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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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NOI MANAGER'S REPORT

Docket 01 NOI-1

Notice of Inquiry into the Recent Increase in the Price of Natural Gas

Presented by
Thomas E. Kennedy

on behalf of the
NOI Staff

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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Notice of Inquiry into the recent increase	:	
in the price of natural gas	:	01 NOI-1

NOI MANAGER'S REPORT

I. Executive Summary

A. Background

On January 3, 2001, Governor George H. Ryan, in conjunction with the creation of the Energy Cabinet (see Executive Order #2, 2001), called upon the Illinois Commerce Commission ("ICC" or "Commission") to complete a full investigation of the recent natural gas price increases which have had a serious impact on Illinois consumers during the 2000/2001 winter heating season. As a part of its efforts to investigate natural gas prices and pursuant to the Commission's rules of practice, the Commission issued a Notice of Inquiry ("NOI"), designated as ICC Docket 01 NOI-1. An initial set of questions was issued by the Commission in the NOI on or about January 31, 2001, and a second set of questions was issued in a "Supplemental Notice of Inquiry" on or about February 7, 2001. In all, the Commission asked thirty questions spanning several different subject areas related to the causes and consequences of the high gas price. There were thirteen respondents to the NOI: 10 utilities and 3 non-utility organizations. This is the NOI Manager's Report, which provides the Commission with a set of findings and recommendations based on the investigation referenced above.

B. Organization of the Report

The main body of this report (Section IX: Review of the NOI Comments) provides a subject-by-subject review and analysis of the initial and reply comments submitted by the various respondents to the NOI on or about March 2 and March 12th, respectively, as well as the oral comments heard by the Commissioners in an open meeting on March 2. Within this subject-by-subject review of the

respondents' comments, the Staff also relates supplemental information that may aid the Commission in its consideration of the issues raised by the NOI. One source of such supplemental information is the written transcripts from public meetings conducted by the Commission on January 18 and January 24. Finally, this section of the report discusses the recommendations of the respondents and reports the Staff's own findings and recommendations, within each of the following ten main subject areas:

A. Initial Questions on the cause of the high prices;

B. Efforts to Inform and Assist Customers;

C. Supply and Production;

D. Transmission;

E. Distribution;

F. Holding Companies and Affiliates;

G. Wholesale and Trading;

H. Projected Natural Gas Prices;

I. Hedging and Risk Management; and

J. Other Comments Not Directly in Response to NOI Questions

The Appendix to this report provides a relatively-detailed summary of each respondent's answer to each question in the NOI. The complete set of comments can also be found on the Commission's internet site, *www.icc.state.il.us*, more specifically at:

<http://www.icc.state.il.us/icc/gas/noi.asp>.

C. Acknowledgments

The NOI Manager wishes to thank all of the participants in the Commission's investigation for the time and effort that they expended in responding to the NOI questions, as well as the time and effort expended by various members of the Commission Staff who contributed greatly to the production of this report. Because this report was largely the product of multiple divisions, the finding and recommendations within this report are attributed to the "NOI Staff" rather than the NOI Manager.

D. Major Findings and Recommendations

In reviewing the record of this investigation, the NOI Staff concludes that the higher gas prices of the last twelve months have been due largely to factors that affected supply and demand. These factors will be enumerated in the main body of the report. No acts of market manipulation were reported to the Commission. Despite efforts by utilities and the Commission to provide advanced warning of the higher prices, customers were still unprepared for the magnitude of their winter heating bills. A significant contributor to the unwanted surprise was the record cold weather experienced in November and December, which pushed up wholesale (and retail) energy prices as well as the demand for space heating fuel.

Several recommendations were made during the course of the proceeding. Some parties recommended the initiation of rulemakings. As stated in 2 Ill. Adm. Code, Part 1700, it should be noted here that

> the Notice of Inquiry proceeding is not a rulemaking, but that information gathered may or may not form the basis for the initiation of rulemaking or for other purposes at a later date.

The NOI Staff is not recommending the initiation of any rulemakings, based on this NOI. However, further study and consideration of several issues is warranted, at this time. In particular:

- Utilities should continue to inform customers of anticipated gas price movements, conservation measures, and available budget and deferred payment plans. Also, utilities should continue to review and evaluate their communications and collection policies to determine what improvements can be implemented.
- The Commission should invite utilities and other potentially interested parties to participate in Staff-sponsored workshop discussions on the topic of energy usage estimation. Hopefully, such an effort will help to reduce the degree to which inaccurate energy use estimates lead to significant under- or over-collections from customers during periods of significant price volatility.
- Utilities should consider ways to limit ratepayers' exposure to gas price risk through prudent risk management practices.

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V. List of Speakers at the Commission's January 18 Gas Price Roundtable Meeting

Ms. Janice A. Dale
Chief of the Public Utilities Division
Illinois Attorney General's Office

Mr. Marty Cohen
Director
Citizens Utility Board

Ms. Marie D. Spicuzza
Supervisor for the Environment and Energy Department
Cook County State's Attorney's Office

The Honorable William Abolt
Commissioner of Environment
City of Chicago

Mr. Scott Glaeser
Manager of Natural Gas Supply and Transportation
Ameren

Ms. Susan Prebil
Energy Supply Representative
CILCO

Ms. Vonda Seckler
Energy Trading Representative
CILCO

Mr. Larry Altenbaumer
President
Illinois Power Company

Mr. Phil Cali
Executive Vice President of Operations
Nicor

Mr. Thomas M. Patrick
President and COO
Peoples Gas Light & Coke Company
and North Shore Gas Company

VI. List of Speakers at the Commission's January 24th Gas Price Roundtable Meeting

Mr. Robert Ladevich
Director of Planning and Energy
A. Finkl and Sons

Mr. Donato Eassey
First Vice President
Merrill Lynch

Mr. James Osten
Chief Energy Economist and Director of Fuel Analysis
Standard and Poors

Ms. Barbara Mariner Volpe
Senior Advisor, Oil and Gas Department
Energy Information Administration
U.S. Department of Energy

Mr. Skip Horvath
President
Natural Gas Supply Association

Ms. Cynthia Albert
Vice President
CMS Panhandle Pipeline Companies

Mr. Jim McElligott
Senior Vice President
Natural Gas Pipeline Company of America

VII. List of Organizations That Provided Written Responses to 01 NOI-1

UTILITY COMPANY RESPONDENTS:

Alliant Energy

Ameren

CILCO

Illinois Gas Company

Illinois Power

MidAmerican Energy Company

Mt. Carmel Public Utility Co

Nicor

Peoples Gas Light & Coke Co. / North Shore Gas Co.

United Cities Gas Company

OTHER RESPONDENTS:

Citizens Utility Board ("CUB")

Cook County State's Attorney's Office ("CCSAO")

Midwest Community Council ("MCC")

VIII. List of Speakers at the Commission's March 20th Public Meeting in 01 NOI-1

Mr. David Butts
Executive Vice President
Illinois Power

Mr. Rocco D'Alessandro
Vice President
Nicor Gas

Ms. Katherine A. Donofrio
Vice President
Peoples Gas Light & Coke Company
and North Shore Gas Company

Ms. Leijuana Doss
Assistant State's Attorney
Cook County State's Attorney's Office

Mr. D. Fondy James
Executive Director
Midwest Community Council

IX. Review of the NOI Comments

A. Initial Questions on the Cause of the Higher Prices

1. Discussion of Comments

The initial questions that were attached to the NOI primarily sought to determine the cause for the significant changes in natural gas prices, which escalated throughout 2000 and peaked in January 2001. With one exception,[1] the utilities verified that the price increases experienced by retail consumers over the last 12 months were entirely due to wholesale natural gas price increases that were passed through their purchased gas adjustment clauses ("PGAs").

All Illinois gas utilities currently recover their natural gas commodity costs and their interstate pipeline transportation and storage service costs through a PGA mechanism. This is a monthly price adjustment, which closely tracks the utilities' costs and is subject to an annual reconciliation, in which any residual over- or under-recovery of costs is accounted for and subsequently resolved through a rate adjustment applicable in the ensuing months. A comparison of PGA prices over the last three winters is

Table 1: PGA Rates over the Last Three Heating Seasons

	Simple Average of November through February PGA Rates		
	1998/1999	*1999/2000*	*2000/2001*
CILCO	27.94	32.20	77.25
AMEREN (CIPS)	32.07	36.94	67.70
Consumers Gas	33.55	32.13	84.89
Illinois Gas	35.27	41.39	92.51
IP - Rider A	28.08	31.23	70.23
Interstate - Area A	34.31	44.37	73.54
Interstate - Area B	23.02	20.16	68.86
MidAmerican Energy	32.19	39.35	78.44
Mt. Carmel	33.45	36.33	62.75
North Shore	27.68	34.52	81.18
NIGas	26.05	34.32	80.78
Peoples Gas	26.96	33.72	80.94
South Beloit	28.64	36.24	67.89
AMEREN (UE)	30.02	42.29	76.60
UC - Harrisburg	24.93	39.44	81.04
UC - Metropolis	27.52	40.10	76.73
UC - Salem	22.90	41.06	61.83
UC - Vandalia	22.47	38.38	78.75
UC - Virden	19.58	38.27	60.41
UC - St. Elmo	21.43	30.40	70.76

(Also see Figure 5, p. 7)

[1] The exception was MidAmerican, which was granted a base rate increase, based upon a 1998 test year, through a July 11, 2000 Order of the Commission. The Order authorized a monthly customer charge increase from $6 to $9 and an average distribution charge decrease from 9.6 cents per therm to 8.0 cents per therm. No year 2000-specific costs were included in that rate case. These increases are obviously small compared to the above.

shown in Table 1, while a comparison of the total commodity gas costs accounted for in the PGAs over the last two winters is shown in Table 2. The latter shows that state-wide total commodity gas costs increased 180% from $1.2 billion (during the September 1999 to April 2000 period) to $3.5 billion (during the September 2000 to April 2001 period), reflecting both an increase in commodity prices as well as an increase in usage.

Table 2: Comparison of Commodity Gas Costs Over the Previous Two Heating Seasons

	Sept 00-Apr 01	Sept 99-Apr 00	Change	% Change
CILCO	$ 211,463,091	$ 71,210,543	$ 140,252,548	197%
CIPS	$ 120,148,788	$ 43,408,530	$ 76,740,258	177%
Consumers Gas	$ 5,587,217	$ 2,234,564	$ 3,352,653	150%
Illinois Gas	$ 9,722,663	$ 3,616,115	$ 6,106,548	169%
Illinois Power	$ 351,153,819	$ 126,307,523	$ 224,846,296	178%
Interstate Power	$ 4,637,991	$ 1,834,816	$ 2,803,175	153%
MidAmerican Energy	$ 60,874,979	$ 20,873,860	$ 40,001,119	192%
Mt. Carmel	$ 2,684,695	$ 1,080,633	$ 1,604,062	148%
NiGas	$ 1,669,988,208	$ 618,325,907	$ 1,051,662,301	170%
North Shore	$ 170,253,728	$ 55,661,458	$ 114,592,270	206%
Peoples	$ 862,033,799	$ 292,693,632	$ 569,340,167	195%
South Beloit	$ 6,338,000	$ 3,075,100	$ 3,262,900	106%
Union Electric	$ 13,587,389	$ 4,698,521	$ 8,888,868	189%
United Cities	$ 19,633,768	$ 7,319,876	$ 12,313,892	168%
Total	**$ 3,508,108,135**	**$ 1,252,341,078**	**$ 2,255,767,057**	**180%**

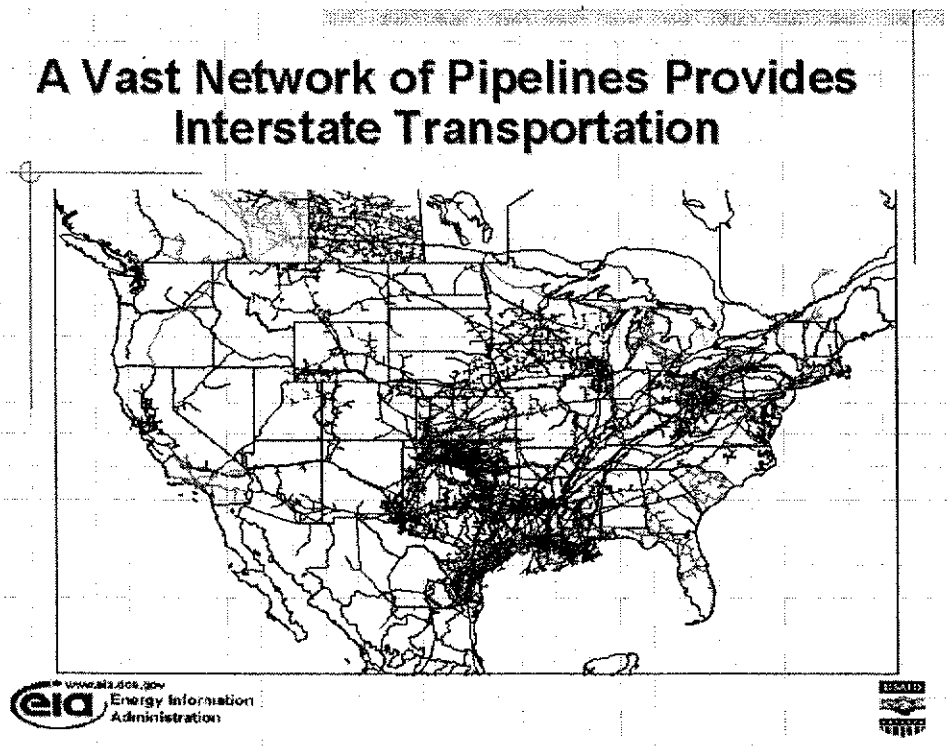
While some utilities noted that they incurred unusual costs for mercury investigation, inspection, and clean-up during 2000, these costs were recovered neither through the PGA nor through any other adjustment in retail rates. Similarly, many utilities cited some increased costs in 2000 for their own use of natural gas, for their efforts to respond to consumer questions and complaints, for customer service, for public relations, for mass communication, for carrying costs, as well as for higher unpaid debt expenses. None of these additional costs were recovered through the PGA. All such costs are normally recovered through base rates, which do not fluctuate by month like the PGA. Typically, such base rates are altered after the Commission has conducted a thorough "rate case" which can take up to 11 months to complete.

To place the recent price increases into context, the history of natural gas prices is displayed in a series of graphs on the next several pages. Figure 1 shows the vast interstate pipeline system which

moves gas throughout North America (the most dense cobwebs of lines revealing the major producing regions and market hubs. Figure 2 shows the annual average of U.S. wellhead prices, from 1970 through 1998. Chronologically, Figure 3 picks up where Figure 2 leaves off, but switches to showing the **monthly** averages of U.S. wellhead prices, through January 2001. Figure 3 also shows the level of prices for the New York Mercantile Exchange's Henry Hub natural gas futures contract. Henry Hub is a major trading point for gas flowing from producing regions of Texas, Louisiana, and Oklahoma to consuming regions in the Midwest and the East. Finally, Figure 4 shows the monthly PGA prices, since January 1998, of five of the largest gas utilities in Illinois.

Examination of the graphs, cited above, shows the significant increases in gas prices that have occurred at both the wholesale and retail levels over the last 12 months. On the wholesale side, for instance, last-trade date settlement prices of the NYMEX gas futures peaked for the

Figure 1: Interstate Pipeline System



Source: Barbara Mariner-Volpe, "The Evolution of Gas Markets in the United States" Energy Information Administration, Slide-show presentation, May 2000. <http://www.eia.doe.gov/pub/oil_gas/natural_gas/presentations/2000/evolution_gas/index.htm>

Figure 2: Natural Gas Wellhead Prices

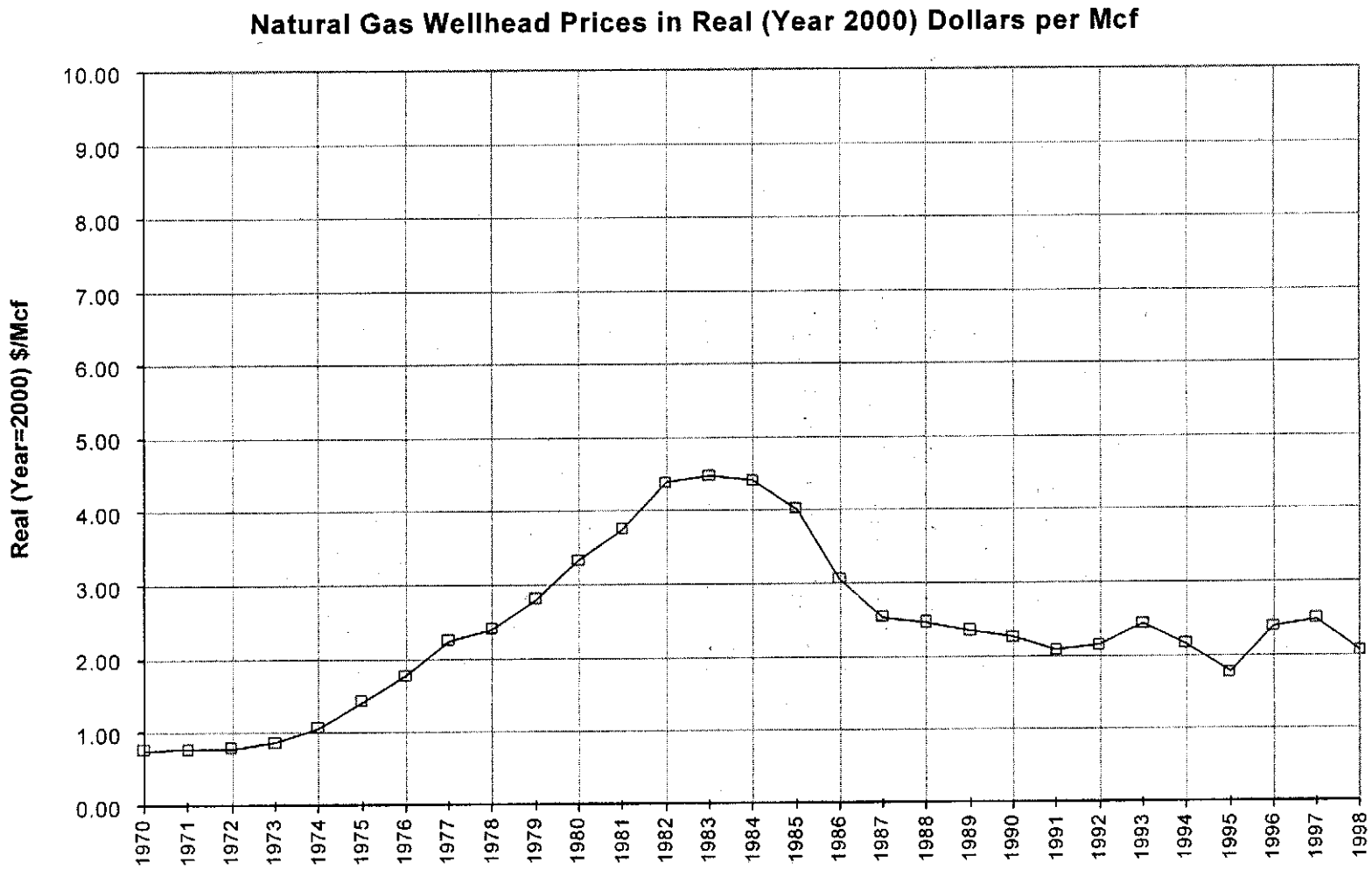


Figure 3: Wholesale Gas Prices Since January 1998

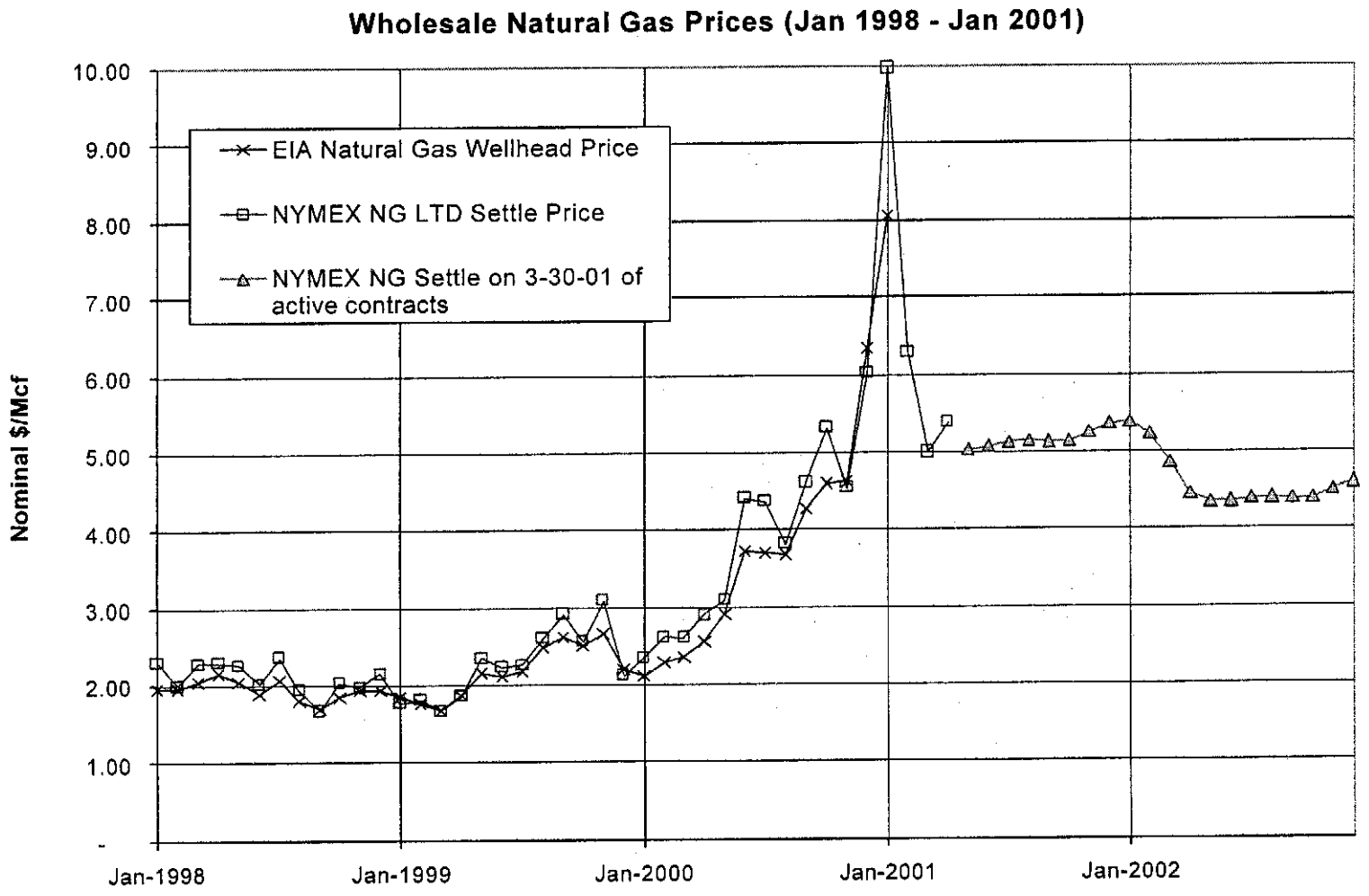


Figure 4: Monthly PGA Rates Since January 1998

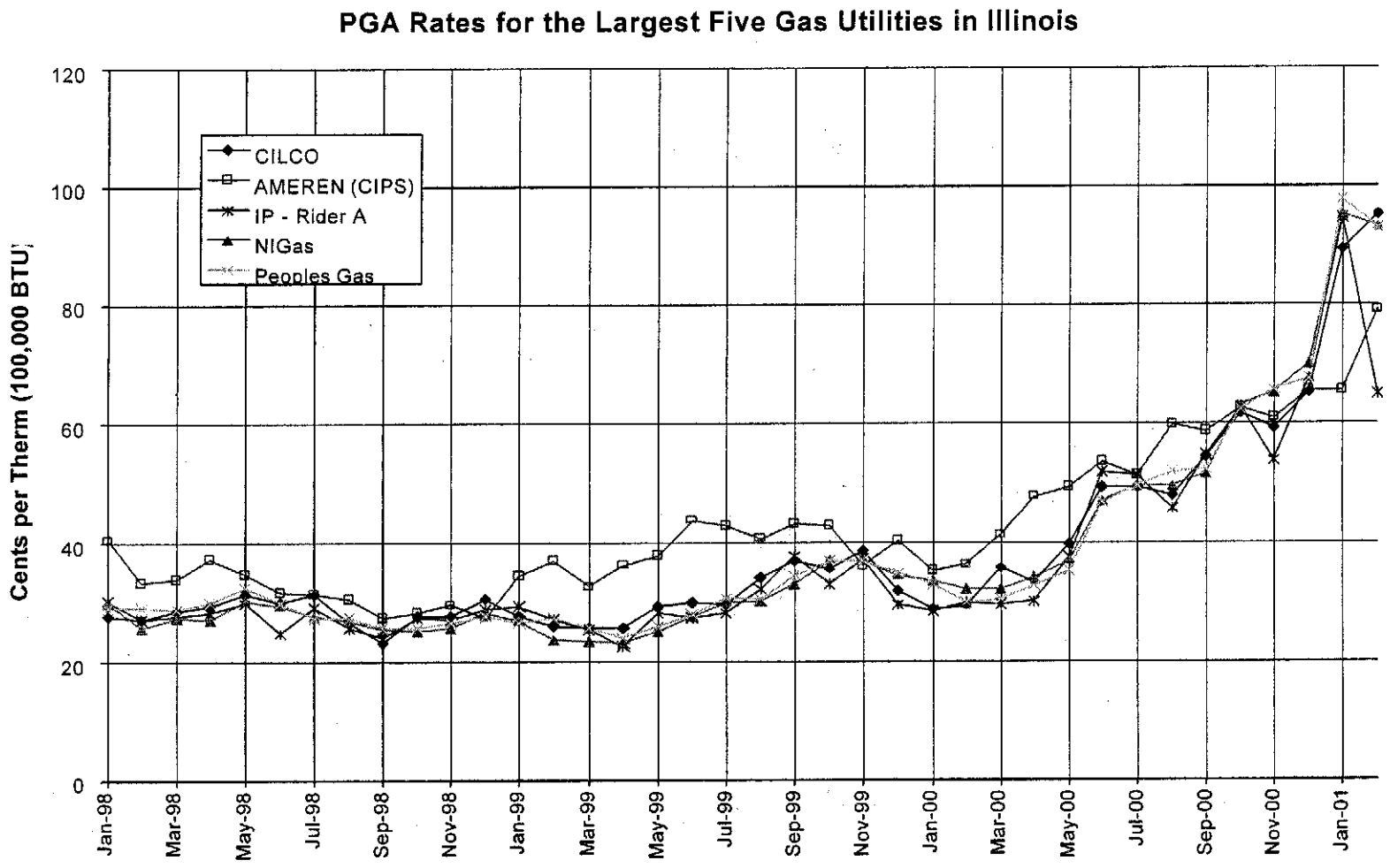


Figure 5: Comparison of Last Three Winter's PGA Rates

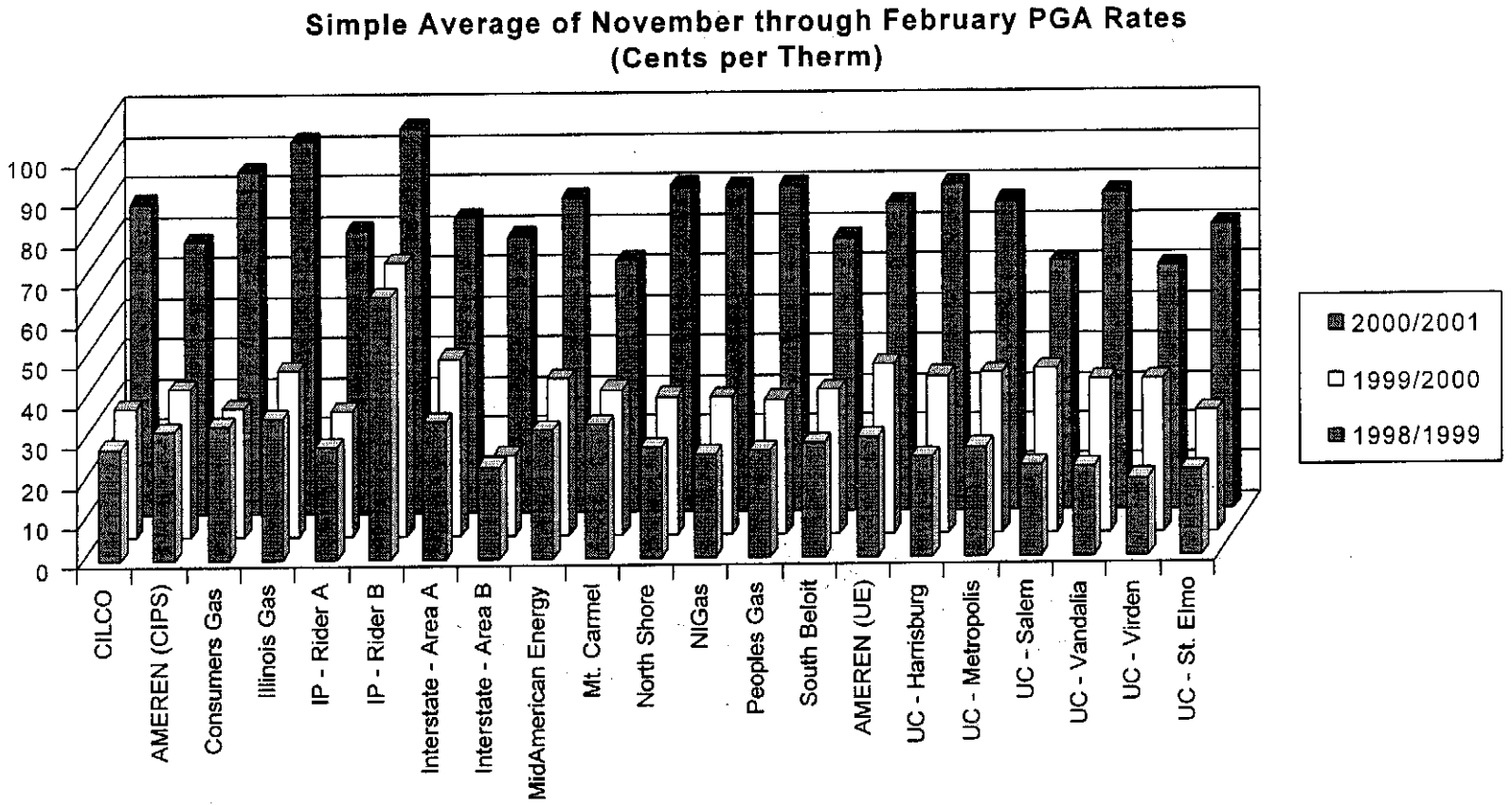
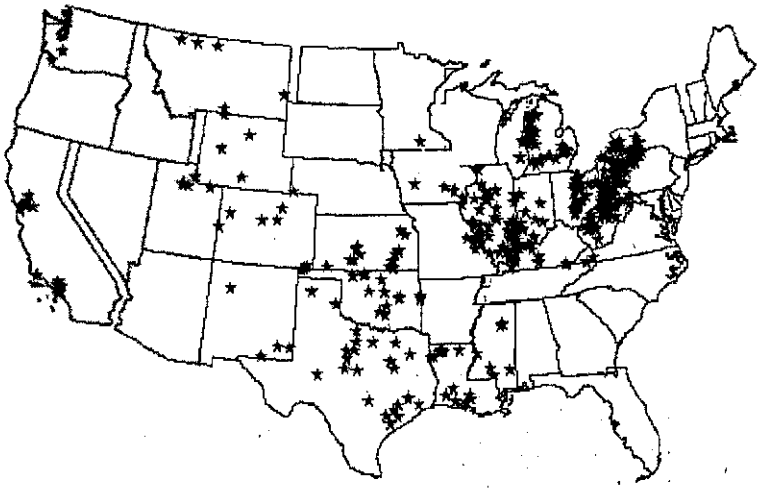


Figure 6: Natural Gas Storage Fields

At the end of 1998 there were 410 underground natural gas storage sites in the U.S.

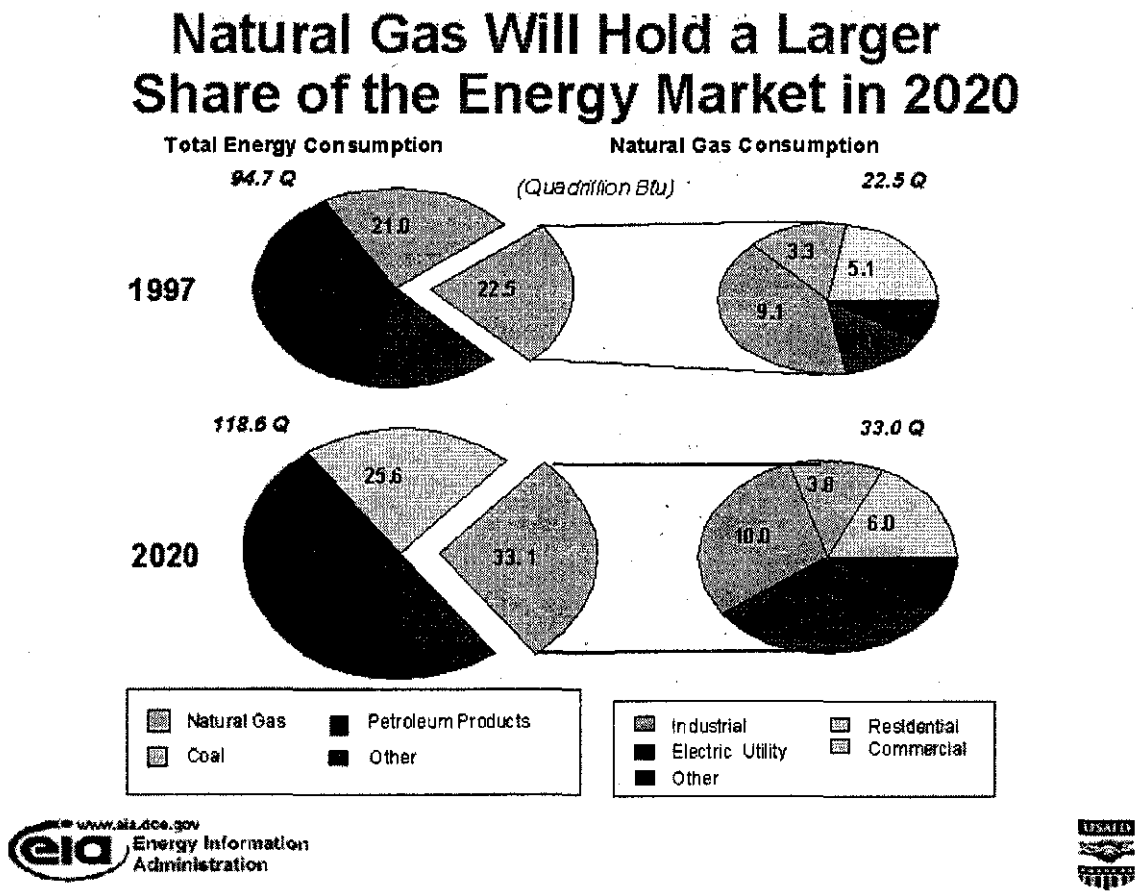


With 76 Bcf per day of Withdrawal Capability and 3,933 Bcf of Working Gas Capacity

www.eia.doe.gov
Energy Information Administration

Source: Barbara Mariner-Volpe, "The Evolution of Gas Markets in the United States" Energy Information Administration, Slide-show presentation, May 2000. <http://www.eia.doe.gov/pub/oil_gas/natural_gas/presentations/2000/evolution_gas/index.htm>

Figure 7: Natural Gas's Share of Energy Market



Source: Barbara Mariner-Volpe, "The Evolution of Gas Markets in the United States" Energy Information Administration, Slide-show presentation, May 2000. <http://www.eia.doe.gov/pub/oil_gas/natural_gas/presentations/2000/evolution_gas/index.htm>

January 2001 contract at almost $10 per MMBtu -- over ***four times*** greater than the January 2000 and January 1999 last-trade date settlement prices for the NYMEX gas futures contract. A recent snapshot of settlement prices for actively traded NYMEX gas futures contracts reveals market expectations that wholesale Henry Hub gas will cost between $5.00 and $5.50 per MMBtu through next January. (Note: One MMBtu equals 10 therms). The graphs also show the close relationship between retail PGA rates and wholesale gas prices over the last two years.

What is the cause of the higher gas prices? In short, respondents to the NOI (as well as various experts that have addressed the issue before the Commission) agree that the price increases are the result of the law of supply and demand. Respondents identified the following factors which lowered supply and raised demand, apparently leading to the change in market prices observed over the period under review in this NOI:

Supply-side factors

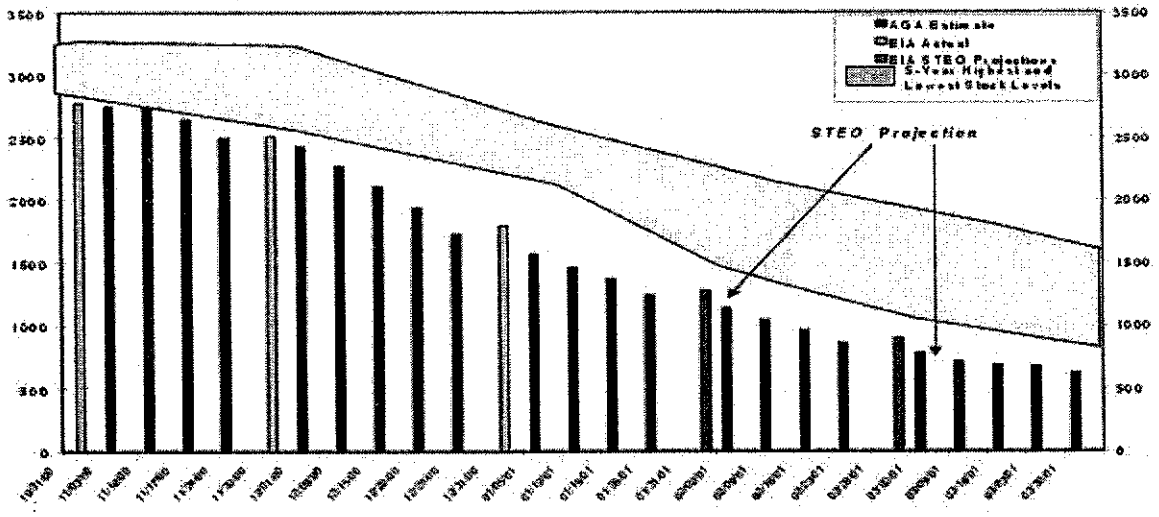
- Reduced investment. Persistently low prices in 1990s inhibited investment in exploration and well development. For example, rig counts dropped from 627 in the 4th quarter of 1997 to 396 in the 2nd quarter of 1999.
- Learning curve. Original expectations for production capability were not met due to the learning curve associated with new drilling technologies.
- Low storage. Prior to the heating season, high summer prices (and perhaps false expectations of subsequently lowering prices) reduced the extent of production-area storage injections. Storage inventories from the beginning to the end of the heating season (and a comparison of this season's levels to highs and lows over the previous five years) are show in Figure 8, below.[2] Also see the Energy Information Administration report, "Natural Gas Storage in the United States in 2001," by James Tobin and James Thompson.[3]

[2] Low storage levels were also noted in the testimony of Mark J. Mazur, Acting Administrator of the Energy Information Administration, before the U.S. Senate Committee on Energy and Natural Resources, December 12, 2000. He noted that inventory levels on December 1, 2000 were 14 percent below the average level for this time of the year during the previous 5 years (1995-1999). See <http://www.eia.doe.gov/pub/oil_gas/natural_gas/presentations/2000/testimony_on_natural_gas_demand/1211sen-test.pdf>

[3] <http://www.eia.doe.gov/pub/oil_gas/natural_gas/feature_articles/2001/storage_outlook_2001/storage.pdf>

- Pipeline capacity. Respondents also cited recent additions to pipeline capacity both entering as well as leaving the State. Various respondents opined diversely that the net effect of these pipeline additions on prices in Illinois was negative, positive, neutral, and indeterminate.

Figure 8: Storage Inventories Actual and Projected



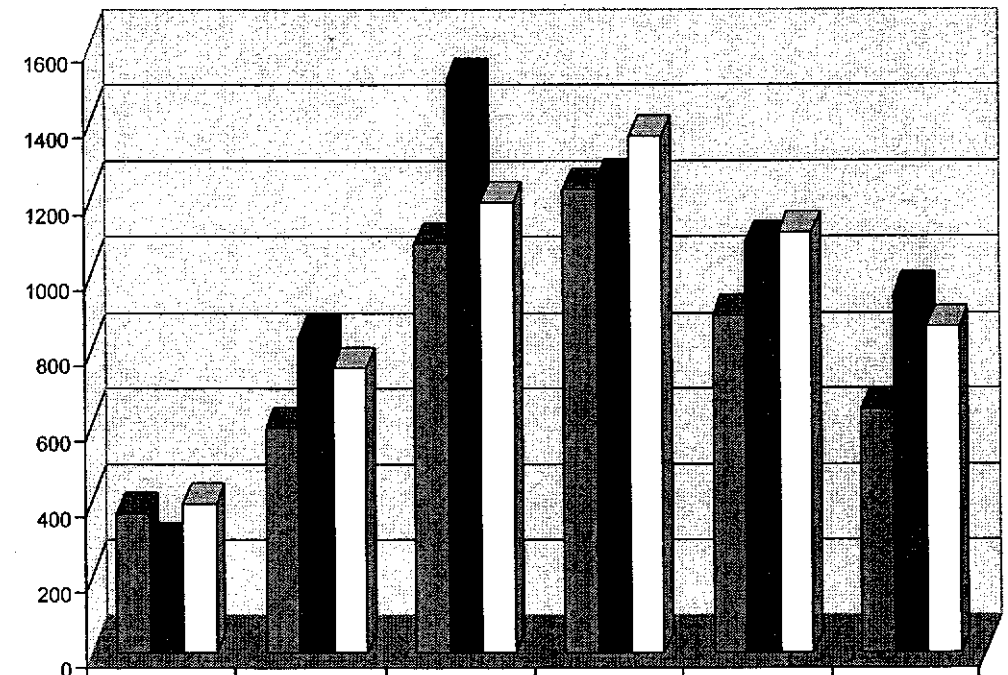
Source: Energy Information Administration's Weekly Storage Report, April 9, 2001
<http://www.eia.doe.gov/oil_gas/natural_gas/data_publications/natural_gas_weekly_market_update/ngwmu.html>

Demand-side factors

- Macro-economic. The economic boom of the 1990s spurred production of many goods and services and the demand for natural gas used in their production.
- Increased number and utilization of natural gas-fired electric generation facilities. Increased natural gas demand due to such facilities was presumably most pronounced during the summer, helping to keep market gas prices high and lowering the amount of gas being injected into production-area storage wells. No respondent was able to estimate the specific effect of increased use of gas-fired generation on the price of natural gas.
- Oil prices. Increased price of crude oil and its refined products, which are substitutes for natural gas as a fuel used in industrial processes as well as electric generation. By definition, demand increases in response to the increases in the price of substitutes.

- Stiffer clean-air regulations. Since in many respects natural gas is a cleaner-burning fuel than most other fossil fuels (like coal or fuel oil), stiffer clean-air regulations lead to an increased use of natural gas by industrial customers seeking to comply in the least-cost manner. However, as one respondent pointed out, as long as such standards accurately reflect the environmental cost of the controlled pollutants, then the associated increase in the price of natural gas is appropriate and consistent with economic efficiency.
- Cold weather of November and December. Finally, the temperatures during November and December of 2000 were particularly low, driving up the demand for natural gas as a space-heating fuel. Figure 9 below shows the heating degree days over the last two heating seasons, as well as the historical average ("normal") number of heating degree days for

Figure 9: Chicago O'Hare Airport Heating Degree Days



	Oct	Nov	Dec	Jan	Feb	Mar
99-00	368	591	1081	1224	892	640
00-01	286	833	1512	1248	1085	948
Normal	391	750	1190	1364	1109	862

Source: National Weather Service - Chicago Forecast Office
<http://www.crh.noaa.gov/lot/climate/>

heating seasons.[4] One respondent reported that the November to December 2000 period was the coldest in the last 106 years. This factor was cited more often than not as the reason why the winter prices exceeded expectations that had been formed during the summer of 2000 and reported to the Commission at an August 8, 2000 Gas Policy Committee meeting. Finally, for residential consumers, both the shift in demand due to weather, as well as the fact that their demands tend to be "inelastic" in the short-run, led to a substantial increase in the **quantity** demanded at the same time that the prices were at such high levels. Hence, for these customers, total bills this winter were significantly greater than in previous winters.

- Inappropriate regulated rate design. A more controversial theory, expounded by one NOI respondent, was that regulation at both the federal level and the state level contributed to the demand peaks by allocating too much of pipeline and distributing costs on the basis of peak demand rather than annual demand. In the NOI manager's opinion, this theory is flawed. In any event, pipeline and distribution costs are a relatively small portion of the overall retail price of gas. Hence, even if valid, the theory could only explain a limited portion of the price increases observed.

To conclude the discussion of demand-side factors, Figure 10, below, shows both the recent history and the near-term projection of gas demand by various sectors.

Of the various supply and demand factors implicated above, none can be singled out as the culprit for the higher gas prices of the last 12 months. Many factors worked together to have the effect that is the subject of this investigation.[5] Furthermore, most if not all of the factors played out on a North American stage. They are neither attributable to nor experienced solely within any one state or region. The high gas price situation is not just an Illinois or Midwestern problem; it is a national phenomenon

[4] Heating Degree Days ("HDD") are typically defined as the sum, over some number of days, of the maximum of zero and the difference between 65 degrees F. and the average temperature for the day.

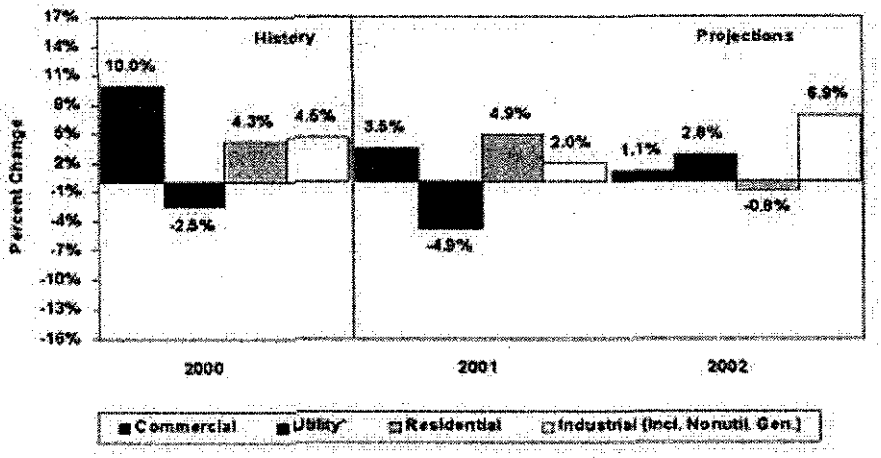
[5] Similar information was provided by Beth Campbell of the Energy Information Administration, before the Subcommittee On Energy And Air Quality of the Committee On Energy And Commerce of the U. S. HOUSE OF REPRESENTATIVES, at the subcommittee's Hearing On Natural Gas, February 28, 2001. <http://www.eia.doe.gov/pub/oil_gas/natural_gas/presentations/2001/hearing_on_natural_gas/hearing_on_natural_gas.htm>

and a national concern. Independent of the NOI, Staff determined that significant PGA increases took place throughout the country.

In assessing the "adequacy" of supply for meeting recent gas demands, none of the utilities cited a "shortage" or an inability to meet their own customers' demands over the last several years. Most respondents were relatively sanguine about the future, as well. Some respondents noted that supply and demand responses are already being observed and will provide a market-based solution to the high price situation. As one respondent argued, the higher prices set in motion their own cure: conservation on the demand-side and exploration, drilling, and increased production on the supply side. As supply

Figure 10: Natural Gas Demand by Sector

Change from a Year Ago



Source: Energy Information Administration - Short-Term Energy Outlook, April 2001
<http://www.eia.doe.gov/emeu/steo/pub/contents.html>

increases and demand decreases, prices should fall. No party expressed concern of natural gas "blackouts" due to physical limitations on production, transmission, or distribution resources.

Finally, none of the participants attributed any of the price increases over the last 12 months to "market manipulation," as the Commission had phrased one of its NOI questions.

2. *Conclusions and Recommendations*

The NOI manager agrees with the conclusion reached by most if not all respondents: the high gas price situation was and continues to be a result of normal market forces in a competitive national

marketplace for the commodity, natural gas. In addition, the NOI manager sees no reason for abandoning faith in the free-market economic policies that have served consumers so well over the years. This is not a blind faith, but one based on the economic history of market-based economies in general and the natural gas market in particular.

Wholesale natural gas prices were once subject to government regulation (price controls), which were lifted beginning in the late 1970s, when policy makers recognized that their price controls were not only unnecessary, but were actually harmful to consumers. They were unnecessary, since there appeared to be a large number of existing (as well as potential) natural gas producers, none of whom could exercise any significant market power over wholesalers or retail consumers. (See Table 3, below, for the current state of the industry). Hence, competition between suppliers could be expected to adequately protect the interests of consumers and keep prices from rising above the cost of production for any sustained period of time.

The price controls were actually harmful because they discouraged economically justifiable exploration and production, leading to a classic "shortage." In other words, at the price established, a greater quantity was being demanded by willing buyers than was being supplied by willing producers. Hence, a mechanism other than price was required to ration the limited supply among consumers. The government chose the highest uses of natural gas and limited the availability of gas to those chosen uses. Newly-built residential communities were often denied access to natural gas, due to this government-created and sustained shortage of natural gas.

All of this non-price rationing ended with the "deregulation" of wellhead prices. As was expected, there was an increase in gas prices. However, production increased and a natural balance between supply and demand was obtained through market forces. Soon thereafter, wellhead prices settled down to a level that fell between the previously regulated price of gas and the price that existed shortly after deregulation (See Figure 2: Natural Gas Wellhead Prices, p. 4). More importantly, the purchasers of natural gas rather than government agencies ultimately dictated what natural gas was worth to them, while producers competed to supply gas, as long as they were able to earn at least a normal economic profit. Such a market structure continues to this day, although, arguably, the market

currently may be in a heightened state of disequilibrium, due to the various supply and demand shifts discussed earlier.

Table 3: Number of Producers, Pipelines, Marketers, Local Gas Utilities, and End Users

The U. S. Natural Gas Industry At A Glance

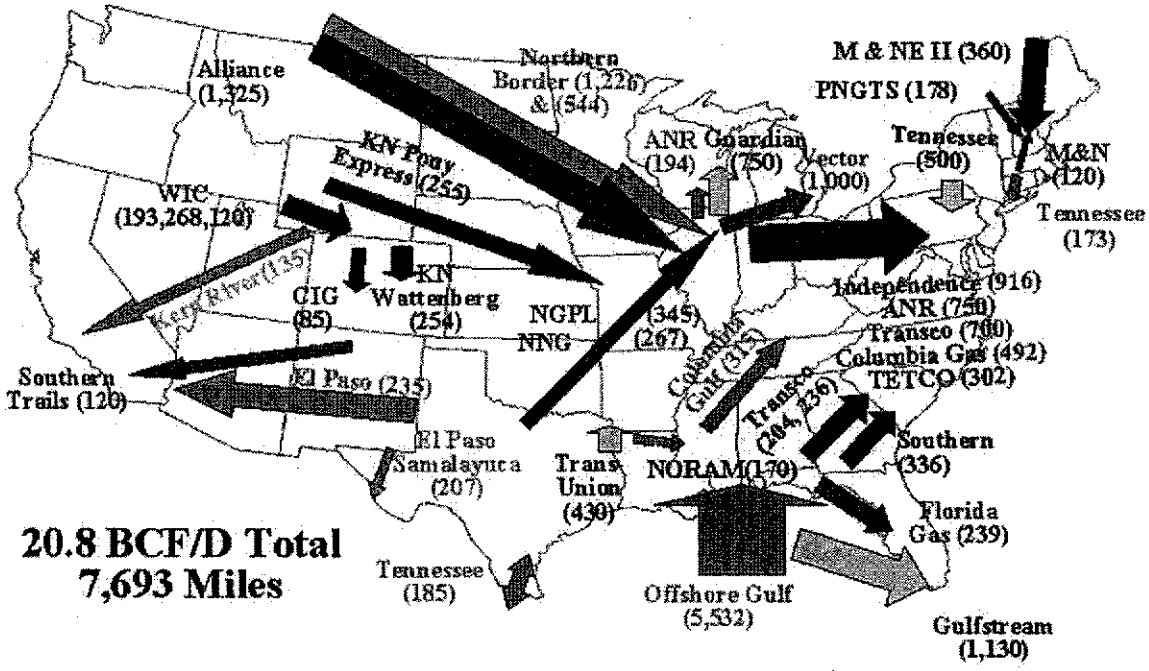
	Participants	Miles of Pipe	Regulatory Regime in 2000
Producers	8,000 Independents 24 Majors	0	Phased price deregulation Begun in 1979, completed in 1989
Pipelines	160	285,000	Federal Energy Regulatory Commission (FERC)
Natural Gas Marketers	260	0	Unregulated
Local Gas Utilities	1500	833,000	State Utility Commissions
End Users	Residential 53 million Commercial 4.5 million Industrial 40 thousand	0	Unregulated
	Electric Utilities 500	0	Interstate - FERC Intrastate - State Commissions

www.eia.doe.gov Energy Information Administration

In the NOI Manager's opinion, no action should be taken by the State to disrupt the normal workings of the market for natural gas, where that market continues to be competitive. However, as has been recognized since before the deregulation of wellhead prices, the long-distance transportation and the local distribution of natural gas will most likely remain highly concentrated or monopoly industries. Thus, the services of interstate pipelines (regulated by the Federal Energy Regulatory Commission) as well as local distribution companies (such as the gas utilities regulated by the Illinois Commerce Commission) should continue to be price regulated.

As for interstate pipeline companies, since 1990, the level of pipeline capacity in the Midwest has increased by 16 percent, a percentage growth exceeded only by that into the Northeast.[6] Figure 11 below shows the major projects projects for 1997 - 2001 that have been certificated by the Federal Energy Regulatory Commission ("FERC").

Figure 11: Major Pipeline Projects Certified 1997-2001 (MMcfd)



(Source: FERC)

While natural gas consumption has grown steadily during the past decade, new pipeline construction has kept pace in the region. The growth in natural gas consumption in the Midwest has been met mostly through construction focused on expanding the deliverability of Canadian gas to the Midwest and Northeast. The bulk of that expansion is attributable to the Alliance Pipeline beginning service in December 2000. The Alliance Pipeline is capable of transporting up to 1,325 million cubic feet per day ("MMcfd") of natural gas from British Columbia to Illinois.[7] In addition to the Alliance pipeline, the new Vector Pipeline system became operational in December of 2000. Vector Pipeline is

[6] Department of Energy, Energy Information Administration, "Status of Natural Gas Pipeline System Capacity Entering the 2000-2001 Heating Season" (2000)
[7] http://www.alliancepipeline.com

a new 344-mile, 42-inch pipeline project that transports 720 MMcfd of natural gas from the Chicago area to parts of Indiana, Michigan and into Ontario, Canada.[8]

The completion of the Alliance project has the potential to result in short-term excess capacity in the Midwest. However, there is significant expansion focused on serving growing regional markets such as Wisconsin, Michigan and northern Indiana. For example:

- In February of 2000, FERC issued an Order allowing ANR pipeline to install two proposed 10,000 hp compressor units at the Woodstock, IL Compressor Station, which would provide a total of approximately 109 MMcfd into Wisconsin.[9]
- ANR is also pursuing a "Supply Link" expansion project that would allow a total of approximately 750 MMcfd to be transported from the Joliet hub to Indiana, Michigan, and Ohio. FERC issued a certificate for the Supply Link project in July of 2000.[10]
- CMS Energy, Viking Gas Transmission Company and WICOR are responsible for the Guardian project. Guardian will provide for the shipping of up to 750 MMcfd from the Joliet hub in to northern Wisconsin. The Guardian project received certification from FERC on March 14, 2001 and is not expected to commence operations until the fall of 2002.[11]
- Northern Border Pipeline Company's "Project 2000" consists of a 30-inch pipe, a new compressor station in Illinois, the upgrade of two existing Iowa compressor stations and a final delivery point in North Hayden, Illinois. Project 2000 will result in a system receipt capacity of 861 MMcfd in Chicago and 548 MMcfd to Northern Indiana. FERC issued a letter order in February 2001 authorizing construction of portions of Project 2000.[12]
- The Horizon Pipeline Company is a joint venture between Nicor and NGPL that would allow the transportation of 380 MMcfd from the supply hub at Joliet with the northern part of the Nicor Gas distribution system and an existing NGPL pipeline. FERC certification is pending an environmental review.[13]
- Trunkline Gas Company has filed with FERC a proposal to abandon and convert 720 miles of pipeline to transport refined petroleum products from Beauregard Parish, Louisiana to Douglas County, Illinois. Trunkline would continue natural gas service to existing customers by relocating certain gas taps to its two remaining parallel gas transmission mainlines. On March 9, 2001 FERC granted a certificate of abandonment and authorized the conversion with some restrictions. It is expected that the conversion will be completed in January 2002.

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[8] http://www.vector-pipeline.com
[9] FERC Docket CP99-241, 90 FERC ¶ 61,171 (2000)
[10] FERC Docket CP97-319, 92 FERC ¶ 61,022 (2000)
[11] FERC Docket CP00-36, 94 FERC ¶ 61,269 (2001)
[12] FERC Docket CP99-21
[13] FERC Docket CP00-129

The emphasis on proposals to redistribute the nearly 800 billion cubic feet of natural gas a year that could flow on the additional pipeline capacity now directed into the northern Illinois area by the Northern Border Pipeline system extension and the new Alliance Pipeline system (2000) could reflect the development of capacity constraint situations developing in the Midwest. This condition could be exacerbated if demand growth outpaces the implementation of these proposals. Nevertheless, there appears to be available capacity on routes in to the Midwest and these lines are not expected to be capacity constrained in any measure over the next several years.

As for the local gas distribution companies (the utilities regulated by the ICC), the Commission should consider how utilities could change and improve upon their natural gas purchasing practices (for example, greater utilization of price "hedges"), methods for estimating usage and bills in the absence of customer-specific meter read data, and efforts to inform customers of anticipated gas price movements. These issues will also be addressed in later sections of this report. In addition, each year, the PGAs are subject to annual reconciliation process, involving an audit and a prudence review of the utility's gas purchasing practices. Gas utilities are only permitted to recover prudently incurred gas costs. The Commission is currently reviewing last year's gas expenditures by utilities so that any imprudent expenditures can be detected and subject to refund as expeditiously as possible.

B. Efforts to Inform and Assist Customers

1. Discussion of Comments

This section of the investigation concerns efforts by the utilities 1) to explain and offer level/budget and deferred payment plans, 2) to promote customer understanding to manage gas consumption, 3) to describe what measures were and could be taken to alert customers of the potential for increased gas prices, and 4) to describe eligibility requirements for participation in a deferred payment plan.

The investigation of the high gas cost in the winter of 1996-1997 (97 NOI-1) led to a recommendation that utilities provide their customers timely and early warning information about impending higher gas prices, including information regarding deferred payment and budget payment

plans. As the result of that Commission investigation, utilities now routinely alert their customers to potential increases in natural gas prices.

Hence, as the market price of gas began to rise and predictions for further increases became widespread throughout the gas industry[14], Illinois utilities began alerting customers of the potential for high bills in the upcoming heating season of 2000/01. Through bill messages and bill inserts, gas utilities notified customers (beginning as early as May/June) of the expected increase in gas prices, an explanation of prices, payment plans, and conservation tips. Most companies sent multiple notices and all gas utilities had provided information to their customers by September/October.

Since early September, the Commission's Consumer Services Division ("CSD") has monitored the efforts of utilities with respect to communications, billing, collection, payment plans (both budget billing and deferred payment arrangements). The CSD is currently reviewing budget billing practices of gas (and electric) utilities.

The Commission's Consumer Services Division published a brochure, ***Understanding Natural Gas Prices / Natural Gas Energy Savings Tips,*** which offers information about the cost of natural gas and suggestions for reducing gas consumption. The material is sent to consumers who contact CSD, has been provided to legislators, and is available from the Commission's web site.[15]

In addition, Commissioner Ruth Kretschmer, Chairman of the Illinois Commerce Commission's Gas Policy Committee, hosted the Illinois Natural Gas Roundtable 2000 in Chicago. Meetings on November 17, 2000 brought together consumer representatives and industry representatives having a general knowledge of the natural gas industry as a whole and in-depth expertise in specific areas. Consumer participants included residential consumer advocates, large commercial users, large industrial users, and state and local government consumer representatives. Industry participants included representatives of producers, interstate pipelines, local distribution companies, marketers, and entities

[14] Specifically, in the spring and early summer of 2000, there were reports of increasing natural gas prices and predictions of soaring prices for the winter heating season. Gas prices were the subject of articles in virtually every newspaper in the state. National and local television stations reported on the subject. Coverage of the increases in gas prices and the effects continue to the present.

[15] The Commission's web site <www.icc.state.il.us> has other information on the subject of high gas costs as well as links to related sites on the internet.

involved in research and technology. Participants shared their opinions on current issues and made recommendations for future policies or actions that should be considered.

In December, Commissioner Kretschmer issued a report to Commissioners, legislators, and the public. In her report, Commissioner Kretschmer offered her conclusions:

- A recommendation was made by the Consumer Participants that the Commission should consider adopting a "best practice" approach to budget payment plans rather than having payment plans vary dramatically across the state. This sounds reasonable. I will recommend that the Commission direct our Consumer Affairs Division to investigate this recommendation.
- The Commission should consider a recommendation to the Illinois General Assembly whether or not natural gas marketers should be certificated.
- Participants in both roundtables agreed that a realistic national energy policy is needed. I agree.
- A number of people also said that another roundtable should take place again in six to twelve months to discuss the changes in the industry. I will consider holding another roundtable at a later date.

Commissioner Kretschmer's full report is also available on the Commission's web site.

As the winter progressed, utilities, regulators, and public officials recognized the need of consumers to better understand natural gas prices, and the importance of providing information that could help customers manage their bills. Customers were encouraged to consider budget payment plans, conservation, and deferred payment plans if they owed past due amounts. Nevertheless, warnings from utilities, government officials, and local and national media about impending increases in natural gas prices did not prepare consumers for the bills they received. Prices far outstripped those predicted in the summer and early fall and temperatures in December were much colder than in recent years.

As the magnitude of the problem became more apparent, utilities reviewed budget billing plans and some made changes to their practices. Customers shocked by bills looked for options. Some utilities made revisions to their budget plans to make enrollment easier – permitting customers to enroll directly by check-off on the bill, allowing customers to enter budget billing plans any time of the year, and promoting enrollment as a way to manage bills. For customers already participating in budget billing plans, adjustments were made to budget amounts to help customers avoid huge underpayment at the end of the budget period.

In January, Governor Ryan announced the creation of an Energy Cabinet to coordinate and handle key energy related issues. Regional meetings were held across the state to educate the public about the state services available to help families cope with high home energy costs this winter. The Departments of Commerce and Community Affairs, Aging, Human Services, Illinois Commerce Commission and the State Fire Marshal participated in public meetings held in Rockford, Waukegan, Chicago Ridge, Chicago, Carterville, and Decatur. Members of Commission staff from the Consumer Services and Energy Divisions participated in each of the public meetings.

The availability of financial assistance was a subject of the regional meetings, referenced above. Financial assistance is available to low income households in Illinois through the Low Income Home Energy Assistance Program ("LIHEAP") This year, the General Assembly raised the eligibility level for LIHEAP from 125% to 150% of the federal poverty guideline. In addition to the increase in the number of customers served, the benefits for natural gas customers increased by 35%. This year $175 million is expected to be available, this includes $65 million from the state and $110 in federal funds. Last year $110 million was available. The program is administered by the Illinois Department of Commerce and Community Affairs ("DCCA") through thirty-five agencies that operate in all Illinois counties. Utilities are also working with DCCA to implement arrearage reduction programs.

In special open meetings on January 18 and 24th, the Commission conducted hearings on natural gas prices. The Chairman asked utilities for a description of voluntary initiatives summarizing their communication and billing practices. Utilities participated in conference calls and followed with a letter to the Chairman summarizing the their efforts.

The utilities reported considerable communications efforts beginning as early as the spring of 2000 to alert customers to rising prices, describe and encourage customers to consider options for managing bills, and provide conservation tips to help customers control their usage. These messages were conveyed through the following media and others:

- bill messages, bill inserts and newsletters
- web sites
- press releases
- speakers bureaus

- community meetings
- information to public officials and legislators
- informational packets to local stores selling weatherization items.

Utilities also informed their customers about the availability of financial assistance programs offered by the Department of Commerce and Community Affairs and provided contact information. Some of the major utilities have programs that offer financial assistance that are funded through voluntary contributions from customers and matching contributions from the utility. Other utilities have or are developing programs such as Illinois Power Company's *A Hand Up* program. This program allows eligible customers to work at non-profit agencies in exchange for assistance on bills.

Utilities made other efforts to address the problems experienced by their customers. Some provided special training to their customer service representatives. Most utilities modified their policies regarding budget billing and deferred payment agreements allowing more favorable terms for customers. Two companies reviewed estimated bills and revised them resulting in credits to customers.

On February 2, 2001, Chairman Mathias attended an energy town meeting sponsored by State Senator Shaw at Thornridge High School in Dolton. Roughly 300-400 people attended the event. Questions pertaining to the issue of gas prices and their consequences for customers prompted the Chairman to request information from utilities regarding shutoff policies for residential and small business customers.

Chairman Mathias also led conference calls to discuss utilities' plans to deal with delinquent accounts as the weather becomes warmer. Utilities described how they prioritized disconnection primarily based upon the customer's payment history. During the discussions, the Chairman urged the utilities to continue to initiate contact with their delinquent customers to encourage those customers to make arrangements for payment of their delinquent accounts.

In a memo dated March 5, 2001 to the Energy Cabinet, Chairman Mathias included the following description of his discussions pertaining to disconnection of service.

> Shut Offs of Delinquent Customers
>
> During recent discussions with Illinois LDCs I have been told that substantially more residential and small business natural gas customers will be delinquent on April 1, 2001 than