STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own Motion,	)))	
-vs-	))	
North Shore Gas Company	)))	05-0748
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 North Shore Gas Company ("North Shore") 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"). North Shore posted in its business offices notice of the filing of its testimony and exhibits with the Commission. North Shore 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 North Shore, the Commission Staff, the People of the State of Illinois ("AG") 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, North Shore, the Commission Staff, the AG and CUB 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 each filed reply briefs.

On August 10, 2007, North Shore, _____ 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 North Shore: Respondent's Exhibit A (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 Schedule 1; 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 Attachment 3.1; and ICC Staff Exhibit 4.0 (Rebuttal Testimony of Dianna Hathhorn) and Schedules 4.1 - 4.7 and Attachment A.

For CUB: CUB Exhibit 1.0 (Direct Testimony of Jerome D. Mierzwa) and Schedules JDM 1 - JDM 4; CUB Exhibit 2.0 (Rebuttal Testimony of Jerome D. Mierzwa) and Schedules JDM 5 - JDM 7; and CUB 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. North Shore Gas 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 North Shore to address. Resp. Ex. A. Mr. Orsi sponsored Exhibit 1, which is North Shore's Determination of Reconciliation Balance for Gas Charge Year Ended September 30, 2005 and the audit report of North Shore's independent public accountants. He stated that North Shore was not requesting a Factor O. Resp. Ex. A, p. 10.

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. He testified that The Peoples Gas Light and Coke Company provides gas supply administration service to North Shore under a Commission-approved intercompany service agreement. 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 only two significant changes to its capacity portfolio. First, it increased the amount of Rate Schedule DSS storage capacity that it purchased from Natural Gas Pipeline Company of America ("Natural"). Second, it increased the amount of firm transportation service it purchased from Natural to meet the additional storage refill requirements and a slightly higher peak day requirement. Resp. Ex. B, p. 6. Capacity (both pipeline storage and transportation) transactions are

subject to contracts with the pipelines and the pipelines' FERC Gas Tariffs. Resp. Ex. B, p. 5.

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 fifteen suppliers. Resp. Ex. B, p. 4. 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, p. 5.

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, pp. 4-5.

Mr. Zack stated that North Shore used requests for proposals ("RFP") to obtain competitive offers for baseload supplies and supply to fill its purchased storage services. Resp. Ex. B, p. 6.

Mr. Zack stated that North Shore 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, North Shore began executing its hedges approximately eight months prior to the start of each season (*i.e.*, winter or summer). Mr. Zack explained that North Shore executed its hedge transactions relatively evenly over the eight months prior to the hedged period.

Under normal weather conditions, Mr. Zack stated that North Shore would expect to hedge about 50% of its annual purchases. Resp. Ex. B, pp. 7-8.

Second, North Shore's purchased seasonal storage services provided a natural physical hedge. Resp. Ex. B, p. 8.

Third, Mr. Zack stated that North Shore purchased gas from a variety of parties and from different producing regions to protect against regional price anomalies. Resp. Ex. B, p. 8.

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, North Shore dampened the effect that large swings in gas prices have on its total gas costs. Resp. Ex. B, pp. 8-9.

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. 6.

B. Uncontested Issue

1. Gas Lost Due to Third Party Damage

Staff

Staff witness Ms. Hathhorn recommended that North Shore "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. She proposed a disallowance of $335.47 for revenues collected from third parties during the Reconciliation Period for the cost of gas lost as a result of damage to North Shore's facilities. ICC Staff Ex. 1.0, p. 13. The Staff did not opine on North Shore's proposed method for estimating damages.

CUB

CUB did not take a position on this issue.

AG

The AG supported Staff's proposed adjustment. AG In. Br., p. 7. The AG did not opine on North Shore's proposed a method for estimating damages.

North Shore

Mr. Zack stated that North Shore bills for lost gas in a few cases. North Shore 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, North Shore agreed to flow amounts recovered from third parties for lost gas through the Gas Charge. North Shore did not oppose the recommended disallowance of $335.47. Resp. Ex. D, p. 4.

North Shore also proposed a method for estimating damages. A few key factors affect the quantity of gas lost when a third party damages North Shore's facilities, notably size of the pipe, pressure, whether the pipe is fully or partially open and how long it is open. North Shore developed a table that it proposed to use to estimate gas lost based on these key factors. Resp. Ex. D, p. 5 and Sch. 1. North Shore requested that the Commission find that this is a reasonable approach to billing for lost gas from third party damage to North Shore's facilities. North Shore In. Br., p. 5.

Commission Conclusion

The Commission agrees with Staff that North Shore 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 North Shore's proposed method for billing third parties is a reasonable way to compute damages and takes appropriate factors into consideration.

The Commission orders North Shore to refund, through Factor O applied to its Commodity Gas Charge, the $335.47 that North Shore recovered from third parties for lost gas during the Reconciliation Period.

C. Contested Issues

1. Gas Purchase and Agency Agreement

Staff

Staff witnesses Mr. Anderson and Dr. Rearden each testified that the Commission previously found that North Shore's Gas Purchase and Agency Agreement ("GPAA") was imprudent. The GPAA was in effect in October 2004.

Dr. Rearden recommended a disallowance of $337,269. ICC Staff Ex. 2.0, p. 3; ICC Staff Ex. 3.0, pp. 4-5 and Attach. 3.1. Dr. Rearden stated that he calculated his recommended disallowance using the same method that he used in Docket No. 01-0706, which was North Shore's fiscal 2001 Gas Charge reconciliation case. That method involved calculating a value for discrete elements of the contract. Dr. Rearden stated that he made one adjustment to his calculation (namely, his calculation of the value of demand credits foregone) because the contract was in effect for only one month in the Reconciliation Period. ICC Staff Ex. 3.0, p. 5 and Attach. 3.1

CUB

CUB 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 North Shore paid under the GPAA *versus* what it would have paid without these elements. The recommended adjustments in his direct testimony were $21,675 for the SIQ and $563,654 for the capacity release provision. CUB Ex. 1.0, pp. 5-7 and Schs. JDM-2 and JDM-3. In his rebuttal testimony, he reduced his recommendation associated with the capacity release element to $509,480. Mr. Mierzwa stated that this adjustment addressed a point raised by North Shore witness Mr. Zack. CUB Ex. 1.0, pp. 2-3 and Sch. JDM-6.

AG

In its initial brief, the AG supported the $337,269 disallowance that Staff proposed and North Shore did not contest. AG In. Br., p. 7.

North Shore

North Shore witness Mr. Zack stated that North Shore would not oppose Staff's proposed disallowance. Citing Dr. Rearden's testimony, Mr. Zack concluded that the Staff calculation is consistent with the Commission's approach to the GPAA in Docket No. 01-0706, and, for that reason, it is more appropriate to adopt that recommendation than CUB's Resp. Ex. F, p. 2. The GPAA in

effect in the Reconciliation Period was the same as the contract in effect during the 2001 Reconciliation Period and considered by the Commission in Docket No. 01-0706. ICC Staff Ex. 2.0, p. 3. Mr. Zack also testified that Mr. Mierzwa appeared to have calculated his capacity release disallowance by assuming North Shore would have sourced its purchases from the location with the lowest overall delivered cost. Mr. Zack stated that it appears that Mr. Mierzwa may have simply used the lowest possible prices, without considering if North Shore could, in fact, have made the purchases. Resp. Ex. D, pp. 3-4.

Commission Conclusion

The Commission agrees with the Staff, CUB and the AG that a disallowance for the GPAA is appropriate. The Commission reviewed the two proposals and concludes that basing the disallowance on the method that was before the Commission in Docket No. 01-0706 is reasonable. The Staff witness' one adjustment to that method was supported by his testimony and is reasonable. Accordingly, the Commission orders North Shore to refund, through Factor O applied to the Commodity Gas Charge, $337,269.

2. Bank Gas Liability

Staff

Ms. Hathhorn initially proposed a disallowance of $468,868.12[2] for North Shore's bank gas liability adjustment. ICC Staff Ex. 1.0, p. 6 and Sch. 1.6. However, in her rebuttal testimony, she accepted North Shore's explanation for a portion of this amount ($80,741.64) and reduced her recommendation accordingly. Staff's recommended disallowance is $388,126.48. 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 North Shore's description. She explained that the adjustment was strictly an accounting adjustment. In other

[2] This is the full amount of North Shore's adjustment and is the product of the amount of the increase in the bank gas liability (70,826 dekatherms) and the LIFO price ($6.62) for a total adjustment of $468,868.12. Resp. Ex. C, Sch. 1.

words, due to the adjustment, transporters would not receive more gas from North Shore, nor does North Shore 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 Reconciliation Period and it relies on questionable internal controls. ICC Staff Ex. 1.0, p. 6. She explained that North Shore 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 North Shore 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 North Shore did not answer these key questions, and she questioned if North Shore would be able to do so. She stated that North Shore 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 North Shore's 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 North Shore's reconciliation and audit procedures were insufficient because North Shore did not reconcile any customer bills from the billing system to the general ledger system to confirm that the billing records (North Shore's C-first system) should be used instead of the general ledger records (North Shore's SAP system). Ms. Hathhorn concluded that North Shore 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 North Shore's 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

In his direct testimony, Mr. Mierzwa recommended a disallowance of $468,868 (CUB Ex. 1.0, p. 8), 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, and he reduced his proposal to $388,126 (CUB Ex. 2.0, pp. 4-5). Mr. Mierzwa stated that because North Shore 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 Ex. 1.0, pp. 8-9.

AG

In its initial brief, the AG, citing Ms. Hathhorn's and Mr. Mierzwa's testimony, supported the Staff's and CUB's proposals. AG In. Br., pp. 4-5, 7.

North Shore

During the Reconciliation Period, North Shore made a correction to its bank gas liability. The correction increased gas costs by less than $0.5 million.[3] North Shore 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 North Shore's obligation to deliver bank gas to customers. Transportation customers' ("transporters") deliveries to North Shore 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.

[3] The adjustment is the product of the amount of the increase in the bank gas liability (70,826 dekatherms) and the LIFO price ($6.62) for a total adjustment of $468,868.12.

Ms. Kallas explained that on any day when transporters deliver more gas than they consume, North Shore does not literally store the gas for the customer, but it becomes part of system supply. Resp. Ex. B, pp. 4-5; Resp. Ex. C, 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, North Shore 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. Hathhorn 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. North Shore In. Br., p. 14 citing ICC Staff Ex. 1.0, p. 7.

Ms. Kallas stated that when North Shore 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, North Shore 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 North Shore 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. North Shore 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 North Shore needed to make the GBA correction to reconcile its general ledger and certain subsidiary ledgers. The way North Shore 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, pp. 3-4.

Ms. Kallas explained that North Shore 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 North Shore, 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, North Shore must confirm the nominated quantity with the pipeline that will be delivering the gas to North Shore's system. If there is a discrepancy, North Shore, 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 North Shore, 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 North Shore, 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 North Shore. Resp. Ex. E, p. 6.

In response to Staff's criticism that North Shore's 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. 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. Ms. Kallas stated that this would not be practical or cost efficient. Resp. Ex. G, p. 2.

North Shore agreed that a flaw in the way it determined the bank gas liability led to the correction in the Reconciliation Period. North Shore acknowledged that a reconciliation between ledgers needed to occur, and it has worked to eliminate the problem. Resp. Ex. C, pp. 8-11. However, North Shore 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, North Shore 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 North Shore's bank gas liability procedures were deficient during, and for some indeterminate period prior to, the Reconciliation Period. North Shore 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 North Shore put mechanisms in place to ensure that the proper reconciliation occur 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 North Shore's 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 North Shore's 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 North Shore's 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.

3. Bank Gas Liability Alternative

Staff

Ms. Hathhorn stated that North Shore's proposed alternative disallowances missed the point. Ms. Hathhorn asserted that North Shore did not substantiate its claim that the adjustment is 100% correct. Thus, North Shore 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

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 $150.5 thousand disallowance would be reasonable. Mr. Mierzwa stated that, of the two adjustments, this should be selected because of its conservative nature. CUB Ex. 2.0, pp. 4, 6.

AG

The AG did not address the alternatives.

North Shore

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. 7-9 and Sch. 2; Resp. Ex. E, pp. 7-8.

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. North Shore 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 North Shore does not agree that any disallowance is proper, Ms. Kallas proposed two alternatives. To compute its proposed

alternatives, North Shore 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. North Shore reviewed the number of customers in February 2007, who were also customers in previous years. The analysis showed, *inter alia*, that 71% of North Shore's current customers who were customers in 2005 were also customers in 2000 and 29% 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 North Shore began to account for the obligation as a bank gas liability. The 2000 scenario was selected because that is when North Shore implemented a new customer information system. Starting from an amount of $388,126.48, 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 $150,502.50. Under the 2000 scenario, the resulting adjustment would be $59,422.15. 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.

4. 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 $279,054.45. ICC Staff Ex. 1.0, p. 12 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, pp. 12-13. 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 North Shore's 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

CUB 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. 5-7.

North Shore

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 North Shore's year-end LIFO rate, causing both the liability and gas costs to be understated in that month. This error was discovered after North Shore had closed the books for September 2004. Accordingly, North Shore 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 North Shore's 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. North Shore argued that the Commission does not and need not re-open a docket every time such an adjustment occurs.

Commission Conclusion

The Commission agrees with Staff that North Shore's 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.

VI. Gas Supply Audit

Pursuant to the Commission's orders in Docket Nos. 01-0706, 02-0726, 03-0704 and 04-0682, a third party is currently conducting a management audit of North Shore's 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 witness Mr. Mierzwa testified that CUB reserves the right to propose further adjustments based on the audit. CUB Ex. 1.0, p. 10. 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. 7.

North Shore argued that it is premature to address what, if any, effect the audit will have on this proceeding. North Shore 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.

North Shore 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 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, North Shore 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 ordering two disallowances of $337,269 and of $335.47 to be flowed in the form of Factor O through the Commodity Gas Charge. As adjusted for those items, the Commission approves North Shore's reconciliation.

VIII. Findings and Ordering Paragraphs

(1) North Shore Gas Company ("North Shore") 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 North Shore 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) North Shore should implement Factor O refunds of $337,269 and of $335.47 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 North Shore's 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 North Shore Gas Company of the

revenues collected under its Gas Charge tariff with costs incurred for the purchase of natural gas for its fiscal year 2005, $337,604.47 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

North Shore Gas Company
Docket 05-0748 Appendix A
For the Year Ended September 30, 2005

Line		Commodity Gas Charge (CGC)	Non-Commodity Gas Charge Demand Gas Charge and Aggregation Balancing Gas Charge (NCGC, DGC and ABGC)	Transition Surcharge (TS)	Total Gas Charge
	Fiscal 2004				
1	Unamortized Balance at September 30, 2004 (Refund) / Recovery	$658,504.74	$1,268,171.57	$9,699.00	$1,936,375.31
2	Factor A Adjustments unreconciled at September 30, 2004 (Refund) / Recovery	$519,158.65	$206,958.30	$1,751.75	$727,868.70
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)	$1,177,663.39	$1,475,129.87	$11,450.75	$2,664,244.01
	Fiscal 2005				
5	Costs Recoverable through the Gas Charge	$162,012,461.22	$16,368,416.76	$0.00	$178,380,877.98
6	Revenues Arising through Application of the Gas Charge	$163,433,782.99	$16,126,544.55	$0.00	$179,560,327.54
7	Separately Reported Pipeline Refunds or Surcharges	$0.00	($13,055.91)	$0.00	($13,055.91)
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	($20,606.58)	$6,229.52	$238.02	($14,139.04)
10	(Over)/Under Recovery For Reconciliation Year (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	($1,441,928.35)	$235,045.82	$238.02	($1,206,644.51)
11	(Over)/Under Recovery Balance For Reconciliation Year (Line 4 + Line 10)	($264,264.96)	$1,710,175.69	$11,688.77	$1,457,599.50
12	Factor A Adjustments unreconciled at September 30, 2005 (Refund) / Recovery	($70,584.44)	$487,332.38	$1,777.02	$418,524.96
13	Unamortized Balance at September 30, 2005 (Refund) / Recovery (Line 11 - Line 12)	($193,680.52)	$1,222,843.31	$9,911.75	$1,039,074.54
14	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$0.00	$0.00	$0.00	$0.00
15	Factor O, Not Requested and Pursuant to Order	$337,604.47	$0.00	$0.00	$337,604.47