STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company, d/b/a AmerenCILCO	)	05-0160 (cons.)
Central Illinois Public Service Company, d/b/a AmerenCIPS	)	05-0161
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)	)	

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

CUB Exhibit 2.0

June 15, 2005

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Direct Testimony of William Steinhurst
on behalf of the Citizens Utility Board
ICC Dockets No. 05-0160, 05-0161, 05-0162

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND OCCUPATION.

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 DID YOU PREPARE THIS PREFILED TESTIMONY?

A: I prepared this testimony on behalf of the Citizens Utility Board.

Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS?

A: I have twenty-four years' experience in utility regulation and energy policy, including work on renewable portfolio standards and portfolio management practices for default service providers and regulated utilities, green marketing, distributed resource issues, economic impact studies, and rate design. Prior to joining Synapse, I served as Planning Econometrician and Director for Regulated Utility Planning at the Vermont Department of Public Service, the State's Public Advocate and energy policy agency. I have written or co-authored numerous papers and reports on utility regulation, energy policy, statistics, and modeling and provided consulting services to the Illinois Energy Office, the

Massachusetts Executive Office of Energy Resources, the Natural Resources Defense Council, the Regulatory Assistance Project, the Delaware Public Service Commission, the Nova Scotia Utility and Review Board, the Connecticut Office of Consumer Counsel, the Maine Office of the Public Advocate, AARP, the Conservation Law Foundation, the Vermont Auditor of Accounts, the James River Corporation, and the Newfoundland Department of Natural Resources.

I have testified as an expert witness in approximately 30 cases on topics including utility rates and ratemaking policy, prudence reviews, integrated resource planning, demand side management policy and program design, utility financings, regulatory enforcement, green marketing, power purchases, statistical analysis, and decision analysis. I have been a frequent witness in legislative hearings and represented the State of Vermont in numerous collaboratives addressing energy efficiency, resource planning and distributed resources.

I was the lead author or co-author of Vermont's long-term energy plans for 1983, 1988, and 1991, as well as the 1998 report *Fueling Vermont's Future: Comprehensive Energy Plan and Greenhouse Gas Action Plan*, as well as Synapse's study *Portfolio Management: How to Procure Electricity Resources to Provide Reliable, Low-Cost, and Efficient Electricity Services to All Retail Customers*.

I hold a B.A. in Physics from Wesleyan University, and an M.S. in Statistics and Ph.D. in Mechanical Engineering from the University of Vermont.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. My testimony will address the proposal by Illinois Power Company, doing business as AmerenIP; Central Illinois Public Service Company, doing business as AmerenCIPS; and Central Illinois Light Company, doing business as AmerenCILCO ("together Ameren" or "the Companies") to use a clearing price auction for procurement of wholesale power to serve Basic Generation Service (BGS) load in its service territory. I will begin by considering the heart of the Companies' request, namely that the Illinois Commerce Commission (Commission, ICC) consider only one procedure for the procurement of power for BGS customers after the transition period and, in approving that procedure, relieve the Companies of any responsibility for the results of procurement if the Companies follow that procedure. I argue that this request, while offering hypothetical benefits to customers, is too narrowly tailored and should be rejected because it cuts off Commission review of the broad range of options that should be considered as Illinois steps out from the transition period.

I then consider witness Fagan's testimony on the state of the wholesale markets and the implications for the Commission's consideration of the Companies' particular proposal, the clearing price auction proposal. In addition, I discuss a number of other ways in which the Companies' auction proposal fails to provide necessary protections for consumers. I then recommend that the Commission reject the Ameren proposal and instead order the Companies to carry out the necessary procurement under traditional ratemaking.

Following that, I will consider, in the alternative, how the proposed auction process ought to be improved, should the Commission decide to authorize a mechanism similar to that proposed by Ameren.

II. REASONS FOR CONCERN WITH THE COMPANIES' REQUEST

Q. PLEASE GENERALLY DISCUSS THE COMPANIES' REQUEST TO THE COMMISSION.

A. The Companies' testimony and exhibits present a very narrow question to the Commission and then examine in minute detail only one preferred answer to that question. In focusing only on the issues of why an auction is better than other types of procurement and of *how* the auction should be carried out, the Companies' testimony skirts or brushes aside the threshold issues of (1) whether to grant summary approval of the proposed shift to new procurement option--the clearing price auction, (2) when and how the Commission should review the prudence of prior actions by the Companies that have led us to the point of apparently needing to rely on market-based procurement, and (3) whether to grant the Companies' request to relieve it of any responsibility for power procurement other than implementing the auction as defined.

Q. PLEASE ILLUSTRATE HOW THE COMPANIES' FILING AND REQUEST ARE NARROWLY FRAMED.

A. The Companies' witnesses consider procurement and competitive issues primarily within the limited, specific context of an auction for full requirement

supply. Little or no room is allowed in the Companies' picture of this proceeding for consideration of rate impacts. The Companies merely make sweeping assertions such as that the Companies' preferred approach "'is expected to come the closest' of any procurement approaches to address the concerns of Staff and other parties." Resp. Exhibit 2.0 at lines 294-296. I do not agree that the Commission's options are so limited.

Q. WASN'T THERE A CONSENSUS ON THE COMPANIES' PROPOSED AUCTION APPROACH?

A. No, there was not. Contrary to the testimony of witness Baxter, the Procurement Working Group did not come to a consensus on a specific procurement method. *Cf.* Resp. Exhibit 1.0 at lines 77-78. In light of this lack of consensus, the litigation process should provide the Commission with a broad view of the options and alternatives open to it. Ameren ignores this lack of consensus.

Q. IS THERE ANOTHER CONCERN WITH HOW THE COMPANIES HAVE LIMITED OR NARROWED THE MATTER BEFORE THE COMMISSION?

A. Yes. In a broad sense, Ameren's focus on ensuring smooth, timely implementation of the proposed auction avoids the more important questions of what prices are likely to come out of the auction. Ameren fails to adequately address consumers' exposure to rates set under extreme circumstances.

Additionally, there is little consideration of the Commission's inability to protect consumers from adverse outcomes in an auction. If auction anomalies are present but not detected, or the region experiences severe price spikes at the time of the auction, the Commission would be unable to protect consumers. Customers with no supply alternatives would have no recourse.

Q. DO YOU HAVE ANY CONCERNS ABOUT THE REQUESTS MADE BY THE COMPANIES?

A. Yes, I do. The Commission faces two momentous decisions—the choice of how to fashion a method for post-transition power procurement to serve Basic Generation Service customers and the choice of mechanisms for the Companies' cost recovery under that new power procurement system.

For decades, procurement has been the responsibility of the retail utility and cost recovery has followed traditional rate making principles, including after the fact review of whether the Companies' costs were prudent and resulted in just and reasonable rates. In this proceeding, the Companies have presented a single option for the Commission's consideration, an option that relieves the Companies of the greatest part of their responsibility for the results of its power procurement decision. The Commission and Ameren's BGS customers deserve better.

Foreseeing the need for these choices, the Commission wisely established an investigation of the alternatives for procurement after the transition period, well in advance of the end of that transition period. After numerous workshops and meetings, the stakeholders who participated did not reach consensus on a new

system for procurement or a new approach to cost recovery. In those workshops, there was sometimes agreement that certain approaches would work better if fashioned in one way or another, but to my knowledge there was not agreement among all the stakeholders that any one approach, even in the best form that could be identified, would meet all the needs of customers and the State of Illinois. The final report of the convener identified a "consensus" list of desired criteria for procurement. However, even if all Parties were to accept this list as complete, it does not address how those criteria should be either prioritized or, whether any of them were essential. In fact, the final report stated, "The group agreed, given the wide range of opinions among the 'stakeholders', that it would be next to impossible to recommend either a specific scenario or to rank scenarios in order of preference." Final Report to the Illinois Commerce Commission Presented by the Procurement Working Group, September 23, 2004, at 2.

The Commission should consider broadly all the available options and their potential impacts on all interests, including the smallest customers who are the least able to shop for alternatives to BGS. Currently, there are *no* competitive retail alternatives to BGS for residential customers. The Companies' proposal seeks to sidestep immensely important issues relating to responsibility for power procurement decisions, as well as alternative methods and cost recovery for the power procurement.

Q. WHAT DO YOU RECOMMEND THE COMMISSION DO CONCERNING THE COMPANIES' PROPOSAL, WHICH SHIFTS POWER

PROCUREMENT FOR BASIC GENERATION SERVICE TO A COMPETITIVE AUCTION AND ELIMINATES THE COMPANIES' RESPONSIBILITY FOR ITS POWER PROCUREMENT CHOICES AND THE RESULTS OF THOSE CHOICES?

A. I recommend that the Commission:

a. Reject the Companies' proposal;

b. Open a new docket to consider the full range of procurement options; and

c. 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 the companies' decisions.

III. REASONS FOR CONCERN WITH AMEREN'S PROPOSED CLEARING PRICE AUCTION

Q. WHAT PARTICULAR TYPE OF PROCUREMENT HAVE THE COMPANIES RECOMMENDED FOR POWER TO SERVE BGS CUSTOMERS?

A. The Companies have proposed a multiple-round, descending clock auction. The Company describes that process as follows:

> The auction is a simultaneous, multiple round descending clock auction. The auction simultaneously procures supply for all products, namely for all load categories (i.e., BGS-FP, BGS-LFP, and BGS-LRTP) and for all contract terms (i.e., 17 months for BGS-FP, BGS-LFP, and BGS-LRTP, as well as 29 months and 41 months for BGS-FP). The auction proceeds in

> rounds. In each round, bidders submit bids, bids are tabulated, and bidders are provided information on the general progress of the auction. The auction is a descending clock because prices tick down until there is just enough supply to meet the requirements.

Resp. Exhibit 6.0 at line 1510 ff. This auction includes the procurement of rolling three-year, fixed price contracts for customers smaller than 1MW in size. For customers 1MW or greater in size, there would be an auction for one-year fixed-price contracts. In addition, there would be an auction for one year fixed capacity service with energy at spot market prices to serve real time pricing customers.

The Companies also propose that the Commission pre-approve the process, assure the Companies full cost recovery for the cost of the process *and* for all the power purchased pursuant to the process, and provide for automatic approval of the results of each auction (unless the Commission acts otherwise within two business days after receiving reports on the auction).[1]

Q. DOES THE COMPANIES' PROPOSED PROCESS FOR RUNNING ITS CLEARING PRICE AUCTION PROVIDE PROPER OVERSIGHT AND REVIEW OF POWER PROCUREMENT FOR BASIC UTILITY SERVICE?

A. No, it does not. The Companies' proposed procedures allow for only the briefest and most narrow review of certain very limited and narrow issues.

[1] *See,* for example, proposed Rider MV in Cilco tariff binder at Sheet No. 27.028. Note that the tariff binder states the auction is deemed approved if the Commission does not act within *three* days of the Auction Completion Date, but the Auction Manager and Auction Advisor have one business day to prepare their confidential reports for the Commission, so the Commission only has two days in which to deliberate and act. River MV does provide for the possibility that the Commission could choose to institute an investigation of the auction results. If that occurs, the Company will not execute purchase contracts pursuant to the auction, but will either repeat the auction or purchase from the PJM markets to serve load. *Loc. cit.*

Q. DO THESE PROCEDURES PROVIDE FOR A REASONABLE ALLOCATION OF RESPONSIBILITY FOR POWER PROCUREMENT FOR BASIC GENERATION SERVICE?

A. No, they do not. Under the Companies' proposed procedures and the orders requested by the Company, Ameren would have no responsibility for the costs that result from its proposed process. Such a simple pass through of whatever costs an auction develops will not protect the interests of BGS customers and is not reasonable.

Q. ISN'T IT ROUTINE FOR UTILITIES TO SIMPLY PASS THROUGH COSTS FROM PROCUREMENT IN COMPETITIVE MARKETS?

A. No. Some states that have instituted competitive procurement for default service have approved such a pass through. New Jersey and Maryland are examples. However, utilities routinely purchase goods and services from auction-based markets, requests for proposals (RFPs), or other competitive processes (forward contracts and spot purchases of fuels from commodity exchanges, power from generators and other suppliers, equipment of all sorts, and many other goods and services). Those purchases likewise have been routinely subject to ordinary, after the fact rate review in subsequent rate cases, which includes prudence review.

Q. DOES THE PROPOSED AUCTION PROCESS ASSUME AND DEPEND ON A FULLY COMPETITIVE WHOLESALE ELECTRICITY MARKET?

A. Absolutely.

Q. SHOULD THE COMMISSION BE CONFIDENT THAT SUCH A COMPETITIVE WHOLESALE MARKET EXISTS NOW OR WILL EXIST AT THE TIME OF THE FIRST PROPOSED AUCTION?

A. Definitely not. This issue is addressed at length in the prefiled testimony and exhibits of witness Fagan. He identifies multiple, serious concerns about the lack of competitiveness and maturity of the MISO wholesale electricity markets now and similar concerns about that market as it is likely to exist for at least some time after the time of the first proposed auction.[2] His conclusion is clear: the Illinois region of the MISO wholesale electricity market, on which the entire proposed auction depends, cannot be viewed as fully competitive. His testimony clearly indicates that there is a strong possibility that any competitive procurement will be relying on a flawed wholesale market.

Q. WHY SHOULD THE COMMISSION BE CONCERNED IF COMPETITIVE PROCUREMENT FOR BASIC GENERATION SERVICE IS BASED ON A FLAWED WHOLESALE ELECTRICITY MARKET?

A. The Commission should be concerned about this problem, because a flawed wholesale market can result in wholesale market prices that are higher

[2] MISO is the Midwest Independent Transmission System Operator, the RTO responsible for a number of Midwest states and Canadian provinces or portions thereof, including the non-PJM portion of Illinois.

than fair or necessary; some market participants will be able to cause market-clearing prices to be higher than would occur otherwise in a fully competitive market. This would translate into unnecessarily high bids from participants in Ameren's proposed Competitive Procurement Auction (CPA) process and, hence, into higher than necessary retail rates for BGS customers.

Q. GIVEN WITNESS FAGAN'S CONCERNS ABOUT THE WHOLESALE MARKETS, HOW SHOULD THE COMMISSION VIEW THE COMPANIES' REQUEST?

A. The Commission should be very cautious about committing BGS customers to taking power to be procured under mechanistic procurement that depends on such a flawed market, no matter how well designed that mechanism may be.

Q. WHAT OTHER CONCERNS SHOULD THE ICC BEAR IN MIND WHEN CONSIDERING THE PETITION?

A. There are at least two such concerns. First, even if those wholesale markets were not potentially flawed, the shift to providing BGS from a clearing price auction is likely to have a severe economic impact on ratepayers and the Illinois economy. Second, even if the auction did not pose such problems, the auction design, as proposed, does not provide adequate oversight and accountability and does not take all supply and demand-side resources into account.

Q. IS A CLEARING PRICE AUCTION LIKELY TO RESULT IN INCREASED COSTS FOR BASIC UTILITY SERVICE CUSTOMERS?

A. Yes, it is. The Ameren Companies have "publicly stated that they presently anticipate average rate increases in the range of 10-20% for Illinois electric operations as a whole." Ameren Resp. to CUB DR 1.32. This is an increase in the bundled rate due *only* to the power supply component. The impact on the Illinois economy as a whole from such a rate increase would be substantial. In my prefiled testimony in a related Commonwealth Edison proceeding before the Commission, I estimated that a rate increase of approximately 13% for the Commonwealth Edison service territory (as is expected from implementing Commonwealth Edison's proposal) would cause job losses in excess of six thousand in Illinois, not counting the effect on the Illinois economy of any potential distribution rate increase.

While I have not performed a similar study for the smaller Ameren footprint, I would expect the impacts from an Ameren increase to be of a similar kind and of a scale proportional to the dollar burden of the Ameren footprint rate increase relative to the dollar burden of the Commonwealth Edison rate increase. This study utilized a macroeconomic model of Illinois. The impact on the state's economy from an increase in Commonwealth Edison's bundled rate was simulated, including the effect on employment for the state as a whole. While a similar type of rate increase for the Ameren footprint would represent a different annual dollar cost to consumers, the estimated impact on the Illinois economy *per*

dollar of increased electric costs would be similar.

Q. IS THE PROPOSED AUCTION, IN FACT, WELL DESIGNED?

A. Not entirely. While the Companies' proposal is based on a model that has worked reasonably well, there are a number of flaws in the proposed auction design and process. The proposed auction design and process impose unnecessary economic risks on BGS customers, do not provide adequate oversight and accountability, and do not take all supply and demand-side resources into account. Those flaws threaten the interests of BGS consumers, especially small commercial and residential consumers.

Q. PLEASE SUMMARIZE HOW THE COMPANIES' AUCTION DESIGN, AS PROPOSED, IMPOSES UNNECESSARY ECONOMIC RISKS ON BASIC UTILITY SERVICE CUSTOMERS.

A. The proposed auction imposes unnecessary economic risks on BGS customers because it does not include long term, fixed price renewables or energy efficiency among the resources used. I am aware that the Governor's Sustainable Energy Plan (and counterproposals that have been made) contains concepts that would deliver such benefits to BGS customers. Hence, this issue may be dealt with in another forum. But as the outcome of that proceeding remains in doubt at this time, if the Commission approves a competitive procurement in this proceeding, it should include in that order a requirement that the benefits of long-term fixed price renewables and energy efficiency be provided as part of BGS,

should the proceedings on the Governor's Plan fail to deliver them. Even if the Governor's Plan proceeding does deliver such benefits, the Commission should require that any competitive BGS procurement include such additional long-term renewable energy and energy efficiency resources as are needed to provide the level of economic risk mitigation that is warranted for BGS customers.

Q. PLEASE EXPLAIN HOW THE COMPANIES' AUCTION DESIGN, AS PROPOSED, FAILS TO PROVIDE FOR ADEQUATE OVERSIGHT AND ACCOUNTABILITY.

A. It does so in two ways. First, the Companies' proposal does not provide for consumer representation inside the procurement process. While it provides for an outside observer (the Auction Advisor), the Auction Advisor is not focused on or accountable to consumer interests. Second, the Companies' proposal does not provide for an adequate level of monitoring of market power that would affect the relevant wholesale electricity markets nor for a mechanism to initiate vigorous state-level action to mitigate such market power or to counter abuse of such power.

Q. ARE THERE ANY OTHER CONCERNS WITH THE PROPOSED AUCTION PROCESS THAT THE COMMISSION SHOULD TAKE INTO ACCOUNT?

A. Yes, one additional broad concern with the proposed process seriously threatens the interests of consumers. As, I explained above, the Companies'

proposal would price power for BGS customers on the basis of a clearing price auction, rather than on the basis of the cost of power.

Q. HOW SERIOUS IS THE CONCERN ABOUT SHIFTING TO A MARKET-CLEARING PRICE FOR BGS POWER?

A. In my prefiled testimony in a related Commonwealth Edison proceeding before the Commission, I estimated that a shift to pricing all power at market clearing prices stands to cost Commonwealth Edison ratepayers as much as $1 Billion per year relative to cost-based procurement.[3] A copy of that study is attached as CUB Exhibit 2.2. While I have not performed a similar study for Ameren, I believe that a clearing price auction, where one pays the price of the most expensive offer for all power used, is likely to impose costs on BGS customer load that are substantially greater that those that would have flowed from traditional cost-based ratemaking.

Q. PLEASE SUMMARIZE YOUR VIEW OF THE PROPOSED AUCTION DESIGN AND PROCESS.

A. Acceptance of the proposed auction design and process would be a huge leap of faith that is unjustified, given the flawed wholesale market underpinning the proposed auction and the additional design flaws in the Companies' proposed procurement.

[3]Our study compared the revenues that Exelon could expect from market-based pricing of its Illinois nuclear units to the revenues Exelon would receive if the output of those units were priced at the system lambda plus 10%. The system lambda is the year-round average of the marginal generating cost of all units in the region (including peakers) and is, itself, certainly higher the variable operating costs of baseload units.

IV. RECOMMENDATIONS FOR REJECTION OF PROPOSED AUCTION

Q. GIVEN THESE CONCERNS WHAT DO YOU RECOMMEND THE ICC DO?

A. I recommend that the Commission reject the Ameren proposal and refuse to place BGS customers on competitive auction procurement.

Given the level of concern about market power and other issues in the Illinois region of the MISO wholesale market, the potential for a substantial increase in power costs by establishing power costs for retail customers solely on the basis of a clearing price auction, and the various economic risks that the Companies' proposal would impose on BGS customers, especially those that are the smallest and least able to access competitive alternatives, I recommend that the Commission adopt an alternative approach.

Q. IF THE ICC REJECTS THE PROPOSED AUCTION, WHAT ARE ITS ALTERNATIVES?

A. While there are many possibilities, I would bring the following to the Commission's attention:

a. The Commission could require a different form of competitive procurement, such as a Request for Proposals (RFP), which has some of the benefits of a "pay as you bid" auction, but is more flexible. Significant controls on affiliate transactions would be required under this option.

b. The Commission could reject the competitive procurement and require Ameren to procure least cost power under traditional cost recovery standards. Such procurement would be subject to traditional ratemaking standards.

I recommend the Commission adopt the second alternative above, namely to reject the auction proposal and order the Company to procure least cost power supply for BGS customers subject to traditional ratemaking standards.

V. RECOMMENDATIONS FOR AUCTION ENHANCEMENTS IF AN AUCTION IS ORDERED

Q. DO YOU HAVE RECOMMENDATIONS FOR THE COMMISSION ON HOW TO MITIGATE THE SHORTCOMINGS OF THE COMPANIES' PROPOSED AUCTION DESIGN, SHOULD THE COMMISSION DECIDE TO AUTHORIZE AN AUCTION OF THE TYPE PROPOSED BY THE COMPANIES?

A. Yes. Although I recommend that the Commission reject the Ameren proposal and refuse to place BGS customers on competitive auction procurement, if the Commission chooses to order an auction procurement, I recommend that it require the following:

a. An option for the Commission to reject the entire procurement if the result is unsatisfactory (not just if a procedural flaw is discovered);

b. Improved oversight and accountability for the auction process in the form of a Consumer Observer[4];

[4] I explain the meaning of this term and the role of the Consumer Observer in my testimony below.

c. Inclusion of a State entity who is assigned responsibility for market monitoring and taking action in the event of exercise of wholesale market power;

d. An allocation of power to long term, fixed price renewable sources and energy efficiency, if consideration of those resources as part of the Governor's Sustainable Energy Plan does not result in comparable risk mitigation benefits to BGS customers.

I discuss each of these recommendations below in more detail.

a. THE COMMISSION SHOULD RETAIN THE OPTION TO REJECT THE PROCUREMENT RESULT

Q. IF, AS YOU RECOMMEND, THE COMMISSION RETAINED THE OPTION TO REJECT THE ENTIRE PROCUREMENT OUTCOME DUE TO AN UNSATISFACTORY RESULT, WHAT ALTERNATIVES WOULD IT HAVE AT ITS DISPOSAL TO ENSURE CONTINUATION OF BASIC UTILITY SERVICE AFTER SUCH A REJECTION?

A. The primary alternative would be (1) to order Ameren to temporarily carry out least cost procurement using short term to medium term instruments (spot purchases, bilateral contracts and forward contracts of one month up to one year, appropriate hedges, and the like), and (2) consider whether to reschedule the auction for another attempt or use a different competitive process. I discuss the reasons for this recommendation in my testimony below regarding the proposed Consumer Observer's role.

b. NEED FOR A CONSUMER OBSERVER

Q. IS THERE ANOTHER ASPECT OF THE COMPANIES' PROPOSAL THAT SHOULD BE CORRECTED?

A. Yes. Ameren has proposed that the auction it recommends be monitored by a single entity, called the Auction Advisor. The Auction Advisor would be a representative of the Commission's Staff. I believe that a specific consumer perspective also needs to be represented in the oversight of the auction, should the Commission choose to authorize one.

Q. DO YOU HAVE A RECOMMENDATION REGARDING HOW A SPECIFIC CONSUMER PERSPECTIVE SHOULD BE INCORPORATED INTO THE OVERSIGHT OF SUCH AN AUCTION?

A. Yes. I recommend that the Commission provide a role for Consumer Observer. This role would be similar to that of the Auction Advisor proposed by Ameren who would be charged with observing and reporting on how well the process conforms to the approved model. *See*, Resp. Exhibit 6.0 line 1452 ff. The role I would recommend for the Consumer Observer would be similar, but with a different focus. The Consumer Observer should have the same access to information and processes as the Auction Advisor, but would be charged with monitoring the process and outcome from a consumer perspective and presenting that perspective to the Commission prior to its deliberation as to whether to accept or reject the results of the auction. The Consumer Observer would also be

positioned to play a fully knowledgeable and active role in process improvement reviews each year and in the formal review I recommend every three years (as well as in the annual informal reviews proposed by Ameren). Resp. Exhibit 4.0 at lines 275 ff. The presence and full participation of a Consumer Observer is a fundamental issue of fairness and of the perception of fairness.

Q. IS THERE A PRECEDENT FOR A CONSUMER OBSERVER?

A. Yes. The Maryland procurement process (an RFP approach) provides for such a role.

Q. WHY IS IT IMPORTANT THAT CONSUMERS BE ALLOWED AN OBSERVER TO OVERSEE ANY ICC ORDERED AUCTION PROCESS FOR BASIC UTILITY SERVICE PROCUREMENT?

A. Many auction advocates cite transparency as one of the primary benefits of the auction process. For wholesale bidders (both generation suppliers and purely financial bidders) and basic utility service providers, this holds true. Throughout the auction, these parties know exactly what is taking place—they are fully aware of different bids and bid strategies; they see which generators win supply contracts and which ones fail to win. All of this is beneficial to these parties. It helps them not only understand what goes on during the auction, but more importantly, that the process worked as intended. In other words, for these parties, the auction process is transparent.

The same cannot be said for consumers. From their perspective, the auction process is a big black box; all they know is that a generation rate was determined. In other words, consumers bear the full consequences of the process without having adequate insight into the actual process.

In the Companies' filing, it is clear that this situation is not projected to change. However, there is absolutely no valid reason why a Consumer Observer could not nor should not be allowed to observe and review the auction process in the same way the Auction Advisor currently observes and reviews the auction process.

I therefore recommend that a Consumer Observer be allowed to observe any auction process ordered by the Commission.

Q. PLEASE EXPLAIN WHAT THE CONSUMER OBSERVER'S ROLE SHOULD BE.

A. The Consumer Observer's role is multi-faceted. It includes the following activities:

a. Observing all activities leading up to the auction itself, including software development and testing, bidder education and communications, bidder qualification, and so on;

b. Observing preparatory steps such as establishment of the opening prices and number of tranches;

c. Real-time monitoring of all aspects of the auction;

d. Reviewing and analyzing auction data and documents, as needed;

e. Briefing of the Commission Staff on all of the above;

f. Forming its own assessment of the auction;

g. Making recommendations to the Commission regarding the acceptance or rejection of the auction results;

h. Assisting the Commission in its decision on acceptance or rejection of the auction;

i. Providing an independent report covering the same issues and factors as do the Auction Manager's and Auction Advisor's reports to the Commission;[5] and

j. Making recommendations to the commission about future auctions.

Q. WOULDN'T SOME OF THIS DATA BE AVAILABLE TO THE PUBLIC IN THE FORM OF REPORTS PROVIDED BY THE AUCTION MANAGER?

A. In New Jersey and I believe as proposed in Illinois, reports provided to the public by the Auction Manager are in a redacted form. In my view, such reports are of insignificant value to an entity responsible for protecting consumers' interests. All of the important data is redacted. The position of some parties that only the Auction Manager and the Commission Staff's Auction Advisor may have access to confidential information about bids and the auction process is a judgment on the part of those parties and not necessarily correct. In fact, in Maryland, the Office of the Public Advocate has played a role quite similar to the one I propose for the Consumer Observer. That role was the result of a settlement signed by many parties, including suppliers that bid in the Maryland procurement.

[5] *See*, Resp. Exhibit 6.0, line 1465 ff.

Q. WHAT KIND OF RECOMMENDATIONS COULD THE AUCTION ADVISOR AND CONSUMER OBSERVER MAKE?

I believe that it is appropriate and necessary for the Auction Advisor, as well as the Consumer Observer, to have the ability to recommend rejection of the auction results on the basis that the auction resulted in unreasonable price bids. I understand that this is controversial, and that it has been argued that this provision would chill competition. This is not an acceptable reason for prohibiting such authority. Innumerable competitive solicitations occur in private, commercial and government procurement processes where the purchaser reserves the right to reject the results for any reason or no reason without chilling competition. I see no reason why this procurement would be any different. Furthermore, I believe that potential bidders, especially generation owners, have a strong incentive to capture a share of the BGS load (a very large market), and that they will aggressively bid to serve that market.

Q. HOW WOULD THE CONSUMER OBSERVER BE CHOSEN?

A. The Consumer Observer should be selected by, and *only* by, the specific consumer advocacy entities that are identified as appropriate for that role in the design of the auction procurement. In particular, no other stakeholders should have any authority over that selection or over the actions of the Consumer Observer. The only exception to that provision should be the ability of the Company to request the ICC to enforce whatever agreements or orders cover the

activities of the Consumer Observer, including but not limited to confidentiality agreements.

Q. WHO WOULD THE CONSUMER OBSERVER REPRESENT?

A. The entities that appoint the Consumer Observer and to whom the Consumer Observer reports and is accountable should be recognized as official consumer advocates. Possible choices include the Citizens Utility Board (CUB) and the Illinois Attorney General's Office. There may be similar entities in other regions of the state. Ad hoc membership organizations, such as representatives of only limited subsets of consumers, should not be included. Whatever entities are included should be subject to the jurisdiction of the Commission, at least for the purpose of enforcement of the agreements or orders governing the activities of the Consumer Observer.

Q. HOW DO THE COMPANIES RESPOND TO THE CONCEPT OF A CONSUMER OBSERVER?

A. In response to Data Request CUB 1.26, the Companies say that they reserve consideration of an "Auction Monitor" or Consumer Observer, as long as confidentiality provisions acceptable to suppliers would be adopted and enforced.

Q. WHAT IS YOUR VIEW REGARDING CONFIDENTIALITY OF DATA AND THE CONSUMER OBSERVER?

A. Confidentiality is an issue relevant to protecting bidders from competitive harm between and among other bidders or potential bidders. However, this becomes a non-issue given that the consumer observer would sign a confidentiality agreement. My understanding is that, in New Jersey, the Auction Advisor is provided with all information in the possession of the Auction Manager and has access to observe all stages of the procurement process prior to and during the auction. The Consumer Observer should be subject to the same confidentiality requirements as the Auction Advisor - no more and no less.

c. NEED FOR AN INDEPENDENT STATE MARKET MONITORING ENTITY

Q. DO YOU HAVE ANY ADDITIONAL RECOMMENDATIONS FOR IMPROVING THE CHANCE THAT AN AUCTION PROCUREMENT WOULD BE APPROPRIATE?

A. Yes. I recommend that Illinois create a state-level entity to monitor the presence or abuse of market power in both wholesale and retail sectors of the electricity industry in Illinois. I will refer to this entity as the Illinois Market Monitoring Unit (MMU). It is my understanding that the Illinois Attorney General's Office is already authorized to perform this function (as well as monitoring of retail electricity markets) and has a statutory right to access the

information needed to do so, at least to the extent that the Commission has or obtains such information.

Q. WHY IS SUCH AN ENTITY NEEDED?

A. First of all, as witness Fagan explains in detail, the existence of a variety of wholesale electricity market flaws in MISO's Illinois region is evident. Those flaws mean that we should be concerned about the existence and potential abuse of market power.

When the Federal Energy Regulatory Commission (FERC) allowed wholesale market rate authority to go into effect, it required the various Independent System Operators (ISOs) to create internal market monitoring entities within the ISO's organization. FERC required that those entities have responsibility for monitoring for abuse of market power and for establishing procedures for the mitigation of that power.

FERC also endorsed the concept of an independent market monitor, in addition to the internal MMU each ISO is required to employ. Such independent entities are in place in New England, New York and MISO. Such an independent entity is able to provide an additional perspective on market operations, market rules, and market abuses as well as address the issue of possible shortcomings within the ISO's internal market monitoring unit. Also, an independent market monitor can compare the RTO's practices with those of other RTOs and recommend improvements.

From a consumer perspective, it is important to have a truly independent entity to look at the effectiveness of the overall market structures, as well as the effectiveness of market monitoring and mitigation procedures. RTO market monitors often support market and rule change proposals made by their own RTO, which may weaken the RTO's market monitoring and mitigation ability. An Illinois MMU's charge should include providing an independent voice on changes or needed improvements to RTO markets and rules. A state-level MMU could effectively do this since it is not absorbed in daily monitoring of market activity and would have a broad public interest view. This role is especially important as the RTO MMU's role and authority is and has always been under constant attack by various market participants.

Q. WHAT CONCLUSION DO YOU DRAW FROM THE ABOVE POINTS?

A. Consumers will see little or no benefit from retail competition or competitive procurement of Basic Generation Service (BGS) if wholesale power markets are not fully competitive. This is more than a theoretical issue. For all these reasons, Illinois should to explore all available avenues for enhancing the monitoring and mitigation of market power in its wholesale electricity markets.

Q. WHY IS ILLINOIS AN ESPECIALLY APPROPRIATE JURISDICTION FOR IMPLEMENTING A STATE MMU?

A. Illinois is one of the few states that developed its own institutional oversight of the nuclear power industry. The success of that nuclear oversight

covering a number of years, and numerous historical examples of states' economic and environmental self-advocacy in fields supposedly protected at the federal level, suggest that a similarly useful role could be crafted to protect consumers for wholesale electricity market power abuse. In addition, the Illinois Attorney-General's Office has relevant statutory authority for access to the necessary information.

Q. WHAT DO YOU PROPOSE?

A. I propose that the Commission require, as a condition precedent to any competitive procurement process for Illinois, the establishment of a state-level entity charged with representing electricity consumers' interests by monitoring the development and performance of wholesale electricity markets and associated markets for capacity, transmission and other goods and services. The purpose would be to detect actual and potential market power and abuse and to take action to prevent or eliminate such market power or abuse wherever it occurs.

Q. WHAT TOOLS OR AVENUES WOULD SUCH A STATE MMU HAVE FOR SEEKING REDRESS IN THE EVENT OF ACTUAL OR POTENTIAL ABUSE?

A. That would depend on the specific issue. If flaws were detected in wholesale market structures or regulation, solutions would likely be sought through proposals to the RTO or petitions to FERC seeking alterations to the market structure in question or with promoting remedial legislation. Remedies for

actual abuses could be sought through FERC, RTO, or US Department of Justice action to enforce or improve competitive standards, through litigation in the courts, or through promoting remedial legislation. There might also be opportunities to address problems impacting BGS customers through changes and enforcement under Illinois' regulatory authority.

This idea could, potentially, extend far beyond RTO-administered markets, if Illinois wished. Scrutiny of the behavior of electricity and natural gas exchanges and traders, such as we see carried out by the New York Attorney General's office and, perhaps, scrutiny of retail electric marketing abuses (to the extent there is a retail electric market) could also be included.

Q. WHAT WOULD IT COST TO IMPLEMENT AN ILLINOIS MMU?

A. The primary cost of this action would be personnel costs for monitoring and potential litigation costs for taking action in the case of detected market power abuse. There might also be costs for personnel or technical assistance in actively participating in PJM[6] or MISO committee activities or FERC rulemakings, as well as associated research costs. Experience suggests that a credible job of routine monitoring and RTO/FERC involvement could be done for something on the order of $1 million per year. Given the large scale of the wholesale market and the magnitude of effects that can be seen even with infrequent exercise of market power, the savings to consumers from addressing

[6] PJM is the RTO responsible for a number of MidAtlantic and central states or portions thereof, including the non-MISO portion of Illinois.

almost any detected abuse would far exceed the cost of establishing an Illinois MMU.

I would expect there to be numerous side benefits for consumers, as well. One very important benefit is that by merely existing, this entity may deter bad behavior saving customers lots of money.

Q. YOU HAVE MENTIONED ACCESS TO INFORMATION SEVERAL TIMES. WOULD AN ILLINOIS MMU BE ABLE TO ACCESS THE INFORMATION NEEDED TO DO ITS JOB?

A. Confidentiality of wholesale market data, such as bids and generation costs, is a very contentious issue. Generators fight hard to keep this information secret. RTO and FERC market monitors routinely collect and summarize such data, but are barred by various RTO rules from disclosing it. The Independent Market Monitors in New York and New England have access to all market information. State public utility regulators also have the right to request and receive this data under information disclosure procedures adopted in New England and PJM. In addition, masked market bid and offer data in some jurisdictions become public after a certain length of time passes, e.g., six months.

Furthermore, while FERC has ruled that access to wholesale market transaction data and other confidential market monitoring data is limited to "state commissions who have the regulatory and legal authority to monitor retail electric markets within the state," and expressed concern about "the possibility of many other state agencies being able to receive confidential information," I understand

that the Illinois Attorney General's Office has specific constitutional and legal authority in this area. 107 FERC 61,322 at 10. I recognize that FERC has issued certain orders establishing confidentiality requirements for ISO or RTO release of confidential market data that have implications for state regulatory commission access to that data. To the extent that such data are necessary for a state-level MMU to carry out its duties, other avenues may need to be pursued, such as requests to FERC to find that data are not confidential, use of subpoena powers, or other options.

d. INCLUSION OF RENEWABLES AND ENERGY EFFICIENCY INTO BGS

Q. WHAT IS BEING DONE IN ILLINOIS WITH REGARD TO RENEWABLE GENERATION AND ENERGY EFFICIENCY PLANNING?

A. The Governor of Illinois has called upon the ICC to set up a task force, the Governor's Sustainable Energy Plan Task Force, to explore the best ways to incorporate renewables and energy efficiency into Illinois's electricity supply and demand-side options.

Q. HAVE THERE BEEN ANY RESULTS WITHIN THE TASK FORCE THUS FAR?

A. Both Ameren and ComEd submitted proposals, and several counter proposals followed. Given the uncertainty of the outcome of the Task Force, my

overall recommendation regarding energy efficiency and long-term renewables in BGS procurement is that the ICC should retain the authority and option to act on matters relating to the incorporation of renewables and energy efficiency should the Governor's proceedings fail to deliver the right set of benefits to basic utility service customers.

Q. PLEASE EXPLAIN WHY THE COMMISSION SHOULD RETAIN FLEXIBILITY TO ADDRESS THESE ISSUES.

A. Consumers need and value electric price stability. Adding energy efficiency resources and long-term contracts (life of unit or fixed terms of 10-years or more) with fixed and reliable pricing is a practical way to deliver that stability. Such products also reduce the overall proportion of supply procured from more volatile shorter-term clearing price markets. Long-term or life of unit renewable energy purchases enhance price stability, since their costs are not affected by fossil fuel price swings or temporary shortages of generation. Energy efficiency resources enhance price stability for the same reason and also because many of the most attractive sources of efficiency savings also reduce on-peak energy use and peak demand.

Q. PLEASE EXPLAIN THE BENEFITS ASSOCIATED WITH LONG-TERM RENEWABLE CONTRACTS AND ENERGY EFFICIENCY.

A. I specifically recommend use of long-term contracts from renewable sources. Long-term, fixed price contracts for traditional fossil fuel supply are

difficult to procure at a reasonable price, because such resources are associated with high fuel price risk and environmental regulatory risk, such as the risk of future carbon dioxide emission regulation. Renewable resources, on the other hand, are free of such risks. Thus, only renewables can promise consumers reasonable, fixed generation prices for the long-term.

Energy efficiency resources make sense in constructing a default service procurement strategy, but for different, yet complementary, and compelling reasons. Not only does acquisition of efficiency savings reduce the cost of service and bills paid by BGS consumers, but it does so in a way that simultaneously mitigates price volatility, reduces the potential for wholesale market power abuse, and improves service reliability.

In combination with wise procurement practices to mitigate market power, inclusion of long-term fixed price renewables and energy efficiency in the portfolio for BGS procurement reduces a number of financial risks that would otherwise be borne by BGS customers, and over time, can reduce cost as well. Therefore, the Commission, if it approves an auction of any kind, should ensure that those enhancements are included, either as a result of the outcome of its proceedings on the Governor's Sustainable Energy Plan or directly via this proceeding.

Q. ARE THERE OTHER ADVANTAGES TO LONG-TERM RENEWABLE CONTRACTS?

A. Yes. Renewable developers can obtain better financing terms from the financial markets when a project has long-term supply contracts in place. In other words, long-term contracts are associated with lower capital costs for the construction of new plants. I view this as a win-win; long-term renewable contracts could pair lower capital costs with more stable and lower prices for BGS customers over the long-term.

Q. DO YOU HAVE A RECOMMENDATION FOR THE COMMISSION WITH REGARD TO THE INCORPORATION OF RENEWABLE GENERATION INTO BASIC UTILITY SERVICE PROCUREMENT, SHOULD THE COMMISSION NEED TO ACT ON THIS MATTER?

A. Yes. A portion of the basic utility service system energy requirements, increasing each year, should be procured from renewable resources on a long-term basis.

Q. WOULD THIS APPROACH DELIVER GREATER FINANCIAL PROTECTION AND RATE STABILITY TO BGS CUSTOMERS THAN A RENEWABLE PORTFOLIO STANDARD (RPS) APPROACH?

A. Yes, as mentioned above, an RPS approach can be somewhat effective at getting renewable plants built, but consumers do not realize the full economic benefits of including renewables in the BGS portfolio unless they can also benefit

from a long-term fixed price contract for their use. The cost savings and price stability that BGS consumers would obtain from including long-term, fixed price contracts for renewable power would not available to BGS consumer from a system that relies only on compliance with a renewable portfolio standard (RPS) with tradable credits alone; the RPS approach generally re-prices the cost of renewable certificates each year, leaving customers to pay high prices for certificates now with no assurance of avoiding fossil fuel risks later. Let me explain this further. With an RPS in place, but without specific long-term contracts for renewables in place, renewables end up being simply another generation option. And their price, like the price of any other generation option, is based on the cost of the unit on the margin. In the case of Illinois, all generation is therefore generally priced by reference to fossil fuel generation via the market clearing prices. In this scenario, even though renewable energy has no fuel component, since the price for all generation is based on the marginal unit cost, customers pay for energy from renewables as if they were paying for energy that runs on fossil fuel.

Alternatively, were there specific long-term renewable contracts in place to service basic utility service customers, the renewable generation component could be priced at the true cost of operating the renewable resource without regard to fossil fuel prices. This cost should be significantly lower, over-time, than the cost of operating a fossil fuel resource. Therefore, it makes sense for the Commission to link any renewable policy directly to basic utility service policy

by procuring a certain percentage of basic utility service supply through long-term renewable contracts.

Q. WHAT IS YOUR RECOMMENDED PROCESS FOR PROCURING LONG-TERM RENEWABLE CONTRACTS?

A. I believe it might be best to use an RFP process for the renewable supply contracts, while continuing to use an auction process for the remainder of the load. This is because the RFP process offers a bit more flexibility and may allow for longer terms. For example, if in any given year, bids for renewable generation seem unreasonable, offers could simply be rejected and another RFP would be issued the following year.

Q. SHOULD SUCH AN RFP PROCESS BE RUN SIMULTANEOUSLY TO THE AUCTION PROCESS?

A. No. I propose running the RFP process for the renewables contracts prior to the auction date for the majority of load. This way, the result of the RFP process will be known to all suppliers prior to the auction and should not be a risk factor that negatively affects suppliers' bids.

Q. PLEASE EXPLAIN FURTHER THE BENEFITS ASSOCIATED WITH INCLUDING ENERGY EFFICIENCY IN PORTFOLIO MANAGEMENT.

A. Energy efficiency:

- Reduces the risks associated with fossil fuels and their inherently unstable price and supply characteristics and avoids the costs of unanticipated increases in future fuel prices;
- Avoids the hard to predict costs of complying with potential future environmental regulations, such as CO2 regulation;
- Improves the overall reliability of the electricity system by lowering peak demand and providing more time and flexibility to respond to changing market conditions, while moderating the "boom-and-bust" effect of competitive market forces on generation supply;
- Defers expensive transmission and distribution upgrades and mitigating expensive transmission congestion problems; and
- Promotes local economic development and job creation.

Q. HOW CAN ENERGY EFFICIENCY BE INCORPORATED INTO THE PROCUREMENT OF BASIC GENERATION SERVICE?

A. I believe there are two ways to approach this task. One would be to allow providers of demand-side resources to bid into the auction just as do supply-side options. The other would be to set aside a portion of the BGS load and then to procure this portion separately through energy efficiency programs carried out by the utility or an independent third party. Either would be compatible with competitive procurement of the remaining residual load from an auction or alternative method or delivery by the utility.

Q. HOW WOULD THE PROCUREMENT OF ENERGY EFFICIENCY RESOURCES "FIT INTO" THE COMPANIES' PROPOSED COMPETITIVE PROCUREMENT PROCESS?

A. The short answer is that the Companies would not and do not need to directly enter that process. Rather, the most convenient way to procure energy efficiency resources would likely be to procure them separately from the BGS power procurement. The BGS power procurement "product" is already defined in terms of each winning bidder committing to supply a certain set percentage of the BGS customer load as it happens to occur. To the extent that efficiency resources are procured outside of that process, the BGS supply bidders will simply see a reduced load before the auction takes place. Of course, they should be provided with a clear picture of the funding and procurement goals for efficiency resources so that they will be able to estimate the load they are likely to need to serve.

e. ADDITIONAL COMMENTS ON AUCTION DESIGN

Q. DO YOU HAVE CONCERNS ABOUT THE FIXED-PRICE 3-YEAR CONTRACT LADDERING SCHEME THAT THE COMPANIES HAVE PROPOSED FOR SMALL RESIDENTIAL CUSTOMERS?

A. I would prefer to see a more diversified laddering scheme such as one that incorporated a mix of 1, 3, and 5-year contracts, but given the size of the Ameren BGS territory and the immaturity of the MISO markets, I recommend, for the time being, keeping a simple ladder, such as the one that is proposed by Ameren. Of course, as I discussed above, I would still like to see the inclusion of both

renewables and energy efficiency at this time. But, beyond this modification, I am currently satisfied with the Companies' 3-year laddering proposal.

Q. HOW OFTEN SHOULD THE AUCTION PRODUCTS BE REVISITED?

A. The Companies propose an informal workshop after each auction. Resp. Exhibit 4.0 at lines 276 ff. I do not disagree with this. The mix of auction products could be discussed at such informal workshops. However, over time, as market conditions and financial hedging instruments mature and change, it might make sense to incorporate entirely new products into the auction mix and an informal workshop would not necessarily result in such a significant issue being addressed fully. I, therefore, recommend that the ICC order a formal review of the product mix every three years. I say this having in mind that the ICC and utility should make such changes that are in the public interest with care and deliberation, and with participation by intervenors, so as not to unduly disrupt wholesale markets or auction participants' perceptions. But I see no need to arbitrarily rule out changes, should markets or other circumstances require them consistent with the public interest.

Q. DOES THAT CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes, it does.