ILLINOIS COMMERCE COMMISSION

DOCKET NO. _____

DIRECT TESTIMONY

OF

CRAIG D. NELSON

Submitted On Behalf

Of

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

February 28, 2005

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6 **I. INTRODUCTION AND SUMMARY**

7 **Q. Please state your name and business address.**

8 A. My name is Craig D. Nelson. My business address is One Ameren Plaza, 1901
9 Chouteau Avenue, St. Louis, Missouri 63166.

10 **Q. What is your relationship to the Applicants in this case?**

11 A. I am Vice President – Strategic Initiatives of Ameren Services Company
12 ("Ameren Services") and Vice President of Central Illinois Public Service
13 Company, d/b/a AmerenCIPS ("AmerenCIPS").

14 **Q. Please describe Ameren Services.**

15 A. Ameren Services is a subsidiary of Ameren Corporation ("Ameren Corp.").
16 Ameren Services provides various administrative and technical support services
17 for its parent and other subsidiaries including Union Electric Company doing
18 business as AmerenUE ("AmerenUE"), Central Illinois Light Company d/b/a
19 AmerenCILCO ("AmerenCILCO"), AmerenCIPS, and Illinois Power d/b/a
20 AmerenIP ("AmerenIP"). Ameren Services was formed in connection with the
21 December 1997 merger of Union Electric and CIPSCO Incorporated.

22 **Q. Please describe your educational background.**

23 A. I earned a bachelor's degree in accounting in 1977, graduating with highest
24 honors, and a master's in business administration in 1984. Both degrees were

25 awarded by Southern Illinois University - Edwardsville. I am a Certified Public
26 Accountant.

27 **Q. Please describe your qualifications.**

28 A. I worked for Arthur Andersen & Co. from 1977 to 1979, when I joined Central
29 Illinois Public Service Company as a Tax Accountant. In 1979, I was promoted
30 to Income Tax Supervisor. I served in various tax and accounting positions until
31 1985 when I was appointed Assistant Treasurer. In 1989, I became Treasurer and
32 Assistant Secretary, a position I held for seven years. In 1996, I was elected Vice
33 President of Corporate Services. After Union Electric and CIPSCO merged, I was
34 named Vice President, Merger Coordination for Ameren Services effective
35 December 31, 1997. In 1998, I assumed the additional responsibility of Vice
36 President of Regulatory Planning. Effective June 1, 1999, I was appointed Vice
37 President, Corporate Planning. Most recently, effective October 15, 2004, I was
38 appointed Vice President, Strategic Initiatives.

39 **Q. Please describe your duties and responsibilities as Vice President, Strategic**
40 **Initiatives.**

41 A. My duties and responsibilities include Ameren's business and corporate services
42 initiative, Ameren's post-2006 initiative and power supply acquisition for
43 Ameren's utility companies..

44 **Q. What is the purpose of your testimony?**

45 A. I am testifying on behalf of AmerenCIPS, AmerenCILCO, and AmerenIP (the
46 "Ameren Companies" or the "Companies"). The purpose of my testimony is to
47 present an overview of the Ameren Companies' proposed revisions to its

48 determination of market value, and how that market value will be reflected in
49 rates at the end of the mandatory transition period. In this regard, I will discuss
50 how the Ameren Companies propose to supply and structure their post-2006
51 regulated electric service offerings to their remaining native load. (I will explain
52 how current Illinois customers of AmerenUE will be affected by this proposal.)
53 In particular, my testimony will: (1) discuss the market developments, regulatory
54 requirements and state policy initiatives in response to which the Ameren
55 Companies developed their market value rider and procurement proposal; (2)
56 summarize the competitive procurement process we propose to obtain supply to
57 full requirements service at regulated rates, how the price the Companies pay for
58 this supply reflects market value, and how the costs of supply will be reflected in
59 bundled retail rates; (3) summarize the benefits of our proposal; and (4) explain
60 why our proposal also is fully consistent with federal standards governing power
61 purchases from affiliated generation companies.

62 **II. BACKGROUND**

63 **Q. Why are the Ameren Companies filing for Commission approval of revised**
64 **tariffs that reflect an auction-based competitive procurement approach ?**

65 A. As Mr. Warner Baxter explains in his direct testimony, we are filing our proposal
66 for a post 2006 competitive procurement process and post 2006 retail tariff for
67 bundled service rates in response to several interrelated market developments,
68 regulatory requirements and state policy initiatives:

69 1. January 1, 2007 marks the statutory end of the "mandatory transition
70 period" provided under the Electric Service Customer Choice and Rate
71 Relief Law of 1997 (the "Customer Choice Law"), which means, among

72 other considerations, that both the restructuring-related retail rate freezes
73 and the long-term power supply contracts of the Ameren Companies
74 expire, recognizing as well that the Ameren Companies (with very limited
75 exceptions) no longer own generation in Illinois;

76 2. As a condition to its acquisition of AmerenCILCO, Ameren Corp.
77 committed to work with the Commission Staff to develop a competitive
78 procurement process for the supply of the native load of AmerenCILCO
79 and AmerenCIPS;

80 3. The regional wholesale market structure continues to evolve successfully,
81 and provides a meaningful opportunity to implement a highly transparent,
82 competitive procurement process;

83 4. The Federal Energy Regulatory Commission ("FERC") has imposed
84 increasingly stringent conditions on how utilities can purchase power from
85 affiliated generation companies, which makes it less likely that
86 distribution companies can simply turn to their affiliates for supply as they
87 could and did in the past; and

88 5. Substantial guidance was provided through the Commission's Post 2006
89 Initiative, our additional discussions with stakeholders and outside experts,
90 and the review of other restructured states' experience with addressing
91 similar procurement and ratemaking challenges.

92 *A. The Statutory End of the Transition Period*

93 **Q. Please explain in more detail the implications of the Customer Choice Law**
94 **and how the end of its statutory "transition period" affects the rates and**
95 **supply contracts of the Ameren Companies.**

96 A. The Customer Choice Law initiated: (1) the opportunity for customers to purchase
97 power from the supplier of their choice; (2) a restructuring of the State's electric
98 power industry; and (3) a transition toward delivery service unbundling and
99 greater reliance on market forces to determine how electric power and energy
100 would be provided to retail customers who remain with the utility. As the
101 Commission's recent report on its Post 2006 Initiative to Governor Blagojevich
102 explains, the Customer Choice Law's transition to market forces resulted in
103 "dramatic and positive changes" that have occurred in the industry:

104 • "Residential customers have benefited from one of the largest and
105 longest rate reductions, and today are paying 20% less than they
106 paid for electricity in 1994. The total savings statewide are
107 estimated to be 3.5 billion dollars.

108 • Many new entities have entered Illinois to compete for electric
109 supply. Customers have been given the power of choice, and have
110 selected these alternative retail electric suppliers ('ARES').

111 • Many industrial and commercial customers have realized
112 significant savings from selecting the Power Purchase Option
113 ('PPO') or an ARES; some indicate that these savings have helped
114 them to keep their business in Illinois rather than move to a lower
115 cost state.

116 • Statewide service reliability has improved dramatically.

117 • Over 9000 MWs of new generation has been built in Illinois by
118 private investors. These investors, and not customers, have
119 mustered the capital to build these plants and have borne the risk of
120 cost overruns as well as the potential of uneconomic results in
121 stranded costs.

122 • Illinois utilities have restructured operations by divesting
123 generation, and have become more productive and efficient in
124 order to face the emerging competitive marketplace."[1]

125 Illinois now approaches the end of its first phase of restructuring. In particular,
126 January 1, 2007 specifically marks: (1) the end of the "transition charges"
127 imposed on unbundled retail rates of several Illinois utilities; (2) the end of the
128 rate freeze for bundled retail service that was imposed on all major utilities; and
129 (3) the end of the long-term supply contracts that most Illinois utilities entered
130 into when, consistent with the Customer Choice Law's requirements and/or
131 Illinois Commerce Commission ("Commission") rules, they sold or spun off their
132 generating assets as part of the restructuring process. The resulting challenges
133 include the post-2006 replacement of expiring power purchase contracts that
134 currently supply the utilities' regulated service options, the structure of these
135 regulated retail service options after 2006, and the nature of utilities' post-2006
136 service obligations.

137 In response to these challenges, the Ameren Companies' current filing
138 specifically addresses: (1) how they will procure power for their regulated service
139 offerings to achieve the lowest possible, most competitive price; (2) how their
140 bundled retail rates will be structured to result in stable but market-based prices;
141 and (3) how they will recover their prudently-incurred, market-based procurement
142 costs fairly from each customer class. I will discuss each of these items in Section
143 III of my testimony.

[1] Final Report of the Illinois Commerce Commission's Post 2006-Initiative to Governor Rod. R. Blagojevich and the Illinois General Assembly, December 2004, p. 1.

144 *B. Ameren's Central Illinois Light Company Commitment ("CILCO*
145 *Commitment")*

146 **Q. Please explain the nature of Ameren Corp.'s CILCO commitment.**

147 A. As a condition to its 2002 acquisition of CILCORP Inc., the parent of Central
148 Illinois Light Company (now d/b/a AmerenCILCO), Ameren Corp. committed to
149 work with the Commission Staff to develop a competitive procurement process
150 for supply of the native load of AmerenCILCO and AmerenCIPS subsequent to
151 the December 31, 2006 expiration of their supply arrangements with Ameren
152 generation and marketing affiliates.[2] (Ameren Corp. had not yet acquired
153 AmerenIP.) In making the commitment to utilize a competitive procurement
154 process, Ameren Corp. also agreed to cause AmerenCILCO and AmerenCIPS to
155 seek approval from the Commission for such a procurement process, which would
156 exclude sole supplier arrangements unless specifically authorized by the
157 Commission.

158 **Q. What has Ameren Corp. done to comply with this commitment?**

159 A. To satisfy its CILCO commitment, Ameren Corp. started to meet with Staff to
160 explore options for a competitive procurement process in late 2003. In early
161 2004, Ameren Corp. integrated its efforts under the CILCO commitment with the
162 Commission's Post 2006 Initiative and has developed a procurement proposal that
163 is consistent with the recommendations received from Staff, the Post 2006
164 process, and additional stakeholder meetings. As I will explain, the Ameren

[2] Ameren's RFP commitment is set out in Section F of Appendix A to the Commission's order in Case 02-0428, December 4, 2002. Consistent with the Commission's restructuring policies and orders, supply arrangements of CIPS and CILCO with Ameren generation and marketing affiliates will expire on December 31, 2006.

165 Companies have developed a proposal consistent with the provisions of the
166 Customer Choice Law that cap power costs as a function of market value (*i.e.*,
167 Sec. 16-111(i)).

168 **Q. Is the Ameren Companies' proposed procurement process consistent with**
169 **the CILCO Commitment?**

170 A. Yes. The Ameren Companies have developed a competitive procurement process
171 for Commission approval as required under the conditions imposed on the CILCO
172 acquisition. However, in developing its proposal, the Companies have taken into
173 account two important developments. First, retail choice has reduced the demand
174 for the Ameren Companies' regulated supply offerings (e.g., "bundled service")[3]
175 and is expected to continue to reduce the scope of the utilities' power
176 procurement needs as additional customers switch from regulated service to
177 alternative retail suppliers. As the Commission's electric switching statistics
178 show, consistent with the experience in other retail access states, ARES have
179 made significant inroads in the supply of Illinois retail electric customers,
180 particular in the large customer segment.[4] For example, as of December 2004, a
181 total of 32% of the MWh load of large commercial and industrial customers in the
182 AmerenCIPS service area were served by registered RES (including Ameren
183 Energy Marketing Company ("AEM")). For AmerenIP, 48% of large customers'

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[3] The term "bundled service" generally is used in the context of the Ameren Companies' current or post-2006 obligation to provide customers with regulated service options that include both the generation and wires portions of retail supply. Today these regulated service options typically include the utilities' bundled service, a power purchase option, and interim supply service among others.

[4] See "Electric Switching Statistics" as posted at http://www.icc.state.il.us/ec/switchstats.aspx.

184 December 2004 load was served directly by alternative retail suppliers.[5]
185 Although the utilities remain the supplier of last resort for all retail customers
186 served through their distribution system, the successful introduction of retail
187 access has reduced, and is expected to reduce further, the power supply obligation
188 under their bundled service offerings. Consistent with these regulatory
189 requirements, the Ameren Companies will continue to provide customers with
190 regulated service options.

191 Second, the scope of procurement needs for post-2006 supply of bundled
192 service has increased due to Ameren Corp.'s acquisition of AmerenIP and the
193 pending transfer of the Illinois service territory of AmerenUE-Illinois ("Metro
194 East") to AmerenCIPS. Although not specifically addressed in the CILCO
195 commitment, Ameren Companies propose to include both the regulated supply
196 needs of AmerenIP and Metro East in the competitive procurement process.

197 **Q. What is the status of AmerenUE's transfer of Metro East to AmerenCIPS?**

198 A. The Commission has approved the transfer of the Metro East plant and business
199 to AmerenCIPS. The Missouri Public Service Commission, by its order of
200 February 10, 2005, has also approved the transfer. I anticipate that the transfer
201 will be completed later this year.

[5] In addition, a significant portion of AmerenIP's and Commonwealth Edison Company's ("ComEd's") customers have selected the "Power Purchase Option," which is a regulated supply service whose priced is based on a market value index.

202 *C. Procurement Opportunities Created by Restructured Wholesale Markets*

203 **Q. Please explain how opportunities to implement a highly transparent and**
204 **competitive procurement process are provided by the regional wholesale**
205 **market structure.**

206 A. It is important to recognize that the post-2006 procurement for Illinois utilities'
207 regulated service will occur in a substantially evolved wholesale market structure.
208 The Ameren Companies have already completed the transfer of operational
209 control over their transmission facilities to the Midwest Independent
210 Transmission System Operator ("MISO"), one of the two large Regional
211 Transmission Organizations ("RTOs") that serve Illinois. MISO is in process of
212 starting up its hourly energy markets, which are subject to FERC-approved
213 market power mitigation procedures. The introduction of these energy markets,
214 along with MISO-PJM seams coordination and the creation of central/southern
215 Illinois as a MISO trading hub, significantly increase the competitive procurement
216 options available to meet the Ameren Companies' post-2006 supply obligations.

217 With the introduction of energy markets, MISO will also facilitate
218 competitive procurement through greatly improved transmission access and
219 generation deliverability standards. For example, as currently planned, starting on
220 April 1, 2005, all MISO-internal transactions will be able to utilize network
221 integration transmission service ("network service"), including transactions that
222 span multiple control areas. Also, external resources will only need to obtain firm
223 service to a MISO boundary and, although such scheduling requirements remain
224 for imports from PJM, the MISO-PJM seams coordination effort has already

225 resulted in the elimination of through-and-out rates between the two RTOs.
226 Moreover, MISO has completed the preliminary generation deliverability
227 analyses for its Day 2 energy market and resource adequacy standard. As
228 explained by Mr. Ronald McNamara in his direct testimony in support of this
229 filing, MISO identified over 120,000 MW of generating capacity from designated
230 network resources that will be deemed deliverable (through network service) for
231 the purpose of satisfying participants' resource adequacy requirements within the
232 entire MISO footprint, including central and southern Illinois. All generating
233 units, even those that have not yet passed MISO's deliverability test, will be able
234 to participate in the MISO energy market, subject to MISO's market-based
235 congestion management process. In this market structure, MISO will evolve to be
236 the primary provider of ancillary services to both retail and wholesale power
237 providers in the region and will introduce centralized markets for capacity and
238 ancillary services over the course of the next two years. Mr. McNamara's direct
239 testimony addresses these market developments in more detail.

240 These developments substantially enhance the efficiency and
241 competitiveness of post-2006 power procurement for retail customers in Illinois.
242 The progress made to date on MISO-PJM market structure initiatives ensures the
243 feasibility and competitiveness of the proposed auction-based procurement of the
244 Ameren Companies' post 2006 supply obligations, and additional developments
245 will serve to further enhance the procurement process.

246 *D. FERC Affiliate Transaction Standards*

247 **Q. You also mentioned FERC standards for inter-affiliate power sales. Why are**
248 **these standards an important consideration in the design of any post-2006**
249 **procurement proposal?**

250 A. FERC's affiliate sales standards impose stringent conditions on how a
251 procurement process needs to be structured. These federal standards, which
252 would apply to *any* post-2006 procurement process, require that utilities'
253 procurement processes involving potential purchases from affiliated suppliers
254 must be highly transparent and managed independently. I address these
255 standards, which have evolved considerably since Ameren Corp. first committed
256 to utilize competitive procurement process during the CILCORP acquisition, in
257 more detail in Section V of my testimony. As I also explain in that Section, the
258 proposed competitive procurement process fully satisfies these requirements.

259 *E. Guidance Provided by Commission's Post-2006 Initiative, Stakeholders,*
260 *and outside Experts*

261 **Q. What was the Ameren Companies' role in the Commission's Post-2006**
262 **Initiative?**

263 A. The Ameren Companies have been very active participants in the workshops that
264 the Commission organized to address the identified post-2006 challenges. Since
265 the issues that the Ameren Companies have already been working on under its
266 CILCO commitment were essentially the same as those addressed in the
267 Post-2006 Initiative, the Ameren Companies have been able to contribute
268 constructively to this process from the very beginning. In fact, at the very first

269 Post-2006 Initiative workshop I presented research performed by in-house and
270 outside experts to identify and evaluate available competitive procurement
271 options based on the experience from other restructured states.[6] Since that initial
272 meeting, the Ameren Companies have fully participated in and contributed to
273 each of the six Post-2006 Working Groups: procurement, rates, competitive
274 issues, utility service obligations, energy assistance, and implementation.

275 **Q. How has the Post-2006 Initiative influenced the procurement and retail rate**
276 **proposal that the Ameren Companies have filed?**

277 A. The Ameren Companies have designed their market value measurement and
278 procurement proposal to take into account the insights and recommendations that
279 resulted from the Post-2006 Initiative. For example, as the Post-2006 Staff
280 Report also notes, the Procurement Working Group developed a list of 18
281 desirable characteristics for selecting a post 2006 procurement process, which
282 Staff summarized into five overarching policy goals: "(a) mitigation of market
283 structure problems, (b) provision of regulatory certainty for suppliers and utilities,
284 (c) provision of market based prices and rate stability, (d) provision of a
285 straightforward mechanism to convert supply acquisition costs into retail rates
286 using traditional rate design, and (e) provision of a working option by January
287 2007."[7] As I will discuss in further in Section IV of my testimony, based on the
288 discussions in the Commission's Post 2006 workshops and additional input from
289 Staff, other stakeholders, and consultants, the proposed auction-based

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[6] Craig Nelson, *Power Procurement Post 2006*, April 29, 2004 (as posted at http://www.icc.state.il.us/ec/docs/040503ecPostNelson.pdf)

[7] Post 2006 Staff Report, pp. 3, 7 and 12.

290 procurement approach was designed so it would to best satisfy these five
291 overarching policy goals and the identified 18 desirable characteristics. In
292 particular, the proposed auction-based competitive procurement process is also
293 consistent with the "Staff's preferred procurement method", which, as Staff
294 recognizes, not only "assures full transparency to all stakeholders" but also "is
295 expected to come the closest" of any procurement approaches to address the
296 concerns of Staff and other parties.[8]

297 **Q. How have the Ameren Companies solicited input from stakeholders and**
298 **outside experts?**

299 A. The Ameren Companies first met with experts from The Brattle Group in
300 February 2004 to review the procurement models used and the experience gained
301 from other restructured states that have already addressed similar procurement
302 and ratemaking challenges. This review showed that the general structure of our
303 proposal competitive procurement approach is used in many restructured states
304 and almost exclusively in restructured states similar to Illinois. I presented the
305 insights from this review of other states' procurement models at the April 29,
306 2004 workshop. Mr. Hannes Pfeifenberger's testimony further discusses this
307 review of procurement approaches in other states, a summary of which has also
308 been published as an article in The Electricity Journal.[9] We also sponsored the
309 June 3, 2004 Procurement Working Group presentation of the competitive

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[8] Post 2006 Staff Report, pp. 9-10.

[9] Pfeifenberger *et al.*, "Keeping up with Retail Access? Developments in U.S. Restructuring and Resource Procurement for Regulated Retail Service," *The Electricity Journal*, December 2004, pp. 50-63.

310 procurement model used in Maryland, which in many ways is structured very
311 similar to the New Jersey model.

312 The review of the experience in other restructured states also showed that
313 the same procurement method frequently is used by all major utilities within a
314 State. Through the Procurement Working Group's discussion of the approaches
315 used by the utilities in Maryland and New Jersey it also became apparent that
316 these two models have found the support of a broad and diverse group of
317 stakeholders. Through these discussions it became apparent to us that the
318 procurement approach utilized in New Jersey was uniquely suited to address the
319 identified post-2006 challenges in Illinois, satisfy the procurement characteristics
320 identified by the Procurement Working Group, and also meet FERC's standards
321 for power purchases from affiliates. Through our participation in the other Post
322 2006 Initiative working groups, it also became clear that the New Jersey
323 procurement approach would be able to address many of the issues identified and
324 discussed by the other Post 2006 Working Groups.

325 **Q. Have you utilized additional stakeholders' input in the development of its**
326 **procurement process?**

327 A. Yes. We repeatedly solicited input from Staff, Commonwealth Edison Company,
328 the manager of the New Jersey auction, regional power suppliers, industrial
329 customers, consumer representatives and the Attorney General's office. In June
330 2004, we met with the manager of the New Jersey auction, Chantale LaCasse of
331 National Economics Research Associates ("NERA"), who is testifying in this
332 proceeding, to discuss the feasibility of applying the New Jersey model in Illinois.

333 We subsequently developed a whitepaper, "Post 2006 Guidelines and Ameren
334 Competitive Procurement Proposal," that synthesized the guidance and insights
335 we had obtained at that point.

336 On several occasions from June through September 2004, the Ameren
337 Companies met to discuss their post-2006 guidelines and competitive
338 procurement proposal with the ICC Staff, potential wholesale suppliers of post-
339 2006 service (including, among others, Dynegy, Midwest Gen, Morgan Stanley,
340 Calpine, Goldman Sachs, Select Energy, Constellation, Ameren Energy
341 Marketing, and Exelon Generation), as well as the consumer representatives,
342 industrial customers and the Attorney General's office, as mentioned above.
343 Several of these meetings with Staff and other stakeholders also included ComEd
344 and Dr. LaCasse.

345 Based on the feedback from these stakeholder meetings, we first updated
346 our whitepaper in early September and, with further guidance through the
347 Commission's Post-2006 Initiative process and additional feedback from Staff
348 and the other stakeholders, developed the details of the procurement and retail
349 rate proposals that we present in this filing. The auction process itself was
350 designed by Dr. LaCasse based on the Illinois market structure and her experience
351 with developing similar auctions in New Jersey and Ohio. The auction process
352 and its development is discussed in more detail in Dr. LaCasse's testimony (Resp.
353 Ex. 6.0).

354 **III. SUMMARY OF THE AMEREN COMPANIES' PROPOSAL**

355 **Q. What is the essence of your filing?**

356 A. In essence, "market value" would be based on the results of a Commission-
357 approved Competitive Procurement Auction ("CPA") process and methodology
358 used to translate the Auction outcome into class-specific retail values. Retail rates
359 for Basic Generation Service ("BGS") would reflect the "translated" market
360 values. We hope to receive regulatory approval no later than January 2006. An
361 order in this time frame is needed so that the independent Auction Manager has
362 sufficient time to prepare the auction. Upon approval, the Auction Manager would
363 immediately prepare to hold the first auction for BGS supply in May 2006. Under
364 our procurement proposal, the Commission would monitor the auction with the
365 help of Staff and an independent Auction Advisor retained by the Commission,
366 and, if conducted in accordance to the pre-specified process, the Commission
367 would confirm its results within a few days after close of the auction. The price
368 of the awarded BGS contracts would then be reflected in the BGS component of
369 bundled retail rates based on the pre-specified, Commission-approved rate
370 allocation methodology. The market value would be subject to periodic
371 adjustment, as provided for in the Customer Choice Law. Mr. Robert Mill and
372 Mr. Wilbon Cooper elaborate further on the rate treatment.

373 To implement this process, the tariff filing addresses three closely
374 interrelated aspects of the Companies' post-2006 bundled service offerings: (1)
375 how they will procure power in wholesale markets for their regulated service
376 offerings to achieve the most competitive price; (2) how the bundled retail rates of
377 regulated service offerings will be structured to result in stable but market-based
378 prices for utility-provided energy; and (3) how they propose to recover their

379 prudently-incurred procurement costs. I will also explain in this section of my
380 testimony the customer protection measures built into this proposal and its
381 consistency with other State policy considerations.

382 ***A. Competitive Procurement Process for Post-2006 Supply Requirements***

383 **Q. How do the Ameren Companies propose to procure wholesale supply for**
384 **their Post-2006 bundled service offerings?**

385 A. The testimony of Dr. LaCasse and Mr. James Blessing explain the procurement
386 process in more detail and the filed procurement-related documents—the Market
387 Value Tariff, the Competitive Auction Procurement Rules, and the BGS Supplier
388 Forward Contracts—contain the full specification of the proposed process.

389 In summary, the Companies[10] propose to use the filed auction process to
390 procure energy and other services from wholesale suppliers for three categories of
391 full requirements products: (1) fixed-priced BGS for residential and small
392 business customers ("BGS-FP"); (2) fixed-priced BGS for large business
393 customers ("BGS-LFP"); and (3) a fixed-price capacity product that, combined
394 with spot purchases of energy from MISO, provides real-time pricing of energy
395 for large business customers ("BGS-Large Service Real-Time Pricing" or "BGS-
396 LRTP"). To provide additional price stability for residential and small business
397 customers, BGS-FP supply will be procured through overlapping three-year
398 contracts where approximately one third of the BGS-FP load is auctioned on an
399 annual basis.

[10] Owing to the pending Metro-East transfer, AmerenUE will not be an Illinois distribution company when the delivery of BGS begins.

400 The proposed CPA process is modeled after the New Jersey auction
401 process designed, in large part, by Dr. LaCasse, who is expected to act as the
402 independent Auction Manager. All BGS products will be auctioned off
403 concurrently through the proposed "multi-round, descending clock auction",
404 which is recognized as a highly transparent and efficient competitive procurement
405 process that will best be able to address market structure and other procurement-
406 related concerns. Dr. LaCasse's testimony and that of Mr. Blessing discuss
407 product definition and auction design in more detail.

408 Under the filed procurement process, the Ameren Companies will solicit
409 bids for individual load shares (or "tranches") of full-requirements wholesale
410 electric power supply for each of the three BGS groups to meet the combined
411 regulated service load of the Ameren Companies. Full requirements service
412 means that each supplier is physically responsible for all of the capacity and
413 energy necessary for each of the Ameren Companies to perform its
414 responsibilities as a MISO load serving entity ("LSE") for its regulated retail
415 service customers, and. In addition, each supplier will also be financially
416 responsible for its proportionate share of the ancillary services necessary to serve
417 its portion of the BGS load.[11]. The Ameren Companies will procure network
418 integration transmission ("NITS") service and ancillary services from the MISO.
419 Suppliers only need to arrange transmission services to deliver their supply to the
420 Ameren Companies' control areas.

[11] Ameren will procure the ancillary services but will be reimbursed by the suppliers.

421 To promote a large set of qualified suppliers, each tranche of BGS supply,
422 defined as a fixed percentage of the procurement group's BGS load, is sized to be
423 only approximately 100 MW of peak load. Once bids are awarded, each supplier
424 would be obligated to supply that fixed percentage of the Ameren Companies'
425 combined retail load at all times regardless of the actual magnitude of the load.
426 This also means that qualified BGS suppliers, not the distribution companies, take
427 on price and volume risks (e.g., customer switching risks) as well as the day-to-
428 day responsibility for resource procurement and portfolio/risk management.

429 **Q. Why do the Ameren Companies propose to combine their power**
430 **procurement?**

431 A. A combined procurement process for all three Companies is consistent with a
432 wholesale market structure in central/southern Illinois that is reasonably
433 homogenous across the heavily-intertwined service areas of the Ameren
434 Companies. A single procurement process will be able to take advantage of
435 MISO's Illinois trading hub and is also expected to result in greater supply
436 diversity, reduce the relative market shares of individual local generators (e.g.,
437 Dynegy and Ameren Corp.'s own generation affiliate), streamline and thus
438 increase the competitiveness of the bidding process, and reduce implementation
439 and ongoing administrative costs.

440 **Q. Why do the Ameren Companies propose to remain LSEs for BGS service?**

441 A. Although most of their obligations as a MISO LSE would be passed on to BGS
442 suppliers through the BGS Supplier Forward Contracts, the Ameren Companies
443 propose that they remain the LSE for two reasons. First, it clarifies that the

444 Companies remain the providers of last resort for their regulated service
445 customers, which will require the Ameren Companies to supplement and replace
446 BGS supplies in contingency situations such as supplier default. Second, the
447 designation of the distribution company as the LSE also makes clear that the
448 transaction between the BGS supplier and the distribution companies is a
449 wholesale contract, and that the BGS supplier will not be deemed a supplier at
450 retail under Illinois law, which could discourage suppliers from bidding in the
451 auction.

452 **Q. Does the procurement process contain any safeguards and additional**
453 **measures to protect customers, assure a competitive outcome, and maintain**
454 **reliability?**

455 A. Yes. The proposed competitive procurement process contains a number of
456 provisions to protect customers, assure a competitive outcome, and maintain
457 reliability.

458 First, the competitive auction would be monitored by the Commission
459 through its Staff and an independent Auction Monitor. This will ensure a
460 transparent, unbiased bidding process and, like in other states that employ similar
461 approaches, allow for prompt review and confirmation of the auction results by
462 the Commission. We also propose additional safeguards to alleviate concerns
463 over affiliate participation. The Ameren Companies' affiliates would be
464 permitted to participate in the proposed third-party-monitored procurement
465 process subject to additional safeguards: (1) distribution company employees will
466 not be able to participate in the preparation of a bid; and (2) employees from

467 generation or marketing affiliates will not be able to participate in the
468 administration of the procurement process. All existing affiliate transactions and
469 standards of conduct rules will also continue to apply.

470 Second, the BGS procurement will benefit from MISO resource adequacy
471 standards and market mitigation. For example, MISO's mitigation of spot
472 markets will provide a clear constraint on the pricing of any longer-term supply
473 contracts, including BGS contracts. Due to buyers' and marketers' ability to
474 hedge spot market volatility and arbitrage average price differences between
475 forward and spot purchases, a generator would not be able to sell longer-term
476 bilateral contracts at a price above the (risk adjusted) expected future spot market
477 prices. MISO's market monitoring efforts and automated mitigation procedures
478 to directly address suppliers' ability to exercise market power in spot markets will
479 thus also mitigate purchases under the BGS auction's longer-term contracts. In
480 addition, MISO resource adequacy standards will ensure that sufficient capacity is
481 dedicated to achieve reliable service.

482 Third, the auction process itself contains a number safeguards, including: a
483 requirement for suppliers to provide indicative offers; scaling of the procurement
484 process to avoid bid insufficiency; contingency procurement provisions under
485 which energy can be purchased through power purchase agreements, for limited
486 periods, directly from MISO spot markets; and load caps under which no more
487 than 50% of the Ameren Companies' combined fixed-priced BGS products and
488 no more than 50% of Ameren Companies' BGS-LRTP product can be awarded to