

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

**ILLINOIS COMMERCE COMMISSION** )  
**On Its Own Motion** )  
 )  
**vs.** )  
 )  
**ILLINOIS POWER COMPANY** )  
 )  
**Reconciliation of revenues collected under** )  
**gas adjustment charges with actual costs** )  
**prudently incurred.** )

**Docket 00-0714**

**ILLINOIS POWER COMPANY'S  
INITIAL BRIEF**

**Randall B. Palmer  
Illinois Power Company  
500 South 27<sup>th</sup> Street  
Decatur, Illinois 62521**

**Owen E. MacBride  
Schiff Hardin & Waite  
6600 Sears Tower  
Chicago, Illinois 60606**

**Attorneys for  
Illinois Power Company**

**August 28, 2001**

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## **I. INTRODUCTION AND SUMMARY OF ILLINOIS POWER'S CASE**

This case is the reconciliation of revenues collected by Illinois Power Company (“Illinois Power”, “IP” or “Company”) under the Uniform Gas Adjustment Clause with actual costs prudently incurred, for the year ended December 31, 2000, pursuant to §9-220 of the Public Utilities Act, 220 ILCS 5/9-220. The Commission Staff (“Staff”) has proposed disallowances of IP’s gas costs totaling \$1,717,678, based on three specific issues. In all other respects, Staff accepts IP’s proposed reconciliation of UGAC revenues and actual costs for the year.<sup>1</sup> (See Staff Ex. 1.0, pp. 3-5; Staff Ex. 3.0, pp. 2-3 and Schedules 1.0 and 2.0) Accordingly, this brief addresses only Staff’s three proposed disallowances.

**Freeburg Propane Plant.** Illinois Power’s decision to retire the 30-year old Freeburg propane plant – the last of IP’s five propane plants still operating – was reasonable and prudent. The Company appropriately based its decision to retire the facility on safety concerns associated with the need to handle and maintain an 800,000 gallon liquid propane storage inventory, the growth of development in the surrounding area, the need for substantial capital expenditures on the facility and for additional expenditures in the future as the plant continued to age, the likelihood of more stringent regulations becoming applicable to the facility, and the lesser risk and greater reliability and convenience associated with using firm pipeline transportation to obtain the same amount of supply capacity, as well as other factors detailed in this record. Further, present value of future revenue requirements (“PVRR”) analyses submitted in this docket confirm that retirement of the propane plant was a reasonable and appropriate decision. In addition, Staff’s disallowance calculation related to the Freeburg retirement is overstated.

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<sup>1</sup> Staff also accepts IP’s reconciliation of revenues and costs under Rider H, Adjustment for Pipeline Transition Surcharge, for the year 2000. (Staff Ex. 1.0, pp. 5-7)

**Gillespie Storage Field.** IP's decision to retire the 42-year old Gillespie Storage Field – by far the smallest of the Company's storage fields – was reasonable and prudent. The Company appropriately based the decision to retire the Field on the amount of capital expenditures needed in 2000 to renovate its compressor station and control systems, and on operational risks associated with its use. Further, PVRR analyses submitted in this docket confirm that retirement of the Field was a reasonable and appropriate decision. In addition, Staff's disallowance calculation related to the Gillespie retirement is overstated.

**Gas Purchasing Practices.** Illinois Power's longstanding practice of awarding firm supply reservation contracts to bidders on the basis of lowest reservation cost is a reasonable and prudent practice. These contracts provide assurance of winter gas supply capacity, but do not obligate IP to actually purchase any gas under the contracts. Instead, IP is free to, and does, continue to search the market for lower-priced gas commodity. The amount of gas that will actually be purchased under any firm supply reservation contract is totally unpredictable, and has ranged from 0% of the gas that can be purchased under the contract, to almost 100%. Thus, any attempt to estimate the amount of gas that will be purchased under a firm supply reservation contract, and to factor the commodity prices in the contract proposals into the contract award decision, would not contribute to improved decisionmaking, and would produce wholly stochastic results.

**II. ILLINOIS POWER'S DECISION TO RETIRE THE FREEBURG PROPANE PLANT WAS PRUDENT AND REASONABLE; STAFF'S PROPOSED DISALLOWANCE SHOULD BE REJECTED**

During the year 2000, subsequent to the conclusion of the 1999-2000 winter season, Illinois Power decided to retire its last remaining propane facility, the Freeburg propane plant located near Freeburg, Illinois in St. Clair County. Staff contends that decision was

imprudent, and that as a result a disallowance of \$1,273,000 should be imposed. Staff is wrong. The decision to retire the Freeburg propane plant was based on appropriate factors, and was prudent. Further, economic analyses presented in this docket confirm that the decision was economic. Accordingly, Staff's contention that the retirement was imprudent must be rejected. Moreover, the cost of replacing the capacity of the Freeburg propane plant for the 2000 reconciliation year was only \$955,000, not \$1,273,000; therefore, Staff's proposed disallowance amount is overstated.

**A. Retirement of the Freeburg Propane Plant Was Reasonable and Prudent**

The Freeburg propane plant was installed in 1971; by 2000, it was 30 years old. (Rev. IP Ex. 3.2, p. 4; IP Ex. 3.6, p. 13) The Freeburg facility stored propane in liquid form in an 800,000 gallon, refrigerated above-ground storage tank. (Rev. IP Ex. 3.2, pp. 2-3; IP Ex. 3.6, p. 6; Rev. IP Ex. 4.3, p. 2) The volume of propane needed to fill the storage tank was equal to 90 transport truck deliveries.<sup>2</sup> (IP Ex. 3.6, p. 12) The 800,000 gallon inventory was sufficient for about three days of operation. (*Id.*, pp. 7, 14; Tr. 35)

When the Freeburg facility was placed in service, in 1971, natural gas supplies and transportation were not as readily available as they are today; the facility was installed to provide additional assurance of supply within IP's service area under high demand conditions. (Rev. IP Ex. 3.2, p. 4) Freeburg was the last of IP's five propane plants; the other four propane plants had already been retired, in 1994 (Galesburg and Jacksonville),

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<sup>2</sup> The reference to 90 transport truck deliveries is intended to provide perspective on the volume of propane stored at the plant site. As can be seen from Staff Cross Ex. 1, an aerial photograph of the plant site and surrounding area, a rail line runs through the plant site, hence rail tank car deliveries of propane to the facility were also an option. Propane deliveries were first loaded into a 90,000 gallon transfer tank at the site and from there were transferred into the 800,000 gallon refrigerated storage vessel. (IP Ex. 3.6, p. 6)

1995 (Danville) and 1996 (Champaign), respectively.<sup>3</sup> (Id., pp. 3-5) IP had relied on its propane plants for peaking use in extreme weather conditions, and thus typically operated them only a few days each winter season. (Id., p. 4) The Freeburg facility had only been called upon to produce system supply gas a total of six times from 1995 through 1999. (IP Ex. 3.6, p. 13) While the propane plant could reasonably be expected to provide only about three days of service per five-month winter season, a replacement firm pipeline transportation (“FT”) contract of equivalent MMBtu to the capacity of the propane plant provides the ability to bring firm gas supplies into IP’s system on every day of the winter season. (Id., p. 14) Thus, under current conditions, firm transportation and supply contracts are preferable from a reliability perspective. (Rev. IP Ex. 3.2, p. 4)

By 2000, existing facilities at the Freeburg propane plant had reached the end of their useful life. (Rev. IP Ex. 3.2, p. 5) The facility had obsolete compressor controls and switchgear, its fire protection and gas detection equipment did not conform to current standards, and the insulation on the 800,000 gallon refrigerated storage tank required replacement. Other equipment required replacement as well. The estimated capital cost to replace or upgrade these components was \$1,873,000.<sup>4</sup> (Rev. IP Ex. 3.2, p. 2; IP Ex. 3.3) Beyond these immediate needs, other capital projects that would have been necessary over the next several years had IP continued to operate the propane facility included replacement of the heaters and vaporizers (the existing heaters and vaporizers were original equipment

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<sup>3</sup> Review of the orders in IP’s reconciliation cases for 1994 (Docket 95-0122 (Dec. 9, 1998)), 1995 (Docket 96-0035 (Dec. 9, 1998)) and 1996 (Docket 97-0018 (Nov. 5, 1998)), shows no issues raised in those cases related to the retirement of the other four propane plants.

<sup>4</sup> Staff’s witness did not dispute IP’s figure of \$1,873,000 of capital improvements required in 2000 in order to continue to operate the plant, and in fact used this amount in his own economic analysis. (Tr. 36; Staff Ex. 4.0, Sched. 3.0, p. 1 and Sched. 4.0, p. 1)

installed in 1971), replacement of the condenser and cooling fan, replacement of the collector tank, insulation of the 90,000 gallon transfer tank, and replacement of and upgrades to valves and piping.<sup>5</sup> (Rev. IP Ex. 3.6, p. 6)

In considering whether to make the substantial expenditures that would have been necessary to continue to operate the Freeburg propane plant, or whether on the other hand to retire the facility and rely instead on pipeline FT capacity to meet reliability needs, the Company focused primarily on safety and reliability issues and the associated costs. Safety was a concern because of the age of the facility, the fact that 800,000 gallons of propane must be delivered to and stored at the site, and the fact that over time, development had moved closer to the plant site, and could be expected to continue to come closer to the site in the future. (Rev. IP Ex. 3.2, pp. 2-3, 5; Tr. 132) Reliability was a concern because of the age of the facility, and because stricter regulatory requirements could become applicable to the facility, leading to additional costs for continued operation.<sup>6</sup> (Id., pp. 2, 4; IP Ex. 3.6, pp. 13-14; Tr. 128, 132-33) Impacting both safety and reliability concerns was the need to continue

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<sup>5</sup> In addition to the replacements and upgrades identified by IP, Dr. Russell Ogle of Packer Engineering conducted a safety analysis of the Freeburg facility in July 2001 which identified additional potential costs. These additional costs, which could have added to the costs of continuing to operate the facility, included expenditures to perform a comprehensive inspection of the 800,000 gallon storage tank to determine if corrosion had degraded the wall of the vessel (the inspection could have shown the need for repairs or replacement of the vessel); to install additional fire protection equipment including an adequate on-site water supply; and to update the plant's engineering documentation. (Rev. IP Ex. 4.3, pp. 3-4)

<sup>6</sup> For example, performance of major upgrades to the facility, such as those needed in 2000, could bring the plant under current versions of codes and standards rather than the earlier versions to which the plant was "grandfathered." (Tr. 127-28, 132-33)

to maintain an operator training program in order to have qualified personnel to operate IP's sole remaining propane facility.<sup>7</sup> (Rev. IP Ex. 3.2, p. 3; IP Ex. 3.6, pp. 14-15)

As Company witness Frank Starbody explained, in deciding to retire the Freeburg propane plant, IP was concerned not only with the growth and development that had occurred in the Freeburg area over the past 30 years, but also with the likelihood that development would continue to move closer to the site over the 10 to 15 additional years the Company would need to operate the facility in order to justify the \$1,873,000 capital expenditure that would have been necessary in 2000 to keep it operating. (IP Ex. 3.6, p. 12; Tr, 122) There has been considerable growth in the populations of the two closest communities, Freeburg and Smithton, since the propane plant was installed in 1971. The popularity of the area as a "bedroom" community for St. Louis, and for developing areas of the Metro-East area in Illinois that are closer to St. Louis, has increased over the years. Freeburg is only 25 miles from St. Louis, only 12 miles from rapidly developing commercial areas on the Illinois side of the Mississippi River, and only 10 miles from Scott Air Force Base and Mid-America Airport (from where one can take the Metrolink rail system to downtown St. Louis). These are all reasonable commuting distances. (IP Ex. 3.6, p. 11; Tr. 79, 84)

In addition, the village limits of Freeburg are 2.5 miles north of the plant site on Illinois Highway 13; the area extending approximately 1.4 miles south of Freeburg has recently been re-zoned from farmland to commercial. (Id.) Highway 13 has recently been

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<sup>7</sup> Packer Engineering's safety analysis identified the need to develop a new operator training program, as well as additional costs for annual operator training. (Rev. IP Ex. 4.3, p. 4) As IP recognized, the infrequency of operation of the propane facility actually increases the need for operator training. (Rev. IP Ex. 3.2, p. 3) As Packer's report explained: "The effectiveness of operator actions in preventing or mitigating accidents decreases as the frequency of operation decreases, i.e., routine operations become non-routine. Without formalized training and practice, the probability of operator error may increase as the operator becomes less familiar with the facility and its equipment." (Rev. IP Ex. 4.3, p. 3)

widened and resurfaced (IP Ex. 3.6, p. 11), indicating increased use of this road in the future is anticipated. West of the plant, towards Smithton, the nearest residential development is approximately 4.3 miles away; however, there are some 27 houses along the road from the plant site to that development, including 16 within two miles of the plant site. A number of these houses have been built within the last four years. (IP Ex. 3.6, p. 11; Tr. 84-85, 123)

In addition to the “not in my backyard” issues inherent in operating, in a growing area, a facility that requires maintenance of 800,000 gallons of volatile, flammable liquid propane in an above-ground tank on site, and the equivalent of 90 tank trucks rumbling through the area to off-load propane to replenish the inventory after only three days of operation (IP Ex. 3.6, pp. 12-13), continued operation of the Freeburg facility would present the risk (however remote) of a propane explosion or fire with catastrophic consequences to persons or property in the surrounding area. Dr. Ogle’s report detailed the potential consequences of such an event:

The fact that propane exists as a liquid presents a special hazard not found with natural gas: the ability to suffer a Boiling Liquid Expanding Vapor Explosion (BLEVE). In the event of a fire caused by a leak in the propane storage system, the storage vessel can become weakened by the fire, which allows the vessel to rupture. The vessel rupture results in the spontaneous (and nearly instantaneous) vaporization of the propane liquid. The presence of a pre-existing fire nearly guarantees the ignition of the propane resulting in a devastating explosive blast and fireball.

The Freeburg facility stored approximately 800,000 gallons of liquid propane. In the event of a BLEVE, the consequences would be enormous:

- ??The primary fireball would measure approximately 2,100 feet in diameter.
- ??The explosive blast would destroy any residential or commercial structures within 1.2 miles of the facility.
- ??The explosive blast would break windows in residences out to a distance of 3 miles from the facility.
- ??The fireball would cause second degree burns to exposed human skin at a distance of 1.75 miles from the facility.

Predictions of the fire and explosion damage caused by an accident such as this contain some uncertainty. The reported distance from the facility to the nearest development (2.5 miles) is not a sufficient buffer zone distance to protect these residents from injury and/or property damage. (Rev. IP Ex. 4.3, p. 2)

Staff took the position that IP's concern about development in the vicinity of the Freeburg propane plant was not valid, because existing residential development is still a significant distance from the site. (Staff Ex. 4.0, pp. 6-7) Based on the information summarized above as to the current state of development in the area, and the potential consequences of an accident at the facility, the Company disagrees with Staff that development in the area is not a serious concern that warranted retiring the propane plant. Further, Staff's perspective on this issue is based on a snapshot in time, whereas the Company's concerns were rooted in observations of the trends in the development of the surrounding area over a period of years. (IP Ex. 3.6, p. 10) Illinois Power was trying to determine whether to expend some \$1,873,000 in capital improvements costs needed in order to continue to operate the facility; this of necessity means that the Company would need to operate the facility for at least another 10 to 15 years to justify this expenditure.<sup>8</sup> IP was concerned not only with the current location of development in the area, but with the likelihood that development would continue to grow towards the plant site over that period. (IP Ex. 3.6, pp. 11-12) The population growth in the area over the preceding 30 years, the ease of commuting from the area to St. Louis or to business centers in the Metro-East area, the re-zoning of land south of Freeburg from farmland to commercial, and the recent

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<sup>8</sup> The Staff witness acknowledged that whether the facility is likely to continue to operate for the additional time period needed to recover the capital improvements costs was an appropriate consideration in whether to incur those costs or retire the plant. (Tr. 42)

construction of new homes in the area, were all factors pointing to a continuation of growth and development in the vicinity of the plant site.<sup>9</sup>

Illinois Power was also concerned that, although there had been only a small number of incidents affecting the reliability of the Freeburg propane plant over its 30-year life, reliability would become an increasing issue given the age of the facility. The Company recognized that the leaks or unreliable operation would increase as the plant continued to age. Adding to this concern was the fact that the facility was called upon to operate only in severe weather conditions, and only for a few days each year. There is always a concern about the ability of equipment that is operated only sporadically to operate reliably when called upon. (Rev. IP Ex. 3.2, p. 4; IP Ex. 3.6, p. 13) These types of concerns would not be present if IP were to use pipeline FT capacity to replace the capacity of the propane plant.

As Mr. Starbody, who was personally involved in the decision to retire the Freeburg propane plant, stated in describing the Company's reasoning (IP Ex. 3.6, p. 14):

Illinois Power determined that, as the Freeburg-Smithton area continued to grow, operation of an aging propane facility presented liability risks that the Company did not want to accept . . . . [T]he same supply capacity can be obtained through FT (or pipeline leased storage) without the need to continue to be responsible for managing a large volume of flammable, volatile substance, and with less risk and more convenience in other respects as well.

**B. PVRR Analyses Presented in this Case Confirm That Retirement of the Freeburg Propane Plant Was the Economic Choice**

In deciding that the Freeburg propane plant should be retired, Illinois Power did not conduct a formal economic study, i.e., it did perform an analysis comparing the PVRR

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<sup>9</sup> Further, while Staff focused on the proximity of residential development to the plant site, Staff's analysis gave no consideration to the persons who would be most at risk in the event of a fire or explosion at the propane facility: employees and emergency response personnel. As Dr. Ogle testified, in accidents that have occurred at other propane facilities, it is employees and emergency response personnel who have most often been injured or even killed, not bystanders in the area. (Tr. 175)

associated with continuing to operate the facility to the PVRR of retiring the facility and relying on pipeline FT purchases (or other alternatives, such as pipeline leased storage) to replace the capacity of the propane plant, over a long-term future period. As Mr. Starbody explained, based on the factors that the Company considered (summarized in §II.A above), retirement was the obvious choice, and a formal study was not needed. (Rev. IP Ex. 3.2, p. 5) Indeed, as he observed, “I do not think it would be reasonable to base a decision as to whether to spend \$1.8 million to keep this 30-year old facility operating on a quantitative analysis whose results depend on assumptions and projections of costs over the next 30 years or even the next 15 years” (IP Ex. 3.6, p. 3). However, at the instigation of Staff, studies comparing the PVRR of making capital expenditures on, and continuing to operate, the Freeburg plant to the PVRR of replacing the plant’s capacity with FT, were presented in this docket. These analyses further confirm that retirement of the Freeburg propane plant was the correct decision.

Staff presented analyses comparing the PVRR for continued operation of the Freeburg facility to the PVRR for replacement with pipeline FT capacity, over 30 and 15-year periods. Staff’s analyses purported to show lower PVRRs associated with continuing to operate the facility than with retiring the facility and replacing its capacity with pipeline FT. (See Staff Ex. 4.0, Sched. 2.0-6.0) However, there were a number of omissions and inaccurate assumptions in Staff’s analyses, including the following:

- ✍ Staff’s analyses included no provision for additional capital additions to this 30-year old facility over the ensuing 15 or 30 additional years for which it was assumed to operate.
- ✍ Staff’s analyses assumed that O&M expenses for the facility would increase only at the general rate of inflation, and made no provision for increases in O&M expense in real (constant dollar) terms as this 30-year facility continued to age over the ensuing 15 or 30 years covered by the analyses.

- ✍ Staff's analyses did not include carrying costs on the inventory of propane that would need to be maintained at the Freeburg plant in order for it to operate.<sup>10</sup>
- ✍ Staff's analyses assumed that IP would need to buy pipeline FT for all 12 months of the year to replace the capacity of the propane plant. However, since the propane plant is a winter-peaking facility, it would only be necessary to purchase additional pipeline FT for the five winter months to replace the capacity of the Freeburg plant.<sup>11</sup> (IP Ex. 3.6, pp. 3-6)

The Company presented PVRR analyses that took into account each of the cost components listed above. Specifically, the Company's analyses (i) included additional capital expenditures on the Freeburg facility over the study period, assuming there would be a need for \$200,000 of additional capital expenditures every three years; (ii) assumed that O&M on the facility would grow at a rate 1% per year above the rate of inflation (i.e., real O&M growth of 1% per year); (iii) provided for carrying costs on propane inventory, based on current and anticipated propane prices; and (iv) included the costs to purchase replacement pipeline FT capacity for the five winter season months, rather than for the entire year, in the "plant retirement" scenario. (IP Ex. 3.6, pp. 6-7) With these assumptions included, the revised analyses show PVRR savings for retiring the Freeburg propane plant and buying replacement pipeline FT capacity, over continuing to operate the plant, for both the 30 and 15-year study period. (Id., pp. 7-8):

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<sup>10</sup> This point refers only to the carrying costs on the propane inventory, not to the actual cost of the propane. The cost of the propane would be expensed as and when the facility operated, and thus would be accounted for comparably to the cost of gas supplies purchased by IP for delivery to customers.

<sup>11</sup> Pipeline FT rates are higher for the winter months than for the summer months (see IP Ex. 3.6, p. 5), but the total cost to purchase FT for the five winter months would be less than the total cost to purchase FT for all 12 months.

**30-year analysis (PVRR)**

|                               |                    |
|-------------------------------|--------------------|
| Continue to operate Freeburg: | \$5,630,160        |
| Retire Freeburg:              | <u>\$5,297,160</u> |
| PVRR savings for retirement:  | \$ 333,000         |

**15-year analysis (PVRR)**

|                               |                    |
|-------------------------------|--------------------|
| Continue to operate Freeburg: | \$4,616,201        |
| Retire Freeburg:              | <u>\$3,942,249</u> |
| PVRR savings for retirement:  | \$ 673,952         |

Staff might quibble over the values that IP used for capital additions, O&M, inventory carrying costs and replacement FT costs. However, it was clearly unreasonable for Staff to assume that the 30-year old Freeburg propane facility can operate for another 15 to 30 years after 2000 with no need for any additional capital expenditures during that period, or to fail to include any carrying costs on propane inventory. With respect to increases in real O&M costs for the propane facility in years 31 through 60 of its operating life, the Company's assumption that O&M expenses would increase at a rate only 1% above the level of general price inflation was an extremely modest assumption. Finally, the ability to purchase pipeline FT capacity for only the five winter months is now a market reality (IP Ex. 3.6, pp. 5, 9); there is no reason to assume a twelve-month pipeline contract would have to be purchased to replace the capacity of a propane plant that was used only for peaking purposes on the most severe weather days in the five-month winter season.

However, although Illinois Power believes that a PVRR analysis using appropriate assumptions demonstrates that retiring the Freeburg propane plant and replacing its capacity with pipeline FT has a lower PVRR than continuing to operate the facility, the Company

continues to question Staff's premise that a 15 or 30-year PVRR analysis should be the basis for deciding whether to retire the facility. The capital expenditures that would have been required in 2000 in order to continue to operate the facility were significant in the context of this 30-year old facility. Given the age of the plant in 2000, the likelihood that with continued operation additional plant components (beyond those that had to be replaced in 2000) would require replacement or renovation, the likelihood of residential and commercial development moving closer to the plant site, the possibility that stricter regulations could become applicable to operation of the propane facility, and the possibility of other, currently unforeseeable cost factors arising, basing a decision to spend \$1.8 million on a 30-year old facility on an analysis whose outcome is dependent on projections or assumptions over the subsequent 30 years or even 15 years of operation that would have been necessary to justify the investment, would not be reasonable.<sup>12</sup> (IP Ex. 3.6, p. 3)

In summary, the Company's decision to retire the Freeburg propane plant was reasonable and prudent based on the factors that IP considered, including the age of the plant; the safety issues associated with operating a facility that requires maintenance on site of 800,000 gallons of volatile liquid propane under refrigeration; the trend of development towards the plant site; the likelihood of decreasing reliability as the facility continued to age;

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<sup>12</sup> Although acknowledging that the likelihood of the facility operating long enough to recover the additional capital investment is a factor that should be considered (Tr. 42), the Staff witness failed to give adequate consideration to the possibility that future developments could result in retirement of the propane plant before it had operated long enough to allow for recovery of the \$1,873,000 capital investment that was needed in 2000 to continue to operate the plant. Further, when asked whether, if a PVRR analysis conducted five years from now showed retirement of the plant was appropriate at that time, IP should be allowed to recover the unrecovered portion of the \$1.8 million investment from its customers, the Staff witness dodged the question, claiming it was outside his area of responsibility. (Tr. 41-42) Certainly IP would be criticized if it made a substantial capital expenditure without giving due consideration to whether the plant was likely to be in service long enough to recover the costs!

the need to maintain an operator training program and trained operators for this one last propane plant on the system; the specific capital expenditures that were required on the facility in 2000 in order to continue to operate it; the likelihood that additional capital expenditures would be required as the plant continued to age; the possibility that the plant would become subject to more stringent regulatory requirements with respect to its operations; and the greater convenience, greater reliability, and reduced risk associated with using pipeline FT to provide equivalent winter peaking capacity for IP's gas system. The PVRR analyses presented in this docket simply confirm that retirement of the Freeburg propane plant was, and continues to be, the appropriate decision.

**C. Staff's Proposed Disallowance Amount is Overstated**

Staff proposes that the Commission should disallow \$1,273,000 of costs incurred by IP during the 2000 reconciliation year as the consequence of IP's allegedly imprudent decision to retire the Freeburg propane plant. For the reasons set forth in Sections II.A and B of this brief, the decision to retire the Freeburg facility was prudent. However, assuming there were to be a disallowance for imprudence, it should not be \$1,273,000, as proposed by Staff. Rather, a disallowance relating to the Freeburg propane plant retirement should not exceed \$955,000.

The \$1,273,000 number is a figure that IP supplied to Staff as the annual fixed cost to obtain 20,000 MMBtu of pipeline FT (i.e., an amount of FT equal to the capacity of the Freeburg plant). (IP Ex. 3.6, p. 15) However, the Freeburg propane plant was available for service in the winter of 1999-2000. It was not retired until after the conclusion of the 1999-2000 winter season. (Id.) Thus, IP did not begin to incur replacement FT costs until at least April 2000. Accordingly, for purposes of determining the replacement FT costs incurred by

IP during the 2000 reconciliation year, the annual cost figure used by Mr. Lounsberry must be reduced by at least 25% (i.e., 3 months divided by 12 months). (Id.)

Although the \$1,273,000 figure Staff used for his disallowance recommendation was an accurate answer to the data request Staff had posed to the Company, the data request did not ask the correct question to determine the amount of replacement FT costs IP incurred in 2000 following the Freeburg plant retirement. The data request Staff posed asked: “. . . what was the peak day capacity of the retired propane plant? Provide the annual fixed cost to reserve the same amount of supply capacity to serve IP’s system?” (Tr. 32-33; emphasis supplied) In response, IP stated that \$1,273,000 was the annual fixed cost to reserve 20,000 MMBtu of FT capacity. (Tr. 33-34) Thus, IP accurately answered the question posed by Staff, but Staff applied the answer without considering that the propane plant was in service for the first three (winter) months of the 2000 reconciliation year. Accordingly, any gas cost disallowance relating to the Freeburg propane plant retirement for the 2000 reconciliation year should not exceed \$955,000 (i.e., \$1,273,000 times 0.75.) (IP Ex. 3.6, p. 15)

### **III. ILLINOIS POWER’S DECISION TO RETIRE THE GILLESPIE STORAGE FIELD WAS REASONABLE AND PRUDENT**

During 2000, Illinois Power decided to retire its Gillespie Storage Field. Staff claims that this decision was imprudent, and that a total of \$442,000 of gas costs incurred in 2000 should be disallowed as a result. (Staff Ex. 4.0, p. 18) Again, Staff is wrong. The Company’s decision to retire the Gillespie Field was reasonable and prudent. Further, Staff’s calculation of the costs IP incurred in 2000 as a result of the Gillespie Storage Field retirement is overstated by at least \$117,000; accordingly, any disallowance in this case should not exceed \$325,000.

**A. Retirement of the Gillespie Storage Field Was Reasonable and Prudent; PVRRA Analyses Confirm That Retirement Was a Reasonable Decision**

IP retired the Gillespie Field because significant capital expenditures, in relation to the size and use of the Field, would have been required to renovate and upgrade equipment at the Field in order to continue to use it. (Rev. IP Ex. 3.2, p. 6) The Gillespie Field was placed in service in 1958. (IP Ex. 3.6, p. 19) It was by far IP's smallest storage field, with a capacity of about 32,000 MMBtu versus about 143,000 for the next smallest of IP's seven other storage fields.<sup>13</sup> It held only about 6 days inventory, and therefore typically was used only as a peaking facility on the most severely cold days. (Rev. IP Ex. 3.2, pp. 6-7)

In 2000, in order to continue to operate the Gillespie Field, capital expenditures were needed to renovate the control systems and the auxiliary systems for the compressor at the Field. (*Id.*, p. 7) In analyzing the expenditures needed to renovate this equipment, IP used a cost of \$1,020,000, which is the amount IP had incurred in 1995 to make similar upgrades to the South Shanghai compressor station for the Shanghai Storage Field. (*Id.*, p. 8) During the course of this docket, further review of the work orders for the South Shanghai upgrades determined that the cost of that work in 1995 was \$1,199,000. (*Id.*) Moreover, based on inflation from 1995 to 2000 (at the rate of 1.62% per year over this period), the same work would have cost \$1,320,494 in 2000. (IP Ex. 3.6, p. 20)

In addition to the cost of the renovations needed for the Gillespie compressor, IP took into account operational concerns with the Gillespie Field in deciding to retire it. Specifically, in order to withdraw gas from this Field, it was necessary to reduce pressure in the distribution system in the surrounding geographic area. This practice created concerns

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<sup>13</sup> In addition to its seven operating storage fields, IP in 2000 leased storage services from a total of four interstate pipelines. (IP Ex. 3.1, p. 7)

for system integrity, because if the storage field compressor tripped off line, there was a risk that service (gas flow) to distribution customers in the area would be lost. (Rev. IP Ex. 3.2, p. 6) Although IP had the capability to monitor system pressures remotely, if the Gillespie compressor station were to fail or trip off line, the operators could not raise the pressure in the surrounding distribution system quickly enough to prevent service outages. (IP Ex. 3.6, p. 21) Moreover, the service consequences of any adverse external events affecting the distribution system (such as damage to a line by a contractor) would be exacerbated due to the fact that the system was operating at reduced pressure. (Id.) This operational issue was not a concern when the Gillespie Field was developed, since at that time there was only limited development in the area of the Field (Rev. IP Ex. 3.2, p. 7), and thus only a limited distribution system. However, it had become a matter of increasing concern over the years as the area around the Field became more developed. (Id.)

Staff took issue with the Company's decision to retire the Gillespie Storage Field because in making the decision, IP did not perform a quantitative analysis comparing the PVRR for making the capital expenditures on the compressor station and continuing to operate the Field, to the PVRR for obtaining replacement pipeline and gas supply capacity for the retired Field. (Staff Ex. 4.0, pp. 13-14) As with the decision to retire the Freeburg propane plant, however, PVRR analyses presented in this docket confirmed that retirement of the Gillespie Field was the appropriate decision.

In fact, Staff's own PVRR analyses confirmed that retirement of the Gillespie Field was the appropriate decision. Staff presented analyses comparing the PVRR to make the capital expenditures on the Gillespie Field and continue to operate it, to the PVRR for replacement pipeline FT and firm gas supply capacity, over 15 and 30-year periods into the

future. (Staff Ex. 4.0, Sched. 8.0-11.0) Staff's 30-year analysis showed that the option of making the capital expenditures and continuing to operate the Field had a lower PVRR than did retiring the Field and relying on replacement FT and gas supply capacity, but by only 2.8% of total PVRR over the 30-year period. (IP Ex. 3.6, p. 16) In contrast, Staff's 15-year PVRR analysis showed that retirement of the Field and reliance on replacement FT and gas supply capacity had a lower PVRR than incurrence of the necessary capital expenditures and continued operation of the Field, by 14.6% of the total PVRR over the 15-year period. (Id.) Thus, the PVRR advantage for retirement of the Field in Staff's 15-year analysis was much more robust than the PVRR advantage for continued operation in the 30-year analysis. (Id.) Further, given the increasing uncertainty as to the accuracy of assumptions and projections the farther into the future one extends the analysis, reliance on the 15-year analysis (which showed retiring the Field had a lower PVRR) as a basis for decision-making would be much more reasonable than reliance on the 30-year analysis. (Id.)

In addition, Staff's PVRR analyses of the Gillespie Storage Field retirement suffered from some of the same omissions as did Staff's analyses of the Freeburg propane plant retirement. Specifically, Staff's 30 and 15-year PVRR analyses (1) made no provision for any future capital additions expenditures if IP were to continue to operate Gillespie, (2) made no provision for increases in real O&M expense as the 42-year-old facility continues to age, (3) made no provision for carrying costs on the inventory of gas in storage that would have to be maintained if IP continued to operate the Field, and (4) assumed that with Gillespie retired, IP must buy an equivalent amount of pipeline FT capacity on a year-round basis to replace it, rather than just contracting for replacement FT capacity for the five winter months. Illinois Power presented modified PVRR analyses which (1) provided for additional capital

expenditures at the Gillespie facility of \$10,000 per year over the study periods, (2) assumed that real O&M would grow at a rate of 1% per year over the study periods, (3) included carrying costs on the Gillespie gas inventory,<sup>14</sup> and (4) assumed that with the Gillespie Field retired, IP would replace its capacity by purchasing an equivalent amount of pipeline FT for the five winter months.<sup>15</sup> (IP Ex. 3.6, pp. 18-19; Tr. 47)

Both Staff's and the Company's PVRR analyses used the cost incurred in 1995 to renovate the South Shanghai compressor station, \$1,199,000, as the cost of the renovations needed on the Gillespie compressor station in 2000 in order to continue to operate the Field. The Company's analyses, with the additional assumptions summarized in the preceding paragraph, showed the following results (IP Ex. 3.6, p. 19):

**30-year analysis (PVRR)**

|                                 |                    |
|---------------------------------|--------------------|
| Continue to operate Gillespie : | \$2,983,662        |
| Retire Gillespie:               | <u>\$2,739,844</u> |
| PVRR savings for retirement:    | \$ 243,818         |

**15-year analysis (PVRR)**

|                                |                    |
|--------------------------------|--------------------|
| Continue to operate Gillespie: | \$2,529,156        |
| Retire Gillespie:              | <u>\$2,000,665</u> |
| PVRR savings for retirement:   | \$ 528,491         |

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<sup>14</sup> As it did in the Freeburg propane plant PVRR analyses, IP only included carrying costs on the storage inventory, not the actual cost of the gas in storage. The cost of the gas would be expensed as it is withdrawn from storage for delivery to customers.

<sup>15</sup> Gillespie was typically used as a peaking facility on only the most severely cold days. (Rev. IP Ex. 3.2, p. 7)

In addition, Illinois Power presented 30 and 15-year PVRR analyses using the 1995 capital improvements cost escalated to 2000, when the work would have been done. The results were as follows (Id., p. 20):

**30-year analysis (PVRR)**

|                                 |                    |
|---------------------------------|--------------------|
| Continue to operate Gillespie : | \$3,257,393        |
| Retire Gillespie:               | <u>\$2,739,844</u> |
| PVRR savings for retirement:    | \$ 517,549         |

**15-year analysis (PVRR)**

|                                |                    |
|--------------------------------|--------------------|
| Continue to operate Gillespie: | \$2,774,266        |
| Retire Gillespie:              | <u>\$2,000,665</u> |
| PVRR savings for retirement:   | \$ 773,601         |

These analyses show a significant PVRR advantage for retiring the Gillespie Storage Field and replacing its capacity with pipeline FT and equivalent gas supply contracts, rather than incurring the capital expenditure costs necessary to continue to operate the facility.

Staff, however, contended that both Staff's own PVRR analyses as well as the Company's used an overstated figure for the capital improvements needed to the Gillespie Field in 2000, because (Staff asserted) the renovations needed to the Gillespie Field likely would not have cost as much as the 1995 renovations to the South Shanghai compressor station. Staff contended that the Shanghai Storage Field is considerably larger than the Gillespie Storage Field, and therefore that it was unreasonable to assume that the renovations needed at the Gillespie facility would cost as much as the renovations that were made to the Shanghai facility. Staff attempted to support its contention with various comparisons of the

capacity of, and facilities at, the Shanghai Field, to those at the Gillespie Field. (Staff Ex. 2.0, pp. 11-12; Staff Ex. 4.0, pp. 12-13)

Staff's concerns about the Gillespie capital improvements cost estimate are misplaced. Illinois Power acknowledges that the Shanghai Storage Field is larger than the Gillespie Field by a number of measures, including storage capacity and deliverability. (Rev. IP Ex. 3.2, p. 6) However, the work that was done at South Shanghai in 1995 involved essentially the same piece of equipment that needed to be upgraded at Gillespie, namely, a single compressor. (Id., p. 7) IP did not rebuild all the equipment at the Shanghai Field in 1995, and did not need to rebuild all the equipment at the Gillespie Field in 2000. The costs to upgrade the South Shanghai compressor station in 1995 were not a function of the overall size of the Shanghai Storage Field, and the costs to upgrade the compressor station at Gillespie would not have been materially different from the South Shanghai compressor station costs even though the Gillespie Field is smaller than the Shanghai Field in other respects. (IP Ex. 3.6, p. 17)

Further, the components that were upgraded at South Shanghai, primarily control systems and fire protection systems, were similar to those that needed to be upgraded at the Gillespie compressor station. In fact, as Mr. Starbody explained, the work required on the Gillespie compressor station may have been more extensive, and therefore more costly, than the work that was performed on the South Shanghai compressor station. (Id., p. 18) Finally, both Staff's PVRR analyses and IP's base PVRR analyses used the actual 1995 cost for the upgrades to the South Shanghai compressor station, rather than the 1995 cost escalated to 2000. The costs in 2000 for the same work that was performed in 1995 would have been higher due to escalation. (Id.)

In summary, the capital cost estimate IP and Staff used for the renovations needed at the Gillespie Storage Field in 2000 was a reasonable cost estimate. The PVRR analyses show that it was far more economic (lower PVRR) to retire the Gillespie Storage Field and replace its capacity with pipeline FT and firm supply contracts, than to renovate the equipment and continue to operate the Field. Illinois Power's decision to retire the Gillespie Storage Field in 2000 was reasonable and prudent.

**B. Staff's Proposed Disallowance Relating to the Gillespie Storage Field Retirement is Overstated**

Staff proposes a \$442,000 disallowance of 2000 gas costs as the consequence of Illinois Power's allegedly imprudent action in retiring the Gillespie Storage Field. The \$442,000 amount consists of \$318,250 for replacement pipeline FT capacity, \$6,100 for firm gas supply reservation, and \$117,328 for additional gas commodity costs which IP purportedly incurred during the period December 17-22, 2000 as a result of not having Gillespie available for withdrawals of gas to serve system load. (Staff Ex. 2.0, pp. 12-14 and Sched. 2.0-3.0)

Assuming there were to be a disallowance imposed with respect to the Gillespie retirement, IP does not dispute Staff's inclusion of components for the costs of replacement pipeline FT capacity and for the costs of replacement firm gas supply reservation. However, there should be no disallowance component for excess gas costs incurred during the period December 17-22, 2001, because, based on conditions during that period, Illinois Power would not have withdrawn gas from the Gillespie Field to serve system load.

The commodity cost component of Staff's proposed disallowance is based on the assumptions that (1) IP would have operated the Gillespie Field in a manner similar to its next largest storage field, the Centralia Field, and (2) IP would have needed to withdraw gas

from Gillespie during the December 17-22 period because the Hillsboro Storage Field was out of service at that time due to an explosion. (Staff Ex. 2.0, pp. 13-14; Staff Ex. 4.0, p. 17) As Mr. Starbody explained, however, it would not have been IP's usual practice to make withdrawals from the Gillespie Field this early in the heating season, and conditions during the December 17-22 period were such that IP would not in fact have needed to withdraw from Gillespie, even with the Hillsboro Field out of service:

- ☞ IP uses its storage inventories to mitigate impacts of high winter season spot gas prices, consistent with maintaining assurances of reliable supply for the entire winter season. Since the potential peak day coverage period extends into February, limitations are placed on storage withdrawals early in the winter season to ensure deliverability throughout the potential peak day coverage period – IP coordinates operations at its storage fields to ensure adequate aggregate inventories and withdrawability to serve demand throughout the entire heating season. (IP Ex. 3.1, p. 7; Rev. IP Ex. 3.2, p. 9)
- ☞ Due to abnormally cold weather that had already occurred in November and December, and high commodity gas prices, IP's storage inventories were being depleted faster than anticipated. IP had already been withdrawing gas from storage fields to the extent deemed not critical to maintaining peak day coverage reliability and the physical and contractual limitations of the fields. (IP Ex. 3.1, p. 7; Rev. IP Ex. 3.2, p. 9)
- ☞ The Gillespie Field in particular, due to its small size (only 6 days' supply), was not normally used for withdrawals as early in the heating season as the December 17-22 period unless absolutely needed. (Rev. IP Ex. 3.2, pp. 9–10)
- ☞ During the December 17-22 period, there were not any severely cold days of the type that would have been likely to result in withdrawals from the Gillespie Field. On December 21, the peak day for that period, the total non-transportation load on IP's system was only about 78% of that expected on a design peak day. The loads on the December 17-20 and 22 were even less. (Rev. IP Ex. 3.2, p. 10; IP Ex. 3.6, p. 22)
- ☞ During the December 17-22 period, IP was not close to full utilization of its storage field deliverabilities. On December 17-21, utilization of the storage fields ranged from 31% to 54% of their aggregate rated deliverabilities, excluding in this calculation the deliverability of the Hillsboro Field, which was out of service. On December 22, when Hillsboro returned to service at 65% deliverability, IP utilized only 33% of the aggregate rated deliverabilities of its storage fields. (IP Ex. 3.6, p. 22)

In summary, during the December 17-22 period, Illinois Power 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 Gillespie. Under the conditions prevailing during that period, IP would have continued to conserve the inventory in the Gillespie Field for use later in the season. (Id., pp. 22, 23) The commodity component of Staff's proposed disallowance is unfounded, speculative, and does not represent costs actually incurred by IP in 2000 that would not have been incurred had the Gillespie Field still been available. Accordingly, if there is any cost disallowance relating to the Gillespie Storage Field retirement, it should not exceed \$325,000 (i.e., \$442,000 minus \$117,000).

**IV. ILLINOIS POWER'S PRACTICE OF AWARDING FIRM "SWING" GAS SUPPLY RESERVATION CONTRACTS BASED ON LOWEST RESERVATION COST IS REASONABLE AND PRUDENT**

The firm gas supply portfolio that Illinois Power develops for each winter season includes a number of "swing" firm supply reservation contracts. These "swing" contracts guarantee the buyer that supply will be available in the amount purchased under the contract, but do not obligate the buyer to actually take any gas commodity under the contract. (Rev. IP Ex. 3.2, p. 12) Illinois Power enters into these "swing" contracts for the purpose of guaranteeing sufficient supply reservation, but does not enter into these contracts with the intention of actually buying substantial amounts of gas under these contracts. Rather, since the Company is not obligated to purchase any gas under any of the swing contracts, it continues to search the market for commodity from alternative sources, at prices lower than the commodity prices specified in the swing contracts. IP continues to monitor and search the market on a monthly and daily basis for opportunities to purchase commodity at lower

prices, and it ultimately purchases the least expensive delivered supply available.<sup>16</sup> As a result, except under severe winter conditions, little or no commodity may in fact be taken under any particular firm supply reservation contract. (IP Ex. 3.1, pp. 3-4; Rev. IP Ex. 3.2, pp. 12-13)

The “swing” contracts specify a daily reservation fee which must be paid throughout the term of the contract, even if no gas is taken. Because IP does not enter into the firm supply reservation contracts with the expectation of buying substantial gas under those contracts (or of buying a particular amount of gas under any particular contract), IP does not take the commodity prices specified in these contracts into account in deciding which contracts to enter into. Rather, IP selects the “swing” contracts it enters into based solely on the lowest reservation fee bid among the potential suppliers for particular delivery points.<sup>17</sup> (IP Ex. 3.1, pp. 3-4; Rev. IP Ex. 3.2, pp. 12-13) Given the purpose of the “swing” contracts, the fact that the reservation fee must be paid throughout the term of the contract, the fact that IP is not required to purchase gas under these contracts but rather can and does obtain commodity from alternate, lower-priced sources, and the likelihood that little or no gas may be purchased under a swing contract, the selection of swing contracts based solely on lowest reservation charges is a prudent purchasing practice. (Id.)

Staff, however, contends that the practice of selecting the firm supply reservation contracts solely on the basis of lowest reservation cost is imprudent, and that the Company should in some manner take into account the commodity prices specified in the swing

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<sup>16</sup> IP may even wind up purchasing spot gas from a supplier with whom it has a firm supply reservation contract, at a lower price than specified in the firm reservation contract. (Rev. IP Ex. 3.2, p. 13)

<sup>17</sup> IP has followed the practice of selecting firm supply reservation contracts based solely on lowest reservation costs for a number of years. (Rev. IP Ex. 3.2, p. 12)

contracts offered to it when deciding which offers to accept. (Staff Ex. 2.0, pp. 19-20; Staff Ex. 4.0, pp. 22-24) Illinois Power strongly disagrees with Staff that consideration of the commodity prices specified in the swing contract proposals would result in improved decision-making in the selection of these contracts, and strongly disagrees with Staff that the Company's practice of selecting these contracts based on lowest reservation cost is imprudent. (Rev. IP Ex. 3.2, pp. 12, 13-14)

While one could engage in the exercise of taking the commodity prices specified in the firm supply reservation bids into account by applying them to an amount of capacity expected to be purchased under the contract, such an exercise would not be useful. The volume of gas, if any, that may be purchased by IP under these "swing" contracts will depend on numerous factors, including weather during the succeeding winter season, spot versus firm gas prices, basis differentials (i.e., the price differential, if any, for gas delivered from different pipeline receipt points, and the prices that can be obtained from suppliers on a daily basis. (Rev. IP Ex. 3.2, p.13) The accuracy and reliability of any estimate of the amount of gas that might actually be purchased under a "swing" contract, and thus the accuracy and reliability of the resultant commodity cost calculations, would be completely overwhelmed by the uncertainty of the assumptions that went into it. (Id., pp. 13-14; IP Ex. 3.6, p. 26) This reality is manifested by examining the actual load factors (i.e., the actual amount of gas purchased versus the amount that could have been purchased based on the contract reservation amounts) under the "swing" contracts IP entered into for the 1999-2000 and 2000-2001 winter seasons:

✍✍ For the 1999-2000 winter season, IP entered into 16 swing contract. Their actual load factors ranged from 15% to over 58%, with an average of 26.8%. (IP Ex. 3.6, p. 25)

- ✍✍ For the 2000-2001 winter, IP entered into 18 swing contracts. Their actual load factors ranged from less than 1% (two contracts) to over 90% (four contracts), with an average of 56.1% (more than twice the previous winter's average). (Id.)
- ✍✍ For the five swing contracts IP entered into for the 2000-2001 season based on lowest reservation cost even though the next best reservation cost bid had a lower commodity price, the actual load factors were 0%, 1%, 34%, 43% and 98%. (Rev. IP Ex. 3.2, p. 15)

Obviously, there is simply no predictability to the “expected” load factor for any particular contract. Indeed, as the above data illustrate, if IP had attempted to forecast the amount of commodity that would be taken under its firm supply reservation contracts for the 2000-2001 winter based on its experience in the 1999-2000 winter, its estimates would have been seriously in error.

Staff's position on this issue is entirely hindsight-based, and is not premised on any identified standard of prudence. Staff did not present any analysis of any of the 16 firm supply reservation contracts that IP entered into for the 1999-2000 season, or of any of the 18 such contracts IP entered into for 2000-2001, to show how IP should have analyzed these contracts, and which contracts it should have selected from the proposals received, based on information that would have been available at the time the decisions were made. That is, Staff did not (for example) estimate likely amounts of usage for each of the contracts, and employ those estimates to determine whether IP should have accepted other contract proposals rather than entering into the swing contracts it did. (Rev. IP Ex. 3.2, pp. 13-14) Instead, Staff looked only at the five swing contracts that IP entered into for the 2000-2001 season that had higher commodity prices than the next best offer, applied the actual load factors IP experienced under these contracts (rather than a reasonably estimated load factor from the perspective of the time of contracting), and took into account in recommending a

prudence disallowance only those contracts for which the sum of reservation fees paid and actual commodity costs paid were more than would have been the case had IP taken the next best offer. Staff's analysis is *purely hindsight based*.

Not only is Staff's position hindsight-based, it is also in conflict with Staff's prior positions on this same topic. The Administrative Law Judge and the Commission should ponder these passages from the order in IP's 1999 reconciliation case, Docket 99-0477:

Mr. Brian Blackburn sponsored IP Exhibit 3.1, including Attachment 3.2 thereto ("1999 Pipeline Services"), and IP Ex. 3.1-DR. With regard to IP's natural gas procurement activities in 1999, Mr. Blackburn stated that IP purchased 59.0 million MMBtu of natural gas from various producers and marketers. He said IP reserves firm natural gas supply for the winter months pursuant to contracts with suppliers providing the lowest reservation costs. Purchases under these contracts are typically priced at applicable market indices, using either a first of the month index or a daily index. He stated that IP continues to search the market throughout the winter, and will purchase more economically priced gas wherever possible. (Order in Docket 99-0477 (May 23, 2001), p. 3; emphasis supplied)

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Mr. Eric Lounsberry of the Engineering Department of the Commission's Energy Division stated that Staff reviewed IP's filing and the Company's responses to numerous data requests concerning the prudence of IP's gas purchases during the reconciliation period. He indicated that Staff found no reason to dispute IP's assertion that all its gas supply purchases during that period were prudently incurred. (Id., p. 4)

\* \* \* \*

(4) the evidence indicates that IP acted prudently in its purchases of natural gas during calendar year 1999. (Id., p. 5)

Staff has offered no explanation as to why a purchasing practice that Staff found unobjectionable in 1999 is suddenly "imprudent" in 2000. Moreover, from the point of view of rationale and predictable regulation, the Commission must consider how a utility is

supposed to conform its practices to acceptable standards of conduct when practices accepted as prudent in one year are challenged as imprudent in the very next year.

Further, even if the Commission were to conclude that Illinois Power's practice of selecting firm supply reservation contracts on the basis of lowest reservation cost were imprudent, the resulting disallowance in this case should be zero. As noted above, IP entered into 18 swing contracts for the 2000-2001 winter season, all on the basis of lowest reservation cost. Thirteen of these 18 contracts also had the same or lower commodity prices than were offered to IP by the bidder offering the next lowest reservation cost. Thus, by definition, regardless of the amount of gas taken under these 13 contracts, IP realized lower total costs than if it had taken the proposal with the next best reservation cost. For five of the 18 contracts, the offer with the next lowest reservation cost had a higher commodity price than the commodity price in the offer IP selected. For these five contracts in the aggregate, based on the amount of gas actually purchased, IP realized a **total savings** of \$16,815 during 2000, as compared to the costs IP would have incurred had it taken the proposals with the lower commodity prices. (Rev. IP Ex. 3.2, p. 15; IP Exs. 3.4-3.5) Although acknowledging this fact (Tr. 57), however, Staff looked only at the two contracts for which (per Staff's calculations) IP incurred higher total costs than if had taken the proposals with lower commodity price, and proposed as a disallowance the "losses" on those two contracts.<sup>18</sup> Staff

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<sup>18</sup> Staff's calculation that there were higher costs incurred on one of these two contracts is erroneous. The contract that IP entered into was for a specified firm supply reservation amount. The next best offer, which had a higher reservation cost but lower commodity price than the winning bid, was for only about one-half of the firm supply reservation amount as the winning bid. Staff compared the cost paid under the winning contract for gas actually taken to the lower cost for that gas that would have been paid under the next best bid, but erroneously compared the reservation cost paid under the winning contract to the reservation cost that would have been paid under the next best offer for only half the reservation amount of the winning contract. (IP Ex. 3.6, p. 26; see Staff Ex. 4.0, Sched. 12.0) In order to do a

completely ignored the savings IP realized on the other 16 contracts that IP selected through consistent application of its criteria of lowest reservation costs, or the aggregate savings that IP realized on all 18 contracts. (See IP Ex. 3.6, p. 27)

If Staff (or the Commission) thinks the Company's uniformly-applied practice of selecting firm supply reservation contracts solely on the basis of lowest reservation costs is imprudent (which, as shown above, it is not), any resulting disallowance should be based on the aggregate excess costs, if any, incurred on all the contracts that IP selected based on this practice – not just on a selected subset of those contracts.

**V. CONCLUSION**

For the reasons set forth in this brief, the Commission should reject the adjustments to Illinois Power's 2000 reconciliation proposed by Staff. The Commission should adopt, without adjustment, the 2000 reconciliation presented by the Company in IP Exhibit 2.2.

Respectfully submitted,

ILLINOIS POWER COMPANY

Randall B. Palmer  
Illinois Power Company  
500 South 27<sup>th</sup> Street  
Decatur, Illinois 62521  
(217) 362-7930  
(217) 362-7458 (fax)  
[randall\\_palmer@illinoispower.com](mailto:randall_palmer@illinoispower.com)

By /s/ Owen E. MacBride  
Owen E. MacBride  
Schiff Hardin & Waite  
6600 Sears Tower  
Chicago, Illinois 60606  
(312) 258-5680  
(312) 258-5700 (fax)  
[omacbride@schiffhardin.com](mailto:omacbride@schiffhardin.com)

Its Attorneys

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proper comparison for this contract, it was necessary to include the third best offer as well in order to get the total amount of firm supply reservation provided by the winning contract. This analysis, which was presented by the Company, should that the winning contract produced a savings in 2000 of \$1,835 over the next best offers for the same reservation amount. (Rev. IP Ex. 3.2, pp. 14-15; IP Ex. 3.4)