STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	
Peoples Gas Light and Coke Company	:	06-0752
	:	
Reconciliation of revenues collected	:	07-0312
under gas adjustment charges with	:	
actual costs prudently incurred.	:	(Cons.)

INITIAL BRIEF OF
THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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 21, 2006, 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 The Peoples Gas Light and Coke Company ("Peoples" or the "Company") to present evidence reconciling revenue collected under the Company's purchased gas adjustment clause ("PGA") with the actual cost of natural gas supplies prudently purchased for the twelve-month period from October 1, 2005, through September 30, 2006. (Initiating Order, Docket No. 06-0752, p. 2.)

On August 3, 2006, WPS Resources Corporation, Peoples Energy Corporation, Peoples and North Shore Gas Company ("North Shore") filed an application pursuant to Section 7-204 of the Act, 220 ILCS 5/7-204, for authority to engage in a reorganization. The Commission approved the application on February 7, 2007, in Docket No. 06-0540. Included in the application, Peoples and North Shore proposed to change their reconciliation years from the 12-month period ending September 30 to the 12-month period ending December 31 and to facilitate the transition through a three-month reconciliation period covering October 2006 through December 2006. The Commission granted these requests in the Order approving the reorganization.

To address the three-month interval spanning October 1, 2006, through December 31, 2006, the Commission, on May 16, 2007, entered an Order directing Peoples to present evidence showing the reconciliation of PGA revenues with the actual cost of gas supplies prudently purchased for the three-month period from October 1, 2006, through December 31, 2006 (together with the twelve-month period ended September 30, 2006, the "Reconciliation Period"). (Initiating Order, Docket No. 07-0312, p. 2.)

On July 25, 2007, the Administrative Law Judge granted Staff's June 29, 2007 motions to consolidate Docket Nos. 06-0752 and 07-0312.

Pursuant to proper legal notice, a pre-hearing conference was held on January 18, 2007, before duly authorized Administrative Law Judges of the Commission at its offices in Chicago, Illinois. An evidentiary hearing was held on December 11, 2008. Appearances were entered by counsel on behalf of the Company, the City of Chicago (the "City"), the People of the State of Illinois ("AG"), the Citizens Utility Board ("CUB"), and Staff. Peoples presented the testimony of Christine Gregor, Assistant Controller, Peoples; and Richard E. Dobson, Manager of Gas Supply, Peoples. CUB, the AG, and the City jointly presented the testimony of Jerome D. Mierzwa, Principal and Vice President of Exeter Associates, Inc. Staff presented the testimony of Dianna Hathhorn, Accountant, Accounting Department of the Financial Analysis Division; Dennis L. Anderson, Senior Gas Engineer in the Gas Section of the Engineering Department of the Energy Division; and David Rearden, Senior Economist, Policy Program of the Energy Division.

II. LEGAL STANDARDS

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

The standard used by the Commission to assess the prudency 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. UNCONTESTED ISSUES

A. Prudence of Peoples' Natural Gas Purchasing

Staff witness Anderson reviewed the Company's testimony and responses to numerous Staff data requests that directly addressed issues related to the prudence of Peoples' natural gas purchasing. He concluded that he found no reason to dispute the Company's assertion that all gas supply purchases were prudently incurred during the Reconciliation Period. (ICC Staff Exhibit 2.0, p. 3; ICC Staff Exhibit 4.0, p. 1.)

B. Banked Gas Reconciliation Adjustment

Staff witness Hathhorn disallowed $571,933.44 for a reconciling adjustment made by Peoples in September of 2006 for banked gas for items not identified and presumed to be prior to the Reconciliation Period. (ICC Staff Exhibit 1.0, p. 5.) The Commission, in its Order in the Company's 2005 PGA reconciliation proceeding, stated:

> The language of Section 525 of the Administrative Code supports the position that a utility may generally not recover a cost out of the reconciliation period, except in the limited instances enumerated in the rules…Although we are hesitant to say that exceptions will never occur, this situation does not warrant making such an exception.

(Order, Docket No. 05-0749, January 16, 2008, p. 9.)

Since the Company cannot identify items related to the Reconciliation Period, and in accordance with the Commission's Order in Docket No. 05-0749, this adjustment is appropriate to disallow non-reconciliation period costs from the gas charge. (ICC Staff Exhibit 1.0, p. 6.) The Company did not oppose Staff's adjustment. (Peoples Gas Ex. CG-3.0, p. 2.)

Staff recommends that the Commission adopt Staff's proposed PGA reconciliations as reflected in Appendix A attached hereto. Appendix A presents the summary schedules originally presented in ICC Staff Exhibit 1.0.[1] Page 1 of Appendix A is a summary of the twelve- and three-month periods being reconciled in this proceeding. Page 2 of Appendix A reflects the details of the twelve-month period from October 1, 2005 through September 30, 2006, and page 3 reflects the details of the three-month period from October 1, 2006 through December 31, 2006. Staff's reconciliation on page 1 of Appendix A shows that $571,933.44 is to be refunded to Peoples' PGA customers via the Commodity Gas Charge through an Ordered Reconciliation Factor to be reflected in the Company's first monthly PGA filing submitted after the date a Final Order is entered in this proceeding.

IV. STAFF'S RECOMMENDATIONS REGARDING THE COMPANY'S PRACTICES THAT DO NOT INCLUDE CORRESPONDING DISALLOWANCES

A. Manlove Field

1. Allocating Between Ratepayers and the Hub

Staff witness Rearden did not propose a disallowance for Peoples' Manlove Field usage during the Reconciliation Period, since he had no basis for finding Peoples' use of Manlove Field to be imprudent. (ICC Staff Exhibit 3.0, p. 6.) At the same time, Dr. Rearden did not endorse the Company's analysis of how it used Manlove Field during the Reconciliation Period. (ICC Staff Exhibit 5.0.) In particular, he stated that Peoples compared the total cost to ratepayers for three different Manlove Field allocations. The cost was calculated with Linear Programming, which can find a solution in complex situations. However, the Company did not use its model to systematically solve for the

[1] Staff's position, and thus its schedules, did not change during the course of the instant proceeding.

best overall asset mix, but instead, ran the model only for the three allocations, calculated the cost for each allocation, and selected the one with the lowest cost for ratepayers. (*Id*., pp. 6-7.)

Peoples did not examine what Manlove Field's capacity should be, and it only looked at three allocations. Staff witness Rearden testified that the benefits from allocating a fixed amount between the groups may not benefit ratepayers as much as finding the correct total field capacity. He stated that Peoples should consider a wider range of allocations. He opined that the results of the approach were heavily dependent upon the specific values chosen for the various constraints. As such, Dr. Rearden recommended a more analytical approach that directly examined the net benefit to use the Hub's share of Manlove Field for ratepayers versus when it was used by Hub customers. (*Id.,* pp. 7-8.)

Accordingly, Staff recommends that the following Findings Paragraph and corresponding Ordering Paragraph be included in the Commission's Final Order in this proceeding:

> (X) In its 2008 PGA reconciliation direct testimony, Peoples shall fully explain its Manlove Field capacity allocations between ratepayers of North Shore and Peoples and the Hub, and how the Manlove Field allocation decision fits into its entire asset portfolio.
>
> * * *
>
> IT IS FURTHER ORDERED that in its 2008 PGA reconciliation direct testimony, Peoples shall fully explain its Manlove Field capacity allocations between ratepayers of North Shore and Peoples and the Hub, and how the Manlove Field allocation decision fits into its entire asset portfolio.

2. Mr. Mierzwa's Disallowance

In addition, as pointed out by CUB-AG-City witness Mierzwa, when price spreads between injection periods and withdrawal periods are large, storage can lower ratepayers' costs, while it provides the same value for Hub customers. When spreads are small, the opposite is true, but it is equally true for both Hub customers and ratepayers. Staff witness Rearden opined that Peoples needed to do a better job of explaining why ratepayers are better off with Hub capacity at a certain level, when benefits and costs are the same for both ratepayers and Hub customers. Dr. Rearden testified that this is especially true when, as noted in an internal memo (*Id.,* Attachment A), ratepayers are expected to pick up any shortfall in Manlove Field usage caused by slackening demand from Hub customers. (*Id.,* p. 8.)

Staff witness Rearden recommended that the Commission order Peoples to explain its Manlove Field capacity allocations between ratepayers of North Shore and Peoples and the Hub in its 2008 PGA reconciliation direct testimony. Dr. Rearden stated that to be useful, the testimony must fully explain the Company's plans for Manlove Field and how the Manlove Field allocation decision accounts for its entire asset portfolio. He explained that such testimony would allow Staff to evaluate actual Manlove Field usage using predetermined standards for the 2008-2009 winter season. (ICC Staff Exhibit 3.0, pp. 6-7.)

Staff witness Rearden agreed with CUB-AG-City witness Mierzwa that it was not prudent to incur gas costs on ratepayers' behalf without a rigorous study of the Manlove Field allocation issue. He stated that Manlove Field was the single biggest storage asset that Peoples used to provide service to its customers; storage was a significant element of its asset portfolio. The Manlove Field capacity allocated to its customers affected how much gas commodity, transportation and other storage it needed to purchase and how it managed those assets, as well. Dr. Rearden opined that when Peoples failed to closely examine how to allocate Manlove Field, it acted imprudently. (ICC Staff Exhibit 5.0, p. 4.)

However, Staff witness Rearden did not agree with Mr. Mierzwa's calculation for harm to ratepayers. He testified that there were significant shortcomings in Mr. Mierzwa's calculation that prevented it from being used to calculate a disallowance. Dr. Rearden mentioned two issues that undermined the proposed disallowance. One, the period of the calculation did not coincide with the fiscal year. The disallowance was calculated over two full injection and withdrawal cycles, even though the reconciliation period covered only one full and one partial injection period and one full and one partial withdrawal period. Two, although Mr. Mierzwa offset his disallowance with estimated Hub revenues, his figure appeared to be much smaller than the actual Hub revenues for the same period, and he did not explain the difference. (*Id.*)

Therefore, Staff recommends that the Commission reject CUB-AG-City witness Mierzwa's proposed disallowance.

B. Kinder-Morgan Illinois Pipeline

Staff witness Rearden explained that the Kinder-Morgan Illinois Pipeline ("KMIP") contract was an interstate transportation contract for delivery to the Chicago citygate. KMIP provided Peoples with additional delivery flexibility to the Chicago citygate. Dr. Rearden stated that Peoples did not recover any costs related to the KMIP contract in the Reconciliation Period, since the contract did not become operational until late 2007. He further indicated that Peoples briefly addressed the contract in its direct testimony in

Docket No. 07-0577, which was the Company's PGA reconciliation proceeding for January through December 2007 (*See* Peoples Gas Ex. RD 1.0, pp. 17-18, Docket No. 07-0577). (ICC Staff Exhibit 3.0, p. 7.)

However, since Dr. Rearden believed that the Company's description and examination of the contract were insufficient for meeting its burden of proof of prudency, he recommended that Peoples supplement its direct testimony in Docket No. 07-0577. He testified that the purpose of the supplemental testimony was to describe the contract in detail and to fully explain all changes to the Company's transportation and storage portfolio that the contract caused. Further, he suggested that the supplemental testimony comprehensively explain why the KMIP contract was the best alternative to construct the Company's portfolio. (*Id.,* pp*. 7-8.)* Peoples filed the Supplemental Direct Testimony of Richard Dobson (Peoples Gas Ex. RD 2.0) on October 31, 2008 in Docket No. 07-0577, which addressed these issues. Staff did not comment on the supplemental direct testimony filed in Docket No. 07-0577 in the instant proceeding.

V. CONCLUSION

For the foregoing reasons, Staff of the Illinois Commerce Commission respectfully requests that the Commission adopt Staff's proposed PGA reconciliations as reflected in Appendix A attached hereto. Appendix A presents the summary schedules originally presented in ICC Staff Exhibit 1.0. Page 1 of Appendix A is a summary of the twelve- and three-month periods being reconciled in this proceeding. Page 2 of Appendix A reflects the details of the twelve-month period from October 1, 2005 through September 30, 2006, and page 3 reflects the details of the three-month period from October 1, 2006 through December 31, 2006. Staff's reconciliation on page 1 of

Appendix A shows that $571,933.44 is to be refunded to Peoples' PGA customers via the Commodity Gas Charge through an Ordered Reconciliation Factor to be reflected in the Company's first monthly PGA filing submitted after the date a Final Order is entered in this proceeding.

Staff also respectfully requests that the Commission include Staff's recommendations regarding Peoples' Manlove Field in the Final Order in the instant proceeding.

Respectfully submitted,

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The Peoples Gas Light and Coke Company
PGA Reconciliation Summary of Both Periods
for the Periods Ended September 30, 2006 and December 31, 2006

Line No.	Description	Total (1) at Sept. 30, 2006 (App. A, page 2)	Total (2) at Dec. 31, 2006 (App. A, page 3)	Total Factor O per Staff
	(A)	(B)	(C)	
1.	Unamortized Balance at September 30, 2005/2006 Respectively (Refund) / Recovery	$ 4,122,655.50	$ (21,690,102.66)	
2.	Factor A Adjustments Amortized to Schedule I at September 30, 2005/2006 Respectively	2,745,404.97	(23,603,023.31)	
3.	Factor O (Refunded) / Recovered	-	-	
4.	Balance (Refundable) / Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	$ 6,868,060.47	$ (45,293,125.97)	
5.	Costs Recoverable through the Gas Charge	$ 996,405,023.99	$ 282,261,717.00	
6.	Revenues Arising through Application of the Gas Charge	1,047,102,349.61	250,204,484.11	
7.	Separately Reported Pipeline Refunds or Surcharges	(1,080,064.67)	-	
8.	Separately Reported Other Adjustments	-	(190,264.06)	
9.	Interest	(955,729.59)	(70,545.92)	
10.	(Over) / Under Recovery for Reconciliation Year (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	$ (52,733,119.88)	$ 31,796,422.91	
		-		
11.	(Over) / Under Recovery Balance at September 30 and December 31, 2006 Respectively (Line 4 + Line 10)	(45,865,059.41)	(13,496,703.06)	
12.	Factor A Adjustments Amortized to Schedule I at September 30 and December 31, 2006 Respectively	(23,603,023.31)	(8,747,850.23)	
13.	Unamortized Balance at September 30 and December 31, 2006 Respectively (Refund) / Recovery	(21,690,102.66)	(4,748,852.83)	
14.	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$ (571,933.44)	$ -	$ (571,933.44)

(1) Reconciliation Period: October 1, 2005 through September 30, 2006

(2) Reconciliation Period: October 1, 2006 through December 31, 2006

The Peoples Gas Light and Coke Company
PGA Reconciliation Summary
for the Year Ended September 30, 2006

Line No.	Description	Commodity Gas Charge (CGC) (Staff Ex. 1.0, Schedule 1.3)	Non-Commodity Gas Charge, Demand Gas Charge & Aggreg. Balancing GC (NCGC, DGC and ABGC) (Respondent Ex. CG-1.1)	Transition Surcharge (TS) (Respondent Ex. CG-1.1)	Total Company (B+C+D)
	(A)	(B)	(C)	(D)	(E)
1.	Unamortized Balance at September 30, 2005 (Refund) / Recovery	$ -	$ 4,147,881.62	$ (25,226.12)	$ 4,122,655.50
2.	Factor A Adjustments Amortized to Schedule I at September 30, 2005	2,046,888.38	702,911.11	(4,394.52)	2,745,404.97
3.	Factor O (Refunded) / Recovered	-	-	-	-
4.	Balance (Refundable) / Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	$ 2,046,888.38	$ 4,850,792.73	$ (29,620.64)	$ 6,868,060.47
5.	Costs Recoverable through the Gas Charge	$ 956,793,842.60	$ 39,611,181.39	$ -	$ 996,405,023.99
6.	Revenues Arising through Application of the Gas Charge	1,007,399,059.65	39,703,292.75	(2.79)	1,047,102,349.61
7.	Separately Reported Pipeline Refunds or Surcharges	(845,673.00)	(234,391.67)	-	(1,080,064.67)
8.	Separately Reported Other Adjustments	-	-	-	
9.	Interest	(958,652.52)	4,034.27	(1,111.34)	(955,729.59)
10.	(Over) / Under Recovery for Reconciliation Year (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	$ (52,409,542.57)	$ (322,468.76)	$ (1,108.55)	$ (52,733,119.88)
11.	(Over) / Under Recovery Balance at September 30, 2006 (Line 4 + Line 10)	(50,362,654.19)	4,528,323.97	(30,729.19)	(45,865,059.41)
12.	Factor A Adjustments Amortized to Schedule I at September 30, 2006	(24,248,452.82)	650,106.64	(4,677.13)	(23,603,023.31)
13.	Unamortized Balance at September 30, 2006 (Refund) / Recovery	(25,542,267.93)	3,878,217.33	(26,052.06)	(21,690,102.66)
14.	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$ (571,933.44)	$ -	$ -	$ (571,933.44)

The Peoples Gas Light and Coke Company
PGA Reconciliation Summary
for the Quarter Ended December 31, 2006

Line No.	Description	Commodity Gas Charge (CGC) (Respondent Ex. CG-2.1)	Non-Commodity Gas Charge, Demand Gas Charge & Aggreg. Balancing GC (NCGC, DGC and ABGC) (Respondent Ex. CG-2.1)	Transition Surcharge (TS) (Respondent Ex. CG-2.1)	Total Company (B+C+D)
	(A)	(B)	(C)	(D)	(E)
1.	Unamortized Balance at September 30, 2006 (Refund) / Recovery	$ (25,542,267.93)	$ 3,878,217.33	$ (26,052.06)	$ (21,690,102.66)
2.	Factor A Adjustments Amortized to Schedule I at September 30, 2006	(24,248,452.82)	650,106.64	(4,677.13)	(23,603,023.31)
3.	Factor O (Refunded) / Recovered	-	-	-	-
4.	Balance (Refundable) / Recoverable from Prior Periods (Line 1 + Line 2 + Line 3)	$ (49,790,720.75)	$ 4,528,323.97	$ (30,729.19)	$ (45,293,125.97)
5.	Costs Recoverable through the Gas Charge	$ 271,413,834.62	$ 10,847,882.38	$ -	$ 282,261,717.00
6.	Revenues Arising through Application of the Gas Charge	234,471,270.41	15,733,252.74	(39.04)	250,204,484.11
7.	Separately Reported Pipeline Refunds or Surcharges	-	-	-	-
8.	Separately Reported Other Adjustments	(190,264.06)	-	-	(190,264.06)
9.	Interest	(83,884.60)	13,609.50	(270.82)	(70,545.92)
10.	(Over) / Under Recovery for Reconciliation Period (Line 5 - Line 6 + Line 7 + Line 8 + Line 9)	$ 36,668,415.55	$ (4,871,760.86)	$ (231.78)	$ 31,796,422.91
11.	(Over) / Under Recovery Balance at December 31, 2006 (Line 4 + Line 10)	(13,122,305.20)	(343,436.89)	(30,960.97)	(13,496,703.06)
12.	Factor A Adjustments Amortized to Schedule I at December 31, 2006	(8,973,539.51)	234,243.13	(8,553.85)	(8,747,850.23)
13.	Unamortized Balance at December 31, 2006 (Refund) / Recovery	(4,148,765.69)	(577,680.02)	(22,407.12)	(4,748,852.83)
14.	Requested Factor O (Line 11 - Line 12 - Line 13) (Refund) / Recovery	$ 0.00	$ -	$ -	$ -