

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	:	
	:	No. 05-0159
Proposed tariffs filed pursuant to Article IX of the	:	
Public Utilities Act defining a competitive supply	:	
procurement process and, pursuant to Section	:	
16-112(a) of the Act, establishing a market value	:	
methodology to be effective post-2006; providing	:	
for Power Purchase Options and for recovery of	:	
transmission charges post-2006; and enabling	:	
subsequent restructuring of rates and unbundling	:	
of prices for bundled service pursuant to	:	
Sections 16-109A and 16-111(a) of the Act.	:	

Rebuttal Testimony of
ANDREW PARECE
Managing Principal
Analysis Group, Inc.

July 6, 2005

1 **I. INTRODUCTION AND SUMMARY OF TESTIMONY**

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

3 A. My name is Andrew Parece. My business address is 111 Huntington Avenue, Boston,
4 Massachusetts.

5 **Q. What is your current position?**

6 A. I am a Managing Principal at Analysis Group, Inc., an economics, business and strategy
7 consulting firm.

8 **Q. On whose behalf are you submitting rebuttal testimony?**

9 A. I am submitting rebuttal testimony on behalf of Commonwealth Edison Company,
10 hereafter referred to in my testimony as ComEd.

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

12 A. I was asked by ComEd to respond to issues raised in the testimony of Dr. David Salant,
13 Dr. Arthur Laffer and Mr. William Steinhurst in this proceeding with respect to the
14 Competitive Procurement Process Auction proposed by ComEd (hereafter referred to in
15 my testimony as the CPP Auction or CPP Auction proposal), as specified in the CPP
16 Auction Manual (ComEd Ex. 3.4), and described in the testimony of Mr. William P.
17 McNeil (ComEd Ex. 3.0) and Dr. Chantale LaCasse (ComEd Ex. 4.0). My rebuttal
18 testimony addresses issues related to:

- 19 • Completeness of the CPP Auction proposal;
- 20 • Discretion of the Auction Manager;
- 21 • Management of the CPP Auction;
- 22 • Independence of the Auction Manager; and
- 23 • Suggested modifications to the CPP Auction rules and process.

24 Q. **Please summarize your experience in the design and implementation of competitive**
25 **power auctions as a consultant?**

26 A. In 2002, I managed an assignment for the New Jersey Board of Public Utilities (NJ BPU)
27 to serve as Auction Monitor (Board Advisor) to its first auction for Basic Generation
28 Service (BGS). In 1997, I managed projects to design auctions for Standard Offer
29 Service (SOS) for two utilities in Massachusetts. The auction design recommended to the
30 utilities in Massachusetts was the first to involve a simultaneous multi-round (SMR)
31 clock auction for vertical slices of load, similar to the approach that is being proposed for
32 the CPP Auction, and the approach that has been used successfully in New Jersey since
33 2002. In 2001, I was also a member of the team that implemented an SMR auction of
34 Power Purchase Arrangements (PPAs) for the Alberta Department of Resource
35 Development. More complete details of my work in this area are provided below.

36 Q. **What material have you relied upon in preparing your testimony?**

37 A. In addition to my prior experience with auctions in New Jersey, Massachusetts and
38 Alberta, I reviewed the following testimony filed in this proceeding as part of my
39 preparation for this testimony:

- 40 • Direct testimony of William P. McNeil (McNeil Dir., ComEd Ex. 3.0 to 3.5) and
41 rebuttal testimony (McNeil Rebuttal, ComEd Ex. 10.0);
- 42 • Direct testimony of Dr. Chantale LaCasse (LaCasse Dir., ComEd Ex. 4.0 to 4.9), and
43 rebuttal testimony (LaCasse Rebuttal, ComEd Ex. 11.0 to 11.6);
- 44 • Rebuttal testimony of Arlene A. Juracek, P.E. (Juracek Rebuttal, ComEd Ex. 9.0);
- 45 • Direct testimony of Dr. David J. Salant (Salant Dir., Staff Ex. 1.0) and responses to
46 ComEd data requests; and
- 47 • Direct testimony of Dr. Arthur B. Laffer (Laffer Dir., BOMA Ex. 1.0) and responses
48 to ComEd data requests;
- 49 • Direct testimony of William Steinhurst (Steinhurst Dir., CUB-CCSAO, Ex. 2.0).

50 In addition, I have relied on other publicly available information related to auctions of
51 standard offer, or basic generation, service, including: the New Jersey Electric
52 Distribution Companies' (NJ EDCs) Proposal for Auction of BGS (June 2001);¹ the
53 order of the NJ BPU approving the 2002 NJ BGS auction (December 2001);² the final
54 approved 2002 NJ BGS auction rules (December 2001);³ the final approved 2005 NJ
55 BGS auction rules (November 2004);⁴ the Post-Auction Reports of the Board Advisor for
56 each of three years of the NJ BGS procurement (2002-2004);⁵ and the report of the
57 Auction Advisor for the Ohio Public Service Commission Auction (December 2004).⁶

58 **Q. Please summarize your testimony.**

59 **A.** I offer the following conclusions in my testimony:

60 (1) Completeness of the CPP Auction proposal – The CPP Auction rules and process as
61 specified in the CPP Auction Manual and described in the testimonies of Dr.
62 LaCasse and Mr. McNeil, with certain clarifications described in the rebuttal
63 testimonies of Dr. LaCasse and Mr. McNeil, and ComEd responses to data requests,
64 provide sufficient detail for the ICC to evaluate and approve the CPP Auction
65 proposal.

¹ *In the Matter of The Provision Of Basic Generation Service Pursuant To The Electric Discount And Energy Competition Act*, Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, Proposal for Auction of Basic Generation Service, June 29, 2001.

² *Decision and Order, I/M/O The Provision of Basic Generation Service Pursuant To The Electric Discount And Competition Act, N.J.S.A. 48:3-49 et seq.*, State of New Jersey Board of Public Utilities Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, December 11, 2001.

³ Public Service Electric & Gas Company Compliance Filing to *Decision and Order, I/M/O The Provision of Basic Generation Service Pursuant To The Electric Discount And Competition Act, N.J.S.A. 48:3-49 et seq.*, State of New Jersey Board of Public Utilities Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, December 12, 2001.

⁴ *In the Matter of The Provision Of Basic Generation Service For Year Three of the Post Transition Period*, Docket No. EO04040288, Electric Distribution Company Compliance Filing, dated November 3, 2004.

⁵ *Post-Auction Report of the New Jersey Utilities' Basic Generation Service (BGS) Auction Process, Final Report*, Charles River Associates, CRA Project D03231-00, April 8, 2002; *Post-Auction Report of the New Jersey Utilities' Basic Generation Service Auction Processes: BGS Supply Period Beginning August 1, 2003, Final Report*, Charles River Associates, CRA Project D04053-00, April 8, 2003; *Post-Auction Report of the New Jersey Utilities' Basic Generation Service Auction Processes: BGS Supply Period Beginning June 1, 2004, Final Report*, Charles River Associates, CRA Project D04054-00, May 4, 2004.

⁶ *The Public Version of the Post-Auction Report for the FirstEnergy Competitive Bid Process Auction*, Case No. 04-1371-EL-ATA, Charles River Associates Incorporated, December 8, 2004.

66 (2) Discretion of the Auction Manager – The CPP Auction proposal allows an
67 appropriate degree of discretion for the Auction Manager. Certain clarifications
68 related to the formulas for volume adjustments and price decrements, and the
69 degree of judgment of the Auction Manager, if any, in setting parameters are
70 provided by Dr. LaCasse in her rebuttal testimony. These clarifications serve to
71 eliminate the discretion of the Auction Manager during the auction with respect to
72 these parameters.

73 (3) Management of the CPP Auction – Responsibility for the CPP Auction
74 management, including planning and implementation, should rest entirely with one
75 entity, the Auction Manager, to clearly distinguish the roles of each party involved
76 in the auction process, and to maintain the independence of the ICC Staff and its
77 auction advisor or other experts who it shall rely upon (referred to herein
78 collectively as the Auction Monitor), in reviewing and evaluating the auction
79 outcome. The ICC Staff and Auction Monitor should provide advice and serve as
80 independent reviewer and monitor of the process, while also providing advice to
81 ensure that it is implemented in accordance with the auction rules and protocols. In
82 this role, the ICC Staff represents the interests of ComEd’s electricity consumers,
83 by ensuring that the CPP Auction is implemented and evaluated in accordance with
84 the process that is approved by the ICC to obtain the lowest cost, reliable electricity
85 supply for consumers. Direct involvement of other parties in the auction
86 implementation, to represent the interests of electricity consumers or others, is not
87 recommended.

88 (4) Independence of the Auction Manager – There is a balance of objectives in the
89 selection of the Auction Manager, one of which is independence, in order to assure
90 a fair outcome for the CPP Auction. While there is potential for perceived conflicts
91 of interest when the Auction Manager is engaged by the utility to manage the
92 planning and implementation of the auction, these and other perceived conflicts can
93 be mitigated by (a) careful review and monitoring of the auction planning and
94 implementation by the ICC Staff and the Auction Monitor; and (b) communication
95 protocols governing the interaction of parties involved in the auction, including
96 ComEd and its affiliates, the Auction Manager, the ICC and ICC Staff, the Auction
97 Monitor, bidders and other stakeholders. In addition, FERC regulations regarding
98 interactions between regulated utilities and unregulated affiliates,⁷ as well as rules
99 of law, may apply in the case of collusion, fraud or affiliate abuse that may result
100 from such conflicts of interest.

101 (5) Suggested modifications to the CPP Auction rules and process – Based on the
102 feedback of the parties to this proceeding, specific modifications and clarifications
103 related to the CPP Auction proposal have been provided in rebuttal testimony and
104 responses to data requests. With such modifications and clarifications approved by
105 the ICC, no further prudence review of the auction outcome, beyond that specified
106 in the approved CPP Auction proposal, would be required. This approach has been
107 taken in other jurisdictions, such as for the BGS auctions in New Jersey.

⁷ See, e.g., 16 USC 824(m); and FERC, *How to Get Market Based Rate Authority*, pages 9-11. Available at <http://www.ferc.gov/industries/electric/gen-info/how-to-pm.pdf>. Accessed on June 29, 2005.

108 **II. ACADEMIC BACKGROUND & QUALIFICATIONS**

109 **Q. Please summarize your academic background.**

110 A. I hold an MBA from the Johnson Graduate School of Management, Cornell University,
111 and a BA in Economics and Computer Science from Cornell University. My resume is
112 attached to my testimony as Exhibit 12.1.

113 **Q. Please summarize your consulting experience.**

114 A. For the past 19 years, I have consulted to clients in the energy industry (among others)
115 and have managed consulting assignments that are directly relevant to this proceeding.
116 Prior to joining Analysis Group in September 2002, I was a Vice President at Charles
117 River Associates (CRA), where I managed assignments related to the restructuring of the
118 electricity industry, including procurements of wholesale supply for retail standard offer,
119 or basic generation, service. Prior to joining CRA in 1996, I was a Principal, and
120 Manager of the Utility Consulting Group at XENERGY, Inc., an energy consulting firm
121 based in Burlington, MA. From 1986 through 1996, I held various positions at
122 XENERGY and managed assignments for clients in the electricity and gas industries as
123 well as government agencies such as the U.S. Department of Energy. My work in the
124 energy industry has covered a wide range of issues, including rate design, integrated
125 resource planning, supply management, forecasting, demand-side management, market
126 research, program evaluation and energy modeling.

127 Q. **Please describe the specific qualifications and experience that you have with respect**
128 **to this proceeding.**

129 A. I have been directly involved in assisting both utilities and state regulators in the design
130 and implementation of competitive power procurements to supply full-requirements
131 needs of standard offer, or basic generation, service.

132 From August 2001 through February 2002, while I was with CRA, I managed the
133 assignment wherein CRA served as Board Advisor (i.e., Auction Monitor) for the NJ
134 BPU for the first BGS auction in 2002. In this role, I was directly involved in reviewing
135 the joint proposal of the NJ EDCs for the 2002 BGS auction,⁸ and making
136 recommendations to the NJ BPU regarding the auction design, process, rules and master
137 supply agreements. These recommendations were the basis for several modifications to
138 the auction design and process included in the procedural order of the BPU approving the
139 auction in December 2001⁹ (the final approved auction rules were contained in the EDCs'
140 compliance filings with the NJ BPU¹⁰). I was also involved in monitoring the 2002 BGS
141 auction onsite at the offices of the Auction Manager (NERA Economic Consulting) in
142 early February 2002. This assignment provided direct experience with the procedural,
143 logistic and regulatory details of auction design, planning, promotion, implementation,
144 approval and communication between the EDCs, the Auction Manager (NERA), the BPU
145 and BPU Staff, the Auction Advisor (CRA), bidders and other stakeholders.

⁸ *In the Matter of The Provision Of Basic Generation Service Pursuant To The Electric Discount And Energy Competition Act*, Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, Proposal for Auction of Basic Generation Service, June 29, 2001.

⁹ *Decision and Order, I/M/O The Provision of Basic Generation Service Pursuant To The Electric Discount And Competition Act, N.J.S.A. 48:3-49 et seq.*, State of New Jersey Board of Public Utilities Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, December 10, 2001.

¹⁰ *Public Service Electric & Gas Company Compliance Filing to Decision and Order, I/M/O The Provision of Basic Generation Service Pursuant To The Electric Discount And Competition Act, N.J.S.A. 48:3-49 et seq.*, State of New Jersey Board of Public Utilities Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, December 12, 2001.

146 Prior to the 2002 NJ BGS auction, I consulted to other electric utilities in auction
147 design and implementation for Standard Offer Service (SOS) in electricity markets
148 during the transition to competitive markets. In 1997, while I was with CRA, I assisted
149 two electric utilities in Massachusetts, COM/Electric and EUA Services Corp., in
150 developing a procurement approach for SOS, the utilities' supply obligation for serving
151 customers that did not choose a competitive supplier when choice of suppliers became
152 possible in March of 1998. Competitive procurement for SOS load during the transition
153 period was mandated by the Massachusetts restructuring legislation,¹¹ and was further
154 detailed in the utilities' settlements with the Massachusetts Attorney General's Office.¹²
155 CRA was retained by both COM/Electric and EUA Services Corp. to develop auction
156 designs for SOS, and I managed both assignments. For COM/Electric, I also managed
157 the implementation of the SOS auction that was held in December 1997.

158 Collaborating with academic affiliates Professor Peter Cramton of the University
159 of Maryland and Professor Robert Wilson of Stanford University, we recommended that
160 the utilities use a simultaneous multi-round (SMR) clock auction of vertical slices (or
161 percentages) of the SOS load, i.e., the product was defined to be a load-following
162 obligation versus a fixed energy or capacity block. Two features of the recommended
163 auction design that were suggested by Professor Cramton, the clock auction approach and
164 defining the product to be a vertical slice of load, were first introduced in the context of
165 standard offer, or basic generation, service procurement in a white paper that I co-

¹¹ St. 1997, c. 164, *An Act Relative to Restructuring the Electric Utility Industry in the Commonwealth, Regulating the Provision of Electricity and Other Services, and Promoting Enhanced Consumer Protections Therein*, § 37.

¹² See, e.g., *Offer of Settlement for Massachusetts Electric Company*, Massachusetts Department of Telecommunications and Energy, Docket No. D.P.U. 96-25, October 1, 1996 ; *Offer of Settlement for Eastern Edison Company*, Massachusetts Department of Telecommunications and Energy, Docket No. D.P.U./D.T.E. 96-24, May 16, 1997 ; *Offer of Settlement for Boston Edison Company*, Massachusetts Department of Telecommunications and Energy, Docket No. D.P.U./D.T.E. 96-23, July 9, 1997.

166 authored with Professors Cramton and Wilson, "Auctions for Standard Offer Service"¹³
167 (see Exhibit 12.2) and later codified into the auction rules for the COM/Electric SOS
168 auction. The approach developed for the COM/Electric and EUA Services Corp. SOS
169 auctions, an SMR clock auction of vertical slices of load, contrasted with the auction
170 approaches that were proposed by other utilities in Massachusetts, as discussed in the
171 white paper referenced above.

172 From October 1999 through August 2000, I was a member of the CRA team that
173 implemented the auction of Power Purchase Arrangements (PPAs) for the Alberta
174 Department of Resource Development using an SMR auction format. The auction
175 involved bids for long-term contracts for the energy and capacity associated with specific
176 generating units of fossil fuel plants in the Province of Alberta. The auction was
177 completed in August 2000, with winning bids totaling approximately CN\$1.1 billion.
178 For the Alberta PPA auction I was responsible for developing the Information
179 Memorandum that was distributed to potential bidders, coordinating bidder information
180 sessions in Canada and the U.S., establishing communication processes and protocols, as
181 well as directing auction promotion through a variety of media outlets and trade
182 organizations.

¹³ "Auction Design for Standard Offer Service," Peter Cramton, Andrew Parece and Robert Wilson, Working Paper, University of Maryland, September 1997.

183 **III. AUCTION BACKGROUND AND OBJECTIVES**

184 **Q. What has been the experience with SMR type auctions in the electric power**
185 **industry?**

186 A. As discussed in the direct testimonies of Dr. Chantale LaCasse and Dr. David Salant,
187 variations on the SMR auction format, including the simultaneous descending clock
188 auction (SDCA) proposed for the CPP Auction, have been applied a number of times in
189 the electric power industry and have also been widely used to auction spectrum rights in
190 the telecommunications industry. Examples of SMR auctions in the electric power
191 industry include SOS supply procurement (Massachusetts, 1997), PPAs (Alberta, 2000),
192 capacity entitlements (Texas, 12 auctions since 2001), BGS supply procurements (New
193 Jersey, four auctions from 2002-2005), and Competitive Bid Process (Ohio, 2004).

194 The SMR auction format has generally proven to be successful for auctions in the
195 electric power industry, with respect to meeting auction objectives. Both Dr. LaCasse
196 and Dr. Salant have testified in this proceeding as to the appropriateness of the SMR
197 auction format for ComEd's Competitive Procurement Process. Although I agree with
198 and support the use of the SMR format for the CPP Auction, my testimony concerns itself
199 with specific issues raised about the implementation details of ComEd's CPP Auction
200 proposal.

201 **Q. Is it important to clearly define the objectives of the auction?**

202 A. Yes. Depending on the situation, auctions can have very different objectives and these
203 objectives will dictate the appropriate auction rules and process. However, there are
204 trade-offs in the design of an auction that are necessary to meet the auction objectives.
205 Many aspects of the auction design and process issues raised in the current proceeding

206 involve trade-offs between multiple objectives. In defining or specifying auction
207 parameters (e.g., products, tranche sizes and duration, load caps, volume adjustments,
208 switching rules, affiliate rules, discretion of the Auction Manager, or disclosure of bidder
209 information), trade-offs are necessary to accomplish the auction objectives, and there is
210 not one set of rules or parameters that are preferred with certainty over all others and
211 fully supported by prior experience. As one example, the specific information that is
212 provided to bidders during the course of the auction involves a trade-off between the
213 value of information in promoting price discovery, an essential element of an SMR
214 auction, and the potential that the information would lead to strategic bidding behavior
215 that could be detrimental to the auction. To balance these two considerations, the CPP
216 Auction proposal specifies that information related to the excess supply for each product
217 will be revealed to bidders, with a narrow range of excess supply reported in the initial
218 rounds, and a wider range provided in later rounds when strategic bidding behavior based
219 on that information may be more likely to occur.

220 Furthermore, many auction design parameters are interrelated, and it is necessary
221 to consider the impact on the overall objectives when specifying any one parameter.
222 Because bidder participation and bidding behavior are affected by aspects of the design
223 that increase or decrease uncertainty and risk, minimizing sources of uncertainties is
224 important – to the extent that doing so does not undermine the overall auction objectives.

225 Q. **Are the objectives of the CPP Auction well defined?**

226 A. Yes. The key objectives of ComEd's CPP Auction proposal are described in the
227 testimony of Dr. LaCasse (LaCasse Dir., ComEd Ex. 4.0, 55:1298-1310):

- 228 • Obtain reliable supply for its customers at market prices, i.e., at prices that are the
229 result of competition and that are reflective of market conditions;
- 230 • Provide protection to small customers from the volatility of short-term market
231 fluctuations;
- 232 • Provide information to all prospective bidders and promote the participation of all
233 market participants on a fair and equal basis;
- 234 • Provide reasonable protection from anti-competitive behavior;
- 235 • Provide an objective and clear method for determining winning suppliers and final
236 auction prices;
- 237 • Provide for ICC involvement and oversight of the process; and
- 238 • Provide for continuous and open communications with all interested stakeholders.

239 These objectives and the proposed auction format are consistent with 18 “desirable
240 characteristics” associated with an ideal procurement method identified by the Post-2006
241 Procurement Working Group and reported by the ICC Staff in its report Post-2006
242 Initiative: Final Staff Report to the Commission.¹⁴ For the purposes of my testimony, I
243 have assumed that the primary objective of the Competitive Procurement Process is the
244 first objective listed above, i.e., to obtain the lowest cost, reliable source of electricity to
245 meet the needs of ComEd's electricity consumers in Illinois that are eligible for CPP
246 service.

¹⁴ *Post-2006 Initiative: Final Staff Report to the Commission*. Report of the Staff of the Illinois Commerce Commission December 2, 2004.

247 Q. **Is Dr. Salant's definition of a successful auction consistent with the objectives of the**
248 **CPP Auction proposal, i.e., obtaining the lowest cost, reliable supply of electricity**
249 **for eligible customers in Illinois?**

250 A. No. Dr. Salant does not define an auction's success from the perspective of electricity
251 consumers. Dr. Salant has testified that the Ohio First Energy (Competitive Bid Process)
252 auction was less successful than the New Jersey BGS auctions (Salant Dir., Staff Ex. 1.0,
253 6:132-133), and in his response to ComEd data requests he clarifies that this is because
254 "no contracts were secured through the Ohio First Energy auction" (Response of Staff
255 Witness David Salant, ComEd-Staff 2.11) and further that "the only 'successful' SDCA
256 auctions have been the New Jersey BGS auctions" (Response of Staff Witness David
257 Salant, ComEd-Staff 2.35). The objective of both the Ohio and New Jersey auctions was
258 to provide the lowest cost, reliable supply of electricity for consumers, which does not
259 imply securing contracts through the auction. In some jurisdictions, such as Ohio, there
260 are alternatives to the auction for securing electricity supply for eligible customers, for
261 example, the First Energy Rate Stabilization Plan. The purpose of the auction in these
262 situations is to determine whether there are sources of electricity supply in the market that
263 would result in lower prices for consumers than existing options. If properly
264 implemented, the auction serves to confirm that the lowest cost supply is obtained for
265 customers, whether or not contracts are secured through the auction.

266 **IV. COMPLETENESS OF THE CPP AUCTION PROPOSAL**

267 **Q. Do you agree with the assertion in Dr. Salant’s testimony that “numerous details**
268 **regarding the rules of the proposed auction have not yet been addressed at all and**
269 **other aspects of the proposed auction rules have not been specified in sufficient**
270 **detail” (Salant Dir., Staff Ex. 1.0, 6:119-121) and that absent such detail one cannot**
271 **fully evaluate the CPP Auction proposal (Salant Dir., Staff Ex. 1.0, 6:126-127)?**

272 **A.** No. The CPP Auction rules and process specified in the CPP Auction Manual and
273 described in the testimony of Mr. McNeil and Dr. LaCasse provide sufficient detail for
274 the ICC to evaluate the CPP Auction proposed by ComEd. The level of detail is
275 consistent with industry “best practice” standards in designing and implementing
276 competitive procurements for full-requirement electricity service, and the level of detail
277 provided also is appropriate for this point in the CPP Auction process. With a limited
278 number of clarifications, as outlined in my testimony and further described in the rebuttal
279 testimonies of Dr. LaCasse and Mr. McNeil, there is a sufficient basis for the ICC to
280 approve the CPP Auction proposal and allow ComEd to implement it.

281 ComEd’s CPP Auction proposal provides detail comparable to the original joint
282 proposal filed by the four electric distribution companies (EDCs) in New Jersey for
283 procuring supply for Basic Generation Service (June 2001) as well as the most recent
284 BGS auction conducted in February 2005. The original joint proposal of the NJ EDCs
285 was evaluated and approved by the NJ BPU with a limited number of clarifications to the
286 auction rules, as contained in Attachments A, B and C to the NJ BPU order approving the
287 auction in December 2001.¹⁵ I also note that Dr. Salant states that he developed the

¹⁵ *In the Matter of The Provision Of Basic Generation Service Pursuant To The Electric Discount And Energy Competition Act*, Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, Proposal for Auction of Basic Generation Service, June 29, 2001.

288 SDCA auction format for BGS procurement in New Jersey (Salant Dir., Staff Ex. 1.0,
289 11:233-234) and that he was “solely responsible for developing the basic rules for the
290 simultaneous, descending price, multi-product clock auction” for the first NJ BGS
291 auction (Response of Staff Witness David Salant, ComEd-Staff 2.04b).

292 Exhibit 12.3 to my testimony provides a comparison of the auction design and
293 processes in the NJ EDCs’ proposal for BGS (June 2001),¹⁶ the final approved NJ BGS
294 auction rules (December 2001),¹⁷ the most recent NJ BGS auction rules (November
295 2004),¹⁸ and ComEd’s proposed CPP Auction rules (McNeil Dir., ComEd Ex. 3.4). It
296 shows that the level of detail provided in the CPP Auction proposal is comparable to
297 auctions that have been approved and implemented in other jurisdictions.

298 Dr. Salant’s testimony contains many references to the CPP Auction proposal
299 being incomplete (e.g., Salant Dir., Staff Ex. 1.0, 6:117-118, 6:123-126, 6:138-139,
300 25:572 - 26:575) and suggests that for that reason it cannot be evaluated by the ICC. Yet,
301 most of the topics addressed by Dr. Salant’s direct testimony, and many of the 38 specific
302 items listed in Appendix 2.0 of his testimony (Salant Dir., Staff Ex. 1.0, Appendix 2.0) do
303 not involve incomplete or missing details in the CPP Auction proposal, but instead are
304 Dr. Salant’s suggested modifications to specific parameters or rules in the CPP Auction
305 proposal; or other topics on which he requests clarification of the CPP Auction proposal.
306 There are very few areas of the CPP Auction proposal in which there are missing details,
307 and in my opinion, none of these prevent evaluation of the CPP Auction proposal.

¹⁶ *Decision and Order, I/M/O The Provision of Basic Generation Service Pursuant To The Electric Discount And Competition Act, N.J.S.A. 48:3-49 et seq.*, State of New Jersey Board of Public Utilities Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, December 10, 2001.

¹⁷ *Public Service Electric & Gas Company Compliance Filing to Decision and Order, I/M/O The Provision of Basic Generation Service Pursuant To The Electric Discount And Competition Act, N.J.S.A. 48:3-49 et seq.*, State of New Jersey Board of Public Utilities Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, December 12, 2001.

¹⁸ *In the Matter of The Provision Of Basic Generation Service For Year Three of the Post Transition Period*, Docket No. EO04040288, Electric Distribution Company Compliance Filing, dated November 3, 2004.

308 Several of the issues raised in Dr. Salant’s testimony have been clarified in the
309 rebuttal testimonies of Dr. LaCasse and Mr. McNeil and in ComEd responses to data
310 requests. For many others, it would be premature at this time to define certain details or
311 information identified by Dr. Salant as incomplete or missing, as they are dependent on
312 other elements of the auction process, they are more appropriately handled after approval
313 of the CPP Auction proposal and prior to the auction, or they involve confidential
314 information that would be developed in consultation with the ICC Staff prior to the
315 auction. This approach allows the Auction Manager, in consultation with the ICC Staff
316 and Auction Monitor, to have flexibility in adapting certain details, e.g., the specific dates
317 for schedule of release of information to bidders, and avoids the inevitable changes to
318 these details that could lead to confusion for bidders. Exhibit 12.4 to my testimony
319 contains a list of the issues raised by Dr. Salant in his testimony and in Appendix 2.0 of
320 his testimony, and an assessment of which of these are suggested modifications to the
321 approach in the CPP Auction proposal, which are premature to specify at this time, and
322 which clarifications have been addressed in rebuttal testimony or ComEd responses to
323 data requests.

324 **Q. Please provide examples of areas of Dr. Salant’s testimony that concern themselves**
325 **only with suggested modifications to auction parameters or rules.**

326 **A.** The following are examples of Dr. Salant’s testimony that represent suggested
327 modifications to auction parameters or rules rather than issues of completeness or detail
328 in the description of the CPP Auction proposal:

- 329 • Separate auctions for CPP-A/ CPP-B and CPP-H and Ameren products – The CPP
330 Auction proposal specifies two separate auctions for ComEd (CPP-A/ CPP-B and

331 CPP-H), separate from auctions for Ameren products. Dr. Salant suggests that there
332 should be one auction with switching between all products and both utility companies
333 (Salant Dir., Staff Ex. 1.0, 31:707 - 47:1058);

334 • Information disclosures – The CPP Auction proposal specifies that aggregate
335 information related to the excess supply will be provided to bidders during the
336 reporting phase of each round, and that information about bidders’ associations will
337 not be disclosed to the public. Dr. Salant suggests reporting information on each
338 bidder’s bid to all bidders during the reporting phase of each round (Salant Dir., Staff
339 Ex. 1.0, 49:1110 - 51:1149) and full public disclosure of affiliates (Salant Dir., Staff
340 Ex. 1.0, 81:1827 - 83:1872);

341 • Tranche sizes and duration – The CPP Auction proposal specifies a tranche size
342 corresponding to approximately 100 MW of peak load, with no product-specific
343 reduction of volume in cases in which one or more products may be undersubscribed.
344 Dr. Salant suggests that a much smaller tranche size, 2 MW, is more appropriate, and
345 that a fixed rule be applied to shift auction volume from undersubscribed products to
346 oversubscribed products (Salant Dir., Staff Ex. 1.0, 52:1168 - 57:1286);

347 • Load caps – The CPP Auction proposal specifies an auction-specific load cap of 50
348 percent. Dr. Salant suggests a load cap in the range of 25 to 35 percent (Salant Dir.,
349 Staff Ex. 1.0, 64:1456-1458); and

350 • Discretion of the Auction Manager – The CPP Auction proposal provides for some
351 discretion for the Auction Manager in setting certain auction parameters, such as
352 price decrements and timing of rounds. Dr. Salant suggests that the Auction
353 Manager’s discretion “should be either limited or entirely removed” and argues for

354 automated rather than manual calculations, and ICC Staff and Auction Monitor
355 control over the auction implementation (Salant Dir., Staff Ex. 1.0, 9:197-198,
356 70:1587 - 71:1602, 76:1709-1714, 83:1876 - 85:1935).

357 These points raised by Dr. Salant involve important details related to the CPP Auction
358 proposal. Dr. Salant's suggestions have been considered by ComEd, with several of the
359 suggested modifications addressed in ComEd's rebuttal testimony (McNeil Rebuttal,
360 ComEd Ex. 10.0). However, it is important to recognize that these details reflect
361 differences in opinion regarding the proper design of the CPP Auction for ComEd; they
362 do not involve missing details necessary for the ICC to evaluate the CPP Auction
363 proposal.

364 **Q. Are there other examples in Dr. Salant's testimony that concern themselves only**
365 **with suggested modifications to auction parameters or auction rules?**

366 **A.** Appendix 2.0 of Dr. Salant's testimony is intended to "identify missing details" that need
367 to be addressed to evaluate the CPP Auction proposal (Salant Dir., Staff Ex. 1.0,
368 Appendix 2.0, 1:6-10). Several of the items listed, however, are suggestions regarding the
369 auction design or rules, not missing details, including the following:

- 370 • Simplify the complexity of the proposed switching and exit bid rules through small
371 bid decrements and short rounds (item 15, Salant Dir., Staff Ex. 1.0, Appendix 2.0,
372 3:57-60);
- 373 • Grant requests for switches when there are offsetting switches to products for which
374 withdrawals are requested (item 16, Salant Dir., Staff Ex. 1.0, Appendix 2.0, 3:61-
375 66);

- 376 • Inform bidders of the provisional allocation of tranches as soon as the auction closes
377 and before an official decision comes from the ICC (item 25, Salant Dir., Staff Ex.
378 1.0, Appendix 2.0, 5:93-96); and
- 379 • Require bidders to disclose all agreements that would prevent them from meeting the
380 disclosure and affiliate requirements (item 27, Salant Dir., Staff Ex. 1.0, Appendix
381 2.0, 5:99-102).

382 These suggestions should be considered by the Auction Manager but do not need to be
383 resolved in order to evaluate or approve the CPP Auction proposal.

384 **Q. Please provide examples of other areas identified in Dr. Salant’s testimony with**
385 **respect to the CPP Auction proposal in which he states that information is**
386 **incomplete or details are missing.**

387 **A.** Dr. Salant’s testimony identifies several areas where he claims that information required
388 to evaluate the CPP Auction proposal is incomplete or details are missing. For many of
389 the areas highlighted by Dr. Salant in Appendix 2.0 of his testimony it would be
390 premature to provide details at this time either because they require resolution or
391 approval of other aspects of the CPP Auction proposal, or because it is more appropriate
392 that they be fully specified closer to the auction date. They are not essential to evaluating
393 the CPP Auction proposal, and can be addressed by the Auction Manager prior to the
394 auction, in consultation with the ICC Staff and the Auction Monitor. These include the
395 following:

- 396 • Auction calendar (item 1, Salant Dir., Staff Ex. 1.0, Appendix 2.0, 1:14);
- 397 • Bidder information packet (item 2, Salant Dir., Staff Ex. 1.0, Appendix 2.0, 1:15);

- 398 • Auction management manual (item 3, Salant Dir., Staff Ex. 1.0, Appendix 2.0, 1:16-
399 17);
- 400 • Timeline for information available to the ICC Staff and Auction Monitor (item 4,
401 Salant Dir., Staff Ex. 1.0, Appendix 2.0, 1:18-22);
- 402 • Mechanism for bidding (item 5, Salant Dir., Staff Ex. 1.0, Appendix 2.0, 2:23-27);
- 403 • Testing protocols for bidding (item 6, Salant Dir., Staff Ex. 1.0, Appendix 2.0, 2:28-
404 32);
- 405 • Schedule for release of data to bidders (item 7, Salant Dir., Staff Ex. 1.0, Appendix
406 2.0, 2:33-35);
- 407 • Schedule for release of information related to how auction prices are translated into
408 the commodity supply portion of customer rates (item 8, Salant Dir., Staff Ex. 1.0,
409 Appendix 2.0, 2:37-39);
- 410 • Specification of how charges for ancillary services are determined (item 9, Salant
411 Dir., Staff Ex. 1.0, Appendix 2.0, 2:40-42);
- 412 • Specification of the mechanism for nominating FTRs (item 10, Salant Dir., Staff Ex.
413 1.0, Appendix 2.0, 2:43);
- 414 • Recess or extension determination (item 23, Salant Dir., Staff Ex. 1.0, Appendix 2.0,
415 5:88-90);
- 416 • Criteria to determine action if bidder cannot make required certifications (item 28,
417 Salant Dir., Staff Ex. 1.0, Appendix 2.0, 5:103-104); and
- 418 • Contingency plans in the event that the Auction Manager or Auction Monitor is
419 unable to perform its duties (item 30, Salant Dir., Staff Ex. 1.0, Appendix 2.0, 6:109-
420 111).

421 Q. **Are there any specific areas of the CPP Auction proposal where clarification would**
422 **be helpful in order for the ICC to approve it?**

423 A. Yes. There are a limited number of areas in the CPP Auction proposal for which
424 clarification of rules or processes are appropriate (some of which have been identified in
425 Dr. Salant's testimony). These have been addressed in ComEd rebuttal testimony as
426 indicated below, including:

427 (1) Auction management roles and responsibilities – Dr. Salant states in his testimony
428 that “The ICC Staff and the Auction Monitor should manage the actual auction”
429 (Salant Dir., Staff Ex. 1.0, 8:184-185); “the ICC staff and the Auction Monitor should
430 have ultimate authority over the decision to adjust auction volume” (Salant Dir., Staff
431 Ex. 1.0, 85:1923-1924); “during the actual auction, however, the Auction Manager
432 should be an observer” (Salant Dir., Staff Ex. 1.0, 9:189-190); “ICC Staff and the
433 Auction Manager [should] have final say on when rounds start or end, on price
434 decrements, and on volume adjustments” (Salant Dir., Staff Ex. 1.0, 9:192-194); and
435 “ICC staff in consultation with its Auction Monitor should be able to make any
436 discretionary decisions during the auction that could potentially bias the auction
437 outcome” (Salant Dir., Staff Ex. 1.0, 88:1985-1987).

438 While I disagree with Dr. Salant's suggestions regarding auction management
439 for reasons explained later in my testimony, it is important that ComEd clarify the
440 specific roles and responsibilities of the Auction Manager, ComEd, the ICC, the ICC
441 Staff and the Auction Monitor in relation to specific components of the auction. This
442 clarification is provided in the rebuttal testimony of Dr. LaCasse, (LaCasse Rebuttal,
443 ComEd Ex. 11.6). In addition, to reinforce the independence of the Auction

444 Manager, and mitigate perceived sources of conflicts, ComEd, in consultation with
445 the Auction Manager, the ICC Staff and the Auction Monitor, should develop a
446 communications protocol for interactions among these entities, bidders (including
447 ComEd affiliates), and other stakeholders. A description of the communications
448 protocol is given in the rebuttal testimony of Dr. LaCasse (LaCasse Rebuttal, ComEd
449 Ex. 11.0, Section 5) which provides the basis for a more detailed communication
450 protocol that should be formalized prior to the auction.

451 (2) Information to monitor and evaluate the auction – Dr. Salant suggests that details
452 about the information that will be provided to the ICC, the ICC Staff and Auction
453 Monitor for evaluating the auction outcome are incomplete (Salant Dir., Staff Ex. 1.0,
454 89:2004 - 91:2064). It is important to clarify the type of information that will be
455 provided to the ICC, ICC Staff and Auction Monitor during and after the auction,
456 including the criteria that will be used to evaluate the outcome and competitiveness of
457 the auction. A detailed description of the information to be provided in the Auction
458 Manager report to the ICC Staff, and the ICC Staff report to the ICC, and used to
459 evaluate the auction outcome are provided in rebuttal testimony of Mr. McNeil
460 (McNeil Rebuttal, ComEd Ex. 10.1 to 10.2). With ICC approval of these criteria for
461 evaluating the auction, 48 hours should be a sufficient amount of time for the ICC to
462 review the auction evaluation report of the ICC Staff and Auction Monitor and
463 approve the auction.

464 (3) Auction rules or processes – In rebuttal testimony and responses to data requests,
465 ComEd has clarified certain items related to the auction rules, including many of
466 those listed in Appendix 2.0 of Dr. Salant’s testimony (Salant Dir., Staff Ex. 1.0,

467 Appendix 2.0), i.e. those not previously identified as being premature to clarify at this
468 time or suggested modifications of the auction rules. Exhibit 12.4 provides references
469 to the specific clarifications in ComEd’s rebuttal testimony.

470 These three areas of clarification generally follow those in Attachments A, B and C of the
471 NJ BPU order approving the first NJ BGS auction in 2002.¹⁹ Together with the
472 clarifications that have been addressed in ComEd rebuttal testimony, I believe that the
473 CPP Auction rules and procedures provide sufficient detail to allow the ICC to fully
474 evaluate and approve the CPP Auction proposal.

475 **Q. Are there any other areas that you would like to comment where Dr. Salant suggests**
476 **that the CPP Auction proposal is incomplete or that there is missing detail?**

477 A. Yes. In his testimony, Dr. Salant recommends that there be specific post-auction review
478 of such things as pre-auction promotion and information dissemination (Salant Dir., Staff
479 Ex. 1.0, 91:2068 - 92:2071). In fact, the CPP Auction proposal provides for a “process
480 improvement workshop” that would address such aspects of the auction to provide
481 feedback for future CPP Auctions (McNeil Dir., ComEd Ex. 3.0, 44:964 - 45:980,
482 63:1373-1376).

483 **Q. Is there evidence from other auctions that the CPP Auction proposal can be**
484 **evaluated, and can be successfully implemented?**

485 A. As noted in my testimony above, in 2001 the NJ BPU evaluated and approved the NJ
486 EDCs’ BGS auction proposal with limited modifications. This proposal was comparable
487 in detail to ComEd’s CPP Auction proposal, as illustrated in Exhibit 12.3 to my

¹⁹ *Decision and Order, I/M/O The Provision of Basic Generation Service Pursuant To The Electric Discount And Competition Act, N.J.S.A. 48:3-49 et seq.*, State of New Jersey Board of Public Utilities Docket No. EX01050303, EO01100654, EO01100655, EO01100656 and EO01100657, December 10, 2001.

488 testimony. Further, the objectives of the NJ BGS auctions are similar to the objectives of
489 the CPP Auction process in Illinois. The NJ BGS auctions generally have been viewed as
490 successful, and constitute a “best practice” standard that the ICC should consider. I
491 believe that a process similar to the one used to approve the BGS auctions in New Jersey
492 can be applied in the case of the CPP Auction proposal, and that the auction can be
493 successfully implemented.

494 **Q. Is there sufficient time for the ICC to review and evaluate the CPP Auction proposal**
495 **so that it can be implemented in time for meeting the January 2007 timeframe for**
496 **supplying eligible CPP customers?**

497 A. Yes. It is important that there be sufficient time for each component of the auction
498 process, in order to maximize participation and achieve the objective of obtaining the
499 lowest-cost, reliable electricity supply to serve ComEd’s customers that are eligible for
500 CPP service. Exhibit 12.5 to my testimony compares the timelines associated with the
501 procurement processes in Illinois and the first New Jersey BGS auction in 2002. This
502 exhibit is intended to demonstrate that there is sufficient time for the ICC to review,
503 evaluate and approve the CPP Auction proposal.

504 V. **DISCRETION OF THE AUCTION MANAGER**

505 Q. **Do you agree with the assertion in Dr. Salant's testimony that the discretion of the**
506 **Auction Manager as specified in the CPP Auction proposal should be either limited**
507 **or entirely removed (Salant Dir., Staff Ex. 1.0, 9:195-198)?**

508 A. No. In my opinion a certain degree of discretion is beneficial and the level that is
509 proposed is preferable to rules that would prevent the Auction Manager from mitigating
510 the impact of unforeseen developments during the course of the auction. In some cases,
511 it may be possible to provide bidders with guidelines or formulas that would be used to
512 set certain auction parameters, while indicating that the Auction Manager may override
513 them in rare situations.

514 Q. **In what areas does the CPP Auction proposal allow for judgment of the Auction**
515 **Manager in decision making during the course of the auction?**

516 A. There are four areas in the CPP Auction proposal that would allow for some judgment
517 with respect to the management of the auction:

- 518 (1) Volume adjustments;
519 (2) Price decrements;
520 (3) Timing of rounds (bidding, calculating, and reporting phases), and pauses; and
521 (4) Violations of auction rules and sanctions of bidders.

522 Q. **Please explain the trade-offs between allowing some judgment for the Auction**
523 **Manager, and specifying fixed or formulaic rules that cannot be overridden by the**
524 **Auction Manager under any circumstances.**

525 A. The main benefit of allowing some judgment for the Auction Manager is that the Auction
526 Manager may be able to mitigate the impact of unforeseen events during the auction (that

527 could result in the auction outcome being sub-optimal or possibly rejected by the ICC),
528 which otherwise would not be possible. For example, in the 2002 NJ BGS Auction, the
529 Auction Manager’s judgment was exercised to accelerate the pace of the auction.²⁰ The
530 disadvantage is that allowing such judgment creates some incremental uncertainty for
531 bidders over fixed or formulaic rules, and may result in the auction taking longer to
532 complete. The main cost of specifying fixed rules, i.e., not allowing any judgment for the
533 Auction Manager, is the potential that a sub-optimal outcome could result from the
534 Auction Manager not being able to mitigate unforeseeable developments in the auction.
535 The benefit of fixed rules is that there is incrementally less uncertainty for bidders, and
536 the possibility that the auction could be completed faster.

537 **Q. Is the degree of judgment of the Auction Manager in setting auction parameters as**
538 **specified in the CPP Auction proposal appropriate?**

539 **A.** Yes. While I believe that the degree of judgment of the Auction Manager as specified in
540 the CPP Auction proposal is appropriate, clarifications in the rebuttal testimony of Dr.
541 LaCasse with respect to volume adjustments and price decrements will serve to make
542 these parameters formulaic and allow no discretion with respect to these parameters
543 (LaCasse Rebuttal, ComEd Ex. 11.0, Section 5). I believe that the authority that would
544 remain with the Auction Manager is appropriate.

²⁰ *Post-Auction Report of the New Jersey Utilities’ Basic Generation Service (BGS) Auction Process, Final Report*, Charles River Associates, CRA Project D03231-00, April 8, 2002; “Several bidders complained that the initial rounds were too slow. The Auction Manager proposed to us that the bid decrement formula be over-ridden and we agreed (2002, 13).”

545 Q. **Do you agree with the testimony of Dr. Salant that the level of discretion of the**
546 **Auction Manager provided for in the CPP Auction proposal in setting the timing of**
547 **rounds will result in bidders being “provided with more time than is necessary to**
548 **submit bids in each round” (Salant Dir., Staff Ex. 1.0, 73:1651-1653) and a much**
549 **longer auction duration?**

550 A. No. Dr. Salant provides no evidence or analysis to support his assertion that the proposed
551 CPP Auction will take longer than a week (Salant Dir., Staff Ex. 1.0, 71:1609-1611). His
552 statements assume that decisions about the timing of rounds would be consistent with
553 those made in previous auctions conducted by the proposed Auction Manager. However,
554 calculating the volume adjustments and price decrements with fixed rules, as clarified in
555 the rebuttal testimony of Dr. LaCasse, would likely reduce the auction duration relative to
556 SDCA implementations in other jurisdictions, for example, the NJ BGS auctions. In
557 addition, the Auction Manager in consultation with the ICC Staff and the Auction
558 Monitor should continue to explore ways to reduce the auction duration without
559 compromising the reliability of the process, or the time needed by bidders to evaluate
560 information during the course of the auction. ComEd’s proposed process improvement
561 workshop is one forum where these suggestions can be raised by other parties.

562 While there are some advantages to completing the auction more quickly, completing
563 the auction in one day should not be an objective in and of itself, i.e., it is not obvious
564 that faster is always better. Bidders need sufficient time between rounds to evaluate the
565 results of the previous round and possibly revise their bidding strategies as appropriate.
566 Dr. Salant’s position on these issues seems to be supported mainly by his particular set of
567 experiences. He states in his testimony that “I have been on-site advising bidders in over

568 a dozen auctions. A significant amount of time in those auctions was spent waiting for a
569 particular round to close and for the results of that round to be announced. I note that if
570 bidders are provided with an adequate amount of time to prepare in advance of the
571 auction, they require relatively little time during and between rounds to make decisions”
572 (Salant Dir., Staff Ex. 1.0, 73:1656-1661). Dr. Salant’s testimony indicates that he has
573 published extensively on the topic of auctions, has extensive experience designing and
574 participating in auctions, and is often hired to consult on bidding strategies for auction
575 participants. Not all bidders will bring such extensive training or experience to the
576 auction, or devote the resources to support consultants to assist with bidding strategy. In
577 addition, as a result of information that is revealed during the course of the auction, some
578 bidders may revise their strategies, possibly requiring additional time for approval of
579 these strategies. The amount of time that should be devoted to rounds should consider the
580 resources, expertise and time requirements of the typical bidder, not extremely
581 experienced ones.

582 The only data that I am aware of concerning the time required by bidders between
583 rounds in an SMR descending clock auction for electricity procurement are contained in
584 the Post-Auction Reports of the NJ BGS Auctions for 2002-2004.²¹ The relevant sections
585 are excerpted below:

²¹ *Post-Auction Report of the New Jersey Utilities’ Basic Generation Service (BGS) Auction Process, Final Report*, Charles River Associates, CRA Project D03231-00, April 8, 2002; *Post-Auction Report of the New Jersey Utilities’ Basic Generation Service Auction Processes: BGS Supply Period Beginning August 1, 2003, Final Report*, Charles River Associates, CRA Project D04053-00, April 8, 2003; *Post-Auction Report of the New Jersey Utilities’ Basic Generation Service Auction Processes: BGS Supply Period Beginning June 1, 2004, Final Report*, Charles River Associates, CRA Project D04054-00, May 4, 2004.

- 586 • 2002 NJ BGS Post-Auction Report: “Was there evidence that bidders felt unduly
587 rushed during the process? Not that we were aware of. We did not have any
588 communications with bidders but the Auction Manager did not report any such
589 evidence. In addition, bidders did not make full use of opportunities they had to delay
590 the auction (through the use of round extensions and recess requests), contrary to
591 what one would expect if they were unduly rushed” (13).
592 “Were there any complaints from bidders about the process? Several bidders
593 complained that the initial rounds were too slow. The Auction Manager proposed to
594 us that the bid decrement formula be over-ridden and we agreed” (13).
- 595 • 2003 NJ BGS Post-Auction Report: “Was there evidence that bidders felt unduly
596 rushed during the process? We saw no such evidence. We understand that some
597 bidders asked for more time to review results during the later rounds of the FP
598 auction. The Auction Manager agreed to this request and altered the schedule
599 accordingly” (19).
- 600 • 2004 NJ BGS Post-Auction Report: “Was there evidence that bidders felt unduly
601 rushed during the process? We saw no such evidence. On at least one occasion the
602 Auction Manager broadcast a question to bidders to gauge their desire to accelerate
603 the pace of bidding or increase the number of rounds per day, but after reviewing
604 bidder responses, chose not to undertake these actions. In addition, bidders did not
605 make full use of opportunities they had to delay the auction (through the use of round
606 extensions and recess requests), contrary to what one would expect if they were
607 unduly rushed” (16).
608 “Were there any complaints from bidders about the process that CRA believed were
609 legitimate? We are not aware of any bidder complaints, aside from some unhappiness
610 over the number of days it took to complete the bidding” (16).

611 These Post-Auction Reports indicate that not all bidders viewed the duration of the
612 auction as a problem. To the extent that some bidders needed the allotted time to
613 formulate their bid strategies, the decisions affecting the duration of the rounds and the
614 total auction duration should be considered reasonable.

615 **Q. Is it appropriate for the Auction Manager to have authority over certain aspects of**
616 **the auction management, as outlined in the CPP Auction proposal, or should such**
617 **authority be vested with the ICC Staff, the Auction Monitor or some other entity?**

618 **A.** My opinion is that the authority for setting auction parameters, to the extent there is a
619 need for exercising such authority, should be vested with the Auction Manager. The role
620 of the ICC Staff and the Auction Monitor should be to review and monitor the auction

621 planning and implementation, and provide advice to the Auction Manager during both the
622 planning and implementation, as well as to make a recommendation to the ICC regarding
623 approval of the auction outcome. I elaborate on this topic in the following section on
624 Management of the CPP Auction.

625 **VI. MANAGEMENT OF THE CPP AUCTION**

626 **Q. Do you agree with Dr. Salant’s testimony that “the ICC Staff and the Auction**
627 **Monitor should manage the actual auction” (Salant Dir., Staff Ex. 1.0, 8:184-185),**
628 **and that “during the actual auction, however, the Auction Manager should be an**
629 **observer” (Salant Dir., Staff Ex. 1.0, 9:189-190)?**

630 **A.** No. I believe that it would inappropriate to have one entity, the Auction Manager, be
631 responsible for planning the auction, communicating information to bidders, evaluating
632 bidders’ creditworthiness, and preparing the software and systems to be used in the
633 auction, and to have another entity manage the auction implementation. Dividing
634 responsibility for different aspects of the auction (i.e., planning vs. implementation)
635 leaves neither party ultimately responsible for the outcome. To the extent that there is
636 any need for discretion in the management of the CPP Auction, it should be vested with
637 the Auction Manager. Furthermore, empowering the ICC Staff and Auction Monitor
638 with a role in running the auction is fundamentally at odds with the purpose of an
639 independent monitor – to review and monitor the auction process, to verify that the
640 auction is implemented in compliance with the ICC approved process, and to make an
641 independent recommendation to the ICC with respect to approval of the auction outcome.
642 If the ICC Staff and Auction Monitor have a role in managing the auction, there is no
643 independent entity serving as reviewer and monitor.

644 Q. **Do you agree with the roles proposed in the CPP Auction proposal for the Auction**
645 **Manager, ComEd, the ICC, the ICC Staff and the Auction Monitor?**

646 A. Yes. I am in agreement with the roles proposed by ComEd for the Auction Manager,
647 ComEd, the ICC, the ICC Staff and the Auction Monitor in the CPP Auction proposal
648 (LaCasse Dir., ComEd Ex. 4.0, 51:1196 - 53:1258) and further clarified in the rebuttal
649 testimony of Dr. LaCasse, (LaCasse Rebuttal, ComEd Ex. 11.6).

650 Q. **Have there been successful auctions of Basic Generation Service in other states that**
651 **have defined the roles of these parties consistently with the CPP Auction proposal?**

652 A. Yes. The four New Jersey BGS Auctions conducted between 2002 and 2005 have
653 successfully used the same approach to auction management as contained in the CPP
654 Auction proposal with respect to the roles of the utilities, the Auction Manager, the
655 regulatory agency and its staff, and the Auction Monitor. Based on my involvement with
656 the process in the 2002 NJ BGS auction, I believe that roles and responsibilities outlined
657 in the CPP Auction proposal are appropriate, and the approach described is preferred over
658 that suggested by Dr. Salant, for the reasons outlined above. Furthermore, I am not
659 aware of other auctions in the electric power industry wherein the recommendations
660 made by Dr. Salant with respect to the CPP Auction proposal have been used.

661 Q. **Should the ICC authorize review and monitoring of the auction planning and**
662 **implementation by parties other than the ICC Staff and the Auction Monitor?**

663 A. No. The ICC Staff have a responsibility to protect the interests of electricity consumers
664 in Illinois along with the authority to approve, review and evaluate the CPP Auction
665 process to ensure that it is implemented in accordance with approved auction rules and
666 procedures, so as to obtain reliable electricity supply at the lowest rates possible for

667 ComEd customers in Illinois who are eligible for CPP service. Furthermore, the CPP
668 Auction proposal provides for an outside advisor to the ICC Staff, the Auction Monitor,
669 with expertise in planning and implementing auctions. Involving other parties in this
670 review process unnecessarily complicates auction planning, implementation, monitoring
671 and review, and can only decrease the confidence of bidders that the auction outcome
672 will be approved, and increase the potential for unauthorized release of sensitive or
673 confidential information that could compromise the auction outcome. In addition, after
674 careful consideration of these issues and alternative approaches, the NJ BPU Staff and its
675 advisor have served as the sole independent monitor in the successful NJ BGS auctions.
676 For these reasons, I would not support the involvement of a Consumer Observer as
677 proposed in the testimony of William Steinhurst (Steinhurst Dir., CUB-CCSAO Ex. 2.0,
678 35:786 - 40:922).

679 **VII. INDEPENDENCE OF THE AUCTION MANAGER**

680 **Q. Please comment on Dr. Salant's testimony that "there are some potential conflicts of**
681 **interest with a utility-appointed Auction Manager" (Salant Dir., Staff Ex. 1.0,**
682 **86:1940-1941).**

683 **A.** There are many sources of perceived conflicts of interest, which, if not handled properly,
684 may undermine the auction. It is critical to mitigate these sources of perceived conflict
685 and there are two important ways that this can be accomplished to assure bidders that
686 affiliates of ComEd will not be treated any differently than other bidders, have access to
687 information that other bidders do not have access to, or have such access earlier than
688 other bidders:

689 (1) Review and monitoring by ICC Staff and Auction Monitor – the CPP Auction
690 proposal calls for the independent review and monitoring of the auction planning and
691 implementation by the ICC Staff and the Auction Monitor. Having the ICC Staff and
692 the Auction Monitor closely involved with the auction planning in this review and
693 monitoring capacity adds credibility to the process and mitigates the perception of
694 conflicts.

695 (2) Communication protocols – In my testimony above, I recommend that
696 communication protocols be developed to specify the types of communication that
697 are appropriate among various parties involved in the auction, including ComEd,
698 ComEd’s affiliates, the Auction Manager, ICC Staff, the Auction Monitor, bidders
699 and other stakeholders. These communication protocols should be clearly defined and
700 should be consistent with existing standards for communications between ComEd and
701 its affiliates. A description of the communications protocols is contained in the
702 rebuttal testimony of Dr. LaCasse (LaCasse Rebuttal, ComEd Ex. 11.0, Section 5),
703 and more detailed protocols identifying specific individuals and the information that
704 they may have access to should be developed in consultation with the ICC Staff and
705 Auction Monitor, and should be considered confidential. Violations of the protocols
706 should result in sanctions.

707 Together, these two provisions will serve to limit the potential for, and perception of,
708 conflicts in the auction process and implementation. The measures outlined above also
709 will serve to mitigate other possible sources of conflict of interest separate from those
710 that may be related to the independence of the Auction Manager, such as affiliate abuse,
711 or inappropriate sharing of confidential or sensitive information by any party involved in

712 the auction. In addition, the auction rules, confidentiality restrictions contained in
713 auction participation agreements, and FERC regulations governing interactions between
714 regulated utilities and unregulated affiliates²² all serve to inform bidders and others of the
715 legal and regulatory obligations regarding sharing of confidential information, bidding
716 behavior and other restrictions. Ultimately violations of these restrictions could result in
717 sanctions against bidders, and other state and federal laws apply to protect against
718 criminal or fraudulent activity. In light of the many criteria for selecting the Auction
719 Manager, the most effective way to address potential conflicts is to provide for measures,
720 such as independent monitoring and clear communication protocols, which govern
721 certain interactions and serve to mitigate the potential for, and perception of, conflicts.

722 **Q. In what ways have bidders been assured of the independence of the Auction**
723 **Manager in other jurisdictions?**

724 **A.** In addition to the review and monitoring of the NJ BPU Staff and the Auction Monitor
725 (Board Advisor), starting with the 2003 NJ BGS auction, communication protocols
726 governing the interaction between the utilities and bidders (including affiliates) have been
727 instituted. The protocols identify the individuals within the utility who can communicate
728 with the Auction Manager and bidders during the auction planning and implementation.

²² See, e.g., 16 USC 824(m); and FERC, *How to Get Market Based Rate Authority*, pages 9-11. Available at <http://www.ferc.gov/industries/electric/gen-info/how-to-pm.pdf>. Accessed on June 29, 2005.

729 Q. **Do you have any direct experience or observation with respect to the independence**
730 **of ComEd’s proposed Auction Manager, Dr. LaCasse and other NERA staff, in the**
731 **course of auction planning or implementation?**

732 A. As manager of the assignment to assist the NJ BPU, as Board Advisor to the 2002 NJ
733 BGS Auction, I interacted with NERA staff and Dr. LaCasse who served as Auction
734 Manager. I found NERA staff, including Dr. LaCasse, to have treated all bidders equally,
735 and to have worked collaboratively with the BPU, BPU Staff and Board Advisor. Based
736 on information contained in the Post-Auction Reports of the NJ BGS Auctions for 2002-
737 2004,²³ the only public sources of information that I am aware of on this issue, there have
738 not been any indications of violations of communication protocols or Auction Manager
739 bias toward any particular bidders.

740 **VIII. SUGGESTED MODIFICATIONS TO THE CPP AUCTION RULES, PROCESS**
741 **AND MANAGEMENT**

742 Q. **Do you agree with Dr. Salant’s suggestion for conducting one simultaneous auction**
743 **for ComEd’s CPP-A/ CPP-B and CPP-H products, with switching allowed between**
744 **ComEd’s CPP-A/ CPP-B and CPP-H products (Salant Dir., Staff Ex. 1.0, 32:713-**
745 **715)?**

746 A. No. While there may be benefits to allowing switching between the CPP-A/ CPP-B and
747 CPP-H products, the potential benefits are likely to be small and it is not clear whether
748 the benefits would outweigh the additional cost, complexity and potential for strategic
749 bidding behavior that may be detrimental to the auction.

²³ *Post-Auction Report of the New Jersey Utilities’ Basic Generation Service (BGS) Auction Process, Final Report*, Charles River Associates, CRA Project D03231-00, April 8, 2002; *Post-Auction Report of the New Jersey Utilities’ Basic Generation Service Auction Processes: BGS Supply Period Beginning August 1, 2003, Final Report*, Charles River Associates, CRA Project D04053-00, April 8, 2003; *Post-Auction Report of the New Jersey Utilities’ Basic Generation Service Auction Processes: BGS Supply Period Beginning June 1, 2004, Final Report*, Charles River Associates, CRA Project D04054-00, May 4, 2004.

750 Switching between products is advantageous when the products are sufficiently
751 similar that they are considered to be substitutable or complementary by some bidders,
752 and hence the price of one product has a significant impact on the price of another
753 product. This is likely not the case here. The reason that products are unlikely to be
754 considered substitutes or complements, and hence the prices of the CPP-A/CPP-B
755 products would be independent of the price of the CPP-H product, relates to how the
756 energy component is priced. The price determined at auction of the fixed-price products
757 includes payment for the energy component of the full-service product, while the price
758 determined at auction for the hourly product does not. Therefore, the largest determinant
759 of the CPP-A/CPP-B auction price, energy, is entirely missing from price of the CPP-H
760 product (and the bidder has the option of selling energy on the spot market outside of the
761 auction), leaving only the other portions of the full-service product common to both the
762 hourly and fixed-price products. Consequently, the only opportunity for arbitrage
763 between the hourly and fixed-price products is in the non-energy component which
764 comprises a small portion of the full-service product. It is not clear whether bidders
765 would be interested in actively arbitraging the non-energy component of the full-service
766 product across the fixed-price and hourly markets.

767 Contrary to Dr. Salant's assertion, the costs of allowing switching across the
768 hourly and fixed-price products could be significant. One cost would be the added
769 complexity of the auction. To allow switching between the products, the auction rules
770 would have to specify how auction eligibility is translated between the hourly and fixed-
771 price products (an important detail left out of Dr. Salant's testimony). For example,
772 when a bidder switches from offering one tranche of the CPP-A product to offering one

773 tranche of the CPP-H product, the rules must specify either that the two products
774 represent the same amount of eligibility or that a tranche of the CPP-H product represents
775 some fraction of the eligibility of a tranche of the CPP-A product. Given the significant
776 difference in the composition of the hourly and fixed-price products, it is not obvious
777 how the relative eligibility of the two types of products should be set.

778 Another cost of allowing switching is that it would create an opportunity for
779 strategic bidding behavior that does not exist with separate auctions. As just one
780 example, a bidder might be able to bid for one product, say a CPP-H product, in the
781 initial stages of the auction when the bidder is really interested in another product, say
782 one of the CPP-B product. By not bidding on the CPP-B product early in the auction, a
783 bidder can send a false signal about overall interest in the product. This misleading level
784 of interest could induce bidders that are actively bidding on the CPP-B product to reduce
785 their eligibility more quickly than they otherwise would. The first bidder could then take
786 advantage of this situation by switching to the CPP-B product later in the auction when
787 the other CPP-B bidders are less able to react to the first bidder's interest in the CPP-B
788 product. Any strategic behavior, including the example described, entails risks and may
789 or may not be pursued by any bidder. The point, however, is that allowing switching
790 between the hourly and fixed-price products opens the door to increased strategic bidding
791 behavior that may be detrimental to the auction. That increased strategic behavior comes
792 with a potential cost to the auction, as it may result in the auction not obtaining the lowest
793 prices.

794 I believe that it is unlikely that the potential benefits from having a single auction
795 for ComEd's CPP-A/CPP-B and CPP-H products, which would allow switching between

796 the fixed-price and hourly products, outweigh the costs associated with the added
797 complexity and potential for bidding behavior that may be detrimental to the auction.

798 **Q. Would you be in favor of conducting a simultaneous auction for ComEd fixed price**
799 **products (CPP-A/CPP-B) and Ameren fixed-price products (BGS-FP), with**
800 **switching allowed during the auction, and a separate, simultaneous auction for the**
801 **ComEd hourly product (CPP-H) and Ameren hourly product (BGS-LRTP) with**
802 **switching allowed during the auction, if issues related to the PJM/MISO**
803 **interconnection could be resolved?**

804 **A.** Yes. Assuming that it is feasible for bidders to arrange to economically acquire the
805 components of the full service product across the ISO seam without incurring significant
806 additional risk, auctioning the fixed-price products of the two utilities simultaneously,
807 with switching allowed between the two utilities' fixed-price products, would be
808 desirable because it would have the potential to lower the costs of electric supply for one
809 or both of the utilities. As explained in my testimony above, the advantage of allowing
810 switching between the CPP fixed-price products is that bidders can arbitrage price
811 differences between the products during the auction. For example, bidders may do this
812 by switching some of their offered supply from a lower-priced product to a higher-priced
813 product during the auction. Overall cost of electric supply is expected to decrease
814 because the overall efficiency of total supply is expected to increase. Assuming that some
815 suppliers could economically arrange to supply power to both regions, allowing such
816 switching will increase the opportunities for arbitrage and, consequently, overall
817 efficiency of the CPP auction process.

818 Similarly, assuming issues related to the PJM/MISO interconnection could be
819 resolved, there may be opportunities for some bidders to arbitrage between the ComEd
820 and Ameren hourly products. Allowing switching between the two utilities hourly
821 products during the auction would then lead to a more economically efficient outcome
822 than would be the case with no switching. For reasons identified in the response to the
823 previous question, however, I would not be in favor of a simultaneous auction of all four
824 product types, i.e., Com Ed’s fixed price and hourly products, and Ameren’s fixed price
825 and hourly products, with switching between all four product types during the course of
826 the auction.

827 **Q. Please explain the approach proposed by Dr. Laffer that he refers to as “pay-as-bid”**
828 **pricing (Laffer Dir., BOMA Ex. 1.0).**

829 **A.** Dr. Laffer proposes a significant revision to the CPP Auction proposal. As in the CPP
830 Auction proposal, in each round of the auction, bidders indicate the number of tranches
831 that they are offering to supply at the “clock” price. However, instead of ending the
832 auction when the clock is reduced to the point at which the total number of tranches
833 offered is equal to the number of tranches sought in the auction, as in the CPP Auction
834 proposal, Dr. Laffer suggests that the auction continue with additional reductions in the
835 clock price until the price drops to a point at which no bidders offer to supply any
836 tranches. To encourage bidders to continue to bid past the point where the total number
837 of tranches bid is equal to the total number of tranches sought in the auction, Dr. Laffer
838 suggests not providing the bidders with any information about the aggregate number of
839 tranches bid at any given price, i.e., no information would be provided to bidders in the
840 reporting phase of the auction other than the price decrement and the resulting clock price

841 in the next round. In Dr. Laffer's view, limiting information disclosure is required to
842 increase the likelihood that bidders will bid according to their marginal costs (and
843 presumably below their estimate of the market clearing price). Dr. Laffer then suggests
844 paying bidders what they bid instead of a market clearing price, i.e., the price on the
845 clock when the number of tranches bid is equal to the total number of tranches sought in
846 the auction. He claims that this approach will reduce electric supply costs by the amount
847 of the difference between the market clearing price and the bidders' actual bids.

848 Although Dr. Laffer's suggested changes to the CPP Auction process nominally
849 retain the multi-round auction format, the approach is functionally equivalent to a sealed
850 bid, pay-as-bid auction, wherein bidders submit one supply schedule.²⁴ In fact,
851 implementing Dr. Laffer's approach as a descending clock auction would be unnecessary
852 because, unlike an SMR auction, bidders do not learn anything during the auction that
853 would inform their bids from round to round, and there is no demand constraint to
854 promote competition.²⁵ In Dr. Laffer's approach, the bids could all be submitted at once
855 by each bidder and there is no need for a series of rounds in which the clock price ticks
856 down. Bidders know that if they are successful in the auction, they will sell the amount
857 they offer at the lowest price, and the incremental amount they offer at the next higher
858 price increment (if it is accepted), and so on to the maximum price accepted. For
859 example, suppose that in the CPP Auction approach a bidder would be prepared to bid 7

²⁴ Dr. Laffer views his suggestions as a modification of the CPP Auction proposal, not an alternative auction methodology. (See, BOMA's response to ComEd-BOMA 2.03.) Nevertheless, his suggested changes drastically alter the auction, creating one that is comparable to a sealed bid, pay-as-bid auction, as the only information revealed during the auction is the price at each 'clock tick'. (See BOMA's response to ComEd-BOMA 2.08.)

²⁵ Pay-as-bid pricing in Prof. Laffer's suggested approach is fundamentally different from an SMR auction wherein information is made available to bidders and there is price discovery as the auction progresses. In a clock auction with price discovery, all winning bids will have the same bid price and the uniform price will equal the pay-as-bid price, except for possibly any rationed bids. Even if the auction involves bidding a supply schedule, price discovery over the course of several rounds will result in small differences between uniform, or market clearing prices, and the actual prices bid for winning bids. A pay-as-bid approach in an auction with price discovery is described in "Auction Design for Standard Offer Service," Peter Cramton, Andrew Parece and Robert Wilson, Working Paper, University of Maryland, September 1997. (Exhibit 12.2)

860 tranches at 6¢ per kWh, 3 tranches at 5¢ per kWh, and 1 tranche at 4¢ per kWh as the
861 clock ticks down. In Dr. Laffer’s approach this bidder could simply submit a bid
862 schedule offering 1 tranche at 4¢ per kWh, 2 tranches at 5¢ kWh, and 4 tranches at 6¢ per
863 kWh without the need for rounds to reduce the price (no individual bidder will win a
864 higher priced tranche without first winning the lower priced tranche at the price bid). As
865 explained in the next question, the bidder also would likely add a premium to its bid (i.e.,
866 reduce its quantity bid at each price) under Dr. Laffer’s approach to account for the fact
867 that the bidder has no information about other bidders’ valuations, as it would in the CPP
868 Auction approach.

869 **Q. Do you believe that the suggestion by Dr. Laffer to use “pay-as-bid” pricing rather**
870 **than uniform pricing in the CPP Auction will result in lower electricity supply costs**
871 **than the approach proposed by ComEd (Laffer Dir., BOMA Ex. 1.0, 2:24-25)?**

872 **A.** No. I believe that Dr. Laffer’s suggestion would lead to higher electric supply costs than
873 the CPP Auction proposal.

874 Bidders in a reverse auction such as the CPP Auction want to receive the best
875 (i.e., highest) price they can. Therefore, absent market power, an auction participant’s
876 bid will be just low enough to win, so long as the bid is high enough to cover the bidder’s
877 marginal costs. It is unlikely that bids would be the same in the auction proposed by Dr.
878 Laffer and the one proposed by ComEd. In a sealed bid, pay-as-bid auction, each bidder
879 must form an expectation about the level of bids that it must beat to win. Uncertainty
880 about what other bidders will bid leads each bidder to adjust its bid – in this case, to offer

881 a price higher than it otherwise might to avoid underpricing the product that it is selling.²⁶
882 Recognizing this disincentive to be willing to place bids at marginal costs, and the
883 potential for lower economic efficiency as a result of this uncertainty, Nobel Prize
884 winning economist William Vickrey proposed an auction format that creates incentives
885 for bidders to bid at their costs and have the winners pay the price set by the marginal
886 losing bidder.²⁷ The SMR auction format is designed to have many of the beneficial
887 properties of the Vickrey auction.²⁸

888 The advantages of open or multi-round auctions that determine a market clearing
889 price as compared with sealed bid, pay-as-bid auctions are well established.²⁹ A multi-
890 round auction, such as the CPP Auction, has two distinct advantages over a sealed bid,
891 pay-as-bid auction which is equivalent to what is proposed by Dr. Laffer. The first is that
892 the multiple rounds allow for a process of price discovery among bidders, much as in an
893 “open” auction where the auctioneer calls out a price. Price discovery is valuable when
894 the item(s) in an auction have a ‘common value’ component for all of the bidders, as is
895 the case for the full service product sold in the CPP Auction because each bidder has a
896 common opportunity cost if it is not successful in the auction. Observing other bidders’
897 behavior during the auction (for example, how excess supply is reduced as the price ticks
898 down) allows each bidder to confirm or adjust its expectations, avoid overbidding, and
899 thus reduces the need to shave their bids. The second advantage of the SMR auction

²⁶ This is known as the winner’s curse – a situation in which the winner of an auction is the bidder with the most optimistic expectations (and, thus, likely overly optimistic expectations) about value and, therefore, regrets having won. Hal R. Varian, *Intermediate Microeconomics*, Sixth Edition, W.W. Norton & Company, 2003, p. 317.

²⁷ William Vickrey, “Counterspeculation, Auctions, and Competitive Sealed Tenders,” *The Journal of Finance*, Vol. XVI, No. 1, March, 1961, pp. 8-37.

²⁸ John McMillan, “Selling Spectrum Rights,” *Journal of Economic Perspectives*, Vol. 8, No. 3, Summer 1994, pp. 145-162.

²⁹ See, e.g., Peter C. Cramton, “The FCC Spectrum Auctions: An Early Assessment,” *Journal of Economics and Management Strategy*, Vol. 6, No. 3, 1997, pp. 431-495.

900 format over the sealed bid, pay-as-bid format is that it enhances the efficiency of the
901 process by allowing for arbitrage across similar products.

902 Dr. Laffer's suggested auction approach would eliminate virtually all exchange of
903 information during the auction along with the benefits of price discovery which is
904 essential to avoid the uncertainty and economic inefficiency of sealed bid, pay-as-bid
905 auctions. Despite Dr. Laffer's assertions (Laffer Dir., BOMA Ex. 1.0, 10:232 - 11:242,
906 12:272-278), under his proposed approach bidders will not be more likely to bid their
907 marginal costs, and the auction will not be more competitive. One reason is that bidders
908 have the option to participate in the spot market if they are not winners in the auction, and
909 this option affects whether they would bid significantly below their estimate of the future
910 spot market price. Secondly, even without the option of selling in the spot market,
911 bidders will have little incentive to offer supply at a price below their estimate of the
912 marginal supply price in the auction because they know they only need to beat that price
913 to win. Thirdly, without the benefit of price discovery, auction participants will add a
914 premium to (i.e., increase) their estimate of the marginal supply price to account for
915 uncertainty and submit bid schedules higher than their marginal costs, leading to
916 inefficient outcomes. Regardless, bidders have no incentive to reveal the lowest priced
917 portions of their cost schedules, thus defeating the proposed benefits of the pay-as-bid
918 format proposed by Dr. Laffer.

919 For these reasons, I believe it is likely that replacing the SMR auction format with
920 Dr. Laffer's pay-as-bid proposal will increase the cost of electric supply for ComEd's
921 customers compared with the CPP Auction proposal.

922 Q. **Have “pay-as-bid” auctions been used successfully in auctions for competitive**
923 **supply procurements such as the CPP in Illinois?**

924 A. No, none that I am aware of. In fact, the New Jersey BPU rejected a proposal for a pay-
925 as-bid format for auctioning BGS, commenting:

926 The RPA’s pay-as-bid proposal is opposed by the EDCs as
927 unfounded in theory (EDCs’ Final Comments at 23) and as
928 possibly detracting from the current auction process. (Id at 24).
929 The Board has reviewed the position of the parties in this highly
930 theoretical debate. From the authorities cited in the comments, it
931 appears as though the best that could be hoped for from the RPA’s
932 proposed modification is no net change in the resulting prices, if
933 bidders act according to the theory. If they do not, auction prices
934 could actually rise. (Id at 23.) Additionally, the Board is concerned
935 that the RPA’s position would undermine certain basic auction
936 principles. In particular, a pay-as-bid rule would result in bidders
937 being paid different prices for delivering the same product and may
938 distort the perceived difference between products in the auctions.
939 The value to bidders of these two features of the current process is
940 similarly difficult to quantify. What is clear to the Board is that the
941 first two auctions, following basically similar rules to those
942 currently proposed by the EDCs, have worked well and produced
943 results acceptable to the Board. Based on the submissions, the
944 Board is not persuaded that the RPA’s modifications would
945 enhance this process. Therefore, the Board APPROVES the
946 auction rules as proposed by the EDCs.³⁰

947 Furthermore, Dr. Laffer’s descriptions of other auctions as “pay-as-bid” auctions are
948 somewhat misleading. Characterizing the FCC spectrum license auctions as pay-as-bid
949 auctions (Laffer Dir., BOMA Ex. 1.0, 7:143-151) is technically correct, but misleading
950 because in those auctions typically only one, two, or three licenses of the same bandwidth
951 for the same geographic area are offered out of the hundreds of items sold. Therefore, the
952 FCC auctions did not sell many identical items, as is the case with the tranches sold in the
953 proposed CPP Auction. Dr. Laffer also misrepresents the early electricity supply

³⁰*Decision and Order, In the Matter of The Provision Of Basic Generation Service For Year Two of the Post-transition period, State of New Jersey Board of Public Utilities Docket No. EO03050394, October 22, 2003.*

954 auctions in England and Wales when he characterizes them as “essentially the same as
955 the approach proposed by ComEd in this case: a uniform, market clearing price” (Laffer
956 Dir., BOMA Ex. 1.0, 8:170-171). Two key differences between the England and Wales
957 auctions³¹ and the proposed CPP Auction are: (a) the England and Wales auctions set a
958 market clearing price every half hour in response to real-time demand, whereas, in the
959 ComEd proposal, a single price would be set for at least one year and up to five years;
960 and (b) in the England and Wales auctions, there were only two dominant bidders.

961 **Q. Can the ICC evaluate the CPP Auction proposal in light of specific proposed**
962 **modifications, and approve the auction?**

963 A. Yes. I believe that the CPP Auction proposal provides sufficient detail to allow the ICC
964 to review and evaluate it. With a limited number of clarifications, as outlined in my
965 testimony, I believe that the ICC should approve the CPP Auction proposal. Such an
966 approach to approving the CPP Auction proposal would be consistent with how approval
967 of other utilities’ proposals of SDCAs for procuring standard, or basic generation, service
968 has been conducted in other states such as New Jersey.

969 In my opinion, the CPP Auction proposal is the most effective approach for
970 procuring the lowest cost, reliable source of electricity supply for ComEd’s customers in
971 Illinois that are eligible for CPP service.

972 **Q. Does this conclude your testimony?**

973 A. Yes.

³¹ Richard J. Green and David M. Newbery, “Competition in the British Electricity Spot Market,” *Journal of Political Economy*, 1992, Vol. 100, No. 5, p. 930.