Reported to the Board of Trustees
January 21, 2010

UNIVERSITY OF ILLINOIS
URBANA-CHAMPAIGN • CHICAGO • SPRINGFIELD

Natural Gas & Electricity Procurement Program

Status Report to the Board of Trustees

January 21, 2010

Natural Gas and Electricity Procurement Program

OVERVIEW

At the September 2008 meeting of the Board of Trustees, Walter Knorr, Vice President/Chief Financial Officer and Comptroller, presented and received approval of the Natural Gas Cost Management Policy. Among other things, the policy authorized natural gas purchases for fiscal years 2010 and 2011, with certain restrictions. At its March 2009 meeting, the Board approved the Energy Cost Management Policy to replace the Natural Gas Cost Management Policy. The new policy expanded purchasing authority to include other energy commodities (electricity and coal) and expanded the timeframe to a rolling three-year period.

A strategy for procuring natural gas and electricity within the policy framework was developed with assistance from our external advisors, Nicor Enerchange, American Electric Power, Brubaker and Associates, Inc., and Larry Altenbaumer. The primary objective of the strategy is to provide budget certainty and to stabilize the price of purchased fuel to the University.

The strategy has three primary components - (i) a rolling 36-month series of regularly timed purchases, (ii) budget management for the 36 months, and (iii) an opportunistic purchase program based on aggressive pricing targets.

i. The program is designed to even out over time the University's exposure to the spot market and the risk of price spikes; it functions similarly to a "dollar-cost averaging" investment strategy.

ii. The 36 month term provides a high degree of budget certainty (financial risk management) for the fiscal budget periods affected by allowing purchases up to 95% for the first 12 months, 90% for the second 12 months, and 85% for the third 12 months of the natural gas required to meet the University's steam load.

iii. The opportunistic purchases program incorporates a capability to increase purchases for a particular period. Consideration is based on variances between currently available market pricing and the established budgeted target price coupled with consideration of levels of actual committed purchases relative to target purchase commitments levels for the specified period.

PROGRESS TO DATE

The procurement activity under the Policy began in August 2008. Significant progress continues to be made in securing natural gas at a fixed price for fiscal years 2010-2013. All transactions have been reviewed by the *Energy Management Committee* ("Committee") and were executed using forward fixed-price purchase contracts with Nicor Enerchange. No futures contracts or other derivative products were employed. Table 1 summarizes the Natural Gas procurement activity.

Through December 31, 2009	FY2010	FY2011	FY2012	FY2013
Volume Requirement[1] (MMBTU)	5,174,946	5,440,865	5,440,865	5,440,865
Volumes Committed To Date (MMBTU)	4,958,798	4,951,452	1,876,584	114,759
Percent Committed Volumes (%)	96%	91%	34%	2%
Budgeted Landed Price [2,3] ($/MMBTU)	$7.43	$6.86	$7.21	$7.11
Landed Price for Committed Volumes[2] ($/MMBTU)	$7.91	$7.51	$7.42	$7.00

Table 1: Summary of Gas Procurement Program

1. *Volume Requirement = Must Run Gas Requirements to produce steam only*
2. *Landed Price = field price + basis + Nicor Enerchange fee + NGPL fees.*
3. *Budgeted Landed Price reflects budgeted pricing as of 5/7/2010. FY2013 thru October contracts only.*

Fixed price block purchases of electricity have been contracted between American Electric Power Service Corporation and Prairieland Energy, Inc. for delivery during fiscal year 2010 as outlined in Table 2 below. All transactions have been reviewed by the *Committee.*

Through December 31, 2009	FY2010

Volumes Committed to Date (kwh)	116,783,000
Block Price for Committed Volumes ($/kwh)[1]	$ .03305 (UIUC) $ .03410 (UIC)

Table 2: Summary of Electricity Procurement Program

1. *Block price is the cost of power only.*

BACKGROUND ON SUPPLIERS

- **Natural Gas Supply –** The forward purchase contracts for natural gas are with Nicor Enerchange, who stands between the University and the originating field suppliers. Nicor Enerchange is contractually responsible for covering damages if it fails to deliver the nominated amount of gas to the University's specified delivery points. Nicor Enerchange is owned by Nicor, Inc.
- **Natural Gas Transportation –** The natural gas is transported between the gas fields and the University by Natural Gas Pipeline Company of America ("NGPL"). NGPL is a subsidiary of Kinder Morgan and owns in whole or in part over 10,000 miles of interstate pipelines. Peoples Gas provides transportation services from the Chicago City Gate to the UIC campus under a contract which expires March 31, 2010.
- **Power Supply –** Fixed price block purchases of electricity are transacted under a Master Power Purchase and Sale Agreement between American Electric Power Service Corp. for fiscal year 2010. AEP owns nearly 38,000 megawatts of generating capacity in the U.S. AEP also owns a 39,000-mile transmission network that includes more than 765 kilovolt extra-high voltage transmission lines.
- **Power Transmission –** Transmission of the contracted block purchases is provided by Ameren IP to the UIUC campus and by Commonwealth Edison to the UIC campus.

FEES

Nicor Enerchange provides the University market advice, transaction execution, analytical and other services under an existing agreement with the University that runs through June 2012. Nicor Enerchange charges the University 2.5¢/MMBTU for providing these services. Beginning with the fiscal year 2013 forward contracts, transactions are executed under an agreement with Prairieland Energy, Inc. The fee for these services decreased to 2.0¢/MMBTU with the fiscal year 2013 transactions.GPL provides natural gas transportation services to the University. NGPL has a variety of charges that typically are in the range of 60¢ to 70¢/MMBTU. The transportations costs charged by Peoples Gas to the Chicago City Gate is approximately 40¢ per/MMBTU.

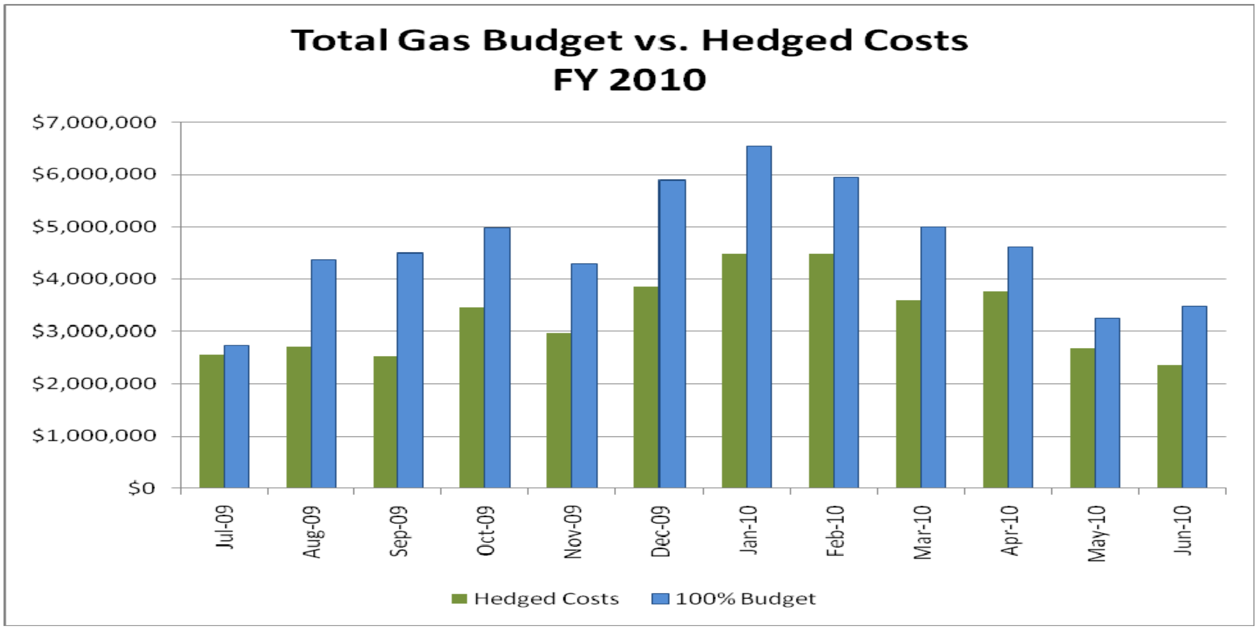
GRAPHICAL ANALYSIS

A graphical analysis of FY10 natural gas activity is attached. FY11-FY13 activity is reported in Table 1 above.

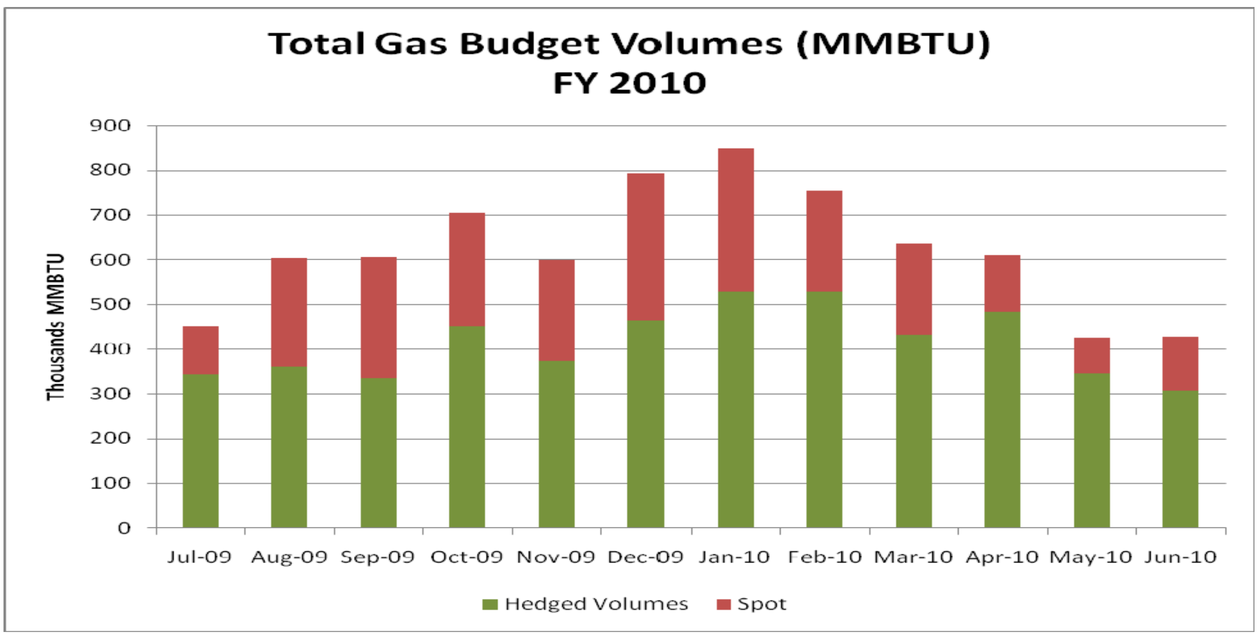
Natural Gas Procurement Program

FY2010 Graphical Analysis

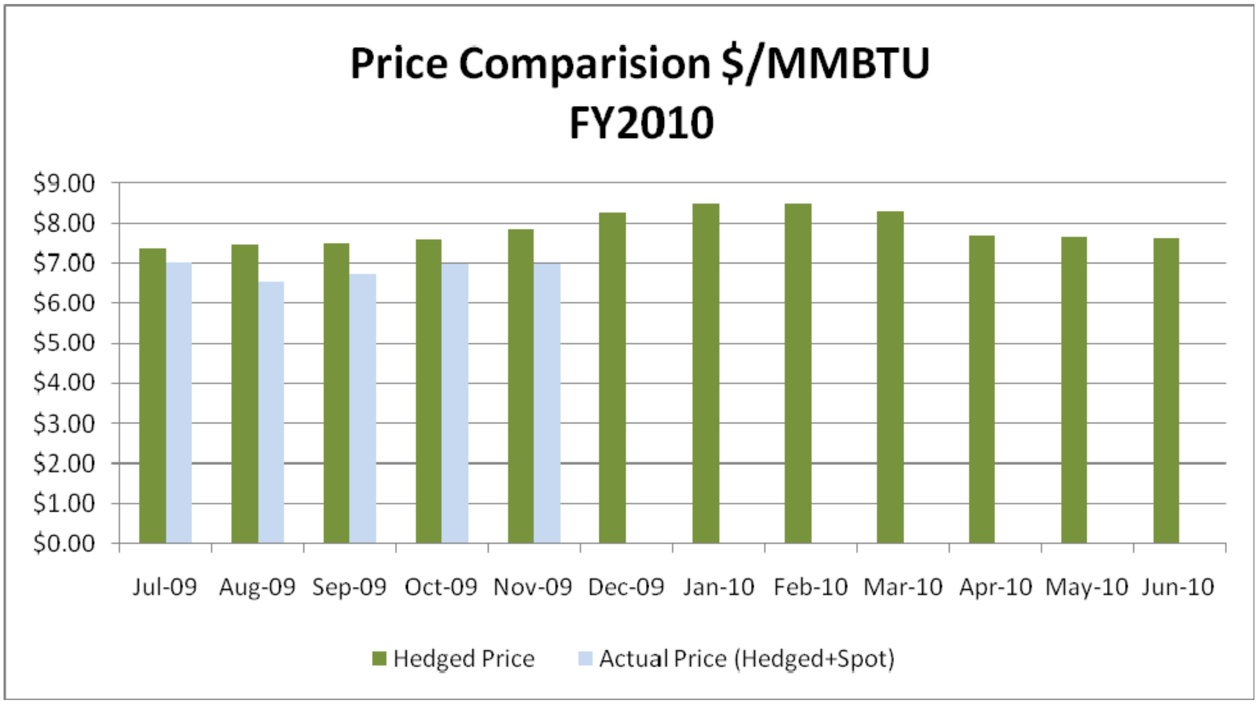
January 21, 2010



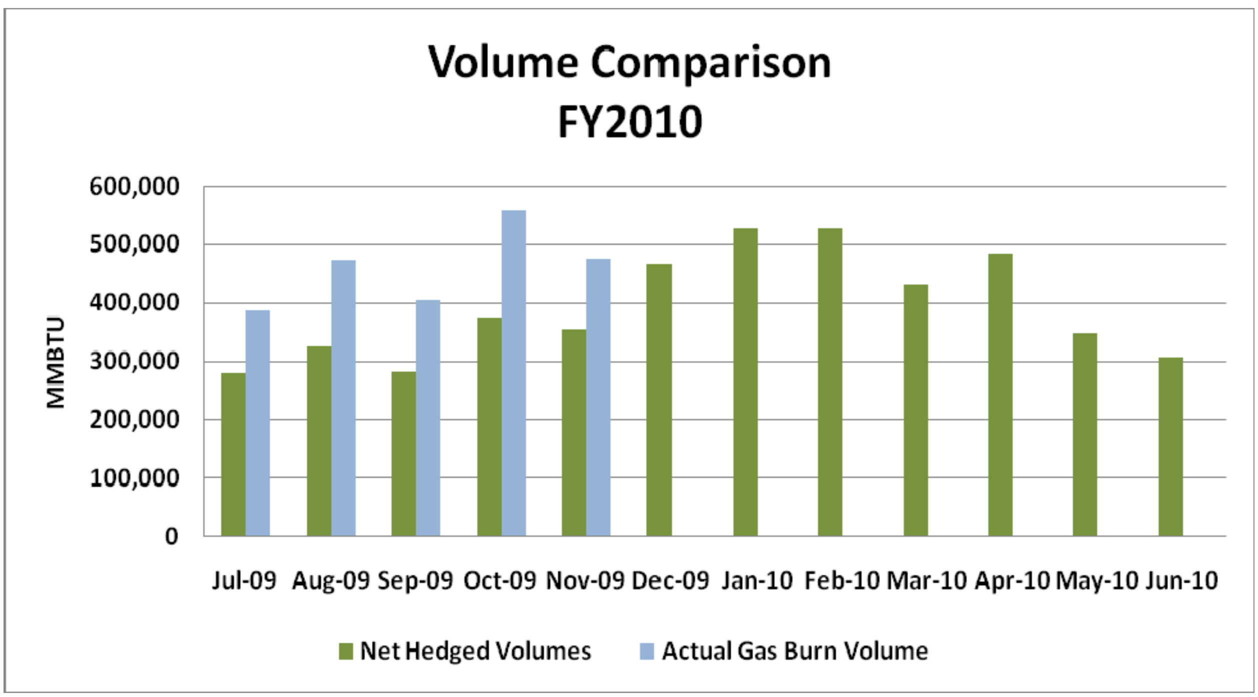
- *100% Budget is defined as all natural gas anticipated to be consumed during each month.*
- *Hedges for 2010 were executed during the time period September 2008 and April 2009 providing a high degree of budget certainty for fiscal year 2010.*



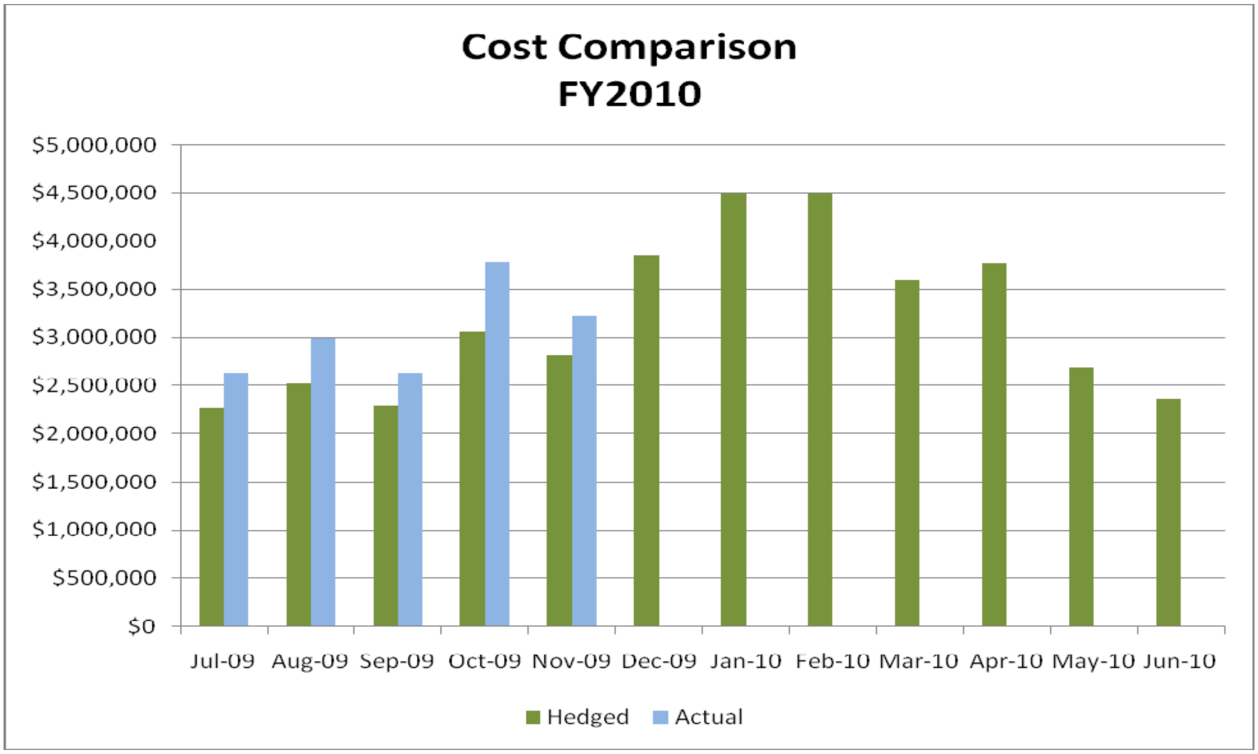
- *Total Gas Budget is defined as all natural gas anticipated to be consumed during each month.*
- *Hedges for 2010 were executed during the time period September 2008 and April 2009 providing committed natural gas prices for the University in time for the development of the plant operating strategies.*



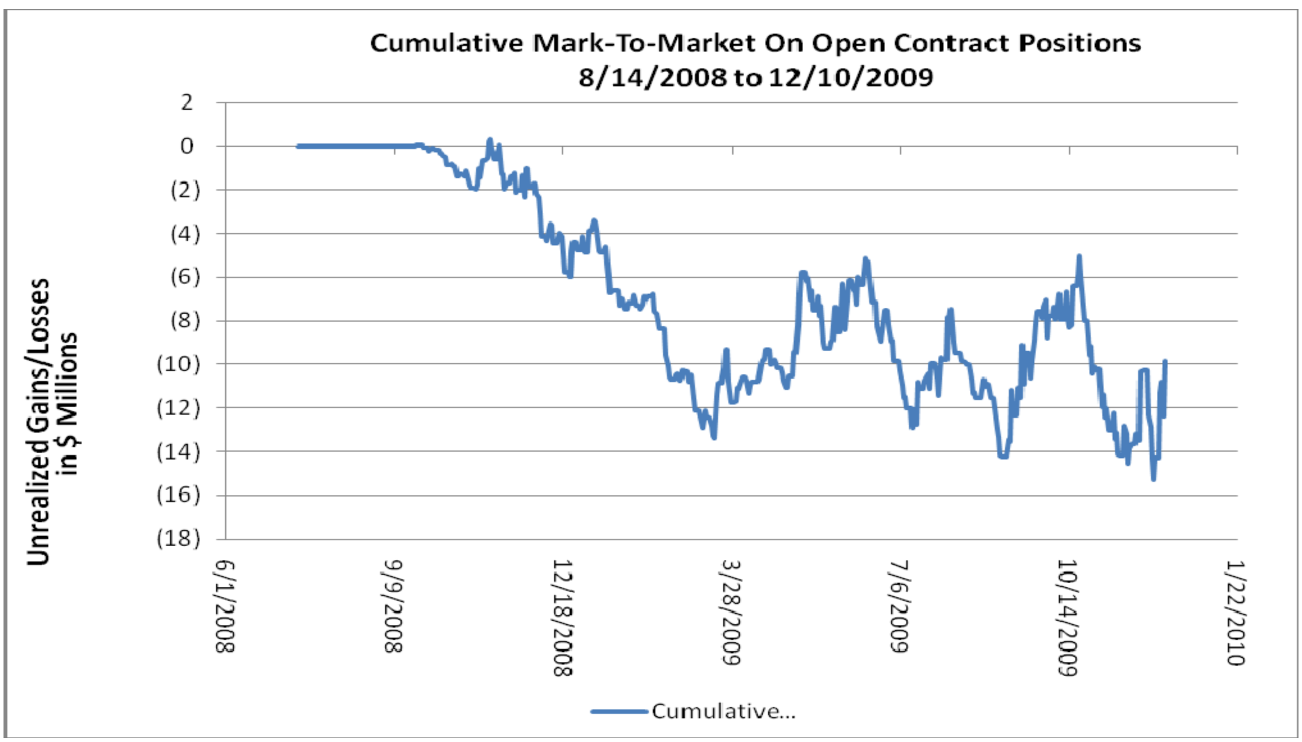
- *Actual price less than hedged price due to daily spot prices being less than hedged price.*



- *Differences between Hedged Volumes and Actual Volumes is a result of purchases made in the spot market to satisfy the remaining natural gas requirements.*



- *Differences between Hedged costs and Actual costs is a result of purchases made in the spot market to satisfy the remaining natural gas requirements.*



- *Mark to Market depicts the unrealized cumulative difference between the market price and the hedge price. The university initiated its hedging program when prices were relatively high versus today's prices.*