

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
	:	
vs	:	
	:	05-0741
Consumers Gas Company	:	
	:	
	:	
Reconciliation of revenues collected	:	
Under gas adjustment charges with	:	
Actual costs prudently incurred.	:	

**INITIAL BRIEF OF THE STAFF  
OF THE ILLINOIS COMMERCE COMMISSION**

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Staff of the Illinois Commerce Commission (“Staff”), by and through its undersigned counsel, pursuant to Section 200.800 of the Illinois Commerce Commission’s (“Commission”) Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Initial Brief in this proceeding.

**I. INTRODUCTION**

On November 22, 2005, the Commission approved an Order commencing reconciliation proceedings in accordance with the requirements of Section 9-220 of the Illinois Public Utilities Act (the “Act”), 220 ILCS 5/9-220. The Commission's Order directed Consumers Gas Company ("Consumers" or the "Company") to present evidence reconciling revenue collected under the Company's purchased gas adjustment ("PGA") clause with the actual cost of natural gas supplies

prudently purchased for the twelve-month period from January 1, 2005 through December 31, 2005. (Initiating Order, Docket No. 05-0741, p. 2.)

Pursuant to proper legal notice, status hearings in this matter were held on September 26, 2006, November 15, 2006, December 6, 2006, March 13, 2007, May 22, 2007, and August 2, 2007, before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois. Thereafter, an evidentiary hearing was held on January 10, 2008. Appearances were entered by counsel on behalf of the Company and Staff. Consumers presented the testimony of C.A. Robinson, a director, shareholder and President of Consumers. Staff presented the testimony of Daniel G. Kahle, Accountant, Accounting Department of the Financial Analysis Division; Dennis L. Anderson, Senior Energy Engineer in the Gas Section of the Engineering Department of the Energy Division; and Eric Lounsberry, Supervisor of the Gas Section, Engineering Department of the Energy Division. At the conclusion of the hearing on January 10, 2008, the record was marked "Heard and Taken."

## **II. LEGAL STANDARDS**

PGA reconciliation proceedings are governed by Section 9-220 of the Act, which provides, in part:

Annually, the Commission shall initiate public hearings to determine whether the clauses reflect actual costs of fuel, gas, power, or coal transportation purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual costs of fuel, power, gas, or coal transportation prudently purchased. In each such proceeding, the burden of proof shall be upon the utility to establish the prudence of its cost of fuel, power, gas, or coal transportation purchases and costs.

220 ILCS 5/9-220.

The standard used by the Commission to assess the prudence of a utility's gas purchases under Section 9-220 of the Act is as follows:

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.

Illinois Power Co. v. Illinois Commerce Commission, 245 Ill. App. 3d 367, 371 (3d Dist. 1993) (quoting the Commission); Docket No. 88-0142, p. 25 (Order entered February 5, 1992). Furthermore, "[i]n determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible." (Id., p. 371 (quoting the Commission); Docket No. 88-0142, pp. 25-26.)

### **III. SUMMARY OF STAFF'S POSITION**

In direct and rebuttal testimony, Staff recommended various adjustments to the Company's PGA reconciliation for the twelve-month period from January 1, 2005 through December 31, 2005. While the Company accepted several of Staff's adjustments, it did not accept others. Staff's uncontested and contested recommendations are discussed herein.

Staff's adjustments in this proceeding total \$62,596, consisting of \$9,863 included in the Company's originally filed reconciliation and \$52,733 in additional adjustments as a result of Staff's review. These adjustments and their sources are set forth in the following table headed ADJUSTMENTS to PGA RECONCILIATION.

<b>ADJUSTMENTS to PGA RECONCILIATION</b>				
<u>Line No.</u>	<u>Description</u>	<u>Adjustment</u>	<u>Total</u>	<u>Source</u>
1	Company Proposed 2005 Factor O		\$ (9,863)	Company Statement 1, Line 14
2	Staff Pricing Adjustment	\$ (42,139)		ICC Staff Exhibit 4.0, Schedule 4.02, Column J, Line 3
3	Staff Injection Adjustment	<u>(11,316)</u>		ICC Staff Exhibit 4.0, Schedule 4.03, Page 1, Column F, Line 5
4	Total Adjustments for Imprudence	\$ (53,455)		Line 2 + Line 3
5	Staff Correcting Adjustments	<u>722</u>		ICC Staff Exhibit 4.0, Schedule 4.01, Column C, Line 14
6	Total Staff Recommended Adjustments		<u>(52,733)</u>	Line 4 + Line 5
7	<b>Total Adjustments (Staff &amp; Company)</b>		<b><u>\$ (62,596)</u></b>	Line 1 + Line 6

As discussed in Staff witness Kahle's rebuttal testimony, Staff's adjustments for imprudent pricing and injection charges involve gas purchased in 2005. Since the purchases were for gas in storage, the adjustments do not impact PGA gas costs until the gas is withdrawn and delivered to customers. Delivery of the gas in question occurred in both 2005 and 2006 with a portion remaining in storage as Cushion Gas. The disposition of the \$62,596 of adjustments, therefore, is varied. These various dispositions are set forth in the following table headed DISPOSITION of ADJUSTMENTS.

<b>DISPOSITION of ADJUSTMENTS</b>				
Line No.	Description	Amount	Total	Source
<b><u>To 2005 PGA Reconciliation</u></b>				
1	Pricing Adjustment	\$ (23,293)		ICC Staff Exhibit 4.0, Schedule 4.02, Column J, Line 6
2	Injection Adjustment	<u>(3,776)</u>		ICC Staff Exhibit 4.0, Schedule 4.03, Page 1, Column F, Line 8
3	Total Adjustments for Imprudence	\$ (27,069)		Line 1 + Line 2
4	Correcting Adjustments	<u>722</u>		ICC Staff Exhibit 4.0, Schedule 4.01, Column C, Line 14
5	Total Staff Adjustments to 2005 PGA	\$ (26,347)		Line 3 + Line 4
6	Company Proposed 2005 Factor O	<u>(9,863)</u>		Company Statement 1, Line 14
7	<b>2005 PGA Reconciliation Factor O</b>		<b>\$ (36,210)</b>	Line 5 + Line 6; agrees with ICC Staff Exhibit 4.0, Schedule 4.01, Column F, Line 14
<b><u>To 2006 PGA Reconciliation</u></b>				
8	Pricing Adjustment	\$ (18,000)		ICC Staff Exhibit 4.0, Schedule 4.02, Column J, Line 5
9	Injection Adjustment	<u>(7,431)</u>		ICC Staff Exhibit 4.0, Schedule 4.03, Page 1, Column F, Line 7
10	<b>Staff Injection &amp; Pricing Adjustment</b>		<b>(25,431)</b>	Line 8 + Line 9
<b><u>To Cushion Gas Inventory</u></b>				
11	Pricing Adjustment	\$ (846)		ICC Staff Exhibit 4.0, Schedule 4.02, Column J, Line 4
12	Injection Adjustment	<u>(109)</u>		ICC Staff Exhibit 4.0, Schedule 4.03, Page 1, Column F, Line 6
13	<b>Staff Adjustment to Cushion Gas</b>		<b><u>(955)</u></b>	Line 11 + Line 12
<b>Total Disposition of Adjustments</b>			<b><u>\$ (62,596)</u></b>	Line 7 + Line 10 + Line 13

Staff requests that the Commission adopt Staff's reconciliation of revenues collected under Consumers' purchased gas adjustment clause with actual costs as reflected on ICC Staff Exhibit 4.0, Schedule 4.01, attached hereto as Appendix A, and order Consumers to refund \$36,210, as a 2005 Factor O

refund, in the first monthly PGA filed after the date of the Final Order in the instant proceeding. Staff also requests that the Commission order Consumers to reduce 2006 gas costs by \$25,431 for pricing and injection charge adjustments. Staff further requests that the Commission order Consumers to reduce the balance of Cushion Gas shown on the Company's general ledger by \$955 for pricing and injection charge adjustments.

Additionally, Staff requests that the Commission order Consumers not to engage in any transactions involving the in-place inventory transfers between Consumers and its affiliate, Egyptian Gas Storage ("Egyptian"), until an agreement expressly covering the potential for that occurrence is approved by the Commission. Staff further requests that the Commission order Consumers to cease any sales for resale transactions involving its Gas Sales Agreement ("GSA") with Egyptian. Finally, Staff requests that the Commission order the Company to prepare its responses to the Accounting Department standard interim and year-end data requests in a more thorough and complete manner.

#### **IV. UNCONTESTED ISSUES**

##### **A. Unamortized Balances**

In direct testimony, Staff witness Kahle proposed three correcting adjustments to the Company's 2005 PGA Reconciliation. First, Mr. Kahle recommended that \$62 be added to the Unamortized Balance as of December 31, 2004 in order to agree with the 2004 Reconciliation approved by the Commission in Docket No. 04-0675. (ICC Staff Exhibit 4.0, Schedule 4.01, Column (C), Line 1.) Second, Mr. Kahle proposed that \$360 be added to the

Factor O Collected/Refunded during 2005 to correct an error in the Company's presentation. (Id., Line 3.) Third, he proposed that \$300 be added to correct the Unamortized Balance as of December 31, 2005, to agree with the Company's monthly PGA filing that "trued up" actual numbers for December 2005. (Id., Line 13.) The net effect of these adjustments is to reduce the Factor O to be refunded by \$722. (Id., Line 14.) These adjustments were necessary to correct various reporting errors by the Company.

The Company did not contest these adjustments.

#### **B. Storage Gas Purchases**

Consumers also did not dispute Staff's analysis that demonstrated the manner in which it had historically purchased its storage gas injections. Staff witness Kahle's analysis indicated that in the prior two reconciliation periods, Consumers purchased its storage injection gas via four monthly increments. Staff witness Anderson's review indicated that Consumers' normal practice was to start injecting gas to its leased storage service in May or June, with the only exception occurring the year that Consumers revised its primary gas supply contract.

### **V. CONTESTED ISSUES**

#### **A. Imprudent Gas Purchase from Consumers' Unregulated Affiliate**

Staff's review revealed that Consumers incurred imprudent gas costs as a result of purchasing gas from its unregulated affiliate. It is undisputed that on June 8, 2005, Consumers reached agreement with its affiliate, Egyptian, to

purchase sufficient in-place storage gas for its June and July injections into the leased storage service which Consumers leased from Egyptian. It is also undisputed that on this same day, June 8, 2005, Egyptian reached an agreement with Atmos Energy Corporation (“Atmos”) to purchase in-place inventory at the same storage facility at which Consumers leased storage capacity from Egyptian.

Another undisputed fact is that the person who made the decision for Consumers to purchase the in-place inventory gas from Egyptian, the person who made the decision for Egyptian to sell the in-place inventory gas to Consumers, and the person who made the decision for Egyptian to buy the in-place inventory gas from Atmos, are all one and the same person, specifically, C.A. Robinson. (ICC Staff Exhibit 2.0, p. 12.) However, what is in dispute is whether the information that Mr. Robinson was privy to as President of both Consumers and Egyptian influenced his decision-making on June 8, 2005, and resulted in Consumers’ customers incurring higher gas costs.

Staff’s review disclosed that the above situation did influence Consumers’ decision-making and resulted in the Company incurring imprudent gas costs in 2005. Staff’s review identified three areas which supported its conclusion that these gas costs were imprudently incurred: (1) the knowledge of the pending in-place inventory transaction between Egyptian and Atmos caused Consumers to deviate from its past practice regarding how it purchased its storage inventory gas; (2) the purchase was a clear conflict of interest between Consumers and its unregulated affiliate, Egyptian; and (3) the agreements in place between Consumers and Egyptian were neither designed nor intended for an in-place

transfer of storage gas.

Staff also discovered that since Consumers purchased the gas in-place from Egyptian, Egyptian had no right to charge or collect an injection fee from Consumers. In fact, an injection fee for this gas had already been collected by Egyptian from Atmos. (Tr., p. 59.) Staff recommended that Consumers not engage in this practice unless in the future a specific agreement allowing this type of transaction is approved by the Commission.

### **1. Timing of Purchase**

Staff witness Anderson's review revealed that Consumers altered the historical timing of its storage injections based on the knowledge that its affiliate was obtaining storage gas from Atmos. Staff determined that Consumers' delay in purchasing its storage injection gas increased costs to its ratepayers. (ICC Staff Exhibit 2.0, p. 9.)

Consumers' historical storage injection practices for the period 2001 to 2004 indicated that it nominated storage refill on a first of the month ("FOM")<sup>1</sup> basis and started its storage injection in May or June. (Id.) Further, in response to a Staff data request, Consumers indicated that during a four-year period prior to June 2005, it had always made first of the month nominations for its gas purchased for system supply. However, when Staff asked this same question regarding the timing and source of its purchases for storage injection gas for the

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<sup>1</sup> First of the month pricing refers to a utility informing its gas supplier five business days prior to the end of the month of the volume of gas it wanted delivered for the following month. This gas is then priced at the specified index price that occurs on the first day of that following month, such that nominations made on May 26 for June delivery are priced for the whole month of June at the June 1 index price. (ICC Staff Exhibit 2.0, pp. 8, 10-11.)

same historical four-year period, Consumers was unable to specify the source of this gas or provide any details regarding these purchases. Further, the data request specifically requested any occasion when non-FOM gas was purchased and Consumers failed to identify any situations where that occurred. (ICC Staff Exhibit 5.0, pp. 7-10.) Therefore, Consumers' response to this data request, as well as Staff's review of Consumers' historical purchasing practices, both indicated the normal practice for Consumers was to purchase all of its gas, system supply as well as storage injections, on a first of the month basis. Therefore, Consumers' decision to purchase in-place storage gas on June 8, 2005, to use as its storage injections for the months of June and July, was a deviation from its past practice.

Mr. Anderson's review found that Consumers had an established pattern for purchasing both its storage injection and system supply gas on a first of the month basis. The only credible explanation for Consumers departing from this established pattern and not making a nomination for storage injections at the end of May for June delivery was the knowledge that its affiliate, Egyptian, had gas or would have gas to sell in the future. (Id., p. 4.)

## **2. Conflict of Interest**

Mr. Anderson's review showed that a conflict of interest existed at the time Consumers reached the decision to purchase the in-place inventory gas from its affiliate, Egyptian. It is undisputed that in August 2004, Atmos Energy Marketing provided Egyptian with the required six-month notice to terminate its leased

storage agreement<sup>2</sup> as of May 1, 2005. However, Atmos failed to withdraw its entire gas inventory, and in April of 2005, Atmos and Egyptian began negotiating the sale of the remaining Atmos in-place storage inventory to Egyptian. On June 8, 2005, Atmos reached an agreement with Egyptian for the sale of the remaining Atmos in-place storage inventory (155,308 Dth). (ICC Staff Exhibit 2.0, p. 6.)

Therefore, when C.A. Robinson, representing Consumers, decided to purchase two months of storage gas from Egyptian on June 8, 2005, C.A. Robinson, representing Egyptian, had already spent almost two months in negotiation with Atmos to purchase its remaining inventory and had coincidentally reached an agreement to purchase this gas on the exact same day, June 8, 2005. Consumers not only purchased two months (June and July) of injection from Egyptian, but it also later purchased the rest of its Summer 2005 injection gas (August and September) priced on the first of the month index from Egyptian. (Id., p. 7.) Because the same individual made both of these decisions, it is axiomatic that the knowledge of Egyptian's purchase of the Atmos inventory influenced the timing of Consumers' purchase of its storage gas.

Mr. Robinson indicated that his role as President of Consumers is to provide least-cost gas service. (Tr., pp. 47-48.) However, he also indicated that as President of Egyptian his role is to maximum profits for that entity. (Tr., p. 49.) Therefore, whenever he makes a decision that impacts both parties, such as the one at question in this proceeding, his sincerity for balancing both parties' interests is strained. Further, Mr. Robinson indicated that Atmos had to have

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<sup>2</sup> Atmos and Consumers both leased storage service from Egyptian and the storage facility used to provide that service is located in Carmi, Illinois. (ICC Staff Exhibit 2.0, pp. 5-7.)

Egyptian's approval for any transaction involving the gas that remained in storage. (Tr., pp. 58-59.) Egyptian clearly had control over Atmos with respect to the disposition of this in-place storage inventory.

Staff's concern is that the decision-maker, C.A. Robinson, is wearing two hats, one hat when he is working for the utility and another hat when he is working for the unregulated affiliate. The concern arises from the potential for the decisions of this individual to be unduly influenced based upon the information or knowledge he obtains regarding how a decision for the utility will also allow the affiliate to benefit. Further, a question is raised as to whether or not the affiliate's involvement was necessary. Since Consumers' gas purchases are made at the first of the month price, there will always be occasion when the market price will decrease from that price during the month. If that price deviates sufficiently for Egyptian to make a profit, it could purchase the gas and resell it to Consumers. However, if there is truly less expensive gas available, Consumers should purchase it without using Egyptian as a middleman. For example, there could be an opportunity to purchase gas from the open market at 15 cents less than the FOM market price. Egyptian could purchase this gas and then sell the same gas to Consumers at 5 cents less than market price. Egyptian automatically locked in a 10 cent profit. Ideally, Consumers should have the opportunity not only to purchase this gas without having to rely upon its affiliate acting as a middleman in the transaction but also to reduce gas costs for its customers by 15 cents instead of 5 cents. (ICC Staff Exhibit 3.0, pp. 12-13.)

Staff's review also revealed that Egyptian benefited from the situation by

reducing its business risk when it purchased the in-place storage gas from Atmos. As Mr. Robinson explained during cross-examination, Egyptian had difficulty obtaining a loan to purchase the gas from Atmos. (Tr., pp. 72-73.) However, a review of the situation that Egyptian faced also indicates it likely used the sale of the in-place inventory to Consumers to mitigate its risk exposure to this purchase.

Egyptian purchased the in-place inventory from Atmos for \$6.25/Dth. However, when Consumers purchased in-place inventory from Egyptian, this gas was priced according to the requirements of the GSA<sup>3</sup> between these two parties.<sup>4</sup> The GSA price formula is \$0.05/Dth less than the price Consumers would pay for its primary supplier, ProLiance, to provide the gas, plus the transportation charges to transport gas to Consumers. (ICC Staff Exhibit 2.0, pp. 27-28.) Staff determined that on June 8, 2005, when Egyptian purchased the in-place inventory from Atmos for \$6.25/Dth, Consumers paid Egyptian \$6.94/Dth, or \$.69/Dth more, for its June and July storage volumes that also constituted in-place inventory.

The primary reason for the price differential on June 8, 2005 is that the pricing associated with the GSA allows for the inclusion of all the transportation costs,<sup>5</sup> plus Egyptian also collected a \$.10/Dth storage injection charge for the

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<sup>3</sup> The GSA is attached to Staff witness Lounsberry's Direct Testimony (ICC Staff Exhibit 3.0), as Schedule 3.03.

<sup>4</sup> Staff does not agree that the GSA authorized Egyptian to sell in-place storage inventory gas to Consumers. (ICC Staff Exhibit 3.0, pp. 2-3; ICC Staff Exhibit 5.0, pp. 13-14.)

<sup>5</sup> Transportation costs during the Summer of 2005 were around \$0.25/Dth plus compressor fuel which was \$0.39/Dth for June and July, \$0.42/Dth for August, and \$0.60/Dth for September. Compressor fuel costs are dependent on the price of gas, so they vary from month to month. (ICC Staff Exhibit 2.0, p. 25.)

gas that was already located in the field.<sup>6</sup> Since the transaction was an in-field transfer, which is essentially just a paper transaction, Egyptian did not incur transportation or injection costs in its transaction with Atmos.

When Egyptian sold the in-place inventory to Consumers on June 8, 2005 (Consumers purchased two months worth – its June and July injections), it already knew the market price was higher than the price it had paid Atmos, plus it added additional charges on top of the market price. Since Egyptian did not incur the transportation charge or the injection charge when it sold the gas to Consumers, Egyptian made an immediate profit of approximately \$90,098 on this paper transaction with Consumers. (Id., p. 27.) Further, Egyptian's risk of incurring a loss on future sales to Consumers if gas prices declined was reduced by the inclusion of the additional costs in the pricing formula for sales to Consumers. (Id., pp. 24-28.)

Therefore, Egyptian was able to reduce its business risk by using its agreements with Consumers to collect transportation and injection charges not incurred on the purchase of in-place inventory gas from Atmos. This allowed Egyptian to lock in a profit on the June 8, 2005 sale to Consumers and reduce the market risk of future sales to Consumers by the amount of transportation and injection charges. Egyptian clearly reduced its business risk by using its affiliate, Consumers, instead of selling the in-place inventory to an independent party in a true arms-length transaction. Staff maintains that Egyptian's actions in this transaction increased the overall gas costs to Consumers' ratepayers.

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<sup>6</sup> Staff disputes the injection charge herein on pages 19–20 in the section titled, Improperly Incurred Storage Injection Charge.

Staff believes that it has convincingly demonstrated that a conflict of interest existed, resulting in an imprudent gas purchase, when C.A. Robinson, as President of Consumers, purchased gas from himself as President of Egyptian on June 8, 2005, to the detriment of utility ratepayers. Staff was so convincing that even C.A. Robinson could see the conflict. (Tr., p. 68.)

### **3. Affiliate Contracts**

It is undisputed that during the 2005 reconciliation period, Consumers had two agreements in place with its affiliate, Egyptian. The first agreement was the previously-mentioned GSA. The second was the Gas Storage Contract.<sup>7</sup> However, Staff testified that the history behind and the purpose of those contracts was not to allow Egyptian to sell in-place inventory to Consumers. Further, Staff opined that although Consumers cited these agreements as the basis for its authority to conduct the transaction at issue in the instant proceeding (Consumers Exhibit 6, lines 245-251), Consumers did not always follow these agreements to the letter when it purchased the in-place storage gas from Egyptian. (ICC Staff Exhibit 2.0, pp. 19-21.)

### **4. Purpose of Agreements**

Staff witness Lounsberry discussed the history associated with Consumers and Egyptian signing the GSA and indicated that the purpose of the GSA was to allow Consumers to purchase local gas production from Egyptian. (ICC Staff Exhibit 3.0, pp. 2, 7-8.) Further, Mr. Lounsberry testified that when

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<sup>7</sup> The Gas Storage Contract is attached to Staff witness Lounsberry's Direct Testimony (ICC Staff Exhibit 3.0), as Schedule 3.04.

Consumers initially signed the GSA in 1997,<sup>8</sup> the Company provided a data request response to Staff that stated,<sup>9</sup> in reference to gas being purchased through the GSA, that local gas would always be 5 cents less than other gas purchased and that this price was sufficient to attract gas producers to drill along its system. (Id., p. 7; Schedule 3.01.) Further, the agreement in effect in the instant proceeding, approved by the Commission in Docket No. 03-0349, was approved after only minimal changes were made to the prior contract, specifically, to update the pricing language and to add the gas quality requirements in 83 Illinois Administrative Code 530 (“Part 530”). (Id., p. 8.)

Mr. Lounsberry testified that the inclusion of Part 530 in the GSA is significant because the rule contains the quality requirements for any local gas purchased by a public utility and sets forth the delivery requirements and the legal rights of the parties. (Id., p. 5.) Further, Part 530 receives its authority from the Gas Transmission Facilities Act (“GTFA”), 220 ILCS 25. Section 3(b) of the GTFA indicates that the interconnection should only take place if it involves natural gas produced within the State and in the service area of the public utility. However, Mr. Robinson indicated that neither Consumers nor Egyptian had purchased any local gas in the 2005 reconciliation year. (Tr., pp. 65-66.)

Staff witness Lounsberry further opined that the manner in which Egyptian sold gas to Consumers was defined as a sales for resale situation. However, the GTFA specifically excluded sales for resale. (ICC Staff Exhibit 3.0, pp. 5-6.)

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<sup>8</sup> The 1997 GSA is attached to Staff witness Lounsberry’s Direct Testimony (ICC Staff Exhibit 3.0), as Schedule 3.02.

<sup>9</sup> The data request response is attached to Staff witness Lounsberry’s Direct Testimony (ICC Staff Exhibit 3.0), as Schedule 3.01.

Therefore, Consumers should not have relied upon the GSA to purchase the in-place inventory from Egyptian.

Staff witness Lounsberry also noted that the other contract in force during 2005 between Consumers and Egyptian, the Gas Storage Contract, merely set forth the rates and charges associated with Consumers leasing storage from Egyptian and the rates and charges that Egyptian could charge for providing transportation service to Consumers' farm-tap customers located off of Egyptian's pipeline. (Id., p. 9.) He also indicated that the Gas Storage Contract contained no language that discussed or allowed for the in-field transfer of storage gas. (Id.)

Consumers provided no evidence whatsoever that the language in either of its two affiliate contracts contemplated the possibility of an in-place transfer of storage gas. Consumers' unwarranted expansion of the types of transactions its affiliate agreements are allowed to conduct creates a conflict of interest between Consumers' management and Egyptian's management. Affiliate agreements are intended to eliminate concerns regarding potential conflicts of interest; however, in the instant proceeding these agreements were used by Consumers to sanction the conflict to the detriment of ratepayers.

## **5. Contracts Not Followed**

Staff witness Anderson's review indicated that although Consumers claimed its authority for purchasing the in-place storage gas came from the GSA, the Company did not always follow the requirements contained in the GSA and the Gas Storage Contract.

Mr. Anderson's review showed that when Consumers made its purchase of June and July gas on June 8, 2005, it did not follow the pricing provisions of the GSA. The GSA references Consumers' primary gas source, which is ProLiance, for the purchase price of gas under the agreement. Two price indexes are specified in the ProLiance pricing agreement that set the price for the Consumers/Egyptian transaction, one for FOM (based off of the NYMEX index) and one for daily purchases (based off of the Platt's Gas Daily). Since the purchase of June and July in-place inventory was made on June 8, 2005, the price index specified by the GSA should have been Platt's Gas Daily. However, Consumers stated it used NYMEX Daily to price the transaction with Egyptian. (ICC Staff Exhibit 2.0, pp. 19-20.)

Another variation from the contract language occurred with the Gas Storage Contract. The Gas Storage Contract specifies that storage injection nominations are to be made ten days prior to the beginning of each month and that a statement shall be submitted by Seller to Buyer on or before the fifteenth day of each calendar month for the gas delivered. (Id., p. 20.) The Gas Storage Contract further provides that payment shall be made by Buyer to Seller on or before the twenty-fifth day of the month in which said bill is received by buyer. However, Mr. Anderson's review indicated that Consumers and Egyptian failed to follow the agreement for either the nomination or billing and payment for the June and July in-place inventory purchase. (Id.)

The manner in which Consumers and Egyptian treated the contractual language that they claim allows the transactions in question to occur supports

Staff's conclusion that these in-place storage transfer transactions resulted from something other than an arms-length negotiation. In fact, Staff's analysis supports the conclusion that the inherent conflict of interest between Consumers and Egyptian resulted in Consumers' customers incurring increased gas costs during the reconciliation period.

## **6. Improperly Incurred Storage Injection Charge**

Staff disputed the costs that Consumers paid Egyptian for an "injection charge" for the in-place storage gas that Consumers purchased from Egyptian. Staff witness Anderson noted that a storage injection charge is a cost incurred to physically inject gas into storage. However, when Consumers purchased the in-place storage gas from Egyptian, it was done via a paper transaction with no physical injection required. (ICC Staff Exhibit 2.0, pp. 15-17.) Since no actual injection of gas was performed, Egyptian did not incur any costs associated with transferring existing storage gas from one entity to another. Since the purchase of in-place inventory by Consumers from Egyptian was a paper transaction, not a physical one, Consumers' ratepayers should not be forced to pay Egyptian for costs it did not incur. (Id., p. 16.)

Consumers' only basis for paying the injection costs was that Egyptian was allowed to collect this charge because it is part of the Gas Storage Contract. (Consumers Exhibit 6, lines 27-37.) However, as Staff has discussed, the Gas Storage Contract was never intended to allow for the in-place transfer of storage gas. Further, Staff noted that assuming any of the gas Egyptian sold to Consumers came from the purchase of Atmos' gas, Atmos would have already

paid Egyptian an injection charge for that gas because Atmos' contract included an injection charge. (ICC Staff Exhibit 5.0, p. 12; Tr. p. 59.) In fact, Egyptian had already received an injection charge from Atmos and then attempted to collect another injection charge on that same gas from Consumers. (Tr., p. 59.) In other words, Egyptian received an injection charge twice for the same gas.

Therefore, Staff recommends the disallowance of all of the injection charges that Consumers paid to its affiliate for the in-place inventory gas. Staff calculated that Consumers was charged \$11,316 in injections costs during 2005. (ICC Staff Exhibit 2.0, p. 16.)

## **7. Logic of Pricing Adjustment**

To determine the imprudent cost incurred by Consumers as a result of its actions, Staff witness Anderson presumed that Consumers, absent its knowledge of the Egyptian negotiations and consistent with its historic purchasing practices, would have nominated its June storage gas injection volumes using the FOM gas pricing associated with its ProLiance contract. Mr. Anderson also assumed that Consumers' actual June injection volume of 31,067 Dth would have been the amount nominated from its gas supplier ProLiance.

Mr. Anderson indicated that his next assumption was that on or shortly after June 8, 2005, Egyptian would have been able to offer in-place storage gas to Consumers. When Consumers was first faced with this opportunity, it made a business decision to purchase two months supply from its affiliate. Mr. Anderson concluded that this same purchase would still have occurred, but that Consumers would have purchased the gas for the months of July and August instead of its

original purchase of June and July. Finally, Mr. Anderson made no changes to the pricing or volumes assumed for the September storage transfer. Therefore, the disallowance that Staff recommends is based upon the changes that occurred to the months of June and August. This methodology resulted in a disallowance of \$42,139. (ICC Staff Exhibit 2.0, pp. 12-13.) Consumers has not disputed the methodology of the calculation, only that the Company's purchase of its affiliate's, Egyptian, in-place gas was not imprudent.

#### **8. Quantification of Pricing and Injection Adjustments**

Staff witness Kahle prepared schedules to quantify Staff witness Anderson's adjustments for: (1) imprudent prices paid for gas supply (\$42,139); and (2) imputed injection charges (\$11,316). (ICC Staff Exhibit 4.0, pp. 2-6.) Mr. Kahle's Schedule 4.02 quantifies the pricing difference between the price Consumers paid to its affiliate, Egyptian, and the lower prices from its regular gas supplier, ProLiance, for the same months. Mr. Kahle's Schedule 4.03 quantifies the disallowance of injection charges proposed by Mr. Anderson due to the Company paying injection charges to its affiliate, Egyptian, for storage gas that was already in storage at the time of the purchase.

In explaining Schedule 4.02 in his rebuttal testimony, Mr. Kahle identified June and August as two months in which gas prices paid to Egyptian were higher than ProLiance's gas prices. (ICC Staff Exhibit 4.0, p. 3.) In his surrebuttal testimony, Mr. Robinson asserted that Mr. Kahle did not identify the correct months. (Consumers Exhibit 6, lines 289-293.) Mr. Kahle's testimony referred only to June and August because those are the only months for which Mr.

Anderson proposed adjustments.

### **9. Staff's Recommended Disallowance**

Staff recommends the Commission approve Staff's recommended disallowance of \$53,455 (Table, supra, p. 4, Line 4) for the 2005 gas purchases because: (1) gas purchases of \$42,139 were not made at a prudent price; and (2) gas costs for injection charges of \$11,316 were not prudently incurred. Of this disallowance, \$27,069 (Table, supra, p. 5, Line 3) would be added to the Company's \$9,863 proposed Factor O to be refunded. After a reduction for the uncontested \$722 adjustment to unamortized balances, the ordered Factor O to be refunded would be \$36,210 (Table, supra, p. 5, Line 7). The remaining disallowance difference of \$26,386 (\$53,455 - \$27,069) consists of a \$25,431 (Table, supra, p. 5, Line 10) reduction of 2006 gas costs and a \$955 (Table, supra, p. 5, Line 13) reduction of the balance of Cushion Gas shown on the Company's general ledger.

### **10. Prohibition of Future Affiliate Inventory Transactions**

Staff made two recommendations regarding Consumers' actions based upon its findings that: 1) Consumers' knowledge of the imminent purchase of Atmos' in-place inventory by Egyptian altered its historical purchasing practices; 2) the purpose of the GSA was only to allow the purchase of local gas production from Egyptian; and 3) Consumers did not have the appropriate authority to expressly conduct in-field transfers of storage gas with its affiliate, Egyptian. First, Staff recommended that the Commission order Consumers not to engage

in any transactions involving the in-place inventory transfers between Consumers and Egyptian until an agreement expressly covering the potential for that occurrence is approved by the Commission. (ICC Staff Exhibit 2.0, pp. 28-29.) Staff also recommended that the Commission order Consumers to cease any sales for resale transactions involving the GSA. (ICC Staff Exhibit 6.0, p. 6.)

## **11. Direct Purchase from Atmos**

Staff testified that Consumers should have attempted to purchase the in-place inventory directly from Atmos versus making an in-place inventory purchase from its affiliate, Egyptian. (ICC Staff Exhibit 2.0, pp. 22-24; ICC Staff Exhibit 5.0, p. 17.) Consumers' excuse for not directly purchasing the gas from Atmos was two-fold: (1) Egyptian was the only entity with the right to purchase the gas; and (2) even if Consumers could have purchased some of that gas, Consumers did not have the financial ability to purchase the gas.

### **a. Right to Purchase the Atmos Gas**

Consumers disagreed with Staff that Consumers should have pursued the direct purchase of the in-place inventory directly from Atmos. Mr. Robinson testified that Atmos had the storage contract with Egyptian and only Egyptian had the right to purchase this gas. (Tr., p. 55.) However, Mr. Robinson later admitted that there was no language in the Storage Service Agreement between Egyptian and Atmos (ICC Staff Cross Exhibit 1) that granted Egyptian the exclusive right to purchase Atmos' in-place inventory. (Tr., p. 57.) Instead of exclusivity, Egyptian did have to provide consent for any disposition of that gas from its storage

facility. (Tr., pp. 58-59; ICC Staff Cross Exhibit 2.)

Consumers also indicated that it would have had no knowledge about business dealings between Atmos and Egyptian. (ICC Staff Exhibit 2.0, p. 22.) Staff disagrees. Mr. Robinson admitted that he was President of both Consumers and Egyptian. (Tr., pp. 47-49.) Moreover, given the situation that Atmos was in, there were a limited number of entities it could have dealt with to eliminate its in-place inventory. Consumers was one of the few entities that also maintained inventory at the same leased storage location. (Tr., p. 59.) As such, Consumers would have known that the Atmos gas was available for sale.

Further, Mr. Robinson never attempted to negotiate a contract between Consumers and Atmos for direct purchase. (Tr., p. 55.) Instead, he fulfilled his role as President of Egyptian, which was to maximum profits for that entity. (Tr., p. 49.) Unfortunately, in order to fulfill that role, it conflicted with his role of providing least-cost gas service to Consumers' ratepayers and instead created a situation where the ratepayers actually experienced an increase in gas costs.

**b. Financial Ability to Purchase the Atmos Gas**

Consumers' claim of a poor financial situation is not a valid excuse for the Company not to have pursued the direct purchase of a portion of the in-place inventory that Atmos ultimately sold to Egyptian. To refute Consumers' assertion, Staff witness Kahle prepared a schedule which demonstrated that a one-time purchase from Atmos would not have been a significant cash burden compared to the purchase of the same gas from its affiliate, Egyptian, over a four-month period. The analysis showed that interest costs would have

eventually been offset by savings from a lower purchase price. Also, in the long-run, the lower purchase price would have resulted in an overall savings. (ICC Staff Exhibit 1.0, pp. 8-9; Id., Schedule 1.04.) In rebuttal testimony, Mr. Robinson argued that Consumers could not have purchased gas directly from Atmos because there was no contract between Consumers and Atmos, and because Consumers did not have sufficient funds to make the purchase. (Consumers Exhibit 5, p. 4.) The argument is not convincing because: (1) Consumers made no attempt to negotiate a contract with Atmos (Tr., p. 55); and (2) Consumers made no attempt to borrow sufficient funds to make the purchase (Tr., pp. 52, 55).

Further, in response to Staff Data Request DGK-018, the Company stated:

Consumers Gas Company has always purchased gas for storage during summer months on a periodic basis. Cash flow would be one reason for this. One large 110,000 Dth purchase would require cash borrowing for a longer term thus increasing the cost of operating funds.

(ICC Staff Exhibit 2.0, p. 23.)

This response is relevant because the Company's initial storage purchase from Egyptian on June 8, 2005, was for two months, June (31,067) and July (30,000) for a total volume of 61,067 Dth and a gas cost of approximately \$467,000. Given the Company's obvious ability to make a two-month purchase at one time, it is not clear why the Company could not have directly purchased at least a portion of the in-place inventory from Atmos, since it purchased over half (61,067 Dth/ 113,154 Dth = 54%) of its refill storage volume as in-place inventory

in one transaction from its affiliate, Egyptian.

Mr. Robinson claimed that financial hardship prevented Consumers from making a large one-time purchase of gas, but Consumers was able to make two months' purchase of gas from Egyptian in a single transaction. This single transaction accounted for over half of the storage gas purchased from Egyptian. This is evidence that: (1) Consumers had the ability to make a large purchase; and (2) given that Mr. Robinson could have been negotiating for both Consumers and Egyptian, Consumers may have been able to purchase that same gas from Atmos at the lower price of \$6.25/Dth rather than the higher price of \$7.00/Dth paid to its affiliate, Egyptian.

Mr. Robinson also argued that Consumers could not have made a contract with Atmos in a timely manner due to the need for Commission approval of the loan. (Consumers Exhibit 5, p. 4.) This, however, is not true because, as Mr. Robinson admitted (Tr., p. 83), Commission approval is not required for short-term operating loans. Based on the payments Consumers made to Egyptian, a loan would have only been for a four-month term.

**B. Inadequate Responses to the Standard Interim and Year-End Accounting Data Requests**

Staff witness Kahle commented on the quality of the Company's data request responses to the Accounting Staff's interim and year-end data requests. Mr. Kahle detailed several deficiencies in the data request responses that required additional data requests and follow-up to correct. He recommended that in its Final Order in the instant proceeding, the Commission direct the Company

to prepare its responses to the Accounting Staff's interim and year-end data requests in a more thorough and complete manner. (ICC Staff Exhibit 1.0, pp. 11-12; ICC Staff Exhibit 4.0, pp. 9-10.) In surrebuttal testimony, Mr. Robinson disagreed with this recommendation. (Consumers Exhibit 6, lines 325-330.)

The generic interim and year-end data requests are standard questions that have been routinely used for quite some time by the Accounting Department Staff for all gas companies. (Tr., pp. 106, 109-110.) Furthermore, these data requests elicit information that is highly quantifiable, such as the cost of gas for the year, the reconciliation of certain numbers, and schedules regarding certain specified amounts. As such, these data requests are neither ambiguous nor subject to misinterpretation, nor do they use highly technical terms known only to CPAs. (Tr., pp. 104-106, 108, 110-111.)

## **VI. CONCLUSION**

For the foregoing reasons, Staff of the Illinois Commerce Commission respectfully requests that the Commission adopt Staff's reconciliation of revenues collected under Consumers' purchased gas adjustment clause with actual costs as reflected on ICC Staff Exhibit 4.0, Schedule 4.01, attached hereto as Appendix A, and order Consumers to refund \$36,210, as a Factor O refund, in the first monthly PGA filed after the date of the Final Order in the instant proceeding. Staff also requests that the Commission order Consumers to reduce 2006 gas costs by \$25,431 for pricing and injection charge adjustments. Staff further requests that the Commission order Consumers to reduce the balance of

Cushion Gas shown on the Company's general ledger by \$955 for pricing and injection charge adjustments.

Additionally, Staff requests that the Commission order Consumers not to engage in any transactions involving the in-place inventory transfers between Consumers and its affiliate, Egyptian, until an agreement expressly covering the potential for that occurrence is approved by the Commission. Staff further requests that the Commission order Consumers to cease any sales for resale transactions involving its GSA with Egyptian. Finally, Staff requests that the Commission order the Company to prepare its responses to the Accounting Department standard interim and year-end data requests in a more thorough and complete manner.

Respectfully submitted,

A handwritten signature in black ink that reads "Linda M. Buell". The signature is written in a cursive, flowing style.

LINDA M. BUELL

Counsel for the Staff of the Illinois  
Commerce Commission

February 15, 2008

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**Consumers Gas Company**  
**Reconciliation of Purchased Gas Adjustment Clause**  
**For the Twelve Months Ended December 31, 2005**  
**(In Dollars)**

Line No.	Description	Amount per Company Statement 1 (B)	Staff Adjustments to include interest and to correct balances (C)	Staff Adjustment for Pricing (Schedule 4.02) (D)	Staff Adjustment for Injection (Schedule 4.03) (E)	Amount per Staff (F)
	(A)					(F)
						Columns (B + C + D + E)
1	Unamortized Balance as of 12/31/2004 per 2004 Reconciliation	\$ 30,000	\$ 62	\$ -	\$ -	\$ 30,062
2	Factor A Adjustments Amortized to Schedule 1 at 12/31/2004	64,039	-	-	-	64,039
3	Factor O Collected/(Refunded) During 2005	14,765	360	-	-	15,125
4	Balance to be Collected/(Refunded) During 2005 from prior periods (sum of lines 1-3)	<u>\$ 108,804</u>	<u>\$ 422</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 109,226</u>
5	2005 Gas Costs	\$ 6,061,363	-	\$ (23,293)	\$ (3,776)	\$ 6,034,294
6	2005 PGA Revenues	(6,298,617)	-	-	-	(6,298,617)
7	Pipeline Surcharges/(Refunds)	-	-	-	-	-
8	Other Adjustments (Rounding)	-	-	-	-	-
9	Interest	244	-	-	-	244
10	2005 Under/(Over) Recovery (sum of lines 5-9)	<u>\$ (237,010)</u>	<u>\$ -</u>	<u>\$ (23,293)</u>	<u>\$ (3,776)</u>	<u>\$ (264,079)</u>
11	Under/(Over) Recovery Balance at 12/31/2005 (line 4 + line 10)	\$ (128,206)	\$ 422	\$ (23,293)	\$ (3,776)	\$ (154,853)
12	Factor A Adjustments Amortized to Schedule 1 at 12/31/2005	(38,231)	-	-	-	(38,231)
13	Unamortized Balance as of 12/31/2005	(80,112)	(300)	-	-	(80,412)
14	Factor O to be Collected / (Refunded) (Line 11 - Line 12 - Line 13)	<u>\$ (9,863)</u>	<u>\$ 722</u>	<u>\$ (23,293)</u>	<u>\$ (3,776)</u>	<u>\$ (36,210)</u>