to make up for gas loaned to third party customers, that it is not feasible to displace purchased storage service by using gas from Manlove field, and that the contested withdrawals were solely due to operational factors. In addition, Peoples Gas incorrectly interprets the method Staff uses to calculate its gas cost adjustments as Staff's rationale for the prudence of Peoples Gas' decisions; they are two separate steps in Staff's analysis. Finally, Peoples Gas incorrectly argues that its purchases actually decreased gas costs.

As is explained below in more detail, the evidence provided by Peoples Gas fails to prove that a reasonable person would have over-allocated the use of Manlove field by third party customers (e.g., customers providing Hub services and non-tariff services) so it would have to purchase additional gas for ratepayers at high daily prices. (Staff IB at 56, 58-59). Moreover, if its goal was to maintain peak deliverability of Manlove field until late January 2001, it was imprudent for Peoples Gas not to interrupt service to third party customers (see Staff IB at 56, 58 and 59) and to loan approximately 5 Bcf of gas

¹² This argument actually responds to Staff's adjustments related to Revenues from Non-tariff services.

to them. The loan was the amount of gas withdrawn for the third party customers in excess of the 7.1 Bcf they had injected. (See IB Table 1: Planned and Net Actual Withdrawals from Manlove, at 26, and Graph 1: PGA and Third Party Gas Inventory in Manlove Field, at 27).

(1) Hub Transactions Increased Gas Costs Because Peoples Gas Allocated Usage at Manlove Field Between Several Customers and Granted Third Parties Preferential Access to it

Peoples Gas argues that Hub services did not adversely effect ratepayers because it did not make the incremental purchases of gas alleged by Staff (PG IB at 60 n.60), that it cannot change plans to provide hub services during the withdrawal season (PG IB at 67), and that the gas in Manlove field in excess of 25.5 Bcf was subject to third party contractual commitments (PG IB at 68). The evidence presented in this proceeding refutes each of Peoples Gas' arguments – it did purchase gas to replenish gas inventory in Manlove field, it can interrupt the provision of gas for hub services, and Peoples Gas' operations with respect to third parties is contradicted by its Operating Statement.

In estimating the cost to be recovered through the Gas Charge due to imprudent operations of Manlove field (Staff Appendix A, Schedule 5.03, Adjustment I), Staff adds the cost of the market purchases that support hub operations. Peoples Gas refers to these as incremental purchases. On pages 68-69 of its Initial Brief, Peoples Gas states that it “did not make incremental purchases to support hub activity and, in fact, did not make the purchases that Dr. Rearden alleged.” Its justification for such an assertion is contained in footnote 60.

At footnote 60, Peoples Gas states that there is “...only a single inventory at Manlove...” and Staff is “...elevating accounting distinctions over operational decisions...” While there is only a single, physical inventory of gas in Manlove field, it has multiple uses. Peoples Gas used it for ratepayers, but it also supported hub services. This is evident by simply examining third party balances. Third parties stored 7 BCF at Manlove field prior to withdrawals beginning in November 2000. But Peoples Gas allowed third parties to withdraw approximately 12 BCF during the withdrawal season. (Staff Ex. 3 at 44). The only way that Peoples Gas could have supported this activity when it needed that gas for ratepayers was to purchase additional gas on the open market. In this way, Peoples Gas’ use of its inventory raised gas costs to its ratepayers.

Peoples Gas uses a rhetorical stratagem to maintain that it did not make incremental purchases during January 2001 by calling those purchases “baseload.” Whether Peoples Gas locked the incremental purchases in before the month began or made them on a day by day basis during the month, Peoples Gas nevertheless had to make the purchases to support the loans it was making to third parties. (Staff Ex. 6 at 37 -39 (demonstrating third party customers had used all of gas it injected into field by January 1001) and Staff Ex. 12 at 30-31 (explaining impacts on ratepayers of loaning gas to third party customers) and 34-35).

In the same footnote, Peoples Gas states that “...at no time during the withdrawal period was inventory in Manlove Field negative.” (PG IB at 69 n.60). While this may be nominally true, it avoids the real point, which is that Peoples Gas raised its ratepayers’ costs because of the way that it used Manlove field. In addition, Peoples

Gas dipped into Manlove field's recoverable base of gas. That means that Peoples Gas would have exhausted Manlove field but for its restraint in withdrawing gas for ratepayers (both Peoples Gas and North Shore). Staff showed that the only reason Manlove field's inventory did not fall below recoverable base was the restriction of Peoples Gas' and North Shore's withdrawals for their ratepayers during the very time it needed it most -- December 2000. (Staff Ex. 7 at 50; see *also* Staff Ex. 7.01).

Peoples Gas also states that "...Respondent cannot change those plans [referring to plans to provide hub services] in the midst of the withdrawal season." (PG IB at 67). At page 68, Peoples Gas states that "Gas in Manlove Field in excess of this amount [25.5 Bcf] was gas subject to third party contractual commitments." This assertion is contradictory to Peoples Gas statements on page 25 of its Initial Brief, in which it states that hub services are "...subject to interruption by Peoples Gas in accordance with the Operating Statement." (PG IB at 25, first sentence). In other words, Peoples Gas seems uncertain about whether or not it can interrupt hub transactions. If, as Mr. Wear acknowledged during cross examination, it does have the ability to interrupt hub services (Tr. 929-35), then it was imprudent not to interrupt them when it needed the capacity out of Manlove field. If, as Peoples Gas claims elsewhere, that it did not have that capability, then it was still imprudent in this reconciliation period for the utility to commit as much of the capacity of the field to third parties as it did. (Staff Ex. 3 at 46-47). Peoples Gas was imprudent in either case.

(2) Peoples Gas Failed to Demonstrate That Ratepayers Were not Harmed By its Imprudent Operations of Manlove Field or That Displacement is Dispositive of Staff's Position

Peoples Gas does not provide sufficient evidence to counter Staff's and GCI's evidence and arguments that ratepayers were harmed by loaning gas to third party customers (e.g., customers using Hub services and non-tariff services). Peoples Gas fails to prove that its loans to third party customers were prudent.¹³ Moreover, Peoples Gas could have interrupted the loans to third party customers, but imprudently chose otherwise.

Peoples Gas relies upon Mr. Wear's testimony (see PG IB at 66) in asserting that "...contrary to Staff's and CUB's assumptions, the amount of Manlove Field storage capacity used for end users was established independently from and not influenced by the provision of hub services." (PG IB at 65). The facts show otherwise. Peoples Gas' operations and decisions between October 2000 and February 2001 contradict Peoples Gas' argument. (See Staff IB at 25-29, and 56-61). To briefly restate the facts recited in Staff's Initial Brief, third party customers had injected 7.1 Bcf into Manlove field prior to the start of withdrawals in mid-November. By January 5, 2001, third party customers had withdrawn 7.1 Bcf. Therefore, all of the gas they had injected had been withdrawn; however, Peoples Gas continued to withdraw gas from Manlove and provide this gas to third party customers via either loans or repayments of gas loaned to it (approximately 5 Bcf over the 7.1 Bcf inventory). The only gas that could support the post January 5, 2001, loans to third party customers was owned by Peoples Gas and North Shore and intended for ratepayers. Moreover, Peoples Gas has not provided contrary evidence

¹³ In fact, Dr. Rearden's Direct Testimony showed that three Storage Exchanges were imprudently entered into, in the sense that the value of the gas that was loaned was greater than the amount that the recipient (in all three cases, EMW) paid for the gas. (Staff Ex. 3 at 51-57).

showing whose gas was withdrawn, and it cannot because of displacement. The only way to determine whether Peoples Gas loaned its gas to third party customers is the way Staff has determined it – looking at the overall balance of third party gas.

Not only was ratepayer gas being provided at peak times to third party customers via loans, but in order to maintain Manlove field's peak deliverability until the third week of January, Peoples Gas needed to reduce ratepayer withdrawals and/or purchase gas on the open market in December and January to serve ratepayers. Gas sold to Peoples Gas, for ratepayer use, was purchased when market prices were high. Said expensive gas made it possible for Peoples Gas to keep Manlove field operating while Peoples Gas let third party customers withdraw gas from the field. Staff's interpretation of the injection and withdrawal data is that Peoples Gas gave priority to third party customers, given the large percentage of gas withdrawn by third party customers from November 2000 through January 2001 and the fact that withdrawals for ratepayers were less than planned during the same period. (Staff Ex. 6 at 45-46; Staff Ex. 7 at 45-46). This information is displayed in Table 1 of Staff's Initial Brief and discussed on pages 25 through 27 of Staff's Initial Brief.

Since Peoples Gas purchased gas in December and January, it did so at expensive market prices. (Staff Ex. 7 at 47-48). The need for Peoples Gas' purchases only arises because Peoples Gas had loaned gas to third party customers, and needed to maintain the peak deliverability of the field. Since Peoples Gas purchased the gas, it became a gas purchase borne by ratepayers. Thus, the ratepayers were incontrovertibly subject to higher gas costs due to Peoples Gas' need to purchase gas

to replace that which was loaned to third party customers (including Hub services). (Staff Ex. 6 at 37) .

Peoples Gas also states that displacing purchased storage services with additional gas from Manlove field is not feasible and that only marginal tweaking is possible between these types of storage. (PG IB at 66). In particular, Peoples Gas notes that the storage services from Natural are used mainly for load-balancing while ANR storage services serves swing loads during the fringe months of October, November, March, and April. (*Id.* at 66-67).

Peoples Gas has consistently failed to notice Staff's careful distinctions between operations and planning. In particular, while it may be true that, for planning purposes, storage services are not easily substitutable, in operational terms this is less true. In planning, Peoples Gas cannot consider all storage as the same, but in operations, it can alter use of leased storage in conjunction with Manlove field. In this way, Peoples Gas uses displacement to serve its customers (*i.e.*, ratepayers, transporters and third parties). Since Peoples Gas uses displacement to perform hub services, Manlove field operations and leased storage services affect each other. (Staff Ex. 2 at 31-41).

In stating that purchased storage services cannot be substituted for gas from Manlove field, Peoples Gas explains the differences between purchased storage service (which enables Peoples Gas to purchase gas in the fringe months if there are unexpected cold days and Manlove field has not been turned over from injections to withdrawals, or peak deliverability is low), no-notice service (which allows Peoples Gas to purchase gas to serve hourly load variations and load changes due to weather forecast errors (PG IB at 66-67)), and gas in Manlove field. Peoples Gas' rationale,

however, does not disprove Staff's position. It does not show that their actions (e.g., loan of an excessive volume of gas to third party customers, purchase of gas at high market prices, or failure to interrupt loans to third party customers) were prudent. As such, Peoples Gas has failed to meet its burden and demonstrate that its loans to third party customers were prudent. 220 ILCS 5/ 9-220(a).

(3) Operational Factors Identified by Peoples Gas Are Not Unusual and Provided only Part of the Motivation for Manlove Field Storage Usage During 2001 Reconciliation Period

Peoples Gas argues that Staff's analysis ignores operational factors the utility has to consider. (PG IB at 76-78). The operational factors that Peoples Gas cites are factors that are considered on a daily basis by every gas utility, and Peoples Gas has not shown that these factors were unusual or more complicated than normal. In addition, Peoples Gas' decisions were not wholly made based on operational factors, but self-admittedly, were also impacted by economic considerations.

a. Operational Factors Experienced in Reconciliation Period Were not Unusual

Peoples Gas identifies a number of operational factors to support its withdrawals for third party customers, even though the withdrawals from Manlove field in December 2000 and January 2001 were less than what Peoples Gas had planned to withdraw for ratepayers. The operational factors Peoples Gas identified are: weather was warm in January 2001 (PG IB at 76), Peoples Gas must use storage to accommodate differences between actual weather conditions and what was forecasted (PG IB at 77), Peoples Gas does not know the transportation needs of all of its customers (PG IB at 77), the demand needs of industrial customers change (PG IB at 78), and it expected

cold weather in January and February 2001 but that did not materialize (PG IB at 78). Staff witness Anderson responded to these factors in his Rebuttal Testimony, stating that these factors contradict Mr. Wear's original rebuttal testimony. (See Staff Ex. 12 at 12-13). In that testimony, Mr. Wear states that the January withdrawals were less than planned to reduce the impact on Manlove field's decline curve, so the field could meet peak deliverability needs through the third week of January. (Staff. Ex. 11 at 12).

Peoples Gas has the burden of proof in this case, and they have the information that would support these statements. These statements, however, remain bald and unsupported. Peoples Gas has not only failed to provide specific instances when these operational factors occurred and to what extent they reduced the level of planned withdrawal, but also they failed to even *claim* that they occurred during the reconciliation period. The statements in their Initial Brief recite possible factors that could impact the withdrawal of gas, but Peoples Gas never claims that they actually did impact operations in the reconciliation period. In addition, these are factors that Peoples Gas has to regularly account for as a gas utility, factors that have been resolved satisfactorily by all other Illinois gas utilities without experiencing the problems faced by Peoples Gas. (Staff. Ex. 11 at 13). Mr. Anderson also states that, if they could not resolve such issues, then the natural gas industry could not function. (*Id.*) Finally, Peoples Gas' rationale does not disprove Staff's position -- that non-tariff transactions contributed to, if not the sole cause for, Peoples Gas having less than planned withdrawals during December and January of the reconciliation period, thereby causing unnecessary expenses to their ratepayers. (Staff Ex. 11 at 13).

Further, Peoples Gas' brief and its testimony contradict the significance it places on these operational factors. On pages 66 and 67 of its Initial Brief, Peoples Gas notes that it received two different storage services from Natural that are used mainly for no-notice load balancing. No-notice load balancing enables Peoples Gas to either withdraw or inject gas, with little or no lead time. No-notice load balancing is valuable because the quick injection or withdrawal capability allows Peoples Gas to serve load variations and changes due to unpredictable weather or unexpected customer demands. (See PG IB at 67). Therefore, Peoples Gas had services in place to accommodate for these operational factors and was not obligated to use Manlove field.

In its testimony, Peoples Gas stated the reasons for the reduced withdrawals from the Manlove field in January were due to both Peoples Gas' concern with the accelerating decline curve caused by early withdrawals from the field and the need to keep the field available to meet peak day conditions through the third week of January. (Staff Ex. 11 at 12). Only after Staff pointed out that excessive withdrawals by third party customers from Manlove field¹⁴ was the real reason for Peoples Gas' concern with Manlove field's accelerating decline curve (Staff Ex. 6 at. 34-46) did Peoples Gas develop its late coming list of reasons why gas withdrawals for ratepayers, from Manlove field, were below planned levels for the months of December and January. Given the lateness of Peoples Gas' explanation as well as the contradictory nature of its' claims, Peoples Gas' statements provide no valid basis for its imprudent behavior in operating the Manlove field in December 2000 and January 2001.

¹⁴ Graph 1 in Staff's Initial Brief, shows that third party customer's gas inventory became zero on January 5, 2001, and continued its negative balance until May 2001.

b. Economic Considerations Impacted Peoples Gas Operation of Manlove Field

Peoples Gas cannot convincingly claim that its storage usage is completely explained by 'operational factors.' (PG IB at 76-78). Its decisions are partly explained by economic considerations. Peoples Gas admits to this fact (Staff Ex. 12 at 24), Staff's review of gas purchases looks at whether the field was operated prudently and whether the economic aspects of the decision support the prudence of it. (Staff Ex. 3 at 41-60; Staff Ex. 7 at 42-55). The prudence standard is not defined in Section 9-220 of the Act, *supra*, therefore in making its decision regarding prudence of a transaction, the Commission must weigh all of the facts presented. There are two examples of the imprudent operation of Manlove field. First, the decision to open up withdrawals of Manlove early was explicitly based upon current prices versus forward prices. (Staff Ex. 12 at 24). Second, during cross examination, Peoples Gas witness Mr. Wear agreed that prices were a reason to interrupt firm transport. (Tr. 929-35).

At page 23 of its Initial Brief, Peoples Gas discusses its decision to begin withdrawals from Manlove field early – in mid-November 2000. The reasons given by Peoples Gas were that the weather was unseasonably cold, and that gas prices were high relative to forward prices. (PG IB at 23). Staff believes the latter reasons reliance on economic considerations is important, chiefly, since it belies another Peoples Gas' position that operational considerations dominate its decisions about Manlove field. Here, Peoples Gas acknowledges that economic considerations played a direct and primary effect on the field's management. In addition, Staff performed a similar analysis during December 2000 and January 2001. When Peoples Gas was overusing Manlove

field for third parties in December and January, the NYMEX also forecast lower prices. (Staff Ex. 7 at 60). Peoples Gas ignored that data, and ratepayers suffered for it.

On page 23 of its Brief, Peoples Gas states “Other than this event [the early withdrawals of gas from Manlove field], storage operations for fiscal year 2001 conformed to that of a typical year.” First, it is disingenuous to imply that beginning withdrawals early is not itself a big difference. Peoples Gas argues that its main goal in operating Manlove field is supply sufficiency, in particular, maintaining peak deliverability through most of January. (PG Ex. F at 35-37). However, starting withdrawals early directly undermines that goal. Second, storage operations did not conform to that of a typical year. Staff extensively discussed the anomalies in Manlove field usage. In particular, usage from the field was allocated much more towards third parties during the important part of the withdrawal season of fiscal year 2001 than in that same period in fiscal year 2000. (Staff Ex. 3 at 42-44).

For example, on page 66 of its Initial Brief, Peoples Gas contends that Manlove field usage cannot substitute for purchased storage services. Such an argument implies two things. One, the decisions about how to run Manlove are made without regard to the use of purchased storage usage. Two, as Peoples Gas has argued, no costs that would otherwise flow through the PGA were used to provide hub services and that implies that the hub revenues are more properly used to offset base rates. (See *supra*, §1.2.C.1.). However, Staff’s argument never relied upon purchased storage usage in making its case concerning Peoples Gas’ imprudent use of Manlove field, thus the leased storage usage is not relevant. However, Peoples Gas contradicts itself when it notes that purchased storage services usage increased during the reconciliation

period relative to usage in previous years. The context for this statement was to reply to Staff's contention that Peoples Gas underused Manlove field for ratepayers relative to previous years (PG Ex. F at 36-37).

At page 80 of its Initial Brief, Peoples Gas states "...Staff's recommended disallowances were based on a false belief that the only purpose of storage is to provide a price arbitrage." Staff has never used the term "price arbitrage," and this mischaracterizes Staff's approach to prudence review. This is a rank misinterpretation of Staff's position. During cross examination, Staff witness Anderson discussed the idea that storage is first used for operational reasons. (Tr. 873). However, a strong second motive must be economic reasons that protect ratepayers from price spikes. (*Id.*). In general, the two factors are often complementary, since gas is often most needed when it provides the best protection.

(4) Peoples Gas Confounds Staff's Adjustment Calculations With its Prudence Review

Peoples Gas argues that Staff's rationale for calculating the amount of the adjustment relies on information that Peoples Gas cannot consider at the time it conducts its transactions. (*See generally*, PG IB at 79-81). Peoples Gas has continually misinterpreted Staff's method for calculating the amount of the adjustment as Staff's prudence analysis. Peoples Gas presents the following arguments in response to Staff -- Peoples Gas did not incrementally purchase gas to support hub activities (PG IB at 68), that the last-in-first-out ("LIFO") price was not known at the time of the transaction and therefore cannot be relied upon in making daily withdrawals (PG IB at 80), and that Staff's recommendation is based on price arbitrage, and ignores operational restrictions (PG IB at 80-81). Peoples Gas is misconstruing Staff's positions. Staff's interpretation

of the injection and withdrawal data lead Staff to believe Peoples Gas purchased additional gas to replace gas used by hub activities, not for hub activities, and Staff is not advocating a “LIFO rate”. That Staff used LIFO as a method of performing its calculation of the disallowance is not a recommendation that Peoples Gas engage in LIFO on a daily basis.

a. Peoples Gas Purchased Gas During the Winter to Maintain Operation of Manlove Field Into Late January

In estimating the cost to be recovered through the Gas Charge due to imprudent operations of Manlove field (Staff Appendix A, Schedule 5.03, Adjustment I), Staff accounts for the costs of the spot market (daily) purchases that support hub operations. Peoples Gas refers to these as incremental purchases. Peoples Gas argues that it did not make incremental purchases. However, Staff’s review of injection and withdrawal data leads Staff to believe Peoples Gas had to purchase additional gas to maintain peak deliverability until late January.

On pages 68-69, Peoples Gas asserts that it “...did not make incremental purchases to support hub activity and, in fact, did not make the purchases that Dr. Rearden alleged.” Again at page 69 of its Initial Brief, Peoples Gas reiterates this same point when it states that “...it made almost no incremental purchases beyond its baseload purchase commitments and those that were made were to meet minimal purchase needs or for optimization.” These statements are misleading. In fact, during January 2001, Peoples Gas did purchase gas to support its hub operations. (Staff Ex. 12 at 34-35). The controversy between Staff and Peoples Gas is resolved by noting that the incremental purchases were baseload purchases. However, it is immaterial what type of purchases Peoples Gas made to support its hub transactions. The

purchases were mandated by the utility's provision of hub services. If Manlove field had been more used for ratepayers, then those purchases would not have been needed. Indeed, it was during January 2001 that the third party inventory began. (Staff Ex. 3 at 60).

Staff examined how Peoples Gas allocated withdrawals from Manlove field for itself, North Shore, and third party customers. (Staff Ex. 12 at 30-31). Staff found that third parties received approximately half% of the gas from Manlove in December 2000. (Staff Ex. 7 at 54). Staff also looked at how usage by ratepayers and third parties compared from fiscal year 2000 to 2001. Dr. Rearden noted that "...despite an almost identical number of heating degree days in January 2000 and 2001, Peoples Gas withdrew almost 40% less gas out of Manlove for ratepayers in January 2001." (Staff Ex. 3 at 43; see *also* Table 3 in Staff Ex. 3 at 41-42). Given the amount of gas delivered from Manlove field to ratepayers, Peoples Gas had to purchase additional supplies¹⁵ in order to maintain its delivery of large volumes of gas field to third parties.

Also, Peoples Gas never explained how its inventory for third parties became negative without using gas purchased and stored in Manlove Field for ratepayers. That means that those purchases, via displacement, supported the hub. Dr. Rearden states that "...the negative balances [for third party customer gas] belie the fact that hub operations are obviously benign for ratepayers. When the Company is a net loaner of gas to third parties, the deliveries of those loans can (and did during this reconciliation period) interfere with the withdrawal plans for ratepayers." (Staff Ex. 12 at 31).

¹⁵ Note that Peoples Gas implicitly calls the purchases during January 2001 'baseload' purchases. But they were still additional purchases that were needed at least in part because it had to support January withdrawals. (Staff Ex. 12 at 34-35).

At page 79 of its Initial Brief, Peoples Gas accuses Staff of proposing an adjustment based upon hindsight information. This is a misreading of the procedure employed by Staff to evaluate prudence. It is a two step process. First, Staff determines whether a given decision of the utility is prudent, and if it is imprudent, then Staff assesses whether and how much additional cost was imposed upon the ratepayers,. In this proceeding, Staff based its conclusion in the first step upon current information. The second step, almost by definition, must rely upon what transpired during the reconciliation period, that is, it is based upon what occurred after Peoples Gas made its imprudent decision. (Staff Ex. 12 at 33).

b. Staff did not Advocate the use of a “LIFO Rate” to Make Daily Withdrawal Decisions, but Gas in Storage can be Valued Using its LIFO Cost Calculate an Adjustment to the Gas Charge

At page 80 of its Initial Brief, Peoples Gas alleges that Staff is imposing a LIFO price on its use of Manlove field. As Dr. Rearden explained in his testimony, Staff is not advocating a “LIFO rule” be used to determine prudence. Staff, instead, used LIFO in its calculation of the disallowance. (Staff Ex. 12 at 35-36). In all adjustments, Staff followed a two-step process. First, Staff reviews the information produced through testimony and discovery to determine if the purchase was prudent in light of the relevant operational and economic factors. Second, if in Staff’s opinion the transaction is imprudent, the higher cost imposed upon ratepayers is used in Staff’s calculation. (Staff Ex. 3 at 6-7). In the case of the imprudent storage usage adjustment, the cost to purchase the spot market gas that supports the imprudent storage usage is subtracted from PGA costs. (Staff Ex. 12 at 36). But the value of the stored gas needs to be determined so that an adjustment can be proposed to the Gas Charge. The exact cost

of Manlove field gas is not known, and Staff accountants determined that the most reasonable value for the gas was the LIFO rate. (Staff Ex. 12 at 36). At not time did Staff advocate that Peoples Gas use the LIFO rate in any decision rule for managing storage. (*Id.*). Despite the imprudence of the usage, no additional economic harm can be calculated when spot prices fall below LIFO. In any case, Staff did not advocate a mechanistic rule to govern storage withdrawals that depends upon LIFO. (Staff Ex. 12 at 35-36).

(5) Peoples Gas Mischaracterizes Staff Witness Anderson’s Testimony Regarding “Peak Winter Period”

Peoples Gas mischaracterizes Staff’s position regarding use of Manlove field by misusing Staff witness Anderson’s response on cross examination. (PG IB at 78, n.67). In footnote 67 Peoples Gas states that it operated the field in the manner it did, because Peoples Gas does not know when the peak time, or most withdrawals, will occur, and gas is needed for anticipated colder January/February days. (PG IB at 78, n.67). Peoples Gas goes on to state that “Staff witness Anderson agreed that what he called the ‘peak winter period’ does not occur at the same time each year.” (*Id.*). This mischaracterizes Mr. Anderson’s cross examination response and does little to explain the preferential treatment Peoples Gas provided third party customers, as discussed above.

On cross-examination, Peoples Gas asked Staff witness Anderson, in his opinion, whether “the peak winter period occurs at the same time each year?” Staff witness Anderson said “no.” (Tr. 873). No utility knows when each winter’s peak period or peak day will occur, therefore, Mr. Anderson’s statement under cross-examination is merely the recognition of the obvious. Moreover, this does not detract from Staff’s

contention that the manner in which Peoples Gas operated Manlove field gave preferential treatment to third party customers to the detriment of ratepayers. (Staff Ex. 6.0 at 35).

The record clearly indicates that Peoples Gas' plan for operating Manlove field was to maintain sufficient inventory in the field through the third week of January in order to meet any potential peak day conditions. (Staff Ex. 6.0 at 40-41). To do so, Peoples Gas had to restrict, or decrease, withdrawals for ratepayers, because Peoples Gas' third party customers were rapidly withdrawing gas from Manlove field and had completely depleted their supply by January 5, 2001. (Staff Ex. 2 at 37; Staff Ex. 6 at 38). Evidence of this is the fact that the withdrawal of gas, by both utilities, for its ratepayers was less than their planned levels of withdrawal during this period. (See Staff IB at 25-27).

Peoples Gas offered no reasonable basis for deviating from its pre-planned withdrawal levels for the ratepayers of Peoples Gas and North Shore. It did, however, allow third party customers who conduct non-tariff transactions to remove all of their gas from Manlove field by January 5, 2001, and then it allowed additional gas be loaned to them until March 2001. This action potentially reduced the peak day deliverability of Manlove field.

Thus, Peoples Gas acted imprudently when it allowed third-party customers to rapidly withdraw its gas from Manlove field, and simultaneously reduced the volume of gas it withdrew for ratepayers in order to extend the life of the field.

D. Revenue from Non-Tariff Services

Staff's adjustments for revenue derived from non-tariff services are based on Subsection 525.40(d) of 83 Ill. Adm. Code 525 ("Part 525"). Peoples Gas is incorrect when it argues that non-tariff revenues (*i.e.*, "hub revenues") are properly accounted for 'above-the-line' and, therefore, should be reflected in its base rate revenue requirement. Peoples Gas likewise incorrectly applies the Commission's Orders in Docket Nos. 93-0320, 02-0779 and 03-0551. Peoples Gas states that these revenues would be taken into consideration in its next rate case. Staff's position is that Peoples Gas' non-tariff revenues should have been recorded as an offset, or reduction, to recoverable gas costs pursuant to the requirements of Subsection 525.40(d), *supra*. Since the recovery of gas costs are subject to the provisions of Part 525, it is therefore proper to address hub revenues in PGA proceedings (not in rate cases). Finally, Peoples Gas must follow the requirements of Subsection 525.40(d), *supra*, which provides neither an exception for transactions under a Federal Energy Regulatory Commission ("FERC") Operating Statement or storage exchanges with third party customers, nor a provision for waiver of the provision.

Peoples Gas' arguments are improper, because, as Staff has shown in its Initial Brief (at 62-73), these non-tariff revenues that Peoples Gas received from transporting, parking and loaning, or storing third party gas were not exempt from Subsection 525.40(d) under either of its two stated exceptions. The first exception is that the revenues were derived under an ICC tariff, and the second exception is for revenues derived from tariffs under the provision of special contracts approved by the Commission. These Peoples Gas' non-tariff revenues falls under neither of the

exceptions and, therefore, these non-tariff revenues should be reflected as a reduction from gas cost recovered from the PGA customers. (Staff IB at 63-67).

In support of its position that revenues from non-tariff services are not recovered through the Gas Charge, Peoples Gas has four main arguments, none of which are new. Staff, in its Pre trial Brief¹⁶ and Initial Brief has already rebutted each of Peoples Gas' arguments and presented compelling arguments for the application of the requirements of Subsection 525.40(d) to these revenues. Peoples Gas' four arguments in support of its position (and Staff's counter-arguments as presented in its Pre-trial Brief and Initial Brief are noted in "[]" brackets and italic font below each argument) are:

1. the costs of the assets used, such as its Manlove Storage Field and the Mahomet (transmission) Pipeline, to provide non-tariff services are recovered through base rates (PG IB at 72-73);

[Staff Position: Staff Pre-trial Brief, at 6-7, Consideration 1.5 and Consideration 1.6 respectively, and Staff IB, at 65].

2. that displacement is not determinative of the accounting treatment of hub revenues (PG IB at 72),

[Staff Position: Staff Pre-trial Brief, Section D, at 12-13 and Staff IB at 65-67].

3. the Commission, in its Order in Docket No. 93-0320, determined that hub service revenues are to be accounted for above-the-line (PG IB at 72-73); and,

[Staff Position: Staff IB at 67-71].

4. that the Commission's Orders in Docket Nos. 02-0779 and 03-0551 apply to this case (PG IB at 73-74).

[Staff Position : Staff IB at 71-73].

¹⁶ Pre-Trial Brief of the Staff Witness of the Illinois Commerce Commission on the Applicability of 83 Illinois Administrative Code 525.40(d), Docket No. 01-0707, March 4, 2005.

(1) Recovery of Revenues through Base Rates is Not Dispositive of Requirements of Subsection 525.40(d)

Peoples Gas argues that its transmission pipeline (i.e., Mahomet Pipeline) and Manlove field are the only assets used to provide non-tariff services and that the costs of these assets are recovered through base rates. (PG IB at 72-73). As discussed below, there are two flaws with this argument. First, non-tariff services are provided through the use of displaced gas.

Displaced gas is also a recoverable gas cost under the definition at Subsection 525.40(a)(1). Second, Section 525.40 does not consider whether or not the costs of the assets are recovered through base rates or not, as Peoples Gas is arguing. Section 525.40 looks at whether any of the associated (or related) costs necessary to complete the transaction are a recoverable gas cost, as defined in Subsection 525.40(a).

Peoples Gas argues that only the costs of Manlove field and the Mahomet Pipeline are necessary to provide non-tariff services. (PG IB at 72-73). Peoples Gas' logic overlooks the fact that the costs related to three assets are necessary to conduct hub transactions; (1) Mahomet Pipeline, (2) Manlove field, and (3) the use of displaced gas. (Staff Ex. 2 at 38-40, lines 784-830; Staff Ex. 1 at 10-13, lines 210-282; and Staff IB at 65-67). Displaced gas allows Peoples Gas to enter into transactions that utilize natural gas facilities "without the physical delivery of the molecules of natural gas" that were received. In other words, displaced gas molecules injected into Peoples Gas' system substitutes for other gas molecules (that are present in the system) in order to facilitate the movement of gas. As such, it is possible that Peoples Gas used each of the four types of recoverable gas costs¹⁷ (as defined in Subsection 525.40(a)) to

¹⁷ The four types of "recoverable gas costs" as defined in Sub-section 525.40(a) are:

accomplish its non-tariff services transactions. (See *Staff Pre-Trial Memorandum* at 7-8).

Peoples Gas further argues, that, since the cost of these assets are recovered through base rates, then it is only appropriate that non-tariff service revenues be afforded base rate treatment, *i.e.*, these revenues would be considered in the determination of the over-all revenue requirement at the time of Peoples Gas' next rate case. (PG IB at 72-73). However, this is a false distinction. Subsection 525.40(d) does not contain the word "asset" or "assets" or any reference to costs recovered in base rates. This argument is not consistent with the express language of Subsection 525.40(d) which states:

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). (83 Ill. Adm. Code §525.40(d)) (emphasis added).

-
- 1) costs of natural gas and any solid, liquid or gaseous hydrocarbons purchased for injection into the gas stream or purchased as feedstock or fuel for the manufacture of gas, or delivered under exchange agreements;
 - 2) costs for storage services purchased;
 - 3) transportation costs related to such natural gas and any solid, liquid or gaseous hydrocarbons and any storage services; and
 - 4) other out-of-pocket direct non-commodity costs, related to hydrocarbon procurement, transportation, supply management, or price management, net of any associated proceeds, and Federal Energy Regulatory Commission-approved charges required by pipeline suppliers to access supplies or services described in subsections (a)(1) through (3) of this Section.

The rule does not consider whether the assets' costs are recovered through base rates or not, as Peoples Gas is arguing. It looks at whether any of the associated (or related) costs necessary to complete the transaction are a recoverable gas cost, as defined in Subsection 525.40(a). If any of the associated costs meet the definition of recoverable gas costs, then the revenues from the transaction must be accounted as an offset to recoverable gas cost unless the transaction meets one of the two exceptions previously discussed.

People Gas' argument ignores the plain language of the rule and fails to show that the transactions are within the Subsection 525.40(d) exceptions. The relevant language of Subsection 525.40(d) that identifies the exceptions is: "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." Staff, on the other hand, explained in its Pre-Trial Memorandum (at 8-11) that hub service transactions do not fall within the Subsection 525.40(d) exceptions. Briefly re-stated, non-tariff transactions are neither pursuant to an ICC tariff nor conducted under a special contract, approved by the Commission, that is pursuant to a tariff. (*Staff Pre-Trial Memorandum on §525.40(d)* at 9-10). Storage exchange transactions are not regulated by ICC tariffs. These exchanges are non-regulated storage service transactions whereby third parties either deliver natural gas into Peoples Gas' system for later withdrawal or borrow gas and repay it at a later date. (*Id.* at 10-11).

(2) Displacement Gas is Necessary to Complete Hub Service Transactions

Peoples Gas also argues that displacement gas is not determinative of the accounting treatment of hub revenues because it is impossible to state that a transaction did or did not have any recoverable gas costs associated with it. (PG IB at 72-73). In support of this position, Peoples Gas relies upon Staff witness Anderson's statement that he was unaware "of any transaction under which a customer would receive the same gas that the customer put in the system and it was not even possible to know if the gas is the same." (PG IB at 72).

Peoples Gas' argument fails to confront the real issue concerning displacement gas -- the inability to track individual gas molecules. Such inability does not invalidate the existence of, or the use of, displacement gas to accomplish hub transactions. (Staff Ex. 2 at 32-36, 38-40; Staff Ex. 6 at 27 (stating that Peoples Gas has not refuted the fact that displacement used in providing non-tariff transactions, which is the equivalent of hub services)). Peoples Gas does not know exactly which gas molecules it will be using when it performs a hub transaction, only that gas molecules will be used through displacement. (PG Ex. L at 22-23 stating "when gas is loaned, it is not loaned from a specific source . . . it could be from any or all of these sources; see *a/so* Staff Ex. 11 at 9-13, responding to PG Ex. L). Therefore, the displacement of gas is essential to the completion of these transactions. Furthermore, Staff never argued that individual gas molecules must be tracked, only that displacement occurs and is necessary to accomplish hub transactions. (Staff Ex. 2 at 33-37). In addition, Peoples Gas acknowledges the use of displacement in conducting its transactions (Peoples Gas

Section 525.40 Brief at 14, lines 303-304)¹⁸. As Staff stated in its Initial Brief --“The question for the Commission is, where did Peoples find the gas to loan if it did not use displaced gas? The only answer is, Peoples Gas could not accomplish this transaction without the use of displacement gas present in its distribution system.” (Staff IB at 67). Displacement gas in its distribution system meets the definition of “recoverable gas costs” (under Subsection 525.40(a)(1)).

Peoples Gas’ argument fails to provide the full picture of the displacement situation. Staff’s analysis and recommendations focus on Peoples Gas’ accounting records for the gas in question, and not on some specific gas molecule review. Peoples Gas has a duty to maintain records of the gas that each customer delivers and receives through its system, including third party customer transactions. As Staff has shown herein, there are instances in which third party customer transactions impact the Gas Charge. If all such records were not kept, Peoples Gas could not bill its customers or ensure its customers stay within their tariff and contractual rights. (Staff Ex. 11 at 10). Another reason records are kept is regulatory oversight – in this case, records sufficient for Staff to review in determining whether or not recoverable gas costs were used when providing hub transactions.

Moreover, Peoples Gas’ records clearly indicate that it continued to provide loans to third parties (or return gas previously delivered, as in Transaction 19) after those entities had depleted their storage inventory at Manlove. Peoples Gas, however, failed to disclose the operational fact – the origination point of this loaned gas. Staff’s position is that the loaned gas was ratepayer gas purchased by Peoples Gas. Instead of

¹⁸ Brief of The Peoples Gas Light and Coke Company on the Applicability of 83 Ill. Admin. Code §525.40 to the Issues in this Proceeding, March 4, 2005.

identifying the origination points, Peoples Gas argues that the individual molecules could be from several sources. (Staff Ex. 11 at 9). Rather than rely upon Peoples Gas pleading ignorance or its attempt to rely upon a molecular defense, which its own brief now derides, Staff reviewed the Company's records for gas receipt and delivery. (Staff Ex. 11 at 10). Staff's analysis of this information indicates that the only source of gas Peoples Gas could access and use in performing and balancing its hub transactions was the PGA system supply natural gas. (*Id.*). Peoples Gas bears the burden of showing that the gas used in non-tariff services was not ratepayer gas, and it has not met that burden.

(3) The 1996 Amendment of Part 525 Supersedes the Commission Finding in the 93-0320 Order that Hub Services are Treated 'Above-The-Line'

Peoples Gas' third argument is that the Commission, in its *93-0320 Order*,¹⁹ determined that hub service revenues are to be accounted for above-the-line. (PG IB at 73-74). As a point of clarification, the phrase "above-the-line" refers to revenues and expenses that are included in the determination of a utility's operating income. The Commission in Docket No. 93-0320, appears to have used the term, "above-the-line", to refer to revenues and expenses that were to be determined in a rate case. (Gas costs that are determined through a PGA proceeding are also included in the determination of operating income. In other word, an expense recorded "above-the-line" does not preclude it from being flowed through the PGA clause).

¹⁹ *Order*, Docket No. 93-0320, Northern Illinois Gas Company: Application for an order approving accounting treatment related to certain market area hub activities, 1996 Ill. PUC LEXIS 151 (March 13, 1996).

As Staff explained in its Initial Brief, the *93-0320 Order*, has been superseded, on this point, by the creation of Subsection 525.40(d) in Docket No. 94-0403. (Staff IB at 67-69). Furthermore, Nicor Gas Company, in its most recent rate case Docket No. 04-0779 (the same respondent utility that was a party to Docket No. 93-0320), agreed with Staff that its hub revenues should be credited to ratepayers through Rider 6 (Nicor's PGA Tariff). (see Nicor Gas Pre-trial Memorandum, Docket No 04-0779, at 41, May 17, 2005). Peoples Gas' reliance on the *93-0320 Order* is misplaced since the Commission could not have considered Section 525.40(d) in its analysis. In addition, the issue of the treatment of Peoples Gas' hub revenues has not been addressed previously by the Commission since the inception of Subsection 525.40(d) in 1996.

(4) The Transportation Contracts Approved in Docket Nos. 02-0779 and 03-0551 Are Not Analogous Because They are Contracts Approved by the Commission, Which is an Exception to a Recoverable Gas Cost

Peoples Gas incorrectly applies the Commission's Orders in Docket Nos. 02-0779 and 03-0551 to revenues from non-tariff services (*i.e.*, hub services or hub transactions). (See PG IB at 74). Staff addressed the applicability of these cases in its Initial Brief (at 71-73), in which Staff explained that the transportation revenues at issue in those dockets qualified for exclusion under one of the two exceptions of Subsection 525.40(d).

With respect to non-tariff transactions, Peoples Gas is asking -- "can we exclude our hub services revenues from the Gas Charge?" The answer is, "no". As described below, hub transactions are not regulated by ICC tariff (instead they are granted under FERC authority) and second, hub services' contracts are not approved by the Commission.

Peoples Gas argues that the firm transportation services approved between Nicor and North Shore in Docket Nos. 02-0779 and 03-0551, which allowed Nicor to exclude the revenue it received from the PGA (*i.e.* from the Gas Charge), are analogous to hub transactions. (PG IB at 74). Peoples Gas is mistaken. The Nicor–North Shore transportation agreements are contracts between two utilities approved by the Commission. They are dissimilar to hub transactions because hub transactions are conducted under FERC authority and not an ICC tariff or contract pursuant to an ICC tariff (although the transactions may be supported by a contract, the contract has not been approved by the Commission). Thus, Peoples’ hub transactions do not qualify for the exemption under Subsection 525.40(d)²⁰

A review of the orders in Docket Nos. 02-0779 and 03-0551 will demonstrate their inapplicability to the instant docket. The facts in those orders show that the revenue from the firm transportation contracts were not included in the Gas Charge because those contracts met one of the exceptions of Subsection 525.40(d). In Docket No. 02-0779²¹, Staff reviewed the transportation contract between Nicor and North Shore for compliance with the public convenience standard of Section 7-102 of the Act,

²⁰ Subsection 525.40(d) states, with the relevant section emphasized with italics:

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). (83 Ill. Adm. Code §525.40(d)) (emphasis added).

²¹ Order, Docket No. 02-0779, Northern Illinois Gas Company d/b/a Nicor Gas Company and North Shore Gas Company: Joint Petition for Approval of a Firm Transportation Agreement Pursuant to Section 7-102, 9-102 and 9-201 of the Illinois Public Utilities Act and Related Relief, at 2 (dated Feb. 20, 2003).

220 ILCS 5/ 7-102. The Commission found that, without the agreement between North Shore and Nicor, North Shore would be required to purchase a more costly service from Natural Gas Pipeline of America. (02-0779 Order, at 2, finding that “Nicor service is less costly than other alternatives available to North Shore”). In addition, the Commission ordered that the Nicor revenues be excluded from the Gas Charge (*Id.*)²² Although not a disputed issue in the docket, the facts show that Nicor’s revenues from this contract qualified as an exception allowed under the provisions of Subsection 525.40(d) because this was a contract approved by the Commission.

In Docket No. 03-0551,²³ the Commission reviewed an agreement that was identical “in all material respects to a firm transportation agreement between the Petitioners that the Commission approved in Docket No. 02-0779, by order dated February 20, 2003.” Since the agreement being reviewed in Docket No. 03-0551 was substantively the same as that approved in Docket No. 02-0779 (except for an

²² Definition of the term “Above-the-Line”: included in utility operating income (i.e., income from utility operations), it does not mean that it is excluded from the Gas Charge.

The Commission, in Orders 02-0779 and 03-0551, appears to use the term “above–the-line” to mean an item excluded from the Gas Charge. “Above-the-line” typically refers to utility operating income, and also means that a revenue or expense item is included in the calculation of utility operating income. “Above-the-line” does not mean that a revenue or expense item is excluded from the Gas Charge. Commission orders frequently refer to above or below the line without definition of these terms. However the terms’ definition is implied by the rulings on the rate issues in the orders themselves. (See e.g., Order, Docket Nos. 02-0480, Consumers Illinois Water Company Petition for issuance of Certificate of Public Convenience and Necessity to operate a water supply and distribution system in Kankakee County; and for approval of a variance from main extension deposit provisions, rates and accounting entries, 2003 Ill. PUC LEXIS 230 at *18 (March 2003); and Order, Docket No. 99-0457, Illinois-American Water Company, United Waterworks, Inc. and United Water Illinois, Inc. Petition for Approval of Proposed Reorganization, 2000 Ill. PUC LEXIS 465 at *61 (May 2000).

Gas costs are recovered via the Gas Charge, and are not determined in a rate case, nor are they recovered in base rates. Section 9-220 a) of the Act and Part 525 Gas costs however, are included in the calculation of operating income (i.e., “above-the-line”) and are also included in the Gas Charge. (See e.g., Order, Docket No. 01-0696, Appendix, reflecting PGA revenues in the utility’s operating income).

²³ Order, Docket No. 03-0551, Northern Illinois Gas Company d/b/a Nicor Gas Company and North Shore Gas Company: Joint Petition for Approval of a Firm Transportation Agreement Pursuant to Section 7-102, 9-102 and 9-201 of the Illinois Public Utilities Act and Related Relief, at 2 (dated Nov. 12, 2003))

extension of the termination date to March 31, 2006), it also would have qualified as an exception allowed under the provisions of Subsection 525.40(d).

Thus, the firm transportation service approved in Docket Nos. 02-0779 and 03-0551 do not support the proposition that revenue from non-tariff services should be exempt from the Gas Charge, because the contracts approved in those dockets were exempt from the Gas Charge under one of the two exceptions of Subsection 525.40(d). The comparison Peoples Gas seeks to make of itself to Nicor is faltering. During the course of this proceeding Peoples Gas has claimed:

1. that its hub revenues are like the Nicor hub revenues that were not recovered through the Gas Charge (*i.e.* Docket No. 93-0320), until Nicor agreed to recover its hub revenue through the Gas Charge (*see* Staff IB at 69); and

2. that its hub revenues are like Nicor's firm transportation revenues which were recovered in base rates, but Nicor's firm transportation contract, unlike the hub service contracts, was approved by the Commission.

For the reasons discussed above, both comparisons need to be rejected.

(5) Non-Tariff Revenues Should Be Included in the Gas Charge, and Not in Base Rates

At the end of the first paragraph, on page 75 of its Initial Brief, Peoples Gas states that it is proper to account for its hub revenues above-the-line and not through the Gas Charge and that the hub revenues will be included in the next base rate case. (PG IB at 75). For the reasons discussed in Section I.2.D(1), *supra*, non-tariff revenues are included in the Gas Charge. Therefore, Peoples Gas' non-tariff revenues should have been recorded as an offset or reduction to recoverable gas cost pursuant to the

requirements of Section 525.40(d). Since the recovery of gas costs are subject to the provisions of Part 525 (the Commission's PGA rule), it is therefore proper to address hub revenues in PGA proceedings (not in rate cases).

E. enovate Adjustment: The “enovate P&L” Statement Demonstrates the Nexus Between enovate’s Profits and Peoples Gas’ Gas Costs, and Peoples Gas Should Not be Rewarded for Failing to Maintain Sufficient Accounting Records

On page 85 of its Initial Brief, Peoples Gas states that Staff and GCI had to establish that enovate's activities caused Peoples Gas ratepayers to pay more for their gas. Peoples Gas is wrong for two reasons. First, the “enovate P&L” statement establishes that certainly some, if not all, of enovate's transactions were to be recovered through the Gas Charge. Second, given this fact, Peoples Gas has the duty to maintain records of those transactions; Peoples Gas failed to maintain such records. (See Staff IB at 75, *citing* 83 Ill. Admin. Code Part §505, Gen. Instruct. #2 and #14).

On page 86 of its Initial Brief, Peoples Gas provides the unsupported assertion that “enovate's costs and revenues did not flow through the Gas Charge.” Whereas Staff, in its testimony and in its brief, discusses the ‘enovate P&L’ which shows that credits to the Gas Charge were made in a number of enovate's deals – “38 Special”,²⁴ “ANR Rolling Thunder”, “NGPL NSS” and “NSS Tidal Wave.” (Staff IB at 74-76; Staff Ex. 9 at 25-26 and Attachment H). The aforementioned Staff's exhibit demonstrates the nexus between enovate's profits and credits to the Gas Charge.

Moreover, Peoples Gas claims that “Staff and CUB/City have not tried, let alone succeeded, in showing any nexus between enovate's profits and Peoples Gas' gas

²⁴ “38 Special”, however, was credited to the PGA in the 2000 reconciliation period, further supporting Staff's recommendation to re-open the docket. – Group Ex. 1 at ST PG 33.

costs recovered from ratepayers pursuant to its Gas Charge. Without such a nexus, Respondent's gas costs should not be subject to disallowance." (PG IB at 88). This is especially egregious argument in light of 83 Ill. Adm. Code 505 which requires them to maintain such information and their failure to produce the information when requested by Staff. (See Staff Ex. 9 at 24-25). Peoples Gas should not be allowed to argue that Staff did not provide evidence when Peoples Gas failed to maintain any data that would be responsive to Staff's data requests about a document that shows as credits to the Gas Charge – the "enovate P&L".²⁵ Staff witness Hathhorn provided the following testimony, at pages 26 and 27 of Exhibit 9, about the lack of documentation Peoples Gas had regarding the deals identified in the "enovate P&L":

"Respondent does not have any workpapers or contracts to describe how the PGA credit was calculated." (emphasis added)

Peoples provided a similar response to data request ACC-4.02 regarding PGA credits totaling \$489,801 for an exchange deal known as "Tidal Wave"

"Respondent does not have any workpapers or contracts to determine how the PGA credit was calculated." (emphasis added)

Again, in response to Staff data request 4.03 concerning a deal known as "38 Special" and a \$50,000 PGA credit, Peoples states:

"The \$50,000 credit to the Gas Charge was an amount mutually agreed to by Respondent and Enron North America ("ENA"). There are no workpapers or calculations which support the \$50,000 Gas Charge credit." (emphasis added)

The 'enovate P&L' and the recovery of Gas Costs related to enovate deals were first discussed in Staff's additional direct/rebuttal testimony. However, Peoples Gas never refuted the accuracy or authenticity of the document. The "enovate P&L" shows

²⁵ The enovate P&L was only provided in additional discovery.

that some of enovate's profits were credited to the Gas Charge, but Peoples Gas failed to explain why certain transactions and amounts were credited to the Gas Charge and others were not. 83 Ill. Adm. Code 505 requires Peoples Gas to maintain records that support its activities. (See Staff IB at 75, *citing* 83 Ill. Admin. Code Part §505, Gen. Instruct. #2 and #14). Furthermore, Peoples Gas had no documentation that verified the "enovate P&L" amounts credited to the PGA. The failure to keep sufficient documentation impedes Staff's ability to verify which transactions should be credited to the Gas Charge, and whether such transactions were appropriate. Given that the aforementioned evidence shows that some transactions were credited to the Gas Charge, Staff recommends an adjustment be made to the Gas Charge.

The accuracy of Staff's adjustment is affected by Peoples Gas' failure to maintain records in compliance with Part 505. Staff therefore based its adjustment on the profits enovate earned. enovate had only one contract – and it was with Trunkline for transportation services. (Staff Ex. 9 at 20). As Dr. Rearden explained in testimony, the lack of records made it difficult to "determine exactly how enovate earned its profits" (Staff Ex. 7 at 72), however, he explained that enovate "was a trading entity that leveraged the utility's assets and employee base. All of its transactions had to use the entire system, including services whose costs are recovered through the PGA." (*Id.* at 71). Since all of enovate's transactions used Peoples Gas' system and used services whose costs are recovered through the Gas Charge, all of enovate's revenues "used services whose costs would normally flow through the PGA, therefore, those profits should be [recovered] through the PGA." (*Id.* at 72).

Staff proposes two adjustments to recover enovate's income. The first adjustment is Peoples Energy's share of enovate's income, net of other Staff adjustments (Staff IB Appendix A, Schedule 5.03, column P; see *also* Staff Ex. 9 at 20-22, and Schedule 9.05). The second adjustment is the amount of enovate income received by Enron (via Enron MW), net of other Staff adjustments (Staff IB Appendix A, Schedule 5.03, column Q; see *also* Staff Ex. 9 at 23, and Schedule 9.06).

F. Storage Optimization Contract

In its Initial Brief, Peoples Gas argues that the Storage Optimization Contract ("SOC") is prudent because Subsection 525.40(a)(4) (83 Ill. Admin. Code §525.40(a)(4)) contemplates the use of third parties to manage excess capacity and that the SOC did not increase Peoples Gas' gas costs. (PG IB at 81). Both arguments are flawed. The fact that Subsection 525.40(a)(4) allows for recovery of supply management fees does not, by itself, make the underlying contract or the decision to enter the contract prudent. The SOC did increase gas costs, because it caused Peoples Gas to spend more money for supply management services than it would have otherwise paid. Not surprisingly, Peoples Gas chose a proposal that subsidized Peoples Gas' parent. (Staff Ex. 7 at 64-66). In addition, Peoples Gas demonstrated neither that the NSS contracts²⁶ were cheaper than their alternatives, nor that an agency arrangement was prudent given the NSS contracts. (Staff Ex. 7 at 65-66).

²⁶ "NSS contracts" refers to the two contracts for leased storage service with Natural Gas Pipeline of America under Rate Schedule NSS that were in the SOC (See Storage Optimization Contract at 4).

(1) There Were Superior Alternatives to the Storage Optimization Contract That Would Have Cost Ratepayers Less Money

Supply management is identified as a recoverable gas cost under Subsection 525.40(a)(4). However, the decision to enter into the contract and the actions taken by the utility still need to be prudent, and in this case they were not. As Staff explained in its Initial Brief, TPC offered an alternative to the SOC, and the terms of that alternative provided a larger percentage of the revenues to ratepayers. (Staff Ex. 7 at 64, 66). As Dr. Rearden stated in his additional direct/rebuttal testimony, under the SOC proposal, Peoples Gas was to share with Enron MW XX% of the first million dollars, increasing to XX% of the second million dollars and to XX % of all profits above two million dollars. (Staff Ex. 7 at 64) Dr. Rearden found that the SOC would not save ratepayers more money than the TPC Profit Sharing Proposal because “[t]he only sharing percentage that is higher for [the] TPC proposal is for the XX XX XX and XX XX XX out of XX XX.” (*Id.*). In addition, the average percentage share to TPC (weighted by volume) equaled XX % of the profits earned under the TPC Profit Sharing Proposal. (*Id.*) The TPC Profit Sharing Proposal was a better deal for ratepayers than the SOC since Peoples Gas had to share less profit than it would have to share under the SOC -- 19% compared to the 25% to 40% range of the SOC. Peoples Gas’ decision to enter into a contract that cost ratepayers more money was imprudent. (*Id.* at 66).

Moreover, the imprudence of this deal is amplified by the indirect routing of profits from Peoples Gas to Peoples Energy. The SOC was an agreement for Enron MW to optimize certain storage capacity for Peoples Gas. (Staff IB at 22-23). Enron MW, however, was sharing XX XX of its revenue with Peoples Energy through an oral agreement (Staff Ex. 7 at 65; Staff Ex. 9 at 15-16), and Peoples Gas did not present any

evidence countering or denying that fact in its surrebuttal testimony (see Staff Ex. 9 at 15-16, explaining rationale for Staff's understanding of profit sharing arrangement). Since Enron MW was to receive between XX % and XX % of profits from transactions, Peoples Energy and its shareholders were earning approximately XX XX XX XX % of Peoples Gas' profits, because XX of Enron MW's profits were being shipped to Peoples Gas' parent company. (Staff Ex. 7 at 65-66). The fact that Peoples Gas' parent company received a percentage of Peoples Gas' profits (through Enron MW) brings into question whether the SOC deal was an arms-length negotiation. This is especially true when the TPC Profit Sharing Proposal offered a better deal to ratepayers than to shareholders. The lack of an arms-length negotiation makes the decision to enter the SOC imprudent.

Thus, Staff recommends that the SOC be found to be imprudent and that all the money paid to Enron MW be recovered through the Gas Charge.

(2) The SOC Resulted in Higher Gas Costs to Ratepayers Because TPC Would Have Received a Smaller Profit Share than Enron MW Did Under the SOC and Peoples Gas' Management Fees and Revenue Sharing Would not Have Been Overstated due to Oral Sharing Agreements Between Peoples Energy and Enron

Peoples Gas argues that the SOC did not increase its gas costs. (PG IB at 81). As was discussed in §I.2.E.1., *supra*, the TPC Profit Sharing Proposal was a better deal for ratepayers than the SOC, and the lower profit sharing would have lowered the gas costs. Consequently, the SOC resulted in higher gas costs than what the TPC Profit Sharing Proposal would have provided.

Peoples Gas claims to have saved ratepayers \$334,344. (PG IB at 82-83). This amount, however, was woefully short of being the amount Peoples Gas should have

recovered; it would have been greater if the TPC Profit Sharing Proposal was chosen. In its testimony, Staff explained its calculation methodology (and is recounted in § II.4.A and B, *infra*) the recovery related to the SOC is \$1,340,000. (Staff IB at 87-89, Sched. 5.03). (Staff has two adjustments for the SOC -- \$623,000 attributed to payment of management fees and Enron MW sharing revenue with Peoples Energy, and \$717,000 attributed to Enron MW profits).

As discussed in the section above, the TPC Profit Sharing Proposal would have Peoples Gas sharing approximately XX % of the profits from the optimized storage with TPC. In comparison, under the SOC Peoples Gas paid Enron MW an amount somewhere between XX XX XX % of the profits from the optimized storage. (See Staff Ex. 7 at 64). All factors being held constant, had Peoples Gas chosen the TPC Profit Sharing Proposal instead of the SOC, Peoples Gas would have less money to recover through the Gas Charge. Thus, the decision to enter into a contract that cost ratepayers more money was imprudent.

G. Transaction 19: Peoples Gas Does not Deny the Transaction was Imprudent and Staff's Calculated Adjustment is Correct

Peoples Gas asserts that its decision to enter into Transaction 19 was prudent. In its view, Transaction 19 was a reasonable way to handle a possible oversupply situation identified in its planning model. (PG IB at 92). The transaction resulted from Peoples Gas beginning withdrawals from Manlove field early. In response to Staff, Peoples Gas argues that early withdrawals would reduce gas purchases by nearly \$3 million per day (PG IB at 93), and that Staff is imposing an obligation upon Peoples Gas to perform a specific type of study to make decisions about off-system transactions. (PG

IB at 94). Peoples Gas also disagrees with Staff's proposed method to assess a disallowance. (PG IB at 94-95).

(1) The Decision to Begin Withdrawals from Manlove Field Early was based on Economic Factors and Probably Affected by Peoples Gas' Strategic Partnership with Enron.

Peoples Gas states "At the time...price of spot gas purchases in Chicago was roughly \$6.00 per MMBtu. An early onset of withdrawals therefore would reduce gas purchases by nearly \$3,000,000 per day of foregone injections." (PG IB at 93). In addition, Peoples Gas also stated in testimony that the reason it began gas withdrawals early was because it forecasted that prices might decline. (PG Ex. F at 35). Both of these are economic motives. However, in its testimony, Peoples Gas continually emphasizes its need to operate the storage field to insure a reliable supply of gas. (PG Ex. F at 33-34 and 43, PG Ex. L at 30, and PG Ex. I at 5-6, describing how field is operated without regard to price). Peoples Gas also responded to Staff's criticisms of the manner in which it operated Manlove field by stressing that operational restrictions were of greater priority than economic considerations. (See *generally*, PG IB at 9 and 79, the basis of its arguments in both locations being that operational factors predominate economic considerations).

The economic motives that inspired Peoples Gas to buy or sell gas also applies to third party customers. That is, third party customers will also desire to withdraw gas when prices are high and may fall. Peoples Energy shared revenues with Enron MW as part of its strategic partnership with Enron. (Staff Ex. 7 at 7-12). To the extent that early withdrawals facilitated deals with Enron that generated profits to share, Peoples Gas' decision-making with regard to how it used assets in place to serve ratepayers may

have been tainted. In the case of Transaction 19, Peoples Gas entered into the transaction even though it risked higher costs for ratepayers. (Staff Ex. 7 at 38 and Staff Ex. 12 at 24-25).

(2) Peoples Gas Ignored all Risks that Weather Might be Something Besides Warmer than Normal when it Began Withdrawals Early and Entered into Transaction 19.

Peoples Gas identified two risks it would experience if it began withdrawing gas from Manlove field early -- "...entering the heating season with less storage inventories than planned, as well as the increased likelihood of a weather-related oversupply situation." The first risk is the chance that weather remains cold, and Peoples Gas' finds its inventory is not sufficient to meet its operational needs. The resulting consequence is that Peoples Gas would need to purchase large volumes of high priced gas for ratepayers. (Staff Ex. 12 at 24). The second risk is the opposite – the chance that weather becomes much warmer. In such an instance, Peoples Gas runs the risk of having to shed its excess supply of gas by selling gas at low prices. (PG Ex. F at 50) Peoples Gas failed to account for either of these scenarios, yet neither situation is unforeseen.

Peoples Gas cannot argue that Transaction 19 is a prudent transaction just because Peoples Gas began withdrawals from Manlove field early. To the contrary, every year Peoples Gas faces the risk that the weather can turn warm after Manlove field withdrawals begin. For this particular reconciliation period, Peoples Gas has not shown that its risk of experiencing extreme weather was any more likely than in previous years. (Staff Ex. 7 at 38-39). Peoples Gas, however, made a fundamentally

different decision than it normally makes – it sold some of its supply of gas coming into the withdrawal season -- without any justification.

Again, Peoples Gas states that operational needs drive its use of Manlove field. During a heating season, that means that Peoples Gas is concerned with retaining Manlove field's peak day deliverability through the third week of January. (PG Ex. L at 29-30). Transaction 19 is antithetical to that goal because it sells gas to Enron. Peoples Gas fails to produce evidence that it considered the risk that warm weather would occur. At the time, it was “colder than normal.” (Tr. 1066, PG witness Wear)

In addition, the explanation provided by Peoples Gas fails to consider the revisions it should have made to its withdrawal plan to account for colder than normal weather. Starting withdrawals from Manlove field earlier than planned exposed the utility to the risk of a supply shortage if weather turned colder than normal. Yet Peoples Gas' explanation of its actions, with respect to Transaction 19, fails to provide any information on its planning for weather that would be colder than normal after Manlove field withdrawals started early.

(3) Peoples Gas did Not Evaluate Whether the Resale Term in the GPAA was Sufficient to Handle Oversupply

Peoples Gas does not try to determine whether the sellback provision of GPAA (Article 2.4) is a better alternative to entering into this transaction. (Staff IB at 79) Peoples Gas justified the transaction outside of the resale provision by claiming that it needed to preserve its resale rights. (PG Ex. F at 49) However, the purpose of the sellback provision was for this very case, yet Peoples Gas did not rely upon it. It further did not evaluate its ability to economically handle any oversupply that it might project. (Staff Ex. 3 at 37-38)

(4) Staff is Not Imposing New Requirements upon Peoples Gas to Justify its Actions, but Does Believe that the Commission Must Insist that a Utility Explain its Decisions when It Changes its Strategy.

Peoples Gas alleges that Staff is imposing a new obligation upon it to perform a specific type of study to make decisions about off-system transactions. (PG IB at 94) Staff does not seek to impose any new, analytic requirement upon gas utilities. However, the burden of proof remains with gas utilities to justify their decisions. The Company stated that Transaction 19 resulted from the decision to begin withdrawals from Manlove Field early. Due to its concern that it might have an oversupply of gas, it ran the risk that it might need to sell off substantial quantities of excess gas in a falling market. Staff sees no other way besides analysis to weigh the pros and cons of each strategy and assess prudence.

In the same vein, Peoples Gas states that it engaged in many off-system deals over the years, but it never needed this level of analysis to demonstrate prudence. (PG IB 94) But in this transaction, Peoples Gas dumped supply early in the heating season (when it simultaneously expressed concern about withdrawing too much gas too early and reducing Manlove Field's peak day deliverability too early). This is a change in operation. It should be justified with an analysis that demonstrates why a decision different from previous years was reached.

Peoples Gas did estimate cost savings, but did not consider any other risks. For example, Peoples Gas apparently did not contemplate the risks from the weather turning cold and Peoples Gas was not long in gas. Peoples Gas does discuss its alternatives in over supply (but not under supply) situations in a footnote. In order to

justify its decision, those alternatives require some analysis to compare their relative risks as well as benefits. Peoples Gas made no such attempt.

(5) Staff's Method of Calculating the Adjustment is Reasonable

Peoples Gas incorrectly argues that Staff's calculation for Transaction 19 is erroneous and inflated. (PG IB at 94). Peoples Gas first argument is that Staff selected the highest priced gas on each day in December 2000 to subtract from the PGA, but Peoples Gas argues that it does not purchase gas this way, and no particular purchase could have been avoided. Consequently, Peoples Gas states that the weighted average cost of gas should be substituted for Staff's calculation. (PG IB at 94). Staff used the highest priced gas on each day for two reasons. First, while Peoples Gas may not be able to rank each MMBtu by cost, it presumably knows more than a little bit about it, by the fact that it is a gas utility and assumed to have knowledge of its contracts. (Staff Ex. 7 at 42). Also, Peoples Gas has not been forthcoming with details that would allow its claims to be evaluated. (Staff Ex. 7 at 39) Second, the highest cost gas, at any given time, is the cost that is imposed upon ratepayers and should be the amount refunded. (Staff Ex. 7 at 42). Presumably, Peoples Gas would reduce purchases starting at the highest cost gas first, other things equal.

Peoples Gas second criticism of Staff's adjustment calculation is the use of 50,000 MMBtus per day on days when Peoples Gas purchased less than 50,000 MMBtus on the spot market. (PG IB at 95). Staff used 50,000 MMBtus on all days because all Transaction 19 volumes nonetheless had value on the open market that is measured by the daily price index. And Peoples Gas surrendered value based upon those volumes in this transaction. (Staff Ex. 12 at 25-26)

Thus, the Transaction 19 should be found imprudent. And for the foregoing reasons, Staff's adjustment amount should be adopted by the Commission. If the Commission finds that Peoples Gas' arguments are more persuasive, Staff's adjustment amount should be adjusted accordingly and not disallowed as Peoples Gas requests.

H. Transaction 103: The Price Paid by Enron MW Was Imprudent Because it was Below the Future Price of Gas at Time Transaction was Entered Into

From pages 95 to 96, Peoples Gas argues that Transaction 103 was prudent because it preserved its injection rights for the storage service, and that such rights gave it additional and valuable flexibility.²⁷ This rationale does not outweigh the fact that the penalty amount paid by Enron MW is less than the projected difference in gas price between October and December 2000. (Staff IB at 94-95). In addition, Peoples Gas could have paid the penalty itself (*i.e.*, if Transaction 103 were never entered into). If Enron MW was to pay the penalty for Peoples Gas, Peoples Gas should have received a benefit. The transaction, however, provided no extra benefit to Peoples Gas or ratepayers. The relevant comparison for ratepayers is the amount of the penalty versus the gas' price at the time of the transaction. (Staff Ex. 7 at 41-42; Staff Ex. 12 at 39-40). Staff examined that issue in its testimony. (Staff Ex. 12 at 39-40).

Peoples Gas claims that Staff's adjustment for Transaction 103 should be rejected because Enron MW paid a fair price for the gas. (PG IB at 96). Peoples Gas' states that Dr. Rearden's analysis is wrong for two reasons. First, the injections were expected on no-notice, and therefore, there could not be a baseload hedge on those volumes. Second, Peoples Gas could not achieve the economic benefit Dr. Rearden

²⁷ These rights were used "...a portion of additional injection rights 69 times." (PG IB at 95-96).

thought was possible because the month in which the transaction was entered had the highest gas prices of the April to October period. (PG IB at 96).

Peoples Gas is wrong, and it confuses the benefits from paying the penalty with the value of the gas in the gas markets. (Staff Ex. 12 at 40). Dr. Rearden did not account for the benefits accruing from the penalty, because those benefits are independent from the identity of the party that pays the penalty. (*Id.*).

The Company does not confront Staff's analysis directly; but it confuses Staff's prudence review with its disallowance calculation. Dr. Rearden conducted a 'spread' analysis to determine prudence, while the disallowance is calculated in the same manner as disallowances for the imprudent storage usage adjustment, Transaction 19 and Transaction 16/22. A spread analysis simply examines the value of the gas at two different points in time. In this case, the first point in time is the value of gas in October, since that is the expected price that is set in the deal. The second point in time is December, since that is when the gas is to be delivered. (Staff Ex. 7 at 41).

The Company provides two reasons why Transaction 103 was not a financial spread transaction. First, it argues that the physical support for the sales to Enron MW took place from May thru October 2000 and that they were no-notice transactions, which implies baseload couldn't be hedged. (PG Ex. 12 at 39-40). It appears that Peoples Gas is claiming that, in order to provide the gas in December 2000, it would be buying gas on a no-notice basis from May through October 2000 and that those purchases were not hedge-able. However, Staff examined the cost to Peoples Gas to provide gas in December at October prices. (Staff Ex. 7 at 41-42). Peoples Gas' second argument was that October 2000 was the highest priced from the month of May

2000 through October 2000 and that Peoples Gas could derive no economic benefit from a hedge. (PG Ex. L at 45, lines 1002-03). Again, this argument misses the point. Peoples Gas appears to be focusing on the operations made possible by the penalty amount. Again, that value is available independently of the identity of the entity paying the penalty. (Staff Ex. 12 at 41).

Peoples Gas' arguments are just not relevant to Staff's analysis. Dr. Rearden estimated Peoples Gas' cost to provide gas in December at October prices by valuing gas at its futures prices, as posted at the time the transaction was entered into. (See Staff IB at 80-81; Staff Ex. 7 at 41). To use any other type of information would be using information not known at the time the transaction was entered into.

Peoples Gas' next argument compares Staff's adjustment for Transaction 103 (*i.e.*, \$1.4M) to its ability to buy gas between April and October, when gas is typically cheaper. Peoples Gas finds, unsurprisingly, that even the prices from April to October would not have allowed them to achieve profits at the level of Staff's proposed adjustment. Peoples Gas misunderstands Staff's adjustment calculation. Therefore, Staff will simply restate its calculation methodology for prudence evaluation so Staff's position is clear. (See Staff IB at 80-81).

Transaction 103 is an imprudent transaction because the amount paid by Enron MW was not equivalent to the projected difference in gas price between October and December 2000. The deal at issue was struck in April 2000, and involved the delivery of gas to Enron MW in December 2000 at October 2000 prices in exchange for Enron MW paying a pipeline penalty that Peoples Gas had incurred. Using the difference between the October and December NYMEX futures prices for gas, as it posted in April

2000, Staff calculated the value of the transaction and compared it to the amount of the money Enron MW paid. Staff used the April futures prices because they were prices Peoples Gas could have referred to at the time of the transaction to estimate the value for the deal versus the benefit of paying the penalty. The penalty was \$ XX XX per MMBtu, and the difference in October and December futures prices was \$ XX XX per MMBtu – Peoples Gas was paid a little less than half the value of the gas. It would have been cheaper to pay the penalty, therefore, the transaction was imprudent. (*Id.*)

Since the transaction was imprudent, a disallowance needs to be calculated. The calculation is accomplished in the same manner as the imprudent storage adjustment, Transaction 16/22 and Transaction 19. Accordingly, Staff recommends that the Commission find Transaction 103 to be imprudent and that the Commission adopt Staff's adjustment amount posted in Appendix A, Exhibit 5.03, which is attached to Staff's Initial Brief.

I. The Trunkline Deal has the Appearance of an Ordinary Gas Purchase but it is an Imprudent Transaction Because it Improperly Cross-Subsidizes Peoples Energy

Peoples Gas argues that Staff has not shown that the Trunkline deal was imprudent or that the gas costs were imprudent. In support of its position, Peoples Gas puts forth two arguments – that the Trunkline deal was an ordinary gas purchase and that the proposed disallowance has no relationship to gas costs. (PG IB at 97-98). Staff's adjustment attempts to recover, through the Gas Charge, the money from that transaction which is the result of improper cross-subsidization of Peoples Energy, by Peoples Gas, through the use of Enron affiliates and enovate.

The Trunkline deal had the appearance of an ordinary gas purchase, but, in effect it redirected funds from Peoples Gas to its affiliate. As Staff explained in its Initial Brief, this was one of the transactions that furthered the entire strategic partnership – by which Peoples Energy and Enron sought to use utility assets and gas to increase profits for themselves and their respective shareholders. (See Staff IB at 3-5). As the facts demonstrate, the Trunkline deal was structured in a way so that money from Peoples Gas would be paid to Enron affiliate companies and then shared with Peoples Energy via oral agreements. (Staff IB at 83-84; Staff Ex. 9 at 17-19). The transaction involved the use of ratepayer gas. (See Group Exh. 1 at ST-PG 262-264, which are the deal tickets showing that the gas is ratepayer gas). The effect is an end-run around Commission scrutiny of affiliate transactions (see 220 ILCS 5/7-101 and 7-102, transactions with affiliated interests; see *also* Staff IB at 83-85, explaining structure of transaction and sharing arrangements). As a matter of public policy, Peoples Gas should not be allowed to recover the transaction’s costs through the Gas Charge. To do so will send a message to all gas utilities that it is acceptable to structure such deals, whereby seemingly proper transactions of the regulated utility are in fact unapproved affiliate transactions.

Section 7-101 (3) of the Act, 220 ILCS 5/ 7-101 (3), states that

No management, construction, engineering, supply, financial or similar contract and not contract or arrangement for the purchase, sale, lease, or exchange of property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act.

220 ILCS 5/7-101 (3). (emphasis added)

The Trunkline deal was a supply contract or arrangement for the sale of gas from Peoples Energy Resource Corporation (“PERC”) to Peoples Gas using enovate, who is also an affiliate of Peoples Gas. On ST-PG 262, note that the customer listed in the upper right-hand corner is identified as “Trunkline/Peoples”. This “Executed Deal Ticket” begins a series of transactions that all occur on the same day. ST-PG 262 records MEH’s (*i.e.* enovate’s) purchase of gas from Trunkline Gas Co., and PERC. ST-PG 263 is an “Executed Deal Ticket” memorializing a purchase of gas by Enron MW (“Enron MW”) from MEH. ST-PG 264 is an “Executed Deal Ticket” documenting the sale of gas to Peoples Gas from Enron MW. In Staff’s opinion, the evidence shows a coordinated sale among all of the parties because the transactions had the same deal date and there was no change in the prices or quantities. (Staff Ex. 13 at 5). As one transaction, it was structured in a way to avoid Section 7-101 of the Act, *supra*, and such a decision is imprudent because it is a void transaction by Peoples Gas. 220 ILCS 5/ 7-101 (3) and 7-102 (E).

Peoples Gas argues that the adjustment does not affect gas costs. Staff’s adjustment attempts to recover, through the Gas Charge, the money from this deal that went from Peoples Gas to Peoples Energy. Staff is not attempting to undo the entire deal, just recover the amount related to Staff’s claim – the improper cross-subsidization of Peoples Energy by Peoples Gas through the use of Enron affiliates and enovate.

The Trunkline deal should be found imprudent, because it improperly subsidizes Peoples Energy with money from Peoples Gas, and it also has the result of circumventing Sections 7-101 and 7-102 of the Act. (220 ILCS 5/7-101 and 7-102, which require the review of affiliate transactions). While the transaction appears to be a

normal transaction between Peoples Gas and Enron MW, other facts show that it was not a deal struck by two parties in arms-length negotiation. The existence of the strategic partnership (with the intent of increasing profits) between the Peoples Energy and Enron corporate families (see Staff IB at 10-11), the fact that it circumvents the statute that regulates affiliate transactions, and profit sharing between Enron MW and Peoples Energy, all bring into question whether the Trunkline deal was an arms-length negotiation. Because of these facts, the decision to enter the Trunkline deal should be found imprudent. Because it is an unapproved affiliate transaction, the Trunkline deal should be found to be void.

J. RFG Deal: Peoples Gas Provides No Evidence That the Refinery Fuel Gas Deal is Prudent

Peoples Gas argues that the Refinery Fuel Gas (“RFG”) deal was prudent because it saved ratepayers \$558,000. (PG IB at 98-99). Peoples Gas provides no evidence that counters Staff’s evidence or argument that the RFG deal was imprudent. The decision to purchase RFG from Enron MW at a price higher than what it would have paid directly to Citgo was an imprudent decision. Likewise it was imprudent to enter into a contract that allowed for the cross-subsidization of an affiliate -- Peoples Energy Resource Corporation.

The RFG deal is similar to the Trunkline deal in that it had the appeared to be an ordinary gas purchase, but instead, it redirected funds from Peoples Gas to an affiliate via an Enron affiliate. This also appears to be another transaction that was part of the strategic partnership between Peoples Energy and Enron, *i.e.*, it was entered into to increase profits for their respective shareholders through use of utility assets and restructuring of existing deals. (See Staff IB at 3-5). Peoples Gas’ Initial Brief fails to

explain why Peoples Gas did not extend the RFG agreement with Citgo and, instead allowed Peoples Energy Resource Company (“PERC”) to assume it. The facts show that direct purchase was a viable alternative, since PERC entered into an agreement with Citgo at the same price and nearly the same terms by which Peoples Gas had previously purchased RFG. (Staff Ex. 9 at 12). Moreover, Peoples Gas fails to explain why it was prudent for Peoples Gas to purchase refinery fuel gas from Enron MW at rates higher than what Peoples Gas either had paid when directly purchasing RFG under the previous contract or could have received if they had extended its existing deal instead of allowing PERC to assume it. (See Staff IB 85-87, explaining imprudence of RFG deal). Staff can only conclude that this was part of the overall strategic partnership between Peoples Energy and Enron. (Staff IB at 85-87; Staff Ex. 9 at 12-13). It is an end-run around Commission scrutiny of affiliate transactions (see 220 ILCS 5/7-101 and 7-102, transactions with affiliated interests; see also rationale provided in §I.2.H, *supra*, regarding §7-101). To the extent, Sections 7-101 and 7-102 of the Act applies, these transactions were void as unapproved by the Commission.

This deal was imprudent, and Staff’s adjustment should be adopted. Acceptance of this adjustment will warn all gas utilities that they cannot escape the application of Section 9-220 of the Act, 220 ILCS 5/ 9-220, by such subterfuges.

3. RECOMMENDATIONS

A. Docket No. 00-0720 Should be Reopened Because Numerous Adjustments Proposed in the Instant Docket Were Not Considered

Peoples Gas argues that Docket No. 00-0720 cannot be reopened because Staff has not met the requirements of Section 200.900 of the Commission’s Rules of

Practice. (PG IB at 100). There is an overwhelming amount of information in the record in this docket impacting adjustments to the Gas Charge that were never part of the record in Docket No. 00-0720; facts that impact adjustments related to the GPAA, Storage Optimization Contract, revenues from non-tariff services, refinery fuel gas deal, maintenance gas and enovate profits. All of these adjustments are related to transactions, contracts or operations that were also in effect in the 2000 reconciliation period. The facts related to these adjustments, however, were never provided to Staff in Docket No. 00-0720, despite data requests seeking such documents, and were discovered in this proceeding during the review of numerous documents produced by Peoples Gas in response to CUB data request 13 and Staff data request POL 16.

The requirement for reopening a docket is set forth in Section 200.900, which states:

After issuance of an order by the Commission, the Commission may, on its own motion, reopen any proceeding when it has reason to believe that conditions of fact or law have so changed as to require, or that the public interest requires, such reopening. No party may petition the Commission to reopen on its own motion until after the time to petition for rehearing has expired.

(83 Illinois Administrative Code §200.900).

The record in this cause is full of new facts that were not provided or considered in Docket No. 00-0720 that would change the results of that docket. Indeed, the majority of the discovery information discussed in the instant proceeding, which was not available for consideration in Docket No. 00-0720, could result in a finding that the Company did not purchase gas supplies prudently in that proceeding.

Herein we will review the most significant facts that came to light in the instant proceeding through a massive production of documents (*i.e.*, 106,000+ paper documents and 75 GB of electronic documents), most of which were not disclosed in Docket No. 00-0720. For example, there is the Aruba analysis and the GPAA analysis contained in Wear Cross Exhibit #15. Both documents were spreadsheets developed by employees of either Peoples Energy or Peoples Gas that analyzed the GPAA agreement. Neither document were previously available to Staff, despite the request for all analyses used to select each new or renegotiated firm supply contracts entered into in a reconciliation period (which would have included the GPAA agreement), a request included in Staff's generic data request in Docket No. 00-0720. (Staff Ex. 8 at 5). Another fact that was not known in the Docket No. 00-0720 proceeding, that also has a high potential for impacting the review, was the strategic partnership between the Enron corporate family and the Peoples Energy corporate family. This partnership, which also existed during the 2000 reconciliation period, is discussed extensively in Staff's Initial Brief, pages 3 through 6 and need not be discussed further here. Suffice it to say, such a relationship impacted the Storage Optimization Contract, the RFG deal, the Trunkline deal, and adjustments related to enovate's operations. All but the Trunkline deal were in effect during the 2000 reconciliation period, and other deals may exist that have never been disclosed by Peoples Gas.

Staff also discovered in the instant reconciliation period that the Company had previously failed to provide Staff with information concern its various non-tariff

transactions²⁸ in any of the Company's prior PGA reconciliations. (Staff Ex. 4 at 5). In particular, Staff noted that the Company's decision not to flow the revenue associated with its non-tariff transactions through the PGA clause only came to Staff's attention during the review of the instant reconciliation period. (*Id.* at 6). A significant subset of non-tariff transactions involve third party storage exchanges ("Exchanges"), and Peoples Gas never reported these Exchanges to the Commission or to FERC. Peoples Gas' failure to previously provide Staff with any Exchange transaction information is especially significant in that 83 Illinois Administrative Code 525.40(a)(1) specifically mentions exchange agreements:

- a) Costs recoverable through the Gas Charge(s) shall include the following:
 - 1) costs of natural gas and any solid, liquid or gaseous hydrocarbons purchased for injection into the gas stream or purchased as feedstock or fuel for the manufacture of gas, or delivered under exchange agreements;... (emphasis added)

Given that the Commission specifically mentions the use of Exchanges within Part 525, Staff is confounded as to Peoples Gas' failure to provide any information about these transactions to the Commission or Staff. The only excuse offered by Peoples Gas is that it interpreted Staff's data requests for this information in such a way that the Company only provided Staff with the data that it believed could be at issue in a PGA proceeding. (Staff Ex. 8.0 at 14). In short, even though the Commission rules specifically refer to Exchanges and Staff's discovery requests sought such information, Peoples Gas determined that this was information the Staff and the Commission should

²⁸ Non-tariff transactions refer to those transactions conducted under the FERC Operating Statement (a.k.a. hub transactions) or the third party storage exchanges conducted outside of the FERC Operating Statement. (Staff Ex. 8 at 11).

not have in reaching a determination of the prudence of its gas purchases. Obviously, this is information that should have been available to the Staff and the Commission and is a highly relevant fact that should be considered in a reopened Docket No. 00-0720 proceeding.

Another new fact that came to light in the instant reconciliation period was the existence of maintenance gas charges associated with the Manlove field, whose cost Peoples Gas included in its Gas Charge. In this docket, Peoples Gas agreed to Staff's recommendation to remove the cost of maintenance gas from its gas costs, however, the record clearly indicates that Peoples Gas started passing maintenance gas costs through the Gas Charge in 1999. (Staff Ex. 2.0 at 48-50). Therefore, Peoples Gas' 2000 reconciliation (that covered the period October 1, 1999 through September 30, 2000) included improper gas charges, namely maintenance gas charges. Given the Company's acceptance of the removal of the maintenance gas costs in the instant proceeding, it is highly probable that reopening the Docket No. 00-0720 reconciliation proceeding would also result in the removal of the maintenance costs in that proceeding as well.

Finally, it is important to note that Peoples Gas witness Wear provided the Company's testimony in Docket No. 00-0720 regarding the gas supply and capacity procurement procedures, as he did for the instant proceeding (*00-0720 Order* at 2 (dated Jan. 24, 2002)). The instant proceeding, however, showed Mr. Wear to be a non-credible witness (see GCI IB at 33-35). The loss of credibility of the Company's primary witness in the instant proceeding also calls into question the validity of his testimony and any discovery responses he provided or sponsored in Docket No. 00-

0720, and also any other testimony he has provided before the Commission. Staff considers the credibility of Peoples Gas' primary witness and any related discovery as a relevant change in fact that supports the reopening of Docket No. 00-0720.

Accordingly, the above recitation of highly relevant facts, that were unknown at the time the proceeding in Docket No. 00-0720 was being conducted and ruled upon by the Commission, provides a sufficient basis to reopen Docket No. 00-0720, pursuant to 83 Ill. Adm. Code 200.900. The conditions of fact have changed from the reconciliation period in Docket No. 00-0720. Thus, both the changed condition of facts as well as the public interest require, in Staff's Opinion, the reopening of Docket No. 00-0720.

B. Peoples Gas' Alternative to Staff's Recommended Internal and Management Audits Does Not Sufficiently Address the Concerns Raised in the Instant Proceeding

Peoples Gas proposes an alternative to Staff's recommendation of an internal audit and a management audit. This proposal is unacceptable to Staff, for the reasons stated below. Staff will also respond to Peoples Gas' assertions that it has made improvements that obviate the need for an audit (PG IB at 101), and that the audits may unnecessarily duplicate and add costs to work being done for compliance with Sarbanes-Oxley (PG IB at 101).

Peoples Gas addresses these two audits as if they are one recommendation. Staff wants to make clear that they are not. They are separate audits, performing separate functions that complement each other. The management audit establishes a series of internal control procedures. The internal audit evaluates those procedures on an annual basis until the Commission finds that it is no longer necessary. (See Staff IB at 91-92).

Although it is unclear, it appears that Peoples Gas proposes as an alternative to both the internal and management audit, that it submit a report to Staff detailing actions it has taken to enhance its procedures and specifically explain how it addresses the concerns raised by Staff. (PG IB at 101). Further, Peoples Gas opines that such a proposal will allow Staff and the Commission to determine if a proceeding is warranted. (*Id.*)

Peoples Gas' proposal is unsatisfactory. Based on the lack of documentation of transactions executed in the 2001 reconciliation period and Peoples Gas' actions in said period, close monitoring by the Commission is warranted. The circumstances that occurred in this case demonstrate an egregious misuse of utility assets and poor documentation of operations. (See Staff IB, generally). The Act mandates that the public be protected and the Rules requires gas utilities to maintain records for Commission review. Nearly all of Staff's adjustments relate to management decisions by Peoples Gas, in conjunction with Enron, to conduct transactions that either used ratepayer gas or redirected funds from Peoples Gas to an affiliate through an Enron entity. This is the same management that entered in to the GPAA with Enron, the same management that claimed it did not perform an economic analysis of the GPAA, and the same management that approved oral agreements to share revenues with Enron. All of these actions 'skirt' the Act, and Peoples Gas still maintains that they are actions that are either outside of our jurisdiction or are ordinary gas purchase transactions. The fact that there were so many management decisions resulting in operational decisions and transactions that 'skirt' the Act, a management and internal audit are the most prudent actions the Commission can take to be assured, and to assure the public, that in the

future Peoples Gas will be operating prudently and as required by Illinois law. Peoples Gas' alternative is merely a form of opposition to the audits. Clearly they will not conduct the audits unless ordered to do so by the Commission.

Peoples Gas states that it has made improvements to its processes that obviate the need for an audit even if Staff's allegations are accepted. (PG IB at 101). As discussed above, in Staff's expert opinion, Peoples Gas has lost the credibility that is needed for a utility to self-report on its own actions. Moreover, Peoples Gas witness Zack, in his Additional Rebuttal testimony, admitted that Staff's internal audit recommendation is not unreasonable. (PG Ex. K at 14). However, that internal audit needs the outside management audit to help direct the areas to be audited.

Finally, Peoples Gas states that a management audit may unnecessarily duplicate and add costs to the work being done for Sarbanes-Oxley compliance. (PG IB at 103). Staff is particularly concerned about weaknesses in the internal controls of gas purchasing practices, gas storage operations and gas storage activities. (Staff Ex. 5 at 15). If a Sarbanes-Oxley compliance audit includes an analysis of the internal controls in the Company's gas purchasing practices, gas storage operations and gas storage activities, the only extra effort and cost to be incurred would be associated with the special report to the Commission. (ICC Staff Ex. 5 at 15). Another problem with the Company's offer is that the Sarbanes-Oxley Act requires financial reporting and certification for any end of year financial statements filed after November 15, 2004 (see www.sarbanes-oxley-forum.com/). Therefore, since the FY 2000 through FY 2004 reconciliation periods occurred prior to the effective date of the Sarbanes-Oxley legislation, internal control weaknesses addressed by Staff during the instant

proceeding will not be addressed in a Sarbanes-Oxley Act mandated financial report, and neither will it include any of the internal controls that Peoples Gas put into place prior to the effective date (which includes Peoples FY 2002 and FY 2003 open PGA reconciliations). Since Peoples Gas' offer would not provide information related to Staff's concern about internal controls, Staff's recommendation for a management audit and an annual internal audit should be approved by the Commission. Moreover, if Peoples Gas has successfully implemented the additional policies, procedures, staffing changes, and software that it discusses in its initial brief, complying with a management audit will not be a burden for Peoples Gas.

C. Corrections to GCI's Characterization of Staff's Recommendations

GCI makes two incorrect assertions in its brief regarding Staff's recommendations. First, GCI incorrectly states that four Staff recommendations are opposed by Peoples Gas. (GCI IB at 94). Peoples Gas opposes five of Staff's eleven Recommendations. Peoples Gas opposes the first five Recommendations listed in the Conclusion of Staff's Initial Brief. (Staff IB at 99-100).

Second, GCI incorrectly states that Peoples Gas is opposed to updating its Operating Agreement (GCI IB at 94), which is not the case. Peoples Gas acknowledges its agreement on page 104 of its Initial Brief.

II. CALCULATION METHODOLOGIES

On July 12, 2005, the ALJ issued a Notice requesting, in part, that each party explain "any number asserted in a party's attached schedule." The amount of each of Staff's adjustments (Factor O in the Gas Charge Formula of Subsection 725.50) are

identified in columns B through Q in its Initial Brief, Appendix A, Schedule 5.03. The method Staff used to calculate each adjustment is the explained below.

1. Gas Purchase and Agency Agreement

Staff's calculation methodology for the adjustment attributed to the GPAA is set forth in Staff Ex. 7.05. The proposed adjustment is \$13,304,910 and is reflected in Appendix A, Schedule 5.03, column C, which was attached to Staff's Initial Brief. Staff described its calculation methodology in its Initial Brief Section V.A.1.d. at pages 55-56.

2. Manlove Storage Field

Staff has split this adjustment into two parts – the value of the gas which Peoples Gas imprudently loaned to third parties, and the cost of gas that Peoples Gas had to purchase to replace the gas loaned to third parties.

A. Value of Gas Imprudently Loaned to Third Parties

Staff's calculation methodology for this part of the Manlove Storage Field is set forth in Staff Ex. 3.08. The proposed adjustment is \$10,268,171 and is reflected in Appendix A, Schedule 5.03, column H, which was attached to Staff's Initial Brief. The adjustment is calculated by multiplying the daily gas price times the volumes withdrawn by third parties on net from Manlove on that day after the third party balance became negative. When third parties began injecting on net, beginning in March, the total is reduced by the daily price times the amount injected by third parties on net. The difference is the value of the loan.

Peoples Gas argues both that Staff's calculation methodology is flawed and that Peoples Gas' operations were prudent.

B. Cost of Gas Purchased by Peoples Gas to Support Hub Operations

Staff's calculation methodology for this part of the Manlove Storage Field is set forth in Staff Ex. 7.06. The proposed adjustment is \$25,920,181 and is reflected in Appendix A, Schedule 5.03, column I, which was attached to Staff's Initial Brief. The costs of the spot market (daily) purchases that support hub operations are subtracted from the PGA. And the value of the gas that would have been withdrawn from Manlove Field is added back to the PGA. The difference is the proposed adjustment.

To find the cost of the spot market purchases that support hub operations requires a couple of steps that result in interactions between the calculations here and those for the other adjustments (except for the GPAA adjustment and the value of loan adjustment). First, the total spot market purchases that need to be reversed are calculated. This includes the off-system transactions and as well as the storage usage. Then for each day, beginning with the highest priced gas first, the individual purchases are selected and valued as price times volume. For each day, total costs reversed are calculated and the average cost per MMBtu is calculated. This average is used for all applicable adjustments. Finally, the costs of the spot market (daily) purchases that support hub operations are the average per day for all adjustments time the volume just for the hub volumes.

Peoples Gas argues both that Staff's calculation methodology is flawed and that Peoples Gas' operations were prudent.

3. Revenue from Non-Tariff Services

Staff has split this adjustment into two parts – revenue received from transactions pursuant to the FERC operating statement and revenue received from storage exchanges.

A. Revenue from FERC Operating Statement Transactions

Staff's calculation methodology for this part of the revenue from non-tariff services is set forth in Staff Ex. 5, Schedule 5.03. The proposed adjustment is \$4,378,466 and is reflected in Appendix A, Schedule 5.03, column F, which was attached to Staff's Initial Brief.

The adjustment calculation was based upon Peoples' responses to Staff Data Request ACC 6.002. No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas argues that the revenue from non-tariff services should not be included in the Gas Charge.

B. Revenue from Storage Exchange Transactions

Staff's calculation methodology for this part of revenue from non-tariff services is set forth in Staff Ex. 5, Schedule 5.03. The proposed adjustment is \$2,250,165 and is reflected in Appendix A, Schedule 5.03, column G, which was attached to Staff's Initial Brief. The adjustment calculation was based upon Peoples' responses to Staff Data Request ACC 6.002.

No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas argues that the revenue from non-tariff services should not be included in the Gas Charge.

4. enovate

enovate splits its profits equally between Enron/Enron MW and Peoples Energy. Staff therefore has split the aggregate adjustment for enovate's impact on the Gas Charge into two adjustments – (1) profits shared with Peoples Energy and (2) profits shared with Enron and Enron MW.

A. Profits Earned by Peoples Energy Corporation

Staff's calculation methodology for this part of the enovate adjustment is set forth in Staff Ex. 9.0, at page 20, and in Schedule 9.05. The proposed adjustment is \$9,052,823 and is reflected in Appendix A, Schedule 5.03, column P, which was attached to Staff's Initial Brief.

Staff's adjustment reflects information provided by Peoples Gas in response to Staff data requests questions ACC-3.02, 3.03, 6.01 and 6.02. So as to avoid double counting the management fees and Enron MW income received by Peoples Energy pursuant to its revenue sharing arrangements with enovate, Staff has deducted its proposed adjustments for the SOC Adjustment related to Peoples Energy and the Trunkline Deal Adjustment from this adjustment.

No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas argues that the transaction is prudent.

B. Profits Earned by Enron MW

Staff's calculation methodology for this part of the enovate adjustment is set forth in Staff Ex. 9.0, at pages 22-23, and in Schedule 9.06. The proposed adjustment is \$10,630,817 and is reflected in Appendix A, Schedule 5.03, column Q, which was attached to Staff's Initial Brief.

Staff's adjustment reflects information provided by Peoples Gas in response to Staff data requests questions ACC-3.02 and 6.02. So as to avoid double counting the management fees and Enron MW income received by Enron MW pursuant to its partnership in enovate, Staff has deducted its proposed SOC Adjustment related to Enron. amount. The Total Revenues amounts in Schedules 9.05 and 9.06 are different because Schedule 9.05 excludes PERC's operating costs to support enovate²⁹ (Staff data request ACC-6.02). For the Enron calculation in Schedule 9.06, there is no need to deduct these costs from the partnership's equity investment income, as they were incurred by PERC, not Enron MW. Staff is not aware of any documents reflecting Enron MW's operating costs for enovate.

No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas argues that the transaction is prudent.

5. Transaction 19

Staff's calculation methodology for the adjustment attributed to Transaction 19 is set forth in Staff Ex. 7.06. The proposed adjustment is \$5,661,703 and is reflected in Appendix A, Schedule 5.03, column E, which was attached to Staff's Initial Brief. The amount subtracted from the PGA is the value of the spot purchases reversed, where the value is calculated as in the imprudent storage usage adjustment using the daily average cost of gas over the most expensive gas over the volumes applicable to the transactions. The amount added back to the PGA is the revenues that the Company received from EMW.

²⁹ PERC paid the operating costs of enovate. Staff Ex. 9 at 23 and Group Ex. 1 ST-PG 43-45.

Peoples Gas argues that the calculation methodology is flawed and that the transaction was prudent.

6. Transaction 103

Staff's calculation methodology for the adjustment attributed Transaction 103 is set forth in Staff Ex. 7.06. The proposed adjustment is \$1,411,000 and is reflected in Appendix A, Schedule 5.03, column K, which was attached to Staff's Initial Brief. The amount subtracted from the PGA is the value of the spot purchases reversed, where the value is calculated as in the imprudent storage usage adjustment using the daily average cost of gas over the most expensive gas over the volumes applicable to the transactions. The amount added back to the PGA is the revenues that the Company received from EMW.

Peoples Gas argues that the calculation methodology is flawed and that the transaction was prudent.

7. Trunkline Deal

Staff's calculation methodology for the Trunkline adjustment is set forth in Staff Ex. 9.0, Schedule 9.04. The proposed adjustment is \$372,000 and is reflected in Appendix A, Schedule 5.03, column O, which was attached to Staff's Initial Brief.

The monthly revenues from this deal, from December 2000 through September 2001, are listed at lines 5 through 15 of Schedule 9.04. These amounts are from a document with bates #01PGL043862. These same monthly revenue amounts are reflected in the "Net" column of the document with bates #01PGL073112, which was entered into the record as part of Attachment F to Staff Ex. 9.0.

No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas argues that the transaction is prudent.

8. Refinery Fuel Gas Deal

Staff's calculation methodology for the Trunkline adjustment is set forth in Staff Ex. 9.0, Schedule 9.01. The proposed adjustment is \$2,232,490 and is reflected in Appendix A, Schedule 5.03, column L, which was attached to Staff's Initial Brief.

The difference in price between the RFG deal at the PERC price and Peoples Gas price is calculated for the months October 2000 through September 2001, and presented on page 2 of Schedule 9.01. The sum of these monthly amounts equals Staff's adjustment, reflected on page 1 of Schedule 9.01.

No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas maintains that the transaction is prudent.

9. Storage Optimization Contract

Staff has split this adjustment into two parts, partly due to the parties involved and partly due to Staff's argument regarding imprudence. The first of two parts of the aggregate adjustment is attributed to revenues Peoples Energy has earned because of an oral profit sharing agreement it has with Enron MW. The second part of the aggregate adjustment is attributed to revenues earned by Enron MW pursuant to the SOC.

Staff argues that the SOC is imprudent for two reasons. Staff's first reason is that it was imprudent to enter into the contract because there was a better deal (i.e., TPC Profit Sharing Proposal). If this argument is accepted by the Commission, then the aggregate amount of \$1,340,455 (i.e., both adjustments, which are attributed to Peoples

Energy and to Enron MW, respectively) should be adopted. Staff's second argument is that it was imprudent to have an oral agreement whereby Enron MW was to share half of the revenues it earned from Peoples Gas with Peoples Energy, because it is a form of affiliate cross-subsidization without Commission approval. (See Staff IB at 88). If the first argument is rejected and the second argument is accepted, then only the revenues received by Peoples Energy should be recovered through the Gas Charge, which are reflected in Staff's Initial Brief, Appendix A, Schedule 5.03, column M.

A. Revenues received by Peoples Energy Corporation

Staff's calculation methodology for this part of the SOC adjustment is set forth in Staff Ex. 9.0, at page 15, and in Schedule 9.02. The proposed adjustment is \$623,000 and is reflected in Appendix A, Schedule 5.03, column M, which was attached to Staff's Initial Brief.

Staff's adjustment reflects information provided by Peoples in response to Staff DRs ACC-1.03, 5.04, 6.01, and 7.01. Schedule 9.02 reflects half of the management fee paid by Peoples Gas (Schedule 9.02, line 6) that was shared with its parent -- Peoples Energy -- through PERC, as a result of its oral revenue sharing agreement with Enron MW. Schedule 9.02 also includes the revenues PERC received as a part of its revenue sharing with Enron MW from the SOC (Schedule 9.02, line 7).

No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas argues that the transaction is prudent.

B. Revenues received by Enron MW

Staff's calculation methodology for this part of the SOC adjustment is set forth in Staff Ex. 9.0, Schedule 9.03. The proposed adjustment is \$717,455 and is reflected in Appendix A, Schedule 5.03, column N, which was attached to Staff's Initial Brief.

Staff's adjustment reflects information provided by Peoples Gas in response to Staff DR ACC-2.02. It totals the Enron MW share of the management fees discussed with respect to Schedule 9.02, and Enron MW's share of revenues from the SOC.

No party has taken issue with this calculation methodology in testimony or brief, although Peoples Gas argues that the transaction is prudent.

10. Maintenance Gas

Staff's calculation methodology for the adjustment attributed to Maintenance Gas is set forth in Staff Ex. 1, Schedule 1.06. The proposed adjustment is \$4,628,267 and is reflected in Appendix A, Schedule 5.03, column B, which was attached to Staff's Initial Brief. The maintenance gas adjustment was developed in Staff's direct testimony and is discussed extensively on pages 14-18, lines 307-588 of ICC Staff Exhibit 1.

Peoples Gas does not contest Staff's proposed adjustment amount on page 103 of its Initial Brief.

11. Transaction 16/22

Staff's calculation methodology for the adjustment attributed to Transactions 16/22 is set forth in Staff Ex. 7.06. The proposed adjustment is \$535,554 and is reflected in Appendix A, Schedule 5.03, column D, which was attached to Staff's Initial Brief. Transaction 16/22 is calculated in the same manner as the Imprudent Storage

Usage Adjustment, discussed *supra*, §II.2.B. -- Cost of Gas Purchased by Peoples Gas to Support Hub Operations.

Peoples Gas does not contest Staff's proposed adjustment amount on pages 103 and 104 of its Initial Brief.

III. CONCLUSION

WHEREFORE, the Staff Witnesses of the Illinois Commerce Commission respectfully requests the Commission (1) accept Staff's 15 adjustments and order Peoples Gas to refund \$91,987,033 to its PGA customers, and (2) order Peoples Gas to implement the 11 recommendations identified on pages 100-101 of Staff's Initial Brief, consistent with the arguments set forth above.

Respectfully Submitted,

Sean R. Brady
James. E. Weging
Illinois Commerce Commission
Office of General Counsel
160 North LaSalle Street
Suite C-800
Chicago, Illinois 60601
312 / 793-2877

August 19, 2005

*Counsel for the Staff Witnesses of the
Illinois Commerce Commission*