

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

Commonwealth Edison Company	)	
	)	
Proposal to implement a competitive	)	Docket No. 05-0159
procurement process by establishing	)	
Rider CPP, Rider PPO-MVM,	)	
Rider TS-CPP and revising	)	
Rider PPO-MI.	)	

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**REBUTTAL TESTIMONY OF WILLIAM STEINHURST  
ON BEHALF OF THE CITIZENS UTILITY BOARD  
AND THE COOK COUNTY STATE'S ATTORNEY'S OFFICE**

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**CUB-CCSAO EXHIBIT 4.0**

**August 3, 2005**

**REBUTTAL TESTIMONY OF  
WILLIAM STEINHURST**

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1 **DOCKET NO. 05-0159**  
2 **BEFORE THE ILLINOIS COMMERCE COMMISSION**  
3 **REBUTTAL TESTIMONY OF WILLIAM STEINHURST**  
4 **ON BEHALF OF THE CITIZENS UTILITY BOARD**  
5 **AND THE COOK COUNTY STATE'S ATTORNEY'S OFFICE**

6 **I. INTRODUCTION**

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

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

11 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

12 A. I am testifying on behalf of the Citizens Utility Board (CUB) and the Cook County  
13 State's Attorney Office (CCSAO).

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

16 Yes, I am.

17 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

18 A. The purpose of my rebuttal testimony is to rebut the critiques raised by the  
19 Commonwealth Edison Company (ComEd or the Company) regarding my initial  
20 testimony as filed on June 8, 2005, and to restate my specific recommendation to the  
21 Illinois Commerce Commission (ICC or Commission).

22 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

23 A. The introductory section includes a brief purpose statement, which is followed by a  
24 brief summary of my rebuttal testimony in Section II. In Section III, I restate certain  
25 issues I raised in my prefiled testimony and provide an overview of the major issues  
26 that ComEd has not addressed in its Illinois Auction Proposal of February 25, 2005  
27 (initial filing) or its rebuttal testimony, submitted on July 6, 2005. Section IV then  
28 restates and clarifies our specific proposal. I next discuss, in Section V, the  
29 importance of reviewing procurement results for prudence. Section VI addresses and  
30 rebuts additional specific critiques of my direct testimony by ComEd's witnesses,  
31 while Section VII discusses other issues including certain modifications proposed by  
32 the Company or Intervenors. Lastly, in Section VIII, I summarize why the  
33 Commission should not adopt the Company's initial or revised proposal and reiterate  
34 my support for the auction changes I proposed in my direct testimony.

35 **II. SUMMARY**

36 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

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

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

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

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

66  
67

67 **III. OVERVIEW OF ISSUES AND RESTATEMENT**

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

70 A. I discuss the following points:

71 1) Due to the nature of the Company's filing in this proceeding, the  
72 Commission does not have before it a procurement docket that allows for  
73 consideration of all the alternatives, nor does the Commission have the information  
74 required for it to make a reasonably well-informed decision about how to proceed.

75 As a result, the Commission has little choice but to reject ComEd's proposal;

76 2) Whatever its reasons, the Company has sought approval of a particular  
77 procurement method and permission to virtually automatically flow through the costs  
78 resulting from that procurement, effectively side-stepping the possibility of a  
79 prudence review of certain past actions regarding divestiture taken after passage of  
80 Illinois' Electric Service Customer Choice and Rate Relief Law of 1997 (220 ILCS  
81 5/16-101, the Restructuring Law);

82 3) How the Company's claim that I have advocated for a reversal of legislative  
83 decisions to promote competition is a gross mischaracterization;

84 4) Why the Commission should be concerned about the competitiveness of  
85 those wholesale electric markets on which the Company's proposed auction would  
86 rely; and

87 5) A few of the Company's mischaracterizations of my previously filed direct  
88 testimony.

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

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

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

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

103 As I discuss in detail below (and subject to a reservation explained at that  
104 place in this testimony), the Procurement Working Group (PWG) of the  
105 Commission's Post-2006 Initiative focused on quite a number of alternative  
106 procurement scenarios. At one point in that consideration, a list of 18 suggested  
107 characteristics of supposed "ideal" procurement processes was floated. Contrary to

108 suggestions by the Company in its rebuttal testimony,<sup>1</sup> the PWG did not reach  
109 consensus about the desirability of any specific procurement mechanism, much less a  
110 determination that one was “ideal.” As Staff put it in their report, “In the end, the  
111 group chose not to recommend a specific procurement strategy.” *See* ComEd Ex. 1.2  
112 at 6.

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

121 **Q. WHAT DID THE COMPANY ACTUALLY SUBMIT IN ITS INITIAL**  
122 **FILING?**

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

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<sup>1</sup> For example, the Company quotes a statement by Constellation Energy Commodities Group, Inc.’s witness Michael Smith, that “The Procurement Working Group last summer developed a list of 18 attributes of a successful procurement model and, of all the different structures considered, the Procurement Working



128 methods on default service consumers other than its favored, once-a-year auction.  
129 *See generally* AG Ex. 2.0.

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

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

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

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Group determined that the Illinois Auction Structure best meets those attributes.” (ComEd Ex. 10.0 at lines 135-38)

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

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

156 The vastness of that management decision, which has undergone only limited  
157 review, calls out for a determination that ComEd's decision to divest was prudent and  
158 calculated to result in the best outcome for ratepayers. If the decision to divest or the  
159 particulars of the transaction were imprudent, ratepayers should not be penalized by  
160 paying higher rates than they would have paid had the management made such  
161 decisions prudently.

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

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

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

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

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

183 A. The typical approach to implementing the prudence standard in utility regulation is  
184 through rate cases. I will briefly describe my understanding of the typical practice  
185 followed in such cases. Generally, a utility seeking recovery of costs, such as power  
186 procurement costs, through retail rates presents evidence of those costs in a rate  
187 filing. The utility is usually accorded a rebuttable presumption that its costs are  
188 prudent, but that presumption disappears when parties challenge a cost. The utility  
189 then bears the burden of producing evidence to support the prudence of its actions

190 leading to the disputed costs, and the Commission renders a decision as to whether  
191 those costs were or were not prudently incurred.

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

204 **Q. IN YOUR EXPERIENCE, WHAT KIND OF ISSUES ARE TYPICALLY**  
205 **MATTERS OF CONCERN IN SUCH A PRUDENCE INVESTIGATION**  
206 **SUCH AS ONE THAT MIGHT BE UNDERTAKEN CONCERNING THE**  
207 **COMPANY'S DIVESTITURE ACTIONS?**

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

211 Taking the Company's decisions to divest itself of its generation resources  
212 following adoption of the Restructuring Law as one example, it is clear that whatever

213 costs will be incurred to serve default service load post-2006 will have been  
214 determined, at least in part, by the Company's divestiture decisions. Hence, a few of  
215 the likely prudence-related questions that could arise include, but would not be  
216 limited to: What did Company management know about potential future costs of  
217 power from those divested plants? How did the Company manage the divestiture  
218 process, including what kinds of purchasers (such as non-affiliates) were considered  
219 and how was that consideration carried out? What evidence did ComEd have or  
220 should have had about how divestiture was likely to affect customers and  
221 shareholders? In addition, questions would likely arise regarding the terms and  
222 conditions set for any divestiture and the manner in which the divestiture was actually  
223 implemented.

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

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

235 A. In its rebuttal testimony, Company witnesses repeatedly claim that my proposal seeks  
236 to “turn back the clock” (ComEd Ex. 9.0 at line 58) and deviate from, if not violate,  
237 existing laws to promote competition in the wholesale and retail electric generation  
238 markets. For example, witness Hogan states,

239 I interpret Dr. Steinhurst’s recommendation as inviting the  
240 Commission to reverse course from the path defined by the  
241 Legislature. He would have the State return to regulated rate-based  
242 generation – all after ComEd has divested its generation in reliance on  
243 the restructuring framework and after ComEd and other parties have  
244 made substantial financial and other commitments consistent with the  
245 original restructuring path.

246 ComEd Ex. 16.0 at lines 161-66.

247 **Q. IN YOUR DIRECT TESTIMONY, DID YOU, IN FACT, RECOMMEND**  
248 **THAT THE LEGISLATURE REPEAL THE RESTRUCTURING LAW?**

249 A. Of course not. My testimony did not suggest undoing retail choice in Illinois, but  
250 simply recommended that the Commission fulfill its obligation *under* the  
251 restructuring legislation. While the regulation of wholesale electricity markets is the  
252 province of the FERC, as the state regulator, the Commission possesses wide latitude  
253 in reviewing a utility's proposal for how to provide default service for those who do  
254 not or cannot shop, including how that service should be priced. In addition, since the  
255 Restructuring Law left ComEd with responsibility to provide default service, the  
256 Commission has a responsibility to determine whether ComEd has fulfilled its  
257 responsibilities as default service provider in a proper manner.

258 In its initial and rebuttal testimony, the Company implies that the process for  
259 determining how it should procure power post-2006 is heavily constrained by the fact

260 of its prior decision to divest. In other words, the Company claims to be helpless to  
261 fulfill its duty as default service provider in any way other than to be a price taker in  
262 the regional wholesale markets and asserts that its proposed auction is the best way to  
263 do so. In so arguing, the Company misrepresents both the breadth of procurement  
264 options open to it, as well as the considerable flexibility given to it under Illinois's  
265 restructuring legislation. It is my understanding that the Company continues to have  
266 all the flexibility it always did in choosing resources and procurement methods, plus  
267 additional, new flexibility in how it runs its business.

268 The company further argues that the Commission should unilaterally reduce  
269 its oversight role by eliminating much of its ability to protect consumers. The  
270 Commission, however, is still responsible for oversight and for ensuring that  
271 company is delivering default service at just and reasonable rates.

272 My testimony simply called for the Commission to reject the Company's  
273 proposal, to open an investigation of the full range of procurement options for default  
274 service, and to affirm that, regardless of which procurement method is employed,  
275 retail rates remain subject to traditional regulatory standards of justness and  
276 reasonableness, which entail a prudence review of the company's decisions. Nothing  
277 in my recommendation is outside of the Commission's jurisdiction or undoes retail  
278 competition in Illinois.

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

280 A. The Company's rebuttal testimony goes to great lengths arguing that the wholesale  
281 market flaws documented in the direct testimony of witnesses Fagan and Rose, and  
282 referenced by my direct testimony, are irrelevant to the Commission's task in this

283 proceeding. ComEd begins with two facts: it does not own any generation and its  
284 existing contracts to supply default service consumers expire after 2006. The  
285 Company interprets these two facts to mean that it has no recourse in the procurement  
286 of power to serve default service customers other than to reflect and flow through to  
287 default service consumers the price effects of any imperfections in the wholesale  
288 power market. As I will explain below, this is not true and, further, the portfolio  
289 design and procurement method proposed by the Company not only passes through to  
290 default service consumers all costs and risks of that procurement, but actually  
291 exacerbates some of those risks by placing all of the default service load on single-  
292 product, single-date auctions.

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

299 **Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE COMPANY'S**  
300 **ARGUMENT.**

301 A. For examples of how the Company begins its argument, we can look at the following  
302 sample quotes:



303 ComEd does not own generation and it has no right to demand that any  
304 owner of generation or financial participant in the market, affiliated or  
305 not, sell it electric power or energy, and it has been recognized that  
306 Illinois certainly has no right to demand that ComEd be sold power  
307 and energy for a lower price than those sellers' FERC-filed rates  
308 permit.

309 ComEd Ex. 9.0 at lines 509-13.

310 ComEd does not own a portfolio of generation that would allow it to  
311 supply its customers and ComEd will have to procure this supply for  
312 its customers in some manner once current contractual arrangements  
313 expire at the end of 2006.

314 ComEd Ex. 11.0 at lines 410 ff.

315 This horse has left the barn. The witnesses appear oblivious to the fact  
316 that the General Assembly restructured the electric industry in Illinois  
317 in 1997 and that ComEd no longer owns the generating units. The new  
318 owners of those divested assets are not Illinois-jurisdictional entities.

319 ComEd Ex. 15.0 at lines 91-94.

320 Leaping off from these simple historical statements, the Company witnesses  
321 seek to convince the Commission not only that it is without recourse against the  
322 power of the markets, but also that we should not worry about any flaws in those  
323 markets. Neither of those inferences is valid.

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

327 For example, Witness Hieronymus states:

328 [I]f the relevant wholesale electricity market is flawed and  
329 insufficiently mitigated, as these witnesses opine, why should a change  
330 in procurement mechanism solve the problem? If the market  
331 underpinning an auction is fraught with market power, using some  
332 other form of "least cost" procurement will not change the situation.

333 ComEd Ex. 15.0 at lines 73-76.

334 Dr. Hieronymus then points to the highly politicized and undisciplined actions  
335 of the California Department of Water Resources as evidence that no one portfolio  
336 manager can do any better than to throw him or herself (100% long in a single  
337 product) on the market. This statement is wrong on its face. Clearly prudent utilities  
338 have relied on a wide range of products, term lengths, and procurement methods to  
339 manage risk and cost. Few, if any, have had the temerity to place their entire resource  
340 portfolio in a "blind trust."

341 Likewise, witness LaCasse states that the Auction Process "is the best  
342 procurement process for customers *whatever the state of the wholesale markets*. If  
343 there is a problem with the wholesale markets, that problem must be fixed directly  
344 and cannot be fixed by ComEd's choice of procurement mechanism." ComEd Ex.  
345 11.0 at lines 447-49 (emphasis added). She bases the above inference on the  
346 following argument:

347 Regardless of the procurement method for such supply that the ICC  
348 ultimately selects – whether this procurement is conducted through an  
349 auction as ComEd proposes, through another competitive process, or  
350 through utility management of a portfolio as some advocate –  
351 ultimately participants in the wholesale markets will be supplying the  
352 inputs to such supply. In this sense, reliance on the wholesale markets  
353 cannot be avoided. The selection of another procurement method does  
354 not alter the state of the wholesale markets and does not remove the  
355 necessity that participants in the wholesale market will deliver the  
356 inputs for the supply of ComEd customers.

357 ComEd Ex. 11.0 at lines 412-20.

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

361 **Q. WHAT IS THE PROBLEM WITH THE COMPANY'S LINE OF**  
362 **REASONING?**

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

369 Even if the market power mitigation tools available to PJM were sufficient,  
370 and we could count on PJM to vigorously apply them so that an auction might elicit  
371 prices for tranches that reflected "a market assessment of the cost of hedging," the  
372 mere ability to hedge does not eliminate the effect of market power, per se. ComEd  
373 Ex. 16.0 at lines 602–05. The potential bidders in the Company's proposed one-  
374 product, one-time auctions have to get their power from somewhere (unless they are  
375 themselves the generation owners who *have* market power) and that somewhere is a  
376 set of wholesale markets that cannot be cleared of the threat of abuse. As Witness  
377 Fagan states:

378 High generation ownership concentration levels, coupled with the  
379 termination of Exelon’s obligation to serve ComEd BUS load, will  
380 lead to the potential for exercise of market power in the Northern  
381 Illinois region. This wholesale market structure flaw, combined with  
382 immature MISO markets and the presence of a market “seam” between  
383 the NI and Southern Illinois regions will result in less than fully  
384 competitive wholesale markets in Illinois. The proposed ComEd BUS  
385 procurement auction can only be successful if the foundation of a fully  
386 competitive wholesale market exists. Thus, even if a superior auction  
387 mechanism was devised, until the regional wholesale markets are  
388 competitive it is likely that resulting prices to consumers will be higher  
389 than necessary.

390 CUB-CCSAO Ex. 1.0 at lines 717-26.

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

402 **Q. WHY SHOULD THE COMMISSION BELIEVE THAT COMED COULD**  
403 **OBTAIN A BETTER RESULT FOR DEFAULT SERVICE CUSTOMERS VIA**  
404 **AN ACTIVELY MANAGED PORTFOLIO DESIGN AND PROCUREMENT**  
405 **STRATEGY THAN THOSE CUSTOMERS WOULD SEE FROM THE**

406 **PROPOSED AUCTION? WOULDN'T CONSUMERS WIND UP NO BETTER**  
407 **OFF SINCE COMED WOULD JUST HAVE TO BUY THE SAME**  
408 **PRODUCTS FROM THE SAME FLAWED MARKETS?**

409 A. Actually, ComEd would not be so constrained. There are many products that ComEd  
410 can combine into an actively managed portfolio design. Remember, ComEd's  
411 proposed portfolio design (aside from transient startup differences, a laddered mix of  
412 1-, 3-, and 5-year fixed-price full requirements contracts in certain set allocations, all  
413 procured in one way on one day each year) represents only one small selection from  
414 that array of possibilities.

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

- 418 • Standard wholesale electric power market forward contracts of various term
- 419 lengths from a month to a number of years and a wide range of starting dates;
- 420 • Spot purchases;
- 421 • Bilateral negotiated contracts of varied terms, sizes or start dates;
- 422 • Unit-specific power contracts with owners of existing units;
- 423 • Non-unit-specific power contracts with owners of groups of existing units;
- 424 • Residual load following contracts;
- 425 • Options to buy (or sell) power at various prices at various times;
- 426 • At-cost, fixed price, turn-key or other types of arrangements for power from
- 427 new or existing units at various locations.<sup>2</sup>
- 428

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<sup>2</sup> Strategic choice of location for new units can create significant savings for the Company's distribution costs. These savings include reduced line losses, especially on peak, and avoided or deferred transmission and distribution upgrades. The Company's proposed procurement methods place *no* value on such savings, a serious omission. It might be argued the locational marginal pricing policies of PJM 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 ComEd 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.

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

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

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

449 I would also point out that the Company's proposal makes no particular effort  
450 to mitigate the risks inherent in the startup of its proposed portfolio design; the most  
451 risky time in the life cycle of its proposed portfolio is the day of the first proposed

452 auction when 100% of the default service load is exposed to the markets, markets  
453 which have had the least time to mature. Even if it were true that the Company's  
454 ongoing portfolio design presented a reasonable risk profile, due to laddering of CPP-  
455 B procurement, for example, that is certainly *not* true on day one of the first auction.

456 Moreover, announcing in advance that all purchases will be made from a  
457 flawed market using a mechanistic process may make it easier and more profitable for  
458 suppliers with market power to drive up prices, because the procurement would occur  
459 at a single, annual event. This also makes the procurement more vulnerable to  
460 external events that affect markets. Plus, under its proposed procurement method,  
461 ComEd does not have an incentive to vigorously protect consumers, since the  
462 automatic pass through of costs ensures that it will recover whatever suppliers charge.

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

468 **Q. WHAT DO YOU MEAN BY REDUCING PORTFOLIO RISK, AND WHAT**  
469 **ARE SOME WAYS TO DO SO?**

470 A. I mean balancing the overall risks of a portfolio of resources as a whole. Some of  
471 these include supplier default, fuel price and availability risk, delivery risks,  
472 regulatory and environmental compliance risk, unit outages, and price volatility.  
473 These risks exist for each component of a given portfolio. The portfolio risk is then  
474 the overall level of these risks in the portfolio as a whole. It can be less than the risks

475 inherent in the individual portfolio components, since carefully chosen components  
476 may have diversified or even offsetting risk profiles.

477 Many consumers, especially small consumers with few opportunities to shop,  
478 value low risk resources. In my opinion, residential electricity consumers as a whole  
479 and many small commercial electricity consumers have a strong preference for  
480 portfolios with a low risk of price swings, particularly very large price swings.  
481 Increasing the variety of products and portfolio options being considered is one way  
482 to deliver this preferred outcome to those smallest consumers. I would observe that  
483 the proposed auction subjects those customers to a resource mix that is diversified in  
484 only three of all the possible ways: use of tranche product contracts that represent  
485 delivery promises by (presumably) a variety of vendors, including three of the many  
486 possible term lengths, and using staggered ladders for two of those term lengths (the  
487 three- and five-year products). Of course, only the first two of those deliver real  
488 diversification in the first auction.

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



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

501 A. Despite suggestion to the contrary, obtaining a managed portfolio priced below the  
502 limited products on which the proposed auction would rely may well be possible  
503 through careful design and procurement and would not require “that somehow the  
504 market participants won’t notice or can be manipulated into selling their power at  
505 below market prices.” ComEd Ex. 16.0 at line 683 ff. It is true that any wholesale  
506 supplier will weigh the benefit of selling power to ComEd against its opportunity  
507 cost—that is, the amount that it can receive for the same product elsewhere.

508 However, what the Company’s witnesses miss or gloss over is that the opportunity  
509 cost is not strictly selling to ComEd versus selling the identical product into “the  
510 market.”

511 “The market” is a vague term. There are numerous spot markets and short-  
512 term forward markets run by PJM. There are commodity markets where electric,  
513 natural gas, weather and other forward contracts and options are bought and sold for a  
514 wide variety of term lengths and starting dates. There are more informal  
515 arrangements where buyers and sellers negotiate bilateral arrangements that provide  
516 various kinds of non-price benefits in return for lower prices. One example is a unit-  
517 specific contract. Such contracts are of great interest to generation owners who may  
518 offer attractive terms and prices to buyers willing to consider such a contract.

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

526           The Company’s proposed auction products have strictly defined contract  
527           lengths, firmness, type of service (i.e., energy, capacity, ancillary services), and start  
528           dates, among other things. In contrast, diversified, actively managed procurement  
529           would allow flexibility in procurement decisions and negotiations. If properly  
530           managed and utilized, this flexibility can provide benefits that would not be possible  
531           under rigid auction rules, by allowing both the buyer and the seller to exchange non-  
532           monetary benefits.<sup>3</sup> The full range of opportunities and benefits to the supplier—  
533           including non-monetary benefits, such as a stable income stream, the value of a  
534           business relationship, or any aspect of the transaction that has value to the supplier  
535           and lead it to reduce the price vis-à-vis an alternative—must be considered for this  
536           comparison.

537           Thus, there is reason to believe that a soundly designed and actively managed  
538           portfolio for the benefit of default service customers can be an improvement in risk,

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<sup>3</sup> While it might be argued that ComEd 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 Exelon corporate structure.

539 price, or both compared to the Company's proposed one-product, one-day-a-year  
540 auction.

541 **Q. IS THERE REASON TO BELIEVE THAT THE COMPANY IS CAPABLE OF**  
542 **ACTIVELY MANAGING A PORTFOLIO?**

543 A. Yes, I believe there is.

544 Dr. LaCasse maintains that

545 [W]hen the portfolio management service is in the hands of the  
546 competitive market, as it is in the Auction Process proposed by  
547 ComEd, the competitive suppliers are the ones who will decide how  
548 efficient it is to leave some of the position open. The competitive  
549 suppliers will factor any such advantages directly into their bids.  
550 Customers will get the benefit of such cost minimizing strategies, and  
551 they will get this benefit at a fixed price.”<sup>4</sup>

552 ComEd Ex. 11.0 at lines 373-77, and

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

556 ComEd Ex. 11.0 at lines 389-91.

557 From this, she argues that a supply portfolio managed by the Company and subject to  
558 Commission oversight could not produce greater benefits for consumers than the  
559 proposed auction. For example, Dr. LaCasse states that

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

563 ComEd Ex. 11.0 at lines 444-47, and that

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<sup>4</sup> The term "leave open" here seems to mean how much of a winning bid would *not* be covered by firm purchases or hedges. Thus, it would be the amount the bidder chooses, at a given time, to leave "open" and subject to the need to make spot or other short-term purchases to cover.

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

568 ComEd Ex. 11.0 at lines 420-423.

569 However, as I have explained above, in an effort to reduce risk, the Company can  
570 further diversify its default service portfolio, use its special financial advantages, and  
571 use its purchasing power to reduce price. While the Company may reply that it no  
572 longer has that expertise in house, there is no reason to think that the Company cannot  
573 obtain this skill any time it chooses to do so.

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

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

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

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

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

597                   Let us examine how each entity would fare if they did not maximize  
598 efficiency and cost savings. Auction participants who didn’t bid low enough to win  
599 tranches might lose the opportunity to sell into the auction, but would see no actual  
600 loss other than the time and money it cost them to participate. Also, auction  
601 participants who are generation owners could sell into the wholesale markets if they  
602 did not win in the auction (and, perhaps, exercise market power in doing so). Those  
603 auction participants who are financial players could simply refrain from locking in the  
604 contracts and hedges that they would have executed if they had won. On the other  
605 hand, if my proposal were adopted and if ComEd did a poor job at portfolio design  
606 and procurement, any disallowance would leave the Company actually out of pocket.  
607 Clearly, this is a powerful incentive for ComEd to prudently manage its portfolio.

608                   In addition, a traditional rate review will provide a level of transparency and  
609 ratepayer confidence that cannot be assured from the Company's auction proposal.  
610 Transparency is widely touted as an important element of competition and economic

611 efficiency. In my opinion, the Company's auction proposal provides little or no  
612 transparency to consumers.

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

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

619 A. Absolutely. In fact it is the norm, while rigid auction procurement is the rare  
620 exception. Diversified, actively managed portfolio procurement has a long history in  
621 many jurisdictions, and certainly it has a greater track record than the so-called “tried  
622 and true” auction proposal. This stands in contrast to Company claims, such as,  
623 “ComEd has consistently proposed mechanisms and procedures which have been  
624 implemented in the past and have track records of success. Simply put, ComEd has  
625 proposed tried and true auction mechanisms.” ComEd Ex. 9.0 at lines 219-21.

626           Only one state is using an auction to procure supply for its non-shopping load.  
627 New Jersey has carried out a series of such auctions, but there are critical differences  
628 between the state of the market in New Jersey when the BGS auctions began in 2001,  
629 almost four years after PJM opened its first bid-based energy market,<sup>5</sup> and the  
630 fragmented, in-flux, and barely-established wholesale markets in Illinois. Witness  
631 Fagan discusses these issues in his direct and rebuttal testimony. Several other

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<sup>5</sup> This market opened on April 1, 1997. See, <http://www.pjm.com/about/overview.html>

632 jurisdictions in the Mid-Atlantic region of PJM have begun to use RFP procurement,  
633 but even here there is typically more diversification than ComEd proposes, including  
634 at least multiple procurement dates each year.

635 Auctions have produced both favorable and unfavorable retail outcomes in the  
636 PJM region: In Washington, DC, the 2004 RFP for 2005 rates resulted in a BGS-FP-  
637 equivalent rate of 5.9 cents per kWh. This represents a quite large increase  
638 (approximately 2 cents/kWh or about 50%) over DC's previous rate. A similar jump  
639 occurred in Maryland; 2004 generation rates were approximately 1.7 cents/kWh  
640 higher than in 2003. Maine is no exception. The 2004 ME RFP process for the  
641 procurement of BGS-FP-equivalent service resulted in 2005 prices of 6.95 and 7.0  
642 cents/kWh. This represents an approximate two-cent or about 40% jump relative to  
643 the last RFP held in 2002. The 2005 NJ BGS auction resulted in a 22% increase in  
644 supplier contracts (resulting rates were only 5% higher due to laddering).

645 **Q. BY PRESENTING THE INFORMATION ABOUT ELECTRICITY PRICE**  
646 **INCREASES ARE YOU SAYING THAT THESE INCREASES RESULTED**  
647 **FROM MARKET MANIPULATION OR IMPROPER PROCUREMENT**  
648 **DESIGN OR EXECUTION?**

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

653 **Q. ARE THERE ANY OTHER OVERARCHING CONCERNS YOU HAVE**  
654 **WITH THE COMPANY'S REBUTTAL TESTIMONY?**

655 A. Yes. Many rebuttal criticisms of CUB/CCSAO mischaracterize the statements made  
656 in our direct testimony. For example, in Company Exhibit 16.0, Dr. Hogan states:

657           Rather, the assumption of both Dr. Laffer and Dr. Steinhurst appears to  
658           be that somehow the market participants won't notice or can be  
659           manipulated into selling their power at below market prices.

660 ComEd Ex. 16.0 at lines 683-85.

661           Nowhere do I claim that ComEd could manipulate or fool market participants.  
662           However, as explained above, outside of a rigid, single product, single date auction,  
663           each potential seller would have a different product, different preference for riding  
664           the market price vs. locking in a stable income stream, different preference for the  
665           firmness of the product being sold, different fuel price risk and availability, different  
666           date at which products become available or have other commitments, different cash  
667           flow requirement and credit resources, different expectation for how the spot and  
668           forward markets will perform and for future loads and supplies, and so on. Although  
669           all potential vendors know certain common market information, such as the forward  
670           price quotes for power and fuels at any given point in time (as will ComEd), there is  
671           no reason to think that every potential vendor will seek the same price for whatever  
672           product it has to sell.

673           Similarly, Witness Juracek states:



674 They also essentially ignore the direct testimony concerning the  
675 operation of the regional electric market, the transmission grid, and the  
676 proposed auction, instead making claims about the supposed  
677 unjustness or unreasonableness of open markets and competition based  
678 on dated and ill-informed misconceptions.

679 ComEd Ex. 9.0 at lines 63-67.

680 As for "essentially ignoring the direct testimony," we (the CUB/CCSAO  
681 witnesses) simply disagree as to the competitiveness of the existing markets and the  
682 merits of the proposed auction. We do not assert that open markets or competition  
683 are "unreasonable" or "unjust" in general. Rather, we point out concerns about the  
684 state of the *actual existing and expected* wholesale markets and level of wholesale  
685 competition. Finally, it is difficult to ascertain what "outdated" information or  
686 "misconceptions" witness Juracek means, but witness Fagan responds to criticisms of  
687 the use of specific reports and data.

688 In general, there seems to be a tendency on the part of Company rebuttal  
689 witnesses to mischaracterize the premises I rely on and then use those  
690 mischaracterizations against me. To be clear, I am not opposed, in principle, to  
691 auctions as a part of a procurement methodology. Auction-based procurement can  
692 have benefits. However, until such time as the relevant wholesale markets are  
693 demonstrably functional, reliance on this singular procurement strategy seems to me  
694 itself "ill-informed." The Company's rebuttal strategy of making numerous  
695 haphazard accusations mixed with rhetoric that makes them hard to tease apart and  
696 respond to systematically is not really helpful to the Commission or to this  
697 proceeding.

698

**IV. PROPOSAL FOR ALTERNATIVE PROCUREMENT**

699 **Q. WHAT HAS THE COMPANY SAID WITH REGARDS TO THE**  
700 **RECOMMENDATION FOR PROCURING POWER IN YOUR DIRECT**  
701 **TESTIMONY?**

702 A. One persistent criticism is that I have not proposed a specific alternative to the  
703 proposed auction. Several Company rebuttal witnesses make much of this supposed  
704 absence. For example,

705           Yet, after more than a year of discussion and debate through  
706           Commission sponsored workshops and legislative hearings, they offer  
707           no viable alternative to meet the critical electricity needs of the State in  
708           2007 and beyond.

709 ComEd Ex. 9.0 at lines 61-63.

710           There are none. It is striking that after well over a year of pre-filing  
711           investigation and analysis in which the Opponents participated and  
712           several months of post-filing analysis and discovery, there is no  
713           concrete substantive alternative suggested by the Opponents in their  
714           testimony.

715 ComEd Ex. 9.0 at lines 496-99.

716           I am forcefully struck by the absence of any meaningful alternative  
717           proposal put forth by these witnesses. Dr. Steinhurst proposes (pages  
718           3, 10), and Mr. Fagan concurs (pages 5, 36), that the proposed auction  
719           should be rejected and ComEd ordered to procure power at least cost  
720           under “traditional ratemaking standards” (Steinhurst, page 23).

721 ComEd Ex. 15.0 at lines 69-72.

722           Q. Do the intervener witnesses propose a plausible alternative to the  
723           ComEd competitive auction approach? A. No.

724 ComEd Ex. 16.0 at lines 615-16.

725 Q. Would the Commission be in a better position if, as Dr. Steinhurst  
726 proposes, it ordered ComEd “to carry out the necessary procurement  
727 under traditional ratemaking” (Steinhurst Dir. 4, 23:530-533)? A. No.  
728 To begin with, Dr. Steinhurst does not explain what he mean by these  
729 terms, but the meaning matters. Since ComEd does not own any  
730 capacity of its own, what exactly is a “procurement under traditional  
731 ratemaking” that is conceptually different from going to the market to  
732 acquire the necessary supplies?

733 ComEd Ex. 16.0 at lines 929-35.

734 **Q. IN YOUR DIRECT TESTIMONY, DID YOU MAKE, IN FACT, A**  
735 **RECOMMENDATION FOR PROCURING POWER?**

736 A. Yes, I did make such a recommendation.

737 Specifically, I proposed that the Commission order ComEd to retain  
738 responsibility for portfolio design and product procurement using a soundly designed  
739 and actively managed resource portfolio.

740 I would also point out that that this docket was not structured to weigh one  
741 portfolio design against another or one procurement method against another. Rather  
742 it is a narrowly framed proceeding in which the Commission is limited to approving  
743 or rejecting the Company's tariff proposals.

744 **Q. DIDN'T THE COMPANY CONDUCT A THOROUGH EVALUATION OF**  
745 **OTHER OPTIONS?**

746 A. No, it did not present such an evaluation in its testimony. For example, with regard to  
747 its portfolio design, the Company has not presented evidence that an assemblage of  
748 100% fixed price products is the best balance of rate stability and price, or that its  
749 choice of term lengths and allocation percentages of the portfolio among them is the

750 best choice. As to its procurement design, just to take the simplest example, the  
751 Company has not compared the expense of multiple procurement dates in each year  
752 to the diversity and risk mitigation that approach would offer. Beyond these simple  
753 examples, the Company has not presented objective evidence comparing its proposal  
754 to any other.

755 The Company rebuttal witnesses make much of our opposition to its proposal,  
756 charging that such opposition amounts to "ignor[ing] the fact that any *realistic*  
757 alternative will also necessarily involve market-based procurement." ComEd Ex. 9.0  
758 at lines 507-08. While this is another mischaracterization of our testimony, this  
759 comment does suggest that the Company has not explored non-market-based options.

760 It seems that the Company simply *assumes* that its proposal will produce the  
761 best of all possible outcomes. For example:

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

769 ComEd Ex. 11.0 at lines 444-49. In each of the Company's proposed auctions,  
770 bidders would be competing to provide the service of assembling a fixed-price,  
771 single-product load following service. That competition would deliver *some* benefit.  
772 However, given the magnitude of the costs and risks from uncompetitive wholesale  
773 markets, it is not appropriate to simply give up on protecting consumers from those  
774 costs and risks without seriously examining the alternatives. Likewise, even if we  
775 assumed that an auction procurement for the Company's proposed portfolio of

776 products would necessarily be better than any other procurement method that could  
777 be employed (an assumption that has not been demonstrated), it has not been  
778 demonstrated that the proposed product mix is the best selection.

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

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

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

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

800 **Q. DO THE STAKEHOLDERS WHO CURRENTLY SUPPORT THE**  
801 **COMPANY’S PROPOSAL REPRESENT A COMPLETE CROSS SECTION**  
802 **OF INTERESTS?**

803 A. No. A Company rebuttal witness states, “the vast majority of the witnesses support  
804 the use of a full requirements, competitive auction process to procure supply for  
805 ComEd’s customers.” ComEd Ex. 10.0 at lines 20-21. However, to put this in  
806 context, it is necessary to examine the interests of those who do and do not support  
807 the Company’s proposal.

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

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

820 It is the consumer interests that have a motivation to seek improvements in  
821 default service procurement that may reduce cost and risk to those consumers. The  
822 US DOE and the IIEC speak to specific interests of large consumers, both seeking a

823 fixed price alternative to the hourly energy price service proposed by the Company.  
824 CUB, CCSAO, and the AG focus on the concerns of small customers—those least  
825 likely to have realistic alternatives to default service.

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

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

831 A. Witness Salgo suggests “more active portfolio management, utilization of the many  
832 other standard products available in the market, and the possibility of negotiating  
833 prices and other contract terms with suppliers.” AG Ex. 2.0, p. 15, lines 21-22; p. 16,  
834 lines 1-5. As I have explained above, this concept is consistent with my  
835 recommendation.

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

840 A. Certainly. I will first point out that while these items are called “consensus criteria”  
841 in the PWG report, they are correctly identified merely as “desirable characteristics.”  
842 See ComEd Ex. 1.2 at 5-6. Those 18 characteristics are:

- 843 1. It should be highly transparent.  
844 2. It should allow for a competitive procurement approach.

- 845 3. It should provide for the opportunity for full cost recovery to the utilities if  
846 they follow the Commission approved procurement approach.  
847 4. It should result in market-based rates for customers.  
848 5. It should include a mechanism for translating the result of the process into  
849 retail rates.  
850 6. It should facilitate and encourage supplier participation of all types in the  
851 wholesale market.  
852 7. It should facilitate stable rates and mitigate rate volatility for applicable  
853 customers for relevant time periods.  
854 8. It should allow for and accommodate RPS, DSM, low-income assistance  
855 programs, etc.  
856 9. It should require an initial regulatory review to approve and an ongoing  
857 regulatory review to oversee and improve the procurement process.  
858 10. It should be capable of implementation prior to January 1, 2007.  
859 11. It should provide specific guidance on crucial issues such as procurement  
860 methodology, rate design, and allocation of risks and provide flexibility to  
861 respond to market conditions.  
862 12. It should provide an agreed upon procurement methodology, which if  
863 followed, minimizes the need for after the fact prudence review.  
864 13. It should include reasonable features or contractual safeguards to manage  
865 counterparty credit risk.  
866 14. It should reflect lessons learned from States that have restructured and the  
867 current state of competition in the retail and wholesale markets in Illinois.  
868 15. Stakeholders should have the opportunity to review and comment on the  
869 procurement process and proposed actions.  
870 16. It should clearly assign accountability and risks.  
871 17. It should provide for prompt regulatory review and approval.  
872 18. The stated public policy goals of insuring resource adequacy should be  
873 considered in the procurement process or elsewhere.

874 **Q. HOW DOES YOUR PROPOSED ALTERNATIVE RATE AGAINST THE**  
875 **PWG’S 18 CRITERIA AND THE ICC’S SUMMARY “CONSENSUS ITEMS”?**

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

878 **Q. PLEASE EXPLAIN.**

879 A. I’ll begin with the two items I mentioned in the immediately preceding answer. The  
880 first is item 3, which calls for “full cost recovery” for utilities that “follow the



881 Commission approved procurement approach.” The second is item 12, which calls  
882 for “minimiz[ing] the need for after the fact prudence review.” While the Company  
883 may wish to obtain such guarantees and might refuse to adopt a novel procurement  
884 approach, such as its own proposal, in their absence, I see no compelling reason for  
885 the Commission to make such a concession. I would note that while my proposal  
886 does not guarantee such recovery, it does not prevent full cost recovery. Instead, it  
887 makes such recovery subject to traditional standards, such as prudence.

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

897 Similarly, some might complain that my proposal does not provide “specific  
898 guidance on crucial issues such as procurement methodology, rate design and  
899 allocation of risks and provide flexibility to respond to market conditions” (item 11).  
900 However, under my proposal, no particular guidance on rate design is needed. In  
901 fact, I would argue that rate design decisions are best made in a rate design  
902 proceeding, not a procurement proceeding. Nothing in my proposal limits the  
903 Company’s flexibility to respond to market conditions, but rather my proposal would

904 free the Company to do so, as it should, rather than locking into a specific, one-time  
905 purchase. Also, my proposal's allocation of risk is quite clear. While the Company is  
906 capable of making management decisions on procurement methodology (or could  
907 acquire such capability if it chose to), if it actually wanted guidance on that issue, it  
908 could have structured this proceeding to fully explore the options.

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

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

925 While the Company’s proposal may reflect the latest “lessons learned” in New  
926 Jersey (item 14), the testimony of Witnesses Fagan and Rose make it clear that

927 Illinois' wholesale market situation differs from New Jersey's. Furthermore, as  
928 Witness Rose points out in his direct testimony, the lessons in other states are not  
929 uniformly in favor of the Company's proposal.

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

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

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

952 A. Yes. In its own Final Report, the ICC stated that the PWG had produced four  
953 “consensus items.” *See* ComEd Ex. 1.1 at 7. This shorter list stated that a  
954 procurement approach should:

- 955 • Be accomplished through a competitive procurement method  
956 that facilitates diverse supplier participation resulting in  
957 market-based prices for power;
- 958 • Strike a balance between encouraging competitive market  
959 development and protecting consumers from market  
960 irregularities by facilitating stable rates, mitigating rate  
961 volatility and mandating ongoing regulatory oversight in the  
962 form of initial regulatory review to improve and monitor the  
963 process;
- 964 • Accommodate RPS, DSM, as well as low income assistance  
965 programs;
- 966 • Reflect lessons learned from other states.

967 If this short list represents a more genuine assessment of the level of consensus,  
968 clearly that “consensus” provided little guidance as to a specific choice for the Post-  
969 2006 system.

970 In fact, I would note that my recommendation is fully consistent with four  
971 “consensus” items. Nothing in my recommendation would preclude the judicious use  
972 of competitive procurement by ComEd in meeting its default service obligations.  
973 Opening up the Company's procurement to a more diverse range of portfolio  
974 components and procurement styles could encourage *more* diverse supplier  
975 participation, rather than limiting participation to those capable of or interested in

976 bidding just another one of many identical vertical tranches. Certainly, nothing in my  
977 proposal would interfere with market-based prices for power procured by the  
978 Company for this purpose, although the Company would have additional options to  
979 consider.

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

989 **V. PRUDENCE REVIEW OF PROCUREMENTS**

990 **Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE COMPANY'S**  
991 **POSITION ON PRUDENCE REVIEW OF FUTURE PROCUREMENTS.**

992 A. The Company appears to want the approval of the procurement process to amount to  
993 a waiver of future prudence review, including company procurement actions taken if  
994 the auction result is rejected. For example, Witness Hogan argues that this would be  
995 justified by the Company's supposed lack of discretion:

996 State regulators do conduct after the fact reviews when circumstances  
997 warrant, but in most of these situations, they are dealing with utility  
998 decisions made in situations in which the utility has some significant  
999 discretion about the choices it makes and the costs it incurs. A  
1000 prudence review seems warranted in those cases. However, where the  
1001 utility procurement is made with limited or no discretion, the process  
1002 has been reviewed and approved by the Commission at the outset, and  
1003 where established market mechanisms are available to establish a  
1004 market price, it would be reasonable for state regulators to establish  
1005 mechanisms that not only accept these procurements but also pass  
1006 through procurement costs with more limited after the fact oversight.

1007 ComEd Ex. 16.0 at lines 1028-37.

1008 **Q. DOES HIS STATEMENT ACCURATELY REFLECT THE PRESENT**  
1009 **SITUATION?**

1010 A. No. I do not agree with Witness Hogan’s point in general. The Company is not  
1011 making its proposed procurement with little or no discretion, but has chosen this  
1012 approach out of a huge universe of possibilities. Just because the Company *asks* to be  
1013 stripped of discretion does not mean that it has none. While there are some situations,  
1014 such as PURPA contracts, where one *might* argue a utility was “only following  
1015 orders” and should only be responsible for *how* it did so, that is different from  
1016 asserting there should be *no* review of such costs before they are passed through to  
1017 customers.

1018 My recommendation properly places procurement responsibility for portfolio  
1019 design and procurement decisions on the Company, which is in the best position to  
1020 make them in real time. Thus, normal ratemaking review of the costs incurred would  
1021 be appropriate.

1022  
1023  
1024

## VI. SPECIFIC CRITIQUES

### A. Out-of-Date Data

1025 **Q. DO COMPANY REBUTTAL WITNESSES CLAIM THAT “OPPONENTS”**  
1026 **RELY ON OUT OF DATE DATA AND MISCONCEPTIONS?**

1027 A. Yes, but I disagree. Witness Fagan’s rebuttal testimony addresses this issue with  
1028 regard to market power and wholesale market conditions generally.

1029 It is also suggested that our concerns regarding the ability of consumers to  
1030 access retail alternatives should be discounted because it stems from the current,  
1031 frozen rates and expressions of interest in Illinois customers by RESs. Certain  
1032 Company default service rates have been frozen for some years. However, the  
1033 general experience in many states is that residential and small commercial customers  
1034 have limited alternatives even when default service rates are not frozen or incorporate  
1035 adders. Of even greater concern is that the smallest and most vulnerable customers  
1036 are those least likely to be marketed to by RESs. As Witness Rose points out in his  
1037 direct testimony:

1038 Many retail markets have remained relatively inactive, particularly for  
1039 smaller residential customers. In some states, market activity for larger  
1040 customers has been somewhat more active. . . . A survey completed  
1041 *last year* reported the percentage of residential customers in 11 states  
1042 and D.C. who take electric service from a supplier other than their  
1043 local utility. Of the 63 distribution companies that have data available,  
1044 over two-thirds of the companies (43), reported less than one percent  
1045 of the residential customers in their service territories choosing an  
1046 alternative – and most of those companies (27) reported that no  
1047 customers were taking service from alternative retail suppliers.

1048 AG Ex. 1.0, Rose, at 26.

1049 Even if some residential competition unexpectedly materializes immediately,  
1050 the smallest, poorest customers still need protection and should not be subjected to  
1051 unnecessarily high default service rates.

1052

1053 **B. Deregulation Study**

1054 **Q. IN HIS REBUTTAL TESTIMONY, MR. MCNEIL STATES THAT IN A JUNE**  
1055 **2004 PAPER, YOU “CONCLUDED THAT DEREGULATED RATES (WHICH**  
1056 **ARE BASED ON PJM MARKET COSTS) APPEAR TO HAVE BEEN**  
1057 **LOWER THAN PRICES IN A SCENARIO IN WHICH PRE-**  
1058 **DEREGULATION COST-OF-SERVICE CONTINUED FROM THE MID-**  
1059 **1990’S TO THE TIME OF THE STUDY.” WAS COMED ONE OF THE**  
1060 **COMPANIES THAT WAS EVALUATED FOR PURPOSES OF THIS**  
1061 **STUDY?**

1062 **A.** No. The study, which Synapse performed under contract with PJM, neither evaluates  
1063 nor makes any conclusion with regard to ComEd, other Illinois utilities, or any  
1064 regions included in the recently expanded PJM region. To clarify, the study  
1065 mentioned by McNeil evaluated three utilities representative of the original PJM  
1066 region, which includes New Jersey, Maryland, Delaware, and Pennsylvania.  
1067 Specifically, the study took a look at Delmarva Power & Light in Delaware  
1068 (Delmarva), Jersey Central Power & Light in New Jersey (JPCL), and the  
1069 Pennsylvania Electric Company in Pennsylvania (Penelec).



1070 **Q. FOR THOSE UTILITIES THAT WERE EVALUATED, WERE THERE ANY**  
1071 **IMPORTANT LIMITATIONS TO THE STUDY CONCLUSIONS?**

1072 A. Yes. In the study, we listed several important caveats to our conclusion, including the  
1073 following:

- 1074 • We examined only three case study companies who may or may not be representative  
1075 of PJM; analysis of other companies in PJM could show different results.
- 1076 • For purposes of our study, the wholesale power costs are strictly generation costs in  
1077 the PJM wholesale markets and do not include some factors that may be included in  
1078 the actual prices that customers are paying at retail such as “retail adders” for  
1079 marketing costs, perceived risks to suppliers, and market power.
- 1080 • The wholesale power costs over the past few years [in the original PJM] have been  
1081 lower than were previously expected as a result of capacity surpluses from the  
1082 addition of new generating plants in the region, a situation which customers will not  
1083 enjoy indefinitely.<sup>6</sup>
- 1084 • The resulting indexed generation service costs are “high” in that they include all the  
1085 “stranded costs” that were collected in transition charges and, likely, some that were  
1086 not, and they also do not include mandated retail rate reductions productivity  
1087 improvements in utility-owned generation or overhead operations.

1088 **Q. GIVEN THE LIMITED NUMBER OF UTILITIES STUDIED, THE LIMITED**  
1089 **GEOGRAPHICAL SCOPE, AND THE MANY CAVEATS ATTACHED TO**  
1090 **THE STUDY CONCLUSION, WOULD IT BE LOGICAL TO INFER FROM**

1091 **THIS STUDY THAT MARKET-BASED RATES IN ILLINOIS, AND**  
1092 **SPECIFICALLY MARKET-BASED RATES FOR COMED CUSTOMERS,**  
1093 **WILL BE LOWER THAN THEY WOULD HAVE BEEN GIVEN A**  
1094 **SCENARIO OF CONTINUED, REGULATED COST-OF-SERVICE RATES?**

1095 A. No, such a conclusion is not clear from the evidence in this study.

1096

1097 **C. Concerns About Market Power**

1098 **Q. DOES WITNESS LACASSE COMMENT ON YOUR CONCERNS**  
1099 **REGARDING WHOLESALE MARKET IMPERFECTIONS?**

1100 A. Yes. For example:

1101 I do not believe that Dr. Rose's conclusions follow from the analysis  
1102 he presents, and I do not believe that Dr. Steinhurst's conclusions  
1103 follow from the analysis in Mr. Fagan's testimony. It is my  
1104 understanding that these witnesses have not provided any analyses of  
1105 what the relevant market is from a wholesale energy perspective, have  
1106 not quantified concentration in what they claim to represent a relevant  
1107 wholesale market, and have drawn unwarranted conclusions as to the  
1108 presence or exercise of market power based on measures of  
1109 concentration in arbitrarily and narrowly defined markets and on other  
1110 incomplete or misleading evidence.

1111 ComEd Ex. 11.0 at lines 400-07.

1112 **Q. DO YOU AGREE WITH THIS CRITICISM?**

1113 A. No. Witnesses Rose and Fagan have quantified the market concentration concerns  
1114 they raise and have explained carefully why those concerns apply to the Company's  
1115 service territory. Their market concentration and market power discussions address a

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<sup>6</sup> This caveat was expressed in the study which applied to the PJM "Classic" region. It is not meant to imply

1116 relevant set of pricing locations, which are neither arbitrary nor misleading. Given  
1117 those concerns, I am justified in advocating for alternative portfolio designs and  
1118 procurement mechanisms that do everything possible to avoid simply throwing  
1119 default service customers to their fate.

1120 **Q. DO YOU AGREE WITH THE COMPANY'S CRITICISMS OF YOUR**  
1121 **RECOMMENDATION AS CALLING FOR A "PAY-AS-BID" OR**  
1122 **"CONTRACT BY NEGOTIATION" APPROACH?**

1123 A. Witness Hogan raises such criticisms. ComEd Ex. 16.0, line 917 ff. He infers that I  
1124 recommend one or the other as if they were the only alternatives to the Company's  
1125 auction proposal. While the Company might choose to use one or both of those  
1126 alternatives, that is not my point. Rather, as explained above, the Commission should  
1127 retain the policy that the Company, subject to Commission review, is responsible for  
1128 choosing how to fulfill its responsibility to procure power to meet its default service  
1129 requirements. He also objects to my proposal for "procurement under traditional  
1130 ratemaking" on the grounds that it presents the Commission with an alternative that is  
1131 no different from "going to the market to acquire necessary supplies." *Id.* at line 932  
1132 ff. If Dr. Hogan is simply referring to arguments in the Company's rebuttal about  
1133 whether it is possible to obtain a result better than the specific one-date, one-product  
1134 auctions the Company proposes, I have addressed that elsewhere. In any event, I  
1135 simply propose that the Company be free to do select procurement methods at its  
1136 discretion and subject to Commission oversight *and* be free to choose other  
1137 alternatives if they are better at a given point in time.

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that there was or is any similar condition in Illinois.

1138 **Q. DOES THE COMPANY CLAIM THAT YOUR PROPOSAL IS**  
1139 **“INCONSISTENT WITH TRADITIONAL RATEMAKING”?**

1140 A. Yes, but that is really the opposite of the truth. Witness McNeil makes this claim  
1141 based on a mischaracterization of my testimony. “Dr. Steinhurst’s proposal is  
1142 inconsistent with traditional ratemaking standards.” ComEd Ex. 10.0 at line 1331. In  
1143 particular, he suggests that I may have offered the nuclear margin study attached to  
1144 my direct testimony for some purpose inconsistent with my recommendation of  
1145 procurement under traditional ratemaking. However, I did not do so. It was offered  
1146 for the purpose of documenting the margins likely to accrue to certain generation  
1147 owners. I did not suggest the Commission set rates based on those plants’ operating  
1148 costs or that those resources alone would suffice to meet ComEd's load. Rather, the  
1149 study is cited to show that there are significant resources available that have costs  
1150 well below market clearing prices. ComEd has not shown that a portfolio  
1151 procurement approach could not obtain at least some substantial portion of its needs  
1152 at less than the market clearing price for slice of system contracts/tranches.

1153

1154 **D. Consumer Observer at Auction**

1155 **Q. WHAT DOES THE COMPANY SAY ON THE ISSUE OF YOUR PROPOSED**  
1156 **CONSUMER OBSERVER?**

1157 A. Witness McNeil discusses a change in the Company’s proposal for monitoring  
1158 the auction. That change seems to eliminate the Auction Advisor and replace it with  
1159 active participation by Staff (with consultant of their choice). Witness Juracek simply

1160 asserts, "ComEd therefore concludes that Staff is in the best position to represent  
1161 consumer interests through the auction process, and during the bidding itself."  
1162 ComEd Ex. 9.0 at lines 297-98.

1163           Regardless of the reasons for this change, it does not solve the problem that  
1164 the Consumer Observer would address. While Commission Staff and consultants  
1165 who have acted as Auction Advisor in past auctions in other states, or who may be  
1166 retained by Staff under the revised proposal, may be expected to be well informed  
1167 about what is going on in the power markets, auction theory, and the like, a Consumer  
1168 Observer is needed for at least two important reasons.

1169           First, there is a vitally important consumer interest that is different from that  
1170 of promoting the best possible auction or of balancing the interests of all stakeholders,  
1171 namely ensuring that the auction results produce just and reasonable default service  
1172 rates. That interest deserves to be heard in any decisions of the Commission to  
1173 approve or reject the results of a particular auction. Second, should an auction  
1174 approach be used, it is impossible for consumer representatives to adequately  
1175 represent consumer interests in subsequent consideration of modifying the proposed  
1176 portfolio design or auction process without knowledge of the specifics of how the  
1177 auctions actually unfolded. That information is available only by observation of the  
1178 actions themselves.

1179 **Q. WITNESS PARECE ALSO OPPOSES THE "INVOLVEMENT" OF A**  
1180 **CONSUMER OBSERVER. ARE HIS REASONS CONVINCING?**

1181 A. No. In his rebuttal testimony Mr. Parece simply states:

1182 Furthermore, the CPP Auction proposal provides for an outside  
1183 advisor to the ICC Staff, the Auction Monitor, with expertise in  
1184 planning and implementing auctions. Involving other parties in this  
1185 review process unnecessarily complicates auction planning,  
1186 implementation, monitoring and review, and can only decrease the  
1187 confidence of bidders that the auction outcome will be approved, and  
1188 increase the potential for unauthorized release of sensitive or  
1189 confidential information that could compromise the auction outcome.  
1190 In addition, after careful consideration of these issues and alternative  
1191 approaches, the NJ BPU Staff and its advisor have served as the sole  
1192 independent monitor in the successful NJ BGS auctions. For these  
1193 reasons, I would not support the involvement of a Consumer Observer  
1194 as proposed in the testimony of William Steinhurst (Steinhurst Dir.,  
1195 CUB-CCSAO Ex. 2.0, 35:786 - 40:922).

1196 ComEd Ex. 12.0 at 667 ff.

1197 The expertise of the proposed Auction Monitor, ICC staff, or the Auction Manager is  
1198 not at issue here. What is important is that the consumer perspective be fully  
1199 represented so that consumers may have full confidence that their interests are being  
1200 monitored and represented to the ICC when the Commission makes its decisions,  
1201 both as to approval of a given auction result and in subsequent discussions of  
1202 improvements or alternatives to the auction.

1203 Instead, the Company wants approval for a procurement process in which the  
1204 results of each auction would be examined only in a closed, deliberative proceeding.  
1205 The Company witnesses justify this novel request by claiming that power products at  
1206 competitive prices can only be obtained by assuring potential vendors who participate  
1207 in an auction that review and approval of procurement results by the Commission will  
1208 be incredibly narrow, as well as secretive and insulated from input by anyone other  
1209 than ICC Staff (and perhaps a consultant selected by the Staff).

1210 There is no reason to believe that bidders would lose confidence in the  
1211 integrity of the auction process, as the Consumer Observer would simply be an

1212 observer, not a participant. If confidentiality is the concern, standard confidentiality  
1213 safeguards should suffice for any need bidders have to protect sensitive information,  
1214 as has been the case in the Maryland default service RFP, where the public advocate  
1215 serves in a Consumer Observer role already. The mere fact that the New Jersey BPU  
1216 did not choose to establish a Consumer Observer is not a convincing reason to omit  
1217 such a precaution in Illinois, particularly when there are greater concerns about  
1218 market power and market maturity in Illinois, both in the northern Illinois control  
1219 zone of PJM and in MISO, as well across their seam.

1220

1221

1222

**E. Renewable Energy**

1223 **Q. IS THE COMPANY’S PROPOSAL “UNFRIENDLY TO RENEWABLE**  
1224 **ENERGY”?**

1225 A. Not exactly, but it also doesn’t maximize the benefits that can be obtained from  
1226 renewable energy development. Witness Juracek states, “[t]he Opponents invite the  
1227 conclusion that the Illinois Auction Proposal is somehow unfriendly to renewable  
1228 energy.” ComEd Ex. 9.0 at lines 478-80. I acknowledge that the Company’s  
1229 proposal could reflect a renewable portfolio standard, were one adopted in Illinois,  
1230 but my direct testimony explains how that approach would not give default service  
1231 customers the full risk mitigation benefit of renewable energy resources. Without  
1232 debating the meaning of “unfriendly,” that point remains valid.

1233 **Q. DOES THE COMPANY OBJECT TO THE NOTION OF LONG-TERM**  
1234 **RENEWABLE PROCUREMENT FOR DEFAULT SERVICE?**

1235 A. Yes, but I believe the objection is misplaced. Witness McNeil states that such  
1236 procurement would be "inconsistent with the vertical auction approach." ComEd Ex.  
1237 10.0 at lines 1049-50. I fail to see where the inconsistency lies. For example, one  
1238 way to make such procurement work in conjunction with a vertical tranche auction  
1239 (or a variety of other alternatives) is simple. All that would be required is to make the  
1240 vertical tranche procurement residual to the long-term renewable procurement. One  
1241 way to do this would be to conduct the long-term renewable procurement in advance  
1242 of each auction and announce the results to the potential auction bidders.

1243 **Q. DOES WITNESS MCNEIL HAVE ADDITIONAL CRITICISM OF THE**  
1244 **CONCEPT OF LONG-TERM RENEWABLE PROCUREMENT FOR**  
1245 **DEFAULT SERVICE?**

1246 A. Yes. He states that it "would risk the creation of stranded costs to be incurred by  
1247 customers" and advocates for "a separate competitive bidding process for the  
1248 procurement of renewable resources under fixed contract durations, and proposes that  
1249 the differences between contract prices and the revenues from the sale of the energy  
1250 procured be passed through to retail customers per a cost recovery rider." ComEd Ex.  
1251 10.0 at lines 1050-54. This appears to differ from my suggestion only by limiting  
1252 procurement to fixed term contracts, rather than life of unit contracts. If such fixed  
1253 terms were long enough, this would deliver a portion of the benefit that would derive  
1254 from life of unit contracts, but only a portion. Consumers would lose the benefit of  
1255 the end of life savings and price stability, likely the most valuable part of the benefits.



1256 This recreates on a longer time scale the problem I have pointed out that happens with  
1257 an annual REC purchase requirements (analogous to an RPS), which leaves much of  
1258 the consumer benefit in the hands of suppliers. There seems to be no operational  
1259 reason to prefer fixed term contracts to life of unit contracts, and I believe that any  
1260 risk involved is justified by the benefits.

1261 **Q. DO YOU HAVE ANY COMMENT ON THE CONCEPT OF A SEPARATE**  
1262 **CHARGE ON CUSTOMERS' BILLS FOR RENEWABLE ENERGY**  
1263 **PROCUREMENT?**

1264 A. Yes. Riders that show up as separate charges on customers' bills ("line-item riders")  
1265 are not in the public interest for several reasons.

1266 First, renewable generation constitutes a hedge against a variety of risks, such  
1267 as volatile fuel prices and uncertainties about environmental regulation. The cost of a  
1268 hedge is a cost that the Company incurs in providing service to customers like any  
1269 other cost. Other costs do not require separate line-item riders, and there is no reason  
1270 to treat the cost of a renewables hedge any differently from the cost of covering any  
1271 other uncertainty. Second, line-item riders are confusing to customers and add  
1272 complexity to bills.

1273 Third, a line item RPS Rider would send an inaccurate signal to consumers  
1274 that renewables add unnecessary expense to bills. Like investment in any new plant  
1275 and many types of purchased power contracts, renewables may increase cost of  
1276 service in the short-term, but over the long-term they should save consumers money.  
1277 There is no greater justification for a separate line item rider for renewables

1278 procurement than there would be for any other purchased power contract or, for that  
1279 matter, for the carrying cost of a transmission and distribution upgrade.

1280 Lastly, the cost of an RPS is certainly not an extraordinary expense, which I  
1281 understand is one standard that has been used to justify line-item riders.

1282 **Q. DOES THE COMPANY HAVE A FURTHER CRITICISM OF LONG-TERM**  
1283 **CONTRACTING FOR RENEWABLE ENERGY?**

1284 A. Yes. Witness Hogan asserts that my argument

1285 mistakenly concludes that renewable suppliers would not receive the  
1286 market price in the contract scenario. The proper comparison would be  
1287 long-term contracts for both sources of power with the same  
1288 allocations of risk between the parties. And with comparable contracts  
1289 the former logic that all suppliers receive the market price would  
1290 apply, so that the contract price for renewables would be set by the  
1291 marginal cost in the market, not by the marginal cost of the individual  
1292 renewable supplier.

1293 ComEd Ex. 16.0, line 709 ff.

1294 This is a mischaracterization of my point. I argue that renewable generation  
1295 developers, for example due to financing considerations, have reason to value a long  
1296 term or life-of-unit contract, and may in fact consider such a contract at a price less  
1297 than their expectation of comparable market prices projections over the long-term.

1298 Likewise, consumers have reason to value price stability and insulation from  
1299 potentially extreme environmental and regulatory risks in their power supply

1300 portfolio. These convergent interests suggest that renewable developers and default  
1301 service portfolio designers and managers could find a mutually advantageous price

1302 (and terms) different from market clearing prices (or their long-term expectations for  
1303 those prices).

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1305

**VII. OTHER ISSUES**

1306 **Q. DO YOU HAVE ANY COMMENTS ON TRANSLATOR DRIVEN RATE**  
1307 **DESIGN?**

1308 A. Yes. In its rate translation for CPP-B, the Company assumes migration risk for PPO  
1309 class of 50%; Staff (Ex. 6.0, Lazare, at line 49) proposes to completely eliminate this  
1310 adjustment, and Constellation (CES Ex. 1.0, O'Connor, at line 628) proposes 100%. I  
1311 agree with Constellation's position. Given that PPO customers already have come to  
1312 grips with market-based pricing and broken from basic default service, I believe that  
1313 it is unreasonable to assume a value of less than 50% and much more reasonable to  
1314 assume a value of 100%. These are customers who have already chosen to go to one  
1315 form of market-based pricing. Elimination of the migration risk premium would  
1316 unfairly burden customers with little or no access to retail alternatives with a  
1317 disproportionate share of the migration risk premium that wholesale bidders will  
1318 necessarily include in the CPP-B bids. Numerous wholesale default service bidders  
1319 in varied jurisdictions state that such premia are built into their offers when they bid  
1320 on a vertical tranche and I am not aware of any default service bidder that has denied  
1321 doing so.

1322 **Q. DO YOU HAVE ANY COMMENT REGARDING CONSTELLATION'S**  
1323 **PROPOSED CHANGE TO THE DEFINITION OF CUSTOMERS TO BE**  
1324 **SERVED IN THE CPP-B AUCTION?**

1325 A. Yes. Constellation recommends that customers with loads from 400 kW to 1 MW be  
1326 moved from the CPP-B auction to a new CPP-A auction. CES Ex. 1.0 at line 131. I  
1327 agree. Given that these larger customers are more likely to migrate than smaller ones,  
1328 based on historical data, wholesale bidders in the CPP-B auction will include some  
1329 extra risk premium in their bids beyond that justified for the smaller customers. This  
1330 creates some risk that such a premium will not be fully eliminated from the default  
1331 service rates for those smaller customers. Moving them to their own auction or  
1332 combining them with the proposed CPP-A auction would eliminate that risk.

1333 **Q. DO YOU HAVE ANY COMMENT REGARDING CONSTELLATION'S**  
1334 **PROPOSED CHANGE TO THE SUPPLY ADMINISTRATION CHARGE**  
1335 **(SAC)?**

1336 A. Yes. Constellation recommends that the SAC be structured to reflect those costs  
1337 "evenly per kWh rather than by a fixed dollar amount per account per month as  
1338 currently proposed by ComEd." *Id.* at line 154. I agree with this recommendation.  
1339 The dominant cost factor in generation supply for default service is the cost of  
1340 energy. The dominant administrative costs are driven by the complexity and size of  
1341 the procurement process and by managing and clearing the many contracts that flow  
1342 from that process. Whether there is one more or fewer small default service customer  
1343 has little to do with the costs incurred.

1344

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## VIII. SUMMARY AND CONCLUSION

1346 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND**  
1347 **RECOMMENDATIONS.**

1348 A. The Company has not demonstrated that the default portfolio design and mechanistic  
1349 auction process with its virtually automatic pass through of the resulting costs  
1350 produces optimal results, nor that it provides adequate protection to consumers. The  
1351 Commission should reject the Company's proposal and recognize that the Company  
1352 retains responsibility for making and managing the decisions and actions necessary to  
1353 serve default service customers using a soundly designed and actively managed  
1354 resource portfolio. Additionally, the Commission should clarify that it has an  
1355 oversight role in the process to ensure that the Company best serves default service  
1356 customers.

1357 In the alternative, if the Commission wishes to entertain the concept of pre-  
1358 approving a portfolio design or procurement method, it should open a proceeding for  
1359 the purpose of exploring alternatives to ComEd's proposal and seeking improved  
1360 portfolio designs and procurement management approaches. In such a proceeding,  
1361 the Company should be required to make a filing that fully and fairly evaluate a range  
1362 of portfolio designs and procurement methods and present analysis comparing their  
1363 costs and risks.

1364 If the Commission rejects these two options I propose and decides to approve  
1365 some form of auction-based procurement approach at this time, I recommend that the  
1366 Commission order the changes to the auction and portfolio design as explained in my  
1367 direct testimony in this proceeding and certain other modifications discussed above.

1368 **Q. SHOULD THE COMMISSION ACCEPT SWEEPING ASSERTIONS THAT**  
1369 **THE AUCTION IS BETTER THAN ANY ALTERNATIVE?**

1370 A. No. One example of such assertions is Witness LaCasse's statement that  
1371 “regulation...is generally acknowledged [to be] a weaker force than competition in  
1372 terms of achieving an efficient allocation of resources and prices that track economic  
1373 realities.” ComEd Ex. 11.0 at lines 343-45. This may be an attractive position in  
1374 theory, but it does not reflect the current situation. I have not suggested that  
1375 regulation is to be preferred to competitive markets where they exist. The proposed  
1376 auction overlays a veneer of competition on flawed wholesale market, turns a blind  
1377 eye to possible shortcomings of past Company actions, and chooses a specific  
1378 competitive process to procure a specific portfolio design, neither of which has been  
1379 shown to be optimal. We do not have a choice between competition and regulation  
1380 here, but rather a proposal for a regulatory mandate for passing through to consumers  
1381 the result of a particular system for deriving prices, a system chosen by the Company  
1382 to excuse itself from any responsibility for the results.

1383 **Q. IS THERE A NATIONAL TREND WITH REGARD TO ELECTRICITY**  
1384 **INDUSTRY RESTRUCTURING, CUSTOMER CHOICE, AND RELIANCE**  
1385 **UPON WHOLESALE MARKETS TO PROVIDE ELECTRICITY FOR**  
1386 **SMALL CUSTOMERS OF WHICH THE COMMISSION SHOULD BE**  
1387 **CONGNIZANT?**

1388 A. Yes, there is. The crises in the Western markets eroded much of the prior enthusiasm  
1389 for electric industry restructuring.<sup>7</sup> Over the last few years, the trend nationally  
1390 toward breaking up vertically integrated utilities has faltered. The FERC's efforts to  
1391 create RTOs throughout the US have stalled. Most states that were considering retail  
1392 electricity market restructuring have reconsidered, and few small customers have  
1393 meaningful choice of their electric supplier. There is certainly no observable national  
1394 trend that would indicate that Illinois should feel pressure to rush to rely on an  
1395 auction to procure electricity for customers.

1396 **Q. IS IT FAIR TO ASSERT, AS THE COMPANY DOES, THAT IT IS SIMPLY**  
1397 **PURSUING GREATER COMPETITIVE EFFICIENCY THROUGH THE**  
1398 **AUCTION?**

1399 A. No, I do not believe so. It seems odd for the Company to support its proposal as an  
1400 ideologically pure "market approach" for default service procurement, when the  
1401 wholesale electricity markets underlying the proposal are being subjected to highly  
1402 questionable regulatory intervention when it helps suppliers. For example, the

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<sup>7</sup> 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 the Company. This is simply a historical fact.

1403 proposed RPM mechanism (essentially an administratively determined price for  
1404 capacity that will deliver a windfall to existing generation owners) supported  
1405 elsewhere by Exelon is a profoundly non-competitive market intervention that would  
1406 raise prices for consumers. It is not reasonable to argue, based on theoretical  
1407 advantages of supposedly competitive markets, that consumers should forego  
1408 improvements to default service procurement—a matter completely within the  
1409 purview of state regulators—when wholesale market participants are voting their self-  
1410 interest to institute non-competitive price supports.

1411 **Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

1412 A. Yes.