

**ILLINOIS COMMERCE COMMISSION**

**DOCKET NO.**

**DIRECT TESTIMONY**

**OF**

**JAMES C. BLESSING**

**SUBMITTED ON BEHALF OF**

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

**February 28, 2005**



24 2004, my position was transferred to the Strategic Initiatives Department and my  
25 title was changed to Managing Supervisor, Power Supply Acquisition.

26 The duties of my current position consist of procuring power supplies for  
27 Ameren Corporation's regulated utilities in Illinois and administering the  
28 contracts that result.

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

30 A. The purpose of my testimony is to describe the certain aspects of the competitive  
31 procurement auction ("CPA") that Ameren Corporation proposes to use to  
32 procure Basic Generation Service ("BGS") for its regulated utilities in Illinois:  
33 Central Illinois Light Company d/b/a AmerenCILCO, Central Illinois Public  
34 Service Company d/b/a AmerenCIPS (including the current AmerenUE-Illinois  
35 service territory upon completion of the transfer of this service territory to  
36 AmerenCIPS as discussed in the testimony of Mr. Craig Nelson) and Illinois  
37 Power Company d/b/a AmerenIP (collectively the "Ameren Companies" or the  
38 "Companies"). In addition, I will describe some of the key supplier contract  
39 terms and conditions that are at issue in the procurement process. First, I will  
40 discuss the detailed product design and then move on to certain aspects of the  
41 auction process.

42 **DESCRIPTION OF AMEREN'S PRODUCT DESIGN**

43 **Q. What is the relevance of the Ameren Companies' service offerings to the**  
44 **CPA?**

45 A. In his direct testimony, Mr. Wilbon Cooper describes BGS, the generation service  
46 that the Ameren Companies propose to offer upon the expiration of the mandatory

47 transition period, on January 2, 2007. Because none of the Ameren Companies  
48 will own any significant generating resources, each company will need to procure  
49 power and energy sufficient to meet those service offerings. The auction process  
50 that the Ameren Companies are proposing is the process by which they will  
51 procure power and energy to supply this service. Thus, while I did not develop  
52 the post-2006 proposal, an understanding of that proposal is necessary to  
53 understand fully how the auction process will work, as well as the intent of the  
54 auction

55 **Q. What is BGS?**

56 A. BGS is the generation service that the Ameren Companies will procure in order to  
57 provide power to their regulated customers who choose not to take service from  
58 an Alternative Retail Electric Supplier ("ARES"). Since the utilities do not own  
59 generation, they will need to procure BGS (capacity and energy) from third  
60 parties.

61 **Q. Please provide an overview of the BGS product design that the Ameren  
62 Companies propose to procure.**

63 A. The Ameren Companies propose to procure three coordinated BGS products  
64 based on their combined load for two primary customer groups: (1) Residential  
65 and Small Business ("R&SB") (peak demand less than 1 MW); and (2) Large  
66 Commercial and Industrial ("LC&I") (peak demand 1 MW or greater). The LC&I  
67 load will be further divided into: (a) customers paying fixed prices for a one-year  
68 term; and (b) those paying prices based on real-time wholesale market prices.  
69 BGS will be procured separately for each of these three classes.

70 **Q. Why is the load divided into the two primary customer groups you described**  
71 **earlier?**

72 A. The reason for breaking the load into two primary customer groups is related to  
73 switching risk and the current state of the Illinois retail markets. The ability of  
74 individual customers to choose an ARES creates uncertainty for the BGS  
75 suppliers with respect to the magnitude of the load that the BGS suppliers will be  
76 required to serve. This switching risk is greater for larger customers, who have  
77 options available to them in the retail markets than for smaller customers (such as  
78 residential customers) whose options currently are limited.

79 In its product design, the Ameren Companies have taken two steps to  
80 mitigate this switching risk. First, the Companies will procure the supply  
81 separately for the two primary groups of customers. The supply for R&SB  
82 customers, whose switching risk is expected to be low, will be procured  
83 independent of that for LC&I customers, whose switching risk is expected to be  
84 much higher. This step places the cost premium associated with switching risk on  
85 the customer group that is creating the risk. Second, as discussed later in my  
86 testimony, LC&I customers taking fixed-priced service from the Companies must  
87 remain on this service for the entire term of the associated BGS supplier contracts  
88 (17 months for the first auction and one-year for all subsequent auctions). This  
89 will help to mitigate the risk premium associated with switching for this group of  
90 customers.

91 **Q. What type of products will the Companies be procuring for R&SB**  
92 **customers?**

93 A. For R&SB customers, the Companies will be procuring through the auction  
94 individual load shares (or “tranches”) of fixed-priced, full requirements wholesale  
95 electric power supply that includes both capacity and energy. In addition, the  
96 suppliers will be financially responsible for the ancillary services, which will be  
97 procured by the Ameren Companies. This supply product will be called Basic  
98 Generation Service – Fixed Pricing (“BGS-FP”). Each tranche of BGS-FP supply  
99 will represent a fixed percentage of the BGS-FP load. To entice the greatest  
100 number of qualified suppliers, each tranche of BGS-FP supply will be sized to be  
101 approximately 100 MW of peak load. Each tranche represents an amount of load  
102 based on a fixed percentage of the total BGS-FP load. It does not represent  
103 individual customer loads or an aggregate of individual customers.

104 The full requirements BGS-FP product places certain risk, including price  
105 and volume risk, on the BGS suppliers. This allows the Ameren Companies to  
106 concentrate on what they do best (deliver energy to the end use customer and  
107 perform customer care functions) and allows the BGS suppliers to concentrate on  
108 what they do best (take on and manage all generation related responsibilities,  
109 including risk management).

110 In the first auction, the BGS-FP supply will be procured for three supply  
111 periods: the first for 17 months; the second for 29 months; and the third for 41  
112 months, each representing one-third of the BGS-FP load. In each subsequent  
113 auction, the Companies will procure a single BGS-FP supply product for a 36-

114 month supply period for the one-third of the BGS-FP load for which the existing  
115 supply contracts are expiring.

116 **Q. Why are the Companies procuring BGS-FP supply for three different**  
117 **contract periods for this group of customers?**

118 A. In order to provide market-based yet reasonably stable pricing for this group of  
119 small customers, the Companies intend to procure overlapping three-year  
120 contracts in which one-third of the R&SB load is procured every year. While  
121 there may be variations in the market from year-to-year, overlapping three-year  
122 contracts will serve to stabilize or smooth out price fluctuation. This requires the  
123 procurement of BGS-FP supply for three separate contract periods in the first  
124 auction in order to step into the process. After the initial auction, the supply  
125 contracts for only one-third of the load will expire in any given year, and the  
126 Ameren Companies will, therefore, only be required to replace those expiring  
127 contracts. By replacing the expiring contracts with three-year contracts, the  
128 Ameren Companies ensure a continued three-year contract renewal cycle.

129 **Q. If the Companies intend to procure overlapping three-year contracts, then**  
130 **why are they procuring for 17, 29 and 41-month terms instead of 12, 24 and**  
131 **36-month terms?**

132 A. The first auction will be for delivery beginning on January 1, 2007. The Midwest  
133 Independent Transmission System Operator, Inc. ("MISO") planning year starts  
134 on June 1 of each year and ends on May 31 of the following year. The 17, 29, and  
135 41-month contracts that the Ameren Companies intend to procure in its first  
136 auction will end on May 31 of 2008, 2009, and 2010, respectively. This approach

137 allows the Ameren Companies' procurement schedule to align with the MISO  
138 planning year. Of course, after the first auction, the replacement contracts with  
139 three-year terms will precisely coincide with the MISO planning year.

140 **Q. Why is it important for the Ameren Companies' competitive procurement**  
141 **schedule to be in line with the MISO planning year?**

142 A. It is important for the competitive procurement schedule to be in line with the  
143 MISO planning year because this will simplify the nomination and acquisition of  
144 Financial Transmission Rights ("FTRs") by the winning bidders in the auction.  
145 FTRs are financial instruments that allow the suppliers to hedge the transmission  
146 congestion risk associated with serving BGS-FP load. Aligning the Ameren  
147 Companies' competitive procurement process with the MISO planning year  
148 allows suppliers to nominate and receive FTRs directly from the MISO. This will  
149 provide each supplier with the opportunity to hedge its congestion risk using the  
150 portfolio of FTRs it acquires from the MISO. The suppliers' ability to nominate  
151 and receive FTRs directly from the MISO is expected to result in a lower price for  
152 the end use customer.

153 **Q. How does the Companies' product design for this customer group compare**  
154 **to the New Jersey product design for similar customers?**

155 A. The product design for R&SB customers used in the New Jersey process is  
156 fundamentally the same. The product in New Jersey is a full requirements  
157 product and is procured using rolling three-year contracts. Two differences  
158 between the Companies' products and those in New Jersey are (1) the breakpoint  
159 between small customers and large customers is different and (2) the suppliers in

160 New Jersey are responsible for procuring Network Integration Transmission  
161 Service (“NITS”) and ancillary services along with capacity and energy. Other  
162 than these differences, the product design is fundamentally the same.

163 **Q. What type of products will the Companies be procuring for LC&I**  
164 **customers?**

165 A. For LC&I customers, the Companies will be procuring two separate products -- a  
166 fixed-price product and a variable energy price product.

167 The first product is a fixed-price, full requirements product that includes a  
168 single fixed price for capacity and energy. In addition, the suppliers will be  
169 financially responsible for the ancillary services, which will be procured by the  
170 Companies. This product will be called Basic Generation Service – Large  
171 Customer Fixed Pricing (“BGS-LFP”). In the first auction, 100% of the BGS-  
172 LFP supply will be procured for a 17-month term. In subsequent auctions, the  
173 BGS-LFP supply will be procured for 12-month terms.

174 The second product will be a full requirements product that includes a  
175 fixed price for capacity and an energy price that varies on an hourly basis. Again,  
176 the suppliers of this product will be financially responsible for the ancillary  
177 services, which will be procured by the Companies. This product will be called  
178 Basic Generation Service – Large Service Real-Time Pricing (“BGS-LRTP”). In  
179 the first auction, the BGS-LRTP supply will be procured for a 17-month term. In  
180 subsequent auctions, the BGS-LRTP supply will be procured for 12-month terms.

181 **Q. Why are the Companies procuring two products for the LC&I Customers?**

182 A. By way of background and for discussion purposes, in New Jersey the distribution  
183 companies only procure a real-time price product for customers greater than 1,250  
184 kW. A New Jersey customer within this classification, therefore, has two power  
185 supply choices: (1) a third party supplier; or (2) the distribution company's real-  
186 time price product.

187 We recognize that, due to the current level of development of retail  
188 competition in middle and southern Illinois, the competitive options for some  
189 customer groups may be limited. For this reason, the Companies have chosen for  
190 the current time to provide a fixed-priced option for these customer groups.

191 **Q. Which of these two products will be the default product for LC&I**  
192 **customers?**

193 A. LC&I customers will default to BGS-LRTP unless they elect to take the BGS-  
194 LFP supply product and commit to remain on that service for the full term of the  
195 product (i.e., 17 months for the first auction and one year for all subsequent  
196 auctions). LC&I customers will have a 30-day open enrollment period in which  
197 they can sign up for the BGS-LFP supply. The 30-day enrollment period will  
198 being on the first business day following the filing of the Market Value  
199 Informational Filing by the Ameren Companies. Those customers who do not  
200 sign up during the open enrollment period will be placed on BGS-LRTP supply  
201 until such time as they choose an ARES. These customers will not be eligible to  
202 sign up for BGS-LFP supply until the next open enrollment period.

203 **Q. You mentioned a 30-day open enrollment period. Does the open enrollment**  
204 **period create additional risk to the supplier?**

205 A. There might be additional risk for the supplier. It is my belief, however, that this  
206 approach will provide a lower overall auction price for this product. To  
207 understand why I believe that this approach yields a lower overall price, you must  
208 look at the alternative.

209 The alternative is to design the BGS-LFP product to be similar to the  
210 BGS-FP product where customers can switch to or from the fixed-priced product  
211 at any time during the year. One would expect that this approach would result in  
212 a larger risk premium to address switching volatility throughout the term  
213 compared to the open enrollment period approach, in which switching risk is  
214 limited to the 30-day open enrollment period. In essence, the risk that the supplier  
215 takes on by holding the price open during the open enrollment period is more than  
216 offset by the fact that, at the end of the enrollment period, the supplier will know  
217 the magnitude of the load for which it will be responsible. In other words, at the  
218 end of the open enrollment period the supplier faces no switching risk.

219 **Q. Will the Companies be procuring the BGS-LFP product in “tranches”,**  
220 **similar to the BGS-FP product?**

221 A. Yes, the BGS-LFP supply will be bid out in tranches with each tranche  
222 representing a fixed percentage of the BGS-LFP load. Like the BGS-FP product,  
223 the tranches of BGS-LFP supply will be sized to be approximately 100 MW of  
224 peak load to allow the greatest number of qualified suppliers. Again, the BGS-  
225 LFP tranche represents an amount of load based on a fixed percentage of the total

226 BGS-LFP load; it does not represent individual customer loads or the aggregate of  
227 individual customers.

228 **Q. Why are the Companies procuring only a single 17-month term, fixed-priced**  
229 **product for the LC&I customers while procuring three fixed-priced products**  
230 **of 17, 29 and 41-month terms for the R&SB customers?**

231 A. In the first auction, the BGS-LFP product is being procured for 17 months to align  
232 the procurement schedule with the MISO planning year. In each subsequent  
233 auction this product will be procured for a 12-month term.

234 The annual fixed-price contracts for these LC&I customers provide the  
235 stable, market-based rates that may be compared with offers from other ARES.  
236 These customers, as I indicated above, have or will have other suppliers interested  
237 in serving their load, among other options. They will have the benefit of deciding  
238 if the fixed, one-year BGS-LFP product is suitable for their needs in comparison  
239 to other offers in the market, whether the other offers are for one year or multiple  
240 years.

241 **Q. What competitive procurement mechanism will the Companies utilize to**  
242 **procure these products?**

243 A. As discussed in detail in the testimony of Dr. Chantale LaCasse of NERA, the  
244 Companies will utilize a Simultaneous, Multiple Round, Descending Clock  
245 Auction similar to the one used by the New Jersey electric distribution companies  
246 to acquire BGS supply each year since 2002.

247 **SUPPLIER CONTRACTS**

248 **Q. Please provide an overview of the supplier contracts that the Ameren**  
249 **Companies will enter into.**

250 A. Accompanying my testimony are the three standard supplier contracts: (1) the  
251 BGS-FP Supplier Forward Contract (Resp. Ex. 3.1), (2) the BGS-LFP Supplier  
252 Forward Contract (Resp. Ex. 3.2) and (3) the BGS-LRTP Supplier Forward  
253 Contract (Resp. Ex. 3.3). These standard contracts define in detail the terms  
254 pursuant to which each auction product will be procured by the Ameren  
255 Companies in the first BGS auction.

256 The BGS-FP Supplier Forward Contract lays out the detailed contract  
257 terms for the fixed-priced, full requirements product that the Ameren Companies  
258 will procure to supply their R&SB customers. Those registered bidders who win  
259 tranches of BGS-FP supply in the auction will be required to sign this contract  
260 following the close of the auction.

261 The BGS-LFP Supplier Forward Contract lays out the detailed contract  
262 terms for the fixed-priced, full requirements product that the Ameren Companies  
263 will procure to supply their LC&I customers who choose to take service under  
264 Rider BGS-L. Those registered bidders who win tranches of BGS-LFP supply in  
265 the auction will be required to sign this contract following the close of the  
266 auction.

267 The BGS-LRTP Supplier Forward Contract lays out the detailed contract  
268 terms for the real-time priced, full requirements product that the Ameren  
269 Companies will procure to supply their LC&I customers, who choose to take

270 service under Rider RTP-L. Those registered bidders who win tranches of BGS-  
271 LRTP supply in the auction will also be required to sign this contract following  
272 the close of the auction.

273 **Q. Why is it important that the terms of the standard contracts be clearly**  
274 **defined prior to the auction?**

275 A. The contracts are referred to as standard contracts because each supplier who wins  
276 load for a specific product will be required to sign virtually the same supplier  
277 contract (only the supplier name and number of tranches will differ from contract  
278 to contract). The terms of these contracts will be finalized prior to the start of the  
279 auction. There will be no individual negotiations with respect to these contracts.  
280 The use of standard contracts is essential to the auction process because it adds to  
281 the transparency of the process and increases the participation in the auction.  
282 Because all suppliers are registered using the same standard qualification  
283 requirements, and all contract terms are known before the start of the auction, bids  
284 can be compared purely on price. This approach results in an extremely  
285 transparent bid evaluation process that makes the auction more attractive to a  
286 wide range of potential suppliers.

287 **Q. How did the Companies develop these standard contracts?**

288 A. We developed these supplier forward contracts using the New Jersey Supplier  
289 Master Agreements as the starting point. We recognize that the supplier contracts  
290 are integral components of a successful auction. By starting with the New Jersey  
291 contracts and changing only those terms that are required to make the process

292 work in the Ameren Companies' service territories, we can build on the successes  
293 already obtained in the New Jersey auctions.

294 **Q. What terms have changed from the New Jersey contracts?**

295 A. As stated in the previous question, the changes that were made to the New Jersey  
296 contracts were made to make the process work in the current market and  
297 regulatory environments in Central and Southern Illinois. The following major  
298 modifications were made.

299 First, the Ameren Companies will have three forms of standard contracts  
300 based on their product design. In New Jersey, only two products are procured in  
301 auctions.

302 Second, the New Jersey contracts were modified to reflect the fact that the  
303 Ameren Companies will remain the Load Serving Entities ("LSEs") for the load  
304 and, therefore, will be responsible for the procurement of NITS and ancillary  
305 services. As discussed in the direct testimony of Mr. Nelson, the Ameren  
306 Companies have chosen to remain the LSE to make it clear that the transaction  
307 between the BGS suppliers and the Companies are wholesale transactions and  
308 also to reflect that the Ameren Companies continue to have the provider of last  
309 resort responsibility. By having the utilities responsible for the procurement of  
310 NITS, it makes it clear that the suppliers are not responsible for changes in  
311 network transmission services prices. In addition, the utilities will be responsible  
312 for the procurement of ancillary services from the MISO via the MISO Open  
313 Access Transmission Tariff ("OATT"). The costs of such ancillary services will

314 then be passed on to the suppliers, who can embed them into their fixed-price  
315 offers.

316 Third, the New Jersey contracts were modified to reflect a different  
317 delivery point. In New Jersey, the delivery point is at each utility's PJM meters  
318 while the title change takes place at the retail meter. In the Ameren Companies'  
319 standard BGS contracts, the delivery point is defined as the specific load zones  
320 recognized by the MISO as encompassing the BGS load for which the specific  
321 BGS supplier is responsible. The MISO's current market rules do not allow the  
322 definition of a load zone that spans multiple control areas. Therefore, the winning  
323 suppliers in the Ameren Companies' BGS auction will deliver to three load zones,  
324 one for the AmerenCIPS portion of the BGS load, one for the AmerenCILCO  
325 portion, and one for the AmerenIP portion. The title transfer will be at the  
326 delivery point.

327 Fourth, the Companies' standard BGS contracts include specific language  
328 related to PURPA Qualifying Facility ("QF") generation. Specifically, the  
329 contracts clearly state that the QF generation will be treated as negative load that  
330 will be considered as an offset to BGS-LRTP load. There is no similar language  
331 in the New Jersey contracts.

332 Fifth, the New Jersey contracts were modified to reflect necessary changes  
333 to the treatment of FTRs and Auction Revenue Rights ("ARRs"). FTRs and  
334 ARRs are financial instruments that allow MISO market participants to hedge the  
335 congestion risk associated with delivering energy to the load. The MISO  
336 currently allocates FTRs and ARRs to LSEs annually based on the MISO's

337 planning year which begins on June 1 of a given year and ends on May 31 of the  
338 following year. This creates two issues that need to be addressed in the standard  
339 BGS contract: (1) the re-allocation to the winning suppliers of the FTRs/ARRs  
340 that will be allocated to the Ameren Companies for the January 1, 2007, through  
341 May 31, 2007, time period; and (2) transferring the Ameren Companies' right to  
342 directly nominate and receive FTRs/ARRs to the winning suppliers for the MISO  
343 planning period beginning June 1, 2007 and all future MISO planning periods.  
344 The Ameren Companies' standard BGS contracts define how the FTRs/ARRs will  
345 be re-allocated from the Ameren Companies to the winning suppliers for January  
346 1, 2007, through May 31, 2007, time period and how the right to nominate and  
347 receive FTRs/ARRs will be transferred to the winning suppliers on an ongoing  
348 basis.

349 Sixth, the New Jersey contracts contain specific language related to load  
350 caps. This language was not included in our contracts because we consider load  
351 caps to be an auction design issue. These standard contracts will not be in effect  
352 until after the auction is complete at which point load caps are no longer relevant.

353 Seventh, the Ameren Companies' standard BGS contracts contain slightly  
354 different tranche terms than what is contained in the New Jersey contracts. The  
355 reason for our use of slightly different tranche terms was explained in detail  
356 earlier in my testimony when I was discussing the product design. Restated  
357 briefly, our tranche terms are different in order for the Ameren Companies to step  
358 into a process where rolling three-year contracts are used to supply the BGS-FP  
359 load and to allow the CPA to synchronize with the MISO planning year.

360 Eighth, in our standard contracts, the supplier generally is responsible for  
361 all taxes owing before receipt at the delivery point and the Ameren Companies are  
362 responsible for taxes owing after receipt at the delivery point. In New Jersey, the  
363 winning suppliers are responsible for all federal, state, municipal, and other taxes.  
364 The reason for this change is due to the change in the title transfer point.

365 Ninth, the credit provisions in our standard BGS contracts are  
366 fundamentally the same as in the New Jersey contract, with the exception that the  
367 Independent Credit Requirement (“ICR”) was eliminated and the Credit Limit  
368 Caps were modified. The reasons for these changes are discussed in detail in the  
369 direct testimony of Mr. Roger Fetter.

370 Tenth, the contract language was modified to make it clear that our  
371 standard BGS contracts are forward contracts. This included, primarily, adding  
372 provisions stating clearly that the agreement is a "Forward Contract" and that each  
373 party is a "Forward Contract Merchant", as those terms are defined under the U.S.  
374 Bankruptcy Code. These changes are designed to provide assurances that the  
375 Ameren Companies can terminate a standard BGS contract if a supplier files for  
376 bankruptcy protection.

377 Finally, there were various minor changes to the contract language to  
378 reflect differences in terminology between New Jersey and Illinois. These include  
379 things such as replacing “EDC” (Electric Distribution Company) with “the  
380 companies”, and “Third Party Supplier” with “Retail Electric Supplier” among  
381 others.

382 **Q. Have any potential suppliers had an opportunity to provide input into the**  
383 **development of these contracts?**

384 A. Yes, they have. On December 17, 2004, the Ameren Companies and  
385 Commonwealth Edison Company hosted a meeting with interested suppliers to  
386 discuss the specific terms of each company's standard BGS supplier contract for  
387 their below 1 MW customers. At the end of the meeting copies of the contracts  
388 were distributed to the suppliers, who were then given the opportunity to submit  
389 questions and comments to the companies. A second meeting with the suppliers  
390 took place on January 14, 2005, in which the companies provided responses to the  
391 questions and comments submitted by the suppliers. We utilized the feedback  
392 received from these supplier meetings in drafting the standard BGS contracts  
393 included in this filing.

#### 394 **CONTINGENCY PLANS**

395 **Q. What is a contingency plan?**

396 A. Contingency plans define the process that the Ameren Companies will use to  
397 procure replacement supply in the unlikely event that additional supply sources  
398 are required beyond what is procured in the Ameren Companies' BGS auctions.  
399 While not every contingency can be anticipated, we have identified three possible  
400 scenarios for which a contingency plan would be required: (1) the Ameren  
401 Companies receive an insufficient number of bids to provide for a fully  
402 subscribed auction volume for one or more of the products being procured in a  
403 BGS auction; (2) supplier default prior to or during the delivery period of a BGS

404 supplier contract; and (3) the Illinois Commerce Commission (“Commission” or  
405 “ICC”) rejects the results of a BGS auction.

406 **Q. Please describe the circumstances which would lead to an auction not being**  
407 **fully subscribed.**

408 A. In order for the auction process to achieve the best price for customers, the level  
409 of competition in the auction must be sufficient. To ensure a sufficient level of  
410 competition, the Auction Manager has the option to reduce the auction volume.  
411 The process that the Auction Manager will use when deciding to reduce the  
412 auction volume is discussed in the direct testimony of Dr. LaCasse.

413 **Q. Please describe the contingency plan for a less than fully subscribed auction**  
414 **volume.**

415 A. In the event that the auction volume fails to procure 100% of a BGS auction  
416 product, we will purchase the necessary services for the unfilled tranches of BGS  
417 supply through the MISO-administered spot markets until the next scheduled  
418 BGS auction. The remaining term of the unfilled tranches of BGS supply would  
419 be included in the next scheduled BGS auction. To the extent that the MISO has  
420 not yet implemented a market for capacity, the Ameren Companies will procure  
421 the required capacity through the bilateral capacity markets.

422 **Q. Why do the Companies believe it is appropriate to purchase replacement**  
423 **supplies for this contingency from the MISO-administered spot markets?**

424 A. The Companies believe that purchasing replacement supplies from the MISO-  
425 administered spot markets is appropriate because it will alert bidders that in order  
426 to secure BGS supply prices from the Ameren Companies, it will be necessary to

427 bid in the auction. Purchasing BGS supply in the MISO-administered markets is  
428 a strong feature of the auction proposal because it provides bidders a strong  
429 incentive to participate in the auction process. Bidders would have a diminished  
430 incentive to participate in the auction and present their best offers if they believed  
431 that a less than fully subscribed auction would lead to a negotiation or a secondary  
432 market in which the Companies, on behalf of their customers, would seek to  
433 acquire fixed-priced supplies.

434 **Q. How would the Ameren Companies procure power in the unlikely event that**  
435 **one of its BGS suppliers defaults?**

436 A. To protect customers against (however unlikely) cases in which a supplier  
437 defaults on its obligation after bids have been awarded, the Companies propose  
438 the following contingency plan:

- 439 • Immediately upon default-related termination of the supply contract, the  
440 Companies would replace the defaulted-on supply obligation through  
441 purchases from the MISO-administered spot markets as a stop-gap  
442 (temporary) mechanism. To the extent that the MISO has not yet  
443 implemented a market for capacity, the Companies will procure the  
444 required capacity through the bilateral capacity markets.
- 445 • If the default occurs less than 90 days before the end of the defaulted-on  
446 contract's last delivery day, the Companies will continue to replace the  
447 contract's supply obligation through MISO spot market purchases for the  
448 remaining delivery period of the defaulted-on contract.
- 449 • If the default occurs 90 or more days before the end of the contract's last  
450 delivery day, the Companies immediately will issue a request for proposal  
451 ("RFP") to replace the remaining term of defaulted-on BGS tranches  
452 through a power purchase agreement ("PPA") with deliveries starting 20  
453 days after termination of the defaulted-on contract's supply obligation.  
454 The RFP would be sent to all registered bidders from the most recently  
455 completed BGS auction. Winners in the RFP would be required to sign  
456 the same BGS Supplier Forward Contract with the only modifications  
457 being the term and price. Until delivery is taken under the replacement  
458 supplier contract, the contract's supply obligation will be replaced through  
459 the MISO-administered spot market purchases.

460 • Any incremental costs or savings associated with prudently-procured  
461 replacement power purchases would be collected from the defaulted BGS  
462 supplier. To the extent that some portion of the incremental cost is unable  
463 to be collected from the defaulted BGS supplier, this cost would be trued  
464 up through a market value adjustment factor explained by Mr. Robert Mill  
465 in his direct testimony.

466 **Q. Why do the Companies believe that this is an appropriate contingency plan**  
467 **in the case of supplier default?**

468 A. The Companies' contingency plan for supplier default is appropriate because it:  
469 (1) maintains a continuous supply of the full requirements product required to  
470 serve the load; and (2) allows the Ameren Companies to quickly identify the full  
471 replacement cost of the defaulted supply contract. Identifying the replacement  
472 cost quickly will enable the Companies to settle with the defaulting supplier as  
473 soon as reasonably as possible.

474 **Q. What contingency plan do the Companies propose in the unlikely scenario**  
475 **that the Commission rejects the results of a BGS auction?**

476 A. Should the Commission reject the results of a BGS auction, the Companies would  
477 meet with the ICC Staff, the Auction Manager and Auction Advisor within five  
478 days and review the reasons why the Commission rejected the results.

479 If the auction results were rejected for reasons that could easily be  
480 corrected (e.g., some flaw in the auction process, the behavior of a particular  
481 supplier, etc.) then the appropriate corrections would be made and it is expected  
482 the Auction Manager would re-run the auction .

483 If the auction results were rejected for reasons that are not easily  
484 corrected, the Companies would work with the ICC Staff to develop an alternative  
485 procurement plan to be used to procure the required BGS supply until the next

486 scheduled BGS auction. The Ameren Companies would file the plan with the  
487 Commission for approval. The unfilled tranches of BGS supply would be  
488 included in the next scheduled BGS auction.

489 **Q. Why do the Companies believe that this is an appropriate contingency plan**  
490 **in the case where the Commission rejects the results of a BGS auction?**

491 A. We believe that this is an appropriate contingency plan in the case where the  
492 Commission rejects the results of a BGS auction because it allows the utilities and  
493 the ICC Staff the appropriate level of flexibility to evaluate the reason for the  
494 Commission rejection and take the appropriate action. The reasons for complete  
495 Commission rejection of a BGS auction can vary widely and attempting today to  
496 determine a precise alternative procurement plan that is appropriate for all  
497 possible scenarios simply does not make sense.

498 **COMPETITIVE WHOLESALE MARKETS AND HOW MARKET**  
499 **PARTICIPANTS WILL ASSEMBLE BIDS**

500 **Q. What is the role of the MISO in the auction process?**

501 A. Although the MISO does not have a direct role in the auction process, the  
502 existence of the MISO day-ahead and real-time markets is important to the  
503 success of the auction or any other competitive procurement process. These  
504 markets are the foundation of the wholesale market from which the pool of  
505 potential suppliers will assemble the products that they will bid. The expected  
506 level of prices in the day-ahead and real-time markets will set the value of the  
507 standard wholesale products (e.g., 5x16 Energy, 7x24 Energy, Off-Peak Energy,  
508 etc.) in the general marketplace. These markets also provide potential bidders  
509 with the ability to purchase energy on an hourly basis to convert the standard

510 products available in the market into the full requirements, load following  
511 products up for bid in the auction.

512 **Q. How will potential suppliers assemble the auction products that they will bid**  
513 **into the CPA?**

514 A. There are various ways in which a potential supplier could assemble the capacity  
515 and energy products needed to participate in the auction. I will discuss two such  
516 ways: (1) assembling the auction product from a portfolio of physical generating  
517 assets; (2) assembling a portfolio of readily available energy and capacity  
518 products. A potential supplier could also use a combination of these two.

519 **Q. Please describe how a potential supplier would participate in the auction**  
520 **utilizing a portfolio of owned or controlled generating assets to serve a**  
521 **tranche of load?**

522 A. A potential supplier who owns or controls a portfolio of generating assets could  
523 participate directly in the auction utilizing the uncommitted portions of these  
524 facilities to supply the capacity and energy requirements of the BGS supply  
525 contract.

526 An owner of generating assets also may choose to participate in the  
527 auction indirectly. In this scenario, the supplier could sell the output of its  
528 generating assets to a third party who then could participate in the auction  
529 directly. This approach might make sense for a supplier who only owns peaking  
530 generation, for example.

531 **Q. Do the generating assets need to be located within the footprint of the**  
532 **Ameren Illinois service territories?**

533 A. No, they do not. The generating units can be located outside the Ameren-Illinois  
534 footprint as long as they meet certain requirements set by the MISO. These  
535 requirements are the same for MISO generators located inside or outside of the  
536 Ameren-Illinois service areas. For all generators located within the MISO  
537 footprint, the generators would have to be considered deliverable to the Ameren-  
538 Illinois Load Zones as determined by the MISO deliverability test. The  
539 deliverability to the Ameren-Illinois Load Zone for every generator within the  
540 MISO footprint will be known prior to the start of the auction. Deliverability is  
541 discussed further in the testimony of Mr. Robert McNamara of MISO.

542 For generating assets located outside the MISO footprint, the supplier  
543 would be required to have a firm transmission path to the MISO border and the  
544 generator would have to be considered by the MISO to be deliverable to the  
545 Ameren-Illinois Load Zone. It is unlikely that the deliverability of generating  
546 units outside the MISO footprint would be known prior to the auction.

547 **Q. Please describe how a financial participant would participate in the auction?**

548 A. The ability of a financial participant, a market participant who does not own  
549 generating assets in the region, to supply the auction products is premised on the  
550 existence of physical and financial markets operated by the MISO. The  
551 foundation of the MISO markets is the day-ahead and real-time energy markets.  
552 As discussed in the direct testimony of Mr. McNamara, the MISO day-ahead and  
553 real-time energy markets are scheduled to startup on April 1, 2005. These

554 markets will produce the transparent spot-market energy prices that act as the  
555 foundation of the longer-term wholesale energy markets. Layered on top of these  
556 transparent spot markets are a host of financial products for energy at various  
557 trading hubs that allow these financial participants to hedge the risk associated  
558 with supplying these fixed-priced, full requirements products. A financial  
559 participant could also enter into a bilateral agreement with an asset owner to  
560 hedge its supply risk.

561 **Q. The MISO does not yet operate markets for capacity or ancillary services.**  
562 **Would that prevent financial participants from bidding into the auction?**

563 A. No. While the existence of RTO-operated capacity and ancillary services markets  
564 do improve the market structure that supports these auctions, they are not  
565 necessary to hold an auction because avenues currently exist for financial  
566 participants to procure each of these products required to assemble the auction  
567 products. Capacity can be procured through bilateral markets and there is more  
568 than sufficient physical assets currently installed in and around the state of Illinois  
569 and the MISO footprint to supply this capacity. And as stated earlier in my  
570 testimony, ancillary services will be procured by the Companies.

571 **Q. Does the MISO currently have plans to operate capacity and ancillary**  
572 **services markets in the MISO footprint?**

573 A. Yes, it does. As discussed in detail in the direct testimony of Mr. McNamara, the  
574 MISO currently projects to have capacity markets up and running in 2006 and  
575 ancillary services markets up and running in 2007. Once up and running, these  
576 MISO-administered capacity and ancillary services markets will increase the price

577 transparency for these products, which should further increase the efficiency of  
578 the auction process.

579 **Q. How would a financial participant use these financial markets to assemble**  
580 **the CPA products?**

581 A. A financial participant who wishes to participate in the auction will utilize the  
582 day-ahead and real-time spot markets operated by the MISO to physically deliver  
583 the energy associated with a full requirements tranche of load. They also might  
584 purchase a combination of on-peak, off-peak, and around the clock energy  
585 products from a liquidly traded trading hub in order to mitigate the risk associated  
586 with delivering from the spot market.

587 In addition, in the near term, the financial participant will purchase  
588 capacity via the bilateral markets to complete the assembly of the auction product.  
589 Later, the financial participant might purchase capacity via the MISO markets.

590 **Q. If there is not a liquid trading hub for energy products delivered to the**  
591 **Ameren-Illinois footprint, will this prevent the financial participants from**  
592 **participating in the CPA?**

593 A. No, financial participants can still participate without a liquid trading hub for  
594 delivery to the Ameren-Illinois footprint. If this should be the case, the financial  
595 participant could hedge its risk by purchasing the energy products at another hub  
596 such as “Into Cinergy” or the PJM NI Hub along with a basis swap.

597 **Q. What is a basis swap?**

598 A. A basis swap is a financial product that is readily available in the market. This  
599 product values the price difference between two trading hubs.

600 **Q. Have financial participants been successful in winning load in the New Jersey**  
601 **auctions?**

602 A. Yes, they have. Past winners in the New Jersey auctions include Morgan Stanley  
603 Capital Group Inc. and Select Energy, Inc. Both of these companies have been  
604 successful despite not owning any generating assets in PJM.

605 **ILLINOIS COMMERCE COMMISSION POST 2006 INITIATIVE**

606 **Q. Have you reviewed the report that the Staff submitted to the Commission of**  
607 **the Post 2006 Initiative?**

608 A. Yes, I have.

609 **Q. Please summarize the Staff's recommendations as they pertain to**  
610 **procurement.**

611 A. The Staff, in its report on the Post 2006 Initiative, grouped 18 desirable  
612 characteristics of a procurement methodology into categories comprising of five  
613 overarching policy goals of the post 2006 procurement process: (1) mitigation of  
614 market structure problems, (2) provision of regulatory certainty, (3) provision of  
615 market based rates and rate stability, (4) provision of a means to convert results  
616 into traditional rate design, and (5) provision of a working procurement option by  
617 January 2007.

618 The Staff also recommends that while the Commission should remain  
619 open to more than one procurement plan, that a New Jersey Style Vertical  
620 Tranche Auction should be encouraged for the large Illinois utilities that do not  
621 own significant generation resources. In addition, the ICC Staff makes the  
622 following recommendations:

- 623 • The Commission should clarify its authority to implement the use of any  
624 given procurement methodology, in general, and a vertical tranche  
625 auction, in particular.
- 626 • Illinois policymakers should continue to work to ensure that the PJM and  
627 the MISO LMP and FTR markets are fully functional and completely  
628 resource non-discriminatory before the end of 2006.
- 629 • Illinois policymakers should continue to work to ensure that market  
630 “seams” between MISO and PJM are eliminated.
- 631 • Illinois policymakers should work to ensure that there exists regional  
632 markets for ancillary services and capacity within and between MISO and  
633 PJM.
- 634 • Illinois policymakers should work to ensure that the winners of a vertical  
635 tranche supply auction are given LSE status for purposes of PJM and  
636 MISO tariffs.
- 637 • Illinois policymakers should work to ensure that auction winners can  
638 receive annual FTR allocations from MISO and PJM.

639 **Q. Do you agree with the ICC Staff’s recommendation that large Illinois utilities**  
640 **that do not own significant generation resources use a vertical tranche**  
641 **auction?**

642 A. Yes. As the ICC Staff states in its report, vertical tranche auctions provide a  
643 viable means of achieving the five overarching goals for a preferred procurement  
644 methodology. A vertical tranche auction is highly transparent, will encourage a  
645 wide range of potential suppliers, and will result in competitively priced, market  
646 based rates. In addition, the use of a vertical tranche auction as proposed by the  
647 Ameren Companies will provide end use customers with relatively stable rates  
648 while preserving their right to choose their retail supplier if they so desire.

649 **Q. The Staff also recommends that Illinois policymakers continue to work to**  
650 **ensure that MISO and PJM have LMP, FTR, capacity and ancillary services**

651 **markets in place before the end of 2006 and that the seams between these two**  
652 **RTOs be eliminated. Do you agree with this recommendation as well?**

653 A. Yes, I do. The elimination of seams and the existence of each of these four  
654 wholesale market components will maximize the efficiency of an auction. But, I  
655 must clarify that of these four wholesale market components only the existence of  
656 real-time and day-ahead energy markets is absolutely necessary for a vertical  
657 tranche auction to be successful. These energy markets are the foundation on  
658 which non-traditional suppliers rely to participate in the auction. Non-traditional  
659 suppliers already have the ability in today's wholesale market to purchase  
660 capacity bilaterally and ancillary services will be provided by the utilities.

661 An auction can take place and be successful without the existence of RTO-  
662 operated capacity and ancillary services markets. With that said, it should  
663 continue to be our goal to maximize the efficiency of the auction process and that  
664 requires both the policy makers and the utilities working with the MISO to ensure  
665 that capacity and ancillary services markets are in place as soon as possible. As I  
666 noted earlier, the MISO is currently projecting the startup of its LMP and FTR  
667 markets on April 1, 2005, its capacity markets in 2006 and its ancillary services  
668 markets in 2007. The Ameren Companies are committed to continue working  
669 with the MISO to ensure that these targets are achieved.

670 **Q. Finally, Staff recommended that Illinois policymakers should work to ensure**  
671 **that auction winners be given LSE status and that they receive annual FTR**  
672 **allocations from the MISO and PJM. Do you agree?**

673 A. While I agree that those suppliers who win tranches of load in the auction should  
674 be allowed to directly nominate and receive FTRs and ARR from MISO, I  
675 disagree that they should be designated the LSE in MISO. As discussed in detail  
676 in the direct testimony of Mr. Nelson, we strongly believe that the distribution  
677 utility should remain the LSE. Retaining the distribution utility as the LSE not  
678 only makes it clear that the transaction between the winning supplier and the  
679 distribution utility is a wholesale transaction (rather than a retail transaction), it  
680 also makes it clear that the distribution utility remains the provider of last resort  
681 for the load. It is important to note that under the MISO tariff, it is possible for  
682 the distribution utility to remain the LSE and the winning suppliers to directly  
683 nominate and receive FTRs from the MISO.

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

685 A. Yes, it does.