STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own Motion, -vs- The Peoples Gas Light and Coke Company Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.	))))))))))))	05-0749

INITIAL BRIEF
OF
THE PEOPLES GAS LIGHT AND COKE COMPANY

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Notice of Filing And Certificate of Service

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Initial Brief of The Peoples Gas Light and Coke Company

Pursuant to Section 200.800 of the Illinois Commerce Commission's ("Commission") Rules of Practice (83 Ill. Admin. Code §200.800) and the schedule established by the Administrative Law Judges on May 30, 2007, The Peoples Gas Light and Coke Company ("Respondent" or "Peoples Gas") submits its Initial Brief in the above-captioned proceeding.

I. Introduction

Pursuant to Section 9-220 of the Public Utilities Act ("Act"), the Commission initiated the instant proceeding by order dated November 22, 2005. The order required Respondent to present evidence reconciling revenue collected under the purchased gas adjustment clause (Rider 2, Gas Charge) with the actual costs prudently incurred and recoverable under Rider 2, for the twelve months ended September 30, 2005, Respondent's fiscal year 2005.

Section 9-220(a) of the Act provides, in pertinent part, that:

> Annually, the Commission shall initiate public hearings to determine whether the [purchased gas adjustment] clauses reflect actual costs of fuel, gas, power, or coal transportation purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual costs of fuel, power, gas, or coal transportation prudently purchased.

220 ILCS 5/9-220(a).

In accordance with Section 9-220(a) of the Act, the Commission evaluates prudence under the following standard:

> Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. In determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible.
>
> Imprudence cannot be sustained by substituting ones' judgment for that of another. The prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being "imprudent."

Commonwealth Edison Company, Docket No. 84-0395, Order dated October 7, 1987, at 17. Also see, Illinois Power Co. v. Illinois Commerce Comm., 245 Ill. App. 3d 367, 371 (3rd Dist. 1993).

Section III describes uncontested issues. Section IV addresses the prudence of gas costs that Respondent incurred and flowed through its Gas Charge in fiscal year 2005. Section V addresses proposals related to reopening this proceeding after the Commission issues a final order. Section VI addresses the accuracy of Respondent's reconciliation of costs and revenues.

II. Executive Summary

As required by the Commission's initiating order, Peoples Gas presented evidence supporting its reconciliation of revenues with prudently incurred gas costs; it showed that its fiscal year 2005 gas costs were prudently incurred, although it agreed not to contest a recommended disallowance of approximately $2.1 million; and it proffered evidence of its price protection program. There is substantial evidence supporting Peoples Gas' reconciliation statement, adjusted to reflect the uncontested disallowance, and the prudence of its gas costs.

First, there are several uncontested issues in this proceeding, namely:

- Peoples Gas' requested Factor O of $10,662,268.27 to flow its fiscal year 2005 hub services revenues through the Commodity Gas Charge;
- Peoples Gas' agreement not to contest a recommended $2,125,334 disallowance associated with a supply contract in effect in October 2004;
- Peoples Gas' agreement to consistently and routinely bill third parties for its estimated cost of gas lost as a result of damage to gas lines by third parties;
- Peoples Gas' agreement to address certain supply and capacity agreements in its Docket No. 06-0752 testimony; and
- Other than two recommendations associated with the bank gas liability issue, there are no recommended disallowances and no other proposed changes to Peoples Gas' reconciliation statement.

Second, there are two recommended, contested disallowances associated with Peoples Gas' bank gas liability. The bank gas liability is a function of Peoples Gas' end use transportation programs. When transportation customers deliver gas in excess of their requirements, this creates a liability for Respondent to deliver an amount equal to that excess at some later time when the customers' requirements are less than their deliveries. During the reconciliation year, Respondent discovered and corrected an error in the quantity used in the liability calculation. The error meant that sales customers had received the benefit of almost 1.3 million dekatherms of gas without paying for that gas. The correction meant that gas costs would accurately reflect the benefit.

The fact that the correction was necessitated by a flaw in Peoples Gas' procedure is not relevant to the recoverability and prudence of the costs. The fact that the error likely existed prior to the reconciliation year and that the prior reconciliation years are the subject of final Commission orders is not relevant to the recoverability and prudence of the costs. Peoples Gas accurately computed the correction, the costs resulting from the correction are properly included in the Gas Charge, and the recommended disallowances should be rejected.

Finally, there is testimony about the possible effect of an ongoing management audit of Peoples Gas' gas supply functions. It is premature to address how, if at all, that audit may affect this proceeding. If the Commission or any other interested party believes that the audit warrants re-opening this docket in the future, the Commission's rules address such a situation. These rules, not the order, are the proper vehicle to address the audit question.

III. Uncontested Issues

A. Requested Factor O for Hub Revenues

Peoples Gas requested a Factor O of $10,662,268.27. Resp. Ex. A, p. 12; Resp. Ex. 1, p. 2 of 9, line 14. This is the amount of Peoples Gas' fiscal year 2005 revenues from its interstate storage and transportation services ("hub" services). Pursuant to the Commission's March 28, 2006 orders in Docket Nos. 01-0707, 02-0727, 03-0705 and 04-0683, Peoples Gas flows hub services' revenues through its Gas Charge. Peoples Gas would flow the requested Factor O through the Commodity Gas Charge. Resp. Ex. A, pp. 11-12. Commission Staff witness Dianna Hathhorn included this requested Factor O in one of her schedules. ICC Staff Ex. 1.0, Sch. 1.2, Col. B, line 14. Citizens Utility Board and City of Chicago ("CUB-City") witness Jerome Mierzwa refers to the requirement to flow the hub revenues through the Gas Charge and does not otherwise comment on the requested Factor O. CUB-City Ex. 1.0, p. 8.

B. Gas Purchase and Agency Agreement

Commission Staff witnesses Dennis Anderson and David Rearden and CUB-City witness Mr. Mierzwa recommended a disallowance associated with October 2004 purchases under Peoples Gas' Gas Purchase and Agency Agreement ("GPAA"). ICC Staff Ex. 2.0, p. 3; ICC Staff Ex. 3.0, pp. 4-6; CUB-City Ex. 1.0, pp. 5-8. Dr. Rearden recommended a disallowance of $2,125,334. ICC Staff Ex. 3.0, p. 6; <u>also</u> <u>see</u> ICC Staff Ex. 1.0, Sch. 1.3, Col. D, line 5. Peoples Gas did not contest the Staff's proposed disallowance. Resp. Ex. F, p.

3. Mr. Mierzwa accepted the Staff's recommendation in lieu of his own. CUB-City Ex. 2.0, p. 3.

C. Third Party Damage to Peoples Gas' Facilities

Ms. Hathhorn recommended that Peoples Gas "consistently and routinely bill third parties for its estimated cost of gas lost as a result of damage to gas lines by third parties." ICC Staff Ex. 1.0, p. 14. Currently, Peoples Gas bills for lost gas in the few cases where there is a significant gas release. Generally, the quantity of gas lost when a third party damages Peoples Gas' facilities would be small. However, Peoples Gas accepted Ms. Hathhorn's recommendation to estimate a quantity and value of gas lost and routinely include this in its bill for damages. As recommended by Ms. Hathhorn, Peoples Gas will flow amounts recovered from third parties for lost gas through the Gas Charge. Resp. Ex. D, pp. 28-29.

Peoples Gas proposed a method for estimating damages. A few key factors affect the quantity of gas lost when a third party damages Peoples Gas' facilities, notably size of the pipe, pressure, whether the pipe is fully or partially open and how long it is open. Peoples Gas developed a table that it proposed to use to estimate gas lost based on these key factors. Resp. Ex. D, p. 29 and Sch. 4. Peoples Gas respectfully requests that the Commission find that this is a reasonable approach to billing for lost gas from third party damage to Peoples Gas' facilities.

D. Issues that Peoples Gas Will Address in Docket No. 06-0752

Staff witness Mr. Anderson recommended that Peoples Gas address two topics in its fiscal year 2006 gas charge reconciliation direct testimony (Docket No. 06-0752). First, he recommended that, if Peoples Gas continues to retain its Rate Schedule NSS storage with Natural Gas Pipeline Company of America ("Natural"), then it should address its use of this storage.[1] ICC Staff Ex. 2.0, p. 6. Second, he recommended that, if Peoples Gas awards supply contracts that combine different supply options, then it should address how this lowers gas costs relative to issuing separate RFPs.[2] ICC Staff Ex. 2.0, p. 7. Peoples Gas agreed to these recommendations. ICC Staff Ex. 5.0, Attachments A and B. Mr. Anderson testified that this satisfied the concerns identified in his direct testimony. ICC Staff Ex. 5.0, pp. 2-3. Neither Mr. Anderson nor Dr. Rearden recommended a gas cost disallowance associated with either issue. Mr. Mierzwa did not address these contracts.

IV. Prudence of Gas Costs Incurred

A. Peoples Gas' Purchasing Practices and the Resulting Gas Costs Are Prudent

As required by the Commission's initiating order (p. 2), Peoples Gas presented extensive evidence showing that its gas supplies purchased during the reconciliation period were prudently purchased. During the reconciliation year,

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[1] Dr. Rearden also testified about this storage service. ICC Staff Ex. 3.0, pp. 19-22. In response to Mr. Anderson's and Dr. Rearden's testimony, Peoples Gas offered extensive evidence in this proceeding about the prudence of the gas costs associated with this storage service and the reasonableness of its management of the service. Resp. Ex. D, pp. 16-19.

[2] Dr. Rearden also testified about these contracts. ICC Staff Ex. 3.0, pp. 6-18. In response to Mr. Anderson's and Dr. Rearden's testimony, Peoples Gas offered extensive evidence in this proceeding about the RFP to procure this supply and the reasonableness of purchasing a service that included more than one component. Resp. Ex. D, pp. 4-16.

Peoples Gas' processes for developing and administering its gas supply and capacity portfolio to meet its customers' requirements were prudent and the resulting gas costs were prudently incurred. Notably, other than the recommendation related to the GPAA, which Peoples Gas is not contesting, there are no recommended disallowances associated with the portfolio and its administration.

In general, personnel in Peoples Gas' Gas Supply Department, and others, as appropriate, developed specific gas supply recommendations for management approval. The Gas Supply and Engineering Division was responsible for entering into and administering supply and capacity contracts. Each month, Gas Supply Department personnel met to address purchasing decisions for the upcoming month. On a daily basis, as changing requirements and the market dictated, these personnel addressed any changes necessary to accommodate the need for additional supply or capacity or the opportunity to release additional supply or capacity. Resp. Ex. B, p. 3.

During the reconciliation year, Respondent made three changes to the storage piece of its capacity portfolio. First, it did not renew a storage contract with Panhandle Eastern Pipe Line Company. The combined services provided by Natural and ANR Pipeline Company ("ANR") gave Peoples Gas the necessary flexibility. Second, it reduced the amount of Rate Schedule DSS storage capacity that it purchased from Natural. Third, it increased the amount of Rate Schedule FSS storage capacity that it purchased from ANR. The increased ANR service replaced the decreased DSS service. The Natural and ANR storage

services provide the appropriate storage flexibility to Peoples Gas on a daily, monthly and annual basis. There were no significant changes to Respondent's firm transportation portfolio. Resp. Ex. B, pp. 7-8. Capacity (both pipeline storage and transportation) transactions are subject to contracts with the pipelines and the pipelines' FERC Gas Tariffs. Resp. Ex. B, p. 6.

Respondent purchased several different types of supply in fiscal year 2005. It purchased the majority of its supply under firm contracts with suppliers. Respondent made these purchases under the terms of its individual contracts with each supplier. Generally, the nature of the service under the contracts was either "baseload" or "swing." A baseload contract obligates Respondent to purchase the full contract quantity each day of the contract term. A swing contract permits Respondent to take any portion of its daily contract quantity on any day, subject to timely nominations to the seller and pipeline transporter. The GPAA and two other citygate supply agreements with capacity release features each included baseload and swing supply. Resp. Ex. B, p. 5.

Respondent purchased a portion of its total supply as spot purchases from over twenty suppliers. It made spot purchases from these suppliers under the terms of the individual master contracts that Respondent had with each of them. These spot transactions typically provided gas on a short-term basis. Resp. Ex. B, p. 6.

A significant portion of Respondent's end use market opts for deliveries of customer-owned gas under Respondent's Schedule of Rates for Gas Service

("Tariff"). This gas was another source available to Respondent for system supply. Resp. Ex. B, p. 5.

Finally, Respondent purchased supply from its affiliate, Peoples Natural Gas Liquids, LLC, under a Commission-approved contract (Docket No. 96-0452). Resp. Ex. B, p. 6.

Several months prior to the beginning of the reconciliation year, Peoples Gas sent a request for proposals ("RFP") to interested parties for the purpose of obtaining competitive offers for citygate supplies. Peoples Gas sent the RFP to thirteen suppliers, and received bids from eleven of them. It awarded contracts to two suppliers. The accepted bids included the most favorable pricing terms and met all other requirements that Peoples Gas prescribed in the RFP. Together, these two agreements accounted for approximately 30% of fiscal year 2005 purchases. Resp. Ex. B, pp. 6-7.

In addition, Peoples Gas sent an RFP to interested parties for the purpose of obtaining competitive offers for baseload supplies. Peoples Gas sent the RFP to sixty-three suppliers, and it received bids from eleven of them. It awarded contracts to six suppliers. These baseload agreements accounted for about 40% of Peoples Gas' fiscal year 2005 purchases. Peoples Gas also issued RFPs to procure supply to fill its purchased storage services and its company-owned storage field (Manlove field). Resp. Ex. B, p. 7.

B. Peoples Gas Took Appropriate Steps to Mitigate Price Volatility

As required by the Commission's initiating order (p. 2), Peoples Gas presented evidence describing the measures it took to insulate the Gas Charge

from price volatility in the wholesale natural gas market, including explaining the hedging strategies it used. Peoples Gas took several steps to address price volatility.

First, it followed a price protection program designed to mitigate the effects of gas price volatility. Under this program, Peoples Gas protected a significant portion of its purchases at fixed prices or within fixed-price collars. It either hedged these purchases physically through fixed forward purchases directly with a supplier or by use of financial instruments. Under its plan, Peoples Gas began executing its hedges approximately eight months prior to the start of each season (*i.e.*, winter or summer). The timing of the transaction execution approximates a dollar cost averaging approach and results in 100% of the planned hedges in place prior to the season. (The term “dollar cost averaging” means that Peoples Gas executed its hedge transactions relatively evenly over the eight months prior to the hedged period. This is in contrast to, for example, purchasing all of the hedges eight months prior or waiting until one month prior to the hedged period to purchase the hedges.) Under normal weather conditions, Peoples Gas would expect to hedge between 50% and 60% of its annual purchases. Resp. Ex. B, p. 9.

Second, Peoples Gas’ company-owned and purchased seasonal storage provided a natural physical hedge. Resp. Ex. B, p. 10.

Third, Peoples Gas purchased gas from a variety of parties and from different producing regions to protect against regional price anomalies. Resp. Ex. B, p. 10.

This approach partially insulated customers against price volatility. By taking fixed price positions on a large portion of its anticipated baseload purchases, Peoples Gas dampened the effect that large swings in gas prices have on its total gas costs. This, in turn, led to more stable prices for Peoples Gas' customers. Absent Peoples Gas' program, customers would be exposed to the full risk of market fluctuations. The program was aimed at dampening volatility, which it did, and not at guaranteeing the lowest possible price for gas. Resp. Ex. B, p. 10.

C. The Bank Gas Liability Correction Represents Prudently Incurred Gas Costs

Peoples Gas corrected the bank gas liability, and this caused an increase of approximately $8.6 million to its fiscal year 2005 gas costs.[3] The correction increased the quantity of gas used to calculate the bank gas liability. Prior to the correction, customers received the benefit of gas delivered by Peoples Gas' transportation customers, but they had not paid for that benefit. In particular, they had not paid for the gas and the related liability that Peoples Gas has under its transportation programs to deliver customer-owned gas accounted for in the customers' banks. The correction meant that Peoples Gas' gas costs accurately reflected recoverable gas costs to serve customers.

Specifically, Peoples Gas reconciled the volumes used to calculate the bank gas liability recorded in the general ledger and the actual balance in the subsidiary ledgers that track transportation customers' bank gas quantities. The bank gas quantity calculated in the customer billing systems was approximately

[3] The precise amount of the correction was $8,633,110.50. Resp. Ex. C, Sch. 1, line 5.

1.3 million dekatherms (dth) greater then the accounting records.[4] Resp. Ex. C, p. 3. As Ms. Hathhorn stated, the correction was strictly an accounting adjustment. It did not mean that transportation customers receive more gas from or owe more gas to Peoples Gas. ICC Staff Ex. 1.0, p. 7. Peoples Gas priced this quantity at the May 2005 commodity LIFO rate[5] of $6.69 per dth to determine the value of the 1.3 million dth and its effect on the bank gas liability and, thus, on gas costs. Resp. Ex. C, p. 3 and Sch. 1.

The Staff and CUB-City witnesses questioned the correction. Ms. Hathhorn recommended a disallowance of $6,942,621. ICC Staff Ex. 4.0, p. 3 and Sch. 4.6.[6] She questioned if the amount of the correction was correct and what portion of it related to the reconciliation period. ICC Staff Ex. 1.0, p. 10; also see ICC Staff Ex. 4.0, p. 3. Mr. Mierzwa also recommended a disallowance.[7] For the reasons stated below, the Commission should reject the

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[4] The precise quantity of the correction was 1,290,450 dth. Resp. Ex. C, Sch. 1, line 3.

[5] Peoples Gas prices its storage gas on a last in, first out ("LIFO") basis. In any month, the LIFO price is the estimated average cost of gas for the fiscal year. Resp. Ex. C, p. 5.

[6] Ms. Hathhorn initially proposed a disallowance of $8,633,110.50 (ICC Staff Ex. 1.0, p. 6 and Sch. 1.6), but, in her rebuttal testimony, she accepted Peoples Gas' explanation for a portion of this amount ($1,690,489.50) and reduced her recommendation accordingly (ICC Staff Ex. 4.0, p. 3 and Sch. 4.6). Ms. Hathhorn also proposed a second disallowance related to the bank gas liability for what she called a prior period adjustment, and this recommendation is in the amount of $812,385.99. ICC Staff Ex. 1.0, p. 13 and Sch. 1.7; ICC Staff Ex. 4.0, p. 9 and Sch. 4.7. This second recommendation is discussed below.

[7] In his direct testimony, Mr. Mierzwa recommended a disallowance of $8,633,110 (CUB-City Ex. 1.0, p. 15), but, in his rebuttal testimony, citing Ms. Kallas's rebuttal testimony, he agreed that a portion of the disallowance related to the costs incurred in the reconciliation period. CUB-City Ex. 2.0, pp. 11-12. He also testified that if the Commission were to accept Respondent's rationale for reducing the adjustment, Ms. Kallas's alternative proposal for a $2.7 million disallowance would be reasonable. CUB-City Ex. 2.0, p. 12. In her rebuttal testimony, Ms. Kallas sought to address concerns about the mismatch between when costs were incurred and when Peoples Gas sought to collect the costs by proposing alternatives that address that timing. Resp. Ex. E, pp. 2, 8-12 and Sch. 1. However, for the reasons discussed below, this timing difference does not affect recoverability. If the Commission concludes that the timing issue should be addressed, then Peoples Gas respectfully urges the Commission to consider the alternatives supported by Ms. Kallas to tie the correction to customers who benefited from the misstated liability. Resp. Ex. E, pp. 10-12 and Sch. 1.

recommended disallowances.

1. The Bank Gas Liability Is a Function of the Tariff

End user transportation customers' deliveries to Peoples Gas do not equal their consumption. The difference is accounted for in gas bank accounts ("GBA"). Peoples Gas' Tariff defines the GBA rights. In general, if a customer's deliveries are more than its consumption, then the quantity in that customer's GBA increases. If deliveries are less than consumption, then the GBA balance decreases. The GBA balance represents Peoples Gas' obligation to deliver this quantity to the customer. The bank gas liability is the dollar value assigned to Peoples Gas' obligation to deliver GBA gas to customers. Resp. Ex. C, p. 4.

2. The Bank Gas Liability Affects Recoverable Gas Costs

When transportation customers over-deliver gas (*i.e.*, deliver more gas than they consume), Peoples Gas uses this over-delivery (the GBA gas) as part of system supply. In other words, Peoples Gas does not literally store the gas for the customer, but it becomes part of system supply on the day it is delivered. Resp. Ex. B, p. 5; Resp. Ex. C, p. 6. Peoples Gas typically would use this gas to serve sales customers, and it would displace purchases on that day, which would reduce that day's recoverable gas costs. If Peoples Gas added the gas to its storage, then, when withdrawn, it would displace requirements that would otherwise be met through purchases and reduce recoverable gas costs at that time. However, the over-delivery creates a Tariff obligation to deliver this gas to the transportation customer at some later time. When transportation customers use more gas than delivered and, as is their Tariff right, take GBA gas, Peoples Gas must purchase more gas than what is needed for sales customers'

requirements or adjust storage activity or both. This purchase and storage activity represents recoverable gas costs. Resp. Ex. C, p. 6.

3. Peoples Gas Includes the Bank Gas Liability in the Gas Charge

When Peoples Gas uses customers' over-deliveries as system supply, it adds to gas costs to reflect the value of these quantities and records a liability to reflect the obligation to deliver this quantity to the transportation customers. Each month, Peoples Gas re-prices the liability quantity to reflect the liability's current value. Any difference in this new value and previously recorded amount is also passed through the Gas Charge. When Peoples Gas delivers GBA gas to transportation customers, the reduction in the updated liability attributable to the smaller quantity being priced will offset the additional cost of gas purchased that month. Resp. Ex. C, pp. 6-7.

This process provides a link between the gas used by transportation customers and the cost of that gas. However, since the GBA balance fluctuates monthly and is adjusted for price and volume, an exact link between the customers using this gas and the cost to pay back the gas is not possible. In a hypothetical situation where gas costs are not changing, the net effect on the Gas Charge for using and returning the gas should be zero. In reality, where prices are changing, the net effect on the Gas Charge is the change in price per unit of gas stored. When this netting occurs depends on how long customers store the gas with Peoples Gas. Additionally, the overall balance will be affected by the net increase or decrease in transportation customers and changes in the quantity of bank rights available to those customers. Resp. Ex. C, p. 7.

4. Peoples Gas Adjusted the Bank Gas Liability to Correct an Error

Peoples Gas needed to make the GBA correction to reconcile its general ledger and certain subsidiary ledgers. Failure to make the correction would mean that the bank gas liability was understated, and customers had not paid and would not pay for prudently incurred gas costs.

Each month, Peoples Gas' Gas Accounting Department compares the transportation customers' deliveries to their actual and estimated usage. This is based on delivery information from the Gas Transportation Department and usage information from the billing system. The difference in these two amounts increases or decreases the bank gas balance. Other balance adjustments occur for bank cash outs where the customer sells its bank balance to Peoples Gas and for company-owned volumes included in the transportation customers' actual and estimated usage such as standby commodity, authorized overtake, and unauthorized overtake and cash outs where the customer buys gas from Peoples Gas. The Tariff defines the amount of company-owned gas sold to customers and the cash out process, including the circumstances under which a cash out occurs and the price at which Peoples Gas buys and sells the gas. The new balance is priced at the current LIFO price, and the liability on the general ledger is adjusted accordingly. Resp. Ex. C, p. 5.

The way Peoples Gas bills transportation customers results in a timing difference that needed to be, but was not being, reconciled. The general ledger included estimated GBA data while the subsidiary ledgers included actual data. For the GBA balance, the source systems do not reflect a given month-end GBA

balance until the middle of the following month in order to accommodate large volume transportation customers who are billed on a calendar month basis. The process of obtaining month-end readings and balancing all volumes to pipeline and pool information results in bills issued after the monthly close of the books. In order to determine an approximate bank gas balance at month-end, an estimate of usage is included in the general ledger calculation. Resp. Ex. C, p. 9.

With or without the correction, Peoples Gas remained obligated to deliver the full amount of bank gas to transportation customers when they demanded it, within the Tariff constraints. As Ms. Hathhorn stated, the correction was an accounting, not a physical, adjustment (ICC Staff Ex. 1.0, p. 7), and, consequently, it had no effect on the quantity of gas in the GBA to which transportation customers had rights. The full amount of the obligation was the actual information in the subsidiary ledgers and included in the transportation customers' bills. However, absent the correction, the sales customers, who used, but did not pay for, the bank gas when transportation customers delivered it, would not be paying for the gas that they used. The effect of Ms. Hathhorn's and Mr. Mierzwa's proposed disallowances would be that sales customers consumed gas for which they will not pay. Resp. Ex. E, p. 4.

5. The Amount of the Correction Was Accurate

Peoples Gas used the correct data to make the correction. The correction is a reconciliation of general and subsidiary ledger data. The general ledger included estimated bank data while the subsidiary ledgers included actual data that was reflected in bills issued after the monthly close of the books. The data

from the subsidiary ledgers, *i.e.*, the actual data, were used to support the correction. Resp. Ex. E, p. 6.

The subsidiary ledger information is an accurate source because of the process that leads to information being recorded there. Each day, transportation customers or their gas suppliers notify Peoples Gas, through what is called a nomination, of the quantity of gas that they will deliver that day. The nomination identifies the contract(s), *i.e*., the customer(s), to which the nomination corresponds. The nominations are handled through a system that has external checks and balances. For example, Peoples Gas must confirm the nominated quantity with the pipeline that will deliver the gas to Peoples Gas' system. If there is a discrepancy, Peoples Gas, the customer or supplier, and the pipeline must resolve the matter. The supplier may also have to involve its upstream supplier(s) and perhaps other pipelines. Thus, the delivery quantity, which coupled with usage determines the amount of gas added to or subtracted from the bank, is the subject of a process involving at least two outside parties. Resp. Ex. E, p. 6.

The system has an additional check in the form of the transportation customers and their suppliers who know, through their nominations and the related pipeline activity, what they have delivered and who know, through their bills from Peoples Gas, how much gas they used. The difference in these data is the GBA activity, which is also shown on the customer's bill. The GBA is a valuable right for transportation customers and their suppliers. If the bills were

wrong, the transportation customer or its supplier would raise this with Peoples Gas. Resp. Ex. E, p. 6. There is no evidence that these checks were flawed.

6. Gas Costs Incurred in One Fiscal Year Are Routinely Recovered in a Subsequent Fiscal Year

Staff witness Ms. Hathhorn proposed a second disallowance[8] related to the bank gas liability. ICC Staff Ex. 1.0, p. 13. The subject of this proposal is that, in September 2004, the routine monthly bank gas entry booked was incorrect due to a spreadsheet error in the supporting document for the entry. This spreadsheet error prevented the proper valuation of the year-end bank gas volumes at Peoples Gas' year-end LIFO rate, causing both the liability and gas costs to be understated in that month. This error was discovered after Peoples Gas had closed the books for September 2004. Accordingly, Peoples Gas deferred a correcting entry to the very next month of October 2004. Resp. Ex. E, p. 11.

The bases for the recommendation is that the adjustment related to the bank gas liability procedures discussed above and it crossed fiscal years. ICC Staff Ex. 1.0, p. 13. Neither basis supports a disallowance.

Regarding the first point, this item is distinct from the bank gas liability correction associated with the reconciliation of the general and subsidiary ledgers. Furthermore, it was prudent to book a correcting entry in the month immediately after the error's detection. Resp. Ex. E, pp. 11-12. It was happenstance that this crossed fiscal years and certainly not imprudence.

[8] The proposed disallowance is $812,385.99. ICC Staff Ex. 1.0, p. 13.

Regarding the second point, the fact that the costs were incurred in fiscal year 2004 does not preclude their recovery in fiscal year 2005. Under the Commission's Gas Charge rules, this occurs routinely. For example Factor A, which is a component of each month's Gas Charge, is predicated on a two-month lag. (The lag in this instance was one month.) The amortization period for Factor A can be up to twelve months. Resp. Ex. E, p. 8; 83 Ill. Admin. Code §525.50. As a second example, the Gas Charge rules require the utility to flow pipeline refunds through the Gas Charge. It is certainly possible for a pipeline refund to pertain to costs incurred in a prior fiscal year.[9] Resp. Ex. C, pp. 8-9; 83 Ill. Admin. Code §525.50(a)(1).

Under Peoples Gas' Tariff, it is likewise inevitable that costs and credits incurred in one year will be recovered or refunded in a subsequent year. The liability tracks deliveries of transportation customers' gas. The Tariff governing transporters' rights ensures that there will be an undefined lag between deliveries to the bank and deliveries from the bank. Resp. Ex. E, p. 2.

Moreover, an adjustment to gas costs crossing fiscal years is not

[9] For example, in an ANR proceeding, the FERC order approving the refund filing stated: "On January 19, 2005, ANR Pipeline Company (ANR) filed the referenced report reflecting a final reconciliation of the Dakota costs and amounts collected through the Dakota surcharge, as required by Section 28.1(c)(8) of the General Terms and Conditions of its tariff. The report reflects that <u>during the period December 2002 through June 2004 that (1) ANR filed to recover $20,492,091 in above-market Dakota costs and (2) ANR recovered $20,749,540 through its surcharge mechanism</u>. The report reflects that <u>on January 13, 2005 ANR refunded</u>, via a credit to a shipper's invoice or via checks, the net over recovery of $257,449 along with interest of $59,148 to eligible shippers." (emphasis added) Docket No. RP05-156, letter order issued February 25, 2005. The lag between costs paid to ANR and the refund received from ANR was over two years form some costs. The Commission may take administrative notice of orders of governmental bodies other than the Commission. 83 Ill. Admin. Code §200.640(a)(1).

uncommon. An example is booking gas cost accruals in the last month of one fiscal year only to have to true-up or true-down those gas costs in the following first month of the next fiscal year to actual gas costs. Resp. Ex. E, p. 12.

The Commission does not re-open a docket every time such an adjustment occurs. Re-opening Docket No. 04-0683 (ICC Staff Ex. 4.0, p. 9) is not the only way to accommodate this adjustment and is contrary to how many other like adjustments are handled. The Commission should reject Staff's recommended disallowance.

7. That the Correction Was Needed to Correct an Error Does Not Mean the Costs Were Not Prudently Incurred

Peoples Gas agrees with Ms. Hathhorn and Mr. Mierzwa[10] that a flaw in the way Peoples Gas determined the bank gas liability led to the correction in fiscal year 2005. As explained above, Peoples Gas had determined the bank gas liability using general ledger data, which were estimates, and it had not reconciled these estimated data with the subsidiary ledger actual data. Peoples Gas acknowledges that this reconciliation needs to occur and has worked to eliminate the problem. Resp. Ex. C, p. 9. However, for the reasons discussed above, the gas costs at issue were prudently incurred. Having performed the necessary reconciliation between the ledgers and based the correction on actual data, which is reliable for the reasons described above, the bank gas liability included in fiscal year 2005 was the correct amount.

[10] *See, e.g.*, ICC Staff Ex. 1.0, p. 12; ICC Staff Ex. 4.0, pp. 3, 9; CUB-City Ex. 1.0, p. 16.

8. Conclusion

The bank gas liability costs associated with the correction were prudently incurred recoverable gas costs. During fiscal year 2005, Peoples Gas corrected an error in the amount of its bank gas liability. It used accurate data to make the correction. It was solely an accounting adjustment. Prior to the correction, customers purchasing gas from Peoples Gas had received the benefit of approximately 1.3 million dth of gas delivered by transportation customers for which the Gas Charge did not include any obligation to pay. The error was caused by a failure to reconcile estimated and actual data. The correction, based on actual data, ensures that these recoverable gas costs are included in the Gas Charge. The Commission should reject disallowances associated with the bank gas liability.

D. Peoples Gas' Use of Its Manlove Storage Field Is Prudent

Peoples Gas uses its Manlove storage field and Mahomet pipeline[11] both to serve its end use customers and to provide hub services. Hub services are provided only after Manlove and Mahomet decisions for gas charge and transportation customers have been made. This means no hub activity can take place if the Manlove and Mahomet assets are fully used for the on-system customers. Resp. Ex. D, p. 22.

CUB-City witness Mr. Mierzwa did not recommend a cost disallowance associated with Peoples Gas' provision of hub services, but he opined that providing hub services "may increase" gas costs. CUB-City Ex. 1.0, p. 14. Mr.

[11] The Mahomet gas transmission pipeline connects the Manlove storage field to Peoples Gas' system. Resp. Ex. D, p. 21.

Mierzwa also contended that Peoples Gas pre-determines the amount of company-owned storage that will be used for customers, and he argued that the Commission should direct Peoples Gas to run its dispatch model "without these Manlove storage restrictions." CUB-City Ex. 1.0, pp. 3, 14.

Regarding Mr. Mierzwa's first point, he testified that the revenues from hub services exceeded the increased gas costs during the reconciliation period (CUB-City Ex. 1.0, p. 9) and, therefore, recommended no disallowance. Peoples Gas agrees that no cost disallowance is warranted for the reconciliation year, but disagrees with his general point. Hub services do not adversely affect customers' gas costs. To the contrary, they provide a benefit. First, gross hub revenues are credited to the Gas Charge.[12] Second, the additional amount of gas in Manlove acts to extend the field's decline point, which is important to maintaining peak day deliverability requirements. The decline point is the point during the winter in which withdrawals from the field begin a rapid decline. Third, the hub provides added liquidity to Peoples Gas' citygate market. Resp. Ex. D, p. 24.

Regarding Mr. Mierzwa's second point, Mr. Mierzwa is correct that Peoples Gas includes operating parameters in its model for Manlove field, and it is appropriate to do so. Resp. Ex. D, p. 24. For purchased storage services, the pipeline's tariff and Peoples Gas' contract with the pipeline govern how the service is used. Resp. Ex. D, p. 23. If a pipeline service restricts use in excess of a certain limit, then it would not be appropriate for Peoples Gas to assume that

[12] Peoples Gas requested a Factor O to effectuate this treatment for fiscal year 2005 revenues. For subsequent years it occurs as part of the monthly Gas Charge filing. See Section III.A, *supra*.

it could use the service in excess of that limit. Likewise, the operating limitations associated with Manlove are proper limits to include in the model.

Including restrictions on Manlove's use in the model is consistent with the limitations on the service available from the field. Increasing Peoples Gas' Manlove inventory would not increase daily deliverability, but it would increase the total amount that must be withdrawn in the Manlove withdrawal period. This would decrease daily flexibility by causing a higher daily required withdrawal for every day of the withdrawal season. This effect most closely mirrors a baseload supply component of Peoples Gas' portfolio. By contrast, increasing purchased storage services typically increases both the inventory and maximum daily withdrawal proportionally, maintaining daily flexibility. For example, the Rate Schedule NSS storage service that Peoples Gas purchases from Natural has no cycling requirements, could provide more daily withdrawal capability, has no-notice injection capability, and has no incremental required seasonal withdrawals. Resp. Ex. D, pp. 26-27.

Moreover, Manlove storage and pipeline storage services are not fungible. Purchased storage services have longer withdrawal seasons that begin before and continue after the Manlove withdrawal season. These services also have varying levels of daily no-notice injection and withdrawal capabilities, and annual cycling requirements of 50% or less. If Peoples Gas used for system requirements the Manlove capacity currently used for hub services, it would displace some baseload supply and its associated firm transportation that could not be released because it would still be needed on the peak day. In fact, the

flexibility of the purchased storage services becomes more important as Manlove's flexibility is reduced by adding more inventory without proportionally adding daily withdrawal capability. Resp. Ex. D, p. 28.

The way that Peoples Gas reflects Manlove in its model is appropriate. It is a function of operational considerations and is unrelated to hub services. Removing restrictions on Manlove's use in running the model would produce results that would either be operationally unworkable or adversely affect other elements of the portfolio. The Commission should reject Mr. Mierzwa's proposal.

V. Reopening This Docket

Pursuant to the Commission's orders in Docket Nos. 01-0707, 02-0727, 03-0705 and 04-0683, a third party is currently conducting a management audit of Peoples Gas' gas supply function. Staff witness Ms. Hathhorn testified that if, after the Commission issues a final order, the management audit uncovers any material issues or adjustments related to fiscal year 2005, then this proceeding should be reopened. ICC Staff Ex. 1.0, p. 15. Staff witness Mr. Anderson stated that, after the audit is completed, a course of action will need to be determined. ICC Staff Ex. 2.0, p. 5. CUB-City witness Mr. Mierzwa testified that CUB and the City reserve the right to propose further adjustments based on the audit. CUB-City Ex. 1.0, p. 16.

It is premature to address what, if any, effect the audit will have on this proceeding. The Commission's rules address reopening a docket. The rule (83 Ill. Admin. Code §200.900) 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.

Section 200.900 will govern when and whether this proceeding is re-opened. There is no basis in the record to speculate about the effect of the audit, nor are there any rights for parties to reserve in this regard. When the audit report is issued, Section 200.900 of the Commission's Rules of Practice is sufficient to address the concerns raised by the Staff and CUB-City witnesses.

VI. Peoples Gas' Reconciliation Statement, as Adjusted for the Uncontested Issues, Should Be Approved

As required by the Commission's order, Peoples Gas filed a copy of the audit report of its independent public accountants, Deloitte & Touche, LLP, and the verification by Respondent's Vice President and Controller, Linda Kallas. The audit report includes a copy of Respondent's Statement to Illinois Commerce Commission – Determination of Reconciliation Balance for Gas Charge for the Year Ended September 30, 2005 and Independent Auditors' Report, as described in Rider 2, Section G, of Respondent's Tariff. Resp. Ex. 1. Respondent's witness James Orsi testified about the required elements of the filing. Resp. Ex. A. Peoples Gas included a requested Factor O. Resp. Ex. A, pp. 11-12. In addition, as stated above, Peoples Gas is not contesting a proposed disallowance, to be flowed in the form of Factor O through the Commodity Gas Charge, of $2,125,334. As adjusted for that uncontested item, Peoples Gas' reconciliation should be approved.

WHEREFORE, The Peoples Gas Light and Coke Company respectfully submits its Initial Brief in this proceeding and requests that the Commission: (1) approve the reconciliation statement, as filed, with the addition of a Factor O of $2,125,334 to be flowed through the Commodity Gas Charge[13]; (2) reject proposed cost disallowances related to the bank gas liability; (3) find reasonable Peoples Gas' proposed approach to calculating and billing third parties for damages to Peoples Gas' facilities; and (4) reject proposals prescribing how Peoples Gas factor in the use of company-owned storage in running its planning model.

Respectfully submitted,
The Peoples Gas Light and Coke Company

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Dated at Chicago this
12th day of July, 2007

[13] This is in addition to the Factor O of $10,662,268.27 included in Respondent's reconciliation statement.

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own Motion,	)))	
-vs-	))	
The Peoples Gas Light and Coke Company	)))	05-0749
Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.	))))	

NOTICE OF FILING AND CERTIFICATE OF SERVICE

To: Service List

PLEASE TAKE NOTICE that on this 12th day of July, 2007, I have filed with the Chief Clerk of the Illinois Commerce Commission, the Initial Brief of The Peoples Gas Light and Coke Company, a copy of which is hereby served upon you by e-mail, messenger, overnight courier and/or United States Mail on July 12, 2007.

/S/ MARY KLYASHEFF
Mary Klyasheff
An Attorney for
The Peoples Gas Light
and Coke Company

Dated at Chicago this
12th day of July, 2007