STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company,	)	
d/b/a AmerenCILCO	)	05-0160
	)	(cons.)
Central Illinois Public Service Company,	)	05-0161
d/b/a AmerenCIPS	)	
	)	
Illinois Power Company, d/b/a AmerenIP	)	05-0162
	)	
Proposals to implement a competitive	)	
procurement process by establishing	)	
Rider BGS, Rider BGS-L, Rider RTP,	)	
Rider RTP-L, Rider D, and Rider MV.	)	
(Tariffs filed on February 28, 2005)	)	
	)	

REBUTTAL TESTIMONY OF WILLIAM STEINHURST ON BEHALF OF THE CITIZENS UTILITY BOARD

CUB EXHIBIT 4.0

August 10, 2005

REBUTTAL TESTIMONY OF
WILLIAM STEINHURST

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DOCKET NOS. 05-0160, 05-0161, 05-0162
BEFORE THE ILLINOIS COMMERCE COMMISSION
REBUTTAL TESTIMONY OF WILLIAM STEINHURST
ON BEHALF OF THE CITIZENS UTILITY BOARD

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is William Steinhurst, and I am a Senior Consultant with Synapse Energy Economics (Synapse). My business address is 45 State Street, #394, Montpelier, Vermont 05602.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of the Citizens Utility Board (CUB).

Q. ARE YOU THE SAME DR. WILLIAM STEINHURST THAT PREVIOUSLY FILED DIRECT TESTIMONY IN THIS PROCEEDING?

Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to rebut the critiques raised by Illinois Power Company, d/b/a AmerenlP, Central Illinois Public Service Company, d/b/a AmerenCIPS, and Central Illinois Light Company, d/b/a AmerenCILCO (together "Ameren" or “the Companies”) regarding my direct testimony as filed on June 15, 2005, and to restate my specific recommendation to the Illinois Commerce Commission (“ICC or Commission”).

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. The introductory section includes a brief purpose statement, which is followed in Section II by a brief summary of my rebuttal testimony. In Section III, I restate certain issues I raised in my direct testimony and provide an overview of the major issues that Ameren has not addressed in its Illinois Auction Proposal of February 28, 2005 (initial filing) or in its rebuttal testimony, submitted on July 13, 2005. Section IV then restates and clarifies my specific proposal. I next discuss, in Section V, the importance of reviewing procurement results for prudence. Section VI addresses and rebuts additional specific critiques of my direct testimony by Ameren's witnesses, while Section VII discusses other issues including certain modifications proposed by the Companies or Intervenors. Lastly, in Section VIII, I summarize why the Commission should not adopt Ameren's initial or revised proposal and reiterate my support for the auction changes I proposed in my direct testimony.

II. SUMMARY

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Because Ameren's proposed auction procurement and portfolio design depend entirely on the performance of certain wholesale markets that are flawed, the Commission should reject both the initial and revised proposals. Instead, the Commission should recognize that the Companies retain responsibility for making and managing the decisions and actions necessary to serve default service customers and should clarify that the Commission will ensure, as part of its oversight responsibility, that the Companies have done so in a manner that best serves default service customers.

In the alternative, if the Commission wishes to entertain the concept of pre-approving a portfolio design or procurement method, it should open a proceeding for the purpose of exploring alternatives to Ameren's proposal. Such a proceeding (which I will refer to below as a "procurement docket") would seek improved portfolio designs and procurement management approaches that might be considered for the future, when and if electric markets can be demonstrated to be competitive. In such a proceeding, the Companies should be required to fully and fairly evaluate a range of portfolio designs and procurement methods and present analysis comparing their costs and risks.

Because the relevant wholesale electricity markets are currently significantly flawed, because default service customers would face substantial and unwarranted risks in the proposed flash cut to auction procurement, and because the Companies should not be absolved of the duty to procure the best possible result for default service customers (especially in light of the open issues on past actions regarding divestiture), my primary recommendation continues to be that the Companies remain responsible for meeting those needs using a soundly designed and actively managed resource portfolio.

However, should the Commission decide to approve some form of auction-based procurement approach at this time, I recommend that the Commission order the changes to the auction and portfolio design as explained in my direct testimony in this proceeding and certain other modifications discussed below in response to Intervenor Direct and Ameren Rebuttal testimony.

III. OVERVIEW OF ISSUES AND RESTATEMENT

Q. WHAT ISSUES DO YOU ADDRESS IN THIS SECTION OF YOUR TESTIMONY?

A. I discuss the following points:

1) Due to the nature of Ameren's filing in this proceeding, the Commission does not have before it a procurement docket that allows for consideration of all the alternatives, nor does the Commission have the information required for it to make a reasonably well-informed decision about how to proceed. As a result, the Commission has little choice but to reject Ameren's proposal;

2) Whatever their reasons, the Companies have sought approval of a particular procurement method and permission to virtually automatically flow through the costs resulting from that procurement, effectively side-stepping the possibility of a prudence review of certain past actions regarding divestiture taken after passage of Illinois' Electric Service Customer Choice and Rate Relief Law of 1997 (220 ILCS 5/16-101, the Restructuring Law);

3) Why the Commission should be concerned about the competitiveness of those wholesale electric markets on which Ameren's proposed auction would rely; and

4) A few of Ameren’s mischaracterizations of my previously filed direct testimony.

Q. THE FIRST ISSUE YOU MENTIONED IS THE ABSENCE OF A “PROCUREMENT DOCKET.” WHAT DO YOU MEAN BY “PROCUREMENT DOCKET?”

A. Broadly speaking, I mean formal review of the broad range of portfolio design and product procurement options for default service provision that the Commission should consider as Illinois steps out from the transition period.

Q. IS A PROCUREMENT DOCKET RELEVANT AND NEEDED AT THIS TIME?

A. Not necessarily. If the Commission adopts my recommendation that the Companies retain responsibility for default service portfolio design and procurement, subject to Commission oversight, a procurement docket would not be essential. In the alternative, if the Commission were to entertain the concept of pre-approving some specific portfolio design or procurement method, such a proceeding should be conducted.

As I discuss in detail below (and subject to a reservation explained at that place in this testimony), the Procurement Working Group (PWG) of the Commission's Post-2006 Initiative focused on quite a number of alternative procurement scenarios. At one point in that consideration, a list of 18 suggested characteristics of supposed "ideal" procurement processes was presented. Contrary to suggestions by Ameren in its rebuttal testimony,[1] the PWG did not reach consensus about the desirability of any specific procurement mechanism, much less a determination that one was "ideal." As Staff stated in their report, "In the end, the group chose not to recommend a specific procurement strategy." *See* http://www.icc.illinois.gov/ec/docs/041203ecPostRptFinal.pdf.

Given the absence of or, at least, limits to consensus in the PWG, the Commission and the public deserve an opportunity to fully explore a range of options for portfolio design and procurement. Should the Commission wish to consider pre-approving a portfolio design or procurement method, a procurement docket would, at least, afford all participants an appropriate forum in which to address unanswered questions about how well different alternatives can be expected to serve the public interest. It also would allow the Commission to make such a monumental decision based on a complete record of evidence.

Q. WHAT DID AMEREN ACTUALLY SUBMIT IN ITS INITIAL FILING?

A. Ameren filed for approval of a single, narrowly-defined option—a vertical full-requirements descending clock auction. Ameren presented only that one option and has not shown that this is the best option. For example, Ameren has not addressed the balance between price and volatility in its product selection as recommended by witness Salgo, nor has it analyzed the effect of procurement methods on default

[1] For example, Ameren (Ex. 12.0, Blessing, lines 712-3) "Among other things, the Ameren Companies considered the consensus opinions of the ICC's Post 2006 Initiative Procurement Working Group (PWG)."

service consumers other than its favored, once-a-year auction. *See generally*, AG Ex. 2.0.

Q. PLEASE EXPLAIN THE IMPACT OF THAT NARROW FILING ON THE PRESENT PROCEEDING.

A. Because only that narrow proposal is before it, the Commission is hampered in carrying out the kind of review that is needed and appropriate at this transition point. The present docket, as it has been framed, does not provide an opportunity to examine fully the options open to the Commission. If, on the one hand, the Companies had filed for post-transition period rate changes with cost of service justification, as contemplated by the Restructuring Law, the Commission and intervenors could have reviewed those costs and the actions leading up to the need for them to see if they constituted a just and reasonable result. That review could have included a full prudence review.

Alternatively, the Commission could have been presented with a full exploration of the range of options for procuring resources to serve default service customers, comparing them objectively in terms of their impact on the costs and risks. Such a proceeding could have allowed a reasoned determination of which approach would best satisfy the needs of ratepayers and other parties. With Ameren's filing restricted to a single, specific approach, the Commission simply does not have the information required for it to make a reasonably well-informed decision about how to proceed.

Q. WHAT IS THE SECOND CONCERN YOU WOULD LIKE TO DISCUSS IN THIS SECTION OF YOUR TESTIMONY?

A. In its proposal, Ameren seeks to justify its urgent demand for process pre-approval and relieve itself of responsibility for the results of portfolio management or procurement by the fact that it no longer owns generation (except via unregulated affiliates). Illinois law, however, *allowed* divestiture. It did not mandate it. It is my understanding that only limited review of those transactions has taken place.

Q. TO PROVIDE CONTEXT FOR THIS DISCUSSION, PLEASE EXPLAIN YOUR UNDERSTANDING OF THE CONCEPT OF PRUDENCE AS IT IS GENERALLY APPLIED IN UTILITY RATEMAKING.

A. Prudence is a widely acknowledged concept used for judging the actions of a utility for the purpose of determining whether costs resulting from those actions should or should not be included in retail rates.

Q. PLEASE EXPLAIN FURTHER YOUR UNDERSTANDING OF HOW THAT STANDARD IS GENERALLY APPLIED IN UTILITY RATE MAKING.

A. The prudence standard is commonly used in regulatory reviews of the management of assets and expenditure of funds for public utility purposes. This standard is based on judgments concerning how reasonable persons, with the skill and knowledge attributed to reasonable utility managers, should have been expected to cope with the circumstances and problems confronting them, taking into account their obligation to provide least cost service to consumers. This standard also requires that the utility's decisions and actions be evaluated in light of the information that it had or should have had during the pertinent time frame. Information that is available only through hindsight is given no weight.

Q. AS YOU UNDERSTAND ITS GENERAL APPLICATION IN UTILITY RATEMAKING, HOW IS A PRUDENCE REVIEW NORMALLY CARRIED OUT IN UTILITY RATE MAKING AND HOW DOES THE PRESENT PROCEEDING DIFFER FROM THAT NORM?

A. The typical approach to implementing the prudence standard in utility regulation is through rate cases. I will briefly describe my understanding of the typical practice followed in such cases. Generally, a utility seeking recovery of costs, such as power procurement costs, through retail rates presents evidence of those costs in a rate filing. The utility is usually accorded a rebuttable presumption that its costs are prudent, but that presumption disappears when parties challenge a cost. The utility then bears the burden of producing evidence to support the prudence of its actions leading to the disputed costs, and the Commission renders a decision as to whether those costs were prudently incurred.

Because of the unusual nature of this case as filed by the Companies, Ameren has left no room in this proceeding for such a review now or, apparently, forever. Specifically, since this is not a rate case proceeding, no particular cost of service evidence has been filed. There is no opportunity now for the Commission or interveners to examine any actions of the Companies that may have led to incurring costs (past, present or future) affecting default service rates. At the same time, Ameren's proposed auction approval would appear calculated to preclude any such review in the future. In this landmark policy proceeding, should the Commission blithely grant approvals that could effectively eliminate such an important consumer protection and potentially give a permanent "pass" to what may have been some of the most influential resource decisions ever made by Ameren's management, I believe that the Commission would be misrepresenting consumer interests.

Q. IN YOUR EXPERIENCE, WHAT KIND OF ISSUES ARE TYPICALLY MATTERS OF CONCERN IN SUCH A PRUDENCE INVESTIGATION SUCH AS ONE THAT MIGHT BE UNDERTAKEN CONCERNING AMEREN'S DIVESTITURE ACTIONS?

A. It is not possible to identify all such issues in the abstract. Identification of prudence concerns is generally based on the utility's specific costs and a review of particular actions leading to those costs, along with related documentation.

Taking Ameren's decisions to divest itself of its generation resources following adoption of the Restructuring Law as one example, it is clear that whatever costs are incurred to serve default service load post-2006 will have been determined, at least in part, by Ameren's divestiture decisions. Hence, a few of the likely prudence-related questions that could arise include, but would not be limited to: What did Ameren's management know about potential future costs of power from those divested plants? How did Ameren manage the divestiture process, including what kinds of purchasers (such as non-affiliates) were considered and how was that consideration carried out? What evidence did Ameren have or should Ameren have had about how divestiture was likely to affect customers and shareholders? In addition, questions likely would arise regarding the terms and conditions set for any divestiture and the manner in which the divestiture was actually implemented.

As I mentioned above, the Restructuring Law provides for the filing of a rate case at the end of the transition period if there were a need for an increase, as well as standards for review of such a case. Under a traditional procurement methodology and ratemaking practice, such a rate case would have been an opportunity for a prudence review. As things have played out, Ameren didn't file for a rate increase, but rather filed this narrow auction case that includes no place in it for any review of any past actions. This creates at least the perception that Ameren wishes to avoid that type of review. It would be wrong to permit such a huge management decision to avoid proper scrutiny in this way. Such a review is needed to determine if default service rates will be just and reasonable.

Q. DO YOU HAVE ANY FURTHER CONCERNS ABOUT AMEREN'S REBUTTAL ON THE ISSUE OF PRUDENCE REVIEW?

A. Yes. I am concerned that witness Nelson's testimony mischaracterizes my testimony and presents an inappropriate picture of the traditional prudence standard.

Q. WHAT DOES NELSON'S TESTIMONY HAVE TO SAY ABOUT AMEREN'S PROPOSED AUCTIONS AND PROPOSED TREATMENT OF PRUDENCE?

A. As I explained above, the Companies seek Commission approval for a process where the auction results "would be presumed prudent and their full costs would be recovered in rates as long as the procurement process was followed." Ameren Ex. 10.0 at lines 531-34. He also mentions the possibility of "unambiguous evidence that the auction outcome has been manipulated," a standard I believe would be most extraordinarily difficult to meet. *Id.* at lines 541-42.

Q. WHAT ELSE DOES HE HAVE TO SAY ABOUT PRUDENCE?

A. Witness Nelson claims to "agree" with my recommendations regarding prudence review of the Companies' procurement results, but he is "agreeing" with a revision of my recommendation that has been distorted beyond recognition. He "agrees" with my recommendation only on the condition that it is modified to be the same as the Companies' proposal. *See*, Ameren Ex. 10.0 at lines 551-86. Witness Nelson has not rebutted my argument, but merely substituted his own wishes for my recommendation. I unequivocally reject his redefinition of my recommendation and reiterate my original position.

Q. WHAT IS THE THIRD ISSUE YOU WANT TO ADDRESS?

A. In its initial and rebuttal testimony, Ameren implies that the process for determining how it should procure power post-2006 is heavily constrained by the fact of its prior decision to divest. In other words, Ameren claims to be helpless to fulfill its duty as default service provider in any way other than to be a price taker in the regional wholesale markets and asserts that its proposed auction is the best way to do so. In so arguing, Ameren misrepresents both the breadth of procurement options open to it, as well as the considerable flexibility given to it under Illinois's restructuring legislation. It is my understanding that Ameren continues to have all the flexibility it always did in choosing resources and procurement methods, plus additional, new flexibility in how it runs its business.

Ameren, in effect, asks the Commission to unilaterally reduce its oversight role by eliminating much of its ability to protect consumers. The Commission, however, is still responsible for oversight and for ensuring that Companies are delivering default service at just and reasonable rates.

My testimony simply calls for the Commission to reject Ameren's proposal, to open an investigation of the full range of procurement options for default service, and to affirm that, regardless of which procurement method is employed, retail rates remain subject to traditional regulatory standards of justness and reasonableness, which entail a prudence review of Ameren's decisions. It is important to note that nothing in my recommendation is outside of the Commission's jurisdiction or undoes retail competition in Illinois.

Q. WHAT IS THE FOURTH ISSUE YOU WANT TO ADDRESS?

A. Ameren's rebuttal testimony argues that the wholesale market flaws documented in the direct testimony of witnesses Fagan and Rose, and referenced by my direct testimony, are irrelevant to the Commission's task in this proceeding. Ameren's argument rests on two facts: it does not own any generation, and its existing contracts to supply default service consumers expire after 2006. Ameren interprets these two facts to mean that it has no recourse in the procurement of power to serve default service customers other than to reflect and flow through to default service consumers the price effects of any imperfections in the wholesale power market. *See*, Ameren Ex. 10.0, at line 741 ff. As I will explain below, this is not true. Further, the portfolio design and procurement method proposed by Ameren not only passes through to default service consumers all costs and risks of that procurement, but actually exacerbates some of those risks by placing all of the default service load on single-product, single-date auctions.

I also note that witness Nelson mischaracterizes my recommendation. He asserts that I recommend that the Companies conduct an RFP procurement. He then asserts that this recommendation is inconsistent with CUB's contention that the "Illinois market cannot fully support the auction," and that this supposed inconsistency is a "fatal flaw." *See id*. First, I do not recommend that the Companies rely on an RFP, much less one that merely "relies on the very same wholesale market." *Id*. Rather, I recommend that the Companies retain responsibility for procurement subject to Commission oversight and rate review, and only identify RFPs as one option the Companies could choose from. Second, there is no singular market that the Companies need rely on in their procurement. They can seek various products in various ways to minimize or avoid the impacts of market shortcomings. Thus, there is no inconsistency in my recommendation.

There also is a bigger question facing regulators here. Witnesses Fagan and Rose make a compelling case that there exists a potential for serious market power problems in the wholesale electric markets, and Ameren has failed to clearly demonstrate that these problems don't exist. Until the wholesale market exhibits that it *actually* is competitive, it would be arguably imprudent to rely upon it for such a large procurement.

Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF AMEREN'S ARGUMENT.

A. The basis of Ameren's argument stems from the following quote:

> The Ameren Companies do not own the generation capacity needed to provide BGS to their retail customers. Accordingly, they need to go to the market to procure these supplies. When they do so, they will pay the market price. That market price then will become part of their costs for supplying this service. So any "alternative, cost-based approach" that is employed by the Ameren Companies in fact will involve their, and therefore their retail customers via the regulatory process, paying the market price for the bulk power that is procured. As a result, the Ameren Companies will end up paying the market-price whether their CPA proposal is accepted or whether some now undefined "alternative, cost- based approach" is used.

Ameren Ex. 13.0 at lines 437-45.

Leaping from this statement, Ameren seeks to convince the Commission not only that the Commission is without recourse against the power of the markets, but also that we should not worry about any flaws in those markets. Neither of those inferences is valid.

Ameren maintains it cannot procure power for less than the wholesale market forward price of power, because all power will be procured directly or indirectly from the wholesale market, or priced in reference to trades in that market.

This statement is patently wrong. Clearly, prudent utilities have relied on a wide range of products, term lengths, and procurement methods to manage risk and cost. Few, if any, have had the temerity to place their entire resource portfolio in a "blind trust."

Witness LaCasse also states that the Auction Process "is the best procurement process for customers *whatever the state of the wholesale markets*. If there is a problem with the wholesale markets, that problem must be fixed directly and cannot be fixed by Ameren's choice of procurement mechanism." Ameren Ex. 12.0 at lines 489-90 (emphasis added).

It is true that the wholesale markets exist as backdrop to whatever other resource procurement strategies might be selected. However, it does not follow that buyers are helpless in the face of those markets.

Q. WHAT IS THE PROBLEM WITH AMEREN'S LINE OF REASONING?

A. Despite inapt criticisms leveled in Ameren's rebuttal testimony, the direct testimony of intervenor witnesses Fagan and Rose, as well as witness Fagan's rebuttal testimony, show that there are good reasons to be concerned about the wholesale electric markets and the limited measures that are in place to mitigate market power, systems on which the proposed auction would depend.

The potential bidders in Ameren's proposed one-product, one-time auctions have to get their power from somewhere (unless they are themselves the generation owners who *have* market power) and that somewhere is a set of wholesale markets that cannot be cleared of the threat of abuse. As witness Fagan states:

> Immature MISO markets and the presence of a market "seam" between the Northern Illinois and Central and Southern Illinois regions will result in less than fully competitive wholesale markets in Illinois. The proposed Ameren BGS competitive procurement auction can only be successful if the foundation of a fully competitive wholesale market exists. Thus, even if a superior auction mechanism was devised, until the regional wholesale markets are competitive it is likely that resulting prices to consumers will be higher than necessary.

CUB Ex. 1.0, at lines 393-99.

Second, it is my understanding that the Companies, like any other public utility, have an obligation to procure power for its customers (in this case, its default service customers) at reasonable rates. If the wholesale market is not competitive, Ameren should act, to the extent possible, to protect consumers from those flaws, not simply to ignore them. Assuming away the flaws in the wholesale market, as Ameren suggests, is an abdication of this responsibility. The Commission should not simply relieve Ameren of that responsibility in the face of serious market challenges. The magnitude of the potential rate increases that might occur is big enough to warrant calling forth every possible resource to manage this risk. The Commission should require Ameren to protect consumers from risks associated with uncompetitive wholesale markets.

Q. WHY SHOULD THE COMMISSION BELIEVE THAT AMEREN COULD OBTAIN A BETTER RESULT FOR DEFAULT SERVICE CUSTOMERS VIA AN ACTIVELY MANAGED PORTFOLIO DESIGN AND PROCUREMENT STRATEGY THAN THOSE CUSTOMERS WOULD SEE FROM THE PROPOSED AUCTION? WOULDN'T CONSUMERS WIND UP NO BETTER OFF SINCE AMEREN WOULD JUST HAVE TO BUY THE SAME PRODUCTS FROM THE SAME FLAWED MARKETS?

A. Actually, Ameren would not be so constrained. There are many products that Ameren can combine into an actively managed portfolio design. Remember, Ameren's proposed portfolio design (aside from transient startup differences, a ladder of 3-year fixed-price full requirements contracts, procured using a single methodology, on one day each year) represents only one small selection from that array of possibilities.

For example, in terms of power and energy, just a few of the products that should be evaluated to determine how their costs and risk profiles would affect default service rates include:

- Standard wholesale electric power market forward contracts of various term lengths from a month to a number of years and a wide range of starting dates;
- Spot purchases;
- Bilateral negotiated contracts of varied terms, sizes or start dates;
- Unit-specific power contracts with owners of existing units;
- Non-unit-specific power contracts with owners of groups of existing units;
- Residual load following contracts;
- Options to buy (or sell) power at various prices at various times;
- At-cost, fixed price, turn-key or other types of arrangements for power from new or existing units at various locations.[2]

In addition, non-power contract products that could be included in portfolios include weather and fuel price futures contracts or options.

A diverse portfolio of resources, actively managed for the benefit of default service customers, could obtain benefits for consumers despite the abrupt end of the transition period and the ongoing uncertainties about wholesale markets' flaws, including potential exercise of wholesale market power. One reason for this is that, as the purchaser of power for default service customers, Ameren would have significant bargaining power and could bring discipline to the wholesale markets. Choosing a diverse portfolio of resources, actively managed for the benefit of default service customers would allow Ameren to pick and choose among offers of different types, opt for short-term or open positions if markets don't produce reasonable results, or fall back on any or all of the many other product choices listed above, all in an infinite range of combinations driven by the actual offers available.

[2] Strategic choice of location for new units can create significant savings for a utility's distribution costs. These savings include reduced line losses, especially on peak, and avoided or deferred transmission and distribution upgrades. Ameren's proposed procurement methods place *no* value on such savings, a serious omission. It might be argued the locational marginal pricing policies of MISO would provide incentives for the location of new generation in the best places to produce such savings as a by-product, but even if that is true, there is no justification for Ameren to arbitrarily ignore one class of costs born by its customers in choosing the procurement method by which it incurs a second class of costs.

One great advantage of a diverse, actively managed portfolio is that it can be readily adapted to cope with changes in markets, both supply and demand. Ameren proposes to deprive default service customers of any such benefits, simply so it can avoid the responsibility for making portfolio design and management decisions, tasks that it once routinely performed and that its affiliates routinely perform today (albeit not for the benefit of ratepayers), and by commodity managers for all sorts of businesses.

I would also point out that Ameren's proposal makes no particular effort to mitigate the risks inherent in the startup of its proposed portfolio design; the most risky time in the life cycle of its proposed portfolio is the day of the first proposed auction when 100% of the default service load is exposed to the markets, which markets have had the least time to mature. Even if it were true that Ameren's ongoing portfolio design presented a reasonable risk profile, due to laddering, that is certainly *not* true on day one of the first auction.

Moreover, announcing in advance that all purchases will be made from a flawed market using a mechanistic process may make it easier and more profitable for suppliers with market power to drive up prices, because the procurement would occur at a single, annual event. This also makes the procurement more vulnerable to external events that affect markets. Plus, under its proposed procurement method, Ameren has no incentive to vigorously protect consumers, since the automatic pass through of costs ensures that it will recover whatever suppliers charge.

If a diverse portfolio of resources were used and was actively managed to obtain the best result for the benefit of default service customers under Commission oversight, Ameren would have to face up to the realities of market power. However, it would then have a greater incentive to advocate for curbing that power and finding ways to circumvent it.

Q. WHAT DO YOU MEAN BY REDUCING PORTFOLIO RISK, AND WHAT ARE SOME WAYS TO DO IT?

A. I mean balancing the overall risks of portfolio of resources as a whole. Some of these include supplier default, fuel price and availability risk, delivery risks, regulatory and environmental compliance risk, unit outages, and price volatility. These risks exist for each component of a given portfolio. The portfolio risk is the overall level of these risks in the portfolio as a whole. It can be less than the risks inherent in the individual portfolio components, since carefully chosen components may have diversified or offsetting risk profiles.

Many consumers, especially small consumers with few opportunities to shop, value low risk resources. In my opinion, residential electricity consumers as a whole and many small commercial electricity consumers have a strong preference for portfolios with a low risk of price swings, particularly very large price swings. Increasing the variety of products and portfolio options being considered is one way to deliver this preferred outcome to those smallest consumers. I would observe that the proposed auction subjects those customers to a resource mix that is diversified in only two of all the possible ways: use of tranche product contracts that represent delivery promises by (presumably) a variety of vendors, and procuring only a fraction of required power annually. Of course, only the former delivers real diversification in the first auction.

Another way to reduce resource selection and procurement risk would be to obtain the widest possible critical assessment of the level of risk in a candidate portfolio and make judicious decisions about those risks and the accompanying prices before committing to them. Ameren has not presented an objective analysis of the risks and the price-risk trade-offs in its proposed portfolio design and procurement method. In addition, Ameren has proposed a review process that does not allow the Commission a reasonable opportunity to do such a review, and also precludes input from any other party.

Q. HOW CAN A DIVERSE PORTFOLIO OF RESOURCES, ACTIVELY MANAGED FOR THE BENEFIT OF DEFAULT SERVICE CUSTOMERS, PROVIDE GREATER BENEFITS AS COMPARED TO THE PROPOSED AUCTION?

A. Despite suggestion to the contrary, obtaining a managed portfolio priced below the limited products on which the proposed auction would rely may well be possible through careful design and procurement and would not require generators to sell "at a price below their view of the market value of their resources." Ameren Ex. 10.0 at lines 763-64. It is true that any wholesale supplier will weigh the benefit of selling power to Ameren against its opportunity cost—that is, the amount that it can receive for the same product elsewhere. However, what Ameren's witnesses miss or gloss over is that the opportunity cost is not strictly selling to Ameren versus selling the identical product into "the market."

"The market" is a vague term. There are three markets run by MISO. More importantly, there is extensive bilateral forward electric energy trading, as well as other electricity, natural gas, weather, and other forward contracts and options bought and sold for a wide variety of term lengths and starting dates. There are more informal arrangements where buyers and sellers negotiate bilateral arrangements that provide various kinds of non-price benefits in return for lower prices. One example is a unit-specific contract. Such contracts are of great interest to generation owners who may offer attractive terms and prices to buyers willing to consider such a contract.

At times, there also may be sellers with excess generation not committed to a firm buyer; such a seller may value a firm sale and be willing to trade uncertain future revenue for a fixed lower price. In addition, it is my understanding that nothing in the Restructuring Law prohibits Ameren from building generation as an "above the line" regulated investment if that were less expensive than market prices, and Ameren is certainly able to negotiate turn-key type unit contracts with potential builders on whatever terms seem advantageous to the Companies.

Ameren's proposed auction products have strictly defined contract lengths, firmness, type of service (i.e., energy, capacity, ancillary services), and start dates, among other things. In contrast, diversified, actively managed procurement would allow flexibility in procurement decisions and negotiations. If properly managed and utilized, this flexibility can provide benefits that would not be possible under rigid auction rules, by allowing both the buyer and the seller to exchange non-monetary benefits.[3] The full range of opportunities and benefits to the supplier—including non-monetary benefits, such as a stable income stream, the value of a business

[3] While it might be argued that Ameren could use such "flexibility" in procurement and negotiations to benefit its affiliate which is a dominant supplier, suitable affiliate transaction protections could be crafted. Customers should not be asked to suffer because of the Companies' actions.

relationship, or any aspect of the transaction that has value to the supplier and lead it to reduce the price vis-à-vis an alternative—must be considered for this comparison.

Thus, there is reason to believe that a soundly designed and actively managed portfolio for the benefit of default service customers can be an improvement in risk, price, or both compared to Ameren's proposed one-product, one-day-a-year auction.

Q. IS THERE REASON TO BELIEVE THAT AMEREN IS CAPABLE OF ACTIVELY MANAGING A PORTFOLIO?

A. Yes, I believe there is.

Dr. LaCasse maintains that

> when the portfolio management service is in the hands of the competitive market, as it is in the Auction Process proposed by Ameren, the competitive suppliers are the ones who will decide how efficient it is to leave some of the position open. The competitive suppliers will factor any such advantages directly into their bids. Customers will get the benefit of such cost minimizing strategies, and they will get this benefit at a fixed price.

Ameren Ex. 12.0 at lines 402-08. Further, Dr. LaCasse claims that

> the full-requirements product ensures that competitive discipline is brought to bear on the cost of managing the supply portfolio and its price risks.

Id. at lines 420-22. From this, she argues that a supply portfolio managed by Ameren and subject to Commission oversight could not produce greater benefits for consumers than the proposed auction. For example, Dr. LaCasse states that

> [T]he Auction Process is designed to harness the competition for the supply of the portfolio management service and to bring the benefits of the competition that exists in wholesale market to the retail customers

Id. at lines 486-89. Dr. LaCasse also states that

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corporate structure.

> the selection of another procurement method such as utility portfolio management can, however, reduce benefits to customers by failing to harness the competitive pressure for the supply the portfolio management service….

Id. at lines 453-56. However, as I explained above, in an effort to reduce risk, Ameren can further diversify its default service portfolio, use its special financial advantages, and use its purchasing power to reduce price. While Ameren might reply that it no longer has that expertise in house, there is no reason to think that Ameren cannot obtain this skill any time it chooses.

It is also worth keeping in mind that Ameren, as a buyer, could optimize its portfolio with a different objective (protecting customer interests and risk preferences) than suppliers that will optimize based upon their own risk preferences, creating yet more room for mutually beneficial savings.

Q. DO YOU AGREE THAT THE SELECTION OF ANOTHER PROCUREMENT METHOD WOULD NECESSARILY REDUCE BENEFITS RELATIVE TO THE AUCTION?

A. No. It may be true that in an auction like that proposed, competition among the bidders will discipline *auction participants* to manage their portfolios. However, Ameren has certain advantages itself. Among these are experience, access to the best information about customers and their requirements, ongoing real time data collection, and potentially lower equity return requirements and debt rates. In any event, further diversifying the default service portfolio beyond mechanical laddering at pre-selected term lengths should provide additional benefits.

Lastly, LaCasse's argument implies that Ameren would have less incentive to manage its portfolio under my recommended approach than auction participants would have under Ameren's proposal. This is not necessarily the case.

Incorporation of prudence review and other ratemaking practices into the procurement process would give Ameren an incentive to better design and manage its portfolio. If, as I propose, Ameren were responsible for conducting a sound procurement that balances risk and price from a consumer perspective and were subject to traditional rate review for cost recovery, it would certainly have an incentive to do a good job.

Let us examine how each entity would fare if they did not maximize efficiency and cost savings. Auction participants who didn't bid low enough to win tranches might lose the opportunity to sell into the auction, but would see no actual loss other than the time and money it cost them to participate. Also, auction participants who are generation owners could sell into the wholesale markets if they did not win in the auction (and, perhaps, exercise market power in doing so). Those auction participants who are financial players could simply refrain from locking in the contracts and hedges that they would have executed if they had won. On the other hand, if my proposal were adopted and if Ameren did a poor job at portfolio design and procurement, any disallowance would leave Ameren without full cost recovery. Clearly, this is a powerful incentive for Ameren to prudently manage its portfolio.

In addition, a traditional rate review would provide a level of transparency and ratepayer confidence that cannot be assured from Ameren's auction proposal. Transparency is widely touted as an important element of competition and economic efficiency. In my opinion, Ameren's auction proposal provides little or no transparency to consumers, despite witness Nelson's claim that "the auction process is not a 'big black box' in which a generation rate is produced." Ameren Ex. 10.0 at lines 456-57. In actuality, that is exactly what it is. The parties left to pay the produced generation rate have no input whatsoever in whether or not Ameren's proposed auction process produces prudent results. Ameren masks this reality, by continuing to state that consumers are told of the process ahead of the fact and that Ameren shares the following information with them:

> • The process by which bidders will be selected;
> • The process by which the bidders will submit bids and prices will fall;
> • The process by which the final auction prices are determined;
> • The final auction prices;
> • The process by which the retail rates are determined by the final auction prices (*i.e.,* the rate translation prism); and
> • The final rates.

Ameren Ex. 10.0 at lines 466-73. However, it's one thing to be told that a process exists. It's another thing to be able to examine the results of the process to determine if that's the best process to use.

Given these concerns, a diversified, actively managed portfolio could produce a better outcome than a rigid, fixed product auction; there is no reason simply to assume that the benefits of competitive discipline would outweigh the benefits of portfolio management.

Q. HAS THE APPROACH OF DIVERSIFIED, ACTIVELY MANAGED PORTFOLIO BEEN USED IN ILLINOIS OR IN OTHER JURISDICTIONS?

A. Absolutely. In fact it is the norm, while rigid auction procurement is the rare exception. Diversified, actively managed portfolio procurement has a long history in many jurisdictions, and certainly it has a greater track record than the auction proposal.

Only one state uses an auction to procure supply for its non-shopping load. New Jersey has carried out a series of such auctions, but there are critical differences between the state of the market in New Jersey when the BGS auctions began in 2001, almost four years after PJM opened its first bid-based energy market,[4] and the fragmented, in-flux, and barely-established wholesale markets in Illinois. Witness Fagan discusses these issues in his direct and rebuttal testimony. Several other jurisdictions in the Mid-Atlantic region of PJM have begun to use RFP procurement, but even here there is typically more diversification than Ameren proposes, including at least multiple procurement dates each year.

Auctions have produced both favorable and unfavorable retail outcomes in the PJM region: in Washington DC, the 2004 RFP for 2005 rates resulted in a BGS-FP-equivalent rate of 5.9 cents per kWh. This represents a large increase (approximately 2 cents/kWh or about 50%) over DC's previous rate. A similar jump occurred in Maryland; 2004 generation rates were approximately 1.7 cents/kWh higher than in 2003. Maine is no exception. The 2004 ME RFP process for the procurement of BGS-FP-equivalent service resulted in 2005 prices of 6.95 and 7.0 cents/kWh. This

[4] This market opened on April 1, 1997 (http://www.pjm.com/about/overview.html)

represents an approximate two-cent or about 40% jump relative to the last RFP held in 2002. The 2005 NJ BGS auction resulted in a 22% increase in supplier contracts (resulting rates were only 5% higher due to laddering).

Q. BY PRESENTING THE INFORMATION ABOUT ELECTRICITY PRICE INCREASES, DO YOU SUGGEST THAT THESE INCREASES RESULTED FROM MARKET MANIPULATION OR IMPROPER PROCUREMENT DESIGN OR EXECUTION?

A. No. The causes of the price increases were, I expect, driven by many factors including increases in the underlying fuel and power market prices. I offer this information simply to demonstrate that competitive procurements can result in large changes in rates and that caution is in order.

Q. ARE THERE ANY OTHER OVERARCHING CONCERNS YOU HAVE WITH AMEREN'S REBUTTAL TESTIMONY OR CLARIFICATION OF YOUR OWN POSITION?

A. Yes. Many rebuttal criticisms of CUB mischaracterize the statements made in our direct testimony. For example, Ameren witness Nelson states:

> Other flaws in CUB's alternative RFP proposal are that it assumes both that the Ameren Companies can control their affiliates and that the affiliates would be willing to sell their electricity to the Ameren Companies at a price below the relevant market price.

Ameren Ex. 10.0 at lines 741-43. In addition to not recommending an approach that necessarily relies on an RFP, nowhere do I claim that Ameren can or should control its affiliates. However, as explained above, outside of a rigid, single product, single date auction, each potential seller would have a different product, different preference for riding the market price vs. locking in a stable income stream, different preference for the firmness of the product being sold, different fuel price risk and availability, different date at which products become available or have other commitments, different cash flow requirement and credit resources, different expectation for how the spot and forward markets will perform and for future loads and supplies, and so on. Although all potential vendors know certain common market information, such as the forward price quotes for power and fuels at any given point in time (as will Ameren), there is no reason to think that every potential vendor will seek the same price for whatever product it has to sell.

Q. PLEASE CLARIFY: ARE YOU FLATLY OPPOSED TO THE IDEA OF AN AUCTION PROCESS AS A PROCUREMENT METHODOLOGY?

A. To be clear, I am not opposed, in principle, to auctions as a part of a procurement methodology. Auction-based procurement can have benefits. However, until such time as the relevant wholesale markets are demonstrably functional, reliance on this singular procurement strategy seems to me ill informed.

IV. PROPOSAL FOR ALTERNATIVE PROCUREMENT

Q. AMEREN ASSURES THE COMMISSION IN ITS REBUTTAL THAT IT DID EVERYTHING IT COULD TO CHOOSE AN APPROPRIATE PROCUREMENT METHOLODOLOGY. DO YOU AGREE?

A. No. Ameren witness Nelson states, “the auction process was proposed only after detailed, thoughtful review of the post-2006 procurement goals, and numerous procurement options.” Ameren Ex. 10.0 at lines 714-15.

I would like to point out that that this docket was not structured to weigh one portfolio design against another or one procurement method against another. Rather, it is a narrowly framed proceeding in which the Commission is limited to approving or rejecting Ameren’s tariff proposals.

Q. DIDN’T AMEREN PRESENT A THOROUGH EVALUATION OF OTHER OPTIONS?

A. No, it did not present any such evaluation in its testimony. For example, with regard to its portfolio design, Ameren has not presented evidence that an assemblage of 100% fixed price products is the best balance of rate stability and price, or that its choice of term lengths and allocation percentages of the portfolio among them is the best choice. As to its procurement design, just to take the simplest example, Ameren has not compared the expense of multiple procurement dates in each year to the diversity and risk mitigation that approach would offer. Beyond these simple examples, Ameren has not presented objective evidence comparing its proposal to any other.

Instead, it seems that Ameren simply *assumes* that its proposal will produce the best of all possible outcomes. For example:

> The Auction Process is designed to harness the competition for the supply of the portfolio management service and to bring the benefits of the competition that exists in wholesale market to the retail customers. *It is the best procurement process for customers whatever the state of the wholesale markets.* If there is a problem with the wholesale markets, that problem must be fixed directly and cannot be fixed by Ameren's choice of procurement mechanism.

Ameren Ex. 12.0 at lines 486-92. In Ameren's proposed auction, bidders would compete to provide the service of assembling a fixed-price, single-product load following service. That competition would deliver *some* benefit. However, given the magnitude of the costs and risks from uncompetitive wholesale markets, it is not appropriate simply to give up on protecting consumers from those costs and risks without seriously examining the alternatives. Likewise, even if we assumed that an auction procurement for Ameren's proposed portfolio of products would necessarily be better than any other procurement method that could be employed (an assumption that has not been demonstrated), Ameren has not demonstrated that the proposed product mix is the best selection.

Q. DIDN'T THE PROCUREMENT WORKING GROUP REACH CONSENSUS THAT AN AUCTION BEST MEETS THE CRITERIA IN THE FINAL REPORT?

A. No. As I have explained above, there was no consensus on the proposed auction. But before I discuss this issue any further, I wish to explain my understanding of the status of the PWG's discussions and why I am offering testimony on that subject. It is my understanding that the discussions and information exchanged in those workshops was not to be used in subsequent litigation. In particular, Workshop Preamble contained the following language:

> In order to facilitate free and open discussions the stakeholders wish to assure that statements made, positions taken, and documents and papers provided by the stakeholders in the Post 2006 Initiative Process will not be used by the stakeholders in any subsequent litigation, including administrative proceedings before the Illinois Commerce Commission, the Federal Energy Regulatory Commission, and other federal, state, or local governmental authorities.

See http://163.191.150.5/ec/docs/040511ecPostPreamble.doc. I also understand from counsel that there may be a dispute as to whether such discussions and materials relating to them should be considered in this proceeding. However, in the event that it is determined that such discussions and information are to be considered in this proceeding, I set forth my thoughts below.

Q. DO THE STAKEHOLDERS WHO CURRENTLY SUPPORT AMEREN'S PROPOSAL REPRESENT A COMPLETE CROSS SECTION OF INTERESTS?

A. No. An Ameren rebuttal witness states:

> Through the Procurement Working Group's discussion of the approaches used by the utilities in Maryland and New Jersey it also became apparent that these two models have found the support of a broad and diverse group of stakeholders. It became apparent to the Ameren Companies that the procurement approach utilized in New Jersey was uniquely suited to address the identified post-2006 challenges in Illinois, to satisfy the procurement characteristics identified by the Procurement Working Group, and to meet FERC's standards for power purchases from affiliates.

Ameren Ex. 12.0 at lines 694-701. However, to put this in context, it is necessary to examine the interests of those who do and do not support Ameren's proposal.

It is certainly in Ameren's interest for it (and all of its witnesses) to support Ameren's proposal. Chief among the reasons for this is that Ameren's proposal is carefully tailored to relieve it of any and all risks involved with its obligation to provide default service, and that it allows Ameren to side step the possibility of prudence review of any past actions, such as those associated with its divestiture of generating assets.

Similarly, it is in the interest of potential auction participants to support Ameren's proposal, at least in its general form. If there are alternative procurement strategies that would result in lower prices, why would potential auction participants have an interest in seeing those alternatives advanced? Likewise, competitive retail suppliers have little interest in promoting a default service portfolio or procurement strategy that may do better than Ameren's proposal.

It is the consumer interests that have a motivation to seek improvements in default service procurement that may reduce cost and risk to those consumers. IIEC witnesses speak to specific interests of large consumers, such as seeking a fixed price alternative to the hourly energy price service proposed by Ameren. CUB and the AG focus on the concerns of small customers, who are the least likely to have realistic alternatives to default service.

The issue before the Commission is not how many parties or witnesses support Ameren's proposal, but whether that proposal best serves the interests of consumers and others. I believe it does not.

Q. HAVE OTHER STAKEHOLDERS ADVOCATED A PROCUREMENT MECHANISM SIMILAR TO YOUR PROPOSAL?

A. Witness Salgo suggests "more active portfolio management, utilization of the many other standard products available in the market … and the possibility of negotiating prices and other contract terms with suppliers." AG Ex. 2.0, p. 11, lines 11-15. As I explained above, this concept is consistent with my recommendation.

Q. EARLIER IN THIS TESTIMONY YOU EXPLAINED HOW EACH OF THE PROCUREMENT APPROACHES CONSIDERED BY THE PWG WAS ALSO CONSIDERED BY THE GROUP IN RELATION TO A SET OF 18 CRITERIA. PLEASE RESTATE THOSE CRITERIA.

A. Certainly. I will first point out that while these items are called "consensus criteria" in the PWG report, they are correctly identified merely as "desirable characteristics." *See* http://www.icc.illinois.gov/ec/docs/041018ecPostProcureFinalRpt.pdf. Those 18 characteristics are:

1. It should be highly transparent.
2. It should allow for a competitive procurement approach.
3. It should provide for the opportunity for full cost recovery to the utilities if they follow the Commission approved procurement approach.
4. It should result in market-based rates for customers.
5. It should include a mechanism for translating the result of the process into retail rates.
6. It should facilitate and encourage supplier participation of all types in the wholesale market.
7. It should facilitate stable rates and mitigate rate volatility for applicable customers for relevant time periods.
8. It should allow for and accommodate RPS, DSM, low-income assistance programs, etc.
9. It should require an initial regulatory review to approve and an ongoing regulatory review to oversee and improve the procurement process.
10. It should be capable of implementation prior to January 1, 2007.

11. It should provide specific guidance on crucial issues such as procurement methodology, rate design, and allocation of risks and provide flexibility to respond to market conditions.
12. It should provide an agreed upon procurement methodology, which if followed, minimizes the need for after the fact prudence review.
13. It should include reasonable features or contractual safeguards to manage counterparty credit risk.
14. It should reflect lessons learned from States that have restructured and the current state of competition in the retail and wholesale markets in Illinois.
15. Stakeholders should have the opportunity to review and comment on the procurement process and proposed actions.
16. It should clearly assign accountability and risks.
17. It should provide for prompt regulatory review and approval.
18. The stated public policy goals of insuring resource adequacy should be considered in the procurement process or elsewhere.

Q. HOW DOES YOUR PROPOSED ALTERNATIVE RATE AGAINST THE PWG'S 18 CRITERIA AND THE ICC'S SUMMARY "CONSENSUS ITEMS"?

A. It rates rather well on those items with the exception of two items that seem tailored mainly to benefit the Companies.

Q. PLEASE EXPLAIN.

A. I'll begin with the two items I mentioned in the immediately preceding answer. The first is item 3, which calls for "full cost recovery" for utilities that "follow the Commission approved procurement approach." *Id.* The second is item 12, which calls for "minimiz[ing] the need for after the fact prudence review." *Id.* While Ameren may wish to obtain such guarantees and might refuse to adopt a novel procurement approach, such as its own proposal, in their absence, I see no compelling reason for the Commission to make such a concession. I would note that while my proposal does not guarantee such recovery, it does not prevent full cost recovery. Instead, it makes such recovery subject to traditional standards, such as prudence.

I suspect that some might also argue that my proposal would not "result in market-based rates for customers." *Id.* item 4. If one artificially defines "market-based rates for customers" as "rates that are a mechanical computation from the result of a pre-defined product procured in an auction," I suppose one might reach that negative conclusion. However, my proposal would produce default service rates that flow from market results to the extent that Ameren chooses to use markets for procurement and other types of costs to the extent it does not. I see no reason to arbitrarily prefer rates based on markets to rates based on costs or a mixture of the two.

Similarly, some might complain that my proposal does not provide "specific guidance on crucial issues such as procurement methodology, rate design and allocation of risks and provide flexibility to respond to market conditions." *Id.* item 11. However, under my proposal, no particular guidance on rate design is needed. In fact, I believe that rate design decisions are best made in a rate design proceeding, not a procurement proceeding. Nothing in my proposal limits Ameren's flexibility to respond to market conditions. Rather, my proposal would free Ameren to respond to market conditions, as it should, rather than to lock into a specific, one-time purchase. Also, my proposal's allocation of risk is quite clear. While Ameren is capable of making management decisions on procurement methodology (or could acquire such capability if it chose to), if it actually wanted guidance on that issue, it could have structured this proceeding to fully explore the options.

Turning to the remaining items, my proposal would increase transparency, at least from the perspective of every party other than Ameren and ICC Staff, (item 1) and give ample opportunity for all stakeholders to review and comment on proposed actions (item 15). Moreover, it leaves Ameren free to use a multitude of competitive procurement approaches (item 2), would use standard "mechanism[s] for translating the result of the process into retail rates" (item 5), and encourage participation by even more types of suppliers than Ameren's single-product auctions (item 6).

My proposal would be just as capable as the proposed auction of "facilitat[ing] stable rates and mitigat[ing] rate volatility" (item 7) and "allow[ing] for and accommodate RPS, DSM, low-income assistance programs" (item 8). It could include such "reasonable features or contractual safeguards to manage counterparty credit risk" (item 13) as Ameren deems necessary, and "insure resource adequacy" (item 18) as well as Ameren's proposal, if not better, since my proposal might actually lead to the addition of new, optimally-sited generation resources.

While Ameren's proposal may reflect the latest "lessons learned" in New Jersey (item 14), the testimony of witnesses Fagan and Rose make it clear that Illinois' wholesale market situation differs from New Jersey's. Furthermore, as witness Rose points out in his direct testimony, the lessons learned in other states are not uniformly in favor of Ameren's proposal.

My proposal would certainly provide "initial regulatory review" via this proceeding and provide much greater "ongoing regulatory review to oversee and improve the procurement process" (item 9) than Ameren's proposal. It can be implemented by the end of the transition period as it requires no new procedures or special lead-time other than that required by Ameren to carry out procurement (item 10). Unlike Ameren's, my proposal does not involve any artificial or inherent lead times. Ameren might argue that it would require lead-time to reconstitute its procurement functions; functions that it chose to spin off to unregulated affiliates. However, if Ameren finds it cannot reconstitute those functions as quickly as it needs to, it can certainly contract them to a third party for as long as necessary.

My proposal and Ameren's both clearly assign accountability and risks (item 16), but I believe that my proposal is a more fair and reasonable assignment than Ameren's, which places all risk on wholesale suppliers and consumers. As for "prompt regulatory approval," (item 17) it might be argued that this should mean, "prompt approval of the results of each particular procurement." I have explained elsewhere why Ameren's proposal provides insufficient time for a reasonable review. I also do not believe that the degree of "promptness" sought by Ameren is necessary except under its proposed procurement method, if at all.

Q. HAS A DIFFERENT TAKE ON THE DESIRABLE CHARACTERISTICS OF METHODS FOR PROCURING DEFAULT SERVICE BEEN OFFERED IN THE PROCEEDING?

A. Yes. In its own Final Report, the ICC stated that the PWG had produced four "consensus items." This shorter list stated that a procurement approach should:

- Be accomplished through a competitive procurement method that facilitates diverse supplier participation resulting in market-based prices for power;
- Strike a balance between encouraging competitive market development and protecting consumers from market irregularities by facilitating stable rates, mitigating rate volatility and mandating ongoing regulatory oversight in the form of initial regulatory review to improve and monitor the process;

- Accommodate RPS, DSM, as well as low income assistance programs;
- Reflect lessons learned from other states.

See http://www.icc.illinois.gov/ec/docs/041208ecPostRptExe.pdf. If this short list represents a more genuine assessment of the level of consensus, clearly that "consensus" provided little guidance as to a specific choice for the Post-2006 system.

In fact, I would note that my recommendation is fully consistent with the four "consensus" items. Nothing in my recommendation would preclude the judicious use of competitive procurement by Ameren in meeting is default service obligations. Opening up Ameren's procurement to a more diverse range of portfolio components and procurement styles could encourage *more* diverse supplier participation, rather than limiting participation to those capable of or interested in bidding just another one of many identical vertical tranches. Certainly, nothing in my proposal would interfere with market-based prices for power procured by Ameren for this purpose, although Ameren would have additional options to consider.

I contend that my proposal has (1) a greater potential than Ameren's to balance wholesale competitive market development, (2) would do nothing to harm retail competition, (3) has greater ability to protect consumers and mitigate rate volatility, and (4) surely facilitates ongoing regulatory oversight. In addition, my proposal fully accommodates RPS, DSM, and low-income assistance. Lastly, it reflects many of the lessons learned in other states, such as the recent experience recounted by witness Rose, not just the lessons learned in New Jersey, the one state that procures default service power via an auction like that proposed by Ameren.

V. PRUDENCE REVIEW OF PROCUREMENTS

Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF AMEREN'S POSITION ON PRUDENCE REVIEW OF FUTURE PROCUREMENTS.

A. Ameren appears to want the approval of the procurement process to amount to a waiver of future prudence review.

> The auction process removes virtually all discretion from the utility in the procurement process. The auction process provides a set of rules intended to isolate a single variable - price - in the process. As long as the rules have been followed, there is no discretionary action by the utility to review after the auction process has been completed and contracts executed. There is no other action the utility could have taken under the auction rules approved by the ICC, and thus no action whose prudence requires evaluation.

Ameren Ex. 10.0 at lines 570-77.

Q. DOES HIS STATEMENT ACCURATELY REFLECT THE PRESENT SITUATION?

A. No. There may be some situations, such as PURPA contracts, where one *might* argue a utility was "only following orders" and should only be responsible for *how* it did so. (Of course, that is different from asserting there should be *no* review of such costs before they are passed through to customers.) However, the Companies are not making the proposed procurement with little or no discretion, but have chosen this approach out of a huge universe of possibilities. Just because they *ask* to be stripped of discretion does not mean that they have none.

My recommendation properly places procurement responsibility for portfolio design and procurement decisions on the Companies, who are in the best position to make them in real time. Thus, normal ratemaking review of the costs incurred would be appropriate.

VI. SPECIFIC CRITIQUES

A. Concerns about Markets

Q. DOES WITNESS LACASSE COMMENT ON YOUR CONCERNS REGARDING WHOLESALE MARKET IMPERFECTIONS?

A. Yes. For example:

> I do not believe that Dr. Rose's conclusions follow from his analysis or from the analysis of Professor Sibley on which he relies, and I do not believe that Dr. Steinhurst's conclusions follow from the analysis in Mr. Fagan's testimony. It is my understanding that these witnesses draw unwarranted conclusions as to the lack of maturity and competitiveness of the MISO electricity markets without a structural analysis of a relevant market from a wholesale energy perspective.

Ameren Ex. 12.0 at lines 917-23.

Q. DO YOU AGREE WITH THIS CRITICISM?

A. No. Witnesses Rose and Fagan documented the market concerns they raise and have explained carefully why those concerns apply to Ameren's service territory. Given those concerns, I am justified in advocating for alternative portfolio designs and procurement mechanisms that do everything possible to avoid simply throwing default service customers to their fate.

B. <u>Consumer Observer at Auction</u>

Q. WHAT DOES AMEREN SAY ON THE ISSUE OF YOUR PROPOSED CONSUMER OBSERVER?

A.

> the Ameren Companies remain open to the participation of a consumer representative on appropriate terms. Those terms, at a minimum, would have to address the confidentiality concerns

Ameren Ex. 10.0 at lines 508-11. I welcome this openness and recommend again that the Commission order such a role subject only to appropriate confidentiality requirements.

Q. DO YOU HAVE ANY PROBLEM WITH HAVING THE PROPOSED CONSUMER OBSERVER SIGN REASONABLE AND APPROPRIATE CONFIDENTIALITY AGREEMENTS?

A. Absolutely not. I would expect the consumer representative to sign the same sorts of confidential agreements as does the Auction Manager and any consultant to the Commission.

Q. IS THERE ANY OTHER POINT RELATING TO THE CONSUMER OBSERVER THAT YOU WISH TO CLARIFY?

A. Yes. Witness Nelson states, “Under CUB's proposal, the Consumer Observer would be under the authority of "official" consumer advocates like the CUB or the AG. It is unclear to me whether other actual consumer representatives (e.g., AARP and IIEC) would participate in appointing the Consumer Observer.” Ameren Ex. 10.0 at lines 446-49. I believe my direct testimony was clear on this point, but I will restate that my proposal is for the Consumer Observer to be appointed by and to be accountable to consumer advocates for electric customers designated as such by state law. I believe that implies that the CUB and the Office of the Attorney General would be included, but that private organizations like AARP and IIEC would not.

Also, I did not claim that confidentiality in an auction *was* a "non–issue" as witness Nelson states in his testimony. *Id.* at line 483. I only claimed that it would *become* one if proper confidentiality agreements were signed.

C. <u>Renewable Energy</u>

Q. DO YOU HAVE ANY CONCERNS ABOUT AMEREN'S PROPOSAL REGARDING RENEWABLES AND THE RELATIONSHIP OF THE RENEWABLES TO DEFAULT SERVICE PROCUREMENT?

A. Yes. Witness Mill states, "[Ameren's] proposal does not require that the Ameren Companies take physical delivery of the renewable energy being generated by our contracts, but to receive green certificates, proof that such generation occurred." Ameren Ex. 16.0 at lines 309 ff. He also objects to requiring physical deliverability for renewable energy. *Id.* at lines 327-9. I concur that long term contracting is the central issue and agree that green certificates is one way to implement such a program. However it is not the best way, since a physical delivery requirement would increase the likelihood that Illinois customers would benefit directly from reduced air emissions from traditional generation and from economic stimulus from renewable generation facility construction and operation.

VII. OTHER ISSUES

Q. DO AMEREN REBUTTAL WITNESSES MAKE CLAIMS THAT RELY ON MISCONCEPTIONS?

A. Yes. For example, Witness Nelson states “Mr. Steinhurst appears to suggest that customers were entitled to a rate freeze not just for the stated duration of the freeze, but indefinitely after the rate freeze ends, as well. Moreover, it is not unreasonable for utilities to be concerned about their own continued existence.” Ameren Ex. 10.0 at lines 783-86. I am not aware of suggesting either an arbitrary rate freeze or actions that ignore the continued existence of the Companies.

Q. DO YOU HAVE ANY CONCERNS REGARDING WITNESS COOPER'S SUGGESTED CHANGE TO WITNESS LAZARE'S RATE MODERATION PROPOSAL?

A. Yes. Witness Cooper's change would "modify Mr. Lazare’s proposal by treating each of the non BGS-4 rate classifications as a group (BGS 1-3), irrespective of the Ameren Company.” Ameren Ex. 15.0 at lines 99-100. However, as he acknowledges later in his testimony, under his suggested change to Mr. Lazarre's proposal, “a current bundled customer class within an Ameren Company may experience a post 2006 increase outside of Mr. Lazare’s constraints.” *Id.* at lines 115-17

I do not believe that the central issue in this case is how to mitigate the potential impacts of what I believe is a flawed proposal. However, I agree that it may be reasonable to moderate rate impacts on customers in certain circumstances. I am concerned that witness Cooper's proposed change would simply not assure the degree of protection sought by witness Lazare's original proposal. If the Commission wishes to ensure that short-term rate impacts are moderated in the manner suggested by witness Lazare, it should follow his original proposal.

VIII. SUMMARY AND CONCLUSION

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS.

A. Ameren has not demonstrated that the default portfolio design and mechanistic auction process with its virtually automatic pass through of the resulting costs produces optimal results, nor that it provides adequate protection to consumers. The Commission should reject Ameren's proposal and recognize that Ameren retains responsibility for making and managing the decisions and actions necessary to serve default service customers using a soundly designed and actively managed resource portfolio. Additionally, the Commission should clarify that it has an oversight role in the process to ensure that Ameren best serves default service customers.

In the alternative, if the Commission wishes to entertain the concept of pre-approving a portfolio design or procurement method, it should open a proceeding for the purpose of exploring alternatives to Ameren's proposal and seeking improved portfolio designs and procurement management approaches. In such a proceeding, the Commission should require Ameren to make a filing that fully and fairly evaluates a range of portfolio designs and procurement methods and to present analyses comparing their costs and risks.

If the Commission rejects these two options I propose and decides to approve some form of auction-based procurement approach at this time, I recommend that the Commission order the changes to the auction and portfolio design as explained in my direct testimony in this proceeding and certain other modifications discussed above.

Q. SHOULD THE COMMISSION ACCEPT SWEEPING ASSERTIONS THAT THE AUCTION IS BETTER THAN ANY ALTERNATIVE?

A. No. One example of such assertions is witness LaCasse's statement that, "[r]egulation has its place. However, it is generally acknowledged that it is a weaker force than competition in terms of achieving an efficient allocation of resources and prices that track economic realities." Ameren Ex. 12.0 at lines 370-72. This may be an attractive position in theory, but it does not reflect the current situation. I have not suggested that regulation is to be preferred to competitive markets where they exist. The proposed auction overlays a veneer of competition on a flawed wholesale market, turns a blind eye to possible shortcomings of past Ameren actions, and chooses a specific competitive process to procure a specific portfolio design, neither of which has been shown to be optimal. We do not have a choice between competition and regulation here, but rather a proposal for a regulatory mandate for passing through to consumers the result of a particular system for deriving prices, a system chosen by Ameren to excuse itself from any responsibility for the results.

Q. IS THERE A NATIONAL TREND WITH REGARD TO ELECTRICITY INDUSTRY RESTRUCTURING, CUSTOMER CHOICE, AND RELIANCE UPON WHOLESALE MARKETS TO PROVIDE ELECTRICITY FOR

SMALL CUSTOMERS OF WHICH THE COMMISSION SHOULD BE CONGNIZANT?

A. Yes, there is. The crises in the Western markets eroded much of the prior enthusiasm for electric industry restructuring.[5] Over the last few years, the trend nationally toward breaking up vertically integrated utilities has faltered. The FERC's efforts to create RTOs throughout the US have stalled. Most states that were considering retail electricity market restructuring have reconsidered, and few small customers have meaningful choice of their electric supplier. There is certainly no observable national trend that would indicate that Illinois should feel pressure to rush to rely on an auction to procure electricity for customers.

Q. IN PRESENTING THIS INFORMATION ABOUT NATIONAL TRENDS RELATING TO DEREGULATION ARE YOU SUGGESTING THAT WHOLESALE ELECTRICITY MARKETS ARE A COMPLETE FAILURE OR THAT RETAIL CHOICE SHOULD BE ABANDONED?

A. No, I am not. I am simply trying to point out some trends and concerns that the Commission should take into account in the proceeding as justification for being reasonably cautious.

Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes.

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[5] In order to avoid further mischaracterizations, let me hasten to state that I am not asserting that the Illinois wholesale markets or the Illinois retail choice regime suffer from the same problems as those in California, nor that the problems seen in California exist in the proposed auction scheme of Ameren. This is simply an historical fact.