

STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	01-0701
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 its Initial Brief in this matter.

**I. Background**

On November 7, 2001, 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 ("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, 2001. (Initiating Order, Docket No. 01-0701, p. 3.)

Pursuant to proper legal notice, a pre-hearing conference was held on May 8, 2002, before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois. Thereafter, an evidentiary hearing was held on October 1, 2002. Appearances were entered by counsel on behalf of IP and Commission Staff. IP presented the testimony of Gary Murphy, Business Leader – Controller's Group; Mark

Peters, Control Area Resource Manager – Energy Supply Group; Kevin Shipp, Director of Gas Supply; Nancy Gudeman, Project/Case Manager – Legal and Regulatory Affairs; and Timothy Hower, President of Malkewicz Hueni Associates Incorporated. Staff presented the testimony of Burma 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 October 1, 2002, the record was marked "Heard and Taken."

## **II. Legal Standards**

PGA reconciliation proceedings are governed by Section 9-220 of the Act, which provides, in part:

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, p. 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, p. 25-26.)

### **III. Argument**

#### **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 2001 reconciliation period. Staff noted several areas where IP made imprudent decisions that caused IP's customers to pay approximately \$986,000 in additional gas supply costs during the reconciliation period. (ICC Staff Ex. 2.00, p. 3.) First, in March of 2000 IP improperly decided to retire its Freeburg propane facility, which caused it to incur \$614,000 of additional gas supply costs during the 2001 reconciliation period. (Id.) Second, IP entered into a natural gas swing supply contract that caused it to experience higher natural gas costs than if it had selected available alternative bids. The higher cost gas swing contract caused IP to incur an additional \$2,000 in gas supply costs during the present reconciliation period. (Id.) Finally, IP improperly decided to reduce the peak day capacity of its Shanghai storage field. This action caused IP to incur an additional \$370,000 in gas supply cost during the instant reconciliation. (Id.)

Staff also proposed an adjustment of \$1,575 of delayed payment interest charges from recoverable PGA costs for 2001 because they are not gas costs recoverable through the PGA clause, nor are they the responsibility of ratepayers.

With regard to the Freeburg retirement and swing contract issues, these issues have previously been discussed in last year's reconciliation period. (See Docket No. 00-0714.) Specifically, the Commission ruled in its November 27, 2001 Order in Docket No. 00-0714, finding 4:

the evidence shows that for the calendar year 2000 reconciliation period, Illinois Power acted reasonably and prudently in its purchase of natural gas, except with regard to its decision to retire its Freeburg propane plant and its method of selecting swing firm supply reservation contracts (emphasis added)

Order, Docket No. 00-0714, p. 35

IP ignores the Commission's ruling regarding the Freeburg plant and swing contract and fails to support decisions made during the present reconciliation period, demonstrating 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.

#### **B. Retirement of Freeburg Propane Facility**

In Docket No. 00-0714, the Commission found IP's decision to retire the Freeburg Propane facility imprudent. (Order, Docket No. 00-0714, Finding 4, p. 35.) With regard to the 2001 reconciliation, Staff applied this finding to determine that the Company imprudently incurred \$614,000 during the instant reconciliation period as a result of its previously determined imprudent action. (ICC Staff Ex. 2.00, pp. 4-5.) At no point does IP's testimony take issue with Staff's numerical calculation. The \$614,000 was calculated in part by assuming the Company purchased a seasonal transportation and supply contract to replace the Freeburg facilities' capacity for the period November and December of 2001. (Id. at 5.) For the months of January through March 2001,

Staff assumed the same replacement gas costs as used by the Commission in Docket No. 00-0714 in order to remain consistent with that Order. (Id.)

However, despite controlling law to the contrary, IP wants the Commission to revisit its decision from the prior reconciliation period. This is improper and inappropriately ignores the fact that the Commission has already spoken.

IP's own witness admitted that the decision to retire the Freeburg facility was made in April 2000. (IP Ex. 3.0, p. 3.) Further, IP notes that the various issues associated with the Company's decision to retire the Freeburg facility were discussed extensively in Docket No. 00-0714. (Id.) Notwithstanding these facts and the Commission's decision in Docket No. 00-0714, IP paid for a study in an attempt to justify, after the fact, that its original decision to retire the Freeburg facility was appropriate.<sup>1</sup>

IP claimed, for the first time during its surrebuttal testimony, that it conducted the most recent study in order to determine, hypothetically, whether to retire the facility or not for the 2001 reconciliation year. (IP Ex. 3.6, p. 2.) However, IP admits that it did not perform its the PVRR analysis associated with its "latest" decision until early 2002. (Tr., p. 205.) Further, IP argues that the Commission's prior decision has no bearing on the Company's decision to retire the plant for the 2001 reconciliation year and thereafter. (IP Ex. 3.6, pp. 2-3.) Staff finds the Company's arguments are illogical and ludicrous. IP's arguments ignore the basic tenet of prudence propounded by the Commission on numerous occasions, that is, prudence is that standard of care which a reasonable

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<sup>1</sup> Apparently, IP does not grasp the concept that hindsight review of a decision is not permissible. In last year's reconciliation, IP also offered evidence from another study regarding its decision to close the Freeburg plant. This attempt was disregarded by the Commission: [in determining whether a judgment was prudently made, only those facts available at the time the judgment was exercised can be considered. Hindsight review is impermissible." (See Order, Docket No. 00-0714, p. 17.)

person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. Furthermore, only those facts available at the time judgment was exercised can be considered. Since IP's decision to retire the Freeburg propane facility was made in April 2000, the facts available to the Company at that time are the only relevant facts to be considered. The Commission has already decided that IP acted imprudently with regard to the Freeburg retirement.

IP's effort to weave the Freeburg retirement into the present reconciliation is a thinly veiled second bite at the apple that attempts to demonstrate the prudence of a decision the Commission has already ruled as imprudent. The Company's new study that purports to support its retirement decision was clearly produced in hindsight and is highly speculative. Therefore, this study is not permissible to determine the prudence of the Company's decision to retire the Freeburg facility. The Commission's conclusion in Docket No. 00-0714 merits a disallowance of \$614,000 in additional costs IP incurred in the instant proceeding as a result of its April 2000 decision to retire the Freeburg facility.

### **C. Selection of Swing Contracts**

In addition to finding that IP's actions regarding the Freeburg retirement were imprudent, in last year's reconciliation, the Commission also agreed with Staff's determination that IP imprudently entered into two firm swing contracts during the 2000 reconciliation period. (Order, Docket No. 00-0714, pp. 33-34.) During the instant reconciliation period, Staff reviewed the additional cost IP incurred as a result of those same two contracts. Staff determined that IP imprudently incurred an additional \$2,000 in the instant reconciliation period as a result of entering into one of those contracts, hereafter referred to as Contract 1. (ICC Staff Exhibit 2.00, p. 6.) The second swing

contract in question from the prior reconciliation period, a contract between IP and Dynegy Marketing and Trade (“DMT”), did not incur any imprudent cost during the instant reconciliation period.

IP argued two main points in response to Staff’s adjustment in the instant proceeding. First, the Company contends that it would have selected Contract 1 had Staff’s “test” been applied at the time the contract was selected by the Company. Second, IP argues that the benefits the Company received from the DMT contract during the instant reconciliation period should be recognized in some fashion. (Revised IP Ex. 2.1, pp 2-3.)

#### **1. Contract 1**

IP asserts that had it used the “test” put forth by Staff in Docket No. 00-0714, at the time it was making its contract selections during 2000, the prior reconciliation period, it would have selected Contract 1. Therefore, IP argues, Staff’s proposed \$2,000 disallowance during the instant reconciliation period is inconsistent and mere hindsight. (IP Ex. 2.1, p. 5.) Staff disagrees.

First, IP ignores that the Commission has already ruled that the Company was imprudent for selecting Contract 1 during last year’s reconciliation period. (Order, Docket No. 00-0714, p. 34.) IP fails to provide any valid reason why the Commission should reach a conclusion in the instant proceeding that is different from its prior decision. The fact remains that the same activity that was deemed to be imprudent last year (i.e., entering into firm swing contracts) also occurred in this year’s reconciliation period. Further, Staff noted that IP was not precluded from presenting the same

information brought forth in the instant proceeding during the prior reconciliation period, but chose to not do so. (ICC Staff Ex. 4.00, p. 5.)

Second, IP assumes Staff's calculation of load factors associated with IP's swing contracts in Docket No. 00-0714 was a definitive "test" for determining whether or not the Company should select a particular swing contract. This is an incorrect assumption. Staff testified that a statement of load factors for the winter season of 1999-2000 and 2000-2001 was entered into the record in Docket No. 00-0714. (Id.) This information demonstrated that IP was wrong to assume no gas usage when determining the appropriate swing contract to select. (Id.) Staff did not put forth a definitive "test", but merely pointed out IP should not ignore commodity price differences when selecting swing contracts. The Commission agreed with Staff's conclusion and noted in Docket No. 00-0714 that the Company's selection method "...wrongly assumes that no gas will be taken." (Order, Docket No. 00-0714, p. 34.)

Staff believes a finding that IP incurred \$2,000 in imprudent gas costs associated with its selection of Contract 1 is proper and fully consistent with the Commission's findings in Docket No. 00-0714. Therefore, Staff continues to recommend the disallowance of \$2,000 in the instant proceeding associated with the additional gas costs the Company incurred that resulted from its imprudent decision to enter into Contract 1.

## **2. DMT Contract**

IP noted that the term of the DMT contract at question in Docket No. 00-0714 ran from November 2000 through March 2001. IP also noted that in Docket No. 00-0714, the DMT contract was one of the two contracts used by Staff to support its \$3,000

disallowance. (Revised IP Ex 2.1, p. 3.) Staff does not dispute this information. IP also noted that when the costs associated with the full term of the DMT contract is reviewed, the DMT contract provided a net benefit to the consumer. (Id. at 3-4.) IP then contends that Staff turned its review of the DMT contract into two distinctly separate decisions for prudence review. (Id. at 4.) Finally, IP claims that the net benefit of the DMT contract associated with the instant reconciliation period must be considered in the calculation of any disallowance associated with this issue. (Id. at 4.) IP's position regarding the DMT contract is without merit.

Staff noted that the Company was not precluded in Docket No. 00-0714 from showing its selection of the DMT contract resulted in a net benefit once the full term of the contract was considered. (Staff Ex. 4.00, p. 5.) Staff also noted that use of two different evaluation periods to determine a disallowance due to the DMT contract is the result of the start and end date of IP's purchased gas adjustment clause reconciliation. (Id. at 4.) The reconciliation periods are set forth by Commission Order and are not dictated by Staff.

IP contends that the Commission made an error in finding the Company imprudent for entering into the DMT contract in Docket No. 00-0714. Staff knows of no basis for reflecting in the instant reconciliation period an adjustment for an alleged error that IP claims was made in a prior reconciliation period.

#### **D. Decision to Reduce Peak Day Capacity of Shanghai Storage Field**

Staff recommended the Commission find the additional cost incurred as a result of Illinois Power's decision to reduce the peak day capacity of its Shanghai storage field imprudent. Staff calculated that the Company incurred an additional \$370,000 as a

result of this decision during the instant reconciliation period. (ICC Staff Ex. 2.00, p. 7.) Staff calculated this adjustment by assuming the Company would purchase seasonal transportation and supply contracts to replace the Shanghai capacity during the months of November and December 2001. (ICC Staff Ex. 2.03.) Staff's basis for making this adjustment is divided into two main areas, IP's actions that relate directly to the Shanghai storage field and IP's actions regarding its storage operations overall.

## **1. Shanghai Specific Items**

### **a. Introduction**

During the current reconciliation period, IP reduced the peak day capacity of its Shanghai storage field by 25,000 Mcf/d. (Id.) Staff's review of the reasons for this reduction indicated that IP should have identified several of the problems it faced at Shanghai prior to encountering the need to reduce the peak day capacity of the Shanghai storage field. Staff determined that the Company failed to properly monitor the Shanghai field and to take advantage of observations at the field that would have caused a prudent storage field operator to conduct a review of its field operations. If IP was more proactive in its approach of monitoring its storage fields, it would not have needed to reduce the peak day capacity of the Shanghai storage field in the instant proceeding.

### **b. Storage Field Deliverability Decline**

Staff noted that IP understood that wells at aquifer storage fields, such as the Shanghai storage field, experience deliverability declines over time. (ICC Staff Ex. 2.00. p. 22.) In fact, IP provided Staff information that indicated that downhole damage in storage field wells could cause a deliverability decline of 3 to 5% a year (Id. at 10.)

Further, IP noted that the decline in storage field deliverability over time was known in the United States as well as overseas. (ICC Staff Ex. 4.00, p. 8.) Therefore, it is undisputed that IP knew of the potential reduction in well deliverability at its Shanghai storage field over time.

Further, Staff noted that the last occasion that IP undertook to conduct work directly on the wells at the Shanghai storage field occurred during the early 1990's. The Company provided Staff specific dates for seven of the eight wells at Shanghai. This information noted that one well was reperforated<sup>2</sup> in 1991, four wells in 1992, and two wells in 1994. (ICC Staff Ex. 2.00, p. 20-21.) IP also noted a well casing repair in 1994. (Id. at 21.) The significance of the above information is that by using the 3-5% downhole damage value mentioned above and using the last occasion for specific well work (1994) suggests the potential for a 21 to 35 percent reduction at some or all of the wells at Shanghai since the last occasion that IP took specific action on a well. (ICC Staff Ex. 2.00, p. 24.) In other words, IP was aware, or should have been aware, that the potential existed for the deliverability of the individual wells at Shanghai to reduce over time and should have known that this would in turn negatively impact the deliverability of the field as a whole.

### **c. Prior Leak at Shanghai**

In the early 1990s, IP detected a casing leak at one of wells at the Shanghai storage field. (Revised IP Ex. 3.3, p. 12.) As noted above, IP repaired this leak in 1994. (ICC Staff Ex. 2.00, p. 21.) IP also noted that during the period 1995 through 1999, IP injected additional gas to make up for the gas lost due to the casing leak.

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<sup>2</sup> Reperforating refers to the process by which new holes or perforations are made in a well casing. (Staff Ex. 2.00 at 21.)

(Revised IP Ex. 3.3, p. 12.) IP estimated the amount of the suspected leakage as 661,000 Mcf. (ICC Staff Ex. 4.00, p.32.) Staff does not dispute this information.

The significance of this event is twofold. First, from the period 1995 through 1999, IP believed it was injecting more gas into the reservoir at Shanghai than was being withdrawn. IP's assumption would later prove wrong due to the discovery of the metering error at Shanghai, which is discussed below, but IP was not aware of that metering error until January 2000. (ICC Staff Ex. 2.00, p. 13.) Second, IP had a specific reason for replacing the gas over a five-year period. IP noted that it injected the gas over that time frame to avoid pushing the gas off structure and not being able to recover it. (ICC Staff Ex. 4.00, p. 32.) Therefore, IP expected the gas contained in the reservoir to expand rather than contract due to the additional injections. (Id. at 33.)

#### **d. Monitoring Wells**

Staff noted that IP failed to capitalize or make use of the fact that the monitoring wells<sup>3</sup> at Shanghai did not “go to gas<sup>4</sup>” (ICC Staff Ex. 4.00, pp. 13-15.) IP was aware that the four Shanghai monitoring wells had not gone to gas for several years. In fact, the last well that went to gas occurred in 1996. (ICC Staff Ex. 4.00, p. 15.) The other three wells had not gone to gas since 1992, 1993 and 1993, respectively. (Id. at 14-15.) However, despite these significant events, IP did not perform an investigation at the Shanghai field to possibly identify any problems until after the Company determined it needed to reduce the peak day capacity of the facility.

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<sup>3</sup> Monitoring wells are wells located at or near the edge of the gas bubble in a storage field and are used to verify that the gas bubble associated with the storage field has not migrated away from the storage formation. (ICC Staff Ex. 2.00, p. 17.)

<sup>4</sup> “Go to gas” refers to the situation when the monitoring wells due to a higher gas saturation around the well head have pressurized the well head and requires the Company to shut off valves on the well to keep natural gas from venting to the atmosphere. (ICC Staff Ex. 4.00, p. at 14.)

IP's 2001 Shanghai Report indicates that the failure of the monitoring wells to go to gas was, in part, due to misaccounted for gas associated with the metering error (the metering error is discussed below). (IP Exhibit 3.8, Att. 1, p. 1.) Staff believes that IP, at a minimum, should have conducted an investigation at Shanghai for potential problems once all of the monitoring wells failed to go to gas as it had historically done.

The failure to conduct such an investigation is even more telling given the fact that at the time the last monitoring well failed to go to gas, IP thought it was adding gas to the reservoir through its casing leak gas replacement discussed above. In fact, also noted above, IP was so worried about pushing gas off structure (movement of gas beyond the monitoring wells), it replaced the gas over a five-year period. (ICC Staff Ex. 4.00, p. 32.) IP thought it was putting more gas into Shanghai, but in the middle of the gas replacement process, the final monitoring well failed to go to gas, but IP did not investigate why this happened. Staff believes this was a genuine opportunity missed by IP to investigate its Shanghai operations and correct any problems that existed at the time (such as the later discovered metering error). If IP had properly investigated the problems at the Shanghai field, IP would not have needed to reduce the peak day capacity of its Shanghai storage field during the instant reconciliation period and would not have incurred the additional \$370,000 in gas supply costs.

**e. Metering Error**

It is undisputed that the Shanghai storage field experienced a metering error that caused IP to withdraw approximately 743,313 Mcf of natural gas above what IP's meters reflected. (ICC Staff Ex. 2.00, p. 13.) This metering error existed from 1995 through its discovery in January 2000. (Id.) This misaccounted for gas represents

approximately 20.6<sup>5</sup> percent of the amount of gas IP normally attempts to cycle in a withdrawal season.

Even though IP discovered this metering error in January 2000, IP did not replace any of the misaccounted gas until the summer/fall injection season of 2001. (Id. at 18.) This delay in replacing the misaccounted for gas contributed to the subsequent deliverability problems at the Shanghai storage field. (Id. at 18-19.)

Staff's assertion that the delay in replacing the gas contributed to the subsequent deliverability problem at Shanghai is challenged by IP's claims that during the late 1980's IP operated the field with a total inventory that was less than the inventory in place during 2001, and that the deliverability of a gas storage field is related to the gas inventory simply because it is a function of pressure. (Revised IP Ex. 3.3, p. 8-9; IP Ex. 5.0, p. 22.) Further, IP claimed that once the gas is replaced, any drop in reservoir pressure would be restored and along with it, the field deliverability. (Id.) Finally, an IP witness opined that a delay in replacing this gas would be of no consequence. (Id.)

However, the Company's own study, developed prior to Staff taking issue with the Company's actions, contradicts the statements made by the Company's witnesses. (ICC Staff Ex. 4.00, p. 16.) The Company study noted that the reduction in total gas volumes during the late 1980's may have adversely impacted field performance at a later date (Id. at 17.) Staff does not dispute that IP operated the field with a reduced inventory during the late 1980's, but to use that as support for a basis for delaying the gas replacement is incredulous given IP's own report that notes the operation of the field with the reduced inventory in the late 1980's may have contributed to the problems at question in this proceeding. IP's point on this topic is irrelevant since after the late

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<sup>5</sup> 743,313/3,600,000 = 20.6% (Tr., p. 111-112.)

1980's, IP determined it was necessary to increase the amount of inventory maintained at Shanghai, making its actions prior to that moot.

Regarding IP's comments that the delay in replacing the gas did not impact Shanghai's deliverability, once again the Company's report disputes this assertion as well. The IP study noted that the lack of gas inventory was causing water production problems in the edge wells that, in turn, were causing deliverability problems. (Id.) If IP had replaced the misaccounted for gas immediately, it may not have experienced water production problems at its edge wells.

Delaying the replacement of the misaccounted for gas was not a proactive action by the Company. Instead IP waited until it experienced deliverability problems at Shanghai to replace the misaccounted for gas. In addition to the deliverability problems noted above, Staff also believes the delay in identifying and then replacing the misaccounted for gas impacted other aspects of the operation of the Shanghai storage field.

#### **f. Mechanical Well Problems**

The Company's reference to mechanical well problems refers to the sand production problems<sup>6</sup> it experienced at one of the Shanghai wells. It is undisputed that Shanghai's F-5-A well, experienced sanding production problems in late January 2000. (ICC Staff Ex. 2.00, p. 19.) The Company also noted that it had never experienced sand production problems at the Shanghai storage field in the past. (Id. at 20.) Further, IP stated that sand production in a well causes a reduction in that well's deliverability. (Tr., pp. 36-37.) Staff noted that given the sanding problem happened for the first time

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<sup>6</sup> Wells that have sand production problems pull a large amount of sand out with the gas during the withdrawal season. This sand can fill the bottom of the well bore or clog the well's perforations, which can limit that well's ability to withdraw natural gas. (ICC Staff Ex. 2.00, p. 19.)

at this field in conjunction with the field operating at a reduced level of inventory, it is likely the events are linked. IP's failure to identify the metering error earlier and to replace the misaccounted for gas in a timely fashion impacted the mechanical problems at the facility.

IP claims it is not aware of any theoretical basis or field examples where a reduced gas inventory was identified as a cause of sand production in storage wells. (IP Ex. 5.0, p. 22.) IP's witness also opined that a reduced gas inventory would actually tend to prevent sand production problems rather than cause them. (Id. at 22-23.) However, IP failed to provide any explanation of why the sanding production problem occurred and did not dispute that the sanding problem occurred when the Shanghai field was operating with reduced inventory.

As noted in the 2001 Shanghai Report, there was an increase in the amount of water being produced from the edge production wells due to low inventory levels. (ICC Staff Ex. 4.00, p. 19.) One manner of maintaining a storage field's deliverability, when it experiences increased water production, is to increase the drawdown pressure<sup>7</sup> placed on the field. (Id.) Finally, Staff noted that IP has an hourly drawdown pressure limit on Shanghai of 150 psi and over the three-year period, 1999-2001, IP exceeded this pressure on 1,200 occasions. (Id. at 20.)

IP noted that pressure readings were taken every hour during a three-year period creating 26,280 data points, IP witness Shipp admitted during cross-examination that IP does not withdraw gas from storage 365 days out of the year. (Revised IP Ex. 3.6, p. 17; Tr., p. 211.) Therefore, the reference to the 26,280 data points is not valid since the

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<sup>7</sup> Drawdown pressure is the difference between the pressure in the storage reservoir and the surface. (Staff Ex. 4 at 19.)

only occasions that are relevant are the periods when IP is withdrawing gas from Shanghai. IP also claimed that Staff failed to account for any margin of error that might exist between the telemetered data and the actual metered data at the field. (Revised IP Ex. 3.6, p. 17.) Staff agrees that it did not consider the accuracy of the information it received from the Company since it is assumed that information provided by the Company in response to a data request is accurate. IP failed to provide a revised estimate of the number of occasions it exceeded the drawdown pressure, so Staff must rely on the data provided by the Company irrespective of whether the Company believes the data to be in error.

IP witness Shipp noted that IP's technical staff and storage engineers believe the sanding at one of the wells was probably caused by unconsolidated sand in the formation that later caused problems after the reperforation efforts. (Id.) How Mr. Shipp reaches this conclusion is unclear since, as was clearly established during the October 1, 2002 hearing, he has no personal knowledge of the sanding problems. Moreover, the "technical staff" that Mr. Shipp alludes to did not submit testimony in this proceeding. It is curious indeed for the Company to assert that problems at the Shanghai field were caused by unconsolidated sand yet hide behind Mr. Shipp's lack of knowledge to question his theory. Staff was unable to question these individuals as to whether or not the failure to identify the metering error earlier or delay in replacing the misaccounted for gas assisted in this process. IP witness, Mr. Hower, provided some guidance on this topic, noting that he had not conducted any studies regarding the cause of the sand production problem at Shanghai. (Tr., p. 36.) Hower, further noted that sanding (or sand production) is brought about by increasing a pressure drop across a sand phase

or pulling too hard on a reservoir. (Tr., p. 60.) Finally, Mr. Hower noted that pulling too hard on a reservoir relates to the rate of withdrawal from the storage field. (Tr., p. 61.)

Staff does not disagree with Mr. Hower's explanation regarding the manner in which sand production problems occur. Further, Staff contends that Mr. Hower's explanation is consistent with Staff's arguments. Mr. Hower noted the well that developed a sand production problem was at the top of the reservoir structure. (Id.) Further, Shanghai's edge production wells had increased water production due to low inventory levels (IP Exhibit 3.8, Att. 1, p. 1.) A means to retain deliverability at Shanghai under those circumstances is to pull harder on those wells without water production, such as the well at the top of the reservoir structure. Staff contends the low inventory levels caused IP to experience increased drawdown pressures (which measures whether or not IP pulled harder on the wells) at Shanghai creating the circumstances that risked the well bore developing sanding problems. (ICC Staff Ex. 4.00, p. 19.)

Mr. Hower noted that after operating the Shanghai gas reservoir for over 33 years, one would expect certain issues such as sand production to arise. (IP Ex. 5.2, p. 10.) Further, he noted that he did not believe the single incident of sand production has anything to do with the reduced level of gas inventory caused by the metering error. (Id.) Mr. Hower admitted that he did not conduct any studies into the cause of the sanding. (Tr., p. 36.) Obviously, something caused the sanding to take place for the first time in 33 years. The only events that converge are the failure to identify the metering error/delay in replacing the misaccounted for gas and a well developing a sand production problem. Staff continues to insist that these events are related.

### **g. Field Monitoring**

IP should have conducted hysteresis graphs<sup>8</sup> to monitor its aquifer storage operations, including the Shanghai storage field. IP claims it was already conducting similar reviews and did not see any purpose in conducting hysteresis graphs. In fact, IP noted it maintained a neutron logging<sup>9</sup> program, tracked the net gas inventory versus time and the material balance on pressure versus volume over time. (IP Ex. 5.0, p. 16.) Staff does not dispute that multiple methods should be used to monitor a storage field. However, IP has not demonstrated that hysteresis graphs would not have revealed problems at its Shanghai storage field or that IP should not be using that monitoring technique.

### **i. Hysteresis Graphs**

Hysteresis graphs could be used to track the performance of a storage field, which in turn provides a means to verify the inventory within the field. This information can also allow for interpretations of gas migration, seepage and bubble growth. (ICC Staff Ex. 2.00, p. 11.) However, IP indicated that since at least 1995, it has not plotted hysteresis graphs for its Shanghai storage field. (Id. at 12.) If IP plotted hysteresis graphs, it could have identified potential problems at the Shanghai storage field much sooner and without incurring the need to reduce the peak day capacity of its storage field. (Id.)

While Staff agrees that hysteresis graphs would have had incorrect inventory data due to the unknown metering error, since IP thought it was injecting more gas into

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<sup>8</sup> A hysteresis curve is a plot or graph of the gas pressure in the storage field versus the field inventory. (ICC Staff Ex. 2.00, p. 11.)

<sup>9</sup> Neutron logs measure the hydrogen ion concentration in a well bore. This information can be used to detect casing leaks and provides a gas saturation value that is used to extrapolate the amount of gas in place at storage fields. (ICC Staff Ex. 2.00, p. 14.)

inventory due to the gas replacement associated with the casing leak, a person reviewing the hysteresis graph would have expected to see an increase in the reservoir pressure in response to the increased inventory.<sup>10</sup> However, due to the metering error, IP was actually slightly reducing the inventory in the reservoir. Staff agrees the hysteresis graph would be based on incorrect information, but that information in and of itself would be significant on a hysteresis plot. IP disagrees with Staff's views about the value of the hysteresis plots, however, IP failed to produce the hysteresis plots for the Shanghai storage field to dispute Staff's claims. If the graphs would show nothing, then why did IP not provide them to support its viewpoint?

Hysteresis graphs are an industry standard. (ICC Staff Ex. 4.00, p. 8.) In fact, the larger gas utilities in the state make use of hysteresis graphs to monitor their storage operations. (IP Ex. 3.7, p. 3.)

IP should have continued to make use of hysteresis graphs to monitor its storage fields' performance, including Shanghai. If IP had plotted hysteresis graphs for its Shanghai storage field, it would have identified the problems it faced at Shanghai much sooner.

## **ii. Neutron Logs**

One of the primary means the Company uses to verify its storage inventory at Shanghai is neutron logs. (ICC Staff Ex. 2.00, p. 14.) Neutron logs' value for detecting small changes in inventory is negligible. For example, IP noted that it would take a reduction on the order of 10 to 20 percent of the total gas in place to be noticeable on a neutron log. (Tr., p. 52.) IP then noted that the 743,313 Mcf of misaccounted for gas

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<sup>10</sup> IP noted that gas deliverability in a storage reservoir is directly related to reservoir pressure. Thus, if the gas inventory is reduced, gas deliverability is reduced. Stated differently, inventory and pressure are directly related. (IP Exhibit 5.2, p. 7-8.)

for the Shanghai storage field amounted to about 7 percent of the total gas in place at Shanghai. (Id.) Thus, the primary means used by IP to monitor the gas would not have detected the misaccounted for gas. Clearly, IP needed to do more.

#### **h. Late Season Well Testing**

IP noted that its ability to diagnose, correct, and verify any changes to the Shanghai storage field is limited because the Shanghai storage field serves a captive load. (Revised IP Ex. 3.3, p. 4.) In particular, if the Company and its customers are not experiencing a normal to severe winter season, the load that the Shanghai storage field serves is not adequate enough to fully test any change made to the field during the prior period. (Id.)

While Staff agrees that the storage field is load constrained to the demand requirements of its captive load, Staff disagrees that this necessarily limits its ability to monitor the storage field. (ICC Staff Ex. 4.00, p. 31.) The Company could test the deliverability of the individual wells at Shanghai. (Id.) In fact, the Company had hired an outside contractor to conduct a study on well performance during the late summer of 2001. (Id.) Further, IP agreed that some operators of gas storage fields use periodic multi-rate flow tests to ascertain the deliverability of their wells and to further obtain a total field flow potential. (Tr., p. 52-53.)

The Company attempts to portray Staff's statements as an indication that Staff believes the Company should conduct individual well tests to replicate the information obtained in a full field deliverability test. (IP Ex. 5.2, p. 11.) This is not correct. At no point did Staff make the claim that the individual well tests could be used in lieu of a full field deliverability test. However, since IP cannot conduct full field tests, conducting

individual wells tests would provide IP with some useful information. Further, IP's own witness notes that individual well deliverability testing has its place in monitoring techniques used for gas storage fields. (Id.) Staff's point is simple: IP failed to make use of a readily available monitoring technique that would have allowed it to identify problems with individual wells at the Shanghai storage field prior to encountering the need to reduce the peak day capacity of the field.

IP claims that a prudent operator should rely on numerous methods to monitor its gas inventory. (IP Ex. 5.0, p. 16.) Staff believe this same adage would apply to IP's monitoring of its storage fields' overall performance. It appears that IP disagrees with the use of any monitoring techniques that it is currently not employing. However, the fact remains that in the late summer of 2001, IP had a consultant conduct a study of well performance that tested individual wells. (ICC Staff Exhibit 4.00, p. 31.) Further, IP had the same consultant provide well treatments to three wells in 2001, with three more wells planned for 2002, to address improve individual well deliverability. (ICC Staff Ex. 2.00, p. 21-22.) IP should have periodically conducted late season well deliverability tests at Shanghai and it could have identified the same problems its consultant found prior to encountering the need to reduce the peak day capacity of Shanghai.

#### **i. Computer Modeling**

IP noted that a reservoir model that is built with an accurate geological characterization and calibrated with a sufficient database of pressure and production data would, with the exception of subtle or very small changes, be able to detect a reduction in the peak day capacity of a storage field. (Tr., p. 33-34.) Further, IP noted that in 1993 it began the development of a model at Shanghai. (Revised IP Ex. 3.3, p.

7.) However, IP did not attempt to refine the model with an accurate geological characterization or calibrate it with a sufficient database of information that would have allowed IP to monitor the Shanghai field's performance. Had IP done this, it could have identified the problems facing Shanghai much sooner and without encountering the need to reduce the peak day capacity of the field. This is another example of IP not expending resources on a monitoring technique that was available in order to identify problems at its Shanghai storage field prior to encountering the need to reduce the field's peak day capacity that, in turn, caused IP to incur additional gas costs during the reconciliation period.

#### **j. Conclusion**

IP utterly failed to proactively address identifiable problems with its Shanghai storage field prior to encountering the need to reduce the field's peak day capacity during the instant reconciliation period. IP ignored the failure of a monitoring well to go to gas even though it thought its was injecting additional gas into the reservoir. The discovery of a well with sand production (which reduced well deliverability) at approximately the same time as the metering error (January 2000) failed to prompt any action until Shanghai developed further problems in the next winter season (2000-2001). Once it was clear that IP could no longer ignore the problems at Shanghai, IP finally replaced the majority of the misaccounted for gas and had a consultant conduct tests on the individual wells at Shanghai. Unfortunately, this was too little, too late.

IP had ample opportunity prior to the instant reconciliation period to review its Shanghai operations and address the problems it faced. Instead, the Company sat idly by either ignoring or misunderstanding signs that the field was having deliverability

problems. IP had other monitoring options available to it, such as hysteresis graphs and late season well deliverability checks, to identify the problems its encountered at Shanghai prior to encountering the need to reduce the peak day capacity of Shanghai. IP has the responsibility to its customers to provide least cost utility service. IP has failed with respect to this responsibility.

Staff recommends that the Commission find imprudent the additional cost incurred as a result of Illinois Power's decision to reduce the peak day capacity of its Shanghai storage field. Staff calculated that the Company incurred an additional \$370,000 as a result of this decision during the instant reconciliation period. (ICC Staff Ex. 2.00, p. 7.)

## **2. Overall Storage Concerns**

Staff raised several concerns in testimony about IP's overall ability to review its storage operations and to identify problems it encountered at its storage fields. Staff is not recommending an adjustment in this year's reconciliation; nevertheless, a discussion of these concerns merits attention in this Initial Brief.

### **a. Reduction in Peak Day Capacity**

Reducing the peak day capacity of a storage field is an uncommon event. (ICC Staff Ex. 2.00, p. 25.) IP recently reduced the peak day capacity of two of its largest storage fields. (Id.) Staff notes that there has only been one other instance where another utility reduced the peak day capacity of its storage field and that was due to the purposeful reduction in inventory at that field. (Id. at 26.)

IP claimed it was not aware of any storage field operator reducing the rated peak day capacity of its storage fields. (Tr., p. 31-32.) IP also stated that there were two

other utilities in the State whose storage plant capacity declined during the period 1996 through 2001. (Revised IP Ex. 3.6, p. 23.) However, IP fully acknowledged it does not know the reason for these declines. (Id.) Staff demonstrated that the storage reduction from one of the utilities was due to the utility maintaining leased storage capacity in the data collected. (ICC Staff Ex. 5.00, p. 1.) For IP to suggest that this information demonstrates that reducing the peak day capacities of company owned storage fields is not that uncommon is nothing more than a distortion of the facts.

IP witness Hower opined that based on his gas industry experience and his past ten years as a consultant for IP, he believes IP operates its storage fields in a prudent and proactive manner. (IP Ex. 5.0, p. 24.) He further noted that IP's data collection and analysis techniques conform to standard industry practice and in many cases exceed what one would consider being industry standard. (Id.) Staff disagrees. First, it should come as no surprise that Mr. Hower reaches the conclusion that he does. After all, he is being paid by IP to provide an opinion. His company has a long-standing relationship with IP and has reaped the benefits of this relationship. Mr. Hower noted that he was being paid \$160/hour for his work with IP. (Tr., pp. 26-27.) Since 1992, he has been paid between \$50,000 and \$100,000 for his services. (Id. at 28.) As noted above in Staff's discussion of Shanghai specific items, IP does not plot hysteresis graphs and does not perform late season flow tests on the wells at Shanghai, both events that Mr. Hower noted were used by the industry. (IP Ex. 5.2, pp. 3-4; Tr., pp. 52-52.) If IP meets or exceeds the industry standard, then why is IP not performing those functions as well?

IP is unique among Illinois utilities in having a reduction in the peak day capabilities of two of its largest storage fields. There are no other Illinois utilities that have reduced their peak day capacities other than the one historical instance noted by Staff. Staff maintains that IP's unenviable position of having its two largest storage fields operating under reduced peak day capacities is not coincidence and is an indictment of the Company's storage field oversight.

**b. Manpower**

IP has reduced the number of storage field supervisors significantly from 1991 through the beginning of 2000. In 1991, IP maintained either three or four supervisors, while at the beginning of 2000 only one remained. (ICC Staff Ex. 2.00, p. 27.) This reduction in manpower impacted IP's ability to timely identify the loss of gas due to the metering error at Shanghai. (Id. at 28.) This lack of manpower also contributes to IP's inability to conduct effective root cause analyses reviews. (Id.)

IP attempted to deflect criticism of its storage field management by noting that in 1995, IP adopted a manpower plan that instituted a self-directed work team philosophy that included a reduction in supervisory positions and that it believes the fields are more reliable, safe and efficient as a result of its decision to implement the self-directed work team concept. (Revised IP Exhibit 3.3, pp. 17, 19.) IP further claimed that it had initiated several projects in relation to its proactive oversight of Shanghai. In particular, IP initiated the re-perforation of the eight wells at Shanghai in the early 1990s. (ICC Staff Ex. 4.00, p.26.) IP also conducted a 1998 study on the historical gas leakage at Shanghai that examined whether or not that field continued to leak. (Id. at 27.) Finally,

IP considered the hiring of a consultant to test the individual wells at Shanghai as proactive. (Id.)

Staff is not persuaded that the actions taken by IP are proactive steps taken to better manage its storage fields. First, it is unclear whether the re-perforation of wells at Shanghai was proactive or not. (Id.) The 1998 study was conducted to determine if gas was no longer leaking from Shanghai. This is hardly proactive, rather it is reactive in attempt to diagnose gas leakage. Instead, it is a study to verify that IP had corrected an earlier leak at Shanghai. (Id.) Staff also does not consider IP's hiring of a consultant to conduct test on individual wells at Shanghai as proactive, since IP did not hire the consultant until after it reached the decision to reduce the peak day capacity at Shanghai. (Id.)

### **c. Capital Expenditures**

The information the Company provided indicates that for the period 1997 through 2002 the budgeted amount of storage field capital expenditures has drastically reduced over time. (ICC Staff Ex. 2.00, p. 28-29.) The Commission should be concerned about the potential for IP to become more reactive rather than proactive due in part to the fact that a utility will not earn a return on investments for improvement or upgrades at storage facilities until it requests and receives a natural gas rate increase from the Commission; but increased gas supply costs, unless deemed imprudently incurred, are automatically passed through the PGA. For example, Staff noted that the cost to treat a well as Shanghai was about \$115,000, but the cost associated with the reduction in peak day capacity for a full winter season at Shanghai exceeded \$900,000. (Id. at 30.)

IP noted that it continues to invest capital dollars, as deemed necessary, to support its storage fields. (Revised IP Ex. 3.3, p. 23.) IP also claimed that Staff used the years with the two highest budgeted dollars to compare to the two lowest years. (Id. at 24.) IP noted that if you subtracted the largest budget item from those years, the capital budget dollars remained fairly constant over the years. (Id. at 25.)

Staff does not disagree that removing the largest budget items from the first two years of data makes the comparison more favorable to IP. However, are there reasons why there are not any large budget items for the last three years versus what IP provided during the first two years? Staff did not arbitrarily select those years to start the comparison. The data speaks for itself: IP spent a significant amount of more money during the first two years of the comparison versus the last three. In order to avoid any confusion on this point, the capital expenditure values provided to Staff by the Company are provided below:

<b>Year</b>	<b>Budgeted Amount</b>
1997	\$3,154,900
1998	\$2,712,561
1999	\$1,061,800
2000	\$760,500
2001	\$1,007,500
2002	\$955,000

Source: (ICC Staff Ex. 2.00, Schedule 2.04.)

**d. Identification of Problems**

In addition to the inability of IP to identify problems at its Shanghai storage field, IP conducted a poor root cause analysis after it experienced an explosion at its Hillsboro storage field on December 16, 2000 (known as the “Hillsboro Incident”). (ICC Staff Ex. 2.00, p. 31.)

The Hillsboro Incident refers to the December 16, 2000 explosion of a 50,000 gallon produced water tank that was launched approximately 275 feet and landed on top of the storage field’s regulator building causing extensive damage to all equipment in the building. (Id. at 31.) Regarding IP’s root cause analyses of the Hillsboro Incident, there were two primary pieces of equipment at Hillsboro involved in the accident, namely, a gas-water separator (the means by which the produced water tank was over-pressurized) and the produced water tank. (Id. at 32.) IP had stated the contributing factors that resulted in the over-pressurization of the produced water tank were still being investigated. (Id. at 34.)

In reviewing the events surrounding the explosion, Staff noted that IP had not determined the water levels that would allow the separator to automatically operate or the amount of time it would take to empty the separator of produced water. (Id., at 34-35.) Staff then requested from the Company the amount of time it would take for a certain amount of water to empty out of the separator. (Id. at 35.) Finally, Staff asked IP, assuming the water was emptied from the separator, to calculate the amount of time it would take to pressurize the produced water tank. (Id. at 36.) Staff received a response to the request in May of 2001. (Id.) This response noted that it was not possible for the separator to cause the over-pressurization due to the relief capacity of

the produced water tank. (Id. at 36-37.) However, this was the first time, even though IP had stated it was still investigating the event, that IP realized the relief capacity of the produced water tank exceeded the separator's ability to pressurize it. (Id. at 37.)

The relief capacity of the produced water tank versus the capacity of the separator to increase the tank's internal pressure was a fairly basic starting point for a utility to review after the Hillsboro Incident. However, it took Staff's prompting approximately 5 months after the fact for IP to reach that basic point. Staff's review of those events indicates that IP failed to properly investigate the root cause of the problems at Hillsboro. The above event exemplifies IP's poor management oversight of its storage fields. (Id. at 38.)

**e. Credibility of Company Witness Shipp**

Kevin Shipp was IP's primary witness regarding its decision to reduce the peak day capacity of the Shanghai storage field. However, he admits he was only the Director of Gas Supply for approximately four months of the reconciliation period and that he was not personally involved in the decision to reduce the peak day capacity of the Shanghai storage field. (Tr., pp. 175, 177.) Other than the four months he held the position of Director of Gas Supply for the Company during the current reconciliation period, he does not have any other gas operations experience. (Tr., pp.173-175.)

Further, Mr. Shipp testified about several topics including chemical treatment of wells, but could not explain what types of chemicals are used in a chemical treatment. (Tr., p. 196.) Mr. Shipp was unable to answer many of the question asked by the Administrative Law Judge regarding basic points he made in his written testimony. This included the inability to explain the use of charcoal filters at a storage field. He also

could not explain how the movement of an electrical wire would indicate that IP was being proactive in its monitoring and verification process, even though he made that claim in testimony. Furthermore, he could not explain the operation of a dump valve or gas scrubber. (Tr., pp. 228-229, 231.) It was a curious spectacle indeed for a witness to be unable to explain his own testimony.

Staff does not fault Mr. Shipp for his inability to discuss technical topics regarding storage since he clearly lacks the requisite education and experience to discuss these topics. However, for the Company to parade this witness as its expert on gas storage field operations when he has no personal knowledge of most of the subjects he testified about is a farce and a disservice to the Commission. The Commission is charged with the responsibility of determining whether purchased gas costs should be passed through to consumers via the PGA, yet the Company cannot produce a witness who has the slightest inkling how gas operations at the Company work. It is an indication of the problems facing IP that someone so unqualified is the primary witness on this highly technical topic.

#### **f. Conclusion**

The combination of concerns that Staff raised regarding the Shanghai specific items, coupled with the overall concerns for IP's storage operations evokes serious problems with IP's oversight of its storage fields. IP has failed to demonstrate it can proactively manage a storage field or conduct effective root cause analyses of problems once encountered. The Commission should take this opportunity to send IP a clear message to alter its behavior and devote more attention to its storage field operations.

## **E. Delayed Payment Interest Charges**

The Commission should accept Staff's proposed adjustment to remove \$1,575 of delayed payment interest charges from recoverable PGA costs for 2001 because they are not gas costs recoverable through the PGA clause, nor are they the responsibility of ratepayers. The charges were incurred when the Company failed to pay various pipeline invoices in a timely manner. Notwithstanding the fact that \$230 of similar charges were inadvertently allowed to be recovered in Docket No. 99-0477, IP's PGA reconciliation for 1999, the only type of interest specifically allowed to be recovered under the PGA clause is interest on under- and over-recovery adjustments. (ICC Staff Ex. 3.00, p. 2.)

The Company makes much of the fact that the current PGA clause does not contain any language that specifically excludes late payment charges from recoverable gas costs. (IP Ex. 1.6, p. 4.) Presumably, the logic is that any cost not specifically excluded is included. However, 83 Ill. Adm. Code 525.40 defines direct commodity and non-commodity gas costs that are recoverable, and late payment charges are in neither category. (ICC Staff Ex. 3.00 p. 4.) Deferred interest payment charges are not the result of purchasing gas; they are penalties for not paying for the purchased gas in a timely manner. They are avoidable costs that should be the responsibility of the shareholders.

According to the Company, "[t]he charges were the result of an unintentional delay in the necessary review and approval process for gas invoices that occurred at the time of a change in responsibilities for the personnel involved." (ICC Staff Ex. 3.00, p. 5.) Ratepayers should not be responsible for incurring costs associated with "an

unintentional delay in the necessary review and approval process for gas invoices.” It is an error in management that causes the delay, and it would be inappropriate to ignore management errors when they are detected. The Company maintains that management should not be expected to be perfect and without error in the processing of invoices. (IP Ex. 1.10, p. 2.) It points to the fact that the immaterial amounts of delayed payment interest incurred and included in the PGA since 1999 supports its position that management has been prudent in this area. (IP Ex. 1.10, p. 3.) However, past performance is not necessarily indicative of future actions. Staff maintains that if the Company were not penalized for unintentional delays in processing invoices, the delay could become a routine financing mechanism funded entirely through the PGA clause. (ICC Staff Ex. 3.00, p. 5.)

Staff’s adjustment to remove delayed payment interest charges from gas costs recoverable through the PGA clause is appropriate and should be accepted.

#### **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 2001 PGA reconciliation by the amount of \$987,238. In addition, Staff requests that the Commission order the Company to implement Factor O refunds of \$931,780 for Rider A, \$55,194 for Rider B Demand, and \$264 for Rider B Commodity, as indicated on Staff Exhibit 1.00, Schedule 1.01, page 1 of 4, in the first monthly PGA filing after entry of the final Order in this proceeding.

Respectfully submitted,



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STEVEN L. MATRISCH  
LINDA M. BUELL

Counsel for 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  
[smatrisc@icc.state.il.us](mailto:smatrisc@icc.state.il.us)  
(217) 785-3808  
[lbuell@icc.state.il.us](mailto:lbuell@icc.state.il.us)  
(217) 557-1142