

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

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

**INITIAL BRIEF OF THE CITIZENS UTILITY BOARD,
THE CITY OF CHICAGO AND
THE PEOPLE OF THE STATE OF ILLINOIS**

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Pursuant to Section 200.800 of the Rules of Practice of the Illinois Commerce Commission (“Commission” or “ICC”), 83 Ill. Admin. § 200.800, and the briefing schedule set by the Administrative Law Judge (“ALJ”), the CITIZENS UTILITY BOARD (“CUB”) by its attorney, the CITY OF CHICAGO (“City”) by its attorney, Mara S. Georges, Corporation Counsel, and the People of the State of Illinois by Illinois Attorney General, Lisa Madigan (“AG”) (collectively, “CUB-City-AG”), submit their Initial Brief in this proceeding.

I. INTRODUCTION AND LEGAL STANDARD

Section 9-220 of the Public Utilities Act (“PUA”) requires the Commission to initiate annual hearings to determine whether the actual gas costs a utility charged through its purchased gas adjustment (“PGA”) clause during the reconciliation period were reasonable and prudently incurred. 220 ILCS 5/9-220. In particular, the purpose of this proceeding is to determine

whether the purchased gas costs recovered by The Peoples Gas Light and Coke Company (“Peoples Gas,” “PGL” or “the Company”) during the 2006 reconciliation period, October 1, 2005 through December 31, 2006, meet the requirements of Section 9-220. The 2006 reconciliation period includes the entire winter of 2005-2006 (November 2005 – March 2006), and the months of November and December 2006 of the winter of 2006-2007. The PUA unequivocally places the burden of proof of all material issues squarely and exclusively on the utility. 220 ILCS 5/9-220(a). Thus, while Peoples Gas passes its gas costs directly to ratepayers without a markup or profit under the PGA, it still must demonstrate that its costs of purchasing and managing the gas were prudently incurred. *Id.*

The Commission previously determined, in Peoples Gas’ 2001 reconciliation proceeding¹, that several aspects of Peoples’ gas purchasing practices were imprudent. *See, e.g.*, ICC Docket 01-0707, Order (March 28, 2006) (“Settlement Order”) at 45-47, 48, 50-51, 52, 53-54, 57-58, 60-61, 64-65, 67, 74-75. Specifically, the Commission found that Peoples Gas’ decision to enter into a contract (the “Gas Purchase Agency Agreement” or “GPAA”) with Enron North America (“Enron NA”)² was imprudent and unnecessarily increased the gas costs of sales customers. *Id.* Further, with regard to the utility’s use of storage services for third-party transactions, the Commission concluded that

PGL failed to provide evidence establishing that its withdrawal practices from Manlove Field during the winter of the reconciliation period complied with the prudence requirement in the PUA. Not only did PGL fail to meet its burden of proof with respect to its withdrawal practices, but other parties provided ample evidence showing PGL acted imprudently.”

Id. at 90.

¹ ICC Docket No. 01-0707 examined the prudence of Peoples Gas’ purchased gas costs for the October 1, 2000 through September 30, 2001 reconciliation period.

² Subsequent to the collapse of Enron, the GPAA was sold to Occidental Energy Marketing, Inc. (“OEMI”).

In interpreting the Commission's rules on recoverable gas costs, the Commission further concluded that

Section 525.40(d) was meant to deter utilities from subsidizing off-system transactions with assets used for consumers and thus subject to a PGA. This is not to suggest that the Commission disapproves of all third-party transactions on the part of utilities. Rather, when third-party transactions involve use of PGA assets, use of those assets, especially gas supply, must be prudent.

Id. at 94.

As a result of a settlement between the parties to Docket 01-0707, which was approved by the Commission in its Settlement Order (which resolved a total of 8 open dockets³ and covered four years of reconciliation proceedings for Peoples Gas and North Shore Gas Company), the utilities agreed to, among other things, refund \$100 million to customers. The Commission approved the settlement and further ordered that all Chicago Hub and non-tariff revenues be used to offset recoverable gas costs in future purchased gas cost reconciliation proceedings. Settlement Order at 144-145.

In the 2005 reconciliation proceeding, ICC Docket 05-0749, CUB-City witness Jerome D. Mierzwa testified that the Company's practice of providing Hub services was unreasonable because of the significant risk that it would increase gas costs recovered from ratepayers. CUB-City Ex. 2.0 at 7, LL. 150-152; *Id.* at 12, LL. 286-87. Specifically, Mr. Mierzwa concluded that Peoples Gas' practice of pre-allocating the amount of storage available for system supply was unreasonable because that practice precludes the Company's gas dispatch model from optimizing the amount of Manlove storage that should be utilized to serve ratepayers. *Id.* at 12, LL. 291-94. In that proceeding, the Commission concluded that, because ratepayers were not adversely affected by the provision of Hub services (Hub revenues exceeded the costs of providing Hub services during the 2005 reconciliation period), it would decline to make a finding of

³ 01-0707, 01-0706, 02-0727, 02-0726, 03-0704, 03-0705, 04-0682, and 04-0683.

imprudence. The Commission further reasoned that “Manlove storage and Hub services is an issue that is being litigated in Docket No. 07-0242, Peoples Gas’ currently-open, gas rate proceeding, as recommended by Staff.” ICC Docket No. 05-0749, Order at 21 (January 16, 2008).

In fact, Peoples Gas’ use of its storage assets was an issue in its last rate increase request, ICC Docket No. 07-0242. In that case, CUB-City witness, Mr. Mierzwa, similarly testified that the Company’s gas dispatch model should be used to optimize the amount of Manlove storage utilized to serve ratepayers. CUB-City Ex. 3.0 at 7, LL. 160-162. On cross-examination, Peoples Gas witness, Mr. Zack, stated that Peoples Gas planned to conduct analyses with regard to determining the most economic use of Manlove storage and the Hub for the benefit of ratepayers. ICC Docket No. 07-0242, Tr. at 540 (September 12, 2007). Mr. Zack further testified that the gas dispatch model would be made part of this analysis. *Id.* at 541. The Commission ultimately required Peoples Gas to “submit to the Director of the Energy Division a report of procedures to document how Peoples Gas allocates Manlove storage capacity; how it ensures that ratepayers are not harmed by its allocation decisions; and, how it will use the gas dispatch model to optimize use of Manlove Field on behalf of its sales customers.” ICC Docket No. 07-0242, Final Order at 119-120.

II. CHICAGO HUB STORAGE ASSIGNMENT

A. Background

Pursuant to its FERC Operating Statement, Peoples Gas provides transportation and storage services to certain counter parties (generally marketers). These services utilize the Company’s on-system storage facility, Manlove Field, and are referred to as Chicago Hub, third-

party or non-tariff services. Under certain transactions, Peoples Gas either accepts gas from a counter party and returns it at a later point in time, or lends gas to a counter party who returns it at a later point in time. As discussed above, though the Commission did not forbid PGL from providing Hub services in the Settlement Order, it required Peoples Gas to flow Hub revenues through the gas charge as a credit to offset the costs associated with providing these services. Settlement Order at 104.

The total seasonal cycling capability of Peoples Gas' Manlove storage field is 36.5 Bcf.⁴ Of this, only 27 Bcf is assigned to system supply (Peoples Gas is assigned 25.5 Bcf and North Shore Gas Company ("North Shore") is assigned 1.5 Bcf). CUB-City-AG Ex. 1.0 at 5, LL. 95-97. The remaining 10 Bcf is reserved for use in Hub services. *Id.* at 5, LL. 98. To serve its sales customers during the winter, the Company uses a combination of procurement strategies: it can either purchase gas at current market prices for direct delivery to its system, or withdraw gas from the Manlove Field storage facility. *Id.* at 5, LL. 103-105. Typically, gas is injected into Manlove Field during the summer at lower prices and withdrawn during the winter when usage and market prices are higher. *Id.* at 5, LL. 105-106.

The provision of Hub services reduces the amount of storage gas that can be used to meet the winter requirements of ratepayers, and this can result in higher costs to sales customers because the quantity of lower-cost summer gas available to sales customers is reduced. *Id.*, LL. 106-110. During the summer period (April-October) prior to each winter, gas prices were lower than in the subsequent winter period. Rather than capturing this seasonal price benefit by filling all of Manlove storage with gas to serve sales customers, the Company used a portion of

⁴ The seasonal cycling capability of Manlove storage increased from 34.6 Bcf in the winter of 2001-2002 to 36.5 Bcf in the winter of 2004-2005.

Manlove to accept gas from counter parties and store that gas to support its Hub services. *Id.* at 5-6, LL.118-123.

B. Peoples Gas Failed to Properly Implement Its Gas Planning Model to Optimize Its Storage Facilities for Ratepayer Benefit

Peoples Gas employs a gas dispatch model to assist it in the gas supply planning process. In its gas dispatch model, Peoples Gas sets the amount of Manlove Field storage available for system supply during the reconciliation period at the aforementioned, predetermined 25.5 Bcf level. *Id.* at 5, LL. 290-93. The remaining portion of Manlove Field storage (except for the 1.5 Bcf allocated to North Shore) is pre-allocated for the use of Hub services, as noted above. Peoples Gas does not allow the gas dispatch model to allocate the entirety of Manlove Field storage capacity for system supply. This is a management decision based on what appears to be only historical experience - the Company has not provided any studies or analyses that justify the prudence of these allocations. See *id.* at 5, LL. 99-100.

The Company itself appears to recognize the benefit of re-examining the amount of Manlove storage allocated for system supply. Attachment A to Staff witness David Rearden's Rebuttal Testimony is a memo served by the Company to Staff, dated August 4, 2008, regarding a change in planned Manlove storage capacity. The memo recommends that the Company reallocate 3 Bcf of Manlove Field storage capacity from Hub services to system supply for the 2008-09 winter. Although the Company makes clear that this change in allocation is only applicable for the current winter, the memo concludes that "PGL Gas Charge Customers are expected to benefit from a reallocation of 3 Bcf of Manlove Field Capacity from the Hub." Staff Ex. 5.0, Attachment A at 3.

The total quantity of Manlove storage has increased over the years, and thus use of a static historical figure is unreasonable. Mr. Mierzwa therefore concluded that "it is unreasonable

to pre-determine and limit the quantity of Manlove storage used to serve ratepayers, especially given the increased capability of Manlove storage.” *Id.* at 9, LL. 193-196. Mr. Mierzwa further concluded that the provision of park and loan Hub services reduces the amount of storage gas that can be used to meet the winter requirements of ratepayers, which can result in higher costs to sales customers. *Id.* at 5, LL. 106-110. The gas dispatch model is not, therefore, being utilized to optimize the use of Peoples Gas storage assets for sales customers. As the evidence in this record clearly demonstrates, the utility’s imprudent provision of park and loan Hub services during the 2006 reconciliation period resulted in unjustifiably increased gas costs for its sales customers.

C. The Evidence Supporting Mr. Mierzwa’s Recommended Disallowance

Similar to his testimony in ICC Docket Nos. 05-0549 and 07-0242, discussed above, Mr. Mierzwa testified in this proceeding that Peoples Gas’ provision of park and loan Hub services during the reconciliation period increased gas costs of system supply customers. CUB-City-AG Ex. 2.0 at 2, LL. 21-22. Additionally, the utility failed to meet its burden of proof to demonstrate that it prudently allocated Manlove Field storage between system supply and park and loan Hub services. To address the utility’s imprudent allocation, Mr. Mierzwa testified that Manlove storage could replace some of the Company’s baseload gas supply purchases and some of its swing supply purchases. Mr. Mierzwa calculated his disallowance using index prices that are applicable to baseload supplies.

While the dollar impact of the utilities’ imprudent storage practices did not warrant a disallowance in the 2005 reconciliation period, the impact of that imprudent pre-allocation during the 2006 reconciliation period was significant. Because gas prices were at record highs during the winter of 2005-06, as a result of Hurricane Katrina, the adverse impact of the

Company's use of 10 Bcf of storage for Hub activities on gas costs of sales customers was approximately \$23.6 million. CUB-City-AG Ex. 1.0 at 6, LL. 125-128. Because \$9.7 million in revenues associated with the Company's Hub transactions during this period are required to be credited against recoverable gas costs, pursuant to the Commission's Settlement Order in Docket No. 01-0707, Mr. Mierzwa originally calculated the net adverse impact of Peoples Gas' provision of park and loan and Hub services to be about \$13.9 million. *Id.* at 6, LL. 131-134. This calculation was based on the Company's original response to CUB data request 3.20, which provided park and loan Hub revenues from transactions initiated during the reconciliation period but not concluded until after the end of the reconciliation period.⁵

After Mr. Mierzwa's rebuttal testimony was filed, Peoples Gas served CUB with a revised response to CUB data request 3.20, which showed an increase in Hub revenue of \$2,900,135 above the amount in the utility's original response to CUB 3.20⁶. Again, because Hub revenues are credited against PGA gas costs, Mr. Mierzwa's recommended disallowance must be modified to account for the Company's change in Hub revenue calculation. Thus, Mr. Mierzwa's recommended disallowance changes from \$13,927,631 to \$11,027,496.

Peoples Gas witness Mr. Dobson took issue with Mr. Mierzwa's approach, insisting that Manlove is a baseload facility only. Mr. Mierzwa testified, however, that "the Company does not operate Manlove storage as a baseload facility." CUB-City-AG Ex. 2.0 at 13, LL. 274-275. In examining daily withdrawals from Manlove during the 2005-2006 winter, Mr. Mierzwa observed that Manlove storage not only displaces baseload supplies, but also eliminated the need to purchase a portion of the Company's swing supplies. *Id.* at 13, LL. 278-280. Mr. Dobson, in

⁵ This response is attached as Attachment A to this brief. CUB filed an uncontested Motion to Admit Late-filed Stipulated Exhibit Into the Record on January 27, 2009, which has not yet been ruled on. Thus, it remains an issue as to whether this exhibit is record evidence.

⁶ For a total of \$6,449,355. This response is also attached to this brief, as Attachment B.

fact, admitted that deliveries from Manlove can fluctuate on a daily basis. Tr. at 44⁷. On cross-examination, Mr. Dobson also acknowledged that, while the Company owns Manlove Field, it obtains transportation capacity or interstate storage leased capacity services by contract, and the terms of those contracts may limit when the Company can access gas that is stored or available under such resources. Tr. at 74-75. Nonetheless, whether Manlove is a baseload facility, a baseload facility with daily fluctuations, or a swing facility is irrelevant to the determinations the Commission must make in this proceeding.

D. Peoples Gas Imprudently Allowed 3rd Parties to Benefit from Seasonal Price Differences Rather than Ratepayers.

Mr. Mierzwa testified that seasonal price difference in gas prices largely drive the demand for park and loan Hub services because gas marketers try to capitalize on seasonal differences in gas prices. CUB-City-AG Ex. 1.0 at 6, LL. 138-141. Peoples Gas' revenues for park and loan Hub services are affected by the magnitude of the seasonal price differences.⁸ For example, in late February 2005, which is when purchases for gas to be delivered in March 2005 would be made, the market price for December 2005 delivered gas, as posted on the New York Mercantile Exchange ("NYMEX"), was approximately \$7.70 per Dth. *Id.* at 6-7, LL. 141-143. At the same time, the NYMEX price for March 2005 delivered gas was approximately \$6.30 per Dth. *Id.* at 7, LL. 144-145. In this example, a gas marketer could have capitalized on this expected \$1.40 per Dth seasonal price difference by purchasing Peoples Gas' Hub services. *See id.* at 7, LL. 145-147. A counter party could exploit this seasonal price difference, (i.e. the difference between March and December 2005 prices), by entering into a park arrangement with Peoples Gas to deliver gas to Peoples Gas in a lower-cost month (March) and have that gas

⁷ Mr. Dobson agreed that the Company engages in swing purchases, where the quantity purchased each day can vary.

⁸ Prices for hub services are negotiated by the counter party and Peoples Gas.

returned in a higher cost month (December), when the counterparty could sell the gas for a significant profit.

In fact, Peoples Gas entered into three Hub park arrangements nearly identical to those described above, which provided for the delivery of gas to the utility in March 2005 and the return of that gas to the counter-party in December 2005. Peoples Gas only received \$0.665 per Dth for these three park arrangements, not the actual seasonal price difference of \$1.40 per Dth which existed at this time. Had the Company used the portion of Manlove storage it used for providing these Hub services to instead serve sales customers, the entire \$1.40 per Dth would have accrued to the benefit of ratepayers. Instead, ratepayers only received \$0.665 per Dth in Hub service revenue. This example clearly demonstrates the inherent problem in the Company's failure to optimize Manlove Field for the benefit of ratepayers identified by Mr. Mierzwa: "ratepayers would typically realize greater benefits if Manlove storage were utilized to serve them rather than to provide Hub services." *Id.* at 7, LL. 165-166.

E. Peoples Gas' Criticisms of Mr. Mierzwa's Adjustment Are Incorrect and Should be Ignored

Peoples Gas witness Mr. Dobson claimed that Mr. Mierzwa's recommended disallowance did not take into effect additional costs that the utility would incur to support increased use of Manlove Field for sales customers in the form of additional purchase gas and pipeline transportation costs to get gas to the citygate. He then, however, states that these costs would be the same. Mr. Dobson also claims that the Company would incur additional injection fuel costs and carrying costs. PG Ex. 3.0 at 6, LL. 119-121. Mr. Mierzwa responded to these claims by pointing out that the total purchased gas and pipeline transportation costs would be lower if the Company used Manlove solely to serve sales customers, because more of those purchases would be made in typically lower-cost summer months. CUB-City-AG Ex. 2.0 at 4,

LL. 77-81. In addition, the injection fuel and carrying costs that Mr. Dobson claims Peoples Gas would incur are costs recovered through base rates – not the PGA. *Id.* at 5, LL. 106-107.

However, if the Commission determines that the costs associated with fuel and carrying charges should be considered, Mr. Mierzwa calculated the impact of such costs to be \$4.9 million.

Mr. Dobson further criticized Mr. Mierzwa's calculations as incorrectly assuming that "the transactions could be done at exactly the prices he quotes and at the times that are optimum." PG Ex. 3.0 at 7, LL. 124-125. Mr. Dobson's criticisms are misplaced, because Mr. Mierzwa's adjustment assumes that the utility used Manlove Field storage assigned to park and loan Hub services to serve system supply in the same manner it was used to provide park and loan Hub services. Because it is impossible to perform an exact accounting of what would have happened had Manlove Field been optimized to the benefit of ratepayers, some substitute calculation must be performed. Nonetheless, even if Mr. Mierzwa were to have instead based his adjustment calculations on the Company's planned Manlove storage injection and withdrawal activity, rather than the actual park and loan activity, Mr. Mierzwa's recommended adjustment would not differ significantly. Thus, the \$11,027,496 adjustment proposed by Mr. Mierzwa in this proceeding is reasonable. CUB-AG-City Ex. 2.0 at 7, LL. 149-151. Notwithstanding this fact, if the storage assigned to Hub services were used to serve system supply consistent with planned Manlove storage activity, the net adverse impact would have been \$7.0 million, rather than Mr. Mierzwa's revised calculation of \$11.0 million, which was based on actual activity (each of these figures is \$2.9 million less than the figures included in Mr. Mierzwa's rebuttal testimony due to the \$2.9 million adjustment discussed above related to the revised response to CUB 3.20). CUB-City-AG maintain, however, that Mr. Mierzwa's Schedule JDM-2 is the most reasonable calculation of the impact of Peoples Gas' imprudent storage activity.

F. Mr. Dobson's Claim that Mr. Mierzwa Miscalculated Hub Services Revenues is Without Merit

Mr. Dobson incorrectly argued that the total Hub services revenue relevant to this proceeding are actually about \$27.5 million and not the \$9.7 million reflected in Mr. Mierzwa's calculations. PG Ex. RD 3.0 at 8, LL. 156. Mr. Dobson's claimed Hub services total revenue, however, includes revenues from Hub services other than park and loan transactions and appears to reflect revenues from park and loan transactions initiated and concluded prior to the reconciliation period, a fact he did not dispute on cross-examination. CUB-City-AG Ex. 2.0 at 9, LL. 181-184; Tr. at 65-66 (December 11, 2008). In fact, when asked whether he would agree that park and loan transactions that are initiated and completed prior to the reconciliation period cannot have an impact on reconciliation period gas costs, Mr. Dobson testified "from an accounting basis, yes. From an operational basis, those activities need to be taken into account." Tr. at 66.

The purpose of Mr. Mierzwa's calculation is to demonstrate the economic impact on sales customers' gas costs of Peoples Gas' imprudent use of Manlove Field during the reconciliation period. Mr. Mierzwa's recommended disallowance includes park and loan transactions that were (1) initiated prior to the reconciliation period and concluded during the reconciliation period; (2) initiated and concluded during the reconciliation period; and (3) initiated during and concluded after the reconciliation period. CUB-City-AG Ex. 2.0 at 9, LL. 171-174. The operational concerns expressed by Mr. Dobson are not relevant to this calculation. Mr. Dobson's calculation of Hub revenues is inappropriate because transactions that did not occur during the reconciliation period are not relevant to the Commission's determinations for this reconciliation period.

Mr. Dobson's claimed \$27.5 million in Hub revenues also inappropriately includes revenues realized from Hub services other than park and loan services, *i.e.* transportation service and interruptible storage service. Mr. Mierzwa responded that

These revenues should not be considered as an offset to the adverse impact of park and loan services because revenues from these other Hub services would have been credited against recoverable gas costs regardless of whether the Manlove storage used to provide park and loan services was used for that purpose or to serve system supply.

CUB-City-AG Ex. 2.0 at 10, LL. 201-206. Mr. Mierzwa's adjustment is based on the Company's actual reconciliation period park and loan activity only because the revenues from other Hub services would be credited against recoverable gas costs whether or not Manlove was used for sales customers. *Id.* at 11, LL. 221-222. Thus, revenues from transportation and interruptible storage services are not relevant to Mr. Mierzwa's recommended adjustment to account for the Company's imprudent use of storage assets.

The substantial evidence of the record shows that Peoples Gas' pre-allocation of the amount of storage available for system supply for Hub services was imprudent and negatively impacted ratepayers. For all of the reasons cited above, Mr. Mierzwa's modified disallowance of \$11,027,496 in imprudent costs attributable to Peoples Gas' imprudent provision of Hub services and allocation of Manlove storage should be adopted by the Commission.

III. REBILLING ADJUSTMENT

In Peoples Gas' 2005 reconciliation proceeding, the Commission disallowed \$6,942,621 due to the Company's failure to appropriately track its banked gas over an unknown period of time consisting of at least several years. ICC Docket No. 05-0749, Order at 9 (January 16, 2008). Additionally, the Commission disallowed \$812,385.99 in costs related to the 2004 fiscal

year. *Id.* at 11. In this proceeding, CUB-City witness Mierzwa and Staff witness Dianna Hathhorn both concluded that a disallowance of \$571,933.44 is appropriate in this reconciliation period, as the liability was accrued during the periods prior to the 2006 reconciliation period. CUB-City-AG Ex. 1.0 at 12, LL. 258-263; Staff Ex. 1.0 at 5-6, LL. 104-121. The Company does not oppose this recommended disallowance. PG Ex. CG-3.0 at 2.0, LL. 19-20. Therefore, the Commission should adopt the recommendation of CUB-City-AG and Staff to disallow \$6,942,621 for the banked gas adjustment.

CONCLUSION

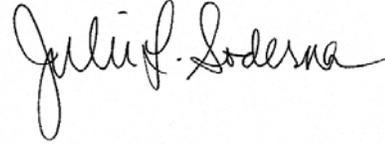
For the reasons set forth above and in testimony, the Commission should disallow \$11,027,496 in imprudent costs attributable to Peoples Gas' imprudent provision of Hub services and allocation of Manlove storage. The Company's current practice of predetermining the quantity of Manlove storage used to serve system supply in its dispatch model is unreasonable. The Commission should require the Company to run its dispatch planning model and determine its on-system Manlove storage assignments in a manner that complies with least-cost procurement principles for system supply. With respect to the Company's proposed rebilling adjustment, the Commission should disallow \$571,933.44, as agreed by the Company, CUB-City-AG and Staff.

WHEREFORE, the Citizens Utility Board, the City of Chicago and the People of the State of Illinois respectfully request the Commission to adopt the positions in this Initial Brief.

February 6, 2009

Respectfully submitted,

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