

ILLINOIS COMMERCE COMMISSION

DOCKET NO.

DIRECT TESTIMONY

OF

WARNER L. BAXTER

SUBMITTED ON BEHALF OF

**CENTRAL ILLINOIS LIGHT COMPANY
CENTRAL ILLINOIS PUBLIC SERVICE COMPANY
ILLINOIS POWER COMPANY**

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25 am also the primary company spokesperson in communications with the financial
26 community, including financial analysts and credit rating agency analysts.

27 **Q. What is the purpose of your testimony in this proceeding?**

28 A. The purpose of my testimony is to provide an overview of the tariff
29 proposal of AmerenCILCO, AmerenCIPS and AmerenIP (the “Ameren
30 Companies” or “Companies”) in this proceeding and to explain why the
31 Companies are making this proposal. In addition, I will introduce the other
32 witnesses who are submitting testimony in support of the proposal.

33 **Q. Please provide an overview of the tariff proposal in this proceeding.**

34 A. In this case, the Ameren Companies have proposed new tariff sheets that
35 accomplish three objectives:

36 1) The revised tariff sheets define and establish the generation services that the
37 Ameren Companies upon the expiration of the mandatory transition period,
38 effective January 2, 2007. As explained by Mr. Wilbon Cooper in his direct
39 testimony, the Ameren Companies will offer Basic Generation Service (“BGS”)
40 beginning January 2, 2007. The rates for BGS will reflect the actual cost of
41 power and energy procured by the Ameren Companies, as determined by a
42 formula to be approved in this proceeding, and certain other costs, which will be
43 set by the Commission in a subsequent rate case. This is appropriate because the
44 utilities serving customers no longer own the generation being used to supply the
45 customers. Power is being procured in the market, and the rates should reflect
46 market prices. In fact, the Public Utilities Act allows the Commission to cap
47 retail generation prices at “market value” plus 10%.

48 2) The revised tariff sheets also establish the procurement process by which the
49 Ameren Companies will obtain the power supply necessary to provide the
50 generation services. As explained by Mr. Craig Nelson and Mr. James Blessing,
51 the Ameren Companies are proposing the use of an auction processed modeled on
52 the auction process that has been used successfully in New Jersey. As our
53 witnesses explain, the proposed auction process is open, transparent, fair and
54 designed to procure power at least-cost, while promoting price stability and
55 minimizing volatility. It satisfies federal and state standards and preserves the
56 Commission's authority over power procurement. As we also explain in our
57 testimony, the auction process was selected after long consideration and the
58 involvement of numerous stakeholders.

59 3) Lastly, the revised tariff sheets establish the methodology by which the auction
60 prices will be "translated" into prices that customers will pay. This is a critical
61 step. Bidders into the auction are assuming certain volume risks. They need to be
62 able to translate the auction prices into retail rates in order to project volumes
63 when they decide what volume to bid on.

64 **Q. Why are the Ameren Companies proposing the use of an auction?**

65 A. The Ameren Companies do not own any significant amount of generation.
66 AmerenCIPS and AmerenCILCO transferred their generation several years ago
67 (except that AmerenCILCO retained ownership of several small (1 MW) power
68 module units that are expected to be transferred out of AmerenCILCO before
69 January 1, 2007.) AmerenIP transferred all of its generation before it was
70 acquired by Ameren Corporation. Presently, each Ameren Company is served

71 under a full requirements contract that expires at the end of 2006. Accordingly,
72 each of the Ameren Companies must purchase its supply into order to provide any
73 generation service.

74 As Mr. Nelson explains in his testimony, the Companies participated in
75 the Commission's post-2006 workshop process, during which several different
76 models were considered. The participants identified 18 different characteristics or
77 criteria that a procurement method should have, and ultimately there was a
78 consensus that an auction satisfied these criteria better than any other method
79 under consideration.

80 An auction satisfies many goals. Mr. Nelson discusses this in greater
81 detail, but I would like to focus on a few aspects. First, an auction spurs vigorous
82 competition in the market. This has been shown to be true in other states. An
83 RFP process can be used to effectively procure power, but an auction process is
84 preferable. In a descending clock auction, bidders are fully informed at the end of
85 each round, which encourages them to be aggressive.

86 Further, an auction satisfies the serious federal and state concerns about
87 affiliate transactions. Historically, both federal and state agencies have been
88 concerned that generation companies selling to utility affiliate could seek to
89 extract above-market prices, to the detriment of customers. More recently, FERC
90 has made clear that it is not concerned only about customers, but about the market
91 itself. If affiliate transactions lock out other competitors, the market as a whole
92 suffers in the long-run. An auction process puts affiliates and non-affiliates on
93 equal footing. The decision is made by the process, not by any individual.

94 The auction method being proposed also preserves a significant role for
95 the Commission. The Commission will have an independent monitor to observe
96 the process and report on the conduct of the auction to the Commission, which
97 can then reject the results of any auction that it believes was run improperly or
98 that it otherwise believes to have not produced a valid result.

99 In this regard, I note that the proposed auction process is modeled on the
100 New Jersey auction, which has been run successfully and which satisfies affiliate
101 transaction standards.

102 **Q. Why is it necessary for the Commission to address 2007 service**
103 **offerings and power procurement now?**

104 A. Power procurement for the entire Ameren Illinois load of approximately
105 7500 megawatts is not something that can be achieved overnight. Additionally,
106 the auction process itself takes some time to put in place. As Mr. Nelson and
107 Dr. Chantale LaCasse explain, new systems must be created, existing systems
108 must be conformed and bidder education must occur. The Ameren Companies
109 need the Commission to act by next January so that an auction can be held in
110 May, 2006, for power delivery in January, 2007.

111 **Q. Is it necessary for the Commission to address all three aspects of the**
112 **Companies' proposal now?**

113 A. Yes, it is. The Ameren Companies do not believe that the three objectives
114 I have identified can or should be addressed separately. The BGS tariffs define
115 the products that are going to be supplied through the auction process; Rider MV
116 defines the auction process; and the translation tool calculates the specific costs to

117 be recovered in the BGS tariffs. The three aspects of the Companies' filing work
118 together.

119 Further, the Ameren Companies seek certainty of cost recovery. Power
120 supply costs represent 60-70% of a utility's costs. The Ameren Companies will
121 be in the market to procure their full power supply requirements, and they, their
122 lenders and investors require assurances that the Companies' rates will be
123 structured to provide for recovery of the actual power supply costs incurred. Any
124 risk of material regulatory lag can adversely affect the Companies' financial
125 position.

126 Moreover, certainty of cost recovery is required as a matter of fairness.
127 As transmission and distribution companies, the Ameren Companies must procure
128 all power supply in the market, and have a limited ability to manage the risks
129 associated with power supply. The Companies cannot control consumption - only
130 customers can do that. The Companies cannot control the cost of production -
131 only suppliers can do that. All the Companies can do is pursue prudent
132 procurement practices, and that is exactly what the Companies are asking the
133 Commission to approve in this docket. And if the Companies adhere to those
134 practices (i.e., conduct an auction pursuant to the Commission-approved auction
135 rules), the Companies should not bear any risk associated with the outcome of the
136 auction.

137 **Q. Are there any other comments you would like to make regarding the**
138 **Companies' proposal?**

139 A. Yes, there are. Any power procurement proposal that comes before the
140 Commission will require the Commission to balance competing interests. For
141 example, on credit requirements, the Commission must achieve a balance between
142 the interests of full participation and protection against default. If credit
143 requirements are too strict, significant potential bidders could be excluded and
144 auction prices would be expected to higher. If credit requirements are too lax, the
145 prospect of default becomes more real, subjecting customers to the risk of higher
146 costs. In crafting their proposal, the Ameren Companies have tried to balance
147 these and other concerns and present the Commission with a proposal that allows
148 for meaningful competition, minimal default risk, certainty of cost recovery and
149 ultimate Commission oversight. There is no single perfect procurement model,
150 and no procurement model can reduce wholesale prices below a competitive level.
151 What we have proposed is a model that we know has worked elsewhere and that
152 is designed to get the best price from the market for our customers.

153 **Q. Please introduce the other witnesses.**

154 A. There are eight other witnesses:
155 **Mr. Craig Nelson**, Vice President – Strategic Initiatives of Ameren Services
156 Company (“Ameren Services”), who presents an overview of the Ameren
157 Companies' proposed revisions to the determination of market value, and how that
158 market value will be reflected in rates at the end of the mandatory transition
159 period. In this regard, he discusses how the Ameren Companies propose to
160 supply and structure the post-2006 regulated service offering to their remaining
161 native load. In particular, his testimony : (1) discusses the market developments,

162 regulatory requirements and state policy initiatives in response to which the
 163 Companies developed their market value rider and procurement proposal; (2)
 164 summarizes the competitive procurement process the Companies propose to
 165 obtain supply to full requirements service at regulated rates, how the price they
 166 pay for this supply reflects market value, and how the costs of supply will be
 167 reflected in bundled retail rates; (3) summarizes the benefits of this proposal; and
 168 (4) explains why this proposal also is fully consistent with federal standards
 169 governing power purchases from affiliated generation companies.

170 **Mr. James Blessing**, Managing Supervisor, Power Supply Acquisition in the
 171 Strategic Initiatives Department at Ameren Services, who describes certain
 172 aspects of the competitive procurement auction process that the Ameren
 173 Companies propose to use to procure BGS. In this regard, he describes some of
 174 the key supplier contract terms and conditions that are at issue in the procurement
 175 process. He discusses the detailed product design, and also the auction process
 176 itself.

177 **Mr. Wilbon Cooper**, Manager – Rate Engineering and Analysis – Regulatory
 178 Policy and Planning of Ameren Services, who presents and explains various
 179 aspects of the development of rate tariffs for the providing of power and energy
 180 service to AmerenUE, AmerenCIPS, AmerenCILCO and AmerenIP retail electric
 181 service customers at the end of the mandatory transition period under the
 182 Customer Choice Law of 1997.

183 **Mr. Robert Mill**, Director of the Regulatory Policy and Planning Department of
 184 Ameren Services, who discusses the Ameren Companies' request for tariff

185 approval, and explains the Companies' plan to implement uniform tariffs and rate
186 policies. He sponsors a tariff for determination of market value. Finally, he
187 describes an auction review process open to all stakeholders that could result in
188 refinements to the procurement process and related tariffs prior to subsequent
189 auctions.

190 **Dr. Chantale LaCasse**, a Vice President with National Economic Research
191 Associates, Inc., who is the past and current auction manager for the New Jersey
192 auction. Dr. LaCasse discusses the advantages of an auction process in
193 determining market value and pricing wholesale procurement and presents a
194 comparison of an auction process to an RFP process. She also describes the New
195 Jersey BGS auction process, including the key elements of that process and how
196 that process is implemented. She further describes competitive safeguards in the
197 auction, and describes the role of the Auction Manager, and the roles of the
198 regulators and their consultant, the auction monitor. Lastly she addresses the term
199 structure of the Ameren auction proposal, and how it may relate to the slightly
200 different term structure proposed by Commonwealth Edison

201 **Mr. Johannes Pfeifenberger**, a Principal and Director of The Brattle Group, an
202 economic consulting firm, who gives an overview of the experience with
203 competitive procurement methods used in other restructured states to provide
204 background and context for the Ameren Companies' Post-2006 procurement
205 proposal.

206 **Mr. Steven Fetter**, President of Regulation UnFettered, an energy advisory firm,
207 who addresses the importance of allowing electric distribution utilities to set

208 reasonable credit quality requirements for potential suppliers so as to limit the
209 likelihood of a later supply default and shortfall, which could trigger the need for
210 the purchasing utilities to take immediate remedial action amidst an atmosphere
211 of uncertainty.

212 **Mr. Robert McNamara**, Vice President of Regulatory Affairs and Chief
213 Economist for the Midwest Independent Transmission System Operator, Inc.
214 ("MISO"), who provides a general description of MISO's operations, including its
215 Midwest Market Initiative, and describes how MISO will interact with the
216 Ameren Companies' auction process being considered in this proceeding. Mr.
217 McNamara outlines the MISO various initiatives, some approved and others
218 underway, that will support and/or facilitate the auction process. He also
219 discusses MISO's commitment to working with the Ameren Companies and all
220 market participants to ensure that the auction process is compatible with the
221 proper functioning of wholesale power markets.

222 **Q. Does this conclude your direct testimony?**

223 A. Yes.

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