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**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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**Illinois Commerce Commission  
On its Own Motion**

**-vs-**

**Consumers Gas Company**

**Reconciliation of revenues collected  
under gas adjustment charges with  
actual costs prudently incurred.**

**Docket No. 07-0570**

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**STAFF OF THE ILLINOIS COMMERCE COMMISSION  
REPLY BRIEF ON EXCEPTIONS**

Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to Section 200.830 of the Rules of Practice (83 Ill. Adm. Code 200.830) of the Illinois Commerce Commission (“Commission”), respectfully submits its Reply Brief on Exceptions (“RBOE”) in the above-captioned matter.

**I. BACKGROUND**

Staff’s Initial Brief (“Staff IB”) was filed and served on Consumers Gas Company (“Consumers” or “Company”) and the Administrative Law Judge (“ALJ”) on May 10, 2013. Consumers also filed and served its initial brief in this matter on the same day. On June 27, 2013 Consumers and Staff filed reply briefs (“Staff RB” “Consumers RB”). The ALJ’s proposed order (“ALJPO”) was served on the parties on July 24, 2014. To address the scheduling conflicts for counsel for Consumers and Staff the due dates for

exceptions and reply exceptions were set as September 12, 2014 and October 10, 2014, respectively.

Only Consumers took exception to the ALJPO and filed its brief on exceptions (“Consumers BOE”) on September 12, 2014. Many of the issues raised in Consumers BOE were addressed in the Staff IB and Staff RB. The absence of a response to a specific issue raised in Consumers BOE in the Staff RBOE should not be construed as agreement with those positions or arguments by Staff.

## **II. ARGUMENT**

### **A. Unamortized Balances at 12/31/06 and 12/31/07**

The Commission should reject Consumers’ suggestions to modify the ALJPO and reject Staff adjustments that are required as a basic part of the function of the reconciliation itself. Without argument or explanation, the Consumers BOE seeks to modify the last paragraph on page 35 of the ALJPO, effectively rejecting Staff’s two proposed adjustments to correct Unamortized Balance at 12/31/06 and to correct unamortized balance at 12/31/07. (Consumers BOE, Exception No. 3, p. 16.) The Consumers position is ill-informed and should be rejected.

As noted in Staff’s briefs, Consumers failed to provide any direct response to these Staff adjustments. (Staff RB, p. 4-5) Rather, Consumers argues that with respect to the unamortized balances issues, the Commission’s findings should be resolved consistent with Consumers’ position on the hedging transactions between Consumers and its affiliate Egyptian. (Consumers IB, p. 6) Consumers’ argument misses the point.

As Staff set forth in its IB, Consumers reconciliation for 2007 failed to accurately reflect the Commission-ordered Unamortized Balance at December 31, 2006 from the 2006 reconciliation. (Staff IB, p. 6) The December 31, 2006 balance must reflect the

amount ordered by the Commission in Docket No. 06-0744. The adjustment necessary to reflect the (\$193,441) from the Commission's Order for Docket No. 06-0744 is \$496. (Staff IB, Appendix 2, columns (c) and (d)).

Further, prudence is not the issue here. The issue concerns basic proper accounting. Staff in its IB argued that the Commission should adopt Staff's adjustment to include in the 2007 reconciliation the accrued interest on the unamortized under-recovery balance for the December 2007 period. Staff proposed an adjustment to increase the Unamortized Balance amount as of December 31, 2007, filed by Consumers to the amount shown on line 15, Schedule II of the Company's February 2008 PGA filing, which includes accrued interest. Consumers' reconciliation filing only included the Unamortized Balance of Factor A from line 13, Schedule II of the Company's February 2007 PGA filing, neglecting to include the interest on the unamortized balance. (Staff Ex. 1.0, pp. 3-4)

The Commission should reject Consumer's exceptions on these issues and affirm the conclusions reached in the ALJPO.

#### **B. Commission Adjustment from Prior Order, Inclusion of O Factor**

The Commission should also reject Consumers suggestions to modify the first two paragraphs on Page 37 of the ALJPO to reject Staff's adjustment to include in the 2007 reconciliation the Factor O ordered by the Commission in the 2006 PGA reconciliation, Docket No. 06-0744. (Consumers BOE, Exception No. 4, p. 16) The Consumers position is ill-informed and should be rejected.

As noted in Staff's briefs, Consumers misses the point of this issue. (Staff RB, pp. 5-6) Consumers argues that to the extent applicable, all findings by the

Commission regarding this issue should be consistent with finding that the hedging transaction between Consumers and Egyptian were prudent. (Consumers IB, p. 6) However, not all of Staff's adjustments relate to prudence of the contested hedging transaction between Consumers and Egyptian. The issue here is that the reconciliation filed by Consumers, due to the timing of the issuance of the Commission's final order in Docket No. 06-0744, did not and could not have reflected the Factor O ordered by the Commission in Docket No. 06-0744. (Staff IB, p. 7)

Staff's recommendation on this issue is simply that the reconciliation for 2007 should reflect the fact that the 2006 Factor O is an amount to be refunded in a future period. By including the 2006 Factor O in this reconciliation it will provide tracking of the 2006 Factor O until the reconciliation period in which it is ultimately refunded to ratepayers. (Staff Ex. 1.0, p. 4)

The Commission should reject Consumer's exceptions on these issues and affirm the conclusions reached in the ALJPO.

## **C. Adjustment to Gas Costs**

### **1. Gas price**

The Commission should reject Consumers suggestions to modify the second two paragraphs on Page 38 of the ALJPO to reject Staff's adjustment to reduce gas costs related to gas purchased jointly by Consumers and Egyptian in May and June 2006. (Consumers BOE, Exception No. 5, p. 16) Once again, Consumers' position is ill-informed and should be rejected.

In its initial brief on this issue, Consumers argued that the Commission's findings with respect to this issue should be consistent with finding that the hedging transactions between Consumers and Egyptian were prudent. (Consumers IB, p. 6) As noted in

Staff's briefs, however, Consumers failed to see that this issue, too, is not a prudence issue. (Staff IB, p. 6) Consumers' exceptions, fail for the same reason.

As discussed in the Staff IB, the transactions at issue here involved a joint purchase by Consumers and Egyptian Gas Storage ("EGS") from Utility Gas Management ("UGM") in May and June 2006. (Staff IB, pp. 6-7) Rather than price the gas purchased at Consumers' portion of the purchase from UGM, Consumers priced the gas as if it were a purchase from EGS via the Gas Sales Agreement existing between Consumers and EGS, which it was not. This same mistake was made by Consumers in its 2006 reconciliation for which Staff proposed an adjustment and Consumers did not contest in that proceeding. (Order, Docket No. 06-0744, April 12, 2011, p. 3) (Staff IB, p. 8)

The Commission should reject Consumer's exceptions on these issues and affirm the conclusions reached in the ALJPO.

## **2. Transportation**

The Commission should reject Consumers suggestions to modify the last paragraph on Page 39 of the ALJPO to reject Staff's adjustment to reduce transportation costs related to gas purchased jointly by Consumers and Egyptian in May and June 2006. (Consumers BOE, Exception No. 6, p. 16) The Consumers position is again ill-informed and should be rejected.

In its initial brief on this issue, just as it did with respect to the issue of cost of gas discussed above, Consumers argued that the Commission's findings with respect to this issue should be consistent with finding that the hedging transaction between Consumers and Egyptian were prudent. (Consumers IB, p. 6) As noted in Staff's briefs,

however, Consumers failed to understand that this issue, like others before it, is not a prudence issue. (Staff IB, p. 6)

As discussed in the Staff IB and above, in May and June 2006, Consumers and its affiliate EGS made joint purchases of gas; however, transportation was paid separately to Texas Eastern Transmission, LP (“TETCO”). TETCO is the interstate pipeline company serving Consumers. (Staff IB, p. 7) Rather than Consumers and EGS each receiving a transportation bill for the volume of gas purchased, Consumers paid for all of the transportation for the joint purchases and then was reimbursed for a portion of the cost by EGS. The transportation costs reimbursed by EGS were not calculated on an equal weighting based on the volume of gas purchased by Consumers and EGS as the reimbursement should have been. (Staff Ex. 1.0, p. 6)

The Commission should reject Consumer’s exceptions on these issues and affirm the conclusions reached in the ALJPO.

#### **D. Hedging Transactions between Consumers and Egyptian**

##### **1. Consumers had no authority to enter into the hedging transactions with Egyptian.**

Consumers argues that the hedging transactions between Egyptian and Consumers were authorized by the Gas Sales Agreement (“GSA”). (Consumers BOE, pp. 6-8) The heart of Consumers’ argument is that the GSA was silent on the issue of local gas sales. (*Id.*) Consumers’ argument seems to be that because the GSA was silent on local gas sales, the non local gas sales, i.e. hedging transactions, were authorized. Consumers’ argument in essence is that unless the Commission has specifically told a utility it cannot enter into a transaction then the Commission has

granted authority to enter into such transaction. Consumers' position is contrary to the plain language of the statute which provides that no transaction is effective unless the Commission has consented to it. Section 7-101 provides in part that:

No management, construction, engineering, supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act.

\* \* \*

[ ] Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.

(220 ILCS 5/7-101(3))(emphasis added) The burden is not on the Commission but rather Consumers to identify the transactions it seeks Commission approval to enter into.

As Staff witness Lounsberry testified to and Staff addressed in its IB, the GSA does not and was never intended to allow Consumers the ability to enter into a pre-purchase or hedging transaction with its affiliate. Instead, the original purpose of the GSA was to allow Egyptian the ability to sell local gas to Consumers. (Staff Ex 2.0, pp. 12-13) Local gas is gas produced along Consumers' systems. (*Id.*, p. 13) Staff also reviewed the predecessor agreement that Consumers and Egyptian based the GSA upon and determined that agreement only involved the purchase of local gas. (Staff Ex. 5.0, pp. 4-5) Finally, Staff concluded that Consumers expanded its interpretation of what type of activity the GSA allows it to conduct with Egyptian over time, which coincided with its desire to enter into the hedging transaction with its affiliate. (Staff Ex. 2.0, p. 15)

The Commission most recently reviewed the same set of transactions in Consumers' 2006 PGA reconciliation in Docket No. 06-0744. The Commission in its order stated the following:

**While Consumers argues that there was a GSA in place between Consumers and Egyptian which allowed the course of conduct in which Consumers engaged in 2006, the Commission suggests that the actions taken by Mr. Robinson went beyond what was authorized in the GSA. The Commission further notes that renewal of the GSA was considered by the Commission in Docket No. 08-0139, and the Commission rejected Consumer's GSA as not in the public interest. While the GSA was admittedly in effect during the time period in question in this proceeding, the actions taken by Mr. Robinson on behalf of Consumers and Egyptian appear to have stretched beyond recognition the actions allowed under the GSA. (Order, Docket No. 06-0744, April 12, 2011, p. 24)**

Staff recognizes that the Commission is not bound by prior decisions. Initially we note that the decisions of the Commission are not *res judicata*. The concept of public regulation includes of necessity the philosophy that the Commission shall have power to deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar or same situation in a previous proceeding. Thus like other administrative agencies, the Commission is free to change its standards so long as such changes are not arbitrary and capricious. (*City of Chicago v. Illinois Commerce Commission*, 133 Ill. App. 3d 435, 440 (1st Dist. 1985) (citations omitted), and that the Commission must decide this case on the evidence in the record (220 ILCS 5/10-103, 10-201(e)(iv)(A)). However, on appeal, Commission decisions are entitled to less deference when the Commission drastically departs from past practice. *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, 136 Ill.2d 192, 228 (1989). In this case based upon the facts in this proceeding, Consumers provides no credible evidence for the Commission to decide this issue differently than it did in the 2006 PGA reconciliation.

**2. The Egyptian hedging transactions were imprudent and created significant benefit for the Egyptian to the detriment of Consumers' ratepayers**

Despite Consumers claims to the contrary, the hedging transactions were imprudent and did not benefit ratepayers. Consumers states, "Dr. Rearden provided no factual support for his conclusion that the relationship between Consumers and Egyptian harmed ratepayers. Instead he opines only that by virtue of the relationship itself ratepayers would presumably suffer harm." (Consumers BOE, p. 8) This is fundamentally misreads Staff's position. Staff concluded and the ALJPO agreed that the GSA did not permit Egyptian and Consumers to enter into the hedging transactions. (PO, p. 32) However, Dr. Rearden's testimony was almost completely concerned with investigating whether the hedging transactions were prudent or not prudent. Again, as the ALJPO carefully notes, Staff fully investigated the hedging transactions by their own terms. The ALJPO did find that the transactions were conducted at imprudently high cost, regardless of the counter-party. (PO, p. 33) Indeed, Staff's brief notes that Dr. Rearden examined alternative transactions that resulted in a locked-in price. The only difference between the alternative transactions and the transaction actually conducted is their lower cost. (Staff IB, p. 25; Staff RB, p. 9) Staff bolstered its case by arguing that the utility had an incentive to inflate the price paid to its affiliate, but it did not conclude that that fact alone determined that the hedging transactions were at a imprudently high cost. In other words, Staff believes that the affiliate relationship provides Consumers with a motive for the high prices of the hedging transaction. (Staff RB, p. 12)

Consumers also argues that Staff's case depends on the identity of the counterparty to the hedging transactions. It states, "There is no dispute that the hedging transactions themselves were improper, only that it was improper to make the purchase from Egyptian." (Consumers BOE, p. 9) In fact, Staff does dispute that the

hedging transactions were proper; that is one of the basis for Staff's disallowance. Dr. Rearden discussed at length why the transactions were imprudent. In particular, Consumers would have been able to lock in a lower price in different months. As shown by Dr. Rearden, this would have provided the same degree of price certainty but at much lower cost. (Staff IB, p. 25) Also as noted by Staff, these counter-examples do not constitute hindsight, since they rely upon the same data that existed at the time the hedges were made that Consumers used for the actual hedges.<sup>1</sup>

Consumers also asserts in its BOE that the "Dr. Rearden explicitly substituted his own judgment for that of another[.]" (Consumers BOE, p.10) However, the Dr. Rearden's investigation did not merely lead to a different opinion than Consumers. As noted above, he examined several viable alternatives to Consumers' decision that accomplished the result that Consumers sought, locking in a price, but at a much lower cost to ratepayers. No reasonable person would have chosen the course of action undertaken by Consumers over the then existing alternatives available to Consumers as testified to by Dr. Rearden. In order for utility's decisions to be examined for whether they are prudent or not, Staff must be able to examine the choices available to the utility and consider whether those alternatives were reasonable alternatives available to the utility. Dr. Rearden has done that in this case. If that is not allowed, no utility action could ever be found to be imprudent.

Consumers argues, "Use of a generally accepted exchange price is prudent." (Consumers BOE, p. 10) Staff does not agree that this is universally true. In fact, this case belies that idea. As can be seen in his cross-examination, Dr. Rearden looked at 'generally accepted exchange prices' for different months to develop his counter-

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<sup>1</sup> Note also that Consumers failed to use the correct information to establish the prices in some of the hedging transactions. (Staff Ex. 3.0, 7:146-9:174)

examples to demonstrate that the price chosen by Consumers was imprudently high.<sup>2</sup>

(Tr. 184: 4-10, March 19, 2013) A further explanation is present in Dr. Rearden's cross-examination, which clearly explains how Consumers' 'hedging' differs from other, hedging utilities. (Id., 193:9-196:7) This cross-examination also contradicts Consumers BOE on page 13, when it states that "Consumers, therefore, followed the same purchasing practices as other utilities in Illinois, yet has now been singled out for disparate treatment." It is quite clear in the record that Consumers did not follow the same purchase practices as other Illinois utilities.

Consumers argues that by conducting the transaction through Egyptian "Consumers achieved greater flexibility with its own 110,000 Dth of storage space, allowing for further insulation of ratepayers from volatile price fluctuations." (Consumers BOE, 12-13) However, Dr. Rearden pointed out that the actual transaction being feasible implies that the hypothetical transactions would also have been feasible. However, there was no gain in 'flexibility' by this transaction when compared to the other available alternatives. (Staff Ex. 6.0, 8:171-9:186)

Consumers states that the use of New York Mercantile Exchange ("NYMEX") pricing in a hedging transaction is a generally accepted exchange price used by the natural gas industry. (Consumers BOE, p. 10) Consumers then argues that because the hedging transaction with its affiliate used the NYMEX pricing, its use of that pricing should be considered prudent. Staff disagrees with Consumers position.

As discussed in Mr. Lounsberry's testimony, Consumers failed to follow the provisions of the GSA when it priced the hedging transaction. (Staff Ex. 2.0, p. 15) In

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<sup>2</sup> Note that CA Robinson managed both Consumers and Egyptian, so the price and month were selected by a single entity. (Id., 3:52-54)

particular, Staff notes the GSA pricing provisions are contained in Article IV - Price, Section 4.1 and that this section indicates as follows:

**4.1** The term “delivered price” as used herein shall mean that price paid by Buyer to Seller for natural gas delivered at Buyer’s gate. The delivered price for natural gas sold and delivered pursuant to this Gas Sales Agreement shall be as follows:

Gas will be priced \$0.05MMBTU less than the gas purchased from Buyer’s primary gas source, J.D. Woodward Marketing or other gas supplier, PLUS the transportation charges equal to the amount charged by TETCO to transport gas to the delivery point. (Staff Ex. 2.0, pp. 15-16 & Staff Ex. 5.0, Attachment 4, p. 2)

Staff noted that Egyptian priced the hedging transaction by using the price agreed upon in May 2006 minus 5¢ plus transportation costs that Consumers primary supplier charged it for gas delivered during January, February, and March 2007. However, that formula did not follow the GSA. Consumers and Egyptian did not price the hedging transaction gas based upon the price of gas “from Buyer’s primary gas source, J.D. Woodward Marketing or other gas supplier.” (Staff Ex. 5.0, p. 2) Even using Consumers logic that it could use the GSA pricing mechanism, which Staff disputes, this mechanism still requires a purchase from another supplier to determine the market price. However, Consumers failed to do that. (Staff Ex. 2.0, p. 16)

Consumers’ contract with ProLiance did contain provisions for a fixed priced purchase that would form the basis for hedge gas transaction with ProLiance, but the pricing did not specify NYMEX pricing. In particular, Staff notes that paragraph F, set forth below, does not specify how ProLiance will determine the fixed price. Instead, the ProLiance contract for fixed prices only references NYMEX in relation to basis differential, not the execution price of the transaction. As such, Consumers could not assume that ProLiance would rely on NYMEX future contract pricing for any fixed priced contracts.

Fixed Price: Buyer shall have the right to request a fixed price for volumes to be sold and delivered during any future month or months remaining in the term of this Agreement. Buyer's request shall be in the form of a written, executed-by-Buyer purchase order, designating the applicable months, volumes, delivery points, price (designating a specific price or requesting to fill at market price). Seller will use commercially reasonable efforts to fill such requests. Seller shall at its sole discretion, fill Buyer's request based on the prevailing gas market for future purchase ("Execution Price") along with the cost of deliveries to the Buyer's Delivery Points. Seller shall subsequently confirm to Buyer in writing, any filling of the Buyer's request. Seller's obligation to fix the price for a state quantity of gas is governed by this provision and any fixed price gas purchase as a result of a filled "buy order" or "trigger request" shall be in accordance with the terms applicable to the fixed price transaction. Although Seller may from time to time provide market information to Buyer, Seller is not responsible for fixing the price of any gas absent a duly executed "trigger request form" from Buyer that is capable of being filled by Seller in a commercially reasonable fashion. Buyer acknowledges that the fiscal or budgetary efficacy of any fixed price position may be impacted by the market volatility wholly outside the control of Seller. The applicable fixed price available to Buyer shall be the Execution Price plus a Basis Differential, if applicable, plus a Transaction Cost. The Basis Differential for the purposes of this Agreement is the difference in value between the index pricing location established in Section 3a above and the NYMEX Henry Hub pricing location. The Transaction Cost shall be defined as the Execution Price multiplied by 0.5%.

(Consumers Ex. CHR 2.0, Attachment 2.1, p. 12) (Emphasis added)

#### **E. Recommended Reconciliation and Factor O**

The Commission should reject Consumers suggestions to modify Findings (4) through (7) and the first Ordering paragraph on Pages 41-42 of the ALJPO. (Consumers BOE, Exception No. 8, pp. 16-17) The Consumers position is again ill-informed and should be rejected.

With respect to Finding (4), for the reasons discussed above in Section D.3 of this RBOE, Consumers exception should be rejected.

With respect to Findings (5) through (7) and first ordering paragraph, Consumers seeks to modify or entirely delete those Findings and Ordering paragraph without

explanation, revealing the Company's failure to comprehend that these findings and ordering paragraph (or some version thereof) are necessary for the Commission to clearly set forth the approved reconciliation of revenues collected under PGA charges with actual prudently incurred costs for Consumers for the period January 1, 2007, through December 31, 2007. Contrary to Consumers' modified language, a reconciliation of PGA charges and costs is absolutely necessary. Reconciliation is specifically required by Section 525.70 of the 83 Illinois Administrative Code. 83 Ill. Adm. Code 525.70. Further, without these paragraphs, it would be impossible for the Company, Staff, and ratepayers to know what PGA charges and costs were approved by the Commission, and what amount of over- or under-recovery was approved to be refunded or recovered in future periods.

The Commission should reject Consumer's exceptions on these issues and affirm the conclusions reached in the ALJPO.

#### **F. Adequacy of Data Request Responses**

Consumers did not take exception to the ALJPO where Consumers is directed by the Commission to "undertake efforts to continue to prepare its responses to Staff data requests in a more thorough and complete manner." (ALJPO, 41) Given that, Staff is hopeful that in the future Consumers will prepare more thorough and complete data request responses.

**III. CONCLUSION**

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this docket.

Respectfully submitted,

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