

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company, d/b/a AmerenCILCO	:	05-0160
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	:	(Cons.)
Central Illinois Public Service Company, d/b/a AmerenCIPS	:	05-0161
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Illinois Power Company, d/b/a AmerenIP	:	05-0162
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Proposals to implement a competitive procurement process by establishing Rider BGS, Rider BGS-L, Rider RTP, Rider RTP-L, Rider D, and Rider MV. (Tariffs filed on February 28, 2005)	:	

Administrative Law Judge’s Ruling

Introduction

The instant proceeding was docketed as a “proposal to implement a competitive procurement Process by establishing Rider BGS, Rider BGS-L, Rider RTP, Rider RTP-L, Rider D, and Rider MV.” The riders were filed by Central Illinois Light Company, Central Illinois Public Service Company and Illinois Power Company (“Ameren Companies” or “Ameren”). The procurement process proposed by the Ameren Companies utilizes a set of formulas intended to pass through market-based procurement costs incurred through an auction process.

On May 17, 2005 a Motion to Dismiss (“Motion”) the portion of above-referenced consolidated dockets relating to Riders BGS, BGS-L, D and MV (“Proposed Tariffs” or “Proposed Riders”) was filed jointly by the People of the State of Illinois, by Lisa Madigan, Attorney General of the State of Illinois; the Citizens Utility Board, and the Environmental Law and Policy Center (“Movants”), by and through their respective attorneys.

On May 25, 2005, responses in opposition to the Motion were filed by the Ameren Companies; Commonwealth Edison Company (“ComEd”); the Commission Staff (“Staff”); jointly by Constellation NewEnergy Inc. (“CNE”), MidAmerican Energy Company, Peoples Energy Services Corporation and U.S. Energy Savings Corporation; Midwest Independent Power Suppliers; Electric Power Energy Association; Midwest Generation EME, LLC (“MWGen”) and the Illinois Energy Association.

A reply to those responses was filed by Movants on May 31, 2005.

A response in support of the Motion was filed by Local Unions 15, 51 and 702, International Brotherhood of Electrical Workers, AFL-CIO ("IBEW"). A reply to that response was filed by Ameren Companies on May 31, 2005.

The arguments of the parties are set forth in their filings, all of which are included in e-Docket, and they have been duly considered. Generally speaking, the arguments will not be set out in detail in this ruling.

For the reasons given below, it is ruled that the Motion to Dismiss is denied. The focus and scope of this ruling are on the specific arguments raised in the Motion, as thereafter addressed in the responses and replies thereto. The ruling is not intended to speak to other issues, legal or factual, and no presumptions are created with respect thereto.

The Motion

In their Motion to Dismiss, Movants claim that the Commission does not have the authority to proceed with this case. They assert, among other things, that Section 16-103(c) of the Public Utilities Act ("Act" or "PUA), 220 ILCS 5/16-103(c), authorizes the Commission to approve market-based rates for only those customers who take electric service that has been "declared competitive" pursuant to Section 16-113 of the Act. Movants cite the following language from Section 16-103(c):

. . . For those components of the service which have been declared competitive, cost shall be the market based prices. Market based prices as referred to herein shall mean, for electric power and energy, either (i) those prices for electric power and energy determined as provided in Section 16-112, or (ii) the electric utility's cost of obtaining the electric power and energy at wholesale through a competitive bidding or other arms-length acquisition process.

At present, Movants state, no Ameren customers receive service that has been declared competitive. Accordingly, Movants argue, all Ameren customers are entitled to "cost-based" rates, which "protect consumers from charges in excess of the actual costs of providing electric service", rather than "market-based rates." (Motion at 4) They claim the Proposed Riders, contrary to law, are an attempt to "abandon cost-based ratemaking" and "replace cost-based rates with market-based rates" that would be set automatically by an auction, without any subsequent substantive review by the Commission to determine whether these rates are prudent, just and reasonable. (Motion at 5, 7)

In Movants' view, the Commission "cannot approve the process proposed in Riders BGS, BGS-L, D and MV without abdicating its duty to enforce consumer protection provisions in the PUA which require: (a) rates based on cost of service; (b) a

determination as to whether the costs were prudently incurred; and (c) review of the justness and reasonableness of the rates.” (Motion at 9) Movants conclude that the Proposed Tariffs fail to comply with the legal requirements specified in the PUA, and must be rejected.

In its Response supporting the Motion, the IBEW argues that nothing in the 1997 PUA Amendments permits the Commission to impose market-based rates on customers who lack access to alternative sources of power. (IBEW Response at 5) In IBEW’s view, the 1997 Amendments provide for market-based rates only for customers whose service has been declared competitive pursuant to Section 16-113 of the PUA.

Opposition to Motion

All parties opposing the Motion disagree with Movants’ contention that the Proposed Tariffs are an attempt to “abandon cost-based ratemaking” and to “replace cost-based rates with market-based rates.” According to the Ameren Companies, one of the changes in the electric industry that has occurred in response to the Electric Service Customer Choice and Rate Relief Law of 1997 is the large-scale divestiture of generation assets by utilities, including the Ameren Companies, pursuant to Section 16-111(g). The Ameren Companies now own virtually no generation. They state that they must obtain electric power from the marketplace after December 31, 2006, when their current contracts expire. The Ameren Companies assert that the Proposed Tariffs are designed to recover the actual costs they will incur in procuring energy, through an auction process, and do not assess rates on any basis other than cost. (Ameren Companies Response at 2, 6-7)

Similarly, Constellation NewEnergy et al. contend that in the absence of rate-based generation, the “cost” of electricity to customers is the market price. (CNE Response at 4, 6-8)

Staff asserts that under 16-103(c), “market-based prices” and “cost-based rates” are not mutually exclusive concepts, and that the phrase “market-based prices” is used in defining costs. (Staff Response at 5, 12) MWGen argues that the term “cost based” refers to the cost incurred by the utility, and that the prices resulting from the auction process will be cost-based. (MWGen Response at 3)

Several of the parties opposing the Motion also take issue with Movants’ assertion that under 16-103(c), the Commission may approve market-based rates for only those customers who take electric service that has been “declared competitive” pursuant to Section 16-113 of the Act. ComEd asserts that Movants manufacture a prohibition in Section 16-103(c) that simply does not exist.

According to Staff, Movants’ argument would also prevent the Commission from setting any power and energy rates for Ameren’s residential and small commercial customers taking non-competitive services. (Staff Response at 18) Since setting rates based on the cost of electric supply acquired through an arms-length negotiation

process is explicitly allowed under Section 16-103(c) for competitive services, Staff reasons, Movants' argument that the Commission is not allowed to set rates under the methodologies set forth in Section 16-103(c) for non-competitive services would prevent the establishment of rates on such a basis. Inasmuch as Ameren no longer possesses its own generation assets, Movants' argument would prevent the Commission from setting rates based on the costs incurred through the only means available to Ameren to obtain such supply, that being third party suppliers. (Staff Response at 18)

Somewhat similar arguments are made by Ameren, ComEd and Constellation NewEnergy, et al. CNE et al. also argue that without Commission-approved acquisition methodologies, the Commission would likely be required to pass through the costs of Federal Energy Regulatory Commission-approved bilateral contracts. (CNE Response at 9-11)

Staff, Ameren and ComEd also contend that Movants' arguments ignore the implications of Section 16-111(i) of the Act requiring the Commission to consider, among other things, "the extent to which the electric utility's tariffed rates for such component for each customer class exceed the market value determined pursuant to Section 16-112". (Staff Response at 19-22; Ameren Response at 4-6)

Opponents of the Motion also respond to Movants' criticism that the Proposed Tariffs "would be set automatically by an auction, without any subsequent substantive review by the Commission to determine whether these rates are prudent, just and reasonable." (Motion at 5)

To the extent Movants are challenging the legality of using formulae to establish rates, Staff disagrees with them, stating that formulae have been used on prior occasions and approved by Illinois courts. (Staff Response at 23) Ameren makes a similar argument, stating that Illinois courts have endorsed such mechanisms in a variety of contexts. (Ameren Response at 10) With regard to a post-auction review process, Ameren asserts that the auction process would eliminate discretionary decision-making by the utility. (*Id.* at 11-12) Staff explains that the Proposed Tariffs provide for Commission oversight of the auction process, including the use of an auction advisor, auction monitor, formal reports and an opportunity for the Commission to prevent implementation of the auction results by notification and initiation of a formal investigation. (Staff Response at 10-12)

Staff, and to some extent ComEd, also address the standard for review of a motion to dismiss. (Staff Response at 2-5) Staff observes that such motions are rarely seen in Commission rate proceedings, in part because rate investigation is legislative in nature. According to Staff, in considering a motion to dismiss, courts in Illinois must "accept as true all well-pleaded facts and all reasonable inferences that may be drawn from those facts" and "construe the allegations in the complaint in the light most favorable to the plaintiff." (Staff Response at 3, citing *Young v. Bryco Arms*, 213 Ill. 2d 433, 441 (2004)) Staff adds that the question presented by a motion to dismiss is "whether the allegations of the complaint, when viewed in a light most favorable to the

plaintiff, are sufficient to state a cause of action upon which relief can be granted”; and “a trial court is to dismiss the cause of action only if it is clearly apparent that no set of facts can be proven which will entitle the plaintiff to recovery.” (Staff Response at 3, citing *Borowiec v. Gateway 2000, Inc.*, 209 Ill. 2d 376 (2004))

In Staff’s view, in reviewing the motion to dismiss the instant proceeding, all facts alleged by the utility in its filing must be accepted as true. Further, Staff says all reasonable inferences to be drawn from those facts must be accepted, and all allegations in those filings must be construed in the light most favorable to the utility. When these standards are applied to Ameren’s proposed tariffs, it is clear, Staff argues, that Movants’ request to dismiss a portion of the instant tariff investigation must be denied. (Staff Response at 5)

Movants’ Reply

Among other things, Movants argue that Section “16-103(c) requires the Commission to continue reviewing the justness, reasonableness and prudence of rates for captive customers. “ (Movants Reply at 7) They assert that the Proposed Riders “propose automatic recovery of the costs of procuring electricity through an auction – whether or not those costs are prudent.” (*Id.* at 3) They complain that the Riders “do not allow sufficient time for an investigation to determine whether rates are just and reasonable and whether costs have been prudently incurred.” (*Id.* at 7)

In Movants’ view, a prudence review must compare the costs of procuring electricity through the proposed auction with other options, such as bilateral contracts. (Movants’ Reply at 8-11) They also argue that there is no Illinois precedent for recovery of commodity costs in the absence of a prudence review. (*Id.* at 11)

In Section I.B. of their reply, Movants reiterate their position that Section 16-103(c) authorizes the use of market-based prices in ratemaking only for customers who take service that has been declared competitive. (Movants’ Reply at 13) In their opinion, the arguments of Ameren, ComEd and Staff are contrary to the plain language of Section 16-113(c).

In their reply, Movants also argue that Section 16-111(i) does not authorize the Commission to use a market value, calculated in accordance with Section 16-112(a), to set retail rates for services that have not been declared competitive. They assert that this determination of “market value” is simply one step in the process of determining the justness and reasonableness of the regulated rates charged to captive customers. (Movants Reply at 15-17)

Analysis and Ruling

As noted above, one of the primary arguments made by Movants is that, contrary to law, the Proposed Riders “replace cost-based rates with market-based rates” set by an auction. Much of the focus in the Motion is on Section 16-103(c). It provides in part

that "...each electric utility shall continue offering to all residential customers and to all small commercial retail customers in its service area, as a tariffed service, bundled electric power and energy delivered to the customer's premises consistent with the bundled utility service provided by the electric utility on the effective date of this amendatory Act of 1997."

Section 16-103(c) goes on to provide:

Upon declaration of the provision of electric power and energy as competitive, the electric utility shall continue to offer to such customers, as a tariffed service, bundled service options at rates which reflect recovery of all cost components for providing the service. For those components of the service which have been declared competitive, cost shall be the market based prices. Market based prices as referred to herein shall mean, for electric power and energy, either (i) those prices for electric power and energy determined as provided in Section 16-112, or (ii) the electric utility's cost of obtaining the electric power and energy at wholesale through a competitive bidding or other arms-length acquisition process. (Emphasis added)

Similarly, Section 16-111(i) provides for the consideration of costs in establishing rates for tariffed services subsequent to the mandatory transition period.

First of all, from a simple reading of Section 16-103(c), and its numerous references to cost, it is clear that market-based prices and cost-based rates are not mutually exclusive concepts. To the contrary, use of market-based prices is recognized as a mechanism for or subset of, not an exception to or "replacement" of, establishing rate components based on cost. That is, use of market-based pricing is identified as one method for determining such costs, not an alternative thereto. In the instant case, Ameren's proposal is intended to recover only such costs as are actually incurred in procuring power and energy through the auction process. How well the proposal is designed to work in that regard is a question best answered with the benefit of a full record, not in a pre-hearing ruling on a dismissal motion.

Thus, the issue is not whether use of market-based prices is inherently inconsistent with the principle of setting rate components at cost. As indicated above, it is not.

The next question is whether Section 16-103(c) prohibits the use of an auction or other market-based process in determining the costs of power and energy in setting rates for non-competitive customers, as argued by Movants. A close reading of Section 16-103(c) reveals that no such prohibition exists. What Section 16-103(c) says is that "[f]or those components of the service which have been declared competitive, cost shall be the market based prices." Hence, rate components for competitive services may only be set, not surprisingly, by using market-based prices to establish cost.

Intrinsic to the position advocated in Movants' Motion on this issue is the proposition that because market-based prices must be used to establish the cost for components of competitive services, it necessarily follows that market-based prices may not legally be used to establish costs on which to base rate components for non-competitive services or customers. However, as indicated by various parties, the Act contains no such language, either in Section 16-103(c) or elsewhere. As parties opposing the Motion correctly observe, just because that particular method is statutorily mandated for establishing certain cost components for competitive services does not somehow mean it is statutorily prohibited for other services or customers, particularly where, as in the instant case, use of market-based prices is expressly recognized as one means of establishing costs in Section 16-103(c).

In addition, as several parties have commented, it is difficult to see by what means Movants envision the cost of procuring power and energy being determined for non-competitive services in a manner consistent with Movants' theory that market-based prices may not be used to establish costs on which to base rate components for non-competitive services. As noted above, Section 16-103(c) contains a broad definition of "market-based prices." It provides that "market based prices as referred to herein shall mean, for electric power and energy, either (i) those prices for electric power and energy determined as provided in Section 16-112, or (ii) the electric utility's cost of obtaining the electric power and energy at wholesale through a competitive bidding or other arms-length acquisition process." (Emphasis added) Since the Ameren Companies have divested themselves of virtually all generation assets pursuant to Section 16-111(g) of the Act, it is unclear how the cost of procuring power and energy would be established for non-competitive services, when existing contracts expire at the end of 2006, if all such market-based mechanisms were prohibited as Movants contend. Stated another way, the Commission cannot set such rates in a vacuum.

In any event, as explained above, use of market-based prices is statutorily recognized as a method for, not an exception or alternative to, basing rate components on cost. The procurement process proposed by the Ameren Companies utilizes a set of formulas intended to pass through market-based procurement costs actually incurred through the auction process. Just how well the procurement proposal advanced by the Ameren Companies is designed to properly quantify those costs, ensure the prudence of them and reflect them in just and reasonable rates is a complicated, multi-faceted question involving a number of issues, some factual in nature, that many parties will likely address in this proceeding. These determinations can best be made by the Commission with the benefit of a full record, including all comments, criticisms, modifications and alternatives proposed by the Movants and other parties. One such issue is discussed below.

As noted above, another element of Movants' theory, and one of Movants' criticisms of the pending proposal, is that the Proposed Riders would be set automatically by an auction, without any subsequent substantive review by the Commission to determine whether the costs were prudently incurred. (Motion at 5, 9) They claim the Riders "do not allow sufficient time for an investigation to determine

whether rates are just and reasonable and whether costs have been prudently incurred.” (Movants’ Reply at 7) In support of their position, Movants cite the Illinois Supreme Court decision in *Citizens Utility Board v. Illinois Commerce Commission et al.*, 166 Ill.2d 111, 121, 651 N.E.2d 1089 (Ill. 1995) (“*Citizens Utility Board*”) for the proposition that in setting rates, the Commission must determine that the rates accurately reflect the cost of service delivery and must allow the utility to recover costs prudently and reasonably incurred.

In the Court’s decision in that case, in review of a Commission order in the generic coal tar proceeding in Dockets Nos. 91-0080 through 91-0095 (Cons.), the Court found that utilities were entitled to recover prudently incurred coal tar cleanup costs. As other parties in the instant proceeding have observed, the Court also found, over the objections of the Citizens Utility Board, that the Commission’s approval of a pass-through rider as the preferred mechanism for recovery of coal-tar cleanup costs is within the Commission’s authority. In its order in that docket, approving use of a rider mechanism, the Commission found, after a review of the testimony and arguments of record, that such riders should be subject to an annual reconciliation with a prudence review.

As noted above, opponents of the Motion have cited the *Citizens Utility Board* case and other instances when formula-based rate mechanisms have been approved by the Commission and courts.

In the instant proceeding, a procurement review process is proposed by the Ameren Companies. As explained by Staff, the Proposed Tariffs contain provisions relating to Commission oversight of the auction process, including a post-auction opportunity to delay implementation of the auction results and initiate an investigation. Whether an auction process, assuming one is approved in some form, should be conditioned on the imposition of a more formal or more comprehensive review process than the one proposed by Ameren involves mixed questions of fact and law that can be addressed by the parties during the course of the proceeding, as was the case in the generic coal tar dockets cited by Movants. The arguments contained in the Motion on this issue are not a sufficient basis to terminate the docket at this time.

For the reasons given above, it is ruled that the Motion to Dismiss filed by Movants on May 17, 2005 is denied.