STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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

REPLY TO BRIEFS ON EXCEPTIONS
OF THE STAFF WITNESSES
OF THE ILLINOIS COMMERCE COMMISSION

*** * * PUBLIC VERSION * * ***

XXX Designation of Proprietary Material

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**REPLY TO BRIEFS ON EXCEPTIONS
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Now comes the Staff Witnesses of the Illinois Commerce Commission ("Staff") by its attorneys and, pursuant to Section 200.830 of the Commission's Rules of Practice, 83 Ill. Adm. Code §200.830, responds to *The Peoples Gas Light and Coke Company's Brief on Exceptions to the Proposed Order* ("PGL BOE"), and *Joint Brief on Exceptions of the City of Chicago, The Citizens Utility Board, and The People of the State of Illinois* ("GCI BOE") filed on October 3, 2005, in the above-captioned proceeding.

Peoples Gas Light and Coke Company ("PGL") took extensive exceptions to the Proposed Order. Given that the schedule in this proceeding allows only one week for Replies to Briefs on Exceptions, the Staff has prepared its Reply in such a way as to highlight its main points of contention with other parties. The Staff has not responded to all arguments of all parties. The lack of response to an argument raised by another party should therefore not be construed as an abandonment or waiver of a position previously articulated by Staff, but rather it is indicative of Staff's reliance on the arguments and explanations set forth in its initial and reply post-trial briefs.

STAFF'S REPLY

1. PGL's Replacement Language is not Wholly Supported by Argument

PGL's presentation of replacement language to the Proposed Order does not comport with the Commission rules. 83 Ill. Adm. Code 200.830 (b) requires that, when exception is taken as to a statement or finding of fact, a suggested replacement statement or finding must be incorporated. Instead PGL has submitted a reworked order with 1,268 changes apparently but no relation to the exceptions in the brief on exception ("BOE"). Some of the changes are merely editorial, such as adding "The" before PGL's name, but such editorial changes are not given any separate designation from the substantive/argumentative changes. Because of this, it is difficult to impossible to determine if or how a proposed change in Exhibit 1 relates to the arguments contained in PGL's BOE. PGL's BOE fails to comport with the Commission rules and could be rejected for this reason alone.

2. Storage Issues

PGL opens its Storage Issues exception's arguments by incorrectly stating that Staff's analysis of Manlove field storage operations was a hindsight review. (PGL BOE at 12-13). As will be discussed below and was explained in Staff's Reply Brief, Staff's review is not hindsight because it was based on a comparison of PGL's actual withdrawals to planned withdrawals and on the operational factors known during the winter of ’00-’01. (Staff RB at 45-47).

Below Staff will respond to each of PGL’s sub-arguments regarding the disallowances for storage issues.

A. Reply to Hindsight Concerning Weather and Demand

PGL claims that it was prudent “to keep an inventory of gas in Manlove Field to meet high demands later in the winter rather than use all of its stored gas in winter’s first two months.” (PGL BOE at 13). In response to Staff data request ENG 2.05(G), PGL provided its plan for injections and withdrawals for this reconciliation period. (Staff Ex. 6 at 37; Staff RB at 26). As Staff witness Anderson testified, actual withdrawals were far less than planned volumes. If PGL thought that it needed more gas for high demands in later months, PGL should have developed a plan that reflected such a concern.

Using planned injections and withdrawals is not hindsight review since it is the use of information PGL had at the time. PGL had a plan for the amount of gas it would inject and withdraw from Manlove field (PGL IB at 22) and did not justify why it departed from its planned withdrawals in December 2000 and January 2001.[1] In fact, given how cold December 2000 and January 2001 were (PGL Ex. F at lines 775-77), PGL’s withdrawals could easily have been higher than planned, but they were not. This also contrasts with the high level of withdrawals by third parties in the same months. (*See* Staff IB at 26-27).

[1] PGL justified its withdrawal of gas early in the winter period – arguing that there was a cold snap – which is not the same reason for departing from planned withdrawal levels. (PGL IB at 23, *citing* PGL Ex. F at 35). Although Staff never formally challenged the prudency of the decision to start early withdrawals, Staff did point out that the reasons PGL gave for the early start implied that the early start provided value to the Hub as well as ratepayers.

Third party withdrawal rates were much higher in this reconciliation period in comparison to the previous winter. (Staff Ex. 3 at 41-42, Table 3). In contrast, PGL's withdrawal rates during December 2000 and January 2001 were lower than the previous winter. (Staff Ex. 3 at 41-42). It was these contrasting trends that spurred Staff's investigation of operations of Manlove field. As Staff discussed in its Exhibit 6 at 37-38, the cumulative percentage of gas inventory withdrawn for ratepayers from November 2000 through January 2001 was only XXXXX of the total amount PGL stored in Manlove, while the cumulative inventory withdrawn for non-tariff customers for the same period was XXXX of their total injections. (Staff Ex. 6 at 38). It is inconsistent with prudent use of Manlove field for ratepayers to have such low gas usage in comparison to non-tariff customers over the same period of time.

Staff's review was not hindsight, since it relied on information PGL had at the time. Going into the season PGL had a plan for its withdrawals. PGL departed from that plan without sufficient explanation. PGL's planned withdrawals contrasted sharply with third parties' withdrawal rates at the time and contrary to what PGL should have been doing given the cold temperatures that winter. Given PGL's lack of explanation on this point, the ALJ was correct in finding PGL's Manlove storage usage to be imprudent.

B. Reply to Hindsight Concerning Market Prices

PGL claims that "NYMEX information does not show what the price of a commodity 'likely' will be; rather, NYMEX shows the prices at which buyers and sellers are willing to transact at a given moment," that the NYMEX data in "December 2000 did not allow Peoples Gas to conclude prices in those months would be lower than they were in December 2000", and thus "the actual price differentials relied upon by Staff only could be known through impermissible hindsight." (PGL BOE at 15). PGL incorrectly characterizes the import and use of NYMEX futures prices as well as Staff's use of actual prices. Staff used actual prices to determine the amount of the disallowance, not whether the operations were imprudent.

It is valid to use NYMEX futures prices data to evaluate the value of (and hence the prudence of) a transaction. It has been used in past cases before the Commission, and is information available at the time the transaction is entered into which the utility can review to determine the prudence of a transaction. NYMEX information has been used in gas reconciliation cases to demonstrate and support the validity of a price. *Order*, Docket No. 03-0698[2], 2005 Ill. PUC LEXIS 296 at *4 (2005); *Order*, Docket No. 03-0697[3], 2005 Ill. PUC LEXIS 263 at *4 (2005). In Docket, No. 03-0698, the witness for Illinois Gas Company acknowledged that "market purchases are made on the NYMEX market for the upcoming month. (*cite omitted*). The Company represents that purchases are made on the futures market for hedging purposes if prices are deemed favorable." (*Order*, Docket No. 03-0698 at *4).

Staff used NYMEX prices to evaluate the prudence of the three exchanges (*i.e.*, "Manlove Jumpstart," "HUB Blowout," and "38 Millennium Special"). Dr. Rearden used the NYMEX futures prices for the days prior to the trades to gauge whether the value of the gas PGL gave in these exchanges would be equivalent to the amount PGL was receiving in payment. As Dr. Rearden explained in testimony, "the futures prices

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[2] Illinois Commerce Commission v. Illinois Gas Company, Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.

[3] Illinois Commerce Commission v. Consumers Gas Company, Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.

represent the financial alternatives that Peoples Gas has for managing its gas supply over time." (Staff Ex. 3 at 54). The NYMEX future prices on or near the day that the trade was entered into indicated that all three exchanges were imprudent, because the value attached to the gas when it was loaned and when it was repaid resulted from trades for those months that were conducted on the same day. Therefore, it is data that can be used to estimate the value of a transaction (whose delivery and receipt dates were in the future). By comparing the two prices, one can determine if the transaction would be a worthwhile and prudent action.[4] Moreover, PGL's argument falls far short of discrediting the entire disallowance amount for the imprudent operations of Manlove Storage Field since Staff found that usage imprudent because of operational factors. Staff did respond to PGL's assertion that Staff's declaration was after the fact (in part due to price factors) by pointing out that:

> NYMEX futures prices during November and December 2000 and January 2001 for the delivery months of February and March 2001…never closed above $10 per MMBtu. Spot prices in Chicago during those months were $11 and above. Even if prices had fallen only to the level predicted in the futures prices, ratepayers would have seen savings from altering the timing of storage withdrawals. (Staff Ex. 7.00 at 60)

PGL also reaches for the conclusion that if the NYMEX data cannot be relied upon, then Staff's calculation cannot be relied upon – stating that the actual price differentials could only be known through impermissible hindsight. Although it is unclear what relationship PGL is attempting to draw between Staff's use of NYMEX prices and "actual price differentials", it appears that PGL is again attempting to claim that Staff's

[4] In addition, NYMEX prices provide a convenient way to assess Transaction 103. In that transaction, Peoples Gas provided gas in one month at another month's price in return for a fixed payment. Thus, the difference in the NYMEX futures prices **on or near the day that the transaction was entered into** between the two months is a valid means to assess the deal's value.

method of calculating the disallowance amount is the method in which we evaluated prudence. PGL's logic appears to be that, since Staff used the actual price differentials in calculating the disallowance amount, its use of dollar amounts known at the time of the gas was exchanged and not at the time the transaction was negotiated was hindsight analysis. PGL's logic is faulty. Staff evaluated the prudence of PGL's operations of Manlove storage field based on factors known at the time – third party customers had injected 7.1 Bcf in to Manlove field (Staff IB at 57; Staff RB at 39-40), and PGL expressed concern about the field being able to provide peak deliverability through the winter (PGL Exh. F at 801-09). Yet despite that concern, PGL loaned gas to third party customers from January 5, 2001 until May 3, 2001, and consequently, PGL had to purchase additional gas to maintain peak deliverability until later winter. (Staff IB at 57-59). All of this information was known at the time the field was being operated and, therefore, is not hindsight review.

C. Reply to Hindsight Concerning LIFO Price

On page 16 of its BOE, PGL incorrectly states that "this actual LIFO price is the lynchpin [sic] of Staff's analysis." Once again, PGL confounds the logic Staff followed in finding PGL's storage usage imprudent with Staff's calculation of the increased costs that PGL's imprudent behavior imposed upon ratepayers. Therefore, PGL's recommendation that Staff's analysis is a hindsight review is in error, as Staff explained in its Reply Brief, on pages 53-54.

D. Reply to Customer Use Not Limited by Hub Services

On pages 16 and 17 of its BOE, PGL provides two reasons in support of its position that customer use of storage gas was not limited by Hub services. Neither reason refutes Staff's arguments.

PGL's first argument in support of its position is that it withdrew almost all the gas it planned to withdraw from Manlove Field (25.13 Bcf actually withdrawn, compared to 25.5 Bcf planned to be withdrawn). (PGL BOE at 16). This argument does not rebut Staff's primary position -- that the timing of PGL's gas loans and its decision not to interrupt third party transactions that would have prevented the need to purchase gas in the winter were the important issues in determining the prudence of its operation of Manlove field. (See Staff IB at 57-59). PGL undoubtedly restricted the amount of gas it delivered to ratepayers from Manlove field during the period when prices were highest (December 2000 and January 2001). Instead, it decided to imprudently allocate large volumes of gas to third party customers so as to support its provision of Hub services. PGL could have either not entered into such transactions or it could have retained the right to interrupt such transactions. This would have prevented PGL from needing to purchase additional gas at spot market prices in the winter and to assure that the field could meet peak deliverability for the winter period. (Staff IB at 57-59).

PGL's second argument is that storage usage in total (which includes leased storage) increased during this reconciliation period relative to the previous year. (PGL BOE at 16-17). That fact, however, does not prove that PGL did not limit ratepayers use of storage gas, as PGL claims. PGL retained the ability to use more storage gas from Manlove field for ratepayers during December and January[5] -- the two critical, high-priced months, despite the large volume of gas being withdrawn for third parties -- by either choosing not to enter into contracts with third parties or exercising its right to interrupt services to third parties. As stated above, the failure to exercise these reasonable options so as to prevent having to buy gas in the winter period (causing ratepayers to pay more money) was imprudent. (Staff RB at 57-59). PGL's decisions regarding how much gas to allocate to ratepayers and to third party customers does not counter PGL's specific failures, as discussed above.

E. Reply to Need to Balance Price Against Operational Concerns

PGL claims that the Proposed Order failed to consider "operational imperatives", and that Staff's disallowances "were based on a false belief that the only purpose of storage is to provide a price arbitrage." Both statements are false. Staff carefully considered the operational considerations PGL raised in its testimony to justify its actions and does not exclusively view storage as a price arbitrage.

In evaluating the prudence of PGL's use of Manlove field, Staff examined the volume of actual withdrawals from Manlove field that were allocated to ratepayers versus the volume of withdrawals that PGL had planned. (Staff IB at 26-27, *citing* Staff Ex. 3.03 and Staff Ex. 6 at 38). In other words, Staff never argued that PGL's primary consideration should be lower costs. (Staff Ex. 12 at 29). In its Reply Brief, Staff summarized its view of operational factors – that "the operational factors that Peoples Gas cites are factors that are considered on a daily basis by every gas utility, and

[5] Staff notes that withdrawals in February 2001 were much higher than in February 2000. PGL even continued withdrawals into March 2001. (Staff Ex. 3 at 41-42 – Table 3) Thus, the only way that PGL could fully cycle the field was to backload withdrawals in months that provided fewer benefits than in earlier months.

Peoples Gas has not shown that these factors were unusual or more complicated than normal." (Staff RB at 45; *see also* Staff RB at 45-46, for Staff's full response to PGL on this issue). In determining imprudence, Staff however, did not propose an alternate physical withdrawal plan. Therefore, in calculating the disallowance, volumes were determined using the actual withdrawals, and not some alternate physical withdrawal plan.

F. Proposed Order was Correct in Relying Upon Staff's Calculation of the Disallowance for PGL's Purchase of Additional Gas To Replace Gas it Imprudently Loaned to Third Parties

PGL attacks Staff's use of the highest priced purchase gas minus the LIFO gas, stating that the amount of disallowance "does not reflect a realistic picture of costs that actually could have been avoided had Peoples Gas used Dr. Rearden's hypothetical storage withdrawal plan," because they could not ". . .know what purchase has the highest price. . ." (PGL BOE at 18). There are two points to be cognizant of. First, PGL's argument attacks only one of two adjustments related to Manlove storage field – the disallowance for the purchase of additional gas to replace that which was loaned to third parties (P.O., Appendix A, col. H). Second, Staff's calculation method is better than the one proffered by CUB and the one proposed by PGL in its BOE (at 18).

Dr. Rearden presumed that PGL can determine the cost of gas from any one transaction relative to other transactions at any given time since PGL must manage its gas costs to prove the prudence of transactions affecting the PGA. (*See*, 220 ILCS 5/9-220). Moreover, Staff's calculation is a better estimate of the cost of gas purchased in the spot market in December 2000 and January 2001 than what PGL proposes in footnote 18 (*see* PGL BOE at 18 and n. 18), because the LIFO value may overestimate the value of gas LIFO tends to understate the adverse impact of the third party transactions. (See CUB Ex. 4 at lines 248 – 56).

3. Storage Optimization Contract

A. Prudence of the SOC in Light of Section 525.40 and Evidence Regarding Whether Enron MW Provided a Legitimate Service

PGL emphasizes that "contracting for third party management is acceptable" because it is allowed under §525.40(a)(4). (PGL BOE at 19). Staff points out that, although Part 525 designates management contracts as recoverable gas costs, such designation does not mean that management contracts are automatically approved or are prudent. Applied to the instant case, the SOC is a contract allowing a third party, Enron MW, to manage gas storage. However, the Commission still has the ability to review the prudence of the decision to enter into such a contract.

PGL continues its support of the prudence of the SOC, by arguing that "there is no basis in the Public Utilities Act or the Commission's rules for the Proposed Order's conclusion that Peoples Gas was required to come forward with documentation to show every transaction Enron MW performed pursuant to the SOC to show that Enron MW performed a service under this contract to earn its fees." (PGL BOE at 19). The basis that requires PGL to explain its transactions with Enron MW is rooted in the standard of review. The Commission is to make a decision based on the preponderance of the evidence and, if PGL fails to provide evidence, then there is no evidence to counter Staff's claims.

PGL's argument responds to the Proposed Order's acceptance of Staff's position that "Peoples Gas never explained why it needed Enron MW to optimize its leased storage." (Staff IB at 87). In his additional direct/ rebuttal testimony Dr. Rearden stated that he had been

> unable to find a reason why Peoples Gas could not simply 'optimize' the asset on its own. To enter into the types of sophisticated deals that Peoples entered into with Enron (and others), it had to possess the analytical and trading capability to conduct much of that activity by itself. Even if Enron or TPC was likely to extract greater value from the asset, it is not self-evident that its superior talent in optimizing storage is worth up to XXX of the profits.
>
> (Staff Ex. 7 at 66).

PGL's response was "The NSS storage optimization allowed a marketer with trading expertise to manage the excess storage capacity that was not needed by the Company. The Company did not possess the necessary skill set or systems to manage a large trading book." (PGL Ex. F at 55). PGL responded on page 66 of its reply brief – "Contracting with EMW was Reasonable." Consequently, the ALJ weighed these arguments and found that the preponderance of the evidence and came to the correct conclusion, as stated in the Proposed Order.

B. Proposed Order Should be Amended to Include Language Supporting Finding That There was Another Offer to Optimize Storage That was More Favorable to Consumers

PGL claims that the Proposed Order concluded that "Peoples Gas should have entered into a new contract with TPC to provide this service [SOC], rather than the SOC with Enron MW, because the terms of the proposed TPC contract were more favorable to consumers." (PGL BOE at 21). Staff provided arguments in support of the conclusion being challenged by PGL. Staff, therefore, recommends adding language to Staff's Position and the Commission Analysis and Conclusion sections of the Proposed Order to reflect Staff's position and rationale for finding that "PGL received an offer, previous to the SOC, that presented terms more favorable to consumers than the SOC yet, it chose Enron Midwest." (P.O. at 118)

Accordingly, Staff proposes the *Staff Position* and *Commission Analysis and Conclusion* sections be amended with language from Staff's Reply Brief at page 72 and 73.

Second paragraph on page 116:

> Staff maintains that PGL's failure to document what Enron was doing to earn the revenues it took pursuant to the SOC was imprudent. Staff posits that PGL never explained why it needed Enron Midwest to optimize its leased storage. And, PGL had an alternative to Enron Midwest, another company that was interested in optimizing this storage, at more favorable terms to consumers. Under the SOC, PGL had to share profits with Enron MW. The percentage of profit sharing varied based on the profits attained through the optimization of storage. The terms of the other proposal would have resulted in Peoples Gas sharing approximately 6 to 21 less percentage points of profits than under the SOC. (Staff Ex. 7 at 64-66). The reduced sharing would have resulted in a larger percentage of revenues going to ratepayers. (*Id*.). Staff contends that PGL chose EMW over this other vendor due to the profit-sharing arrangement Enron Midwest had with PEC. Staff argues that therefore, PGL's choice, Enron Midwest, was imprudent. Staff seeks a disallowance in the amount of money Enron Midwest garnered from this contract. (Staff Init. Posttrial Brief at 87-88, Staff Ex. 7.00 at 49).

Second paragraph on page 118:

> PGL received an offer, previous to the SOC, that presented terms more favorable to consumers than the SOC, yet, it chose Enron Midwest. The terms of this other offer to optimize storage was a better choice than the SOC because a larger percentage of revenues would have been returned to ratepayers is credit to that PGA, and there would not have been any indirect routing of profits from PGL to PEC. Also, PEC~~/PERC's~~ gleaned not only 50% of the SOC profits, but, PEC~~/PERC~~ gleaned 50% of Enron Midwest's

> management fees pursuant to this contract through enovate. If Enron Midwest was truly performing a service that benefited consumers, it would not have been content with only 50% of the fees it "earned" for those services. These two facts are indicia that Enron Midwest did not, in fact, "earn" the monthly fees it collected from PGL, at the expense of consumers. And, PEC~~/PERC~~ did not earn the revenues it/they collected pursuant to this contract.

C. Proposed Order Correctly Found that There was Profit Sharing

On page 21 of its BOE, PGL attempts to argue that there is no evidence that either Enron MW or another party would be satisfied with an alternative percentage of profit sharing. (PGL BOE at 21). PGL argues that there is no support that Enron MW would have provided the service at less than 50% sharing of profits. PGL further claims that it was unreasonable for the Proposed Order to conclude that "Peoples Gas should have received 100% of the revenues associated with optimization" because no "counterparty would have entered into a transaction if it could not retain any revenue for its services." (PGL BOE at 21). PGL's argument should be disregarded because Staff presented testimony supporting the return of the revenues earned by Enron MW and revenues Peoples Energy Corporation ("PEC") received from Enron MW. (Staff IB at

4. Hub Services Revenues (Non-Tariff Service Revenues)

A. Section 525.40 is Intended to Regulate Transactions That are not Pursuant to an ICC Tariff but Impact Recoverable Gas Costs

On page 22 of its BOE, PGL argues that the accounting of Hub revenues should not be determined in a PGA case, but that "fairness dictates that the appropriate forum for deciding upon the proper treatment of Peoples Gas' hub revenues be its next rate case." This argument should be rejected, since Section 525.40(d) of the Commission rules specifically requires revenues received from transactions that are not regulated by the ICC be used to offset the recoverable gas cost. (*Pre-Trial Brief of Staff Witnesses of* *the Illinois commerce Commission on the Applicability of 83 Illinois Administrative Code 525.40(d)*, at 4). Such an offset is required if any of the associated costs are a recoverable gas cost defined in Subsection 525.40(a). As Staff explained in its briefs, the gas in PGL's distribution system is an associated costs that is a recoverable gas cost as defined in paragraph 525.40(a)(1). (*Staff Pre-Trial Brief on 525.40(d)*, at 8).

Moreover, to deny to PGL's ratepayers the revenue earned by non-tariff transactions, as required by Section 525.40, is contrary to Illinois law. The Illinois Supreme Court in *Business and Professional People for the Public Interest v. Illinois Commerce Commission ("BPI"),* 136 Ill. 2d 192 (1990), held that "The Commission may alter or amend its past practice, but it must follow the procedures set forth in its rules and the Act." (*BPI*, 136 ILL. 2nd at 226). As discussed above (and in Staff's reply brief), Section 525.40(d) requires a gas utility to offset the recoverable gas cost with revenues from transactions that are not subject to the gas charge if any of the associated costs of the transaction meets the definition of recoverable gas costs at 525.40(a). Thus, PGL is urging the Commission engage in an action which the courts have declared illegal.

In addition, PGL's "fairness" argument operates to the detriment of the consumer, by depriving them of a credit, in compliance with Section 525.40, until PGL's next rate order. Deferring the credit of Hub revenues would permit PGL to retain all profits from Hub transactions until its next rate order. Using the Commission's Order in Docket No. 04-0779 as a guide to the manner in which Hub revenues should be accounted for (*see infra*, §4(B), discussing import of Order in docket 04-0779)), at the time of PGL's next rate case the Commission would order its Hub revenues to be accounted for as an offset to recoverable gas costs through the PGA. (*Order*, Docket No. 04-0779[6] at 178 (2005) requiring Nicor to credit Hub gross revenues to all customers via the gas charge (*i.e.*, Rider 6)). There is no reason or benefit to the delay that decision.

In addition, PGL claims that Section 525.40 is "an accounting regulation and does not concern operational matters," and as an accounting matter "it is impossible to ascertain precisely what assets support any given hub transaction or to state that a transaction did or did not have any recoverable gas costs associated with it." (PGL BOE at 23). PGL therefore asks that revenues only "be accounted for in the PGA when recoverable gas costs are involved in the transaction." (PGL BOE at 22). This line of argument is contrary to the purpose of accounting and Section 525.40.

All utilities are called to account for their gas, and the accounting of gas follows or tracks the operations of the gas utility. Staff testified that the accounting process follows the operational events. In other words the sequence is as follows; first – an operational event occurs, and second – the accounting records the event as it occurred. As Staff stated in its direct testimony, proper accounting treatment should reflect all events that have occurred and in the proper sequence. Thus, "(t)he accounting for an event should be an accurate representation of what actually happened." (ICC Staff Exhibit 1.00 at 20-21). For PGL to state that it is impossible to ascertain what assets support a transaction is as much as admitting that an audit is needed because its recordkeeping is not sufficient to track its gas operations. In addition, as stated above, Section 525.40 also applies to transactions that occur outside of an ICC tariff if any of its associated costs include a recoverable gas cost (§525.40(a) – defines recoverable gas

[6] Northern Illinois Gas Company d/b/a Nicor Gas Company, Proposed General Increase in Natural Gas Rates.

cost). The associated cost involved in these non-tariff services is the flowing gas in PGL's distribution system (*see* §525.40(a)(1)).

For the foregoing reasons, PGL's arguments regarding the applicability of Section 525.40 should be rejected as improper, and the Proposed Order should not be amended.

B. The Nicor Cases -- Docket Nos. 93-0320 and 02-0779 -- do not Exclude the Revenues from Non-Tariff Transactions from the Gas Charge

On page 24 of its BOE, PGL reargues that the two Nicor transportation cases (Docket Nos. 93-0320 and 02-0779) are applicable to the instant matter and should govern the treatment of Hub revenues. Neither Order cited by PGL addresses the issues of whether Hub revenues ought to be excluded from Section 525.40 or whether such revenues are not to be accounted for in a PGA case. The proper treatment of Nicor's revenues from the transportation agreements was discussed extensively in Staff's Initial and Reply Briefs. (*See* Staff IB at 67-71 and Staff RB at 64-67).

In addition, PGL relies on the two Nicor transportation Orders to argue that a rate case is the proper forum for determining the accounting treatment for hub revenues. On this issue, Staff supports the conclusion of the Proposed Order, and PGL's reliance on the two Nicor transportation orders is misplaced for the reasons stated in the paragraph above. In addition, the Nicor Orders are not subject to the provisions of Section 525.40(d) because the contracts at issue in those cases are exempt from the requirement that a gas utility (*e.g.*, Nicor) offset recoverable gas cost if any of the associated gas costs of the transaction are defined as recoverable gas costs. (*See* Staff RB at 65-67).

Moreover, the Final Order regarding Nicor's most recent petition for an increase in its natural gas rates requires Nicor to credit Hub gross revenues to all customers via the gas charge (i.e., Rider 6). (*Order*, Docket No. 04-0779 at 178 (2005)). In that Order the Commission supported Staff, IIEC, and RGS's proposal, finding that:

> The evidence has shown that all customers pay for the park and loan services provided by the Hub, and all customers pay for the available online storage and pipeline capacity, and for the *gas*, which are necessary for the park and loan services provided by the Hub.
>
> (*Order*, Docket No. 04-0779, at 178 (emphasis added)).

In order to provide consistency between the most recent Nicor rate order (*i.e.*, 04-0779) and the instant case, the Commission should reaffirm the Proposed Order's finding that the use of displaced gas is necessary to complete Hub transactions. Thus, PGL's non-tariff service revenues (*i.e.*, hub revenues) should be accounted for as a reduction to the recoverable PGA gas cost in accordance with the requirements of Subsection 525.40(d).

5. enovate LLC

A. Total Amount of enovate disallowance is $19,683,640

PGL incorrectly states that the disallowance reflected in the Proposed Order concerning enovate, LLC is the amount of GCI's recommendation. (PGL BOE at 27, footnote 26). Staff's proposed disallowance was $19,683,640, net of other adjustments (Staff Ex. 5, Schedule 5.03), and in fact, this is the total amount of enovate adjustments reflected in Appendix A to the Proposed Order. (Schedule 3, page 2 of 2, columns (P) + (Q)). The first line on page 107 of the Proposed Order incorrectly totals the amount and should be amended, for consistency, to $19,683,640.

B. enovate's Revenues were correctly treated by the Proposed Order, and the Caselaw cited by PGL is Inapplicable

PGL argues, beginning at page 27 of its BOE, that enovate was some distant affiliate with which PGL had no real connection. This directly contradics the evidence that shows that at least some of enovate's profits were credited to the Gas Charge by PGL (Staff Ex. 9 at 25-27, and Ex. H, attached thereto). PGL presented no evidence and, indeed, offered no explanation why some enovate transactions and amounts were credited by PGL to the Gas Charge and others were not.

Staff evidence in this cause showed the nexus between enovate and PGL's gas charges (cited on Staff IB at 9-14, 16, 74-77, and 82-84). PGL chose not to present evidence rebutting Staff's and, instead, stands on the complicated corporate structure and nothing more. The only assertion, also unsupported by evidence, is PGL's claim that enovate had nothing to do with PGL and its gas charges. The proposed order clearly is supported by the preponderance of the evidence. (5 ILCS 100/10-15).

The Staff's briefs spent considerable time explaining and detailing the Strategic Partnership between the subsidiaries of PEC (including PGL and North Shore) and the subsidiaries of Enron (Staff IB at 9-14, 16-20, 24-25, 73-77, 82-85, 88 and 92-95) . PGL asks the Commission to put blinders on when reviewing this PGA reconciliation case. However, the Commission should not ignore pertinent factors affecting the gas costs and the PGA clause. (*Archer-Daniels-Midland Co. v. Illinois Commerce Commission*, 184 Ill. 2d 391, 398-400 (1998) [A Section 9-220 FAC reconciliation is not limited to the direct fuel costs. The Commission was authorized to consider the prudence of contract restructuring and allow recovery as a cost of fuel]; *United Cities Gas Co. v. Illinois Commerce Commission,* 235 Ill. App. 3d 577, 583-584 (4th Dist.,

1992) [In a Section 9-220 reconciliation proceeding, Commission could consider the reality of the situation in allocating costs rather than the contract allocation]. *Cf. Illinois Bell Telephone Co. v. Illinois Commerce Commission*, 55 Ill. 2d 461, 470 (1973) [the Commission may not ignore pertinent factors affecting rate structure]).

On page 28 of its BOE, PGL cites *BPI v. Illinois Commerce Commission,* 171 Ill. App. 3d 948 (1st Dist., 1988), concerning the enovate adjustment. The *BPI* case, which dealt with replacement fuel costs, has no application to the requirements of the PGA clause, which requires generally that all gas revenues other than transactions under tariff or contract approved by the Commission be run through the clause. (83 Ill. Adm. Code 525.40. *See* Staff IB, at 7-9 ,14, 24-25, and 73-77 and Staff Reply Brief, at 68-71). PGL once again ignores the reasons for the adjustment used by Staff and accepted in the Proposed Order and attempts to replace those reasons with Staff's method of calculating the imprudence, which PGL then attacks as the "reasons" for the adjustment..

PGL makes an interesting admission in footnote 29 of its BOE; that its accounting records are unreliable and cannot be used as evidence. This admission only serves to bolster Staff's recommendations concerning internal audits and recordkeeping. (P.O. at 128-30, 133).

PGL for the first time makes a general claim that enovate was acting under FERC's jurisdiction (PGL BOE, at 29-30), for which no evidence has ever been submitted. The argument that enovate could use PGL's hub service, because others used said service, directly runs afoul of 220 ILCS 5/ 7-101. (*See* Staff RB at 68-71 and 83-86).

Because of the statutory requirements imposed on PGL, *e.g.,* 220 ILCS 5/ 7-101, 7-102, and 9-220, it is unnecessary for the Commission to find that transactions were shams (BOE, at 30) or were intended to defraud customers (BOE, at 33). A more general piercing of the corporate veil may end up being done in other administrative or judicial proceedings, but not here.[7] It is sufficient to find that these revenues should have been reflected in PGL's PGA clause. The Proposed Order does at two points (pp. 106 and 113) use the term, "strawman", to summarize Staff's evidence. However, PGL chose not to submit evidence proving that these transactions were not related to PGL, its assets, or gas costs, even though PGL bears the burden of proof, which is an evidentiary and not an argument matter. 220 ILCS 5/ 9-220 (a). That the evidence is what it is, is not a matter subject to Staff or Commission control since all records of the transactions are in the control of PGL or its affiliates.

Similarly, PGL's reliance on such cases as *In Re Rehabilitation of Centaur Insurance,* 158 Ill. 2d 166, 172 (1994); *Kelsey Axle & Brake Division v. Presco Plastics, Inc.,* 187 Ill. App. 3d 393, 401 (1st Dist. 1989); and *Divco-Wayne Sales Financial Corp. v. Marti Vehicle Sales,* 45 Ill App. 2d 192, 196, (1st Dist., 1963) is misplaced. Besides being cases involving general lawsuits, they draw on the principle that the "relationship of parent and subsidiary corporation will not, standing alone, render the subsidiary liable on the parent's contract." (45 Ill. App. 2d at 196; *see also* 187 Ill. App. 3d at 400). Nothing accepted in the Proposed Order stands on the relationship of PGL to the other affiliates <u>alone.</u>

[7] Had it been necessary, there was additional evidence submitted during discovery that could have been put into evidence in support of piercing the corporate veils of these companies generally. Staff neither sought further evidence to justify a general piercing of the corporate veils nor submitted all potential evidence which it had in support of such a position. It is sufficient to say that PGL's claim that a rigorous examination will support a finding of legally sufficient separation is questionable at best.

PGL attempts to rely on *Peoples Energy Corp. v. Illinois Commerce Commission,* 142 Ill. App. 3d 917 (1st Dist., 1986). In that case, the spinning off of Natural Gas Pipeline Co. of America (reorganization of the holding company, PEC) was held to be outside Commission approval under what is now Section 7-102 of the Act, 220 ILCS 5/ 7 -102, because the ownership of PGL itself was not being changed. The present case is not one of a general reorganization but specifically deals with the use of PGL's assets and the revenues that need to be run through the PGA clause under Section 9-220 of the Public Utilities Act, 220 ILCS 5/ 9-220. The *Peoples Energy* case did not grant PGL a general exemption for all purposes under the Public Utilities Act. Further, PGL has no valid claim that the enovate transactions did not harm PGL, as PGL's witness Mr. Graves agreed -- prudent–management required the utility to pursue reasonable opportunities-for offsetting revenues, rather than divert them to another entity.-(Apr. 21, 2005 Tr. at 1190-91).

6. Trunkline: The Evidence Supports the Conclusion in the Proposed Order Regarding the Trunkline Deal

Through footnote 29, PGL uses the Trunkline deal as an example of the Proposed Order reaching a conclusion that is contrary to evidence. (PGL BOE at 29, n.29). PGL is incorrect in its argument and in its analysis of the Trunkline deal.

The standard of proof in this case is the preponderance of the evidence (P.O. at 5), and PGL bears the burden of proof (*Id*. at 4). In the evaluation of the Trunkline deal, and in numerous other instances throughout the Proposed Order, the ALJ evaluated and weighed the evidence and found that PGL failed to present evidence in response to Staff or GCI. Clearly, the ALJ made her findings based on the facts in the record and determined that the evidence in the record weighed against PGL. In the instance of the

Trunkline deal, the Proposed Order determined that PGL must offer credible evidence that it benefited from Enron MW's involvement in the Trunkline deal to demonstrate that the deal was prudent. (*See* P.O. at 112, 113). PGL, however, presents no evidence to overcome the Proposed Order's conclusion and merely states that the Proposed Order's conclusion is unsupported by substantial evidence. (PGL BOE at 29 n. 29).

Staff argued in its Initial Brief that Enron MW was included in the Trunkline deal solely to shield PGL and enovate from § 7-101 scrutiny. (Staff IB at 84). Staff supported this position with evidence that Enron MW performed no service in exchange for payment. (Staff Ex. 9 at 17-19). Without evidence to the contrary, PGL cannot overcome the Proposed Order's decision that the Trunkline deal was imprudent.

7. GPAA is imprudent, and PGL should have known it was prior to entering into the contract

Staff is not dismayed that the imprudent GPAA only increased gas costs by $13 million in this reconciliation year. However, at page 33 of the BOE, PGL seems to argue that imprudence can be ignored unless there is a relatively, large adjustment in the reconciliation period.

At page 34 of the BOE, by attacking the Aruba analysis and Wear Cross Ex. 15, PGL inherently admits that PGL entered into the GPAA without any quantitative analysis of its effects on the gas costs to PGL's ratepayers. Thus, even if the Commission were to ignore the only two known, pre-signature analyses (as PGL itself claimed it did), PGL admits that it entered into the GPAA imprudently. Blind hope that an agreement will be economic is not a prudent thing to do (Staff Ex. 3, at 10-11 and Ex. 6, 8-11 and 15-16).

The Commission cannot ignore the Aruba Analysis and Wear Cross Exhibit #15. The studies existed at the time the GPAA was negotiated and were in the possession of company personnel involved in negotiations of the GPAA – Mr. Rodriguez created the Aruba Analysis (Staff Ex. 7 at 12; Staff Group Ex. 1 at ST-PG 102) and Mr. Wear possessed Cross Exhibit #15 on his computer. (Tr. 1146 and Staff IB at 15).

Mr. Morrow identified Mr. Wear as "one of the major parties participating on our team" in evaluating the GPAA, who Mr. Morrow trusted (Group Ex. 1 at ST-PG 096-098). Although Mr. Wear did not negotiate the GPAA by himself, he was involved, at a minimum, in pulling together the operational parameters of the contract (Staff BOE, at 34).

In addition, PGL's failed to produce the documents, despite being in their control. This establishes a rebuttable presumption that the documents are interpreted as negative to their position. The two 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 Staff and GCI raised the issue in testimony and brief and it remained unrebutted by PGL (*Belding, supra*, 358 Ill. at 220-21).

Even expert witnesses are subject to examination of credibility by the fact finder. *Trower v. Jones,* 121 Ill. 2d 211, 220 (1988). In Commission proceedings, it is the Commission which judges the credibility of the witnesses. *Illinois Bell Telephone Co. v. Illinois Commerce Commission,* 327 Ill. App. 3d 768, 776 (3rd Dist., 2002). In its footnote 20 (PGL BOE at 35), PGL argues that too much is made of Wear Cross Ex. 15 and Mr. Wear's credibility. A witnesses' credibility is determined by the trier of fact (*Eychaner v. Gross*, 202 Ill. 2d 228, 270-71 (2002)). As such, the ALJ has the authority to allocate greater weight or less weight to his credibility, and the ALJ was correct in her assessment of Mr. Wear.

To date, Mr. Wear or his employers have never altered the claim that Mr. Wear did not recognize Wear Cross Ex. 15 at all, although as far as the record evidence is concerned he is the only possible author (Tr. 1021, 1024). Mr. Wear also disclaimed seeing the Aruba analysis, although evidence indicates that it was sent to him prior to the signing of the GPAA. The Aruba analysis was not sprung upon Mr. Wear at hearing (Group Ex. 1 at ST-PG 163). It must be remembered that Peoples Gas failed to produce either document after repeated requests by Staff for economic analyses of the GPAA until the documents were found by Staff and Intervenors in the massive amount of paper and electronic documents turned-over after the reopening of discovery. (Staff Ex. 7 at 6-7). The Proposed Order's rejection of Mr. Wear's credibility is proper and supported by the preponderance of the evidence of record.

8. Reopening 00-0720

PGL argues that Docket No. 00-0270 should not be reopened because the additional evidence concerning the GPAA did not change the bases of the Commission's decision that gas costs in FY 2000 were prudently incurred. (PGL BOE at 35). Staff supports the ALJ's decision on this point, and PGL's argument should be rejected because the many significant and relevant facts adduced in this case were not reviewed in the preceding docket. Moreover, there were additional facts reviewed in this docket that required more than just the GPAA to be re-reviewed in the 00-0720 docket. Staff will not go into rearguing the same facts and legal arguments that are set forth and explained in sufficient detail in its Initial and Reply Briefs. (Staff IB at 97; Staff RB at 88-92).

9. Reflection of Factor O in the Monthly Filing

PGL, with no identifiable supporting argument, proposed language changes to the ordering paragraph regarding when PGL is required to reflect its ordered reconciliation Factor O in its monthly filings. (PGL BOE at 164, Exception #s 1255-59). Subsection 525.60(b) of the Commission rules requires the full amount of the Factor O be included in determination of the Gas Charge unless the Commission determines it necessary to amortize such amount. The language in the Proposed Order, therefore, correctly states that "the ordered reconciliation Factor O … be reflected in its first monthly PGL filing submitted after the date of a final order" in this docket. (P.O, at 136, Finding Paragraph 17).

Staff interprets PGL's changes to this paragraph to be its request for an amortization period of twelve months. (PGL BOE at 164, new Finding Paragraph 13)

Staff has no objection to the twelve-month time frame. However, Staff recommends that the monthly payments be weighted by forecasted volumes. This methodology will ensure that ratepayers receive the greatest impact of the Factor O during the heating season, when volumes are greatest.

Therefore, Staff recommends the following language changes to Finding Paragraph 17 of the PO:

> The Commission adopts Staff's proposed reconciliation as is modified herein and as is reflected on ~~Schedule~~ <u>Appendix</u> A, attached hereto, and <u>The</u> Peoples Gas Light and Coke Company shall refund its PGA customers, via the Commodity Gas Charge, through an ordered reconciliation Factor O<u>.</u> ~~to be reflected in the its first monthly PGL filing submitted after the date a final order is entered in this docket.~~ <u>In its first monthly PGA filing submitted after the date a final order is entered in this docket, PGL shall present an amortization schedule, amortizing the total Factor O plus interest amount, using the rate established by the Commission under 83 Ill. Adm. Code 280.70(e)(1), over a twelve-month period. The amortization schedule shall be based upon PGL's forecasted therm sales for the twelve-month period beginning with the month after a final order is entered in this docket. The monthly amount calculated on such an amortization schedule shall be reflected on Schedule 1, line 11, of its Commodity Gas Charge, such that the full Factor O plus interest amount is refunded to ratepayers no more than twelve months after the date of a final order in this proceeding.</u>

CONCLUSION

WHEREFORE, for all the reasons set forth herein, the Staff Witnesses of the Illinois Commerce Commission respectfully requests that the Administrative Law Judge accept the arguments set forth herein, as well as any edits to the *Proposed Order*.

Respectfully submitted,

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