



DEPARTMENTAL CORRESPONDENCE

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Subject Bank Gas

Date June 3, 2005

To L. Kallas

From J. Orsi

Copy M. Gerth J. Metz
To T. Katter C. Gregor
H. Ham M. Small

Peoples Gas and North Shore Gas large volume transportation customers can deliver gas to the company in excess of their current consumption requirements. Based on the provisions of the Company's Transportation Tariffs, the quantity of excess gas is reflected in the customer's Gas Bank Account (GBA). During the winter season, customers satisfy consumption requirements by supplementing winter gas deliveries with withdrawals from their GBA. The company recognizes a liability for the redelivery of gas to the customer's GBA with the offset to gas costs, priced at the current LIFO commodity price. When transportation customers withdraw from their GBA, the prior year's liability is reduced and the volumes are priced at the previous year's commodity LIFO price until the previous year's bank layer is used up. Any remaining volume withdrawals are priced at the current LIFO commodity price.

Currently, there is a difference between the GBA volumes reflected on the books and the GBA that the billing systems report (calculate). The volumes on the books are understated. The billing system (CFirst) can provide a snapshot of our GBA volumes. The design of the system effects a change to the GBA balance, almost instantaneously, when employees perform routine account maintenance (cancel/rebill). This design feature makes it difficult and challenging to reconcile the booked GBA balance with the billing system's calculated GBA balance. Cancel/rebill activity on an account may span several billing periods (calendar months) and the revised consumption will be reflected as a change to GBA balance for each of the billing periods in question. Yet, on the accounting side, the cancel/rebills and change to the GBA balance are reflected in the current month activity (the revenue month when the account activity was performed).

Under certain situations, it is impossible or impractical to cancel/rebill an account to revise consumption. In those situations, Gas Transportation Services will enter a one-sided GBA adjustment – either positive or negative – to resolve the billing error. We discovered that one-sided GBA adjustments are not part of the revenue statistics that are used to determine the GBA balance that is booked by Accounting. Prior to March 2005, these volumes were not adjusted in the book balance, causing a permanent and gradually increasing difference between booked GBA balances and GBA balances calculated by the billing system.

Another factor that adds to the difficulty in reconciling is the fact that current month activity on the books does not reflect current month estimates for company-owned gas and cashout overages while the billing system is real-time and reflects the current month volumes for these items.

As you know, in addition to large volume transportation, the Company allows its residential and small commercial customers (rate 1 and 2) to participate in the Small Volume Transportation program (a.k.a Choices For You). While customers are billed by Cfirst, the participating Suppliers are billed by a separate billing system (SVT). As with transportation customers, SVT can deliver gas in excess of their customers' consumption. The excess quantity of gas is reflected in the SVT supplier's pool storage (Maximum Storage Quantity or MSQ) The storage balance is calculated by the SVT system. During the winter season, SVT

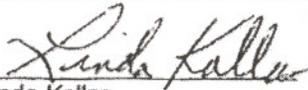
suppliers satisfy pool consumption requirements by supplementing winter gas deliveries with withdrawals from their MSQ.

There are various timing differences in SVT activity between revenue statistics that originate from Cfirst (books) and the SVT system (billing system). ITS, Gas Accounting, Gas Transportation Services and Decision Support have been working to identify these differences at month end in order to reconcile between the two systems.

The attached April 2005 reconciliation indicates an understatement on the general ledger of 1,290,450 Dth for PGL and 70,826 for NS. At this time, it appears appropriate to increase the liability for redelivery by making volume corrections for both PGL and NS, reducing Transportation revenue volumes. The PGL volumes correction would increase our liability for redelivery for PGL as part of our normal monthly close entry by \$8,633,110.50 for these 1,290,450 dekatherms at the estimated current month commodity LIFO price of \$6.69. The NS volumes correction would increase our liability for redelivery for NS as part of our normal monthly close entry by \$468,868.12 for these 70,826 dekatherms at the estimated current month commodity LIFO price of \$6.62. In addition to the above corrections, a number of changes to the billing systems have also been identified and are being reviewed for cost of implementation and prioritization. The below accounts are effected:

Dr. A/C 1149000 - Liability for Redelivery of Gas - Trans Cust (Gas Costs) PC 100100
Cr. A/C 907600 - Acc Liab for Redeliv of Gas To Trans Cust

If you agree, please sign below and we will include the correction in our monthly journal entry.


Linda Kallas
Vice President and Controller

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