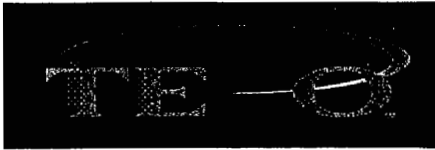


ORIGINAL



PEOPLES GAS

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July 30, 2003

via Federal Express

Ms. Blanca S. Bayo, Director
Division of the Commission Clerk and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

RECEIVED FPSC
30 JUL 31 AM 11:45
COMMISSION
CLERK

Re: Purchased Gas Recovery Docket No. 030003-GU;
Peoples Gas System's Response; Audit Control No. 03-063-2-1

Dear Ms Bayo:

Please accept this as the response of Peoples Gas System ("Peoples"), a division of Tampa Electric Company, to the Final Audit Report for the Purchased Gas Adjustment in Docket No. 030003-GU.

In general, the audit report refers to the total gas supplied in 2002 by certain of Peoples' affiliates as part of its Summary of Significant Findings. Specifically, the report states "When compared to *average pipeline prices* for the two major pipelines used, FGT and SONAT, Prior Energy was less costly than the FGT *average* by \$536,306, and more costly than the SONAT *average* by \$2,009,729. The net additional cost for Prior Energy gas over the *average* prices by pipeline was \$1,473,422." [Emphasis added]

Audit Disclosure No. 1

Just as Peoples responded to a similar disclosure in the Final Audit Report for the Purchased Gas Adjustment in Docket No. 020003-GU, the comparison attempted in this analysis is invalid. As stated before, the price paid to Prior cannot be compared to the price paid for all other gas purchases. Peoples Gas purchases a wide variety of gas packages that have varying parameters such as delivery location, length of term, reliability level, and operational flexibility. Comparing one supplier's gas supply package against the aggregate of all other packages ignores the impact these parameters have on pricing. An analogy of this comparison and how it is flawed is exposed below:

- AUS _____
- CAF _____
- CMP _____
- COM 5
- CTR _____
- ECR _____
- GCL _____
- OPC _____
- MMS _____
- SEC 1
- OTH _____

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FPSC-BUREAU OF RECORDS

PEOPLES GAS
702 NORTH FRANKLIN STREET
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During the period of a year, a customer purchases ground beef at Grocery Store A at an average price per pound of \$2.79. During the same period, the same customer purchases US Choice Grade-A rib-eye steaks from Grocery Store B at an average price per pound of \$6.99.

In this analogy, the conclusion might be that Grocery Store B's average price of beef during the year was higher than that of Grocery Store A. However, such a conclusion would be based solely on a simple mathematical exercise that has no underlying validity. In this analogy, the consumer purchased beef in both stores, but not the same products. By the same token, the audit disclosure in the Final Audit Report might lead the Commission to believe that Prior Energy (a Peoples affiliate) provides an identical product at a higher cost when compared to other suppliers. This is simply not true.

Gas supply contracts are typically "term" deals that cover a period of months spanning the winter and summer periods. Under these contracts, the supplies are purchased on a "firm" basis, which means the supplies are not interruptible and the supplier has an obligation to deliver the gas. "Base load" is gas that flows every day, day in and day out, throughout the term of the agreement. Peoples contracts for base load gas in two ways. First, Peoples purchases "pure" base load gas, the monthly volume of which is not adjustable; that is, Peoples is required to purchase the same amount of gas every day for the term of the agreement. Second, Peoples purchases "adjustable" base load gas, the monthly volume of which may be adjusted by Peoples' giving the supplier 5 to 7 days notice prior to the beginning of each month. (December base load requirements are probably higher than March base load requirements.) Since base load gas supplies are nominated and scheduled monthly, a monthly index can be used to determine the base price. However, prices of various base load supplies differ due to where the gas is delivered into FGT or SONAT by the supplier. This variance is referred to as a basis differential, and varies from day to day, month to month, season to season, zone to zone, and pipeline to pipeline. In addition, supply production cost variances plays a role in the basis differential, one example being on-shore versus offshore production. It is typically more costly for a natural gas producer to research, discover and produce on-shore gas supplies than offshore gas supplies. Peoples purchases its gas supplies at a wide variety of receipt points. This practice ensures supply diversity that is beneficial and necessary during well freeze-offs during the winter and hurricane threats in the Gulf during the summer. Last, there is a finite amount each gas well can produce during a single day which means that one gas supplier may have access to 60% of the gas supplies while another gas supplier may have access to 40% of the supplies. These production and access limits help to explain why Peoples may buy gas from two different suppliers at the same point on the same day. Base load gas supply is typically the lowest priced gas in Peoples' portfolio because the Company takes delivery of the same quantity every day. Unfortunately, Peoples can only contract for base load gas for that portion of the demand for its gas supply that is known and that does not fluctuate on a day-to-day basis (because these packages are considered firm on both the sale and purchase sides of the arrangement).

In addition to base load gas, Peoples also purchases "swing" supplies. These supplies are used to balance the Company's weekday peaks with its weekend lows. These term supplies are nominated and scheduled daily and, as a result, are generally priced using a daily index. Again, the prices of Peoples' swing supplies vary because of daily fundamental market forces such as weather in the Gulf, northeast and mid-west, as well as the basis differential mentioned above. (Swing quantity, frequency, and prior notice to supplier will also impact the price.) Since swing gas allows the buyer to vary the quantity purchased every day, swing gas is generally priced higher than base load gas.

Finally, Peoples also purchases gas in the daily spot market to cover peaks and additional swings in its daily takes. These supplies must be highly reliable as they are used to accommodate extreme peaks caused by high priority load. Peoples purchases a large amount of daily spot gas due to uncertainty in its daily load. The average price of daily spot gas differs from the average cost of Peoples' term gas because of the basis differential, timing of each purchase, i.e. beginning of the month, weekly, daily, or intra-day, as well as the index to which each package is priced. When compared to Peoples' term gas supplies, Peoples' daily spot gas will either be higher or lower in any given day, month or year.

Attached are comparisons of Peoples' term supplies broken down into the base load, swing, and peaking categories. As an example of the effect of location or basis differential, please refer to page 1 of the attached Exhibit 1. If package No. 8 from Exxon is compared with package No. 7 from Prior, one might erroneously conclude that Peoples paid Prior \$0.005 per MMBtu more than it paid to Exxon for gas flowing on the SONAT system. In fact, the differential in pricing paid to Prior is due to the location at which the gas was purchased. (Logansport is an on-shore receipt point and Main Pass is an offshore receipt point. As described above, on-shore production is typically more costly than offshore production.) In reviewing these comparisons, the Commission should take into account the multitude of parameters that drive the pricing of individual natural gas packages, both among the three different types of purchases, and within the same type of purchase from time to time during the year. The auditor's recommendation that Peoples Gas "should not pay more for gas purchased from a related party than it would pay for gas purchased from other suppliers" ignores the multitude of parameters that drive the pricing of individual natural gas packages. Prior Energy has been a valued supplier of Peoples Gas for many years, predating its becoming an affiliate of Peoples. The price paid to Prior Energy for a particular supply package may be higher than the price paid for other gas suppliers' packages, but in no way does this mean a portion of the price should not be recovered through the PGA. It merely means that the package from Prior has parameters that make it more "valuable" than the other package. Comparisons between gas supply contracts can only be made if all terms, conditions, and parameters are identical. Peoples Gas will continue to select natural gas packages based on the best combination of price,

Ms. Blanca S. Bayo, Director
Purchased Gas Recovery Docket No. 030003-GU
Peoples Gas System's Response; Audit Control No. 03-063-2-1
July 30, 2003
Page 4

reliability, flexibility, locations, etc., and made each of the selections of the gas packages purchased during the period covered by the Final Audit Report based on these same criteria.

Please acknowledge your receipt and filing of the above response by stamping a duplicate copy of this letter and returning the same to the undersigned in the enclosed preaddressed envelope.

Thank you for your assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "Matthew R. Costa". The signature is fluid and cursive, with a prominent vertical stroke at the beginning.

Matthew R. Costa
Corporate Counsel

Enclosures

cc: Mr. Frank Sivard (w/encl)
Ms. Angie Llewellyn (w/encl)
Mrs. Wraye Grimard (w/encl)
Mr. W. Edward Elliott (w/encl)

**Peoples Gas System Term Purchase Summary
 2002 Gas Supply Contract Comparisons
 Winter 2001 - 2002**

Package No.	Counter Party	Term	Pipeline	Receipt Point(s)	Month	Min	Volumes Average	Max	Index	Adder	Provisions
FIRM SWING (DAILY)											
1	Prior Energy	11/1/2001 - 3/31/2002	FGT	Koch St Landry Destin	November December January February March	0 0 0 0 0	5,000 10,000 10,000 10,000 5,000	10,000 20,000 20,000 20,000 10,000	IFGMR - FGT Zone 2	\$0 0550	Pipeline Switchable Adjustable Daily Daily volume call priced at beginning of the month index (PGS option)
2	El Paso Merchant Energy	11/1/2001 - 3/31/2002	FGT	Johnsons Bayou	Nov - Mar	0	up to 10,000	10,000	Gas Daily mid-point - FGT Zone 1	\$0.0025	Adjustable Daily
		11/1/2001 - 3/31/2002	FGT	NGPL Vermillion	Nov - Mar	0	up to 10,000	10,000	Gas Daily mid-point - FGT Zone 2	\$0 0025	Adjustable Daily
FIRM PEAKING (DAILY)											
3	Duke Energy	11/1/2001 - 3/31/2002	FGT	NGPL Vermillion	Nov - Mar	0	0	15,000	Gas Daily mid-point - FGT Zone 2	\$0.0050	Adjustable Daily
BASE LOAD											
4	El Paso Merchant Energy	11/1/2001 - 3/31/2002	FGT	Johnsons Bayou	Dec - Feb	5,000	5,000	5,000	IFGMR - FGT Zone 1	\$0 0050	
5	El Paso Merchant Energy	11/1/2001 - 3/31/2002	FGT	Tennessee Carnes	Nov - Mar	4,000	4,000	4,000	IFGMR - FGT Zone 3	\$0.0050	
6	Exxon	11/1/2001 - 3/31/2002	FGT	Mobile Bay	Nov - Mar	10,000	10,000	10,000	IFGMR - FGT Zone 3	\$0 0025	
7	Prior Energy	11/1/2001 - 3/31/2002	SONAT	Log nsport	Nov - Mar	15,000	15,000	15,000	IFGMR - SONAT, La	-\$0 0200	
8	Exxon	11/1/2001 - 3/31/2002	SONAT	Main 2 ss	Nov - Mar	9,379	9,379	9,379	IFGMR - SONAT, La	-\$0.0250	
9	Prior Energy	11/1/2001 - 3/31/2002	FGT	MOFS Tivoli	Nov - Mar	0	up to 15,000	15,000	IFGMR - FGT Zone 1	\$0 0175	Pipeline Switchable & Adjustable Monthly
10	Prior Energy	11/1/2001 - 3/31/2002	FGT	Cironeille	Nov - Mar	0	up to 10,000	10,000	IFGMR - FGT Zone 3	\$0 0100	Pipeline Switchable & Adjustable Monthly
11	Aquila Energy	11/1/2001 - 3/31/2002	FGT	MOFS Tivoli NGPL Vermillion Cironeille	Nov - Mar	0	up to 30,000	30,000	IFGMR - FGT Zone 1 IFGMR - FGT Zone 2 IFGMR - FGT Zone 3	\$0 0100 -\$0 0025 -\$0 0075	Pro-rated delivery across zones regardless of actual receipt point Adjustable Monthly
12	Duke Energy	11/1/2001 - 3/31/2002	FGT	MOFS Tivoli	Nov - Mar	0	up to 10,000	10,000	IFGMR - FGT Zone 1	\$0 0200	Adjustable Monthly
13	Duke Energy	11/1/2001 - 3/31/2002	FGT	Sabine Kaplan	Nov - Mar	0	up to 10,000	10,000	IFGMR - FGT Zone 2	\$0 0000	Adjustable Monthly
14	El Paso Merchant Energy	11/1/2001 - 3/31/2002		Johnsons Bayou	November	0	up to 5,000	5,000	IFGMR - FGT Zone 1	\$0 0075	Adjustable Monthly
15	El Paso Merchant Energy	11/1/2001 - 3/31/2002		Johnsons Bayou	March	0	up to 5,000	5,000	IFGMR - FGT Zone 1	\$0.0075	Adjustable Monthly
16	El Paso Merchant Energy	11/1/2001 - 3/31/2002	FGT	NGPL Vermillion	Nov - Mar	0	up to 5,000	5,000	IFGMR - FGT Zone 2	\$0 0075	Adjustable Monthly

**Peoples Gas System Term Purchase Summary
 2002 Gas Supply Contract Comparisons
 Summer 2002**

<u>Package No.</u>	<u>Counter Party</u>	<u>Term</u>	<u>Pipeline</u>	<u>Receipt Point(s)</u>	<u>Month</u>	<u>Min</u>	<u>Volumes Average</u>	<u>Max</u>	<u>Index</u>	<u>Adder</u>	<u>Provisions</u>
FIRM SWING (DAILY)											
1	Prior Energy	5/1/2002 - 9/30/2002	FGT	NGPL Vermillion Judge Digby Trunkline Vermillion	May - Sep	0	5,000	10,000	IFGMR - FGT Zone 2	\$0.0650	Pipeline Switchable & Adjustable Daily
2	Dynegy	5/1/2002 - 9/30/2002	FGT	Various Zone 2	May - Sep	0	5,000	10,000	IFGMR - FGT Zone 2	\$0.1000	Pipeline Switchable & Adjustable Daily
FIRM PEAKING (DAILY)											
3	Dynegy	5/1/2002 - 9/30/2002	FGT	Various Zone 2	May - Sep	0	up to 10,000	10,000	Gas Daily mid-point - FGT Zone 2	\$0.0100	Pipeline Switchable & Adjustable Daily
4	Dynegy	5/1/2002 - 9/30/2002	SONAT	Main Pass 289 & 310	May - Sep	0	up to 10,000	10,000	Gas Daily mid-point - SONAT, LA	\$0.0100	Pipeline Switchable & Adjustable Daily
5	Prior Energy	4/1/2002 - 10/1/2002	SONAT	SONAT Tier 1 or 2 Pool	Apr - Oct	0	up to 12,524	12,524	Gas Daily mid-point - SONAT, LA	\$0.0200	Intraday peaking supply
									If intraday, higher of Gas Daily SNG absolute high for gas day or following gas day		\$0.0200 reservation fee
BASE LOAD											
6	El Paso Merchant Energy	5/1/2002 - 10/31/2002	SONAT	Elba Island	May - Oct	5,000	5,000	5,000	IFGMR - SONAT La	\$0.1000	
7	Exxon	4/1/2002 - 10/31/2002	FGT	Mobile Bay	Apr - Oct	15,000	15,000	15,000	IFGMR - FGT Zone 3	\$0.0150	Pipeline Switchable
8	Cinergy Marketing	5/1/2002 - 9/30/2002	FGT	MOPS Tilvoli	May - Sep	7,000	7,000	7,000	IFGMR - FGT Zone 1 or IFGMR - SONAT, La	\$0.0125 \$0.0075	Pipeline Switchable
9	Prior Energy	5/1/2002 - 4/30/2003	SONAT	Various	May - Apr	0	up to 15,000	15,000	IFGMR - SONAT, La	-\$0.0200	Pipeline Switchable & Adjustable Monthly

**Peoples Gas System Term Purchase Summary
 2002 Gas Supply Contract Comparisons
 Winter 2002 - 2003**

<u>Package No.</u>	<u>Counter Party</u>	<u>Term</u>	<u>Pipeline</u>	<u>Receipt Point(s)</u>	<u>Month</u>	<u>Min</u>	<u>Volumes Average</u>	<u>Max</u>	<u>Index</u>	<u>Adder</u>	<u>Provisions</u>
FIRM SWING (DAILY)											
1	Prior Energy	12/1/2002 - 4/30/2003	FGT	Zone 3 Pool	Dec - Apr	0	up to 10,000	10,000	Gas Daily mid-point - FGT Zone 3	\$0.0200	Adjustable Daily
2	Prior Energy	12/1/2002 - 4/30/2003	SONAT	PSNG1268	Dec - Apr	0	up to 15,000	15,000	Gas Daily mid-point - SONAT, La	\$0.0100	Adjustable Daily
3	Oxy	12/1/2002 - 4/30/2003	FGT	Johnsons Bayou	Dec - Apr	0	up to 10,000	10,000	Gas Daily mid-point - FGT Zone 1	\$0.0000	\$0.0100 reservation fee Adjustable Daily
BASE LOAD											
4	Anadarko	12/1/2002 - 4/30/2003	FGT	Zone 2 Pool	Dec - Apr	0	5,000	5,000	IFGMR - FGT Zone 2	\$0.0050	\$0.0075 reservation fee Adjustable Monthly
5	Conoco	12/1/2002 - 4/30/2003	FGT	Crosstex	Dec - Apr	5,000	5,000	5,000	IFGMR - FGT Zone 1	\$0.0000	
6	Exxon	12/1/2002 - 4/30/2003	SONAT	Main Pass 289	Dec - Apr	5,000	5,000	5,000	IFGMR - SONAT, La	-\$0.0100	
7	Exxon	11/1/2002 - 3/31/2003	FGT	Mobile Bay	Dec - Mar	15,000	15,000	15,000	IFGMR - FGT Zone 3	\$0.0200	
8	Oxy	12/1/2002 - 4/30/2003	FGT	Johnsons Bayou	Dec - Apr	0	10,000	10,000	IFGMR - FGT Zone 1	\$0.0000	\$0.0075 reservation fee Adjustable Monthly PGS put option @ Gas Daily
9	BP Amoco	12/1/2002 - 3/31/2003	FGT	MOPS	Dec - Mar	0	10,000	10,000	IFGMR - FGT Zone 1	\$0.0050	\$0.0100 reservation fee Adjustable Monthly PGS put option @ Gas Daily -\$0 0100