

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission)	
on its own motion)	Docket No. 01-0705
)	
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	
)	
Illinois Commerce Commission)	
on its own motion)	Docket No. 02-0067
)	
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Proceeding to review Rider 4, Gas Cost, pursuant)	
to Section 9-244(c) of the Public Utilities Act)	
)	
Illinois Commerce Commission)	
on its own motion)	Docket No. 02-0725
)	
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	

REVISED
DIRECT TESTIMONY ON REOPENING
OF
RICHARD J. ZURASKI

Senior Economist
Illinois Commerce Commission
Energy Division—Policy Section

March 9, 2011

****PUBLIC VERSION** (Marked by XXXXX)**

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1 **I. Witness Qualifications**

2 **Q. State your name and business address.**

3 A. Richard J. Zuraski, Illinois Commerce Commission, 527 East Capitol Avenue,
4 Springfield, Illinois, 62701.

5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by the Illinois Commerce Commission (“Commission”) as a
7 Senior Economist in the Energy Division’s Policy Program.

8 **Q. What are your responsibilities within the Energy Division’s Policy Program?**

9 A. I provide economic analyses and advise the Commission on issues involving the
10 gas and electric utility industries. I review tariff filings and make recommendations to
11 the Commission concerning those filings. I provide testimony in Commission
12 proceedings. In selected cases, I sometimes act as an assistant to Commissioners or to
13 administrative law judges.

14 **Q. State your educational background.**

15 A. I graduated from the University of Maryland with a Bachelor of Arts degree in
16 Economics. I obtained a Masters of Arts degree in Economics from Washington
17 University in St. Louis. I completed other work toward a doctorate in economics from
18 Washington University, but did not complete all requirements for that degree.

19 **Q. Describe your professional experience.**

20 A. Since December 1997, I have been a Senior Economist in the Policy Program of
21 the Commission’s Energy Division. I held the same position from February 1990 to

22 December 1997, in the Commission’s Office of Policy and Planning (prior to its
23 incorporation into the Energy Division). Before that, I held positions in the
24 Commission’s Least-Cost Planning Program and Conservation Program. While
25 employed by the Commission, I have testified in numerous docketed proceedings before
26 the Commission. Prior to coming to the Commission in November 1987, I was a
27 graduate student at Washington University, where I taught various courses in economics
28 to undergraduate students in the Washington University night school and summer school.

29 **II. Purpose of Testimony and Background Information**

30 **Q. What is the subject matter of your testimony on reopening?**

31 A. This testimony concerns the investigation by Staff members assigned to this case
32 (“Staff”) of Nicor Gas Company (“Nicor Gas” or “the Company”), the costs included in
33 the Company’s purchased gas adjustment clause (“PGA”) in 1999 through 2002, and the
34 Company’s Gas Cost Performance Program (“GCPP” or “Program”), which was in effect
35 in 2000, 2001, and 2002. This investigation started following the revelation by CUB of a
36 fourteen-page fax (“the whistle-blower fax”). The fax had been sent to CUB on June 21,
37 2002 by an anonymous source who accused Nicor of certain perceived improprieties
38 surrounding the GCPP.

39 **Q. In a case like this, what do you rely upon to conduct your investigation?**

40 A. To a large extent, I rely upon information provided by the utility. I send out data
41 requests and rely upon utility personnel being forthright and accurate in their responses.
42 Typically, there is no independent third party source. The information I need is about the
43 public utility and is only available from the public utility. In this case, I also relied upon
44 the deposition testimony of a number of Nicor employees and officers.

45 In this case, I also had access to the Whistle Blower Fax and the “Report of the
46 Special Committee of the Board of Directors of NICOR Inc.,” by Scott Lassar of Sidley
47 Austin Brown & Wood, LLP, dated October 28, 2002 (“the Lassar Report”),¹ both of
48 which I utilized only to identify potentially fruitful lines of inquiry.

49 **Q. Please provide a brief history of GCPP proceedings before the Commission.**

50 A. The GCPP was approved by the Commission at the end of November 1999, in its
51 Docket 99-0127 Order, and went into effect on January 1, 2000. Two years later, the
52 Commission initiated Docket 02-0067, pursuant to Section 9-244 (c), to determine
53 whether the GCPP was meeting its objectives and to identify any revisions necessary to
54 result in the program meeting its objectives. Testimony was filed and the record marked
55 heard and taken. After the existence of the whistle-blower fax was brought to the
56 Commission’s attention, eventually Docket 02-0067 was reopened and consolidated with
57 the PGA reconciliation dockets 01-0705 (2001) and 02-0067 (2002). Since the Company
58 and Staff have both identified adjustments to the 1999 and 2000 PGAs, arising from this
59 investigation, the 1999 and 2000 PGA reconciliation dockets should also be reopened
60 after the Commission makes a decision in this proceeding.

61 **Q. Please provide an overview of the GCPP.**

62 A. The GCPP is a performance-based regulation (“PBR”) program in which the
63 Company shares in gas cost “savings” (whether they are negative or positive).² Savings
64 are defined as the difference between a multi-part benchmark (which I will describe in
65 the next question and answer) and the actual gas costs that are accounted for using the

¹ Stipulated Exhibit 6

² In this testimony, I use the terms “GCPP” and “the PBR program” interchangeably.

66 standard PGA. The computation of savings takes place at the end of the calendar year
67 and the Company's share of savings is added into (for positive savings) or subtracted
68 from (for negative savings) the following year's rates. The Company's share is 50
69 percent.

70 **Q. Please provide an overview of the multi-part benchmark used in this Program.**

71 A. The GCPP's benchmark gas cost is: a "Market Index Cost" minus a "Storage
72 Credit Adjustment" plus a "Firm Deliverability Adjustment" plus a "Commodity
73 Adjustment."

74 The Market Index Cost ("MIC") is the sum (over the 12 months of the year) of a
75 monthly market price index times the actual monthly quantity of gas delivered to
76 customers. The monthly market price index is an average of several different daily and
77 first-of-the-month published price indexes.

78 The Storage Credit Adjustment ("SCA") represents the difference in the value of
79 gas when it was withdrawn from storage and the value of gas when it was injected into
80 storage. This difference fluctuates from year to year simply due to the movement in
81 market prices. The SCA, for any given year, equals a weighted average price differential
82 times the actual annual withdrawals from storage. The weights were fixed in Docket 99-
83 0127.

84 The Firm Deliverability Adjustment ("FDA") represents various costs accounted
85 for within the purchased gas adjustment clause that are more dependent upon forecasted
86 maximum demand levels than actual demand levels. In Docket 99-0127, the Commission
87 set the level of the "FDA" at a lump sum of \$116,582,612 per year (where it remained
88 throughout the life of the program).

89 The Commodity Adjustment (“CA”) is basically a catch-all or residual
90 adjustment. In Docket 99-0127, a CA rate was set to a level of 1.68 cents per MMBTU,
91 which, on average, over several historical years, would have equated the total benchmark
92 gas costs with the Company’s actual historical gas costs. That is, the average savings
93 would have been zero. During each of the three years that the Program was in existence,
94 the CA has been 1.68 cents per MMBtu times the actual number of MMBtu delivered to
95 customers during the year.

96 **III. Summary of Conclusions and Recommendations**

97 **Q. Please summarize your conclusions and recommendations.**

98 A. According to Nicor witness Bartlett, “Nicor Gas is seeking Commission approval
99 to collect a net amount of \$5,963,283 from its customers.” (Bartlett Direct, Nicor Gas Ex.
100 1.0, p.5). In contrast, Staff is seeking a refund to customers of \$100,247,659. This
101 refund is due to numerous adjustments, which I summarize as follows:

102 **A)** From the start of Docket 99-0127, through June of 2002 in Docket 02-0067, the
103 Company withheld crucial information concerning plans to tap into low cost LIFO
104 (last-in first-out) layers in storage inventory. Of course, LIFO is an abstract
105 accounting concept rather than a physical aspect of storage inventories. In essence,
106 the Company discovered a way to profit through the GCPP with virtually no effort,
107 through net withdrawals of old gas (purchased well before the PBR program went
108 into effect) that originally cost the Company less than 40 cents per MMBTU. Under
109 the GCPP, this old 40 cent gas would be compared to a contemporary market price
110 index that ranged between \$2 and \$10 per MMBTU. Under such circumstances,
111 creating “savings” could not have been easier. Subsequent Company-proposed

112 accounting adjustments--reversing the original accounting of a 1999 sale to a firm
113 called IMD of NGPL storage gas and of various "pre-fill" deals--had a significant
114 effect on the size of the net withdrawals (in fact, eliminating them for 2001).
115 However, in 2000 and 2002, even after those accounting adjustments, there are still
116 significant net withdrawals of the old inexpensive gas. I recommend that the
117 Commission modify the share-the-savings formula for 2000 through 2002 to
118 eliminate the Company's share of savings due specifically to the difference between
119 the market cost of gas and the revised inventory price of the revised net withdrawals
120 from storage. The effect of this adjustment is a refund to customers of \$21,871,934.
121 No comparable adjustment is included in the Company's reopening testimony.

122 **B)** The 2000 through 2002 GCPP benchmarks (specifically, the storage credit
123 component of the benchmarks) were improperly and inaccurately computed by the
124 Company, leading to substantial errors in the computation of "savings" under the
125 Program. In particular, the Company improperly subtracted "infield transfers" from
126 gas withdrawals. In addition, except when it added back "virtual storage," the
127 Company improperly ignored storage withdrawals by IMD (the firm to which Nicor
128 Gas released substantial quantities of storage capacity just prior to the beginning of
129 the program). Furthermore, the Company failed to inform the Staff about these
130 matters until some time after July 2002. These errors generally raised the benchmark
131 and thus inflated the computation of "savings." The Company now proposes several
132 changes in the benchmark that only partially address Staff's concerns. Over the three
133 years of the PBR program, the Company's originally-computed storage credit
134 component of the benchmark led to a combined credit (2000 through 2002) of about

135 \$2 million. In contrast, the Company's re-opening restatement of the benchmark
136 leads to a combined storage credit of about \$38 million. However, my computations
137 lead to a combined storage credit of about \$79 million. Given the 50-50 sharing
138 formula, the effect of my adjustment is a net refund of \$38,520,976. Compared to the
139 Company's reopening testimony, this amounts to an additional refund of
140 \$20,607,725.

141 **C)** Nicor Gas took actions that led to an increase in the cost of gas included in the PGA
142 by engaging in at least one transaction with an affiliate (NICOR Enerchange) in
143 which Nicor Gas sold gas to Nicor Enerchange for future delivery at a price
144 demonstrably less than the spot price of gas at the time of the transaction, the
145 prevailing prices of futures contracts for the delivery months, and the eventual spot
146 prices prevailing at the time of actual delivery. I recommend that the \$8,517,172 of
147 excess costs incurred as a result of this transaction be subtracted from allowable PGA
148 gas costs. This leads to an additional refund to customers of \$4,258,586 (half the
149 excess costs incurred as a result of this transaction). No comparable adjustment is
150 included in the Company's reopening testimony.

151 **D)** The Company took actions that led to an increase in the cost of gas included in the
152 PGA by engaging in at least one transaction where Nicor Gas received a discount on
153 a non-PGA purchase of weather insurance in exchange for providing the vendor
154 (Aquila) with a discount on a sale of gas. I recommend that the \$6,115,050 increase
155 in gas costs that resulted from this transaction be subtracted from allowable PGA gas
156 costs. This removal leads to a refund of \$3,057,525 (half the estimated increase in
157 gas costs). In comparison, the Company makes an adjustment associated with the

158 Aquila transaction, but computes it to be only \$1 million, so my adjustment amounts
159 to an additional refund of \$2,057,525 not included in the Company's reopening
160 testimony.

161 **E)** The Company structured several deals--involving the release of NGPL purchased
162 storage--that shifted the burden of carrying charges from the Company's base rate
163 accounts to the PGA accounts. Arguably, the Company recovered carrying costs both
164 in its existing base rates and in the PGA. In any event, recovery of carrying costs
165 through the PGA is not permitted under Commission rules. Thus, I recommend the
166 reversal of the inclusion of these carrying charges in the PGA. This reversal leads to
167 a refund of \$2,049,913 (half the carrying charges removed from the PGA). No
168 comparable adjustment is included in the Company's reopening testimony.

169 **F)** The Company made an error in the reporting of 2001 deliveries of PGA gas to
170 customers. This error increased the benchmark and thus inflated the computation of
171 2001 "savings" by approximately \$2.3 million, leading to an overpayment by
172 ratepayers of one-half this figure. I recommend that ratepayers receive a refund for
173 the 2001 overpayment to the Company. The Company's re-opening restatement of
174 the 2001 benchmark adequately addresses this concern and results in a refund of
175 \$1,160,484, which the Staff accepts.

176 **G)** The Company erred by excluding certain Nicor Hub services revenues from the PGA.
177 Correcting for this leads to a cost reduction adjustment of approximately \$10.3
178 million between the beginning of 1999 and the end of 2002, with about \$1.9 million
179 of that total applicable to 1999, and the remaining \$8.4 million of that total applicable
180 to the PBR period 2000-2002. After taking into account the effect of the GCPP's 50-

181 50 sharing mechanism, the refund due to ratepayers would be \$6,150,917. No
182 comparable adjustment is included in the Company's reopening testimony.

183 **H)** As noted earlier, the Company made several accounting adjustments, which had
184 effects on both the storage credit adjustment component of the benchmark and on
185 costs. The changes with respect to the storage credit adjustment component of the
186 benchmark have already been discussed (see item B, above). The accounting
187 restatement's direct effect on gas costs was a decrease of \$13,751,764 in 1999 and an
188 increase of \$57,622,435 in 2000 through 2002. Taking all of the former and one-half
189 of the latter, the net change in the PGA gas costs, after PBR sharing, is \$15,059,454.
190 This net increase is due primarily to less of the low-cost gas being withdrawn from
191 older LIFO layers of the storage inventory. Staff is not disputing this restatement.

192 **D)** According to Staff witness Maple, there should be additional refunds of \$10,584,907
193 due to adjustments to the benchmark in 2000 through 2002, as well as to gas costs in
194 1999. No comparable adjustment is included in the Company's reopening testimony.

195 **J)** According to Staff witness Knepler, there should be additional refunds associated
196 with lost storage gas, the cost of which the Company has been including in the PGA.
197 In consultation with Mr. Knepler, I computed the cost of this lost storage gas and
198 removed it from recoverable PGA costs. This leads to an adjustment of \$18,667,265.
199 No comparable adjustment is included in the Company's reopening testimony.

200 **Summary.** To summarize, all the above adjustments amount to a subtotal of
201 \$91,263,052 to be refunded to customers. After netting off (i) a Company-computed
202 undercharge of \$1,329,699 from the originally booked 2001 savings and (ii) the

203 Company's originally-computed 2002 PBR savings of \$26,875,870³, and then adding (iii)
204 a Company-computed \$18,793,860 "PGA Adjustment to reflect 2002 Final Gas Costs,"
205 the total amount to be refunded, before taking into account interest, is \$81,851,343.
206 Taking into account interest accrued through December 31, 2009, pursuant to 83 Ill.
207 Adm. Code 280.70, the final Staff proposed refund is equal to \$102,569,024. These
208 figures are presented in tabular form in varying degrees of detail in the seven attachments
209 found at the end of this testimony.

210 **IV. Corrections and Adjustments to Storage Inventory, Gas Costs, and the**
211 **PBR Benchmark**

212 **A. LIFO-derived Savings**

213 ***1. Basic Explanation of the LIFO Savings Issue***

214 **Q. What was the plan for generating easy no-risk savings by tapping into low-cost**
215 **LIFO layers of its storage inventory?**

216 **A.** At the end of 1998, just before the Company made its GCPP filing, there was a
217 significant range in the per unit gas costs of its gas in storage. The following table shows
218 the years in which annual injections exceeded annual withdrawals, the per unit cost of gas
219 associated with each of these "LIFO layers," and the number of therms in each layer.

³ The Company did not seek to recover its share of the originally-computed 2002 savings during 2003, so the amount remains uncollected, to date. Adjustments in my testimony lead to a corrected version of 2002 savings.

Year(s) of net injection	LIFO Layer Prices	31-Dec-98
	<i>\$/Therm</i>	<i>Therms</i>
2/1/54	0.01882	350,145
2/1-12/31/54	0.02142	6,801
1955	0.02388	29,967
1956	0.02391	24,171
1959	0.02565	477,564
1960	0.02872	530,700
1961	0.02958	27,198
1962	0.02857	38,230
1963	0.02936	12,315,551
1964	0.02895	27,585,092
1965	0.02884	63,629,015
1966	0.02802	28,141,967
1967	0.02818	3,543,990
1968	0.02628	165,383,411
1969	0.02881	71,993,124
1970	0.03102	282,791,456
1971	0.03638	52,837,489
1973	0.04541	35,397,594
1984	0.32315	166,310,843
1996	0.28757	101,399,732

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A net injection in any given year creates a new inventory layer, based on the average cost of purchases in that year. Conversely, a net withdrawal (not shown in the table) results in an inventory reduction, on a last-in first-out (LIFO) basis. Thus, the most recent layers are depleted first. As the 1999 gas year was beginning, there was a significant difference between the price of gas in the last two layers (1996 and 1984) and all the layers created prior to 1984.

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Since July 2002, it became clear to Staff that the Company placed great significance on the opportunity presented by PBR to tap into the difference between contemporary market prices, which would be reflected in the PBR benchmark, and the extremely low prices that were embedded in the Company's pre-1984 storage inventory layers.⁴ The Company was clearly developing the strategy as early as October 1998,

⁴ For example, in a Post Board Information Meeting agenda handout,

232 when a so-called “Inventory Value Team” issued a report to upper management at Nicor
233 focusing on this opportunity.⁵ About four months later, on March 1, 1999, the Company
234 filed its petition to initiate the PBR program.

235 To maximize shareholders’ ability to profit from the difference between current
236 market prices and the pre-1984 storage inventory prices, the Company first had to find a
237 way to brush aside the last two relatively high-priced LIFO layers (i.e., the 1984 and
238 1996 layers). It assured this in December 1999 (just days before the PBR program went
239 into effect) by transferring a large quantity of gas (and capacity) from an NGPL storage
240 account to a firm called IMD. Once that was accomplished, though, the Company would
241 be able to show PBR “savings” in 2000 and beyond by engaging in so-called “pre-fill”
242 deals. These pre-fill deals allowed Nicor to maintain normal physical storage operations
243 while still showing extraordinary net withdrawals, due to the manner in which the
244 Company accounted for the deals. The December 1999 transaction and the pre-fill deals
245 will be explained in greater detail later in this section.

246 Whether Nicor planned all along to generate substantial savings from the low-cost
247 LIFO layers or to simply use them as insurance against other risks, Nicor did in fact end
248 up relying heavily on the LIFO strategy. For 2000 and 2001, prior to the Company’s re-
249 opening accounting restatement, the “savings” attributable to the LIFO strategy were

(NIC 115049)

⁵ The Inventory Value Team Report (Stipulated Exhibit 1) was provided to Staff as NIC 049924-049937, in response to a data request. The first page in the body of the report states, in part, “The ‘top’ 30% of our LIFO layers are priced at close to market value. The ‘bottom’ 70% of our LIFO layers are priced significantly below market value. There is about 75 BCF of gas in these lower priced layers, with market value of about \$100-200 million in excess of cost. ... We recommend that the Company ‘capture’ the LIFO inventory value by filing and implementing a Gas Rate Performance Plan (GRPP) related to gas costs.” (NIC 049926)

250 approximately \$61 million, half of which would be retained by the Company.⁶ And yet,
251 prior to July 2002, the Company never revealed the LIFO strategy to Staff. In fact, an
252 internal memorandum reveals that a key Company employee recognized a need not to
253 highlight the LIFO benefit to Staff.⁷ This planned evasiveness about the LIFO strategy
254 was corroborated by several Nicor employees and managers during depositions.⁸ The
255 evasive tactics continued even after the whistle-blower memo was revealed (June 2002)
256 and the Company pledged to cooperate with Staff's investigation.⁹

⁶ In comparison to the \$61 million in pre-restatement LIFO strategy savings, total pre-restatement savings over the first two years was about \$54 million; so all other strategies combined produced net losses of about \$7 million.

⁷

(Stipulated Exhibit 19, NIC 011421, last paragraph).

⁸

⁹ For instance, in its October 10, 2002 response to Staff data request ICC 9.02 (h), where Nicor was asked to explain why the Company found it desirable to utilize Customer Owned Prefills rather than simply purchase gas and inject it into storage, the Company never mentioned that the pre-fill deals were the mechanism by which the Company was able to gain control over the LIFO layers. Instead, the Company vaguely noted:

The Company was also asked, in ICC 9.02 (i), to explain why, over 2000 and 2001, significantly more gas was shown to have been injected as "Customer Owned Prefill" than purchased by the Company as "Prefill Purchases." The real answer is that this is how the Company was able to create net withdrawals within each of those calendar years and hence dip into the LIFO layers. But the Company's response was simply

257 Overall, the strategy seems to have been the Company's proverbial ace-in-the-
258 hole. Indeed, examination of the Company's so-called "Buckets Reports" (which the
259 Company began creating by the first quarter of 2001 but were provided to Staff only after
260 the whistle-blower fax was sent), reveal how the Company would first project its PBR
261 performance without any LIFO decrement, under both best-case and worst-case
262 scenarios, and Nicor would then compute the amount of LIFO inventory it would need to
263 withdraw in order to reach a pre-determined PBR savings goal. For example, in
264 May/June of 2001, a Buckets Report projected 2001 annual PBR performance without
265 the LIFO inventory decrement to range between a worst-case of [REDACTED]
266 [REDACTED]
267 [REDACTED]
268 [REDACTED]
269 [REDACTED]
270 [REDACTED]
271 [REDACTED].¹⁰

272 **Q. You mentioned that the Company was able to brush aside the last two relatively**
273 **high-priced LIFO layers by transferring a large quantity of gas (and capacity) from**
274 **an NGPL storage account to a firm called IMD, in December 1999, days before the**
275 **PBR went into effect. Would you please elaborate on that transaction?**

[REDACTED]

¹⁰ KPMG 024442. Another example is [REDACTED]
[REDACTED] (NIC 008551). For other examples, see footnote 31.

276 A. Company records show that Nicor Gas transferred to IMD a significant amount of
277 storage capacity in a DSS storage service account with pipeline company NGPL. Along
278 with the capacity, the Company transferred to IMD 18.8 million MMBTU of gas held in
279 inventory.¹¹ The transaction significantly contributed to a large net withdrawal from
280 storage inventory in 1999.¹² This net withdrawal enabled the Company to completely
281 eliminate the two high-priced storage inventory layers that existed as of the beginning of
282 1999: the 29 cent per therm 1996 layer and the 32 cent per therm 1984 layer. As
283 previously noted, this positioned the Company to begin withdrawing the much lower-
284 priced gas in the pre-1984 layers of the inventory during the tenure of the PBR program,
285 where the Company would be able to share in half the “savings” from ostensibly avoiding
286 the purchase of higher-cost gas at contemporary market prices.

287 **Q. What was wrong with this sale to IMD in December 1999?**

288 A. The timing of the sale saddled ratepayers with the entire burden of the high-priced
289 gas layers, after which the Company would then take half the windfall savings associated
290 with withdrawing the remaining low-priced inventory.

291 **Q. How should the December 1999 IMD transaction now be addressed?**

292 A. I believe the Company’s accounting restatement adequately addresses the
293 transaction.

294 **Q. How has the Company addressed this sale to IMD in its re-opening accounting**
295 **restatement?**

¹¹ Before the end of the year, Nicor bought some of that 18.8 million MMBTU of gas back from IMD at the same price, so the net sale in December 1999 was for 16.1 million MMBTU.

¹² The December net sale of 16.1 million MMBTU to IMD formed 58% of Nicor’s 1999 total net withdrawals from storage (pre-restatement).

296 A. The Company's restatement basically pretends that the sale never took place.
297 Instead, the Company's restatement pretends that the sale to IMD was actually a loan
298 from IMD (in order to account for the influx of cash in December 1999). What were
299 subsequent purchases from IMD are now treated, under the restatement, as "loan"
300 repayments. By reversing the sale to IMD in 1999 and the subsequent repurchases of that
301 gas, the restatement also decreases net withdrawals from storage in 1999 and increases
302 them in 2000. The net effect of the restatement is to postpone until 2000 the inclusion in
303 the PGA of the December 1999 accounting losses. Since half of all losses in 2000 were
304 shared with ratepayers, this approach leads to a net rate reduction of about one-half the
305 original losses (approximately one-half of \$13 million).

306 **Q. Earlier, you mentioned the Company's "pre-fill" deals. Can you elaborate on the**
307 **apparent purpose of these deals?**

308 A. As previously noted, the Company was keen to increase its net withdrawals from
309 its storage inventory during the life of the PBR program. This would generate PBR-
310 recognized "savings" as the GCPP mechanism implicitly compared contemporary market
311 prices to the much lower prices that existed in the 1960s and early 1970s, when the
312 relevant LIFO layers of the storage inventory were created. The pre-fill deals gave the
313 Company greater control over annual net withdrawals, without jeopardizing any
314 operational priorities. In addition, the pre-fill deals enabled the Company to double-
315 collect for carrying charges.

316 **Q. How did the pre-fill deals give the Company greater control over annual net**
317 **withdrawals?**

318 A. In effect, the strategy was to purchase significant quantities of gas on credit. That
319 is, the seller would deliver the gas to the Company at one point in time, but Nicor Gas
320 would pay them for it at a later point in time. In fact, significant quantities were not paid
321 for until the following year or later. By the end of 2002, the Company had still not paid
322 for most of the gas delivered to the Company as “pre-fill.”

323 From a storage *accounting* standpoint, while pre-fill deliveries were contributing
324 to the increase in the Company’s storage inventory throughout the year, they were also
325 being explicitly deducted. That is, they were being treated as transportation customer-
326 owned injections and, as such, were deducted from total physical injections. They were
327 not added back again until the Company eventually paid the vendor for the gas.
328 Nevertheless, it is important to understand that the pre-fill deliveries and the later pre-fill
329 purchases are not explicitly tied to any physical storage activity; that is, they cannot be
330 tangibly matched with injections and withdrawals, respectively. From a storage
331 *accounting* standpoint, though, subtracting *X* therms and always adding back *less than X*
332 therms, in any given year, effectively decreases “net injections,” or stated equivalently,
333 increases “net withdrawals” for that year. Thus, lagging pre-fill purchases behind pre-fill
334 deliveries enabled the Company to control the size of net withdrawals and extract more
335 from its heirloom LIFO layers.

336 **Q. Is there anything wrong with the pre-fill accounting, described above?**

337 A. This issue is addressed by Staff accounting witness Mary Everson. However, it is
338 my understanding that for most of the pre-fill deals, the accounting process employed by
339 the Company may have violated certain accounting standards, such as FAS49. Thus,
340 much of the pre-fill accounting has been restated by the Company, in many cases

341 resulting in a purchase being recorded at the time of the pre-fill deliveries (rather than at
342 the time of the actual payments). This has a significant effect on the computation of net
343 withdrawals, significantly reducing them. In fact, the restatement completely eliminates
344 net withdrawals in 2001, instead leaving net injections. As previously discussed, the
345 reduction in net withdrawals basically lowered the PBR “savings” associated with
346 tapping into the old low-cost LIFO layers of storage inventory. However, reversing the
347 pre-fill accounting also preserved more of the low-cost gas in inventory, eventually
348 benefiting consumers.

349 **Q. How did the pre-fill strategy enable the Company to double-collect for carrying**
350 **charges?**

351 A. During rate cases, it is common Commission practice to include a return on rate
352 base, including a return on the cost of gas in storage inventory. For this purpose, a test
353 year is used to compute the average value of gas in inventory. To avoid double-recovery,
354 the Commission’s PGA rules prohibit the inclusion and recovery of carrying charges on
355 gas in storage. However, with the pre-fill deals, where the Company purchased gas on
356 credit, the Company either explicitly or implicitly paid carrying charges to vendors for
357 gas delivered to the Company. These explicit and implicit carrying charges associated
358 with the pre-fill strategy were included in the ultimate price paid by the Company,
359 included in the PGA, and recovered from ratepayers. Since this occurred while the PBR
360 program was in effect, Nicor absorbed one-half of these additional carrying charges.
361 However, at the same time, Nicor saved the full amount of carrying costs that it would
362 have incurred had it purchased these quantities at the time of delivery. Thus, Nicor Gas
363 incurred about the same actual carrying charges it would have without the pre-fill deals,

364 received base rate recovery for such carrying charges, and received additional PGA
365 revenue for one-half the actual carrying charges associated with the pre-fill deals. On
366 net, the Company was ahead by approximately one-half the actual carrying charges
367 associated with the pre-fill deals.

368 **Q. What do you recommend as the remedy for this double-collecting for carrying**
369 **charges?**

370 A. I recommend that the Commission order a refund of one-half the explicit carrying
371 charges associated with the pre-fill deals, which were included in the PGA.

372 **Q. How should the refund for explicit carrying charges be computed?**

373 A. Some of the deals were priced at a current market index (at time of delivery to
374 Nicor Gas) plus explicit carrying charges (up to the time of payment). Thus, it should be
375 a simple matter to alter the accounting entries to increase the PGA when the deliveries
376 took place, and exclude from the PGA any explicit carrying charges. Any subsequent
377 purchases of such pre-fill gas during the 2000-2002 period that were originally included
378 in the PGA would be removed from the PGA. Indeed, this is my understanding of how
379 the Company has reversed the accounting of those pre-fill deals that were explicitly
380 priced at market index at time of delivery plus carrying charges. Thus, the exclusion of
381 the explicit carrying charges occurs automatically with those corrections.

382 Unfortunately, not all of the pre-fill deals were priced at the current market index
383 plus carrying charges, and some that were priced in this manner were later converted to
384 other types of deals. For instance, some of the deals were originally or later converted to
385 be pegged to the future value of market indexes, and did not include explicit carrying
386 charges. In such cases, removing carrying charges would have to rely upon assumptions

387 about the level of carrying charges implicitly included in the purchase price paid by Nicor
388 Gas. Staff has decided not to pursue refunds for such implicit carrying charges.

389 **Q. Were there any long-run implications of the LIFO layer depletion strategy?**

390 A. Presumably, once the PBR program ended, the Company would eventually refill
391 the inventory at contemporary market prices, creating a whole new set of 21st century
392 LIFO layers.¹³ As I stated previously, base rates normally include a return on the cost of
393 gas in storage inventory. Thus, it follows that, at the Company's next rate case, the
394 Company would include the higher-priced inventory in rate base and attempt to recover
395 the resulting higher revenue requirements through base rates. Furthermore, at some
396 point, future net withdrawals from storage would include the higher-priced gas in the new
397 21st century LIFO layers, and ratepayers would pay 100% of the cost of those higher-
398 priced layers in such years. Hence, the LIFO strategy would not so much reduce gas
399 costs as move them around temporally (lowering PGA costs during the life of the PBR
400 program, when the Company would share the "savings," and most likely increasing base
401 rates and PGA rates at a later date).

402 **Q. Should the GCPP have been modified to account for the LIFO strategy?**

403 A. Yes. There is no question that the PBR mechanism as proposed by the Company
404 (and largely adopted by the Commission), was completely blind to the Company's
405 ultimate plan and ignored the value of gas in storage inventory. The LIFO strategy was
406 an accounting trick to take advantage of historical differences in market prices, and not
407 an actual change in the physical operation of storage. The LIFO strategy did not reflect

¹³ A presumption substantiated by [REDACTED].

408 any improvements in efficiency or gas purchasing acumen. Hence, gas volumes and
409 costs associated with net storage injections and withdrawals should have been excluded
410 from the PBR savings calculation.

411 **2. Recommended Refund of LIFO Savings**

412 **Q. Do you recommend any adjustments associated with the LIFO-derived savings?**

413 A. Yes. I recommend that the Company not be permitted to retain the 50% share of
414 LIFO-derived savings otherwise bestowed upon Nicor by the PBR sharing mechanism.
415 That is, I recommend that the Commission modify the share-the-savings formula to
416 eliminate the Company's share of savings due specifically to the difference between the
417 market cost of gas during the life of the PBR and the original cost of gas associated with
418 net withdrawals. However, the level of those LIFO-derived savings is dependent upon
419 the method of accounting for (1) the December 1999 sale to IMD, as well as (2) the
420 subsequent pre-fill deals that were entered between 2000 and 2002, both of which
421 changed with the Company's accounting restatement. For each of the PGA years under
422 review, the restatement changes both the quantity as well as the average LIFO cost of net
423 withdrawals. Prior to the Company's re-opening accounting restatement, there were net
424 withdrawals in 2000, 2001 and 2002. Following the re-opening accounting restatement,
425 net withdrawals are eliminated in 2001 and reduced in 2000 and 2002. Furthermore,
426 prior to the restatement, 100% of the net withdrawals in 2000 through 2002 were from
427 old low-priced LIFO layers. After the restatement, the net withdrawals in 2000 and 2002
428 are from a mix of old low-priced LIFO layers and newer more expensive layers.
429 Nevertheless, even after the accounting restatement, there are still significant savings that
430 can be directly attributable to net withdrawals.

431 **Q. Have you computed the Company’s 50% share of the net withdrawal savings**
432 **existing in 2000 and 2002, following the Company’s accounting restatement?**

433 A. Yes. To perform this computation, one must make assumptions about when the
434 net withdrawals actually occurred because market prices vary significantly, as shown
435 below in the table of market index values used for the PBR benchmark.

436 **Table 1. The Monthly Market Index (MI) throughout the PBR**

	2000 MI	2001 MI	2002 MI
Jan	\$2.4376	\$10.0864	\$2.5345
Feb	\$2.6742	\$6.3332	\$2.1139
Mar	\$2.7139	\$5.2906	\$2.6458
Apr	\$2.9762	\$5.4986	\$3.4112
May	\$3.2948	\$4.7718	\$3.4548
Jun	\$4.4499	\$3.8000	\$3.3080
Jul	\$4.3087	\$3.1439	\$3.1537
Aug	\$4.0952	\$3.1292	\$2.9433
Sep	\$4.8578	\$2.2871	\$3.2897
Oct	\$5.3486	\$2.0803	\$3.8263
Nov	\$4.9498	\$2.9264	\$4.2151
Dec	\$7.3849	\$2.4109	\$4.3794
Avg	\$4.1243	\$4.3132	\$3.2730

437
438 One approach would be to use the simple average of the market index values,
439 which would yield \$4.12 and \$3.27 (per MMBTU) in 2000 and 2002, respectively.
440 However, the main component of the benchmark is the Market Index Cost (over the three
441 PBR years, comprising over 90% of the total benchmark), and the Market Index Cost is
442 the sum (over the 12 months of the year) of the monthly market price index times the
443 actual monthly quantity of gas delivered to customers. Hence, I recommend valuing
444 annual net withdrawals using the weighted average of the monthly market price index,
445 using deliveries to customers as the weights. This recommended approach yields
446 weighted averages of \$4.26 and \$3.25 (per MMBTU) in 2000 and 2002, respectively.

447 In comparison, the inventory withdrawal prices (as revised by the Company) were
 448 \$2.87 and \$1.32 (per MMBTU) in 2000 and 2002.¹⁴ As shown in the table, below, when
 449 the difference in the weighted average market index and the inventory withdrawal price is
 450 multiplied by the net withdrawals for each of the two years, the estimated savings due to
 451 tapping into the LIFO layers is \$24,356,401 for 2000 and \$19,387,467 for 2002, or
 452 \$43,743,869 in total. I propose that the Company’s half (which is implicitly included in
 453 the revised computation of PBR savings) be credited back to ratepayers, amounting to an
 454 additional refund of \$21,871,934. It is notable that, without the accounting restatement
 455 of the pre-fill deals and the December 1999 sale to IMD, the original savings due to
 456 tapping into the LIFO layers in 2000, 2001, and 2002 were about twice the above value.

457 **Table 2. LIFO-derived Savings (Post Accounting Restatement)**

Year	2000	2002	Total
Inventory Withdrawal Price (\$/Therm)	0.2866	0.1324	
Weighted Avg Market Index Price (\$/Therm)	0.4257	0.3246	
Price Difference (\$/Therm)	0.1392	0.1922	
x Net Withdrawals (Therms)	175,019,597	100,879,026	275,898,623
=	\$24,356,401	\$19,387,467	\$43,743,869

458

459 **B. Storage Credit Adjustment**

460 **Q. Please remind us of the role of the storage credit adjustment in the PBR program?**

461 A. Recall that the Storage Credit Adjustment (“SCA”) represents the difference in
 462 the value of gas when it was withdrawn from storage and the value of gas when it was
 463 injected into storage. To represent this value, the SCA uses fixed monthly weights and
 464 actual monthly market prices to compute an annual storage credit rate, which is then
 465 multiplied by actual annual storage withdrawals. Thus, this SCA fluctuates from year to

¹⁴ These revised inventory withdrawal prices represent a weighted average of more than one LIFO layer--some older relatively low-priced layers and some newer layers at contemporary prices. Originally, prior to the Company’s accounting restatement, the inventory withdrawal prices for 2000 and 2001 were only 39 cents and 31 cents per MMBTU, respectively, while 2002 would also have been 31 cents per MMBTU.

466 year due to the movement in market prices and to changes in annual storage withdrawals.
467 When the SCA is positive, it implies that gas was more valuable during the withdrawal
468 season than the injection season and thus, the use of storage is likely to decrease costs.
469 Hence, the SCA is subtracted from the other components of the benchmark (so an
470 increase in the SCA is a decrease in the benchmark, while a decrease in the SCA is an
471 increase in the benchmark).

472 **Q. Please explain what the Company did wrong in computing the storage credit**
473 **adjustment.**

474 A. My analysis reveals that the Company's practices hid a significant portion of
475 storage withdrawals. As shown later in this testimony, this had the effect of slightly
476 increasing the SCA and decreasing the benchmark in 2000 and 2002 (bad for the
477 Company because it *reduced* computed savings), but more significantly decreasing the
478 SCA and increasing the benchmark in 2001 (good for the Company because it *increased*
479 computed savings).

480 **Q. How did the Company's practices hide a significant portion of storage withdrawals**
481 **for sales customers?**

482 *First*, the Company adjusted withdrawals by subtracting "in-field transfers." In
483 subsection 1, below, I will argue that the Company's in-field transfer adjustments should
484 not be made because no such adjustments were made prior to the inception of the GCPP,
485 including the historical period upon which the Program's Commodity Adjustment was
486 based. In Docket 99-0127, if in-field transfers had been accounted for during the
487 historical period upon which the Commodity Adjustment was based, the implied
488 historical storage savings would have been smaller and hence the computed Commodity

489 Adjustment also would have been smaller. Had the Company subtracted in-field storage
490 transfers from the storage withdrawal data used in Docket 99-0127, it would be justified
491 in making similar adjustments to the 2000 through 2002 storage data. However, the
492 Company just started making these in-field transfer adjustments since the GCPP went
493 into effect. “In-field transfers” are not new. In fact, by examining storage injection and
494 withdrawal data from January 1995 through December 2002, there does not appear to be
495 a significant difference in the amount of in-field transfers before and after the GCPP went
496 into effect. The only change since the GCPP went into effect is that Nicor Gas began
497 explicitly accounting for the in-field transfers and began using them as the basis for
498 reducing the volumes used in the storage credit adjustment.

499 *Second*, since the GCPP was approved toward the end of 1999, Nicor Gas
500 released significant quantities of NGPL purchased storage capacity to third parties. As
501 the third parties withdrew gas out of these NGPL storage accounts, they no longer appear
502 as the Company’s storage withdrawals. Instead, they appear as Company purchases.
503 Hence, the storage credit adjustment is reduced proportionally. The Company did not
504 necessarily adopt this strategy simply to alter the benchmark. The Company may have
505 been counting on the third parties to better manage the storage resources and create
506 savings opportunities through such improved management. Nevertheless, as I argue in
507 subsection 2, below, the Company was still expected to benefit from that use of storage
508 and should have accounted for the withdrawals in computing the GCPP benchmark.
509 Notably, in 2000, when the storage credit rate turned out to be “inverted” and the
510 Company stood to gain by increasing reported withdrawals, the Company took steps to
511 partially reverse the hidden withdrawals associated with the released NGPL capacity.

512 Specifically, under the name “virtual storage,” the Company made a positive accounting
513 adjustment of the same magnitude to both withdrawals and injections.

514 **Q. How do you propose to remedy the problems that you identified with respect to the**
515 **storage credit adjustment?**

516 A. Both the in-field transfers and the withdrawals from NGPL storage managed by
517 third parties, which the Company excluded, should be added back into the computation of
518 “withdrawals” for purposes of computing the storage credit adjustment component of the
519 benchmark. These two separate but related issues are addressed more fully in the
520 following two sub-sections.

521 ***1. In-field Transfers***

522 **Q. What is an in-field transfer?**

523 A. From the Company’s response to Staff data request ICC 6.05 on September 10,
524 2002,

525 *Storage volumes are transferred between storage fields when Nicor Gas*
526 *physically withdraws gas from one or more storage fields on the same day*
527 *that it is physically injecting gas in other storage fields. In-field transfers*
528 *result in physical injections and withdrawals and are undertaken for*
529 *operational reasons related to storage field management.*

530 **Q. Have you examined the data supporting the Company’s identification of specific**
531 **quantities of in-field transfers?**

532 A. Yes. First, in response to a Staff data request, the Company provided a series of
533 memoranda that noted specific dates upon which in-field transfers took place in 2000 and
534 2001 (NIC 010143-010154) and in response to ICC 1.09, the Company provided, among
535 other data, a monthly summary of in-field transfers for 1995 through 2002. These
536 responses reveal that the Company did not attempt to identify any in-field transfers prior

537 to 2000, and that it identified in-field transfers in only one month in 2000, ten months in
 538 2001, and no months in 2002.

539 Second, by examining daily data on storage injections and withdrawals provided
 540 in response to Staff data request ICC 1.11, I sought to independently find evidence that
 541 in-field transfers had taken place during the period 1995 through 2002. In accordance
 542 with the Company’s own definition, I looked for when “Nicor Gas physically withdraws
 543 gas from one or more storage fields on the same day that it is physically injecting gas in
 544 other storage fields.” When injections in some fields and withdrawals in other fields
 545 were both positive on the same day, I quantified the in-field transfer as the minimum of
 546 the injections and withdrawals on that day. For any given month, in-field transfers would
 547 be the sum of those daily minimums of injections and withdrawals. The results of this
 548 analysis are summarized in the table, below.

Table 3. Infield Transfers Derived by Staff

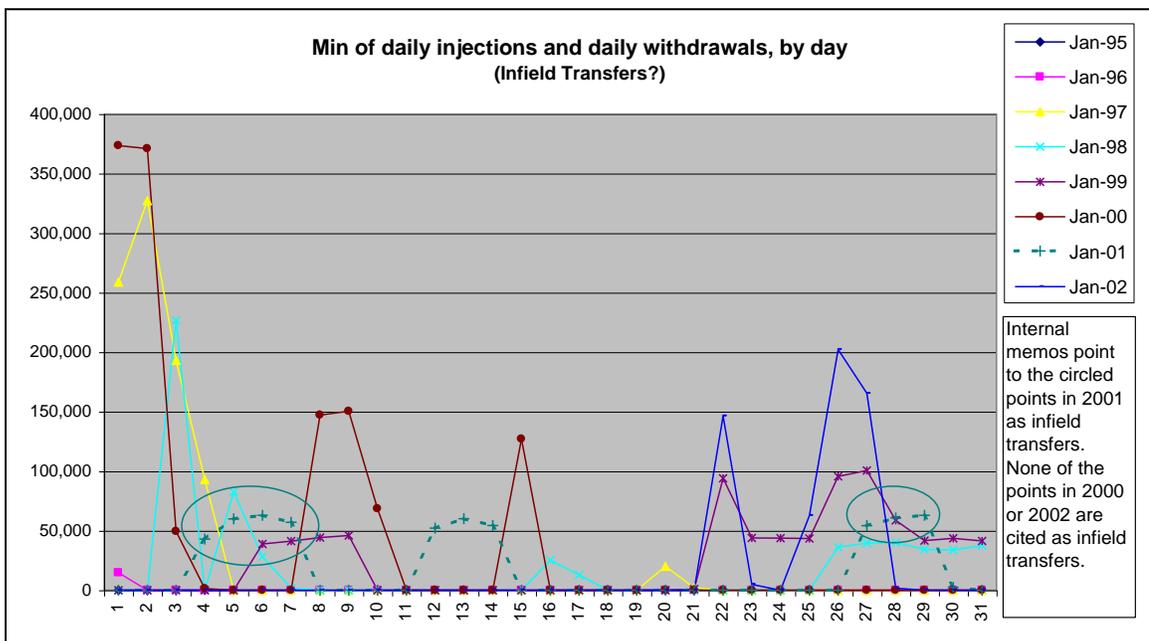
Infield Transfers derived from ICC 1.11 data								
Sum of Sum	Yr							
Mo	1995	1996	1997	1998	1999	2000	2001	2002
1	0	14,743	894,224	598,936	778,161	1,288,633	570,320	583,520
2	0	1,978,779	236,391	488,477	914,885	1,495,855	0	0
3	1,067,409	2,587,064	443,846	434,134	275,780	1,452,503	417,382	153,255
4	1,679,530	1,505,363	1,348,731	1,416,485	264,151	1,546,261	844,079	268,468
5	987,187	38,340	1,344,449	1,342,331	473,075	1,011,810	121,236	1,281,558
6	779,550	0	715,789	962,269	1,490,638	354,682	292,271	866,111
7	125,775	461,800	168,982	1,418,278	790,976	269,865	0	215,065
8	39,612	325,234	0	754,227	508,088	530,505	291,528	0
9	31,913	0	58,535	157,033	0	0	524,230	0
10	0	463,375	914,981	696,964	4,453,283	1,508,269	1,500,161	2,178,679
11	7,645,570	5,265,449	3,966,149	4,861,831	5,250,395	3,811,645	5,678,595	4,446,742
12	819,588	3,443,918	0	0	2,817,273	506,406	2,768,109	617,217
average	1,098,011	1,340,339	841,006	1,094,247	1,501,392	1,148,036	1,083,993	884,218
Total	13,176,134	16,084,065	10,092,077	13,130,965	18,016,705	13,776,434	13,007,911	10,610,615

550

551 Using this methodology, I came relatively close to deriving the same level of in-
 552 field transfers originally reported by the Company for 2001; however, my results and the
 553 Company’s originally reported in-field transfers diverge significantly for 2000 and

554 2002.¹⁵ For example, note the graph of daily in-field transfers for January of years 1995
 555 through 2002, shown in the figure below. The days specifically cited as infield transfers
 556 in internal Nicor memoranda (and excluded from withdrawals in the PBR’s storage credit
 557 adjustment computations) are circled. Although Nicor’s internal memoranda only cite in-
 558 field transfers for 2001, the data nevertheless reveal even greater in-field transfer activity
 559 in 2000 and 2002.

560 **Figure 1. January In-field Transfers**



561

562 Broadly speaking, my analysis also shows that the same general level of in-field
 563 transfers existed for **all** the years in the ICC 1.11 daily storage data (1995 through 2002).
 564 In other words, in-field transfers are not new. The Company’s explicit identification and
 565 quantification of them appears to be the only thing new. The Company only began this
 566 identification and quantification when doing so enabled the Company to compute and
 567 share in greater “savings” under the GCPP. Furthermore, the Company’s specific

¹⁵ Following the Lassar Report ((Stipulated Exhibit 6), October 28, 2002, p. 52 (NIC 049853)), the Company restated in-field transfers for 2002 using apparently the same methodology that I used—getting the same results.

568 identification of in-field transfers appears to have been the most vigorous in 2001, when
 569 it benefited the Company the most.

570 **Q. Why did it benefit the Company the most to identify in-field transfers in 2001?**

571 A. In-field transfers reduced both injections and withdrawals equally. Thus, they
 572 have no effect on the accounting of gas costs, but they do have an effect on annual
 573 withdrawals, which is a component of the SCA. The other component of the SCA is the
 574 winter-summer price differential. In 2001, there was a significantly positive winter-
 575 summer market price differential. Therefore, reducing reported withdrawals for 2001
 576 would reduce the storage credit adjustment component of the benchmark, thus increasing
 577 the overall benchmark and the Company’s reporting of “savings.” In contrast, the winter-
 578 summer differential was negative in 2000 and 2002, so that reducing reported
 579 withdrawals would increase the storage credit adjustment, thus lowering the overall
 580 benchmark and savings. The following table shows the actual SCA rate for each of the
 581 years the PBR program was in effect, along with the total infield transfers originally
 582 reported by Nicor.

583 **Table 4. Storage Credit Adjustment Rates and Annual In-field Transfers**

Year	SCA Rate (per MMBTU)	In-Field Transfers Originally Reported by Nicor (MMBTU)	In-Field Transfers Computed by Staff from ICC1.11 data (MMBTU)
2000	(\$0.686)	738,661	13,776,434
2001	\$2.750	12,059,367	13,007,911
2002	(\$0.326)	0	10,610,615

584
 585 **Q. Was the Company aware of the winter-summer differentials when it went about the**
 586 **process of identifying (or ignoring) in-field transfers?**

587 A. I don't know the answer to that. However, even before each of the years began,
588 futures market prices could have given the Company a clue to projecting the SCA rate.
589 The following table shows the storage credit adjustment rates that would have been
590 projected by the 12-month strips of futures prices that existed just prior to the start of
591 each year. As one can see, the implied SCA rate for 2000 and 2002 were relatively small,
592 compared to the implied SCA rate for 2001, which was almost as large as the actual SCA
593 by the end of the year.

594 **Table 5. Storage Credit Rates**
595 **Implied by 12-month Futures Strip Compared with Actual**

Year	Futures Transaction Date	SCA Rate Implied by Futures	Actual SCA Rate
2000	12/28/1999	\$0.043	(\$0.686)
2001	12/27/2000	\$2.469	\$2.750
2002	12/27/2001	(\$0.006)	(\$0.326)

596
597 **Q. Do you have any reason to suspect that the Company was specifically identifying**
598 **and quantifying in-field transfers for purposes of manipulating the PBR**
599 **benchmark?**

600 A. Yes, I would point to the Lassar Report, where it refers to [REDACTED]
601 [REDACTED]. The report
602 states

603 [REDACTED] says [REDACTED] felt pressured to record in-field transfers. [REDACTED]
604 attended daily meetings where the operational needs of the aquifers
605 [subsurface geological formations used for gas storage] and the ratepayer
606 needs were discussed.¹⁶

¹⁶ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 52 (NIC 049853)

607 According to the Lassar Report, ██████ said that individuals from Gas Supply made
608 comments at these meetings in the fall of 2001 “that transfers which ██████ stated would occur
609 on the given day should be included as infield transfers.” ██████ said that ██████ could not recall
610 the names of anyone who pressured ██████ at the morning meetings,¹⁷ but an individual in Gas
611 Supply confirmed for the Lassar investigation that ██████ had discussed the
612 categorization of transfers at these meetings:

613 ██████, a gas supply employee, confirms that ██████ occasionally would say to ██████
614 at the morning meetings, “this is going to be a transfer, isn’t it?” According to ██████
615 and many of the Gas Supply representatives attending these morning meetings, ██████
616 was stating that the fields required withdrawals of gas above and beyond those
617 required to service the ratepayers. Based on their understanding of in-field transfers, ██████
618 ██████ believed such movements of gas should be appropriately defined as in-field
619 transfers. ██████ did not understand ██████ comments at these morning meetings as
620 “pressure” on ██████, but appropriate give and take to determine which, if any, transfers
621 should be accounted for as in-field transfers. It should be noted, however, that ██████ was
622 a ██████, at the morning meetings.¹⁸

623
624 The Lassar Report further substantiates that ██████ complained during 2001 of being pressured
625 at that time:

626 ██████ Upshaw acknowledges that ██████ told him that ██████
627 was getting pressure in the morning meetings to designate withdrawals of gas as in-
628 field transfers. ██████ says he told ██████ that it was ██████ decision. ██████ said that he
629 gave ██████ the responsibility for deciding whether a gas movement was to be
630 designated as an in-field transfer so that people in the gas supply group would not “game
631 the system.”

632
633 ██████ recorded withdrawals of gas as in-field transfers for each day beginning October
634 24th and running through December 17th, with the exception of only one day.¹⁹

635
636 The Lassar Report further documents the reaction of ██████’s ██████ to these
637 designations:

¹⁷ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 52 (NIC 049853)

¹⁸ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 53 (NIC 049854)

¹⁹ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 53 (NIC 049854)

638 *Upshaw stated that he was not aware that in the fall of 2001 [REDACTED] was designating in-*
639 *field transfers every day, and he did not believe there could be legitimate in-field transfers*
640 *that often.*²⁰

641
642 While the Company recorded in-field transfers on many days during 2001, [REDACTED]

643 [REDACTED]

644 [REDACTED]

645 [REDACTED]

646 [REDACTED]²¹

647 I do not believe it is necessary to determine whether in some objective sense [REDACTED] was in fact
648 pressuring [REDACTED] to record in-field transfers during 2001, or whether [REDACTED]'s perception of
649 the pressure was completely subjective. Either way, the Lassar Report demonstrates that discussions
650 between [REDACTED] on the subject occurred at meetings in the fall of 2001, that [REDACTED]
651 described [REDACTED] as feeling pressured to record in-field transfers, that [REDACTED] recorded such transfers
652 on each day (except one) between October 24, 2001, and December 17, 2001, that [REDACTED]'s
653 direct supervisor was not aware of these designations, and that he subsequently disagreed with the
654 frequency of [REDACTED]'s designations of in-field transfers during this period.

655
656 When the recordation of in-field transfers, as experienced in 2001, no longer resulted in greater
657 "savings," [REDACTED] recorded no further in-field transfers.

658
659 Quite apart from any issue of "pressuring," the Lassar Report demonstrates how in-field transfers
660 were not recorded consistently before and after the initiation of the PBR, or for that matter, during
661 the operation of the PBR itself:

²⁰ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 54 (NIC 049855)

²¹ KPMG 027542

662
663 Prior to the PBR, there was no reason to keep track of in-field transfers. Transfers for
664 operational reasons did not affect the financial results of the Company. . . .
665

666 In the year 2000, the first year of the PBR, the Company did not keep track of infield
667 transfers to properly determine the amount of withdrawals that were made for operational
668 reasons as opposed to servicing the ratepayers. Nor was it in Nicor's interest to do so
669 because, as discussed above, the SCR was inverted during 2000. In other words, Nicor's
670 performance under the Benchmark was not negatively affected by including operational
671 transfers as storage withdrawals to service ratepayers.²²
672

673 During 2001, the SCR which was to apply to each in-field transfer was significant, and thus
674 each unit of gas withdrawn from storage to service the ratepayers had the effect of
675 significantly lowering the Benchmark and making it more difficult for Nicor to beat. It was
676 therefore in Nicor's interest to ensure that only those withdrawals which were made to
677 service the ratepayer were included in the SCA.[footnote omitted] One way to do this
678 would be to keep track of in-field transfers, and thereby decrease the number of withdrawals
679 which would affect the notional benchmark.²³
680

681 Nevertheless, we note that the Company did not use a consistent method for tracking and
682 reporting in-field transfers.²⁴
683

684 Despite the fact the in-field transfers were actually greater in 2000 than in 2001 and almost as
685 significant in 2002 (see Table 3, above), it appears that the company vigorously looked for and
686 recorded in-field transfers only in 2001 when, through the operation of the storage credit
687 adjustment, there was a benefit to the Company to do so. This is either a remarkable coincidence or
688 evidence that there was manipulation of the PBR benchmark.

689 **Q. Does your recommendation to recompute the 2000-2002 benchmark, by including**
690 **rather than excluding in-field transfers, hinge on the possibility that the Company**
691 **was identifying and quantifying in-field transfers for purposes of manipulating the**
692 **PBR benchmark?**

²² Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 50 (NIC 049851)

²³ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 51-52 (NIC 049852-53)

²⁴ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 55 (NIC 049856)

693 A. No. It does not matter why the Company excluded in-field transfers. The
694 exclusion should be reversed in order to correct the PBR benchmark.

695 **Q. Why should the Commission include in-field transfers in the computation of the**
696 **storage credit adjustment, rather than exclude them as the Company has done?**

697 A. If the Company wished to exclude in-field transfers, it should have made that
698 proposal in Docket 99-0127. However, if the Company had made that proposal, it would
699 have had ramifications for another component of the benchmark, namely the
700 “Commodity Adjustment.” Recall from my earlier testimony that the Commodity
701 Adjustment (“CA”) is basically a catch-all or residual adjustment. In Docket 99-0127, it
702 was set to a level that, on average, over several historical years, would have equated the
703 total benchmark gas costs with the Company’s actual historical gas costs. That is, the
704 average savings would have been zero. To compute the CA, actual gas costs were
705 compared to the benchmark’s other components (including the storage credit adjustment)
706 for several historical years ($t = 1994$ to 1998). In essence:

$$707 \quad CA_t = (\text{Actual Costs}_t - \text{MPI}_t - \text{FDA}_t + \text{SCA}_t) \div \text{Use}_t,$$

708 where MPI is the market price index,

709 FDA is the firm deliverability adjustment, and

710 SCA is the storage credit adjustment.

711 An average of the CA_t resulted in the fixed commodity adjustment rate of 1.68
712 cents per MMBTU, which has been applied to the Company’s actual deliveries to
713 customers during the tenure of the PBR program (2000-2002). Had the Company
714 excluded in-field transfers from the historical data used to compute this residual CA, the
715 storage credit (which was positive in each of the historical years examined) would have
716 been smaller in each year. Hence, the CA_t would have been smaller in each year, as

717 would the final average CA selected by the Commission. Such a tightening of the
718 benchmark would have justified the exclusion of in-field transfers while the GCPP
719 program was in effect.

720 In contrast, the Company's approach would allow it to "have its cake" (the higher
721 CA computed in 99-0127 with in-field transfers included) "and eat it too" (subsequently
722 removing in-field transfers and raising the benchmark even more while the program was
723 in effect from 2000-2002).

724 **Q. What is the effect of adding back in the in-field transfers that the Company**
725 **removed?**

726 A. In the two years in which the storage credit adjustment rate was inverted, adding
727 back in-field transfers reduces the storage credit adjustment and thus increases the
728 benchmark and savings by \$506,943 (2000) and \$3,460,131 (2002). However, in 2001,
729 adding back in-field transfers increases the storage credit adjustment and decreases the
730 benchmark and savings by \$33,166,877 (2001). On net, these corrections lead to a total
731 refund of \$14,599,901 (half the total reduction in the savings).

732 **Q. How does your position with respect to in-field transfers differ from the Company's**
733 **re-opening position on this issue?**

734 A. My position is that any in-field transfers that were originally removed by the
735 Company should be added back to the computation of withdrawals. This eliminates the
736 Company's original negative \$29,199,803 in storage credit adjustments due to in-field
737 transfers, returning half of that, or \$14,599,901, to ratepayers. In contrast, the
738 Company's re-opening proposal uses revised levels of in-field transfers, changing the

739 storage credit adjustments from negative \$29,199,803 to negative \$22,299,803 (a change
740 of \$6,900,000), returning half of that, or \$3,450,000, to ratepayers.

741

742 2. NGPL DSS Storage Withdrawals by IMD for Nicor Gas

743 **Q. Why should the NGPL DSS Storage Withdrawals by IMD be included in the storage**
744 **credit adjustment component of the benchmark?**

745 A. First, the storage service in question was included in the Company's PGA mix
746 during the historical period over which the Commodity Adjustment was computed in
747 Docket 99-0127. Analogous with in-field transfers (discussed in the previous sub-
748 section), including these storage withdrawals in the Docket 99-0127 computations raised
749 the Commodity Adjustment higher than it would otherwise have been. Then, after 99-
750 0127 was over, perhaps to boost the benchmark, again, the Company removed further
751 NGPL withdrawals from the on-going storage credit adjustment.

752 Second, even though the released storage was no longer under the direct control
753 of Nicor Gas, there were still expected benefits associated with the use of the service that
754 existed prior to and during the tenure of the PBR program.²⁵ For purposes of evaluating
755 the Company's performance, there was no reason to believe that the Nicor Gas supply
756 portfolio should not continue to reap those expected benefits, even after it released the
757 NGPL storage capacity to a third party. Indeed, since IMD was expected by Nicor to do
758 a better job managing storage, there should have been an expectation of even larger

²⁵ As Company attorney, Steve Mattson, explained during oral arguments in Docket 99-0127, "It stands to reason that you better your prices as a result of having storage because of seasonal price differentials, and the company felt that it was only right to give the customers the benefit of that differential." (Transcripts from November 2, 1999 special open meeting of Commission to consider oral arguments in Docket 99-0127, p. 71, lines 10-15)

759 benefits. Hence, the benchmark should have continued to reflect withdrawals from the
760 released NGPL storage capacity.

761 **Q. Why should we expect Nicor Gas to continue to reap the benefits of storage capacity**
762 **that is released to a third party?**

763 A. There is no reason for us to expect that Nicor Gas would simply give away its
764 control of NGPL storage capacity for no consideration. Rather, it should demand
765 something in return, like its value, either on an expected or after-the-fact basis. Of
766 course, the value of storage does not remain constant from year to year, but fluctuates.
767 That is why the storage credit adjustment was specifically designed to float with yearly
768 changes in the differential between withdrawal and injection season market prices. Some
769 years the value can even be negative, as we saw in 2000 and 2002, but at the end of 1999,
770 it was reasonable to expect that the value would be positive.²⁶

771 **Q. Have you ascertained the amount of third-party withdrawals from released NGPL**
772 **DSS capacity?**

773 A. Unfortunately, the Company claims that it was not able to provide to Staff the
774 actual level of monthly withdrawals and injections from DSS capacity that was released
775 to third parties like IMD. Instead, the Company has only been able to provide net
776 withdrawals (i.e., monthly withdrawals minus monthly injections). Thus, instead of
777 counting withdrawals, I only counted net withdrawals, when those net withdrawals were

²⁶ At the end of December 1999, the SCA rate implied by futures prices was \$0.043 per MMBTU. Also, in Docket 99-0127, when the benchmark was created, the after-the-fact value of the Company's entire storage portfolio within the five-year period, 1994 to 1998, was computed to have ranged between \$9 million and \$116 million (all positive). The Company did not want to take the risk of such large fluctuations. So instead of asking for a fixed adjustment around \$40 to \$50 million, it sought and received from the Commission permission to adopt the fluctuating storage credit adjustment.

778 positive. This procedure provides a floor on the level of possible third party withdrawals
 779 from DSS.

780 For example, in November 2001, there were net withdrawals of 1,875,000
 781 MMBTU, which I counted as withdrawals. Hypothetically, though, withdrawals could
 782 have been 2,000,000 and injections could have been 125,000. That is, hypothetically,
 783 withdrawals could have been more than 1,875,000 if there were any injections during the
 784 month, but they could not have been less than 1,875,000 MMBTU. Similarly, in April
 785 2001, net withdrawals were negative 180,000 MMBTU, so I assumed zero withdrawals,
 786 even though, hypothetically, there could have been 350,000 MMBTU of withdrawals and
 787 170,000 MMBTU of injections that resulted in net withdrawals of 180,000 MMBTU.

788 **Q. What is the effect of adding back in to the benchmark these estimated NGPL**
 789 **storage withdrawals associated with capacity that the Company released to third**
 790 **parties?**

791 A. As shown in the table, below, over the three years (2000-2002), adding back these
 792 minimum additional withdrawals decreases the PBR benchmarks by a total of
 793 \$18,915,648, one-half of which, or \$9,457,824, should be refunded to ratepayers.

794 **Table 6. Impact of Accounting for DSS Storage Withdrawals by IMD for Nicor Gas**

	Released DSS Min WD	Storage Credit Rate	Effect on Benchmark and Savings
2000	3,050,000	-0.6863	\$2,093,215
2001	8,965,254	2.7503	-\$24,657,138
2002	11,187,597	-0.3261	\$3,648,275
Total			-\$18,915,648
Half			-\$9,457,824

795

796 **C. Affiliate Transactions**

797 **Q. Can you describe the transaction in which Nicor Gas provided a discount on gas**
798 **sold to its affiliate, Nicor Enerchange, in January 2000?**

799 Q. On January 28, 2000, Nicor Gas sold 2.4 million MMBTU of gas to its affiliate,
800 NICOR Enerchange. The price was set at \$2.45 per MMBTU. The Gas Daily rate on
801 that day was \$2.73. Hence, in relation to the Gas Daily rate, the \$2.45 sale price
802 amounted to about a 10% discount of 28 cents per MMBtu (almost \$700 thousand).
803 However, the transaction was for future delivery in September and October. The Henry
804 Hub futures price for September and October were \$2.535 and \$2.55, respectively. The
805 basis differential between Chicago and the Henry Hub around this time was about 4 to 5
806 cents per MMBTU. Hence, judging by the prevailing futures price plus basis, the \$2.45
807 sale price amounted to a discount of about 12 to 15 cents per MMBtu (over \$300
808 thousand). However, since prompt payment was made to Nicor, well before operational
809 delivery was required to take place, the actual discount was effectively about one-third
810 this amount (assuming a 5.5% interest rate, which was the PGA interest rate for 2000).
811 Thus, a more reasonable assessment of the actual discount was that it was only about 1%
812 to 2% of the value of the gas at the time of the transaction.

813 **Q. What else occurred on this day?**

814 A. The Company entered into two other transactions on this day. The Lassar Report
815 describes the genesis of these transactions as follows: “Once the details of the transaction
816 [between Nicor and Enerchange] had been worked out, Lenart gave express “approval” to
817 engage in a portion of this transaction with Enerchange. Concerned by the impression of
818 impropriety, and pursuant to Enerchange’s related-party practice, Lenart expressly

819 cautioned that Enerchange could only be involved in the deal if Nicor engaged in the
820 identical transaction with independent third parties.”²⁷ The Company in fact entered into
821 two other transactions with unaffiliated parties for a total of 900,000 MMBTU at the
822 same price and roughly the same future delivery terms.

823 **Q. Was there any need for the Company to enter into these transactions?**

824 A. The Lassar Report’s discussion of this issue leaves the impression that the
825 Company had “a pressing need to eliminate the overflow of gas it experienced in January
826 2000.”²⁸ However, this would largely be a false impression. There was certainly not a
827 pressing need to physically remove gas from storage. After all, the transaction was for
828 future delivery in September and October and therefore involved no immediate
829 movement of gas. The only “pressing need to eliminate the overflow of gas it
830 experienced in January 2000” would have been to increase accounting “withdrawals”
831 because Nicor was behind schedule vis-à-vis its plan for beating the storage credit
832 adjustment component of the PBR benchmark.²⁹ Despite the Company’s claims to the
833 Commission in Docket 99-0127 -- that storage withdrawals were a function of weather
834 and that the Company would not and could not manipulate storage withdrawals³⁰-- here

²⁷ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 69 (NIC 049870)

²⁸ Lassar Report (Stipulated Exhibit 6), October 28, 2002, p. 70 (NIC 049871)

²⁹ For instance, 

³⁰ See, for instance, Docket 99-0127, Initial Post Hearing Brief of Northern Illinois Gas Company, pp. 21-22; and Docket 99-0127, Gilmore Rebuttal, p. 6.

835 in the very first month of the program the Company was already busy manipulating
836 withdrawals from an accounting standpoint.

837 **Q. How do you estimate the harm to ratepayers from these transactions?**

838 A. While the discount at the time of the transactions was relatively small, there was
839 still no legitimate reason for the Company to enter into these transactions. Furthermore,
840 unless Nicor Gas took steps to lock in a buy price for those future delivery months, its
841 commitment for future delivery placed ratepayers at risk for upward fluctuations in gas
842 prices. Such an upward fluctuation indeed occurred, so that when the Company was
843 required to make delivery, the opportunity cost was linked to the spot market prices
844 prevailing in July, September and October. That is, the July, September and October
845 prices are what it would have cost the Company to replace the gas sold to Nicor
846 Enerchange or otherwise what Nicor would have foregone in additional spot market
847 sales. Without the unnecessary transactions, designed to somewhat enrich an affiliate and
848 designed around the manipulation of storage withdrawals, the Company would never
849 have incurred such an increase in gas costs.

850 Therefore, I recommend that the Commission deny recovery of the excess of the
851 replacement cost of the gas at the time of delivery over the revenues received. As shown
852 in the table, below, this leads to a decrease in recoverable gas costs of \$8,517,172, of
853 which the Company retains half due to the PBR sharing mechanism. The net effect of
854 making this adjustment to 2000 PGA costs would be a refund to customers of
855 \$4,258,586.

856

Table 7. Effect on Ratepayers of Affiliate Discount Deal

Month	Volumes sold to Enerchange	Additional Decoy Volumes sold to other parties at same price	Sale Price on Jan 28	Monthly Spot Index Prices	Total Value
Jan-00	2,400,000	900,000	2.45		\$8,085,000
Jul-00		(300,000)		4.3087	-\$1,292,595
Aug-00					
Sep-00	(900,000)	(600,000)		4.8578	-\$7,286,683
Oct-00	(1,500,000)			5.3486	-\$8,022,894
Total					-\$8,517,172

857

858

D. NICOR's Discount On a Gas Sale to Aquila In Exchange For a Discount On a Non-PGA Purchase Of Weather Insurance

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860

Q. Can you describe the transaction in which Nicor Gas received a discount on a non-PGA purchase of weather insurance in exchange for providing a vendor (Aquila) with a discount on a sale of gas?

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863

A. Staff first became aware of this transaction when it read Chapter V of the Lassar Report (Stipulated Exhibit 6, pp. 40-48, or NIC 049841-049849). In that report, it was alleged that Nicor Gas provided a discount to Aquila of \$2 million on a sale of gas in exchange for a \$2 million discount on the premiums for weather insurance for calendar year 2001. More or less confirming the Lassar Report, I determined through review of Company records that 3 million MMBTU were sold to Aquila in the fall of 2000 for future delivery in March and April 2001. Furthermore, the price of the gas sold seemed to be based on the then-current futures prices for those two future months plus basis differentials, less a discount to Aquila of about \$2.2 million.

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Moreover, according to the Lassar report, by the time that Nicor had to make delivery, the market price of gas had risen, and the apparent loss had "ballooned to over

873

874 \$6 million.”³¹ Again, based on review of Company records, I confirmed that the
875 discounted sale of gas led to an actual loss to Nicor of over \$6.1 million.

876 The discounted cost of the weather insurance and any benefits from the insurance
877 were not to be included in the PGA, but were to inure entirely to the benefit of the
878 Company. Because the 2001 temperatures were relatively mild, Nicor Gas received a
879 benefit of [REDACTED] on the weather insurance.³² This financial gain was not included
880 as an offset to PGA costs (and I am not suggesting that it should have been).

881 **Q. How do you estimate the harm to ratepayers of this transaction?**

882 A. Because of this transaction, I estimate that gas costs increased by approximately
883 \$6,115,050 less the half absorbed by Nicor Gas due to the PBR sharing mechanism.
884 Hence, ratepayers should receive a net refund of \$3,057,525. As shown in the table
885 below, this figure is based on the difference in the monthly index prices prevailing at the
886 time of delivery and the contract price for the sale to Aquila.

³¹ [REDACTED]
See, for example, KPMG 024439-024442 and 024444-024448.

³² The Company’s out-of-pocket cost of the weather insurance was a net premium of [REDACTED]. Thus, based on the mild temperatures that existed, the Company netted a [REDACTED]. However, the true cost of the insurance also included an additional \$2 million (the premium discount traded for the gas sale discount). Hence, the true insurance premium was more like [REDACTED].

887 **Table 8. Effect on Ratepayers of the Weather Insurance for Gas Discount Deal**

	Mar-01	Apr-01	TOTAL	One-Half the TOTAL
Aquila Contract Volumes (MMBTU)	1,500,000	1,500,000	3,000,000	
Aquila Contract Price	\$3.5075	\$3.2050		
Total Revenues	\$5,261,250	\$4,807,500	\$10,068,750	
Monthly Price Index	\$5.2906	\$5.4986		
Monthly Price Index minus Aquila Contract Price	\$1.7831	\$2.2936		
Monthly Price Index minus Aquila Contract Price times Aquila Contract Volumes	\$2,674,650	\$3,440,400	\$6,115,050	\$3,057,525

888

889 **Q. Has the Company made any accounting adjustments related to the Aquila**
 890 **transaction?**

891 A. Yes. The Company appears to have made an adjustment equal to what the Lassar
 892 Report concluded was the original \$2 million “discount” to Aquila, notwithstanding the
 893 fact that the loss eventually ballooned to over \$6.1 million. After taking into account the
 894 50% sharing mechanism, Nicor’s adjustment leads to a net refund to customers of
 895 \$1,000,000, whereas my adjustment leads to a net refund of \$3,057,525.

896 **E. Improper Inclusion in the PGA of Carrying Charges Associated with**
 897 **Managed Storage Deals Using Released NGPL Storage**

898 **Q. How did the Company include carrying charges associated with managed storage**
 899 **deals in the PGA?**

900 A. Instead of buying gas during the injection season, leaving it in storage (incurring
 901 carrying costs) and withdrawing it during the withdrawal season, the Company released
 902 NGPL storage capacity to third parties and allowed them to perform all of the above
 903 steps. When the Company bought the gas during the withdrawal season, it paid explicit

904 or implicit carrying charges embedded in the price. As shown in an internal company
905 meeting handout, the Company expected to avoid incurring annual carrying costs of
906 about [REDACTED]

907 [REDACTED]

908 [REDACTED]³³

909 **Q. What do you propose to do about these carrying charges?**

910 A. As noted above, it is common Commission practice to include a return on the cost
911 of gas in storage inventory in base rates. To avoid double-recovery, the Commission's
912 PGA rules prohibit the inclusion and recovery of carrying charges on gas in storage.
913 However, with the released storage capacity, the Company either explicitly or implicitly
914 paid carrying charges to vendors for gas delivered to the Company. These explicit and
915 implicit carrying charges were included in the ultimate price paid by the Company,
916 included in the PGA, and recovered from ratepayers. Thus, I recommend adjustments to
917 remove the explicit carrying charges from the PGA for the years 1999 through 2002. I
918 decided not to pursue refunds for any implicit carrying charges that may have been
919 incurred.

920 **Q. Have you attempted to ascertain the explicit carrying charges associated with**
921 **managed storage deals using released NGPL storage capacity that were included in**
922 **the PGA during the years in question?**

923 A. Yes. According to the Lassar Report, included in the Company's payments to
924 IMD under the various managed DSS storage deals was a cost of carry (i.e., interest

33 [REDACTED]

[REDACTED] (NIC 002408).

925 component) in the following amounts: \$1 million in 2000 and \$3.1 million in 2001. As
926 stated in the Lassar Report, “These costs were included with the cost of gas and included
927 in the PGA. Had Nicor obtained the financing on this inventory directly, the related
928 interest cost would not have been recoverable under the PGA. We do not believe it was
929 appropriate to have included these costs in the PGA.” (Lassar Report, Stipulated Exhibit
930 6, p. 36). Company records provided to Staff reflect these amounts.³⁴

931 **Q. What level of carrying charges do you recommend be excluded from the PGA**
932 **during the period 1999 through 2002?**

933 A. I recommend excluding the \$1 million in 2000 and \$3.1 million in 2001 (about
934 \$4.1 million in total), for which there is explicit documentation, as discussed above. The
935 net effect of this, given the 50% PBR sharing formula, is a total refund of approximately
936 \$2 million. Given that the Company’s own internal documents cite “a fixed guaranteed
937 up front amount of carrying cost savings” totaling \$2.6 million per year, I suspect that I
938 have not captured all the carrying cost that got shifted into the PGA. If there were other
939 similar carrying charges from NSS and/or DSS deals in 1999 through 2002 that were
940 included in the PGA, the Company should bring those to the Commission’s attention
941 when it presents its rebuttal testimony.

942 **F. Error in the Reporting of Deliveries of PGA Gas to Customers**

943 **Q. Please explain the error in the reporting of deliveries of PGA gas to customers.**

³⁴ [REDACTED]

944 A. Apparently, in 2001, there was a metering error that led to a misreporting of gas
945 delivered to customers. Efforts appear to have been made to correct this error. However,
946 those efforts were not complete, resulting in an excess volume of gas being included in
947 the market index and commodity adjustment component of the benchmark. I compute
948 the effect of the error to be a \$2,317,531 overstatement of the benchmark, of which half,
949 \$1,158,765, was absorbed by ratepayers due to the PBR program's 50-50 sharing
950 mechanism.

951 After this error in the benchmark was raised by the whistle-blower fax, the
952 Company alleged in a Staff data request that it was planning to make an adjustment to
953 correct the admitted error. Ultimately, this appears to have been done. I accept the
954 Company's meter error adjustment and adopt it within my own PBR savings computation
955 for 2001.

956 **G. Exclusion of Hub Revenues from the PGA**

957 **Q. What is the Chicago Hub?**

958 A. The Chicago Hub is a name used to identify various services offered by Nicor that
959 are not governed by ICC tariffs, but that rely on the Company's access to various natural
960 gas storage and transportation assets in northern Illinois. An example of a Chicago Hub
961 service is a gas loan (or reverse parking), whereby Nicor loans a quantity of gas to a gas
962 marketer, who brings the same quantity of gas back to Nicor at a later date and also pays
963 Nicor a monetary fee.

964 **Q. Were the revenues from such Chicago Hub services included in Nicor's PGA?**

965 A. In review of Company records, revenues from some of the Hub storage services
966 were flowed through the PGA, while revenues from other Hub services were not flowed

967 through the PGA. At first blush, this *appears* to be in consistent with the Commission
968 order in ICC Docket 95-0219 (the Company's last rate case before the GCPP was
969 instituted).³⁵ However, more careful examination of the latter group of transactions
970 reveals that many of them are not the type of hub services that the Commission
971 authorized the Company to exclude from the PGA. In contrast, they are subject to
972 Section 525.40(d) of the Commission's PGA rule, which requires, in part, that
973 "[r]ecoverable gas costs shall be offset by the revenues derived from transactions at rates
974 that are not subject to the Gas Charge(s) if any of the associated costs are recoverable gas
975 costs as prescribed by subsection (a) of this Section."³⁶ Hence, revenues from those
976 transactions should have been included in the PGA as an offset to gas costs.

³⁵ With respect to "off-system storage revenues," the Commission directed the Company "to remove the entire \$1,164,000 forecast of revenues from the rate case and ... to reflect its actual off-system storage revenues in its PGA calculation, net of related costs not otherwise [*40] recovered and properly shown in the reconciliation proceedings, in accordance with 83 Ill. Adm. Code 525.40(d), beginning with its first PGA calculation filed subsequent to its compliance rate filing in this case." (Docket 95-0219, Order, April 3, 1996, [1996 Ill. PUC LEXIS 204, 39-40](#)). In review of the Company's response to Staff data request ICC 7.05 (10/18/2002), for contracts covering the period between June 1, 1998 and March 31, 2003, there appears to have been about \$1.5-2.1 million per year of hub revenue that flowed through the PGA as an offset to gas costs. However, the Commission concluded that "On March 13, 1996, in Docket 93-0320, [*35] the Commission issued an Order denying the Company's proposed [50-50] sharing of Hub revenues and requiring the treatment of all Hub revenues above-the-line for ratemaking purposes. The Commission determines that, by treating Hub revenues totally above-the-line an additional adjustment of \$ 471,500 is adopted for a total adjustment to revenues of \$ 627,500." (Docket 95-0219, Order, April 3, 1996, [1996 Ill. PUC LEXIS 204, 35](#)). This implies the total revenues included above-the-line in this rate case were 2x\$471,500 or \$943,000. In review of the Company's response to Staff data request ICC 7.05 (10/18/2002) in the instant docket, for contracts covering the period between June 1, 1998 and March 31, 2003, there appears to have been at least \$3.2-3.8 million per year of hub revenue that did not flow through the PGA.

³⁶ In the Commission's Order adopting this rule, it referred to the types of transactions covered by §525.40(d) as "off-system transactions" and noted that they may include capacity releases, sales for resale, buy/sell transactions and exchanges. The Commission concluded:

With respect to off-system transactions, the Commission finds the Staff's proposal appropriate. The utilities' proposals for revenue sharing, i.e., partial rather than full offset to recoverable gas costs, are inappropriate in the application of the Purchased Gas Adjustment as a means of encouraging utilities to maximize the number of prudent off-system transactions in which they engage. In fact, Illinois utilities have [*17] been engaging in such transactions, such as capacity release, without revenue sharing. The Commission is concerned that revenue sharing would create incentives for utilities to subsidize off-system transactions with on-system transactions and could therefore result in PGA gas charge increases. The Commission concludes that utilities already have incentives to engage in prudent off-system transactions which result in PGA decreases. Any additional incentives that a utility wishes to suggest should be handled in a Section 9-244 proceeding and should not be part of a general rule. (ICC Docket 94-0403, Order, August 23, 1995, [1995 Ill. PUC LEXIS 579, 16-17](#))

977 **Q. How did you determine that many of the transactions that Nicor excluded from the**
978 **PGA are not the type of hub services that the Commission previously authorized the**
979 **Company to exclude from the PGA?**

980 A. In the Docket 95-0219 order cited above, the Commission references and adopts
981 the primary conclusion from its earlier order in Docket 93-0320, which denied the
982 Company's proposed 50-50 above and below-the-line accounting treatment for hub
983 revenues and required all those revenues to be recorded above-the-line as an offset to
984 recoverable base-rate gas costs (see footnote 35). Thus, the Commission implied that
985 these hub services should not be included as an offset to gas costs in the PGA. However,
986 at that time, the Commission had a completely different picture of "hub services" than
987 what the Company actually provided during the 1999 through 2002 period currently
988 under review. In Docket 93-0320, Nicor described the Hub's services as follows:

989 *The Hub facilitates the movement of gas between and among interstate*
990 *pipelines attached to the Company's system. The Hub also permits storage*
991 *of gas for short periods of time before redelivery to an interstate pipeline.*
992 *The Hub also will accommodate gas title transfers. The Company provides*
993 *these services pursuant to authorization by the Federal Energy Regulatory*
994 *Commission ("FERC") and subject to operational constraints such that*
995 *the Company's utility customers are not and will not be adversely*
996 *impacted. ([1996 Ill. PUC LEXIS 151, 2 \(Ill. PUC, 1996\)](#))*

997 After reviewing Company records on hub transactions, it appears as if many of those
998 transactions do not fit within the above description. In particular, none of the multi-cycle
999 gas loans appear to fit within the type of transactions that were described to the
1000 Commission in Docket 93-0320. Each of the multi-cycle gas loans appear to have a term
1001 of either eleven or twelve months, from the injection season through the withdrawal
1002 season of the following calendar year, and they are all paired with a long-term storage
1003 agreement, as well. These transactions appear to be completely different than the ones

1004 considered by the Commission in Docket 93-0320, and clearly fit within the meaning of
1005 Section 525.40(d). Hence, I recommend that the Commission order all revenues from
1006 these transactions to be included in the PGA as an offset to PGA costs. Prorating the
1007 revenues collected by the Company by month, this constitutes a cost reduction
1008 adjustment of approximately \$10.3 million between the beginning of 1999 and the end of
1009 2002, with about \$1.9 million of that total applicable to 1999, and the remaining \$8.4
1010 million of that total applicable to the PBR period 2000-2002. After taking into account
1011 the effect of the PBR's 50-50 sharing mechanism, the refund due to ratepayers would be
1012 \$6.1 million (i.e., $0.5 \times \$8.4 \text{ million} + \1.9 million).

1013 **H. Accounting Adjustments**

1014 **Q. Can you summarize the Company's accounting restatement that was presented in**
1015 **its testimony on reopening?**

1016 A. The restatement had effects on both the storage credit adjustment component of the
1017 benchmark and on costs. The changes with respect to the storage credit adjustment
1018 component of the benchmark lead to a refund of about \$8 million and have already been
1019 discussed in Section B. The accounting restatement's more direct impact on gas costs
1020 leads to a surcharge of approximately \$15 million, due primarily to less of the low-cost
1021 LIFO layer gas being withdrawn from storage. Based on Staff Accounting's review,
1022 Staff is not disputing the restatement. However, as reflected in Staff's testimony, the
1023 restatement does not fully account for all the issues related to the PBR and PGAs during
1024 this time frame.

1025 **I. Staff Witness Maple's Adjustments**

1026 **Q. According to Staff witness Maple, there should be additional refunds of \$10,584,907**

1027 **due to adjustments to the benchmark in 2000 through 2002, as well as to gas costs in**
1028 **1999. Have you accounted for these proposed adjustments?**

1029 A. Yes. Mr. Maple's adjustments are included within my summary tables and are included
1030 in my computation of Factor O interest.

1031 **J. Adjustment Related to the Two-percent of Storage Withdrawals**
1032 **Assumed by Nicor to be Lost**

1033 **Q. According to Staff witness Knepler, there should be additional refunds associated**
1034 **with lost storage gas, the cost of which the Company has been including in the PGA.**
1035 **Have you assisted Mr. Knepler in computing the size of this adjustment?**

1036 A. Yes. Based on discussions with Mr. Knepler, it is my understanding that the Company
1037 was accounting for a portion of its lost gas by adding two percent to gross withdrawals
1038 from storage. After transportation customers paid for their share of lost storage gas, the
1039 Company recovered the remaining cost through the PGA. However, according to Mr.
1040 Knepler, the Commission's PGA rule does not permit utilities to recover the cost of lost
1041 storage gas through the PGA. Rather, the expense of lost storage gas is considered a
1042 base-rate item. In consultation with Mr. Knepler, I have computed the quantity of the lost
1043 storage gas recovered through the PGA in 1999 through 2002, by taking 2% of aquifer
1044 withdrawals and subtracting 2% of withdrawals by transportation customers. In net
1045 withdrawal years (1999, 2000, and 2002), I valued the lost gas at the average cost of the
1046 net withdrawals. In the net injection year (2001), I valued the lost gas at the original cost
1047 of the new 2001 LIFO layer, as computed by the Company. Removing from the PGA the
1048 computed cost of lost storage gas leads to an additional refund of \$18,667,265.

1049 **Q. How does this adjustment to PGA costs affect PBR savings?**

1050 A. Since, according to Mr. Knepler, the Company should have been excluding the
1051 cost of lost storage gas from the PGA all along, the PBR benchmark should have
1052 excluded such costs all along, as well. Hence, for purposes of computing savings, I have
1053 left out the reduction in 2000 through 2002 costs arising from the adjustment, discussed
1054 above. However, if this cost disallowance were to be included in the savings calculation,
1055 then the refund to customers arising from this adjustment would be only \$12,343,487.

1056 **K. Net Interest on Factor O Refunds/Surcharges**

1057 **Q. Nicor witness Gorenz computes interest through March 31, 2007 of \$1,565,855 owed**
1058 **by ratepayers to Nicor through the operation of the PGA's Factor O. Mr. Gorenz's**
1059 **computations are shown on the Nicor Gas Ex. 2.6. Do you agree with Mr. Gorenz's**
1060 **computations?**

1061 A. No. My computations of Factor O interest through the end of 2009 result in a
1062 payment to ratepayers of \$20,717,680. This is what is included in my summary of
1063 adjustments. The difference between my proposed interest payment **to** ratepayers and the
1064 Company's proposed payment **by** ratepayers is mostly due to the differences in our
1065 adjustments prior to interest. Another part of the difference is that my calculations go
1066 through 2009 rather than through March 2007. Another part of the difference is due to
1067 the fact that the Company's calculations include no compounding of interest, whereas my
1068 computations include monthly compounding. Finally, in my computations, all PBR
1069 savings for a given year are assumed to be recoverable in the following year and interest
1070 on under or over-recovery of them begins the year after that; the Company follows this
1071 same procedure with 2000 and most of the 2001 savings, but not with 2002 and not with
1072 the new 2001 Oxy adjustment (discussed by Company witness Gorenz in Nicor Gas Ex.

1073 2.0, p. 13). With those two exceptions, Nicor begins collecting interest a year earlier. If
1074 those exceptions were instead the rule, and were used consistently for all three years (i.e.,
1075 if changes in PBR savings for a given year were to begin in the following year for all
1076 three years), then my computation of interest owed to ratepayers would increase to
1077 \$23,161,582 and the Company's computation of interest owed to Nicor would decrease to
1078 \$46,689.

1079 **Q. Does this conclude your testimony?**

1080 A. Yes.

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Attachment 1: Summary by Issue

Issue		Staff Proposed Surcharges	Company Proposed Surcharges	Staff minus Company Proposed Surcharges
A	LIFO-derived Savings	-\$21,871,934	\$0	-\$21,871,934
B	Storage Credit Adjustment:	-\$38,520,976	-\$17,913,251	-\$20,607,725
b1	Accounting Corrections effect on SCA	-\$8,040,338	-\$8,040,338	\$0
b2	2000 Virtual Inventory	-\$4,609,701	-\$4,609,701	\$0
b3	Managed DSS Withdrawals	-\$9,457,824	\$0	-\$9,457,824
b4	Rev. Original Infield Transfers	-\$14,599,901	-\$3,450,000	-\$11,149,901
b5	Add'l 2001 Oxy Deal	-\$1,813,212	-\$1,813,212	\$0
C	Rev. Additional Costs From 2000 Affiliate Discount	-\$4,258,586	\$0	-\$4,258,586
D	Rev. Add'l Costs from 2001 Weather Ins. Deal	-\$3,057,525	-\$1,000,000	-\$2,057,525
E	Rev. Add'l Carrying Costs in Managed DSS Deals	-\$2,049,913	\$0	-\$2,049,913
F	Impact of 2001 Metering Error	-\$1,160,484	-\$1,160,484	\$0
G	Certain Hub Revenues	-\$6,150,917	\$0	-\$6,150,917
H	Accounting Corrections effect on costs	\$15,059,454	\$15,059,454	\$0
H+b1	Accounting Corrections combined effect	\$7,019,116	\$7,019,116	\$0
I	Maple Issues:	-\$10,584,907	\$0	-\$10,584,907
i1	Maple Issue 1	-\$1,475,267	\$0	-\$1,475,267
i2	Maple Issue 2	-\$5,893,472	\$0	-\$5,893,472
i3	Maple Issue 3	-\$3,216,169	\$0	-\$3,216,169
J	Knepler 2% of Withdrawals Issue	-\$18,667,265	\$0	-\$18,667,265
A thru J	Sub-Total	-\$91,263,052	-\$5,014,281	-\$86,248,772
+	Undercharge from Co.'s Original 2001 Savings	\$1,329,699	\$1,329,699	\$0
+	PGA Adj to reflect 2002 Final Gas Costs	-\$18,793,860	-\$18,793,860	\$0
+	One-half of Co's Computation of 2002 Savings	\$26,875,870	\$26,875,870	\$0
=	Total Before Interest	-\$81,851,343	\$4,397,428	-\$86,248,772
K	Interest through 12/31/2009	-\$20,717,680	\$1,929,396	-\$22,647,076
=	Total	-\$102,569,024	\$6,326,824	-\$108,895,848
K	Interest through 3/31/2007, as filed by Nicor	-\$12,607,950	\$1,565,855	-\$14,173,805
	Total with interest through 3/31/2007, as filed by Nicor	-\$94,459,294	\$5,963,283	-\$100,422,577

Shaded rows are sub-totals, and should not be added, or adjustments will be counted more than once

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Attachment 2: Summary by Year

	Staff Proposed Changes in Recoverable Gas Costs Excluding Share of PBR Savings	One-half of Staff Proposed Changes in PBR Savings from Previous Year (including 2001 Rider 4 Oxy Adj.)	One-half of Staff's Proposed Exclusion of LIFO-derived Savings	Undercharge from Co's Originally Booked 2001 Savings	PGA Adj to reflect 2002 Final Gas Costs	One-half of Co's Computation of 2002 Savings	Total Before Interest	Interest	Total Surcharge (Refund) Due as of 12/31/2009
1999	(\$24,919,309)						(\$24,919,309)		(\$24,919,309)
2000	\$19,292,566						\$19,292,566	(\$1,405,645)	\$17,886,921
2001	\$4,099,697	(\$5,996,309)	(\$12,178,201)				(\$14,074,812)	(\$433,742)	(\$14,508,554)
2002	(\$5,587,930)	(\$59,000,290)	\$0	\$1,329,699	(\$18,793,860)		(\$82,052,382)	(\$434,790)	(\$82,487,172)
2003		\$2,720,457	(\$9,693,734)			\$26,875,870	\$19,902,593	(\$1,571,194)	\$18,331,399
2004								(\$1,294,325)	(\$1,294,325)
2005								(\$2,199,869)	(\$2,199,869)
2006								(\$4,097,415)	(\$4,097,415)
2007								(\$4,772,808)	(\$4,772,808)
2008								(\$3,487,736)	(\$3,487,736)
2009								(\$1,020,156)	(\$1,020,156)
Total	(\$7,114,976)	(\$62,276,142)	(\$21,871,934)	\$1,329,699	(\$18,793,860)	\$26,875,870	(\$81,851,343)	(\$20,717,680)	(\$102,569,024)

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Attachment 3: Interest Calculations

Monthly compounding

		Staff	12/31/2000	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006	3/31/2007	12/31/2007	12/31/2008	12/31/2009
		Principal	5.50%	6.00%	2.00%	1.50%	1.50%	2.50%	4.50%	5.00%	5.00%	3.50%	1.00%
1999	Factor O	(\$24,919,309)	(\$1,405,645)	(\$1,623,666)	(\$564,125)	(\$430,644)	(\$437,148)	(\$742,988)	(\$1,383,869)	(\$395,486)	(\$1,216,492)	(\$1,177,955)	(\$344,550)
2000	Factor O	\$19,292,566		\$1,189,923	\$413,426	\$315,603	\$320,369	\$544,508	\$1,014,186	\$289,837	\$891,521	\$863,279	\$252,507
2001	Factor O	(\$14,074,812)			(\$284,091)	(\$216,870)	(\$220,146)	(\$374,166)	(\$696,911)	(\$199,165)	(\$612,621)	(\$593,213)	(\$173,514)
2002	Factor O	(\$82,052,382)				(\$1,239,283)	(\$1,258,000)	(\$2,138,131)	(\$3,982,422)	(\$1,138,107)	(\$3,500,754)	(\$3,389,853)	(\$991,526)
2003	Rider 4	\$19,902,593					\$300,600	\$510,908	\$951,602	\$271,951	\$836,507	\$810,008	\$236,926
TOTAL		(\$81,851,343)	(\$1,405,645)	(\$433,742)	(\$434,790)	(\$1,571,194)	(\$1,294,325)	(\$2,199,869)	(\$4,097,415)	(\$1,170,970)	(\$3,601,838)	(\$3,487,736)	(\$1,020,156)
Cumulative Total										(\$12,607,950)	(\$16,209,789)	(\$19,697,524)	(\$20,717,680)

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Attachment 4: 1999 Details of PGA Cost Revisions

**Staff Proposed Revisions to PGA Costs
1999**

Issue	Issue ID	
Maple Issue #3	I3	(\$3,216,169)
Certain Hub Revenues	G	(\$1,931,667)
Company Accounting Corrections	H	(\$13,751,764)
Knepler 2% of Withdrawals Issue	J	(\$6,019,710)
TOTAL Surcharge (Refund)		(\$24,919,309)

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