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September 20, 2004

BY HAND-DELIVERY

Blanca Bayó
Director Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

Re: Docket No. 040003-GU

Dear Ms. Bayó:

By memorandum dated September 3, 2004, the Commission Staff filed an audit report (Audit Control No. 04-043-4-2) for NUI City Gas Company of Florida ("Company") in the above docket. The transmittal memorandum advised that the Company should file any response with your office. Accordingly, I have enclosed for filing the original and seven copies of the Company's response to the Staff's audit report.

If there are any questions regarding this transmittal, please contact me at (850) 425-2359.

Very truly yours,

Gary V. Perko

Enclosure
cc: Certificate of Service

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the City Gas Company of Florida's Response to Staff's Audit Report (Audit Control No. 04-043-4-2) in Docket No. 040003GU has been furnished by U.S. mail to the following this 20th day of September, 2004.

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NUI CITY GAS COMPANY OF FLORIDA
PURCHASED GAS ADJUSTMENT
YEAR ENDED DECEMBER 31, 2003

AUDIT DISCLOSURES:

AUDIT DISCLOSURE NO. 1 – BACKGROUND INFORMATION

The Company agrees with the facts stated.

AUDIT DISCLOSURE NO. 2 – OFF SYSTEM SALES AND PURCHASES, GAS SUPPLY PURCHASES

The Company agrees with the facts stated.

<u>AUDIT DISCLOSURE NO. 3</u> – CO-OP SALES

City Gas Company of Florida ("CGF"), a division of NUI Utilities, Inc. ("NUI Utilities"), takes exception to the FPSC auditor's recommendation for a refund of $308,115 to CGF customers for transactions made between NUI Energy Brokers, Inc. ("EB") and CGF through the East Coast Natural Gas Cooperative ("Coop"). It is CGF's belief that no refund is due as a result of these transactions.

CGF acknowledges that between March 1997 and the spring of 2003, EB improperly benefited at the expense of CGF (and its other affiliated utilities). However, as documented in the Liberty and Stier Anderson reports, this occurred when EB acted as an agent purchasing and selling gas on behalf of those utilities. In transactions made through the Coop, however, the relationships of the parties differed in that EB did not act as agent for the utilities, was not acting *on their behalf*, and, unlike transactions conducted under the agency relationship, EB did not control the price that the utilities paid for gas purchased through Coop. Instead, in the Coop transactions, EB sold gas directly to its affiliated utilities, including CGF, through a competitive auction.

Neither Liberty nor Stier Anderson reported findings of trader misconduct for the Coop transactions or economic harm to utility ratepayers resulting from the manner in which the auctions were conducted. Further, no regulatory or other prohibitions prevented EB from transacting directly with an affiliated utility. Liberty contended, without any regulatory, statutory, or other legal support, that it was a conflict of interest for EB to conduct such transactions with Elizabethtown Gas Company ("ETG"), a division of NUI Utilities, and, for that reason alone, sought reimbursement. In the case of transactions between the utilities and EB through a Coop competitive auction, all parties were aware that EB was not acting on behalf of the utilities. Rather, EB was like any other competitive supplier responding to requests for bids with the intent of making a reasonable profit on the transactions.

Stier Anderson conducted an exhaustive analysis of the Coop transactions between EB and its affiliated utilities to determine whether there was evidence of any impropriety on EB's part or whether the Coop transactions were otherwise improper resulting in economic harm to the affiliated utilities. Stier Anderson interviewed witnesses and reviewed documents provided by EB and the Coop, including the bid offerings and responses, and procedures employed by EB and NUI Utilities for the Coop transactions. Stier Anderson found that, in Coop transactions, NUI Utilities employees were directly involved in making decisions on behalf of CGF and had exclusive authority for gas purchases. The NUI Utilities' Manager of Supply Planning and his supervisor, the Vice President of NUI Utilities, decided whether to accept bids, including bids from EB, on behalf of CGF and its affiliated utilities. These decisions were based on the competitive offers from bidders and market intelligence. No evidence was found that any of the bids accepted by the regulated utilities were out-of-market, were other than arm's length transactions, or were otherwise improper.

Both parties to the Coop transactions understood that EB was entering into these transactions with the intent to profit, and it behooved the utility buyers to act in a prudent manner when deciding whether or not to accept the bids offered by EB and other suppliers. Stier Anderson found that the NUI Utilities managers responsible for making the decisions operated independently from EB. EB was treated like any other supplier of gas providing a responsive bid to NUI Utility's request. The NUI Utilities' Manager of Supply Planning and Vice President of NUI Utilities rejected EB bids when EB was the lowest auction bidder when they thought the utilities could do better in the market. Further, they rejected most of the suppliers' offers for CGF bid packages, including eleven bids submitted by EB. Of the nineteen Coop bids let out by CGF for bulk and monthly gas supply, the NUI Utilities' Manager of Supply Planning only accepted four bids, three from EB and one from another supplier.

One of the issues raised in the FPSC Audit Report was whether the auctions were blind. In order to determine whether there was harm or the potential for harm to NUI Utilities, Stier Anderson looked at whether the auctions were truly blind or if the identities of the participants were known to each other. As both Stier Anderson and the FPSC Auditor noted, the names of the utilities requesting bids from suppliers was often known to suppliers who responded. However, Stier Anderson found that disguising the identity of the utility seeking bids would have been difficult because the bid package often necessarily contained a transfer point for pricing purposes -- for instance, CGF's city gate -- that would have revealed the identity of the utility to the bidder. Further, there were no Coop requirements that the identity of the utility remain unknown to the suppliers bidding on the packages, and in fact, later bid packages clearly identified the utility seeking bids. Stier Anderson concluded that identifying the purchasing utility did not have the potential for misconduct or harm to the utilities since that knowledge had no improper impact on the pricing and the utilities were free to accept or reject a bid based on their conclusions about market pricing and prudency of purchasing the gas from the responding bidder.

Stier Anderson concluded that it was more important to determine whether the identities of the bidders were "blind". If prospective bidders on the packages knew who the other bidders were, there would be the potential for collusion and resulting harm to the utilities since the suppliers could have conspired and engaged in price manipulation. Stier Anderson found that the identities of the bidding suppliers were "blind" to the other bidders, therefore reducing the likelihood of collusion.

Whether EB actually realized a profit or loss from a Coop transaction may not be relevant from a regulatory perspective but it is somewhat helpful in determining whether CGF paid a market and prudent price for the gas that it purchased from EB through the Coop. Stier Anderson used EB's own records to find the price EB paid for the gas it purchased to meet its Coop sales obligations to CGF. Those records showed that, although EB made a combined profit of $132,000 on two of the Coop transactions with CGF, EB lost $1,082,865 on the third transaction for a net loss $950,764. These figures support the conclusion that CGF paid EB at least a fair market price for the gas.[1] It also supports the conclusion that EB was not engaging in improper conduct in its Coop dealings with CGF.

Without any findings of misconduct in the Coop transactions or that the three EB offers CGF accepted were out-of-market, NUI respectfully maintains that there is no basis for a refund.

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1 Stier Anderson's analysis showing the profit that EB sometimes realized from these transactions should not be read to mean that Stier Anderson concluded that EB should not have made any profit on the transactions.

<u>AUDIT DISCLOSURE NO. 4</u> – DEFERRED PAYMENT CONTRACTS

The Company agrees with facts as stated.

<u>AUDIT DISCLOSURE NO. 5</u> – ENRON TRANSACTION

The Company agrees with facts as stated.