

STATE OF ILLINOIS



ILLINOIS COMMERCE COMMISSION

August 28, 2001

Ms. Donna M. Caton
Chief Clerk
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701

**RE: Docket No. 00-0714
Illinois Power Company**

Dear Ms. Caton:

Enclosed for filing on behalf of the Staff of the Illinois Commerce Commission in the above-captioned docket is the Initial Brief of the Staff of the Illinois Commerce Commission.

Sincerely,

A handwritten signature in cursive script, appearing to read "S. Matrisch".

Steven L. Matrisch
Staff Attorney

SLM/ja

Enclosure

cc: Mr. William J. Showtis, Administrative Law Judge
Service List

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	00-0714
Illinois Power Company	:	
	:	
Reconciliation of revenues collected	:	
under gas adjustment charges with	:	
actual costs prudently incurred.	:	

INITIAL BRIEF OF THE STAFF OF
 THE ILLINOIS COMMERCE COMMISSION

Steven L. Matrisch
 Linda M. Buell
 Office of General Counsel
 Illinois Commerce Commission
 527 East Capitol Avenue
 Springfield, IL 62701
 Phone: (217) 785-3808 or (217) 557-1142
 Fax: (217) 524-8928

August 28, 2001

TABLE OF CONTENTS

I.	Background	1
II.	Legal Standards	2
III.	Argument	3
	A. Introduction	3
	B. Illinois Power Decision Making Process	4
	C. Retirement of Freeburg Propane Facility	6
	1. Capital Expenditures – PVRR Analyses	8
	a. Replacement Gas Costs	8
	b. Costs to Upgrade the Freeburg Propane Facility	10
	c. Additional Future Capital Expenditure	11
	d. Inflation Rate	13
	e. PVRR Conclusion	13
	2. Residential Development/Plant Safety	14
	a. Residential Development	14
	b. Freeburg Facility Safety	16
	c. Report of Dr. Russell Ogle	17
	3. Operator Training	19
	4. Plant Reliability	20
	5. Freeburg Conclusion	20
	D. Retirement of Gillespie Storage Field	21
	1. Adjustment Amount	21
	a. Commodity	22
	b. Pipeline Reservation Costs	23
	2. Upgrade Costs	23
	3. PVRR Analyses	25
	4. Operational Concerns	26
	5. Gillespie Conclusion	26
	E. Gas Purchasing Activity	27
IV.	Conclusion	29

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	00-0714
Illinois Power Company	:	
	:	
Reconciliation of revenues collected under	:	
gas adjustment charges with actual costs	:	
prudently incurred.	:	

**INITIAL BRIEF OF THE STAFF OF
THE ILLINOIS COMMERCE COMMISSION**

NOW COMES the Staff of the Illinois Commerce Commission ("Staff"), by and through its attorneys, and hereby submits an Initial Brief in this matter.

I. BACKGROUND

On November 8, 2000, the Illinois Commerce Commission ("Commission") approved an Order commencing reconciliation proceedings in accordance with the requirements of Section 9-220 of the Public Utilities Act (the "Act"). 220 ILCS 5/9-220. The Commission's Order directed Illinois Power Company ("IP" or the "Company") to present evidence reconciling revenue collected under the Company's purchased gas adjustment clause ("PGA") with the actual cost of natural gas supplies prudently purchased for the 12 months ending December 31, 2000. (Order at 4)

Pursuant to proper legal notice, a pre-hearing conference was held on April 26, 2001 before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois. At the pre-hearing conference, the Administrative Law Judge granted the petition to intervene filed by the Illinois Attorney General on behalf of

the People of the State of Illinois. Thereafter, evidentiary hearings were held on August 3 and 7, 2001. Appearances were entered by counsel on behalf of IP and Commission Staff. IP presented the testimony of Barbara McKinney, Senior Specialist, Business Development Services Department and Michelle R. Shipp (nee Grohne), Business Leader, Controller's Group by affidavit and the testimony of Frank Starbody, Director-Gas Supply and Russell Ogle, Vice President- Chemical Engineering, Packer Engineering, Inc. Staff presented the testimony of Burma C. Jones, Accountant, Accounting Department of the Financial Analysis Division, and Eric Lounsberry, Gas Section Supervisor, Engineering Department of the Energy Division. At the conclusion of the hearing on August 7, 2001, the record was marked "Heard and Taken."

II. LEGAL STANDARDS

PGA reconciliation proceedings are governed by Section 9-220 of the Act that provides, in pertinent part, as follows:

Annually, the Commission shall initiate public hearings to determine whether the clauses reflect actual costs of fuel, gas, power, or coal transportation purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual costs of fuel, power, gas, or coal transportation prudently purchased. In each such proceeding, the burden of proof shall be upon the utility to establish the prudence of its cost of fuel, power, gas, or coal transportation purchases and costs.

220 ILCS 5/9-220.

The standard used by the Commission to assess the prudence of a utility's gas purchases under Section 9-220 of the Act is as follows:

Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made.

Illinois Power Co. v. Illinois Commerce Commission, 245 Ill. App. 3d 367, 371 (3d Dist. 1993) (quoting the Commission); Docket No. 88-0142 at 25 (Order entered February 5, 1992). Furthermore, "[i]n determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible." (Id. at 371 (quoting the Commission); Docket No. 88-0142 at 25-26).

III. ARGUMENT

A portion of the cost of gas that Illinois Power Company purchased during the current reconciliation period was not prudently made.

A. Introduction

IP failed in its obligation to make prudent gas purchasing decisions and to provide least cost gas service to its customers during the calendar year 2000 reconciliation period. Staff noted three areas where IP made imprudent decisions that caused IP's customers to pay approximately \$1,718,000 in additional gas supply costs during the reconciliation period. (Revised Staff Ex. 4.0 at 2) First, IP improperly decided to retire its Freeburg propane facility, which caused it to incur \$1,273,000 of additional gas supply costs during the review period. (Id.) Also, IP improperly retired the Gillespie storage field, which resulted in the Company incurring an additional \$442,000 during the review period. (Id. at 18) Finally, IP entered into two natural gas supply contracts that caused it to experience higher natural gas costs than if it had selected available alternative bids. The higher cost gas contracts caused IP to incur an additional \$3,000 in gas supply costs during the review period. (Id., Sch. 1.0)

IP's lack of support for the decisions made during the reconciliation period demonstrates that IP made shortsighted decisions and failed to consider all relevant

information pertaining to the issues at hand. The Company failed to provide adequate bases for its decisions. Further, IP witness Starbody made certain statements during cross-examination that do not reflect prudent decision making. These statements also conflict with IP's historical actions before the Commission.

B. Illinois Power Decision Making Process

A consistent theme throughout Staff's adjustments is that IP failed to consider vital information that it should have had available to it at the time the decisions at issue in this proceeding were made. The cross-examination of IP witness Frank Starbody demonstrates the extent to which IP failed to meet the basic prudence requirement. When Mr. Starbody was asked to explain under what situations he believed it would be appropriate to conduct a present value of revenue requirement ("PVRR") analysis, he responded that he did not know of any situation that would require a PVRR analysis. (Tr. at 117-118.) During re-cross, Mr. Starbody noted that someone outside of the scope of his areas of responsibility might make use of a PVRR analysis. (Tr. at 130.) Mr. Starbody also noted that he was responsible for making the decisions concerning the retirement of the Freeburg propane facility and the Gillespie storage facility. (Tr. at 76-77; 86-87.) Further, he noted his response regarding the value of PVRR analyses was based upon the Freeburg and Gillespie facilities. (Tr. at 131.) Mr. Starbody's failure to consider a PVRR analysis when making a decision about these types of facilities is a major change from past IP activity before the Commission.

IP's most recent natural gas rate case proceeding before the Commission was Docket No. 93-0183. A central issue in this proceeding was IP's expansion of its Hillsboro storage field. IP's review of this project involved comparing the costs for

expanding the Hillsboro storage field to various other alternatives. This comparison was completed through the use of PVRR analyses. (Order at 7-11.) IP also presented a PVRR analyses when it requested a certificate of public convenience and necessity for the Hillsboro project in Docket No. 91-0499 (Order at 9.) and provided this same analyses in its gas energy plan in Docket No. 91-0024. (Id.)

The various PVRR analyses used by IP to justify the Hillsboro expansion project allowed IP and the Commission to compare projected future gas supply costs and alternative capital intensive projects to the additional capital and operation and maintenance costs associated with the Hillsboro expansion project on an apples-to-apples basis. The use of PVRR analyses to justify why a certain decision is best versus other alternatives is the industry practice before the Commission.

IP's failure to conduct PVRR analyses prior to reaching a decision on the retirement of the Freeburg propane and Gillespie storage facility is, at best, a gross omission by IP's management and, at worst, a decision based upon IP's desire to increase profits for its shareholders. Staff can only conclude that IP is not making decisions on what is best for its customers but instead on what is best for its shareholders. IP does not earn a return on its investments for improvements or upgrades at facilities such as Freeburg and Gillespie until it requests and receives a natural gas rate increase from the Commission. However, increased gas supply costs, unless deemed imprudently incurred, are automatically passed through to customers through the PGA. Unfortunately, IP's failure to conduct any analyses regarding the best decision for upgrading or retiring its existing natural gas facilities suggests that IP is not making decisions from its customers' perspective.

IP has forgotten that it has obligations to both its ratepayers and shareholders when making major decisions such as plant retirements. IP failed in its obligation to conduct the appropriate studies, with supporting documentation, to demonstrate to the Commission that it made the prudent decision in the matters discussed below.

C. Retirement of Freeburg Propane Facility

Staff demonstrated that it is not in the best interests of IP's ratepayers to retire the Freeburg propane facility and that IP acted imprudently when it reached its decision to retire the Freeburg propane facility. Staff calculated that IP imprudently incurred \$1,273,000 in gas supply costs as a result of IP's decision to retire the Freeburg facility. (Revised Staff Ex. 4.0 at 3.)

IP failed to conduct any meaningful analysis prior to making its decision to retire the Freeburg propane facility. IP's arguments throughout the case demonstrate that IP simply created after-the-fact analyses in an attempt to support its decision. However, IP falls short in its attempt to provide after-the-fact analyses to support its decision to retire the facility.

In response to Staff data requests, IP initially claimed the reason for retiring the facility was that the facility had reached the end of its useful life and was therefore retired. (Revised Staff Ex. 2.0 at 5.) IP reported to Staff that the facility was installed in 1971 and had obsolete refrigeration compressor controls and switchgear. (Id.) IP further stated that its plant's fire protection and gas detection equipment did not conform to current standards and, finally, the refrigerated sphere insulation was failing and needed to be replaced. (Id. at 5-6.) However, aside from the above statements, IP failed to

provide Staff with any studies or analyses supporting the decision to retire the facility. (Id. at 6-7.)

After Staff presented its direct testimony that recommended disallowance of all additional gas supply costs associated with the retirement of the Freeburg facility and noted the Company's lack of support for its decision, only then did IP present additional reasons for its retirement decision. According to the Company's rebuttal testimony, four other reasons factored into the decision to retire the facility. First, IP noted that substantial capital expenditures would be required to renovate the plant to allow it to continue to operate. (Revised IP Ex. 3.2 at 2.) Second, IP stated alleged safety concerns regarding encroaching residential growth in the area surrounding the propane facility noting that they were significant factors in the decision to retire the facility. (Id. at 2-3, 5.) Third, IP claimed that the facility operators required specialized training. (Id. at 3.) Finally, IP stated that another reason for the retirement of the facility concerned the reliability of the facility. (Id. at 4.)

In response to the reasons asserted by IP in its rebuttal testimony for the retirement of the Freeburg facility, Staff reviewed the proffered reasons and concluded that no supportable reason exists for IP's decision to retire the facility. In particular, Staff presented PVRR analyses based upon the information provided by IP in the proceeding. The Company's surrebuttal testimony amended Staff's PVRR analyses and attempted to provide further details regarding some of the four reasons for retiring the facility. A detailed discussion of the four areas IP provided as its basis for retiring the facility is discussed *infra*.

1. Capital Expenditures – PVRR Analyses

In its rebuttal testimony, the Company claimed it would require \$1,873,000 in capital improvements to upgrade the propane facility. (Id. at 4.) The capital improvement figure provided by IP, along with Staff's recommended adjustment amount and other information, was used by Staff to develop PVRR analyses to review the Company's decision to retire the facility. (Revised Staff Ex. 4.0, Sch. 2.0.) Staff's PVRR analyses demonstrated that over a 15-year time period, IP would have saved \$4,139,000 had it kept the Freeburg facility in service. (Id.) A 30-year analysis indicated a savings associated with the continued operation of the Freeburg propane facility in the amount of \$6,496,000. (Id.)

In its surrebuttal testimony, the Company claimed changes were needed to the following areas within Staff's PVRR analyses: propane inventory, replacement gas costs, additional future capital additions, and the assumed inflation rate. (IP Ex. 3.6 at 3-6.) While Staff agrees that working capital associated with propane inventory should be included within the analyses, Staff disagrees with the Company's alterations.

a. Replacement Gas Costs

IP's surrebuttal testimony claims two changes should be made to the replacement gas cost amounts calculated by Staff. First, IP claimed that \$588,126 in replacement gas costs is the appropriate value to use within the PVRR analyses. (IP Ex. 3.6 at 6.) Second, IP claimed that Staff's replacement gas cost amount assumed for the reconciliation period is overstated by 25% and should instead be \$954,750. (Id.) Staff disagrees with both adjustments.

IP's recommendation to use \$588,126 is based upon the assumption that IP would only procure winter transportation capacity as opposed to year round capacity. (Id. at 5.) However, IP's estimate of \$588,126 is based upon pure speculation. IP's calculation was not based upon any contracts that it has signed; instead, IP takes the annual gas cost used in the proceeding, determines the discount that IP received for that service versus current maximum rates and then assigns that discount to the current maximum winter rates.

However, IP admits that only winter service comes at a premium. (Id. at 5.) Therefore, it is not intuitive that a discount IP received for a year round contract is applicable to the more desirable winter only service. In fact, IP may not be able to receive any discount from maximum rates for winter only service. Hence, IP has no basis for this calculation.

IP also asserts that since the Freeburg facility was not retired until April 2000, only \$954,750, or 75% of the annual costs associated with replacement transportation service should be disallowed in this proceeding. (Id. at 15.) However, the appropriate amount should be based upon when IP actually obtained the replacement transportation service in question. IP may have purchased that service during the prior reconciliation period because it already knew the facility was to be retired.

It is noteworthy that both of IP's attempts to dispute the replacement gas cost did not occur until it filed surrebuttal testimony on August 1, 2001, a mere two days prior to the evidentiary hearing in this proceeding. In rebuttal testimony, filed on July 12, 2001, IP did not dispute Staff's replacement gas cost value. It was not until the

replacement gas cost was factored into Staff's PVRR analyses that IP concocted last minute changes in the replacement gas cost amount.

b. Costs to Upgrade the Freeburg Propane Facility

In its rebuttal testimony, the Company noted it estimated that it would take \$1,873,000 to renovate the Freeburg propane facility. (Revised IP Ex. 3.2 at 4.) However, once Staff used IP's figure for its analyses, IP generated additional testimony that suggested \$2,500,000 is more appropriate. (IP Ex. 3.6 at 8.) Staff disputes most of that revised amount. IP's basis for the increased capital costs is the testimony of Dr. Russell Ogle. Dr. Ogle was hired on July 26, 2001, to examine the Freeburg facility and to "perform an independent safety analysis of the Freeburg facility." (Revised IP Ex. 4.3 at 1.)

Ogle developed a list of capital items that increase the cost to renovate or operate the facility on an on-going basis. (Id. at 4.) The capital items noted included the development of new operator training program at a cost of \$50,000, an update of engineering documents at a cost of \$30,000, a comprehensive sphere inspection at a cost of \$75,000, and additional fire protection equipment at a cost of \$500,000. (Id.) Staff does not dispute that a comprehensive sphere inspection should be conducted or that IP would incur costs to upgrade its engineering documents. However, IP has failed to demonstrate that any of the other costs are necessary.

IP suggests that it needs to spend \$50,000 to update its operator training program. However, this amount exceeds the total amount of operations and maintenance expense at the facility for the period 1998 through 2000 ($9,900 + 10,500 + 15,900 = \$36,300$) and almost exceeds the combination of operation and maintenance ("O & M")

and capital expenditures for this same time period ($36,300 + 24,400 + 1,600 = \$62,300$). (Staff Cross Ex. 7.) Curiously, despite his report to the contrary, on cross-examination, Dr. Ogle did not note any shortcomings in IP's existing training program for its employees that operate the Freeburg facility. (Tr. at 163.) Given the magnitude of this "update" versus historical expenditures at the plant and the lack of any problems with the existing training program, it is clear that \$50,000 to update IP's operator training program is unnecessary.

Finally, it is clear that at the time the Freeburg facility was retired, no additional fire protection equipment was needed. Ogle's assumption that an additional \$500,000 in fire protection equipment is necessary is pure conjecture. Dr. Ogle noted that depending upon the level of fire risk deemed acceptable by IP, it might be necessary to install the \$500,000 fire monitors. (emphasis added) (Id. at 3.) However, there is no regulatory requirement for IP to do so. (Tr. at 162-163.) IP has operated this facility for 30 years without the need for this equipment and there is no requirement for it. IP's attempt to factor this cost within the PVRR analyses is simply another hindsight attempt to overstate the amount of capital necessary to renovate the facility in order to justify its original decision regarding the retirement of the facility.

c. Additional Future Capital Expenditure

In its revision to Staff's PVRR analyses, IP assumes that an additional capital expenditure of \$200,000 is necessary every three years throughout the remaining assumed life of the facility. (IP Ex. 3.6 at 6.) IP's basis for this assumption is its claim that additional capital projects would be necessary in the future to keep the facility operating. Staff does not agree with this value. Staff does agree that some level of

future capital expenditure could be considered; however, IP's estimate is much too high, and as noted *supra*, IP conducted no studies or analyses regarding what expenditures would be needed.

The assumption of \$200,000 is contrary to IP's historical operation of the facility. The capital expenditures at the Freeburg propane plant for the years 1998 through 2000 ranged from zero to \$24,400. (Staff Cross Ex. 7.) In 1995, IP installed one piece of equipment and in 1996, replaced one piece of equipment at the facility. (Staff Cross Ex. 10.) The details for 1998 show the replacement of various items. (*Id.*) However, IP's response to a Staff data request indicates that in 1998 there was expense associated with no capital additions. (Staff Cross Ex. 7.) In fact, the largest amount of capital additions that IP experienced at Freeburg occurred in 1999 with a total of \$24,400. IP's responses to Staff data requests conclusively establish that \$200,000 is a highly inflated figure.

The information provided by IP does not support its contention that an additional \$200,000 in capital expenditures is required every three years. Further, making major upgrades to the facility should decrease, not increase, the need to repair and replace items at the facility in the future. While Staff agrees that some small amount could be assumed for future capital expenditures, the evidence does not support IP's figure of \$200,000.

It also bears mentioning that Staff overstated IP's O&M amounts within the PVRR analyses, which, in part, provides some leeway for future capital expenditures. Staff assumed \$35,000 as the annual O&M amount for Freeburg, which was based off of the Company's response to Staff data request ENG 2.186. (Revised Staff Ex. 4.0 at

6; Staff Cross Ex. 7.) According to IP, for the period 1998 through 2000, it experienced O&M levels of \$9,900, \$10,500, and \$15,900, respectively. (Staff Cross Ex. 7.) However, the combined costs of O&M and capital from that exhibit for the same time period provide values of \$9,900, \$34,900 and \$17,500, respectively. Unlike many of the Company's assumptions, Staff made conservative estimates in its values within the PVRR analyses.

d. Inflation Rate

Finally, IP asserts that Staff's inflation rate figure is incorrect and that the operation and maintenance expense at the facility would increase at a real rate of 1% in addition to the 2.85% rate of general inflation. (IP Ex. 3.6 at 7.) As noted, *supra*, Staff overstated the O&M amounts for Freeburg. In addition, the updating and renovating of the facility should decrease, not increase, the need to conduct maintenance at the facility. Therefore, Staff does not agree with the use a 3.85% inflation rate for O&M expenses within the PVRR analyses.

e. PVRR Conclusion

Staff does agree with an extremely limited number of the changes made by IP to its PVRR analyses. Since IP failed to develop its own PVRR analyses until the surrebuttal testimony phase, Staff was precluded from presenting revised numbers for its PVRR analyses. The PVRR analyses that most closely resemble Staff's agreement on a limited number of issues are the PVRR results for operating the Freeburg facility noted on lines 155 and 159 of IP's surrebuttal testimony. (IP Ex. 3.6 at 7-8.) These results show a 30-year cost to operate the Freeburg facility of \$5,630,160 and a 15 year cost of \$4,616,201. (*Id.*) While Staff believes these amounts are somewhat overstated,

they nevertheless are the PVRR values of IP that most closely correspond to Staff's position. However, each of those values is still less expensive than the amount Staff calculated for replacement gas costs. Staff calculated the 30-year replacement gas cost amount to equal \$10,989,578, while the 15-year value equaled \$8,056,872. (Revised Staff Ex. 4.0, Schedule 2.0.) Based on the PVRR analyses, it is unmistakable that IP should not have retired the Freeburg facility.

2. Residential Development/Plant Safety

a. Residential Development

IP claims that it was concerned about the continued operation of the propane facility because the area surrounding the site of the plant had been experiencing residential growth. (Revised IP Ex. 3.2 at 2-3.) IP also contends that thickly settled residential areas have been moving closer to the plant site. (Id.) Because of this encroachment, IP alleges that safety issues associated with the residential areas developing near the plant were a significant factor in the decision to retire the plant. (Id. at 5.) However, upon review of these claims, IP's position is meritless.

After the Company put forth its concerns regarding the residential development in its rebuttal testimony, Staff toured the Freeburg facility on July 19, 2001 and reviewed the area surrounding the facility. (Revised Staff Ex. 4.0 at 6.) This review indicated that the residential growth reported by IP was a significant distance away. (Id. at 7.) In fact, the closest new residential development was approximately 4.3 miles away from the facility. (Id.) This residential development is taking place south of the community of Smithton along Illinois Highway 159. (Id.) All other residential growth areas were also occurring south of Smithton along Highway 159. (Id. at 6-7.)

The Freeburg facility is not located along Highway 159. (Id. at 7.) The facility is located about 2.5 miles south of the community of Freeburg along Illinois Highway 13. (Id.) No new residential development in the immediate vicinity of the existing Freeburg propane facility was observed. (Id.) IP claims that its safety concerns were based on the trends in the development of the surrounding area over a period of years. (IP Ex. 3.6 at 10-11.) IP further asserts that its concerns were based upon the likelihood that development would continue to move closer to the site over the time period needed to operate the Freeburg facility in order to justify the capital expenditure necessary to renovate the facility. (Id. at 11-12.) However, the facts simply do not support IP's position. Aside from a few scattered homes, there is no newly developed dense residential development closer than four miles to the facility. (Revised Staff Ex. 4.0 at 7.) The residential development that has occurred in the area is on a different highway than the highway where the Freeburg facility is located. (Id.) Also, as has been the pattern in this case, IP failed to mention potential residential encroachment as a basis for retiring the Freeburg facility until its rebuttal testimony.

In direct conflict with its assertion that potential development around the facility was a significant factor to close the plant, is that any future development would also have to contend with the various injection/withdrawal wells and associated piping in place at the Freeburg natural gas storage field. (Id.) The Freeburg propane facility is not a stand-alone facility. The major equipment associated with IP's Freeburg natural gas storage field is located at the same site as the propane facility. (Id.) This co-existence occurred when the propane facility was initially placed in service in 1971. (Id.)

To support its position that a reason the Freeburg facility was closed was for safety reasons, Dr. Ogle's analysis discusses the consequences of a propane explosion at the facility. According to Ogle, in the event of a propane explosion involving the storage vessel, the blast would destroy residential and commercial structures within 1.2 miles of the facility, break windows in buildings within 3 miles, and cause second degree burns to persons within 1.75 miles. (Revised IP Ex. 4.3 at 2.) Assuming *arguendo* that Dr. Ogle's calculations are correct, they completely undermine IP's assertions that safety was the reason to close the facility. There was no evidence presented that new residential development fell within the damage range predicted by Ogle. In fact, Staff witness Lounsberry testified that based on his personal observation, the nearest residential development was over 4 miles away. (Revised Staff Ex. 4.0 at 7.) Further, it is incongruous for IP to assert safety concerns when the city of Freeburg is only 2.5 miles away and has presumably been there since the propane facility's opening in 1971. Apparently, IP was not concerned about the citizens of Freeburg from 1971 to 2000.

b. Freeburg Facility Safety

IP noted that it had safety concerns with encroaching residential areas because this made the risks and consequences associated with gas leakage or fires that are inherent to propane facilities a matter of increasing concern. (Revised IP Ex. 3.2 at 3.)

In response to this alleged concern, Staff requested that IP provide it with the history of the leaks and/or fires that had occurred at the Freeburg propane facility. In response to this request, IP was only able to provide two known occurrences. The first event was a fire that occurred in June of 1985. (Revised Staff Ex. 4.0 at 8.) The fire was the result of lightning igniting propane vapors seeping from three of four relief

valves on top of the refrigerated sphere. (Id.) IP replaced those relief valves and installed a lightning protection system at the tank perimeter to alleviate the possibility of that occurring again. (Id.)

The second event that IP provided to Staff occurred in October 1995 when a minor leak occurred on an orifice fitting that was used to measure propane being transferred between the surge drum and the refrigerated tank. (Id. at 8-9.) IP isolated the orifice fitting, removed it from the piping, and shipped it to the manufacturer for repair. (Id.) The manufacturer repaired the casting defect and the repaired unit was reinstalled upon its return. (Id.)

The history of the facility itself dispels IP's argument that the plant is susceptible to leaks and fires. In fact, the evidence suggests that the facility has been extremely safe during its operation. The one occasion that a fire did occur, IP took action to prevent reoccurrence of a similar event. The only leak incident identified by IP did not even involve the refrigerated tank. Nothing in the plant's history provides any support to the Company's contention that there is reason to be concerned about the plant's safety.

c. Report of Dr. Russell Ogle

Prior to filing its surrebuttal testimony, IP retained Dr. Ogle to perform what it calls an "independent safety analysis" of the Freeburg facility. (Revised IP Ex. 4.3 at 1.) A portion of that analysis was to estimate what would happen if the Freeburg facility experienced a Boiling Liquid Expanding Vapor Explosion ("BLEVE"). (Id. at 2.) Ogle's report then proceeded to list the consequences of such an event. (*supra* at 16.)

Ogle then presented a list of five accidents where a BLEVE had occurred. (Id. at 2-3.) Of these accidents, relied upon by Ogle to opine about the danger of propane

explosions, one BLEVE event occurred in 1966, three occurred during the 1970s, while the most recent event occurred in 1984. (Id.) Only two of those five events occurred within the United States and one of those occurred after a train derailed while transporting propane rail cars. (Id.) One accident at a propane facility in the United States within the last thirty-five years suggests an impeccable safety record for this type of plant.

Mr. Starbody takes the information presented within Dr. Ogle's testimony and claims IP determined that as the Freeburg-Smithton area continued to grow, operation of the aging propane facility presented liability risks the Company did not want to accept. (IP Ex. 3.6 at 14.)

Starbody misses the point. The issue is not whether a propane explosion can occur; rather, the issue is whether or not safety was a legitimate concern when the Freeburg facility was retired. The evidence overwhelmingly suggests otherwise. Dr. Ogle was not retained by IP until July 26, 2001. (IP Ex. 4.1 at 1.) Thus, eighteen months after IP made its decision to retire the facility it retained an expert witness to help justify that decision. Notwithstanding that IP did not bring up a liability concern until surrebuttal testimony, IP never had access to Dr. Ogle's report when making its initial decision regarding the retirement of the propane facility. Second, upgrading and renovating the propane facility, if anything, should improve the plant's safety, not reduce it. The purpose of Dr. Ogle's testimony is obvious: to provide hindsight justification for closure of the Freeburg facility eighteen months after that decision was already made.

The possibility of a BLEVE did not stop IP from installing the facility, at the same location as its Freeburg storage field in 1971. In fact, Dr. Ogle agreed the BLEVE

results would have been the same in 1971 as when he calculated it for his analysis. (Tr. at 159.) Finally, the history of BLEVE events is extremely limited, with only two occurring in the United States over the last 35 years and as noted above one of those incidents only occurred after the derailment of propane rail cars. The storage of propane and other petrochemicals occurs every day within the United States. The possibility that a BLEVE can occur does not provide adequate justification for retiring an existing facility that operated virtually without incident for 30 years.

3. Operator Training

IP claimed that the complexity of the Freeburg plant increased the level of sophistication in training and expertise required to operate it. As such, IP further noted that the need for this specialized training and expertise, combined with the infrequency with which the plant actually needed to be operated and the resulting lack of hands-on operating experience were additional factors leading to the closing of the Freeburg facility. (Revised IP Ex. 3.2 at 3.) In surrebuttal testimony, IP noted that it was also concerned that if additional regulatory requirements were applied to the renovated propane facility, then there could be an increase in operator training and qualification requirements. (IP Ex. 3.6 at 15.)

Staff's review of this issue found that IP's existing training program for the Freeburg facility was hands-on and was performed during the annual testing of the plant during which the vaporizer heating system was started and operated one day. (Revised Staff Ex. 4.0 at 9.) If appropriate conditions existed, then on the second day the propane injection system was also tested. (Id.) Also, since the Freeburg storage field and propane facility were located at the same site, IP cross-trained those employees to

operate both facilities. (IP Ex. 3.6 at 15.) It is inexplicable how the need to maintain a training program, or even the possibility of expanding the training is a valid reason for retiring the Freeburg facility.

4. Plant Reliability

IP's final concern regarding the Freeburg facility was its concern about the plant's reliability. (Revised IP Ex. 3.2 at 4.) Staff's review found no reason to agree with the Company's concern over the plant's reliability.

IP's concern regarding reliability is based on only four incidents that occurred at the Freeburg facility. Two of those incidents involved pipeline corrosion leaks, one was a pump seal leak, and the final item was failure of a back pressure controller. (Revised Staff Ex. 4.0 at 10.) Given the 30-year history of the facility, only four incidents contradict concerns about the plant's reliability. Also, upgrading and renovating the facility should, at worst, maintain the reliability level of previous years and could increase the plant's reliability in the future. Therefore, the Company's concern about the Freeburg facility's reliability is invalid.

5. Freeburg Conclusion

IP fails to demonstrate it fully considered all the necessary and relevant information when it decided to retire the Freeburg propane facility. Even factoring in IP's belated assertions to support its decision, it is clear that IP should not have retired the Freeburg facility. As a result of IP's decision to retire the facility, IP imprudently incurred an additional \$1,273,000 in gas supply costs during the reconciliation period.

D. Retirement of Gillespie Storage Field

It is Staff's opinion that it is not in the best interest of IP's ratepayers to retire the Gillespie storage facility. IP acted imprudently when it reached its decision to retire the facility. Staff calculated that IP imprudently incurred \$442,000 in gas supply costs during the reconciliation period as a result of IP's decision to retire the facility. (Revised Staff Ex. 2.0 at 12.)

IP failed to conduct a meaningful analysis prior to making its decision to retire the Gillespie storage facility. IP initially claimed the reason for retiring the facility was the age and condition of the facility and that supply alternatives were less costly than upgrading the field to meet safety and code requirements. (Revised Staff Ex. 2.0 at 10.) In rebuttal testimony, IP provided further details about its rationale for retiring the facility. First, the Company claimed significant capital expenditures were required to renovate and upgrade equipment in order to continue to use the facility. Second, IP had operational concerns about the manner in which gas was withdrawn from the field. (Revised IP Ex. 3.2 at 6.) IP also challenged the amount calculated by Staff for the additional gas costs incurred during the reconciliation period and various values included with the PVRR analyses. Each of these issues is discussed *infra*.

1. Adjustment Amount

Staff recommended an adjustment of \$442,000 related to the additional gas costs that IP incurred during the reconciliation period as a result of its decision to retire the Gillespie storage field. (Revised Staff Ex. 4.0 at 18.) This amount is the combination of adjustments with three areas: pipeline reservation charge, contract reservation charge, and commodity savings. (Revised Staff Ex. 2.0, Schedule 2.0.) IP contested

two of the three areas. IP disputed the \$117,000 of commodity savings Staff assumed occurred during the reconciliation period. (Revised IP Ex. 3.2 at 9.) IP also disputed the level of pipeline reservation savings by claiming that a winter only service could have been reserved versus the year-round service assumed by Staff. (IP Ex. 3.6 at 19.)

a. Commodity

IP stated that due to the small size of the Gillespie storage field, it was typically used only during peak conditions. Therefore, it was likely that IP would not have withdrawn any gas from the field during December. (Revised IP Ex. 3.2 at 9.) IP provided additional arguments for its position with its surrebuttal testimony by noting that it plans its gas supply portfolio to serve load under design winter weather conditions (most severe temperatures in the last 20 years). (IP Ex. 3.6 at 22.) Further, the load conditions on December 21 were only about 78% of those expected on a peak day, with the loads on the other days when Staff assumed the Gillespie field would be operated, being under that value. (Id.) Therefore, the Company claimed it had available capacity in both its supply portfolio in general and its storage portfolio in particular and would not have needed to withdraw gas from the Gillespie field. (Id. at 22-23.)

Notwithstanding IP's past experience with operating its storage fields, the time frame that Staff assumed for Gillespie usage is unique from any past experience. Staff assumed that the Gillespie field would operate on December 17 through 22. This corresponds to the same time period that IP's largest storage field, Hillsboro, was out of service due to an explosion at the facility. Staff finds it highly likely that IP would have used the Gillespie facility immediately following the incident at the Hillsboro storage facility if it had still been available. (Revised Staff Ex. 4.0 at 17.)

During the time period Staff assumed for Gillespie operation, IP increased the withdrawal levels from its storage fields to accommodate the capacity lost as a result of the Hillsboro incident. (Id.) In fact, due to the higher than expected level of withdrawals from some of its fields, IP even injected gas into certain fields to ensure it had gas supplies available later in the winter season. (Id.) IP could have withdrawn gas from the Gillespie storage field during the time period in question and still scheduled injections into the field during the winter season of 2000-2001 if IP had a concern about deliverability rates from the field. (Id.) Therefore, Staff's commodity adjustment associated with the assumed operation of the Gillespie storage field is valid.

b. Pipeline Reservation Costs

IP claims that it could have obtained winter-only transportation service on a much less expensive basis than the year-round value assumed by Staff. (IP Ex. 3.6 at 19.) However, this is the same flawed argument IP used in its attempt to reduce the replacement gas cost value for the Freeburg propane plant retirement. (*supra* at 8-10.)

2. Upgrade Costs

IP initially estimated the cost to upgrade the facility as \$1,020,000. (Revised Staff Ex. 2.0 at 11.) However, in its rebuttal testimony IP revised that value to \$1,199,000. (Revised IP Ex. 3.2 at 8.) In its surrebuttal testimony, IP attempted to further increase the upgrade costs to \$1,320,494 by applying an inflation factor. (IP Ex. 3.6 at 20.) The discrepancy in these figures further illustrates Staff's position that IP failed to conduct any meaningful analysis regarding what it would have cost to upgrade the Gillespie facility. The Company's basis for all of these values was the cost IP incurred in 1995 to upgrade a compressor at the Shanghai Storage field. (Revised IP Ex. 3.2 at 8.)

Staff disagrees with the use of the cost to upgrade a compressor at Shanghai as a proxy for the cost to upgrade the Gillespie storage field compressor. It is not reasonable to assume that an upgrade at a field the size of Shanghai would cost as much as an upgrade at the much smaller Gillespie storage field. The Shanghai storage field is an aquifer storage field whose withdrawals at the start of winter are at a pressure of 800 per square inch ("psi"), which reduces to 450 psi by the end of winter. Shanghai also contains 8 injection/withdrawal wells, 11 monitoring wells, 2 dehydration towers, 2 reboilers, 2 separators, a moisture analyzer, 3 supply pipelines and 7 meters measuring the injections to and withdrawals from the field. (Revised IP Ex. 4.0 at 12.)

On the other hand, the Gillespie field is a dry gas field whose withdrawals at the start of winter are at 160 psi and reduce to 90 psi at the end of the winter season. This field consists of 7 injection/withdrawal wells, no monitoring wells, 1 reboiler, 1 separator, 1 supply pipeline and 2 meters that measure the field's injections and withdrawals. (Id. at 13.)

The Shanghai field is larger and more complex than the Gillespie field and operates at a higher pressure. The higher pressure causes any replacement of pipeline, fittings, regulators, valves, etc., that are designed specifically for the higher gas pressure to be more expensive than a similar component at Gillespie. Therefore, it is unreasonable to assume an upgrade at Gillespie would have the same costs as an upgrade at Shanghai. (Id.)

Staff is also concerned about IP's lack of documentation regarding the necessary upgrades at the Gillespie storage field. In its rebuttal testimony, Staff noted that even using IP's estimated cost to upgrade the Gillespie storage field, the 30-year PVRR

analysis was in favor of retaining the field. If IP had been serious about retaining the field's capacity, a more detailed study of what needed upgrading could have been conducted. (Id. at 15.) Also, IP could have looked at alternative means of operating the field that would have required less expensive upgrades to retain the field's withdrawal capability. (Id.)

3. PVRR Analyses

Aside from the adjustments that IP attempted to make to the replacement gas costs discussed above, IP made three other adjustments to the PVRR analyses provided by Staff. IP included an additional \$10,000 in additional capital expenditures for each year in the study period, assumed an additional 1% O&M value to the 2.85% value used by Staff, and included a of carrying cost for the gas maintained with the storage field. (IP Ex. 3.6 at 18-19.) Aside from the use of a 1% O&M adder, discussed *supra* at 13, Staff does not dispute the inclusion of these items within the PVRR analyses.

Using IP's projected upgrade costs and the 1% O&M adder value, provides a 30 year PVRR cost associated with retaining the Gillespie field of \$2,984,000. (Revised IP Ex. 3.13 at 1.) Staff's estimate of the PVRR for replacement gas cost over a 30-year term is \$2,843,000. (Revised Staff Ex. 4.0, Schedule 7.0.) This comparison indicates a slight cost savings from retiring the facility. The 15-year comparison shows even greater savings from retirement of the facility. A comparison of the 30-year PVRR study using the overstated upgrade value proposed by IP to the Staff's replacement gas cost estimate indicates that the 30-year value is a virtual break-even proposition. If IP would have had access to this information when it first made its decision regarding the Gillespie field, then IP should have conducted further studies regarding what work was

actually necessary at Gillespie. At this same time, IP could have also investigated if there were other alternative operating methods that would allow IP to retain its capacity. (Revised Staff Ex. 4.0 at 15.) Since IP did not have that information, IP could not have reached a prudent decision.

4. Operational Concerns

Another reason claimed by IP for retiring the Gillespie storage field was operational concerns at the facility. IP noted that in order to take withdrawals from the Gillespie storage field, it was necessary to reduce pressure on the distribution system in the surrounding geographic area. This practice concerned IP with respect to system integrity within that area. IP's concern was that if the storage field compressor tripped off line, there was a risk that service to distribution customers within the area could be lost. (Revised IP Ex. 3.2 at 6.)

Staff noted that in order to reduce the pressure to the surrounding geographic area, IP's gas system controller had to decrease the pressure requirements at the Staunton regulator station. (Revised Staff Ex. 4.0 at 16.) This regulator station is on automatic control with the gas system pressure being continually monitored by IP's Gas Control Group. (Id.) This process allows IP to remotely change the pressure at the station and provides a means to continuously monitor the system pressure. (Id.) Since IP remotely controls all of those functions, Staff remains unconvinced regarding operational problems at the Gillespie field.

5. Gillespie Conclusion

IP did not take into account pertinent information when it decided to retire the Gillespie facility. As a result of IP's uninformed decision to retire the facility, it impru-

dently incurred an additional \$442,000 in gas supply costs during the reconciliation period.

E. Gas Purchasing Activity

IP failed to account for all the relevant cost factors prior to entering into firm gas supply contracts during the reconciliation period. Specifically, IP failed to consider that two of the gas supply contracts it entered into contained higher commodity costs than contracts offered by alternative gas suppliers. Due to IP's inability to account for all relevant factors prior to entering into those contracts, IP incurred \$3,000 in excessive gas supply costs.

Company witness Starbody argues that using the lowest reservation fee as the basis for selecting IP's firm gas supply contracts is a prudent practice, noting that IP purchases most of its firm winter gas supplies on a swing basis, thus guaranteeing that supply will be available but not obligating IP to take gas under those contracts. This practice allows IP to solicit gas supplies from alternative sources. (Revised IP Ex. 3.2 at 12.) Starbody further argues that IP could account for commodity differences when assigning contracts, but he does not believe it would contribute to improved decision making. (Id.) In particular, the volume of gas purchased under those contracts is dependent upon numerous factors including weather. (Id.) IP claimed the accuracy and reliability of the results of such an analysis would be completely overwhelmed by the uncertainty of the assumptions that went into it. (Id. at 13-14.)

Staff disagrees with the Company argument. IP should consider all factors when assigning gas supply contracts in order to provide the lowest cost gas service for its customers. Further, IP attempts to overly complicate the analysis for the amount of gas

purchased under these contracts. For example, one of the contracts in question involved a supply contract with Dynegy Marketing and Trade (“DMT”). Staff calculated a break-even load factor amount based upon the commodity and reservation difference that existed between the DMT contract and the next best alternative as 25%. (Revised Staff Ex. 4.0 at 23.) Thus, if IP used less than 25% of the volumes available from that contract, the contract with the lower reservation fee provided the lowest total gas supply costs. (Id.) However, if IP used more than 25% of the volumes from that contract, the contract with the lower commodity costs provided the lower total gas supply costs. (Id.)

A historical review of IP’s usage rates for its swing contracts indicates that IP should account for commodity cost differences. During the winter of 1999-2000, IP entered into 16 firm swing contracts whose average load factor was 26.8%. (Id. at 24.) This is higher than the break-even load factor calculated for the DMT contract. This value was available to IP prior to its decision to enter into the DMT and its other swing contract at issue in this proceeding. However, IP failed to consider this information when making its decision to enter into those contracts.

IP’s failure to account for commodity differences between competing offers when assigning winning gas supply contracts is not a prudent practice. A simple comparison between IP’s past usage rates for its swing contracts and the break-even analysis of alternative supply bids should have caused IP to consider more than just reservation costs when assigning its firm winter swing contracts. IP’s failure to follow prudent purchasing practices caused it to incur an additional \$3,000 in gas supply costs during the reconciliation period. IP, not its customers, is responsible for those decisions. Therefore, IP should be held responsible for those costs.

IV. CONCLUSION

For the foregoing reasons, the Staff of the Illinois Commerce Commission respectfully requests that the Commission adopt Staff's recommendation to adjust Illinois Power Company's 2000 PGA reconciliation by the amount of \$1,717,678. In addition, Staff requests that the Commission order the Company to implement Factor O refunds of \$1,614,435 for Rider A, \$96,290 for Rider B Demand, and \$6,953 for Rider B Commodity, as indicated on Staff Exhibit 3.0, Schedule 1.0, page 1 of 4, in the first monthly PGA filing after entry of the final Order in this proceeding.

Respectfully submitted,

STEVEN L. MATRISCH
LINDA M. BUELL
Staff Attorneys

Counsel for the Staff of the
Illinois Commerce Commission

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	00-0714
Illinois Power Company	:	
	:	
Reconciliation of revenues collected under :	:	
gas adjustment charges with actual costs :	:	
prudently incurred.	:	

NOTICE OF FILING

TO: Attached Service List

PLEASE TAKE NOTICE that on this 28th day of August, 2001, I have filed with the Chief Clerk of the Illinois Commerce Commission, the Initial Brief of the Staff of the Illinois Commerce Commission, copies of which are hereby served upon you.



STEVEN L. MATRISCH
Staff Attorney

Counsel for the Staff of the Illinois Commerce
Commission

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Notice of Filing, together with the Initial Brief of the Staff of the Illinois Commerce Commission, were served upon the parties on the attached service list by electronic mail and first class mail, proper postage prepaid, on the 28th day of August, 2001.



STEVEN L. MATRISCH