

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

PROPOSED FORM OF ORDER

By the Commission:

I. PROCEDURAL HISTORY

On November 22, 2005, the Illinois Commerce Commission (“Commission”) entered an Order Commencing PGA Reconciliation Proceedings directing The Peoples Gas Light and Coke Company (“Peoples Gas”) to present evidence at a public hearing in this docket showing the reconciliation of revenues collected under its Purchased Gas Adjustment (“PGA” or “Gas Charge”) tariff with the actual cost of gas supplies prudently incurred and recoverable under the Gas Charge tariff for the twelve-month period ended September 30, 2005 (the “Reconciliation Period”). Peoples Gas posted in its business offices notice of the filing of its testimony and exhibits with the Commission. Peoples Gas caused notice to be published in a newspaper having general circulation in its service territory in the manner prescribed by 83 Ill. Admin. Code Part 255, in compliance with the November 22, 2005 order.

Pursuant to proper legal notice, an evidentiary hearing was held in this matter on May 30, 2007, before duly authorized Administrative Law Judges of the

Commission at the Commission's offices in Chicago, Illinois. Counsel for Peoples Gas, the Commission Staff, the People of the State of Illinois ("AG"), the City of Chicago ("City") and the Citizens Utility Board ("CUB") entered appearances. At the conclusion of the hearing, the Administrative Law Judges marked the record "Heard and Taken."

On July 12, 2007, Peoples Gas, the Commission Staff, the AG and CUB-City each filed initial briefs.

On August 2, 2007, the AG filed a reply brief and on August 3, 2007, Peoples Gas, the Commission Staff, and CUB-City each filed reply briefs.

On August 10, 2007, Peoples Gas, _____ each filed proposed forms of order.

II. Governing Authority

In accordance with Section 9-220 of the Public Utilities Act ("Act")¹, the Commission may authorize an increase or decrease in rates and charges based upon changes in the cost of purchased gas through the application of a PGA clause. Section 9-220(a) of the Act requires the Commission to initiate annual public hearings "to determine whether the clauses reflect actual costs of ... gas ... purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual costs of ... gas ... prudently purchased. In each such proceeding, the burden of proof shall be upon the utility to establish the prudence of its cost of ... gas ... purchases and costs." For gas purchases, the Commission implemented the provisions of Section 9-220 of the Act in 83 Ill. Admin. Code Part 525, Purchased Gas Adjustment Clause. Section 525.40 of the rules defines recoverable gas costs. Section 525.50 of the rules addresses adjustments to gas costs through the Adjustment factor (Factor A). Section 525.60 of the rules contains the Gas Charge formula. Section 525.70 of the rules describes the annual reconciliation procedures.

III. Evidence Admitted

The Administrative Law Judges admitted the following evidence into the record:

¹ 220 ILCS 5/1-101 et seq.

For Peoples Gas: Respondent's Exhibit A (Revised Direct Testimony of James Orsi) and Exhibit 1; Respondent's Exhibit B (Direct Testimony of Thomas E. Zack); Respondent's Exhibit C (Supplemental Testimony of Linda M. Kallas) and Schedules 1 and 2; Respondent's Exhibit D (Rebuttal Testimony of Thomas E. Zack) and Schedules 1 - 4; Respondent's Exhibit E (Rebuttal Testimony of Linda M. Kallas) and Schedule 1; Respondent's Exhibit F (Surrebuttal Testimony of Thomas E. Zack); and Respondent's Exhibit G (Surrebuttal Testimony of Linda M. Kallas).

For the Commission Staff: ICC Staff Exhibit 1.0 (Direct Testimony of Dianna Hathhorn) and Schedules 1.1 - 1.8; ICC Staff Exhibit 2.0 (Direct Testimony of Dennis L. Anderson); ICC Staff Exhibit 3.0 (Direct Testimony of David Rearden) and Attachments 3.1 - 3.4; ICC Staff Exhibit 4.0 (Rebuttal Testimony of Dianna Hathhorn) and Schedules 4.1 - 4.7 and Attachment A; ICC Staff Exhibit 5.0 (Rebuttal Testimony of Dennis L. Anderson) and Attachments A and B; and ICC Staff Exhibit 6.0 (Rebuttal Testimony of David Rearden).

For CUB-City: CUB-City Exhibit 1.0 (Direct Testimony of Jerome D. Mierzwa) and Schedules JDM 1 - JDM 6; CUB-City Exhibit 2.0 (Rebuttal Testimony of Jerome D. Mierzwa); and CUB-City Exhibit 3.0 (Affidavit of Jerome D. Mierzwa).

The AG did not proffer any testimony.

IV. Legal Standard Defining "Prudence"

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 one's 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).

V. Evidence Presented

A. The Peoples Gas Light and Coke Company Direct Testimony

James Orsi, Respondent's Manager of Gas Accounting, addressed the fourteen specified data that the Commission's November 22, 2005 order required Peoples Gas to address. Resp. Ex. A. Mr. Orsi sponsored Exhibit 1, which is Peoples Gas' Determination of Reconciliation Balance for Gas Charge Year Ended September 30, 2005 and the audit report of Peoples Gas' independent public accountants. He stated that Peoples Gas was requesting a Factor O of \$10,662,268.27 to be flowed through the Commodity Gas Charge. This is the amount of revenues from Peoples Gas' interstate transportation and storage services. Flowing this amount through the Gas Charge complies with the Commission's March 28, 2006 order in Docket Nos. 01-0707, 02-0727, 03-0705 and 04-0683. Resp. Ex. A, pp. 11-12.

Thomas E. Zack, Respondent's Director of Gas Supply and Hub Services, presented evidence in this proceeding concerning gas purchasing, planning functions, procedures, and controls. In general, he stated that personnel in the 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. Mr. Zack stated that Gas Supply personnel met each month and on a daily basis to address how to meet customer requirements. Resp. Ex. B, p. 3.

During the Reconciliation Period, Mr. Zack testified that 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 Gas Pipeline Company of America ("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. 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.

Mr. Zack testified that Respondent purchased several different types of supply in the Reconciliation Period. It purchased the majority of its supply under firm contracts with suppliers. Respondent made these purchases under the terms of its contracts with each supplier. Generally, the nature of the service under the contracts was either "baseload" or "swing." Mr. Zack explained that 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. Resp. Ex. B, p. 5.

Mr. Zack stated that Respondent purchased a portion of its total supply as spot purchases from over twenty suppliers. Resp. Ex. B, p. 5. It made spot purchases from spot suppliers under the terms of the master contracts that Respondent had with each of them. These spot transactions typically provided gas on a short-term basis. Resp. Ex. B, pp. 5-6.

According to Mr. Zack, 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.

Mr. Zack stated that Peoples Gas used requests for proposals ("RFP") to obtain competitive offers for citygate supplies, baseload supplies and supply to fill its purchased storage services. Resp. Ex. B, pp. 6-7.

Mr. Zack stated that 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 its plan, Peoples Gas began executing its hedges approximately eight months prior to the start of each season (*i.e.*, winter or summer). Mr. Zack explained that Peoples Gas executed its hedge transactions relatively evenly over the eight months prior to the hedged period. Under normal weather conditions, Mr. Zack stated that Peoples Gas would expect to hedge between 50% and 60% of its annual purchases. Resp. Ex. B, p. 9.

Second, Peoples Gas' purchased seasonal storage services provided a natural physical hedge. Resp. Ex. B, p. 10.

Third, Mr. Zack stated that 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.

According to Mr. Zack, 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. Resp. Ex. B, p. 10.

In the Reconciliation Period, Respondent's reserve margin was approximately 3%. Mr. Zack stated that this is generally consistent with Respondent's actual reserve margins beginning in fiscal year 1996. Resp. Ex. B, p. 8.

B. Uncontested Issues

1. Requested Factor O for Hub Revenues

Staff

Commission Staff witness Dianna Hathhorn included Peoples Gas' requested Factor O in one of her schedules. ICC Staff Ex. 1.0, Sch. 1.2, Col. B, line 14.

CUB-City

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.

AG

The AG included the proposed Factor O in its recommendations. AG In. Br., p. 8.

Peoples Gas

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 Conclusion

The Commission orders Peoples Gas to refund, through Factor O applied to its Commodity Gas Charge, the \$10,662,268.27 in Hub revenues that Peoples Gas received during the Reconciliation Period.

2. Gas Purchase and Agency Agreement

Staff

Commission Staff witnesses Dennis L. Anderson and David Rearden testified that Peoples Gas' Gas Purchase and Agency Agreement ("GPAA") was imprudent, and Dr. Rearden recommended a disallowance associated with October 2004 purchases under the GPAA. ICC Staff Ex. 2.0, p. 3; ICC Staff Ex. 3.0, pp. 4-6. Dr. Rearden recommended a disallowance of \$2,125,334. ICC Staff Ex. 3.0, p. 6 and Attach. 3.1; also see ICC Staff Ex. 1.0, Sch. 1.3, Col. D, line 5.

CUB-City

CUB-City witness Mr. Mierzwa similarly testified that the Commission had previously found the GPAA imprudent. His testimony focused on two elements of the GPAA, namely the Summer Incremental Quantity ("SIQ") and the capacity release and assignment provision of the GPAA. He explained why each element

was imprudent and calculated an adjustment for each element based on what he stated Peoples Gas paid under the GPAA *versus* what it would have paid without these elements. The recommended adjustments in his direct testimony were \$355,355 for the SIQ and \$2,489,066 for the capacity release provision. CUB-City Ex. 1.0, pp. 5-8 and Schs. JDM-2 and JDM-3. In his rebuttal testimony, Mr. Mierzwa accepted the Staff's recommendation in lieu of his own. CUB-City Ex. 2.0, p. 3.

AG

The AG included the uncontested Staff recommendation in its recommendations. AG In. Br., p. 8.

Peoples Gas

Peoples Gas did not contest the Staff's proposed disallowance. Resp. Ex. F, p. 3.

Commission Conclusion

The Commission agrees with the Staff, CUB-City and the AG that a disallowance for the GPAA is appropriate. The Commission orders Peoples Gas to refund, through Factor O applied to the Commodity Gas Charge, \$2,125,334.

3. Gas Lost Due to Third Party Damage

Staff

Staff witness Ms. Hathorn 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. Staff did not comment on Peoples Gas' proposed method for estimating damages.

CUB-City

CUB-City did not take a position on this issue.

AG

The AG did not take a position on this issue.

Peoples Gas

Mr. Zack stated that Peoples Gas accepted Ms. Hathorn's recommendation to estimate a quantity and value of gas lost and routinely include this in its bill for damages. As recommended by Ms. Hathorn, Peoples

Gas agreed to flow amounts recovered from third parties for lost gas through the Gas Charge. Resp. Ex. D, p. 28.

Peoples Gas also 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 requested that the Commission find that this is a reasonable approach to billing for lost gas from third party damage to Peoples Gas' facilities. Peoples Gas In. Br., p. 6.

Commission Conclusion

The Commission agrees with Staff that Peoples Gas should routinely seek to recover damages associated with lost gas when a third party damages its facilities, and it should flow through its Commodity Gas Charge any amounts it recovers for such damages. The Commission also concludes that Peoples Gas' proposed method for billing third parties is a reasonable way to compute damages and takes appropriate factors into consideration.

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

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, then it should address its use of this storage. 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. ICC Staff Ex. 2.0, p. 7. Mr. Anderson stated that Peoples Gas' agreement with his proposals addressed his concerns. ICC Staff Ex. 5.0, pp. 2-3.

CUB-City

CUB-City did not address this issue.

AG

The AG did not address this issue.

Peoples Gas

Peoples Gas agreed to these recommendations. ICC Staff Ex. 5.0, Attachments A and B. Neither Mr. Anderson nor Dr. Rearden recommended a gas cost disallowance associated with either issue.

Commission Conclusion

The Commission adopts Staff's proposal and directs Peoples Gas to address, if it has not already done so, the above-described contract issues in its direct testimony in Docket No. 06-0752.

C. Contested Issues

1. Bank Gas Liability

Staff

Ms. Hathhorn initially proposed a disallowance of \$8,633,110.50² for Peoples Gas' bank gas liability adjustment. ICC Staff Ex. 1.0, p. 6 and Sch. 1.6. However, in her rebuttal testimony, she accepted Peoples Gas' explanation for a portion of this amount (\$1,690,489.50) and reduced her recommendation accordingly. Staff's recommended disallowance is \$6,942,621. ICC Staff Ex. 4.0, p. 3 and Sch. 4.6. Ms. Hathhorn questioned if the amount of the adjustment was correct and what portion of it related to the Reconciliation Period. ICC Staff Ex. 1.0, pp. 9-10; *also see* ICC Staff Ex. 4.0, p. 3.

Ms. Hathhorn's description of the gas bank accounts ("GBA") and the bank gas liability was generally consistent with Peoples Gas' description. She explained that the adjustment was strictly an accounting adjustment. In other words, due to the adjustment, transporters would not receive more gas from Peoples Gas, nor does Peoples Gas have an obligation to deliver more gas to transporters. ICC Staff Ex. 1.0, pp. 6-7.

Ms. Hathhorn stated that she was unable to verify if the adjustment was accurate. She further stated that it includes amounts for periods prior to the

² This is the full amount of Peoples Gas' adjustment and is the product of the amount of the increase in the bank gas liability (1,290,450 dekatherms) and the LIFO price (\$6.69) for a total adjustment of \$8,633,110.50. Resp. Ex. C, Sch. 1.

Reconciliation Period and it relies on questionable internal controls. ICC Staff Ex. 1.0, p. 6. She explained that Peoples Gas discovered the issue as part of its evaluation of the effectiveness of its internal controls, as required by the Sarbanes-Oxley Act of 2002. ICC Staff Ex. 1.0, p. 8.

Ms. Hathhorn stated that Peoples Gas failed to answer what she considered the fundamental question, namely what is the correct GBA balance. She asked if it is the amount in the general ledger, the billing system or something else? What portion of the adjustment relates solely to the Reconciliation Period? Ms. Hathhorn concluded that Peoples Gas did not answer these key questions, and she questioned if Peoples Gas would be able to do so. She stated that Peoples Gas could document what it did but could not prove that what it did was correct. ICC Staff Ex. 1.0, pp. 9-10. She believed that Peoples Gas' nomination system may include checks and balances, but they are not sufficient. She noted that the differences between billings and the general ledger were not investigated for many years. ICC Staff Ex. 4.0, p. 4. Similarly, she stated that Peoples Gas' reconciliation and audit procedures were insufficient because Peoples Gas did not reconcile any customer bills from the billing system to the general ledger system to confirm that the billing records (Peoples Gas' C-first system) should be used instead of the general ledger records (Peoples Gas' SAP system). Ms. Hathhorn concluded that Peoples Gas merely adjusted its general ledger records to agree with its customer billing records without verifying the cause of the differences. ICC Staff Ex. 4.0, pp. 5-6.

Ms. Hathhorn disagreed with Peoples Gas' position that customers had not been harmed by the adjustment. She took issue with Ms. Kallas' examples and deemed them unrealistic. As a simple example, Ms. Hathhorn noted the case of a new customer who was never under-charged for the discrepancy, but that customer is now being charged for the adjustment. ICC Staff Ex. 1.0, pp. 10-11.

CUB-City

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' rebuttal testimony, he agreed that a portion of the disallowance related to the costs incurred in the Reconciliation Period. He agreed that a portion of the adjustment relates to the Reconciliation Period and is, therefore, recoverable. CUB-City Ex. 2.0, p. 12. CUB-City recommended a disallowance of \$6,942,621. CUB-City In. Br., p. 15. Mr. Mierzwa stated that because Peoples Gas could not determine when the undercollection occurred, none of the undercollection should be recovered from sales customers. Also, he noted that the undercollection occurred due to a lack of adequate accounting controls. Finally, he stated that the adjustment could result in the collection of gas costs from customers who were not customers when the undercollection occurred. Mr. Mierzwa stated that it would be inequitable for customers to pay for gas costs not incurred on their behalf. CUB-City Ex. 1.0, p. 16.

AG

In its initial brief, the AG, citing Ms. Hathhorn's and Mr. Mierzwa's testimony, supported the Staff's and CUB-City's proposals. AG In. Br., pp. 4-6.

Peoples Gas

During the Reconciliation Period, Peoples Gas made a correction to its bank gas liability. The correction increased gas costs by approximately \$8.6 million.³ Peoples Gas witness Ms. Kallas submitted supplemental testimony that explained this adjustment. Resp. Ex. C.

Ms. Kallas explained that the bank gas liability is the dollar value assigned to Peoples Gas' obligation to deliver bank gas to customers. Transportation customers' ("transporters") deliveries to Peoples Gas do not equal their consumption. The difference is accounted for in the GBA. The Tariff defines the GBA rights. Generally, if a customer's deliveries exceed its consumption, then the GBA balance increases and *vice versa*. Resp. Ex. C, p. 4.

Ms. Kallas explained that on any day when transporters deliver more gas than they consume, Peoples Gas does not literally store the gas for the customer, but it becomes part of system supply. Resp. Ex. B, p. 5; Resp. Ex. C,

³ The adjustment is the product of the amount of the increase in the bank gas liability (1,290,450 dekatherms) and the LIFO price (\$6.69) for a total adjustment of \$8,633,110.50. Resp. Ex. C, Sch. 1.

p. 6. It would displace purchases on that day, which would reduce that day's recoverable gas costs, or be added to storage such that, when withdrawn, it would displace requirements that would otherwise be met through purchases and reduce recoverable gas costs at that time. However, Ms. Kallas stated that the over-delivery creates a Tariff obligation to deliver this quantity of gas to the transporter at some later time. When transporters 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. As Ms. Hathorn stated, the correction was an accounting, not a physical, adjustment, and, consequently, it had no effect on the quantity of gas in the GBA to which transporters had rights. Peoples Gas In. Br., p. 17, citing ICC Staff Ex. 1.0, p. 7.

Ms. Kallas stated that 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 transporters. Each month, Peoples Gas re-prices the liability quantity to reflect its current value. Any difference in this new value and previously recorded amount is also passed through the Gas Charge. Ms. Kallas stated that when Peoples Gas delivers GBA gas to transporters, 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.

According to Ms. Kallas, Gas Accounting compares the transporters' deliveries to their actual and estimated usage each month. This is based on delivery information from Gas Transportation and usage information from the billing system. The difference increases or decreases the GBA balance. Peoples Gas prices the balance at the current LIFO price and adjusts the liability on the general ledger. Resp. Ex. C, p. 5.

Ms. Kallas stated that Peoples Gas needed to make the GBA correction to reconcile its general ledger and certain subsidiary ledgers. The way Peoples Gas bills transporters 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. The billing process results in bills issued after the monthly close of the books. To determine an approximate month-end bank gas balance, a usage estimate is included in the general ledger calculation. Resp. Ex. C, p. 9. The full amount of the obligation was the actual information in the subsidiary ledgers and included in the transporters' bills. Resp. Ex. E, p. 4.

Ms. Kallas explained that Peoples Gas used the correct data to make the correction. The subsidiary ledger information is an accurate source because of the process that leads to information being recorded there. Each day, transporters 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 customer(s) to which the nomination corresponds. The nominations system has external checks and balances. For example, Peoples Gas must confirm the nominated quantity with the pipeline that will be delivering 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, according to Peoples Gas, the delivery quantity, which 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.

Ms. Kallas stated that there is an additional check because transporters and their suppliers know, through their nominations and the related pipeline activity, what they have delivered and know, through their bills from Peoples Gas, how much gas they used. The difference is the GBA activity, which is also shown on the customer's bill. Ms. Kallas stated that the GBA is a valuable right for transporters and their suppliers. If the bills were wrong, Ms. Kallas stated that the transporter or its supplier would raise this with Peoples Gas. Resp. Ex. E, pp. 6-7.

In response to Staff's criticism that Peoples Gas' reconciliation was insufficient, Ms. Kallas explained that the general ledger system is not intended to be the system that contains detailed billing and receivable information. That information is contained in the billing (C-first) system, which is the sub-ledger of

the general ledger system. The information passed to SAP (the general ledger) is summarized by type of customer but does not contain information on individual customers. On a monthly basis, the total revenue recorded in SAP is reconciled against the summarized daily billings in C-first. Additionally, the total balance of each customer's individual accounts receivable balance, as detailed in the C-first ledger, is reconciled to the balance contained in SAP. Therefore, the general ledger is reconciled to the detailed C-first sub-ledger. Ms. Kallas stated that the only way that an individual customer's bill could be reconciled to the general ledger would be if the detail by each customer was recorded in the general ledger. She concluded that this would not be practical or cost efficient. Resp. Ex. G, p. 2.

Peoples Gas agreed that a flaw in the way it determined the bank gas liability led to the correction in the Reconciliation Period. Peoples Gas acknowledged that a reconciliation between ledgers needed to occur, and Ms. Kallas stated that it has worked to eliminate the problem. Resp. Ex. C, pp. 8-11. However, Peoples Gas argued that the gas costs at issue were prudently incurred, and the bank gas liability included in the Reconciliation Period was the correct amount. Absent the correction, Peoples Gas asserted that the sales customers, who used, but did not pay for, the bank gas when transporters delivered it, would not be paying for the gas that they used. Resp. Ex. E, p. 4.

Commission Conclusion

There is no dispute that Peoples Gas' bank gas liability procedures were deficient during, and for some indeterminate period prior to, the Reconciliation Period. Peoples Gas testified that it is correcting the problems that led to the bank gas liability correction that is at issue in this case, and the Commission finds that it is important that Peoples Gas put mechanisms in place to ensure that the proper reconciliation occurs in a timely manner.

There is no dispute about the concept of the bank gas liability and the way that this liability is reflected in the Gas Charge. It is undisputed that Peoples Gas' obligations to bank gas for its transporters and return that gas at some later time affects the Gas Charge.

Accordingly, the question before the Commission is whether Peoples Gas' adjustment to its bank gas liability, which resulted in higher gas costs in the Reconciliation Period, was accurate and, therefore, represented prudently incurred gas costs. While Peoples Gas' procedures were clearly flawed, the Commission concludes that the adjustment was based on accurate data. The actual billing data for transporters have sufficiently rigorous checks and balances that the Commission concludes that, if that data were unreliable, billing problems would have occurred. The fact that outside parties must verify the accuracy of the data that ultimately becomes a key component of what became the GBA adjustment lends great weight to that data. The record does not include any evidence that the billing data were in any way deficient.

The timing issue does not affect whether the costs were prudently incurred. Customers receive the benefit of transporters' over-deliveries and, at some later point, the customers' Gas Charge reflects the payback of the over-delivered quantity. The Tariff clearly permits a lapse of time between when gas is accounted for as an increase to the GBA and when the transporters draw down their GBAs, and that lapse of time is not confined to falling within a reconciliation year. While the delay leading to the adjustment at issue in this case is unrelated to the timing associated with the Tariff, the mere fact of a delay, including one that crosses reconciliation years, is not determinative of whether a cost is prudently incurred and recoverable.

The Commission finds that no gas cost disallowance is warranted for the bank gas liability adjustment.

2. Bank Gas Liability Alternative

Staff

Ms. Hathhorn stated that Peoples Gas' proposed alternative disallowances missed the point. Ms. Hathhorn asserted that Peoples Gas did not substantiate its claim that the adjustment is 100% correct. Thus, Peoples Gas has failed to explain why it is appropriate for any customer to pay for costs that are due to a lack of internal controls. ICC Staff Ex. 4.0, p. 8.

CUB-City

Mr. Mierzwa testified that if the Commission rejected his proposed disallowance and were to accept Respondent's rationale for reducing the disallowance, Ms. Kallas' alternative proposal (the 1991 scenario) for a \$2.7 million disallowance would be reasonable. Mr. Mierzwa stated that, of the two adjustments, this should be selected because of its conservative nature. CUB-City Ex. 2.0, pp. 11-12.

AG

The AG did not address the alternatives.

Peoples Gas

Ms. Kallas addressed concerns about harm to customers, for example, the fact that the customers in 2005 whose gas costs were affected by the adjustment were not necessarily the same customers who were on the system when the underbilling occurred. Resp. Ex. C, pp. 7-8 and Sch. 2; Resp. Ex. E, pp. 8-11.

First, Ms. Kallas explained that it is not unusual for a customer to receive a gas cost benefit or pay a gas cost not associated with his tenure on the system. She stated that it happens every day because that is how the Commission's Gas Charge rules operate. Peoples Gas computes a Gas Charge that it applies to all purchases of gas by sales customers. It does not compute a Gas Charge for each customer to reflect costs associated with that particular customer and limited to costs and revenues tied to the period when that person was a customer. Resp. Ex. E, p. 7.

Second, although Peoples Gas does not agree that any disallowance is proper, Ms. Kallas proposed two alternatives. To compute its proposed alternatives, Peoples Gas analyzed customer data to determine what portion of the customers were on the system both in years when the understatement of the liability began to develop and in 2005. Resp. Ex. E, Sch. 1. Peoples Gas reviewed the number of customers in February 2007, who were also customers in previous years. The analysis showed, *inter alia*, that 69% of Peoples Gas' current customers who were customers in 2005 were also customers in 2000 and 31% were also customers in 1991. The percentage increases each year from

1991 to 2005. Resp. Ex. E, p. 9. The 1991 scenario was selected because this is the earliest point at which the error could have occurred because that is when Peoples Gas began to account for the obligation as a bank gas liability. The 2000 scenario was selected because that is when Peoples Gas implemented a new customer information system. Starting from an amount of \$6,942,621, Ms. Kallas proposed that this amount be spread evenly over a period of years and adjusted for the percentage of customers who were common to the years in question. Under the 1991 scenario, the resulting adjustment would be \$2,743,075.84. Under the 2000 scenario, the resulting adjustment would be \$1,184,295.43. Ms. Kallas noted that even these alternative adjustments are probably higher than if the analysis had been performed in 2005 rather than 2007. Resp. Ex. E, pp. 9-11 and Sch. 1.

Commission Conclusion

Having concluded that no gas cost disallowance is warranted for the bank gas liability adjustment, the Commission need not address the proposed alternatives.

3. Bank Gas Liability Prior Period Adjustment

Staff

Ms. Hathhorn 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. She testified that these costs pertain to fiscal year 2004, which is a closed reconciliation year. ICC Staff Ex. 1.0, p. 13. To correct the error, the fiscal 2004 docket would need to be re-opened. ICC Staff Ex. 4.0, p. 9. Ms. Hathhorn explained that, in addition to crossing fiscal years, the adjustment is born out of the flawed bank gas procedures, which are discussed above. ICC Staff Ex. 1.0, p. 13. She did not agree with Peoples Gas' testimony that such an out of period adjustment was comparable to Factor A. Ms. Hathhorn stated that Factor A is an ongoing adjustment (a routine true-up) and not a one-time error associated with a period that was the subject of a global settlement. ICC Staff Ex. 4.0, p. 10.

CUB-City

CUB-City did not address this adjustment.

AG

In its initial brief, the AG, citing with Ms. Hathhorn's testimony, supported the Staff's proposal. AG In. Br., pp. 6-7.

Peoples Gas

According to Ms. Kallas, the subject of Ms. Hathhorn's "prior period adjustment" 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 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.

This item is the product of a routine entry and not part of reconciling the general and subsidiary ledgers, *i.e.*, it is distinct from the bank gas liability issue discussed above. Ms. Kallas stated that it was prudent to book a correcting entry in the month immediately after the error's detection. Resp. Ex. E, p. 11.

Ms. Kallas explained that 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, pp. 7-8; 83 Ill. Admin. Code §525.50. As a second example, Ms. Kallas stated that 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. Resp. Ex. C, p. 9; 83 Ill. Admin. Code §525.50(a)(1). Under Peoples Gas' Tariff, Ms. Kallas stated that 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 transporters' 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.

Finally, Ms. Kallas stated that an adjustment to gas costs crossing fiscal years is not uncommon. An example is booking gas cost accruals in the last month of one fiscal year only to have to true-up those gas costs in the following first month of the next fiscal year to actual gas costs. Resp. Ex. E, p. 12.

Peoples Gas argued that the Commission does not and need not re-open a docket every time such an adjustment occurs. Peoples Gas In. Br., p. 21.

Commission Conclusion

The Commission agrees with Staff that Peoples Gas' bank gas liability reconciliation process was flawed. However, this adjustment has no apparent relationship to that procedure beyond the fact that it related to the bank gas liability. Instead, it is simply the case of an error in one month that was corrected in the next month. The fact that fiscal years were crossed or that one year is the subject of a final Commission order does not make the adjustment imprudent, nor is it necessary to re-open the fiscal year 2004 proceeding to address this adjustment. The Commission concludes that no disallowance for this adjustment is warranted.

4. Gas Supply Contracting Process

a. Multi-Attribute Contracts

Staff

The Staff addressed two multi-attribute contracts that were in effect during the reconciliation year. ICC Staff Ex. 2.0, pp. 5-7; ICC Staff Ex. 3.0, pp. 6-18; ICC Staff Ex. 6.0, pp. 2-7. Staff recommended that "if in the future the Company desires to continue including a put in bundled contracts, it should either bid the put out separately or exclude it from the contract. [citation omitted] The Commission should also order the Company to independently evaluate each attribute of the contract." Staff In. Br., p. 7; *also see* ICC Staff Ex. 6.0, pp. 6-7. Staff did not propose a cost disallowance for these contracts. ICC Staff Ex. 6.0, p. 6; Staff In. Br., p. 4.

Staff witness Dr. Rearden stated that the aggregated nature of the contracts meant it was not obvious that the lowest bid for the aggregated services was no higher than disaggregated and field priced contracts. Also, Staff was concerned that the contracts' aggregated nature, itself, raises costs. It is difficult and speculative to evaluate a contract with several different products relative to disaggregated and field priced contracts. Dr. Rearden stated that each element of the contract could be a separate transaction, and this implies that each element needs to be estimated to compare it to entering into the aggregated contract. ICC Staff Ex. 3.0, pp. 7-9. Rather than paying the minimum for each piece of the contract, the buyer will pay the minimum for the package, and this may make the aggregated contract worse than the disaggregated contracts. ICC Staff Ex. 3.0, pp. 9-10.

Dr. Rearden, based on his review of documents provided by Peoples Gas, stated that the framework for the analysis appeared sound, but he believed that some of the values in the analysis exaggerated the benefits from the contract's components. He cited the values associated with weekend flexibility, puts, margins associated with the baseload and swing volumes and basis. ICC Staff Ex. 3.0, pp. 11-17. For example, he stated that the put valuation was based on one bidder's bid and the weekend flexibility value appeared to be arbitrary. ICC Staff Ex. 3.0, p. 12. Regarding basis forecast, Dr. Rearden concluded that Peoples Gas' customers are generally going to be better off when the utility buys gas in the field and uses its own firm transportation to move the gas to customers. ICC Staff Ex. 3.0, pp. 17-18. In his rebuttal testimony, Dr. Rearden concluded that Staff is "very concerned with Peoples adding the put to the contract. On the other hand, Staff is not as concerned when the Company bundles baseload with swing supply." ICC Staff Ex. 6.0, pp. 4-5.

Dr. Rearden stated that Staff did not object to a contract that has variable monthly baseload volumes, but it would be incorrect to conclude that the presence of swing rights in a contract means that the utility is not "in the market" because the swing price is a daily price. He also stated that Peoples Gas has

not demonstrated that the capacity release associated with these contracts was needed to minimize gas costs. ICC Staff Ex. 6.0, p. 4.

CUB-City

CUB-City did not testify about this issue.

AG

The AG, citing Staff's testimony, agreed with the Staff recommendations. AG In. Br., pp. 7-8.

Peoples Gas

Peoples Gas strongly disagrees with the Staff's discussion of and conclusions about the multi-attribute contracts. Mr. Zack stated that the contracts included: capacity release of two separate firm transportation agreements; defined monthly baseload deliveries; an option for Peoples Gas to purchase additional volumes, up to the capacity that it released, at a daily index price; a defined number of put rights Peoples Gas could exercise each winter to avoid baseload purchases when these supplies were in excess of demands; and a provision that allows Peoples Gas the right to restrict the deliveries to the pipelines on which the capacity was released. Resp. Ex. D, pp. 4-5.

Mr. Zack stated that, under the RFPs, bidders were required to incorporate the value and cost of these different requirements into one pricing element, namely an index specified in the RFP to which the bidder specified an amount per dth to add to or subtract from that index. This allowed Peoples Gas to evaluate the bids on an apples-to-apples basis. Everyone was bidding under a uniform pricing structure to provide the same service and to meet the same requirements. Resp. Ex. D, p. 5.

Mr. Zack explained that Peoples Gas entered into this type of service for a number of reasons. First, Peoples Gas determined that firm transportation ("FT") capacity not used for baseload supply could be more efficiently shaped to provide baseload volumes, that varied from month to month (but not within the month), and the option to purchase additional volumes at a defined daily index price. Second, by releasing the capacity at maximum rates, Peoples Gas received at least what it had paid for the capacity, and it allowed the competitive

market to determine the additional market value of the capacity. Third, Mr. Zack stated that Peoples Gas believes that marketers are better able to maximize the value of the capacity, given their large trading organizations, broader geographic footprint, diversity of customer demand, and their ability to optimize Peoples Gas' capacity with their other assets. Resp. Ex. D, pp. 7-8.

Mr. Zack explained that, based on Peoples Gas' conversations with suppliers, they generally perceive less risk when a customer awards a bundled package of assets. Thus, suppliers will lower the profit margin per asset segment, and this reduces the overall cost to the customer. If a supplier submits separate bids for each asset, the total cost would be greater since the risk of not securing all the assets is greater. Resp. Ex. D, p. 9.

Mr. Zack disagreed with Dr. Rearden's assessment of the documents he reviewed. While those support papers attempted to place a value on the individual parts, this was not the basis of Peoples Gas' bid award. The bid award was based a single pricing element, an index rate plus or minus an amount per dth. Resp. Ex. D, p. 9.

With respect to Dr. Rearden's criticism of the puts, Mr. Zack explained that Peoples Gas actually received two responses that indicated a value for the puts. With respect to the value of weekend service, Mr. Zack explained that the value in the support paper was an educated estimate because the market does not provide a non-level nomination service over a weekend period. However, an alternative could be to buy additional storage to cover the 20,000 dth of swing potential. Such storage would probably cost in the range of \$736,800 to \$1,500,000. In the support paper referred to by Dr. Rearden, the Company chose to be conservative and reflected a smaller value. Resp. Ex. D, pp. 11-12.

In response to Dr. Rearden suggesting a preference for buying gas in the field, Mr. Zack responded that he does not believe it is feasible to generalize about field *versus* citygate pricing relationships as one can be better than the other and *vice versa*. According to Mr. Zack, Peoples Gas wanted to capture the greatest value for this transportation. To the extent that the value of firm transportation is greater than the maximum rates that a shipper can receive

under capacity release, Peoples Gas' RFP process allowed that value to be captured. At times, the value may be even greater, but that does not insure that a small trading group focused on a narrow geographic region, like that at Peoples Gas, can capture it on a regular and consistent basis. Resp. Ex. D, p. 13.

Mr. Zack explained that, contrary to Dr. Rearden's criticism of Peoples Gas' ability to forecast basis, Peoples Gas did not forecast basis in its bid review. Peoples Gas incorporated the basis value in the bids, and Peoples Gas took the lowest bids. However, Peoples Gas' workpapers included information from Peoples Gas' Risk Management area based on quotes provided to them by outside sources such as brokers and banks. Resp. Ex. D, pp. 13-14.

Also, as to the recommendation that Respondent simply buy gas in the field and transport it to the citygate to avoid the basis risk, Mr. Zack stated that a significant portion of Respondent's portfolio does that. Resp. Ex. D, p. 15.

Notwithstanding its disagreement with Staff's review of the multi-attribute contracts, Peoples Gas stated that it welcomes any clarity the Commission gives on the prudence standard. It is, however, concerned about the ambiguity in the Staff testimony that underlies the recommendations in the brief. For example, Dr. Rearden stated that Staff is "very concerned" about Peoples Gas adding a put to the contract, but Staff is "not as concerned" when Peoples Gas bundles baseload with swing supply. ICC Staff Ex. 6.0, pp. 4-5. The Staff's initial brief addresses only requiring the put to be bid and evaluated separately, but it characterizes the put as a "particularly good example." Staff In. Br., p. 7. Does this mean that Peoples Gas must require discrete bids on a put option in a contract but it could bundle baseload and swing supply in a contract without discrete bids? Does this mean that a prudent contract may not include more than one attribute or only that a request for bids must require bidders to place a value on each component of the contract? The latter approach would increase the likelihood that Peoples Gas would not be able to evaluate bids on an apples-to-apples basis because bids would include more than one variable. Any guidance on prudence should be as unambiguous and objective as possible. Resp. Ex. F, pp. 2-3.

Commission Conclusion

There is no disallowance recommended for these contracts. However, Staff and the AG asked the Commission to make specific recommendations about what should or should not be included in a bundled contract and how a utility should evaluate a bundled contract. The Commission notes that the utility has the burden of proof in reconciliation cases. Consequently, the utility needs to be able to show the prudence of its gas costs, including gas costs incurred under contracts entered into pursuant to an RFP process. The Commission, however, declines to try to advise utilities on how it must structure supply RFPs and how it must analyze bids. The Commission cannot anticipate and advise utilities on all the different types of contracts, and it declines to do so for specific cases. The prudence standard quoted above applies to all gas supply purchases.

b. Rate Schedule NSS Capacity Release

Staff

The Staff stated that it is concerned about the release of “valuable NSS contracts at maximum rates.” Staff In. Br., p. 7; *also see* ICC Staff Ex. 2.0, p. 6; ICC Staff Ex. 3.0, pp. 19-22; ICC Staff Ex. 6.0, pp. 7-8. The Staff recommends that the Commission “order Peoples to continue to explore ways to use the service directly for ratepayers.” Staff In. Br., p. 8; *also see* ICC Staff Ex. 6.0, p. 8. Staff did not propose a cost disallowance for these contracts. ICC Staff Ex. 6.0, p. 8; Staff In. Br., p. 4.

Dr. Rearden stated that he does not know if releasing the NSS capacity at maximum rates was prudent because Peoples Gas needs to assess the economic value of the capacity. Dr. Rearden stated that Peoples Gas “surmised that because it could not release the capacity at higher than maximum rates, it was not able to receive any more than that.” ICC Staff Ex. 3.0, p. 21. Dr. Rearden stated that Peoples Gas focused on the operational side of the service, but the Staff would prefer that Peoples Gas “consider all the options for the service.” ICC Staff Ex. 3.0, pp. 21-22. He made two recommendations: (1) Peoples Gas should assess the economic value of the service and try to derive ratepayer benefits with low risk methods, and (2) Peoples Gas, if it needs

additional transportation to use the released capacity, should try to acquire that transportation. ICC Staff Ex. 3.0, p. 22. Dr. Rearden stated that Staff wants to see “concrete evidence that Peoples is seriously and empirically evaluating all its alternatives.” ICC Staff Ex. 6.0, p. 7.

CUB-City

CUB-City did not testify about this issue.

AG

The AG, citing Staff’s testimony, agreed with the Staff recommendations. AG In. Br., pp. 7-8.

Peoples Gas

Peoples Gas stated that it does evaluate the best use of its Rate Schedule NSS capacity (“NSS”), which it purchases from Natural, and it will continue to do so. Peoples Gas agreed that NSS is a valuable service. Resp. Ex. D, pp. 16-17. Peoples Gas explained that, by releasing NSS at the tariff maximum rate, it and its customers were not paying anything for the capacity, yet Peoples Gas retained the option of keeping the NSS in its portfolio. Retaining this free option is reasonable, especially when there is no present ability to use this capacity, but going forward this may change. Resp. Ex. D, pp. 18-19.

Commission Conclusion

There is no disallowance recommended for the NSS capacity release. However, Staff and the AG asked the Commission to make a specific recommendation. The Commission notes that the utility has the burden of proof in reconciliation cases. Consequently, the utility needs to be able to show the prudence of its gas costs, including costs associated with purchasing storage. The Commission declines to make a specific recommendation about a specific service as it does not add anything to the generally applicable prudence standard.

c. Storage Refill Contract

Staff

The Staff expressed concern about a contract under which Peoples Gas purchased supply to fill storage. Staff In. Br., pp. 8-9; ICC Staff Ex. 3.0, pp. 22-

24; ICC Staff Ex. 6.0, pp. 8-9. Staff recommended that “the Commission order Peoples to fully and empirically evaluate the optionality it surrenders in contracts similarly structured.” Staff In. Br., p. 9.

Dr. Rearden testified that the storage refill contract allowed the seller to determine the timing for the storage refill. This could forfeit value in three ways. First, Dr. Rearden stated that it surrendered physical control over the system. Second, Peoples Gas lost the opportunity to take advantage of a falling price during a given month. Third, Peoples Gas gave up the ability to choose which months in which to concentrate its purchases. As an example, Dr. Rearden cited the impact on prices of Hurricanes Katrina and Rita. ICC Staff Ex. 3.0, p. 23. Dr. Rearden stated that Peoples Gas did not value the optionality of the contract. ICC Staff Ex. 3.0, p. 24. According to Dr. Rearden, a proper calculation of savings would account for the optionality that Peoples Gas gave up in order to get the price it received. ICC Staff Ex. 6.0, p. 9.

CUB-City

CUB-City did not testify about this issue.

AG

The AG, citing Staff’s testimony, agreed with the Staff recommendations. AG In. Br., pp. 7-8.

Peoples Gas

Mr. Zack stated that the transaction was designed as a proxy baseload storage refill purchase to minimize gas charge customers’ costs. By “proxy baseload contract,” Peoples Gas means that the pricing under the contract assumed baseload deliveries while the actual deliveries could vary somewhat, as long as the supplier met its total delivery obligation. Baseload storage refill volumes are distributed equally over the summer or as dictated by the pipeline tariff to provide a dollar cost averaging-like cost profile. Resp. Ex. D, pp. 19-20.

During the reconciliation period, Respondent’s summer NSS storage refill purchase requirements were about half of normal requirements because the preceding winter was 6% warmer than normal. Respondent could offer the market a flexible injection program while remaining consistent with its baseload

storage refill philosophy. Resp. Ex. D, p. 19. Peoples Gas chose the best priced gas, saving ratepayers \$583,762.50. Resp. Ex. D, p. 21. According to Mr. Zack, Peoples Gas was able to assess the benefit to customers because, concurrent with the flexible storage refill RFP, Peoples Gas requested through a separate RFP process a baseload refill supply RFP designed to meet other storage requirements. Comparing the bids showed the benefits of the NSS storage refill contract. Resp. Ex. D, p. 20.

According to Mr. Zack, Peoples Gas does not speculate by purchasing all required volumes in one month hoping it is the cheapest month, nor does Peoples Gas purchase daily volumes betting that today's daily index prices are cheaper than future daily index prices. Thus, Peoples Gas disagrees with Dr. Rearden's suggestion that customers "would have been able to share in the lower costs if the contract had been structured to allow the utility to time its purchases." ICC Staff Ex. 3.0, p. 23. That suggestion would have required price speculation that could have just as easily increased costs. Indeed, Mr. Zack stated that, in the prior two summers, prices fell in the late summer. Resp. Ex. D, p. 21.

Peoples stated that, as with the Staff recommendations about the multi-attribute contracts, Peoples Gas welcomes any clarity the Commission gives on the prudence standard but requests that it be as unambiguous and objective as possible. Resp. Ex. F, p. 3.

Commission Conclusion

There is no disallowance recommended for this contract. However, Staff and the AG asked the Commission to make a specific recommendation. The Commission notes that the utility has the burden of proof in reconciliation cases. Consequently, the utility needs to be able to show the prudence of its gas costs, including costs associated with purchasing gas to fill storage. The Commission declines to make a specific recommendation about a specific service as it does not add anything to the generally applicable prudence standard.

5. Manlove Field and Hub Services

Staff

The Staff recommended that Hub issues be litigated in Peoples Gas' pending rate case. Staff In. Br., pp. 9-10.

CUB-City

CUB-City witness Mr. Mierzwa concluded that customers were not harmed by Peoples Gas providing Hub services during the reconciliation year, but he stated that "it would typically be expected that Hub revenues would not exceed any increase in the gas costs of ratepayers resulting from the Company's use of Manlove storage to provide Hub services." CUB-City Ex. 1.0, pp. 9, 11. Mr. Mierzwa explained that customers generally buy Hub services to capitalize on seasonal price differences. He provided an example to demonstrate what he considers the "inherent possible problem with Peoples Gas' Hub transactions." CUB-City Ex. 1.0, pp. 10-11.

Mr. Mierzwa stated that Peoples Gas, in its gas dispatch model, sets the amount of Manlove storage available for system supply, at a predetermined quantity. Mr. Mierzwa stated that Peoples Gas' practice of predetermining the quantity of Manlove storage used to serve its system is unreasonable given the increased capability of Manlove and the changing load profile of Peoples Gas' customers. CUB-City Ex. 1.0, p. 12. By predetermining how much on-system storage is available for system supply, Peoples Gas cannot properly analyze whether storage currently assigned to Hub services could displace or eliminate pipeline services. He stated that gas costs could be reduced by \$9.5 million if all of the Manlove storage used to provide Hub services was used to displace pipeline services. CUB-City Ex. 1.0, p. 13.

Mr. Mierzwa agrees that operational parameters should be taken into account in determining the allocation of Manlove, but it is unreasonable for Peoples Gas to include as a parameter in its model the quantity that it plans to inject, rather than allowing the model to select the quantity based on the seasonal cycling and maximum injection and withdrawal limits. Mr. Mierzwa stated that Peoples Gas is assigning storage based on historical experience, but

many things have changed. CUB-City Ex. 2.0, pp. 6-8. He concluded that the “Commission should require Peoples Gas to run its dispatch planning model without these Manlove storage predeterminations in order to determine the appropriate allocation of Manlove storage for system supply, and to determine whether Manlove storage currently supporting HUB services could be utilized to reduce the utility’s contract storage requirements and related costs for system supply.” CUB-City Ex. 2.0, p. 8.

AG

The AG did not address this issue.

Peoples Gas

Regarding Staff’s position, Peoples Gas agrees that issues not pertinent to Peoples Gas’ fiscal 2005 recoverable gas costs should not be addressed in the instant proceeding. Whether, and to what extent, Hub services issues are relevant to the rate case, should be addressed in the rate case and not this proceeding. Peoples Gas R. Br., p. 9.

Mr. Zack stated that Hub services are provided only after Peoples Gas has made Manlove and Mahomet pipeline decisions for gas charge and transportation customers. This means no Hub activity can take place if those assets are fully used for the on-system customers. Resp. Ex. D, p. 22.

Mr. Zack explained that Manlove does displace contract storage. Without the use of Manlove, Peoples Gas would almost certainly contract for more pipeline storage. However, one storage is not the same as another storage. Peoples Gas’ use of Manlove is driven by operational considerations. Mr. Zack stated that as the owner and operator of that field, Peoples Gas must manage it in a way that preserves deliverability. Mr. Zack stated that, by contrast, when Peoples Gas purchases a pipeline service, the pipeline tariff and the contract determine how Peoples Gas may use the service. Peoples Gas’ pipeline services complement Manlove. Resp. Ex. D, pp. 22-23.

Mr. Zack stated that Peoples Gas took current Manlove operating parameters into account when developing the existing supply, transportation, and storage portfolio for Peoples Gas. The parameters included the need to cycle

the entire amount that was planned to be injected for customers. The Gas Dispatch Model was used in fine-tuning the portfolio and testing it under a variety of weather conditions. Resp. Ex. D, p. 24.

Mr. Zack described the Gas Dispatch model and explained that Manlove is accounted for in the model to reflect Manlove's operational limitations. For example, Manlove's typical withdrawal season is about 90 days from early December through early March. Given Manlove's typical withdrawal season and the need to cycle the inventory each year, Mr. Zack stated that, approximately every 90 dth increase in Manlove inventory for Peoples Gas' system supply would take the place of 1 dth/day of December through February baseload supply. Resp. Ex. D, pp. 24-26.

He further stated that, adding 9 Bcf to Manlove inventory for Peoples Gas' system supply would require de-contracting 100,000 dth/day of baseload supply for December through February due to warm year constraints and warm days in a normal year constraints. An alternative would be for Peoples Gas to purchase additional puts for 100,000 dth/d. The seasonally de-contracted supply would still be needed in November and March to support Manlove injections in those months. Thus, Peoples Gas would be in the monthly and daily markets to obtain the necessary supply. Resp. Ex. D, p. 27.

Mr. Zack also explained why replacing purchased storage services with Manlove is not necessarily practical. Pipeline services have longer withdrawal seasons that extend both prior to 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. Mr. Zack stated that, if Peoples Gas used capacity currently used for Hub services, it would displace some baseload supply and its associated FT that could not be released because it would still be needed on the peak day. In fact, the flexibility of the remaining storage services becomes more important as the flexibility of Manlove to Peoples Gas ratepayers is reduced by adding more inventory without proportionally adding daily withdrawal capability. Resp. Ex. D, p. 28.

Commission Conclusion

There is no disallowance recommended for Hub services. However, CUB-City asked the Commission to make specific recommendations. The Commission notes that the utility has the burden of proof in reconciliation cases. Consequently, the utility needs to be able to show the prudence of its gas costs, including costs associated with company-owned and purchased storage. The Commission declines to dictate to the utility how to run its planning model.

VI. Gas Supply Audit

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 in this case, 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-City reserves the right to propose further adjustments based on the audit. CUB-City Ex. 1.0, p. 16. The AG stated that the Commission's order should include a finding and ordering paragraph to permit the re-opening of this docket pending the outcome of the audit. AG In. Br., p. 8.

Peoples Gas argued that it is premature to address what, if any, effect the audit will have on this proceeding. Peoples Gas cited the Commission's rules, which 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.

Peoples Gas argued that 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. Staff agrees that Section 200.900 will govern re-opening, but it is appropriate for the Commission's order to include a finding and ordering paragraph to address the audit. Staff R. Br., p. 5.

The Commission concludes that there is no need to provide for re-opening this docket based on the audit. The Commission on its own motion, the Staff or any interested person may seek to re-open this docket if warranted by the audit. The Commission's rules adequately address this matter.

VII. Reconciliation Statement

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 M. 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. As stated above, the Commission is approving Peoples Gas' requested Factor O and is ordering a disallowance of \$2,125,334, both to be flowed in the form of Factor O through the Commodity Gas Charge. As adjusted for those items, the Commission approves Peoples Gas' reconciliation.

VIII. Findings and Ordering Paragraphs

- (1) The Peoples Gas Light and Coke Company ("Peoples Gas") is a corporation engaged in the distribution of gas to the public and, as such, is a public utility within the meaning of the Public Utilities Act;
- (2) the Commission has jurisdiction over Peoples Gas and of the subject matter of this proceeding;
- (3) the statements of fact set forth in the prefatory portion of this Order are supported by the record and are adopted as findings of fact;

- (4) Peoples Gas should implement Factor O refunds of \$10,662,268.27 and of \$2,125,334 through its Commodity Gas Charge in its first monthly Gas Charge filing after the date of this Order;
- (5) except as provided in Paragraph (4), the Commission approves Peoples Gas' reconciliation statement; and
- (6) all motions, petitions, objections, or other matters in this proceeding that remain unresolved shall be resolved consistent with the conclusions in this Order.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that in the reconciliation statement submitted by The Peoples Gas Light and Coke Company of the revenues collected under its Gas Charge tariff with costs incurred for the purchase of natural gas for its fiscal year 2005, \$12,787,602.27 of said costs were not prudent and reasonable;

IT IS FURTHER ORDERED that the reconciliation set forth on Attachment A is approved;

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Admin. Code Sec. 200.800, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this ____ day of _____, 2007.

(SIGNED) CHARLES E. BOX
Chairman

The Peoples Gas Light and Coke Company
Docket 05-0749 Appendix A
For the Year Ended September 30, 2005

<u>Line</u>		<u>Commodity Gas Charge (CGC)</u>	<u>Non-Commodity Gas Charge, Demand Gas Charge and Aggregation Balancing Gas Charge (NCGC, DGC and ABGC)</u>	<u>Transition Surcharge (TS)</u>	<u>Total Gas Charge</u>
Fiscal 2004					
1	Unamortized Balance at September 30, 2004 (Refund)/Recovery	\$8,645,698.30	\$4,422,192.83	(\$24,669.95)	\$13,043,221.18
2	Factor A Adjustments unreconciled at September 30, 2004 (Refund)/Recovery	\$4,201,077.14	\$697,233.47	(\$4,379.24)	\$4,893,931.37
3	Factor O (Refunded)/Recovered	\$0.00	\$0.00	\$0.00	\$0.00
4	Balance (Refundable)/Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	\$12,846,775.44	\$5,119,426.30	(\$29,049.19)	\$17,937,152.55
Fiscal 2005					
5	Costs Recoverable through the Gas Charge	\$785,210,242.80	\$41,609,827.53	\$0.00	\$826,820,070.33
6	Revenues Arising through Application of the Gas Charge	\$806,693,640.77	\$41,831,811.88	(\$31.86)	\$848,525,420.79
7	Separately Reported Pipeline Refunds or Surcharges	\$0.00	(\$47,283.62)	\$0.00	(\$47,283.62)
8	Separately Reported Other Adjustments	\$0.00	\$0.00	\$0.00	\$0.00
9	Interest Calculated at 1.50% thru Dec. 2004; 2.5% thereafter	\$21,242.64	\$634.40	(\$603.31)	\$21,273.73
10	(Over)/Under Recovery For Reconciliation Year (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	(\$21,462,155.33)	(\$268,633.57)	(\$571.45)	(\$21,731,360.35)
11	(Over)/Under Recovery Balance For Reconciliation Year (Line 4 + Line 10)	(\$8,615,379.89)	\$4,850,792.73	(\$29,620.64)	(\$3,794,207.80)
12	Factor A Adjustments unreconciled at September 30, 2005 (Refund)/Recovery	\$2,046,888.38	\$702,911.11	(\$4,394.52)	\$2,745,404.97
13	Unamortized Balance at September 30, 2005 (Refund)/Recovery	\$0.00	\$4,147,881.62	(\$25,226.12)	\$4,122,655.50
14	Requested Factor O (Line 11 - Line 12 - Line 13)	(\$10,662,268.27)	\$0.00	\$0.00	(\$10,662,268.27)
15	Factor O, Not Requested and Pursuant to Order	(\$2,125,334.00)	\$0.00	\$0.00	(\$2,125,334.00)