

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

**COMMONWEALTH EDISON COMPANY** )  
 )  
**Proposal to implement a competitive** ) **No. 05-0159**  
**procurement process by establishing Rider** )  
**CPP, Rider PPO-MVM, Rider TS-CPP and** )  
**revising Rider PPO-MI.** )

**CITIZENS UTILITY BOARD'S BRIEF IN OPPOSITION  
TO COMED'S PROPOSAL TO IMPLEMENT A  
COMPETITIVE PROCUREMENT PROCESS**

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Citizens Utility Board (“CUB”), on behalf of ComEd’s residential customers in Illinois, submits this brief in opposition to ComEd’s proposal to implement a competitive procurement process by establishing Rider CPP, Rider PPO-MVM, Rider TS-CPP and revising Rider PPO-MI. As pointed out below, ComEd’s proposal must be denied.

## **I. INTRODUCTION**

According to ComEd, its filed tariffs are designed to usher Illinois into the “welcomed” era of market-based rates for residential customers. But as demonstrated below, the ICC cannot relinquish its traditional ratemaking role or forgo the important consumer protections provided by after-the-fact reviews, regardless of ComEd’s requests to the contrary.

That is because the pre-condition to charging market-based rates to residential customers has not been met. The Rate Relief Law of 1997 unambiguously requires the ICC to declare tariff services for these customers as “competitive” before residential customers can be subject to unregulated market prices. The ICC has not made any such declaration. Consequently, the ICC is required to analyze the filed tariffs under traditional ratemaking rules. This entails an after-the-fact prudence review of ComEd’s conduct in acquiring the electricity it needs to meet customers’ demands and to further determine whether the proposed rates are “just and reasonable”.

A review of the proposed tariffs shows that the ICC has no rates or actual conduct to review; the proposals merely provide ComEd a prospective right to set rates into the future. Under these circumstances, the ICC lacks the jurisdiction to approve ComEd’s proposals.

Disturbingly, ComEd’s proposals also are designed to protect it and enrich its parent

company and generating affiliates, at the expense of customers. ComEd appears to be eliminating all regulated risks for itself rather than procuring power at the lowest possible prices. Under its proposals, every dollar it spends to acquire electricity is entirely passed through to its customers. ComEd proposes that it not be subject to any after-the-fact prudence review so as to avoid any risk of having those costs deemed imprudently incurred, thereby eliminating the possibility of not passing on all of its costs to customers. Thus, ComEd has designed a procurement process that places all of the risks of its potential imprudent conduct or unjust and unreasonable rates squarely with residential customers. The ICC should not tolerate this. It should not leave consumers unprotected and should perform after-the-fact reviews as to ComEd's conduct in procuring electricity and as to the justness of the rates.

In addition, ComEd has designed a procurement process that seems to assure ExGen, its generating affiliate, a high price for its low-cost, high-margin electricity production, while avoiding FERC scrutiny at the same time. Why would ComEd do this when it owes a duty to customers to get the best price possible for them, rather than the highest price possible for ExGen? It is because ComEd employees have stock options for Exelon stock. This stock becomes more valuable as ExGen's profits grow. And ComEd and Exelon are fully aware that ExGen will be both a direct bidder and a supplier to other bidders in the auction and that ExGen is well-positioned vis-à-vis non-nuclear generators to profit substantially in the auction. This situation is yet another reason why the proposals should not be approved and the ICC should not abandon after-the-fact reviews.

Finally, ComEd admits that a competitive, robust wholesale electricity market must exist to assure that the auction will result in the best market prices. However, ComEd has

failed to meet its burden of showing that such markets are sufficiently developed and competitive to assure such results. There are significant shortcomings presently in these wholesale markets, particularly in the Northern Illinois (“NI”) region of PJM, that create many price uncertainties. These uncertainties will have the effect of driving auction-bidding prices up.

In addition, as ComEd admits, RTOs are an important factor in contributing to the development of wholesale markets. But yet, as ComEd further admits in its recent filings with the Securities and Exchange Commission (“SEC”):

The FERC has attempted to expand the development of the regional markets, which has generated substantial opposition from state regulators and other governmental bodies. In addition, efforts to develop an RTO have been abandoned in certain regions. While Exelon supports the development of RTOs and implementation of standard market protocols, it cannot predict their success or whether they will lead to the development of the envisioned large successful wholesale markets.

It is this absence of these “envisioned large successful wholesale markets” and the price uncertainties in existing markets that cause ComEd to fail in its burden of showing that the auction will result in just and reasonable rates to customers.

### **III. LEGAL ISSUES**

#### **B. The ICC lacks the authority under the Act to approve the filed tariffs.**

The Illinois Public Utilities Act (“The Act”), 220 ILCS 5/1-101 et seq., provides for the general supervision of all public utilities by the Illinois Commerce Commission (“ICC”). The ICC’s power and authority come strictly from the Act, and the ICC cannot, by its own actions, extend its jurisdiction beyond the law. *Harrisonville Tel. Co. v. Ill. Commerce Comm’n*, 343 Ill. App. 3d 517, 797 N.E.2d 183 (5<sup>th</sup> Dist. 2003) *aff’d*. 207 Ill. 2d 601, 807 N.E.2d 974 (2004). Consequently, the ICC can only determine facts and

enact orders concerning the matters specified in the Act. Id. For the reasons discussed below, the Act does not confer the ICC with the jurisdiction to approve ComEd's proposals.

As a threshold matter, one issue must immediately be put to rest. ComEd has touted its proposals as the best method of ushering Illinois into a new, and supposedly "welcomed" era of market-based prices to its customers. See e.g., McNeil Dir. test. pp. 16-19, 31. According to ComEd, that was one of the primary goals of the Rate Relief Law of 1997, and the time has come to implement it. Market based rates, however, cannot apply here. The condition precedent for the charging of such rates to ComEd's residential customers and other customers below 3 KW has not been met. That is because the ICC has not declared tariff services for these customers "competitive", as required under 220 ILCS 5/16-113.<sup>1</sup>

Accordingly, the ICC must scrutinize ComEd's proposals under its traditional ratemaking rules. 220 ILCS 15/16-103. (15/16-103 provides that "[a]n electric utility shall continue offering to retail customers each tariffed service that it offered as a distinct and identifiable service on the effective date of this amendatory Act of 1997 until the service is ... declared competitive pursuant to Section 16-113.") Among other things, the ICC must determine whether ComEd acted prudently in procuring power and incurring

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<sup>1</sup> Section 5/16-113 provides in part that "the Commission shall declare the service to be a competitive service for some identifiable customer segment or group of customers, or some clearly defined geographical area within the electric utility's service area, if the service or a reasonably equivalent substitute service is reasonably available to the customer segment or group or in the defined geographical area at a comparable price from one or more providers other than the electric utility or an affiliate of the electric utility, and the electric utility has lost or there is a reasonable likelihood that the electric utility will lose business for the service to the other provider or providers; provided, that the Commission may not declare the provision of electric power and energy to be competitive pursuant to this subsection with respect to (i) any retail customer or group of retail customers that is not eligible pursuant to Section 16-104 to take delivery services provided by the electric utility and (ii) any residential and small commercial retail customers prior to the last date on which such customers are required to pay transition charges.

the costs of it, regardless of the procurement method used. 220 ILCS 5/9-101 & 5/9-201. See also *Pullman Co. v. Illinois Commerce Comm'n*, 390 Ill. 40, 60 N.E.2d 232 (1945). Under applicable law, if all the cost of acquiring the power is prudently incurred, then those costs can be passed on to customers through rates. *Id.* But if any cost is deemed imprudent, it cannot be included in the rates. *Id.* In addition, the Act mandates that the ICC establish rates that are just and reasonable. ComEd has the burden of proving the justness and reasonableness of its proposed rates and charges and the prudence of its conduct. *Id.*

Up to a certain point, everyone seems to be in agreement that the traditional ratemaking rules under the Act apply here. Under such rules, ComEd must, and did publicly file, its proposed tariffs with the ICC to request a change under the present tariffs, as required under 220 ILCS 5/9-201(a). Similarly, the ICC did suspend the proposed filings and did convene a hearing under 5/9-201. But from that point, the parties disagree on whether the ICC has the jurisdiction to pre approve ComEd's procurement proposals. Such proposals, among other things, eliminate any after-the-fact ICC prudence review or determination of the reasonableness and justness of the actual rates resulting from the auction. A review of ComEd's proposals in light of the Act and applicable case law shows that the ICC lacks jurisdiction to approve the proposals.

As is evident from ComEd's initial filings, it has not filed a schedule of actual rates, charges, or executed contracts. Consequently, the ICC has no actual rates, charges or executed contracts to review for reasonableness or justness. Stripped of their technical jargon, ComEd's filings merely propose a descending clock auction procurement process that is replete with enormous non-reviewable discretion to be exercised by ComEd and its

auction manager. Then, ComEd is asking the ICC, and equally important, its customers, to accept on blind faith that the resulting clearing prices will automatically be just and reasonable. Indeed, ComEd is proposing that the ICC forgo any meaningful after-the-fact prudence review of the actual, resulting auction prices.

ComEd has fashioned its proposal so that it is completely risk free to it. In particular, ComEd proposes that the auction prices and all of the enormous costs of running the auction be passed on dollar for dollar to its customers. McNeil Dir. test. p. 21, ll. 466-469 (where he states, “ The auction product being procured is full requirements electric supply, making for a back-to-back transaction whereby ComEd sells the same commodity product at retail as it procures at wholesale with adjustments for line losses and other costs, but without any margin added.”) Thus, even if the resulting prices are in fact unjust or unreasonable, ComEd bears no risk of not recouping all of its costs of paying for the power from its customers.

Under the above circumstances, the ICC lacks jurisdiction to approve ComEd’s proposals. The ICC cannot approve proposed tariffs that contain no actual rates or charges and that grant a utility the prospective right to establish rates in the future. *Citizens Utility Board v. The Illinois Commerce Commission*, 275 Ill. App. 3d 329, 655 N.E.2d 961 (1<sup>st</sup> Dist. 1995)

The question of whether the ICC has the jurisdiction to pre-approve the open-ended, type of proposals at issue here was answered in the negative in the *Citizens Utility Board* case. In that case, ComEd filed with the ICC a proposed "load retention" tariff designated as Rate CS Contract Service, Ill. C.C. No. 4, Original Sheet No. 55.50. The purpose of the tariff, as with load retention tariffs generally, was to maintain existing

"load" by inducing customers to remain with ComEd rather than utilize an alternative source of energy. Under the terms of the tariff, ComEd would achieve load retention by offering discounted rates to a limited number of commercial and industrial users vis-à-vis negotiated contracts.

As here, the actual charges under the proposals were not included in the proposed tariff on file with the ICC. The proposals merely granted ComEd the prospective right to set rates in the future. The tariff itself made clear that "the charges for service hereunder shall be the charges contained in the contract between the Company and the customer." 275 Ill. App. 3d at 333. As here too, executed contracts did not exist at the time ComEd filed its tariff. Without the contracts, there were no rates or charges to be reviewed. The only limitation as to the future rate that could be charged was that "the revenues from the discounted rate could not be less than the incremental cost of providing service to the customer, thereby ensuring a positive contribution to the utility's fixed costs." *Id.*

The First District held that the proposal violated the Act, and consequently, the ICC did not have the jurisdiction to approve the proposal. *Id.* at 338-339. The court noted that there were no rates set out in the proposal at the time of ComEd's filing. *Id.* The proposals, like here, merely set out the parameters under which those rates could be set by ComEd. Consequently, the Court held that the ICC could not approve a tariff that permitted a utility to establish rates in the future, subject only to the condition that the rates contribute to the utility's fixed costs. *Id.* Such a condition is implied in every "just and reasonable" rate and, standing alone, does not properly constitute a "rate" under the Act, as further explained by the court. *Id.* Thus, the ICC has no jurisdiction to approve proposals that grant a utility a prospective right to set rates into the future, which is

precisely what ComEd is proposing here.<sup>2</sup> Id.

ComEd asserts that the ICC can pre-approve a procurement process, citing *The City of Chicago v. Illinois Commerce Commission*, 13 Ill 2d 607, 150 N. E. 2d 776 (1958) as its support. That case does not support ComEd's position.

In *City of Chicago*, the ICC approved Peoples Gas' request for a cost-of-natural gas adjustment clause as part of its existing rate tariffs. The clause provided for periodic automatic adjustment of Peoples' sales price for gas, to reflect changes in the wholesale cost to it of natural gas purchased. In substance, the automatic adjustment clause provided for increases or decreases in the charges for gas sold by Peoples to the extent of increases or decreases in the wholesale price of such gas.

The Supreme Court upheld the ICC's approval noting that the automatic adjustment clause was a set formula by which the price of natural gas to the ultimate consumer was fixed by inserting in the formula the wholesale price of natural gas as established by the FPC. The court also noted that The Natural Gas Act of 1938, (U.S. Code, Title 15, sec. 717 *et seq.*) vested the power to fix rates for natural gas transported and sold to distributing companies in interstate commerce exclusively in the FPC and preempted any right which might have existed in the States to regulate such rates. Thus, Illinois had to charge and Peoples had to pay the FPC determined rate, and the Commission had no power over such rate. The court also noted that the City did not contend that the FPC prices were unreasonable and therefore were subject to disallowance by the Commission as an operating expense of Peoples. Consequently, the clause was allowed because it was simply an addition of a mathematical formula to the filed schedules of Peoples under

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<sup>2</sup> The Act was amended to allow for load retention tariffs and for ComEd to enter into the contracts in issue in the *Citizens* case. The holding in the case is still applicable here, however, and has never been overruled or weakened by any subsequent laws or cases.

which existing rates and charges fluctuated as the wholesale cost of gas to Peoples fluctuated.

The proposals at issue here do not even remotely resemble the adjustment clause in *The City of Chicago* case. This is not a case involving a process that merely and mathematically adjusts existing rate schedules. Indeed, unlike the *City of Chicago* case, where the underlying adjustable rates were not challenged, here there are no underlying rates at all. Instead, at issue here is ComEd's request for pre-approval of an auction process never used or tested in Illinois before for ComEd's retail full requirements electric supply at unknown, unconstrained, uncapped and unspecified rates. (New Jersey is the only state using an auction but with supply products different than Illinois. Ohio ran an auction but never used the auction prices because they were higher than the regulated rates.)

Moreover, after the auction, there is no prudence review by the ICC of those rates or the procurement process itself. Instead, there is a mere three day window period in which the ICC can reject the auction, but only if the auction was not run according to the rules or if there is unambiguous evidence of foul play. Lastly, to arrive at such a "prompt decision" of whether to reject the auction prices, the ICC will primarily rely on the auction manager's report that was prepared merely one day after the auction, by a manager hired and paid for by ComEd.

Further, unlike *The City of Chicago* case, where the adjustment clause did not involve any discretionary conduct by Peoples in adjusting natural gas prices, the proposals here are rife with discretionary conduct by ComEd. Among other things, ComEd decides who can bid by establishing the qualifications for bidders. ComEd decides how much of its

retail power requirements are being offered for bid. ComEd decides how much of that requirement can be captured by one bidder by setting a load cap. ComEd decides the maximum and minimum prices for the auction. ComEd designs and creates the “full requirements product” being offered for bid. ComEd creates and designs different “customer groups” within the bidding system. ComEd establishes the duration of the supplier contracts, which differs for each customer group. These are just a few of the many discretionary decisions by ComEd concerning the auction, making this case very different than the non-discretionary adjustment formula at issue in the *City of Chicago* case. Indeed, we can go on *ad nauseam* with the significant differences that make this case not the *City of Chicago* case.

In sum, the Act and applicable case law make clear that the ICC has no jurisdiction to approve ComEd’s proposals.

#### **IV. SUFFICIENCY OF THE COMPETITIVE MARKET**

##### **A. E. G. & J. Markets’ relationship, relevant geographic market, transmission constraints and market monitoring.**

ComEd has made certain representations in this proceeding about the wholesale electrical market--that it is well developed and robust, and provides a solid foundation for a successful auction. Indeed, ComEd admits that the auction’s objective in supposedly obtaining the best prices for its customers depends largely on the competitiveness and development of the wholesale electricity market throughout the United States. See Mr. Clark Aug. 29 test. p. 167 where he states: Q. And to a certain extent the success of the

auction depends upon the development of a wholesale market throughout the United States, including in the Midwest, isn't that right? A. Yes.” As we point out, below, however, the wholesale markets are not as developed or robust, in Illinois and throughout the US, as ComEd has led the ICC to believe.

Robert M. Fagan, a Senior Associate at Synapse Energy Economics, Inc., testified on direct and rebuttal there are many shortcomings and price-influencing uncertainties within the post-2006-period wholesale market structure in the Northern Illinois (“NI”) that will lead to higher bid prices than ComEd is willing to admit.

Among other things, he testified that the generation capacity and energy supply concentration in the Northern Illinois region in post-2006 coupled with the pending expiration of the existing ComEd-Exelon contracts for BUS supply will result in the ability of Northern Illinois generation suppliers to exercise market power at times, leading to wholesale market prices that do not reflect competitive market outcomes. Fagan Dir. test. pp. 7-15. This will influence the pricing strategies of all auction participants, regardless of how many suppliers participate in the proposed auction. Id. The presence of a concentrated supply market in Northern Illinois will influence the PJM spot prices in the Northern Illinois region, thereby influencing auction participant perceptions of the value of power available for purchase, in turn exerting upward pressure on the BUS procurement auction “offer” prices (or bids made by the participants to supply BUS) and leading to higher auction clearing prices. Id.

He further testified that generation supply ownership in northern Illinois remains highly concentrated during instances of binding transmission constraints on power flow into the ComEd region. Fagan Direct test. pp.7-16; Rebut test. ll. 471-492. This supply

concentration undermines the competitiveness of the wholesale markets during these times, and will lead to higher spot market prices or higher prices in the forward market for power, including contracts entered into by suppliers participating in the proposed auction. Fagan Rebut. ll. 69-73 and 743-749.

Mr. Fagan further explained that regional patterns of transmission use can change over surprisingly short time periods; and generation or equipment outages can exacerbate such changes. Fagan Rebut. ll. 431-432. Just as market power cannot be “assumed away”, as noted by Dr. Hogan, the potential for transmission constraints affecting power flow into the ComEd region during the relevant period of 2007-2011 also cannot be assumed away. ComEd needed to conduct--but did not conduct-- a rigorous study to determine if binding transmission constraints into ComEd might become problematic post-2006; and to determine the influencing factors that might cause such problems. Id. ComEd’s view of the transmission future is through rose-colored glasses, and the spectacles are brand new, since PJM has been coordinating power flows across, into and out of ComEd’s transmission system for a relatively short period of time, only since May of 2004. Absent a careful quantitative analysis given the complexity of transmission system operations in PJM, it is premature for ComEd to conclude that no problems exist. Id.

As to a geographical market, Mr. Fagan testified that Northern Illinois is the appropriate market to test for the presence of market power because during times when transmission constraints bind, PJM suppliers not located in northern Illinois and other competing suppliers in MISO cannot directly compete with northern Illinois suppliers. Id at ll. 172-238. Thus, the smaller region of northern Illinois must be examined to

determine if the high concentration of supply might lead to market power exercise. Id.

In addition, Mr. Fagan testified that the existence of separate wholesale market structures in Illinois (PJM in the north, MISO in the central and southern regions) characterizes the market in which the propose auction will take place. Fagan Dir. pp. 17-21. The outcome of the proposed auctions for ComEd will be influenced by the ability of participants in the MISO region to effectively compete with PJM suppliers; however the MISO market remains immature and the price outcomes in that marketplace are uncertain Id. Since MISO participants will rely on the MISO market to some extent in determining the prices they offer into the proposed auction, the MISO market immaturity will be reflected in the outcome of the proposed auction. Id. It is premature to assume that the MISO market will produce competitive outcomes; indeed, Dr. Hogan's claims of market efficiency pertain to the design, not the implementation of the MISO market, and he has produced no evidence that the MISO market has resulted in competitive prices. Fagan Rebut. ll 1102-1111.

Mr. Fagan further testified that ComEd had not offered any evidence on the extent to which transmission constraints for power flow into the ComEd or northern Illinois region might be binding in the 2007-2011 time frame. Fagan Rebuttal ll. 47-53; 448-454; 461-468. Reliance on current data alone, especially data that excludes analysis of summer peak periods, is insufficient to establish that transmission constraints will not be problematic during peak periods in the 2007-2011 time frame. Id. at ll. at.417-447. The historical review undertaken by Dr. Hieronymus is the only piece of analysis introduced into evidence by ComEd, and its retroactive focus is misplaced; a prospective assessment is required but has not been performed. Id.

The existence of the PJM-MISO seam, as Mr. Fagan explained, also presents a barrier to trade across the regions and limits the ability of non-PJM suppliers to reach the northern Illinois region and compete in an integrated marketplace. Fagan Dir. test. ll. 86-91, 421-497. Progress towards minimizing the seams effect is insufficient; the existence of the seam remains even in the presence of the “joint operating agreement” between PJM and MISO. Id. The different market structures of PJM and MISO – e.g., PJM has integrated regulation and reserve markets, and a separate capacity market, where MISO has none of those features; and PJM has a stricter market monitoring and mitigation protocol – limit the effectiveness of competition between the regions. Fagan Rebut. ll. 1033-1047.

Finally, Mr. Fagan testified that the PJM market monitor’s ability to mitigate the exercise of market power in the PJM energy markets is limited. Fagan Dir. ll 101-104, 671-685. The PJM MMU’s authority to mitigate market power may be further eroded pending current FERC actions. Fagan Rebut. test. ll. 74-92, 788-933.

In addition, ComEd admits that RTOs are an important factor in contributing to the development of wholesale markets. Clark Aug. 29 test. pp. 166-169. But yet, as ComEd has admitted in its recent filings with the SEC:

The FERC has attempted to expand the development of the regional markets, which has generated substantial opposition from state regulators and other governmental bodies. In addition, efforts to develop an RTO have been abandoned in certain regions. While Exelon supports the development of RTOs and implementation of standard market protocols, it cannot predict their success or whether they will lead to the development of the envisioned large successful wholesale markets.

In sum, the absence of these” envisioned large successful wholesale markets” and the other market problems identified above cause ComEd to fail in its burden of showing that

the auction will result in just and reasonable rates to customers. Consequently, the proposals either should be denied outright or, at a minimum, the ICC should not give up its duty of performing after-the-fact reviews of the reasonableness of the rates or the prudence of ComEd's conduct.

## **V. AUCTION DESIGN ISSUES**

### **A. C. & E. General Effectiveness, suitability and auction management.**

There are other telling circumstances calling into question ComEd's reasons for proposing this type of auction besides trying to avoid prudence reviews. The auction is structured to financially benefit Exelon Corporation ("Exelon") and Exelon Generation ("ExGen", the generating company) to the detriment of ComEd customers.

ExGen is well positioned and expected to significantly profit from the auction. See Clark Aug.29 test. pp.176-178. ExGen is the largest nuclear producer of electricity in the United States. It produces 90% of its electricity from its nuclear plants, running them at 95% efficiency. As stated by Frank Clark and many other witnesses at the hearing, one of the most efficient ways of producing low cost power is through the use of nuclear power plants. Clark Aug 29 test. pp 161-163; Hieronymus Sept. 2 Test. pp 1012-1013. It has lower production costs, and thus higher margins, than fossil fuel and natural gas plants. Id.

In addition wholesale electricity prices, particularly in the PJM and MISO markets, are set primarily by the wholesale prices of natural gas plants. Clark Aug. 29 test. pp. 175-176. Fossil fuel and natural gas plants, not nuclear power plants, have driven wholesale prices up over the years. Id. Many bidders will use these spot prices in formulating bid price ranges. See Hogan Sept. 1 test. p. 1109-1110 stating that he expects

bidders to use forecasts of those prices in formulating their bid strategy. See also.

Naumann Sept 1 test. pp. 1069-1071; LaCasse Sept. 8 test. pp.840-843;

ComEd's auction proposal allows all of the above factors to work in ExGen's favor at the expense of consumers. As admitted by Frank Clark, ExGen is expected to be a direct bidder in the auction and a base load supplier to other bidders. Clark Aug. 30 test. p. 170.

ExGen is excellently positioned as a direct bidder because, with 90% of its production arising from lower cost nuclear generation, it has a competitive advantage over other bidders whose product blend contains a higher percentage of fossil fuel or gas based generation. But the step down in prices during the auction ends when other bidders with higher costs and lower margins no longer bid any more power into the auction. This is true even though ExGen as a bidder could afford to bid an even lower price. As Mr. Clark testified: "Q. Would you agree that the lowest cost generator and the most efficient generator would be the one who would have the greatest benefit from a market clearing price? A. Yes. Q. Would you agree that the higher the market-clearing price produced by the auction, the greater the potential economic benefit to ExGen for participating in the auction? A. Yes." Clark Aug 29 Test. p. 191 Consequently, ExGen is excellently positioned to obtain a high price for its generation through the auction. Moreover, the consumer loses out by having to pay higher auction prices caused by the higher cost, lower margin producers.

ComEd contends that ExGen would be unwilling to bid or sell lower because it supposedly could get higher prices in the spot market. This position is not well taken. If that were truly the case, then the auction would be doomed from the start. No bidder would be interested in bidding if they believe they are better off selling all of their power

into the spot market. Dr. Hogan, ComEd's own expert, explained, however, why any bidder would prefer to sell into the auction instead of on the spot market.

Q. Okay. Now, let's take the flip side now. Why would someone have an incentive to bid into the auction proposal? A. Well, the principal reason would be risk mitigation and having less volatile sources of revenues. Q. Okay. Are there other incentives as to why they might have to bid into the auction despite the fact that they might be able to sell their electricity elsewhere? A. Well, there are other things I could think of that are derivative from what I just said. So if you've risked it and then hadn't mitigated the risk, then you have a more stable source or revenues and you could get financing for other things you might want to do for a new entrance, for example. Dr. Hogan Sept.1 test. p.1109

Moreover, the auction is also designed to avoid FERC disapproval of ExGen's bid. Ms Moler testified that FERC would be comfortable with accepting a contract between ComEd and an Exelon generation affiliate that resulted from the auction process. Moler Dir. Test. Pp 9-10, ll. 204-206. Mr. McNeil also testified:

Q. Did ComEd take into account federal and state laws as well as policy in designing the proposed competitive procurement process? A. Yes. First, we recognize that our affiliated company owns a substantial amount of generation in northern Illinois and that it is likely to be a part of the post-Transition Period procurement for retail customers. As discussed in the direct testimony of ComEd witness Elizabeth Moler (ComEd Ex. 2.0), the FERC has determined certain criteria that would potentially be applied to a contract between a utility and its affiliated generation company. As Ms. Moler testifies, the best evidence that such a contract is consistent with FERC's policy is that it has been chosen as a result of a competitive process. Ms. Moler observes that a process such as the one proposed here would conform to FERC's policy.

McNeil test. p. 17, ll. 373-382. But ComEd hopes to avoid FERC scrutiny of ExGen's bid or justify the bid by arguing to FERC that ExGen simply received the same bid price as everyone else.

#### **L. Regulatory oversight and review.**

The hearing testimony makes clear that the ICC should reject the proposals even assuming *arguendo* that it has the jurisdiction to act here. The auction proposals eliminate the ICC's obligation to perform an after-the-fact prudence review of the resulting auction prices. The proposals further eliminate the ICC's obligation to determine whether the rates are in fact just and reasonable. This removes the only meaningful protections for consumers and subjects them to the substantial risk of paying unreasonable and unjust rates, all of which is contrary to the Act.

After the auction closes, the auction manager, a ComEd hired agent, has only one business day to file her report concerning the auction. McNeil Dir. Test. P. 30. This report merely provides a factual summary of the activities and events that occurred during the course of the auction, the resulting prices and the manager's affirmation that the auction rules apparently were followed. Notably absent from the report or from any other source is an after-the-fact analysis whether the prices resulting from the auction are fair, reasonable or were prudently incurred by ComEd

Then, the ICC, with no analysis of whether the resulting rates are in fact reasonable, has only three business days from the close of the auction to accept the results. It can reject the results only if there is unambiguous evidence that the auction process was not followed.

ComEd admits that, under its proposals, the resulting auction prices alone are insufficient grounds to reject the auction even if they may seem too high given market conditions. Juracek Aug. 30 test. pp. 434-435. Instead, we are to accept on blind faith that the prices are fair simply because the auction rules have been followed. McNeil Dir. test. p. 13 ll. 286-287. Indeed, ComEd feels so strongly about this assumption that it insists

that the actual auction prices need not be subject to any after-the-fact prudence review of any sort or determination of their justness or reasonableness.

ComEd's testimony, alone, raises serious doubts about such an assumption. In particular, Ms Juracek testified that there will be no benchmarks to determine the reasonableness of the auction clearing prices for the given products. Aug. 30<sup>th</sup> Test. p.434-435. The reason for this is because the products being auctioned are a fairly specialized product and not the usual blocks of power traded in the electric market generally. Id at 613-614. Therefore, the absence of comparably priced products in the market leaves it virtually impossible to determine in real time or immediately thereafter whether the ending auction prices are in fact reasonable.

Mr. McNeil echoed this as well. He testified in rebuttal that at least three years of actual auction prices are needed "to detect whether there are patterns or potential systematic flaws in the process that would prevent consumers from being able to receive fair market pricing. The purpose of the three-year window is to permit sufficient data to make a determination of whether a pattern existed, which may not be apparent from examination of a single auction result." McNeil Reb. Test. p. 743, ll. 743-748.

Does ComEd, however, share any risk that customers are not receiving "fair market pricing"? Obviously not, since it's proposing that its cost of power be passed on to customers dollar for dollar. More importantly, however, customers paying anything other than just and reasonable prices would be in violation of the Act and in derogation of the ICC's obligations to customers. Because of the nature of the "specialized products" being auctioned and the lack of comparably priced market products, only an after-the-fact, traditional ratemaking prudence review will detect whether the customer rates resulting

from the auction prices are just and reasonable. Such a prudence review is precisely what ComEd wants to avoid

ComEd claims that any delay in approving the auction prices might drive prices up. But yet, ComEd hasn't offered one bit of quantitative analysis to support this supposition. Likewise, it did not elicit any similar quantitative testimony from a possible bidder. Mere conjecture should not cause the ICC to eliminate the only true protection consumers have to avoid paying unjust or unreasonable rates.

ComEd's true motivation, however, is that it dislikes after-the-fact prudence reviews: the reviews put it at risk of not being able to pass on all of its costs to consumers.

The cross examination of Mr. McNeil confirmed this:

Q Is it -- now, as I understand the company's proposal here, one of the primary, not the only, but one of the primary reasons it seeks to have the Commission's approval is to avoid what it has characterized as after-the-fact prudence reviews of its power and energy purchases. Is that correct? A Yes. Q. Are you generally in favor of prudence reviews after-the-fact or before the fact? What would you prefer? A I think utilities would generally like to have the prudence reviewed before the fact. Q. Okay. And as an employee of Commonwealth Edison, I'm assuming that you would probably like prudence reviews to occur before the fact, isn't that correct? A As a utility representative? Q Yes .A Yeah .Q And you feel that that puts your company at less of a risk of not being able to pass all of its costs on to the consumer a hundred cents on the dollar? A I think the costs that the company is asking for permission to incur and therefore recover, it just moves the review of those costs and the process, the decisions it's going to make, to incur those costs up front, so the company does have a lower risk that its decisions --Q Aren't going to be second-guessed by somebody? A - - won't be second-guessed. McNeil Aug. 30 test. pp. 551-553.

Obviously, ComEd wants to avoid the type of post auction review the ICC is required to conduct under the Act. Mr. McNeil testified that ComEd rejected other types of procurement methods, such as RFPs and bilaterally negotiated contracts, because ComEd would be subject to after-the-fact prudence reviews. *Id.* at pp.553-555. ComEd criticized

Dr. Steinhurt's proposals on alternative procurement methods primarily for the same reasons. Id.

In sum, the ICC should not abdicate its responsibility to perform an after-the-fact prudence review based on mere conjecture, disputed auction methods and ComEd's distastes for prudence reviews. Customers should not lose their only true protection against paying unjust and unreasonable prices; a risk that the customers only bear because ComEd intends to recover every dollar it pays for the power from its customers.

Dr. Steinhurst hit the nail squarely on the head when he testified:

Q. Why do you believe that it is important that whatever Commonwealth Edison does to procure electricity, that it be subject to regulatory review in a traditional rate case by the Illinois Commerce Commission? A. That's really the only sure safeguard that consumers who lack competitive retail alternatives have to be confident on an ongoing basis that their service is going to be a just and reasonable rate. I don't believe that that decision can be made by approving a particular process at one point in time and just letting the chips fall where they may. The protections developed for what are essentially captive retail customers over the years in the utility arena are balanced, fair, sound and appropriate, and they should not be blown away for such captive customers just because the utility is more comfortable without the responsibility." Steinhurst Sept. 7th Test. p 512.

## **VI. PROCUREMENT PROCESSES ALTERNATIVES**

**A. -E.** ComEd should have presented the ICC with a full exploration of the range of options for procuring resources to serve default service customers, comparing them objectively in terms of their impact on the costs and risks. Such a proceeding could have allowed a reasoned determination of which approach would best satisfy the needs of ratepayers and other parties.

As Dr. Steinhurst explained, ComEd would have certain advantages if it to so manage its own portfolio, including experience, access to the best information about customers

and their requirements, ongoing real time data collection, and potentially lower equity returns requirements and debt rates. Steinhurst Reb. test.pp.19-26. Diversified, actively managed procurement would allow flexibility in procurement decisions and negotiations. If properly managed and utilized, this flexibility can provide benefits that would not be possible under rigid auction rules. Id. The full range of opportunities and benefits to the supplier—including non-monetary benefits, such as a stable income stream, the value of a business relationship, or any aspect of the transaction that has value to the supplier and lead it to reduce the price vis-à-vis an alternative—must be considered for this comparison. Id.

As Dr. Steinhurst further testified, there are many products that ComEd can combine into an actively managed portfolio design. Steinhurst Reb. pp21-29 For example, in terms of power and energy, just a few of the products that should be evaluated to determine how their costs and risk profiles would affect default service rates include standard wholesale electric power market forward contracts of various lengths from a month to a number of years and a wide range of starting dates; spot purchases; bilateral negotiated contracts of varied terms, sizes or start dates; unit-specific power contracts with owners of existing units; non-unit-specific power contracts with owners of groups of existing units; residual load following contracts; options to buy (or sell) power at various prices at various times; and at-cost, fixed price, turn-key or other types of arrangements for power from new or existing units at various locations. Id. In addition, non-power contract products that could be included in portfolios include weather and fuel price futures contracts or options. Id. A soundly designed and actively managed portfolio for the benefit of default service customers can be an improvement in risk, price, or both

compared to ComEd's proposed one-product, one-day-a-year auction.

As the purchaser of power for default service customers, as Dr. Steinhurst further explained, ComEd would have significant bargaining power and could bring discipline to the wholesale markets. Steinhurst Reb pp. 21-29. Choosing a diverse portfolio of resources, actively managed for the benefit of default service customers would allow ComEd to pick and choose among offers of different types, opt for short-term or open positions if markets do not produce reasonable results, or fall back on any or all of the many other product choices listed above, all in an infinite range of combinations driven by the actual offers available. Id.

ComEd, as a buyer, also could optimize its portfolio with a different objective (protecting customer interests and risk preferences) than suppliers that will optimize based upon their own risk preferences. Id. For example, many consumers, especially small consumers with few opportunities to shop, value low risk resources. Increasing the variety of products and portfolio options being considered is one way to deliver this preferred outcome to those smallest consumers. Id. A diverse, actively managed portfolio can be readily adapted to cope with changes in markets, both supply and demand. Id. ComEd's proposed portfolio design and procurement method not only passes through to default service consumers all the costs and risks of that procurement, but actually exacerbates some of those risks by placing all of the default service load on single-product, single-date auctions. Id.

ComEd proposes to deprive default service customers of the benefits that could be obtained from a more diversified portfolio and procurement process, simply so it can avoid the responsibility for making portfolio design and management decisions, tasks that

it once routinely performed and are routinely performed by its affiliates today (albeit not for the benefit of ratepayers), and by commodity managers for all sorts of businesses.

ComEd misrepresents both the breadth of procurement options open to it, as well as the considerable flexibility given to it under Illinois's restructuring legislation. ComEd continues to have all the flexibility it always did in choosing resources and procurement methods, plus additional, new flexibility in how it runs its business. Clearly prudent utilities have relied on a wide range of products, term lengths, and procurement methods to manage risk and cost. Few, if any, have had the temerity to place their entire resource portfolio in a "blind trust." *Id.* Given the magnitude of the costs and risks from uncompetitive wholesale markets, it is not appropriate for ComEd to simply give up on protecting consumers from those costs and risks without seriously examining the alternatives.

Finally, as pointed out above, ComEd's true motives in favoring the auction over other procurement methods are to financially benefit Exelon and ExGen, and to avoid the risks of after-the-fact prudence reviews and after-the-fact determinations of "just and reasonable" rates.

## **IX. OTHER ISSUES**

The employees of Exelon and its affiliates also have a personal financial stake in seeing ExGen succeed. Every ComEd and/or Exelon Services witness who testified here has stock options for Exelon stock. Exelon's stock values, among other things, benefit from ExGen's profitability. These employees therefore have a personal financial interest in ExGen financially benefiting from the auction even though their corporate responsibilities, solely as ComEd employees, are only owed to customers. Then, those

witnesses such as Frank Clark, who serve both masters (i.e. ComEd and Exelon), are further biased in favor of the auction, and not customers, because they have a corporate obligation to maximize profits for the benefit of Exelon's shareholders. Thus, every ComEd and/or Exelon witness has a personal financial stake in this matter that calls into question his or her ability to testify objectively about the proposed auction.

### **X.CONCLUSION**

For all of the above reasons, ComEd's proposals should be denied. ComEd should procure power as it deems appropriate but subject to the traditional rules of ratemaking. In other words, ComEd should acquire the power and then submit its conduct to the ICC for an after-the-fact prudence review, just as the Act requires. The ICC should also do an after-the-fact determination of the rates, assuring that they are "just and reasonable". Again, this is exactly what the Act requires. These after-the-fact reviews are designed to protect consumers and should not--and cannot-- be abandoned.

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