

REDACTED

REBUTTAL TESTIMONY  
OF  
ERIC LOUNSBERRY

ENGINEERING DEPARTMENT  
ENERGY DIVISION  
ILLINOIS COMMERCE COMMISSION

ILLINOIS POWER COMPANY  
2000 PURCHASED GAS ADJUSTMENT RECONCILIATION  
DOCKET NO. 00-0714

JULY 2001

1 1. Q. Please state your name and business address.

2 A. My name is Eric Lounsberry, and my business address is 527 East Capitol  
3 Avenue, Springfield, Illinois 62701.

4 2. Q. Are you the same Eric Lounsberry that previously submitted testimony in  
5 this proceeding?

6 A. Yes. I previously presented direct testimony in this proceeding, ICC Staff  
7 Exhibit 2.0, with supporting schedules ICC Staff Exhibit 2.0, Schedule 1.0  
8 through 4.0.

9 3. Q. What is the purpose of your rebuttal testimony?

10 A. My rebuttal testimony responds to the rebuttal testimony of Frank A.  
11 Starbody regarding the retirement of Illinois Power Company's ("IP" or  
12 "Company") Freeburg and Gillespie facilities as well as the Company's gas  
13 purchasing activity during the reconciliation period.

14 4. Q. Do you have any schedules to support your rebuttal testimony?

15 A. Yes. I have prepared the following schedules:

16	Schedule 1.0	Summary of Adjustments
17	Schedule 2.0	Comparison of Freeburg PVRR Analyses
18	Schedule 3.0	Freeburg 30-Year PVRR Analysis
19	Schedule 4.0	Freeburg 15-Year PVRR Analysis

20	Schedule 5.0	Freeburg 30-Year Gas Supply Cost PVRR
21	Schedule 6.0	Freeburg 15-Year Gas Supply Cost PVRR
22	Schedule 7.0	Comparison of Gillespie PVRR Analyses
23	Schedule 8.0	Gillespie 30-Year PVRR Analysis
24	Schedule 9.0	Gillespie 15-Year PVRR Analysis
25	Schedule 10.0	Gillespie 30-Year Gas Supply Cost PVRR
26	Schedule 11.0	Gillespie 15-Year Gas Supply Cost PVRR
27	Schedule 12.0	City-Gate Contract Comparison

28  
29 5. Q. What recommendations are you making in your rebuttal testimony?

30 A. I continue to recommend that the additional gas supply costs that IP  
31 incurred as a result of its decision to retire its Freeburg propane facility  
32 and Gillespie storage field be found imprudent. IP also entered into two  
33 contracts, one with an affiliate, that was not the least cost decision during  
34 the reconciliation period. Based upon my review of the above topics, I  
35 recommend the Commission make an adjustment of \$1,718,000, in  
36 relation to IP's PGA. This calculation is shown on ICC Staff Exhibit 4.0,  
37 Schedule 1.0.

38 **FREEBURG PROPANE FACILITY RETIREMENT**

39 6. Q. What recommendation did you make in your direct testimony regarding  
40 the Freeburg propane facility?

41 A. I recommended that the Commission find the excess gas costs that IP  
42 incurred during the reconciliation period as a result of replacing its  
43 propane facility's capacity to be imprudent. This resulted in an adjustment  
44 of \$XXXXXXXX. I further noted that IP had failed, prior to the filing of my

45 direct testimony, to provide any information showing that it performed an  
46 analysis necessary to make a prudent decision regarding the retirement of  
47 its propane facility.

48 7. Q. Did the information presented in the rebuttal testimony of IP's witness  
49 Frank Starbody cause you to change your recommendation?

50 A. No. I still recommend that \$XXXXXX in excess gas costs associated with  
51 the replacement of the propane facility's capacity be found imprudent.

52 8. Q. What information did IP provide in its rebuttal testimony to support its  
53 decision to retire the Freeburg propane facility?

54 A. IP raised several issues to support its decision to retire the Freeburg  
55 propane facility. First, IP noted that it would have taken substantial capital  
56 expenditures in order for the Freeburg facility to remain in service. IP  
57 estimated those expenditures to equal \$1,873,000.

58 Second, IP indicated that it was concerned about the operation of the  
59 facility due to the encroachment of residential areas. In particular, IP  
60 noted that safety issues associated with the residential areas developing  
61 near the plant were a significant factor in the decision to retire the plant.

62 In particular, IP noted that it had safety concerns with encroaching  
63 residential areas because:

64 This made the risks and consequences associated with gas  
65 leakage or fires that are inherent to propane facilities a  
66 matter of increasing concern. IP Exhibit 3.2, p. 3 of 19

67 Third, IP noted its employees need specialized training and expertise to  
68 operate the Freeburg facility and with the prior closing of its other propane  
69 facilities the opportunity for hands-on training was limited. If IP kept the  
70 Freeburg facility operational, it would have to conduct training solely for  
71 the purpose of operating this facility.

72 Finally, IP noted that even with extensive upgrades to bring the facility up  
73 to current standards, the facility's reliability and IP's reliance upon the  
74 plant were a concern.

75 9. Q. Do you agree with the reasons IP used to retire its Freeburg propane  
76 facility?

77 A. No. IP has failed to support any of the above listed reasons for retiring the  
78 Freeburg propane facility.

79 10. Q. Why do you believe that IP has not supported the level of capital  
80 expenditure needed to upgrade the Freeburg facility as a reason to retire  
81 the Freeburg propane plant?

82           A.     I agree the amount of capital expenditure should be reviewed in the  
83                     context of whether the facility is economically viable versus the available  
84                     alternatives. However, IP failed to conduct such a review.

85                     It appears that IP, when making its decision to retire the facility, compared  
86                     a non-recurring capital expenditure to a recurring PGA cost. The proper  
87                     comparison for these types of costs is a present value of revenue  
88                     requirements (“PVRR”) for each. Since IP failed to conduct such an  
89                     analysis, I prepared an analysis using the information available to me  
90                     within this proceeding.

91                     ICC Staff Exhibit 4.0, Schedule 2.0, compares the results of my PVRR  
92                     analyses for upgrading the Freeburg facility as well as the costs for its  
93                     replacement. ICC Staff Exhibit 4.0, Schedule 3.0 and 4.0, contains my  
94                     PVRR analysis of the Freeburg propane project using a 30-year and 15-  
95                     year project life, respectively. ICC Staff Exhibit 4.0, Schedule 5.0 and 6.0  
96                     contain the PVRR analyses for the pipeline supply contracts that would  
97                     replace the Freeburg propane facility over a 30-year and 15-year term,  
98                     respectively.

99                     The comparison on ICC Staff Exhibit 4.0, Schedule 2.0 clearly shows that  
100                     IP’s ratepayers are better served by conducting the upgrade to the  
101                     Freeburg propane facility versus retiring the facility and replacing its  
102                     capacity with a pipeline supply contract. The 30-year PVRR comparison

103 shows a savings of \$XXXXXXX, while the 15-year PVRR comparison  
104 shows a savings of \$XXXXXX.

105 11. Q. What assumptions did you make in preparing your PVRR analysis?

106 A. I used a rate of return of 9.29%, which is the value the Commission  
107 allowed IP's gas operations to earn in its last natural gas rate case,  
108 Docket No. 93-0183. I used an annual operations and maintenance level  
109 of \$35,000, which is based off of the Company's response to Staff data  
110 request ENG 2.186. I assumed an annual inflation rate of 2.85%, per the  
111 June 2001, DRI-WEFA Core CPI projections. I also used straight-line  
112 depreciation for the upgrade project over the assumed life of the project. I  
113 used the upgrade cost assumptions that IP provided in its rebuttal  
114 testimony. Finally, I assumed the replacement gas supply cost for the  
115 project equaled the amount I have recommended for disallowance within  
116 this proceeding.

117 12. Q. Did IP provide support for its contention that encroachment by residential  
118 areas upon the Freeburg propane facility is a valid reason for IP to retire  
119 its Freeburg propane facility?

120 A. No. I toured the propane facility and the immediate area in question on  
121 July 19, 2001, to confirm the information described by IP. While some  
122 new residential development has occurred in the general area, the

123 residential growth cited by IP is still a significant distance away. In fact,  
124 the closest new residential development is approximately 4.3 miles away  
125 from the facility. This residential development is taking place south of the  
126 community of Smithton along Illinois Highway 159. All other residential  
127 growth areas were also occurring south of Smithton along Highway 159.  
128 However, the Freeburg facility is located about 2.5 miles south of the  
129 community of Freeburg along Illinois Highway 13. In short, I saw no new  
130 residential development in the immediate vicinity of the existing Freeburg  
131 propane facility.

132 Any development that occurs along the east side of Highway 13, as well  
133 as a small portion on the west side, that approaches the Freeburg facility  
134 would also have to contend with the various injection/withdrawal wells and  
135 associated piping that IP has in place for its Freeburg storage facility. This  
136 occurs because the Freeburg propane facility is not a stand-alone facility.  
137 The major equipment associated with IP's Freeburg natural gas storage  
138 field is located at the same site as the propane facility. This co-existence  
139 occurred when the propane facility was initially placed in service in 1971.

140 Based upon my tour of the facility and area surrounding it, which showed  
141 that the nearest residential development is over 4 miles away, I found no  
142 residential encroachment upon the facility. IP failed to support its  
143 contention that residential encroachment exists near the Freeburg

144 propane facility and, as the question below demonstrates, has failed to  
145 demonstrate that residential encroachment constitutes a valid reason to  
146 retire the facility. Further, most development that approaches the facility  
147 along Highway 13 will also have to contend with the in-place pipeline and  
148 wellheads associated with the Freeburg underground natural gas storage  
149 facility.

150 13. Q. Do you agree with IP's claim that the risks of leaks and/or fires associated  
151 with the propane facility, especially with IP's claim of residential  
152 encroachment, is a valid reason for IP to retire its Freeburg propane  
153 facility?

154 A. No. When I requested a history of the leaks and/or fires that had occurred  
155 at the Freeburg propane facility, IP was only able to provide two known  
156 occurrences. According to the Company's response to Staff data request  
157 ENG 2.176, the first event was a fire that occurred in June of 1985. The  
158 fire was the result of lightning igniting propane vapors seeping from three  
159 of four relief valves on top of the refrigerated sphere. IP replaced those  
160 relief valves and installed a lightning protection system at the tank  
161 perimeter to alleviate the possibility of that occurring again.

162 The second event did not involve fire and occurred in October 1995 when  
163 a minor leak occurred on an orifice fitting that was used to measure  
164 propane being transferred between the surge drum and the refrigerated

165 tank. IP isolated the orifice fitting removed it from the piping and shipped  
166 it to the manufacturer for repair. The manufacturer repaired the casting  
167 defect and the repaired unit was reinstalled upon its return.

168 Notwithstanding my disagreement with IP over its use of residential  
169 encroachment as a basis for retiring the facility, IP also failed to  
170 demonstrate that the Freeburg facility is susceptible to fires or leaks.  
171 Even if more obvious residential encroachment had occurred, IP has not  
172 shown that the propane plant would constitute a public health risk of the  
173 magnitude sufficient to cause IP to retire it.

174 14. Q. Do you agree with the Company that its concern regarding the training of  
175 its employees to operate the Freeburg propane facility is a valid basis for  
176 retiring the facility?

177 A. No. IP operated this facility for 30 years and maintained a training  
178 program for its employees to operate it. Also, since it is located at the  
179 same location as the Freeburg storage facility, IP likely cross-trains its  
180 personnel to operate both facilities. According to the Company's response  
181 to Staff data request ENG 2.180, IP training program for the Freeburg  
182 propane plant was hands-on and was performed during the annual testing  
183 of the plant during which the vaporizer heating system was started and  
184 operated one day. If appropriate conditions existed, then on the second  
185 day the propane injection system was also tested. IP could maintain this

186 or a similar program and keep its personnel fully trained on operating the  
187 Freeburg propane facility.

188 15. Q. Do you agree with IP that its concern over the reliability of the facility is a  
189 valid basis for retiring the Freeburg propane facility?

190 A. No. Staff data request ENG 2.185 requested details of any past incidents  
191 that IP had experienced at the Freeburg propane facility that caused it to  
192 worry about the facility's reliability. IP's response noted three dated  
193 incidents and a fourth item without a date. Two of the events were leaks  
194 caused by piping corrosion; one was a pump seal leak; and the final item  
195 was the comment that IP has experience a failure of a back pressure  
196 controller. Given the 30 years that facility has been in place, I do not see  
197 a reliability problem, given the limited problems noted by IP for the facility.  
198 Further, if IP conducts the extensive upgrades to the facility, then the plant  
199 should remain reliable.

200 16. Q. What do you recommend regarding IP's decision to retire the Freeburg  
201 propane facility?

202 A. I continue to recommend that the Commission find the \$XXXXXX in gas  
203 supply costs associated with obtaining a replacement gas supplies for the  
204 plant to be imprudent.

205

**GILLESPIE STORAGE FIELD RETIREMENT**

206 17. Q. What recommendation did you make in your direct testimony regarding  
207 the Gillespie storage facility?

208 A. I recommended that the Commission find the excess gas costs that IP  
209 incurred during the reconciliation period as a result of replacing its  
210 Gillespie storage facility's capacity to be imprudent.

211 18. Q. Did the information presented in the rebuttal testimony of IP's witness  
212 Frank Starbody cause you to change your recommendation?

213 A. No. I still recommend that the excess gas costs associated with the  
214 replacement of the storage field's capacity be found imprudent.

215 19. Q. What information did IP provide in its rebuttal testimony to support its  
216 decision to retire the Gillespie storage facility?

217 A. IP noted two items to support its decision. First, IP reiterated that  
218 significant capital expenditures were required to renovate and upgrade  
219 equipment at the field to allow for continued use of the field. IP continued  
220 to use the costs associated with the upgrade of another storage field as a  
221 proxy for the costs associated with upgrading the Gillespie storage field.  
222 IP also updated that estimate to include some previously overlooked  
223 expenses incurred during the upgrade.

224 Second, IP noted that it had operational concerns with the field. In order  
225 to receive withdrawals from the Gillespie field, the gas pressure on the  
226 distribution system in the area around the field had to be reduced. IP  
227 claimed that this practice created concerns about system integrity  
228 because the storage field compressor could kick off-line, which would stop  
229 gas withdrawals from Gillespie, and could cause gas flow to distribution  
230 customers in the area to be lost.

231 20. Q. Do you agree with IP's assessment of the viability of the continued  
232 operation of the Gillespie storage field?

233 A. No. IP continues to use what I believe is an invalid cost estimate for  
234 upgrading the Gillespie storage field. It is not reasonable to assume that  
235 an upgrade at a field the size of Shanghai would cost as much as an  
236 upgrade at a much smaller Gillespie storage field. According to the  
237 Company's response to Staff data request ENG 2.190, the Shanghai  
238 storage field is a aquifer storage field whose withdrawals at the start of  
239 winter are at a pressure of 800 psi, which reduces to 450 psi by the end of  
240 winter. Shanghai also contains 8 injection/withdrawal wells, 11 monitoring  
241 wells, 2 dehydration towers, 2 reboilers, 2 separators, a moisture analyzer,  
242 3 supply pipelines and 7 meters measuring the injections and withdrawals  
243 of the field.

244 According to the Company's response to Staff data request ENG 2.191,  
245 the Gillespie field is a dry gas field whose withdrawals at the start of winter  
246 are at 160 psi and reduces down to 90 psi at the end of the winter season.  
247 This field consists of 7 injection/withdrawal wells, no monitoring wells, 1  
248 reboiler, 1 separator, 1 supply pipeline and 2 meters that measure the  
249 field's injections and withdrawals.

250 The Shanghai field is larger and more complex than the Gillespie field and  
251 operates at a higher pressure. This higher pressure itself causes any  
252 replacement of pipeline, fittings, regulators, valves, etc, that are designed  
253 specifically for the higher gas pressure to be more expensive than a  
254 similar component at Gillespie. Therefore, it is not reasonable to assume  
255 an upgrade at Gillespie would have the same costs as an upgrade at  
256 Shanghai.

257 21. Q. Did Illinois Power conduct any studies that compared any estimated costs  
258 to upgrade the Gillespie storage field versus other alternatives?

259 A. No. Once again, it appears that IP is comparing what I believe to be a  
260 overstated one-time capital expenditure to a recurring PGA expense.  
261 Since IP did not conduct a PVRR analysis for the Gillespie project, I  
262 conducted this analysis using many of the same assumptions I used in my  
263 Freeburg propane review.

264 ICC Staff Exhibit 4.0, Schedule 7.0 is a comparison the PVRR analyses  
265 that I conducted versus the supply alternatives. ICC Staff Exhibit 4.0,  
266 Schedule 8.0 and 9.0 are the PVRR analyses for the upgrade of the  
267 Gillespie storage field, using IP's projected costs, using a 30-year and 15-  
268 year project life, respectively. ICC Staff Exhibit 4.0, Schedule 10.0 and  
269 11.0 are the PVRR analyses for the replacement gas costs associated  
270 with the Gillespie storage field.

271 The comparison on ICC Staff Exhibit 4.0, Schedule 7.0 shows that for the  
272 30-year PVRR there is a savings of \$XXXXX associated with retaining the  
273 Gillespie storage field capacity. The 15-year PVRR shows a savings for  
274 eliminating the Gillespie storage field in the amount of \$XXXXXX.  
275 However, both PVRR analyses conducted on the cost to retain the  
276 Gillespie storage field used the upgrade costs that IP provided in its  
277 rebuttal testimony. As I noted above, I do not believe those costs  
278 assumptions are valid.

279 22. Q. What assumptions did you use in your various Gillespie and its gas supply  
280 alternatives PVRR analyses?

281 A. I used many of the same assumptions that I used when conducting the  
282 PVRR analyses for the Freeburg facility. I used a rate of return of 9.29%,  
283 which is the value the Commission allowed IP's gas operations to earn in  
284 its last natural gas rate case, Docket No. 93-0183. I used the annual

285 operations and maintenance level of \$8,100, which is based off of the  
286 Company's 1999 annual report. I assumed an annual inflation rate of  
287 2.85%, per the June 2001, DRI-WEFA Core CPI projections. I also used  
288 straight-line depreciation for the upgrade project over the assumed life of  
289 the project. I used the upgrade cost assumptions that IP provided in its  
290 rebuttal testimony. Finally, for the replacement gas cost assumptions, the  
291 Year 2000 value equaled the amount I have recommended for  
292 disallowance within this proceeding, the following years are based upon  
293 sum of replacement costs associated with the firm pipeline and swing  
294 supply reservation costs with a small commodity savings level assumed  
295 each year. The Year 2001 value was assumed to equal \$XXXXXX.

296 23. Q. What do your PVRR analyses indicate to you?

297 A. IP should have conducted more detailed studies prior to making its  
298 decision to retire this field. Even using IP's estimated cost to upgrade the  
299 Gillespie storage field, the 30-year value is in favor of retaining the field.  
300 Further, if IP had been serious about considering retaining the field's  
301 capacity, then a more detailed study of what exactly needed upgraded at  
302 the field could have been conducted. IP could also have looked at  
303 possible alternative means of operating the field that may have required  
304 less expensive upgrades to retain the field's withdrawal capability.

305 24. Q. Do you agree with IP regarding its operational concerns regarding the  
306 Gillespie storage field?

307 A. No. According to the Company's response to Staff data request  
308 ENG 2.188, in order to take withdrawals from the Gillespie storage field  
309 the gas system controller decreases the pressure requirement at the  
310 Staunton regulator station. This regulator is on automatic control and the  
311 system pressure is continually monitored by IP's Gas Control Group. This  
312 process that allows IP to change controllers remotely while also  
313 continuously monitoring the system pressure should not create operational  
314 problems.

315 25. Q. Did IP have any additional comments regarding your Gillespie  
316 adjustment?

317 A. Yes. IP took issue with the inclusion of the commodity savings portion of  
318 my calculation of the additional cost incurred as a result of not having the  
319 Gillespie storage field available to IP. IP stated that given the small size of  
320 the field and that IP typically only used that field during peak conditions, IP  
321 would have likely not withdrawn any gas from the field during December.

322 26. Q. Do you agree with IP's statement that it would have likely not used the  
323 Gillespie storage field during December of 2000 and that no commodity  
324 savings would have resulted?

325           A.     No. Notwithstanding IP's past experience with operating its storage fields,  
326                     the time frame that I have assumed for Gillespie usage is unique from any  
327                     past experience. My commodity savings calculation assumed that the  
328                     Gillespie field operated on December 17 through 22. This corresponds to  
329                     the same time period that IP's largest storage field, Hillsboro, was out of  
330                     service due to an explosion at the facility. I find it highly likely that IP  
331                     would have used the facility immediately following the incident at the  
332                     Hillsboro storage facility if Gillespie had still been available.

333                     According to the Company's response to Staff data request ENG 2.69, IP  
334                     increased the withdrawal levels from its storage fields to accommodate the  
335                     capacity lost as a result of the Hillsboro incident. In fact, due to the higher  
336                     than expected level of withdrawals from some of its fields, IP even injected  
337                     gas into some fields to ensure it had gas supplies available later in the  
338                     winter season. It is possible that IP, if it was worried about the  
339                     deliverability from the Gillespie field, could have also scheduled injections  
340                     into the Gillespie field during the winter season of 2000-2001. Therefore,  
341                     the commodity adjustment that I calculated in my direct testimony is  
342                     unchanged.

343     27.    Q.     What is your recommendation regarding IP's decision to retire its Gillespie  
344                     storage facility?

345 A. I recommend the Commission find the excess gas costs that IP incurred  
346 during the reconciliation period as a result of replacing its Gillespie storage  
347 facility's capacity to be imprudent. This results in an adjustment of  
348 \$XXXXX. I make this recommendation because IP has failed to provide  
349 any information to me showing that it performed an analysis necessary to  
350 make a prudent decision regarding retirement of the Gillespie storage  
351 field. Without such information, I cannot determine that IP made a prudent  
352 decision.

353 28. Q. After reviewing IP's decisions to retire the Freeburg propane facility and  
354 the Gillespie storage field, do you have any additional concerns?

355 A. I am concerned that IP is making decisions not upon what is best for  
356 customers, but instead on what is best for its shareholders. IP does not  
357 earn a return on its investments for improvements or upgrades at facilities  
358 such as Freeburg and Gillespie until it requests and receives a natural gas  
359 rate increase from the Commission. However, increased gas supply  
360 costs, unless deemed imprudently incurred, are automatically passed  
361 through to customers through the PGA. It appears that IP failed to  
362 conduct any analyses into what was the best decision for upgrading or  
363 retiring its existing natural gas facilities from its customer's perspective. I  
364 would recommend that the Commission remind IP that it has obligations to  
365 both its ratepayers and shareholders and that IP, when making decisions

366 to retire major facilities in the future, should conduct appropriate studies,  
367 with supporting documentation, so it can demonstrate to the Commission  
368 that it made the prudent decision.

369 **GAS PURCHASING ACTIVITY**

370 29. Q. What recommendation did you make in your direct testimony regarding  
371 IP's gas purchasing activity during the reconciliation period?

372 A. I recommended that IP explain why it used different contractual  
373 arrangements for its affiliates than any other gas supply entity, for IP to  
374 explain why it used verbal bids rather than written confirmations when  
375 assigning a firm city-gate contract to its affiliate, and finally for the  
376 Commission to find \$XXXXX in gas costs to be imprudent because IP only  
377 used the reservation costs as its basis for assigning firm supply contracts.  
378 I also requested that IP perform an analysis of several swing contracts to  
379 verify if IP's use of the lowest reservation costs as a basis for selecting  
380 those contracts resulted in any imprudent gas supply costs.

381 30. Q. What information did IP provide in response to your comment that it used  
382 different contractual arrangements for its affiliates than other gas supply  
383 entities?

384 A. IP noted that a prior Gas Industry Standards Board, Inc. (“GISB”)  
385 agreement that it had signed with a predecessor of Dynegy Marketing and  
386 Trade (“DMT”) was still in force and applied to all contracts signed with  
387 DMT. As part of its support for this contention, IP provided the  
388 documentation in response to Staff data request ENG 2.195 that showed  
389 the legal name change from the predecessor company to DMT on July 7,  
390 1998. Further, IP was able to supply an example of another gas supply  
391 company that does not use a GISB form for bid confirmations.

392 31. Q. Did the information that IP provided alleviate your concerns about IP  
393 maintaining a different contractual relationship with its affiliate versus other  
394 natural gas suppliers?

395 A. The information that IP supplied did alleviate some of my concerns.  
396 However, I still have some concern of DMT’s use a document entitled  
397 Exhibit B for its bid confirmations. Mr. Starbody testified that he does not  
398 know why the confirmation sheets from DMT are labeled Exhibit B and  
399 that IP has provided Staff with the complete contracts documents.  
400 However, it does not answer the question what is Exhibit A? I would like  
401 IP to contact its affiliate, DMT, and find out why it uses Exhibit B for its bid  
402 confirmations and to request DMT provide a response regarding what is  
403 and when is an Exhibit A used.

404 32. Q. What information did IP provide in response to your request that it explain  
405 why it used verbal bids rather than written confirmations when assigning a  
406 firm city-gate contract to its affiliate?

407 A. Company witness Starbody noted that IP had solicited verbal bids from a  
408 total of six suppliers and that DMT provided the best bid. He further noted  
409 that taking verbal bids on this one occasion did not disadvantage IP since  
410 IP monitors the gas supply market on an ongoing basis. Further, he noted  
411 that anytime IP's gas personnel solicit bids, they already have a good feel  
412 for what prices, terms and conditions are available.

413 33. Q. Did Mr. Starbody's testimony respond to the comments made in your  
414 direct testimony?

415 A. No. Mr. Starbody did not explain what caused IP to violate its own policy  
416 of not taking verbal bids for firm contracts on this one occasion. I request  
417 that IP explain, in detail, why it violated its own gas purchasing policy for  
418 the above contract and what it has done to ensure that it will not violate  
419 the policy again.

420 34. Q. What information did IP provide regarding your recommendation that the  
421 Commission find \$XXX in IP's gas costs imprudent because IP only used  
422 reservations costs as the sole basis for assigning firm gas supply  
423 contracts?

424 A. Mr. Starbody noted that he strongly disagreed with my assessment. He  
425 noted that most of IP's firm winter gas supplies are purchased on a swing  
426 basis, which guarantees IP that supply will be available but does not  
427 obligate the Company to take any gas under that contract. This  
428 arrangement allows IP to solicit commodity purchases from alternative  
429 sources throughout the winter season whenever their commodity prices  
430 are lower than those specified within the firm gas supply contracts. He  
431 further noted that except under severe winter conditions, IP may take little  
432 or no commodity from these swing contracts.

433 Mr. Starbody did state that it is possible to account for the commodity  
434 costs, but he did not believe it would contribute to improved decision-  
435 making. Specifically, he noted that the volume of gas, if any, that might be  
436 purchased under those contracts will depend on numerous factors  
437 including weather, spot versus firm gas prices, basis differentials, the  
438 availability of lower-priced alternative supplies, and the prices that can be  
439 obtained from suppliers on a daily basis. He further stated that the  
440 accuracy and reliability of the results of such an analysis would be  
441 completely overwhelmed by the uncertainty of the assumptions that went  
442 into it.

443 35. Q. Do you agree with Mr. Starbody's comments?

444 A. Yes and no. I agree that having swing contracts reserves the gas supplies  
445 but does not obligate IP to take any gas from those contracts. I also agree  
446 that IP can look for alternative gas sources that provide a cheaper  
447 commodity rate than those provided by the swing contracts.

448 Finally, I agree there will be some degree of uncertainty regarding how  
449 much gas IP may take under any particular contract, however, to  
450 completely ignore the commodity cost of a contract cannot lead to a  
451 prudent decision making process. I believe the simple process of  
452 calculating the break-even point on the contract's usage factor (also called  
453 load factor) would greatly assist IP's decision making process for gas  
454 purchases.

455 For example, the DMT contract that I calculated a \$XXXX adjustment on  
456 has a break-even load factor amount of 25% when compared to the next  
457 best contract. Stated differently, if IP used less than 25% of the gas  
458 volumes available from the contract over the term of the contract, then the  
459 lower reservation cost contract provides a lower total gas cost. However,  
460 if IP expects to use more than 25% of the contract's gas volumes, then the  
461 contract that had the lower commodity price provides a lower total overall  
462 gas cost.

463 The commodity price difference between bids should never be completely  
464 ignored. Prior to accepting firm bids that include commodity price

465 differences with other offered bids, IP, at a minimum, should investigate a  
466 break-even usage rate or load factor that those contracts would require in  
467 order for the commodity rate difference to enter into the equation.

468 36. Q. What load factors has IP experienced with its swing contracts?

469 A. I asked IP to calculate the usage rates of its firm swing contracts from the  
470 1999-2000 and the 2000-2001 winter seasons. During the winter season  
471 of 1999-2000, XXX  
472 XXX  
473 XXX  
474 XXX  
475 XXXXXXXXX.

476 During the winter season of 2000-2001, XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX  
477 XXX  
478 XXX  
479 XXX  
480 XXX  
481 XXX  
482 XXXXXXXXXXXXXXXXXXXXXXX.

483 37. Q. Did Mr. Starbody have any other comments within this area?

484 A. Yes. Mr. Starbody pointed out that I had made two errors in my  
485 calculation. First, the daily deliverability of the contract should be XXXXX  
486 instead of the XXXX number that I used. Further, the alternative bid that I  
487 used to calculate the adjustment was not for the full XXXXX value, but  
488 instead was limited to XXXXX. I agree with both of those corrections.

489 38. Q. How do those corrections impact your recommended adjustment?

490 A. I recalculated my adjustment to the limit of the alternative contract amount  
491 of XXXXX. Using that smaller contractual amount decreases the  
492 adjustment amount from the original value of \$XXXX to \$XXX. This  
493 calculation is shown on ICC Staff Exhibit 4.0, Schedule 12.0.

494 39. Q. Is it possible that IP could have obtained more than XXXX MMBtu from  
495 the alternative contract?

496 A. Yes. Had IP selected that contract as its best option, IP could have  
497 contacted that supplier to see if additional deliverability was available.  
498 From the information provided in response to Staff data request  
499 ENG 2.35, IP contracted for amounts significantly above the initial bid  
500 limits on two occasions in 2000. However, what additional amount, if any,  
501 that IP could have obtained from the supplier in question is not readily  
502 available so I chose to redo the calculation using the original limits  
503 provided.

504 40. Q. Did you have any other requests in your direct testimony that Mr. Starbody  
505 provided a response?

506 A. Yes. I requested an analysis of several swing contracts that IP entered  
507 into during the reconciliation period on the basis of lowest reservation cost  
508 without regard to the commodity component of the contract.  
509 Mr. Starbody's analyses of these contracts, provided on IP Exhibit 3.5,  
510 showed one further instance where signing a contract with the lowest  
511 reservation fee resulted in additional gas supply costs. In this instance, an  
512 additional \$XXXX was incurred. I recommend the Commission also  
513 consider this amount to be imprudently incurred during the reconciliation  
514 period.

515 41. Q. Does this conclude your rebuttal testimony?

516 A. Yes.