

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

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

**REPLY BRIEF OF THE STAFF OF
THE ILLINOIS COMMERCE COMMISSION**

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Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to Section 200.800 of the Rules of Practice (83 Ill. Adm. Code 200.800) of the Illinois Commerce Commission (“Commission”), respectfully submits its Reply Brief in the above-captioned matter.

I. INTRODUCTION

The Initial Brief of the Staff of the Illinois Commerce Commission (“Staff IB” or “Staff’s Initial Brief”) was filed on October 7, 2005. The Initial Brief Of The People Of The State Of Illinois In Opposition To The Proposed Riders (“AG’s Initial Brief” or “AG IB”), the Initial Brief Of The Building Owners And Managers Association Of Chicago (“BOMA’s Initial Brief” or “BOMA IB”), the Initial Brief Of Constellation Energy Commodities Group, Inc. (“CCG’s Initial Brief” or “CCG IB”), the Initial Brief Of The Cook County State’s Attorney’s Office (“CCSAO’s Initial Brief” or “CCSAO IB”), the Initial Brief Of The Coalition Of Energy Suppliers (“CES’s Initial Brief” or “CES IB”), the Initial Post-Hearing Brief Of Commonwealth Edison Company (“ComEd’s Initial Brief” or “ComEd

IB”), the Citizens Utility Board’s Brief In Opposition To ComEd’s Proposal To Implement A Competitive Procurement Process (“CUB’s Initial Brief” or “CUB IB”), the Initial Brief Of Direct Energy Services, LLC and U.S. Energy Savings Corp. (“DES-USESC’s Initial Brief” or “DES-USESC IB”), the Initial Brief Of The United States Department Of Energy (“DOE’s Initial Brief” or “DOE IB”), Dynegy Inc.’s Opening Brief (“Dynegy’s Initial Brief” or “Dynegy IB”), the Initial Brief Of Illinois Industrial Energy Consumers (“IIEC’s Initial Brief” or “IIEC IB”), the Initial Brief Of Morgan Stanley Capital Group Inc. (“MSCG’s Initial Brief” or “MSCG IB”), Midwest Generation EME, LLC’s Initial Brief (“MWGen’s Initial Brief” or “MWGen IB”), and the Initial Brief of Peoples Energy Services Corporation (“PES’s Initial Brief” or “PES IB”) were also filed on October 7, 2005.¹

II. NEED FOR COMMISSION ACTION

Response to AG

The AG argues that the only action the Commission needs to take is to “permanently suspend the tariffs ComEd has filed.” (AG IB, p. 2) More specifically, the AG argues that the Commission does not need to approve ComEd’s proposed procurement method or any other procurement method for 2007 and beyond. (*Id.*) The AG also contends that the Commission should exercise its ratemaking authority to “effectuate[] an extension of the transition period” (*Id.*, p. 3) The AG observes that the end of the mandatory transition period on January 1, 2007, does not signify the end of regulation in Illinois, and declares that the Commission’s obligations to determine

¹ Several parties filed corrected briefs shortly after the October 7, 2005, filing, and all citations to parties’ briefs in this Initial Brief are to such corrected filings, if applicable.

whether rates are “just and reasonable” and to limit utilities to recovery of costs determined to be “just, reasonable and prudent . . .” will likewise continue. (*Id.*) Finally, the AG notes that the Electric Service Customer Choice and Rate Relief Law of 1997, 220 ILCS 5/16-101 et seq. (the “Restructuring Law”), “continued longstanding consumer protections for electric service for those customers who take service that has not been declared competitive pursuant to Section 16-113 of the Act.” (*Id.*, pp. 3-4)

Although Staff agrees, in most cases, with the generalizations made by the AG regarding the Commission’s ratemaking authority, the AG offers no specific arguments in this portion of its Initial Brief to support its contention that the Commission should “permanently suspend” and “not approve” ComEd’s proposed tariffs. As demonstrated in Staff’s Initial Brief and other sections of this Reply Brief, ComEd’s proposal should be approved (with the modifications recommended by Staff) based on applicable law and the relevant facts established in the record for this proceeding. Although the AG does not support its ultimate conclusion in this section of its Initial Brief, Staff will analyze certain assertions made here by the AG and discuss those assertions in the context of ComEd’s proposal that is the subject of this proceeding.

First, the AG’s assertion that the Commission should “permanently suspend” ComEd’s proposed tariffs is not proper under Illinois law. The Commission’s power to “suspend” tariffs is limited as set forth in Section 9-201 of the Public Utilities Act (“Act” or “PUA”) (220 ILCS 5/9-201), and does not include the power to “permanently suspend” tariffs. As the Commission is well aware, it may suspend tariffs for a period not to exceed approximately eleven months, at which point the filed tariffs become effective on

a pass to file basis if the Commission has not ruled on the merits.² (See Central Illinois Public Service Co. v. Illinois Commerce Comm'n, 5 Ill. 2d 195, 206 (1955) (“If [the suspension] period has expired before the Commission has concluded its inquiry, then the utility may begin collecting charges under the new rate”); 220 ILCS 5/9-201) Staff assumes that the AG intended to indicate that the proposed new tariffs should be rejected and permanently cancelled based on its position that the proposed tariffs are improper as a matter of law or otherwise fail to produce just and reasonable rates. While these positions also lack merit, they would – if accepted – provide a basis to permanently cancel the proposed tariffs rather than permanently suspend those tariffs.

Second, the AG’s assertion that the Commission does not need to approve ComEd’s proposed procurement method or any other procurement method for 2007 and beyond appears to present both legal and policy assertions, and is inadequate on both counts. Staff will not address here the substantive merits of ComEd’s auction procurement proposal except to note, as explained in other portions of this Reply Brief and in Staff’s Initial Brief, that the facts and the law support approval of ComEd’s auction proposal (with certain modifications advocated by Staff). Thus, on a substantive level, the AG is incorrect to assert that the Commission need not approve ComEd’s proposal.

² Section 9-201(a) of the Act provides that no tariff change may become effective on less than 45 days notice absent special permission from the Commission. (220 ILCS 5/9-201(a)) Section 9-201(b) of the PUA provides that the Commission may enter upon a hearing to consider the propriety of any tariff change, and may suspend the effective date of such tariff for a period not more than 105 days beyond the time when such tariff change would otherwise go into effect unless the Commission extends the period of suspension for a further period not exceeding 6 months. (220 ILCS 5/9-201(b)) The 45 day, plus 105 day, plus 6 month period total approximately 11 months.

Assuming, *arguendo*, the Commission found that ComEd's proposed tariffs do not establish just and reasonable rates, the AG is wrong to suggest that that should be the end of the Commission's inquiry from a procedural perspective under the PUA. In Central Illinois Public Service Co. v. Illinois Commerce Comm'n, 5 Ill. 2d 195, 200-201, 203 (1955) ("*CIPS*"), the Court considered an appeal where the Commission rejected and cancelled newly proposed tariffs and found there was not sufficient evidence to determine what would be a new just and reasonable rate. Parties argued that the Commission was obligated to approve the newly filed tariffs or determine new just and reasonable rates. The Illinois Supreme Court rejected these arguments based on the language of Section 36 (now Section 9-201) of the PUA. Specifically, the Court in *CIPS* held that the determination of whether proposed rates are just and reasonable is different and distinct from the determination of what rates would be just and reasonable, and explained that the obligation of the Commission to determine what would be just and reasonable rates depends on the evidentiary showing:

The contention that the Commission must conclude its inquiry into the proposed rate within a ten-month [now eleven-month] period confuses the power of the Commission to suspend with its power to determine the reasonableness of the rate. The ten-month period applies only to the former. If that period has expired before the Commission has concluded its inquiry, then the utility may begin collecting charges under the new rate, so far as pre-existing contractual obligations permit. The running of the period does not terminate the Commission's inquiry, however, and the new rate remains subject to permanent cancellation by the Commission's final order in the proceedings. (Illinois Bell Telephone Co. v. Commerce Com. ex rel. City of Edwardsville, 304 Ill. 357; City of Edwardsville v. Illinois Bell Telephone Co. 310 Ill. 618.) ...

The contention that the Commission should have established some other rate is also based on a misconstruction of section 36 [now Section 9-201]. That section requires the Commission to establish only such rates as the Commission "shall find to be just and reasonable." It does not command the Commission unconditionally to establish a rate without such a finding; nor does it compel the Commission to make such a finding.

It is obvious that the Commission cannot be required to establish some alternative rate without evidence in the record that that rate is reasonable. And we think it equally plain that the Commission is not required to take the initiative in seeking out such evidence. While the act authorizes the Commission to investigate a utility's accounts and to appraise its property, and to assess the expenses against the utility, (Ill. Rev. Stat. 1953, chap. 111 2/3, par. 41a,) there is nothing in the act indicating that such a power carries with it a duty to exercise it whenever a utility applies for an increase in rates. To impose such a duty might seriously impair the Commission's functions.

(*Id.*, pp. 206-207)

Thus, while the Commission has no independent legal obligation to inquire into the issue of what would constitute just and reasonable rates if the utility's filed tariffs fail to meet that requirement, the Commission cannot ignore proper evidence on the issue of alternative just and reasonable rates and simply decline to rule. Here, the evidence provided by Staff and others establishes modifications to ComEd's proposal that result in just and reasonable rates.

Moreover, Staff must note the enormous policy implications of the AG's recommendation to reject ComEd's proposed tariffs and take no further action. ComEd no longer owns generation assets and its existing supply contracts expire on January 1, 2007 -- contemporaneous with the end of the mandatory transition period. Thus, ComEd currently has no identified sources of electric supply to serve its customers' needs post-2006, and such supply must necessarily be acquired from third parties. ComEd prudently filed its proposed procurement plan well in advance of the expiration of its current supply contracts and a decision in this docket is anticipated in January 2006 -- approximately one year prior to the termination of the existing supply contracts. The AG's recommendation to essentially turn a blind eye to the immensely important issue of how ComEd should and will procure its electric supply post-2006 (putting aside

the fact that the auction-based proposal is reasonable), creates pointless and ill-advised uncertainty regarding how ComEd will procure supply after 2006.

Finally, although Staff agrees with the AG that the end of the mandatory transition period on January 1, 2007, does not signify the end of regulation in Illinois or the elimination of various regulatory requirements, the AG never addresses in any reasonable way the fact that the instant proposal (as modified by Staff) passes muster under those very requirements. Staff will address specific arguments in this regard in other sections of this Reply Brief. Similarly, although the AG is correct that the world as we know it will not end on January 1, 2007 (AG IB, p. 1), the AG appears to ignore the fact that the regulatory arena in Illinois underwent significant changes in 1997 as a result of the Restructuring Law. Before enactment of the Restructuring Law in 1997, “[e]ach local utility company was vertically integrated, meaning that each one produced electric energy, transmitted it to the general vicinity of the consumer, and distributed it to the customers’ businesses and homes.” (Illinois Power Co. v. Illinois Commerce Comm’n, 316 Ill. App. 3d 254, 257 (5th Dist. 2000)) The Restructuring Law “was enacted to introduce competition into the Illinois electricity market . . . [and] authorizes electric utilities to transfer nuclear power plants to affiliated or unaffiliated entities and to enter into service agreements and power purchase agreements with the transferee.” (Commonwealth Edison Co. v. Illinois Commerce Comm’n, 332 Ill. App. 3d 1038, 1044 (2nd Dist. 2002)) Consistent with the Restructuring Law, ComEd restructured its electric operations and transferred its nuclear power plants to affiliated entities. The AG and certain other parties fail to acknowledge these significant developments in their arguments.

Because ComEd no longer owns generation facilities (as a result of ComEd taking actions specifically authorized by the Restructuring Law), the only legitimate issue to be considered here is whether ComEd's proposal constitutes a prudent and reasonable method to procure power from third party suppliers consistent with the requirement for just and reasonable rates contained in the PUA – not whether the cost of providing electric energy would have been lower if the Legislature had decided against restructuring and ComEd still owned its generation facilities. This proceeding is not a forum to second-guess the Legislature's decisions embodied in the Restructuring Law. The focus here should be on the best means to procure electric energy given applicable legal and factual constraints. As explained elsewhere, the auction-based procurement method meets these requirements.

III. LEGAL ISSUES

Response to CCSAO and CUB

The CCSAO and CUB have raised issues in this Section that are substantially similar to the AG. Staff's arguments below, although directed to the AG, are equally applicable to CCSAO and CUB.

A. Background: the Illinois Electric Service Customer Choice and Rate Relief Law of 1997

Response to AG

In this section of its Initial Brief, the AG continues to make a number of generalizations regarding the Commission's ratemaking authority following enactment of the Restructuring Law. For the most part, Staff does not contest these general

statements of the law regarding the Commission's ratemaking authority. In particular, Staff agrees that after the termination of the mandatory transition period utilities may seek and obtain changes to rates, provided the changes "result in just and reasonable rates." (AG IB, p. 6) However, the AG quickly jumps to an unreasonable reading of the PUA that is based on misstatements or mischaracterizations of the law and ComEd's auction-based procurement proposal.

The AG states that "the statute does not authorize utilities to charge market rates until sufficient retail competition exists to justify the reclassification of the service as competitive." (*Id.*) Although couched in general terms, this statement is misleading and confuses or ignores the difference between market retail rates and market wholesale rates. ComEd's tariffs embodying its auction-based procurement proposal do not establish market retail rates; instead, ComEd's proposed tariffs establish retail rates through use of formulae based on its wholesale cost of procuring electric energy through auctions. Although these wholesale costs will be market based since FERC allows electricity wholesalers to charge market based rates (see AG IB, p. 15), this is not the same as a market retail rate.

The Restructuring Law, codified as Article XVI of the PUA, establishes that regulation of electric retail services declared to be "competitive services" will be substantially reduced. (See 220 ILCS 5/16-103(a)(e); 220 ILCS 5/16-113(b); 220 ILCS 5/16-116(b)) The genesis of this new regulatory model for competitive electric services is set forth in the statement of electric utility service obligations contained in Section 16-103(a) of the PUA, which provides, in full, as follows:

(a) An 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 (i) declared competitive pursuant to Section 16-113, or (ii) abandoned pursuant to Section 8-508. Nothing in this subsection shall be construed as limiting an electric utility's right to propose, or the Commission's power to approve, allow or order modifications in the rates, terms and conditions for such services pursuant to Article IX or Section 16-111 of this Act.

(220 ILCS 5/16-103(a)) Thus, Section 16-103(a) requires an electric utility to continue to provide each retail tariffed service offered at the time of enactment of the Restructuring Law until “the service is . . . declared competitive pursuant to Section 16-113 . . . or abandoned pursuant to Section 8-508.” (*Id.*)

An electric utility relieved of its provider of last resort obligations for a service declared competitive under Section 16-103(a) could, absent requirements or limitations specified elsewhere in the PUA, decline to offer such service or, if it did offer that service, charge whatever the retail market might bear. The extent of deregulation for services declared competitive is established in Section 16-116(b) of the PUA, which provides, in full, as follows:

(b) An electric utility may offer any competitive service to any customer or group of customers without filing contracts with or seeking approval of the Commission, notwithstanding any rule or regulation that would require such approval. The Commission shall not increase or decrease the prices, and may not alter or add to the terms and conditions for the utility's competitive services, from those agreed to by the electric utility and the customer or customers. Non-tariffed, competitive services shall not be subject to the provisions of the Electric Supplier Act or to Articles V, VII, VIII or IX of the Act, except to the extent that any provisions of such Articles are made applicable to alternative retail electric suppliers pursuant to Sections 16-115 and 16-115A, but shall be subject to the provisions of subsections (b) through (g) of Section 16-115A, and Section 16-115B to the same extent such provisions are applicable to the services provided by alternative retail electric suppliers.

(220 ILCS 5/16-116(b)) The ability to charge market rates for **retail** services declared competitive under the Restructuring Law is the ability under Section 16-116(b) to charge whatever rate a willing buyer will pay, free from Commission scrutiny with respect to

prices, terms and conditions. The AG ignores or misses these important provisions of the Restructuring Law, and accordingly misreads and misapplies the provisions of Section 16-103(c). (See AG IB, pp. 8-9)

Section 16-103(c) of the PUA is an exception to the general ability of an electric utility to (i) refuse to offer or (ii) charge a market rate for certain retail services declared competitive. Section 16-103(c) provides, in full, as follows:

(c) Notwithstanding any other provision of this Article, each electric utility shall continue offering to all residential customers and to all small commercial retail customers in its service area, as a tariffed service, bundled electric power and energy delivered to the customer's premises consistent with the bundled utility service provided by the electric utility on the effective date of this amendatory Act of 1997. Upon declaration of the provision of electric power and energy as competitive, the electric utility shall continue to offer to such customers, as a tariffed service, bundled service options at rates which reflect recovery of all cost components for providing the service. For those components of the service which have been declared competitive, cost shall be the market based prices. Market based prices as referred to herein shall mean, for electric power and energy, either (i) those prices for electric power and energy determined as provided in Section 16-112, or (ii) the electric utility's cost of obtaining the electric power and energy at wholesale through a competitive bidding or other arms-length acquisition process.

(220 ILCS 5/16-103(c))

Thus, Section 16-103(c) of the PUA requires electric utilities to continue to offer traditional bundled electric service on a tariffed basis for residential and small commercial retail customers, notwithstanding the declaration of such services as competitive. Further, Section 16-103(c) restricts the general ability of electric utilities to charge market rates for competitive retail services, and instead requires that rates for competitive residential and small commercial retail services “reflect recovery of all cost

components for providing the service.”³ (*Id.*) Section 16-103(c) also provides a limitation on allowable costs, and mandates that “cost shall be the market based prices . . .” which are specifically defined as “either (i) those prices for electric power and energy determined as provided in Section 16-112, or (ii) the electric utility's cost of obtaining the electric power and energy at wholesale through a competitive bidding or other arms-length acquisition process.” (*Id.*)

While Section 16-103(c) does refer to “market based prices”, this phrase is used in defining “costs” and it is clear from the statutory language of Section 16-103(c) that the Legislature did not consider “market based prices” and “cost based rates” to be mutually exclusive concepts. Thus, it is clear from the language of Section 16-103(c) that “market based prices” as used in Section 16-103(c) may be determined based on the utility’s actual cost of obtaining such power and energy through any arms-length acquisition process – including a competitive bidding process. As a result, the AG’s reference to “market based prices” is improperly used to suggest that market based prices are inconsistent with cost-based rates under Section 16-103(c). Equally erroneous is the AG’s assertion that setting cost based retail rates for services not declared competitive based on market based wholesale costs is inconsistent with Section 16-103(c) and beyond the Commission’s authority. Section 16-103(c) of the Act imposes a limitation on an electric utility’s ability to charge market rates for residential

³ Further evidencing that Section 16-103(c) of the Act expresses a limitation on the general deregulation of competitive services for residential and small commercial customers (rather than a grant of market based rate authority as suggested by the AG), the exemption of competitive services from various Articles of the PUA (including Article IX) in Section 16-116(b) is limited to “[n]on-tariffed, competitive services” – i.e., excluding competitive services for residential and small commercial customers which must be “tariffed” under Section 16-103(c). (220 ILCS 5/16-103(c); 220 ILCS 5/16-116(b))

and small commercial customer competitive services, requiring instead cost based rates specifically defined to include an electric utility's cost of obtaining the electric power and energy at wholesale through a competitive bidding or other arms-length acquisition process. The AG's argument that Section 16-103(c) prohibits the Commission from setting rates according to the cost based methodologies set forth therein is based on a flawed reading of Section 16-103(c) that fails to recognize (1) that the reference to "market based prices" is in the context of cost based rates and (2) that Section 16-103(c) is a limitation on the ability to charge market retail rates rather than a grant a specific rate authority.

The AG concludes by offering additional generalizations regarding the Commission's ratemaking authority, which are identified as "essential elements of rate of return/cost-based regulation in Illinois" (AG IB, pp. 10-12) Like many of the statements in the AG's Initial Brief, the ratemaking principles articulated here are not offered in the context of a specific argument explaining why or how the auction-based procurement proposal under review is inconsistent with these principles. As demonstrated in Staff's Initial Brief and other sections of this Reply Brief, the auction-based procurement proposal as modified by Staff is consistent with applicable ratemaking principles. Given the general failure of the AG to make specific arguments, there is nothing to which Staff can specifically respond. The closest the AG comes to making a specific argument is to state that "markets are not required to consider" these various ratemaking principles. (*Id.*, p. 12)

The AG's statement says nothing about whether the auction-based procurement proposal should be accepted or rejected, as all applicable ratemaking principles can

and are being considered in this docket. Further, the AG's statement is nonsensical in that it implies that there is some means of acquiring wholesale energy other than through the wholesale market. As explained above, any such assertion ignores the fact that the Restructuring Law authorized ComEd to divest itself of its generation assets and that it owns no generation assets at this time. As a result, any possible procurement method will necessarily rely on the wholesale market. Finally, while "markets" obviously do not function in the same procedural context as the Commission in a docketed proceeding, there is no reason to believe that markets will be oblivious to the prudence of management decisions or other sound business practices underlying various ratemaking principles. To summarize, the AG's statement in no way supports rejection of the auction-based procurement proposal.

Response to ComEd

ComEd in its Initial Brief makes the statement that the Restructuring Law created a strong incentive for divestitures of generation assets. (ComEd IB, p. 8) To support that statement, ComEd cites to Section 16-111(i) of the Act and argues that Section 16-111(i) provides "that, after the statute's 'transition period' and before a tariffed service is declared 'competitive,' the Commission 'may establish' a utility's charges for the electric power and energy component of tariffed services 'at a rate equal to the market value [for such electric power and energy] plus 10%'." ComEd goes on further and states that Section 16-111(i) puts a utility at risk of being limited to recovering no more than market value plus 10%, no matter how efficient or prudent the utility's operation of its own generation assets might be. (ComEd IB, p. 8) Staff agrees with ComEd that the

Commission may establish a utility's charges for the electric power and energy component of tariffed services at a rate equal to the market value plus 10%; however, Staff's position is that 16-111(i) creates a ceiling, which is the market value plus 10%. (Staff IB, p. 10) It is not clear from ComEd's brief whether ComEd agrees that Section 16-111(i) creates a ceiling. ComEd's brief could be read as ComEd suggesting that the Commission could establish a utility's charges at an amount greater than its actual cost under the scenario where a utility's cost for electric power and energy is less than the market plus 10%.

Staff's position is that Section 16-111(i) of the Act creates a ceiling on the rates that can be set -- and in the event that a utility's cost for electric power and energy is less than market plus 10%, the Commission cannot authorize rates to exceed the utility's actual cost. Staff's interpretation of Section 16-111(i) is consistent with Section 16-111(i)(1) -- which provides that the Commission should only consider "the then current or projected revenues, [and] costs ... directly associated with the provision of such tariffed services; ..." (220 ILCS 5/16-111(i)(1)) -- and Sections 9-101 and 9-201 (220 ILCS 5/9-101, 9-201) -- which provide that rates must be just and reasonable. Clearly, to allow a utility to recover more than its cost would result in a rate that is unjust and unreasonable. Therefore, the Commission's order should be clear that Section 16-111(i) creates a ceiling and does not allow a utility to charge more than its cost for electric power and energy (i.e., a utility cannot be allowed to recover market value plus 10%) if the actual cost is less than the market value plus 10%.

B. ICC Authority Under Article IX and Article XVI to Approve the Filed Tariffs

Response to AG

The AG contends that “ComEd’s proposal seeks to radically shift risks to consumers and to insulate the Company from any financial responsibility for power procurement decisions.” (AG IB, p. 13) The AG further asserts that this is a “change in regulatory, consumer protections” that is not authorized by the Restructuring Law or the PUA. (*Id.*) While the AG goes on in the balance of this section of its Initial Brief to make an argument that ComEd’s proposed tariffs are deficient based on the ruling in Citizens Util. Bd. v. Illinois Commerce Comm’n, 275 Ill. App. 3d 329 (1st Dist. 1995) – which Staff addresses below – it offers no further explanation or analysis to support its initial contentions. Staff will not speculate as to the unarticulated bases for the AG’s contentions. The Commission clearly has the authority under the PUA to approve rider recovery of certain costs through formula based rates. (See Staff IB, p. 11) Similarly, the Commission has broad authority to make appropriate prudence findings based on the evidence presented, and to incorporate those findings into tariffs providing for recovery through a rider mechanism. (See Central Ill. Light Co. v. Illinois Commerce Comm’n, 255 Ill. App. 3d 876, 881-883 (3rd Dist. 1993) (Rejecting challenge to Commission fact determination requiring presumption of prudence in operations giving rise to current remediation expenses in generic proceeding approving rider recovery of certain environmental clean-up costs), *affirmed in part and reversed in part on other grounds*, Citizens Util. Bd. v. Illinois Commerce Comm’n, 166 Ill. 2d 111, 121 (1995) (Commission determination that Illinois utilities prudently operated and decommissioned manufactured gas plant sites not contested before Illinois Supreme Court.))

ComEd's auction-based procurement proposal fully articulates the criteria and method by which ComEd will enter into contracts for wholesale power and energy to serve its retail customers – removing its discretion in all material respects, incorporating the resulting wholesale costs, with no mark up, into a formula based translation mechanism to determine retail rates. This proposal is not properly characterized as an attempt to avoid regulatory scrutiny or nefariously avoid or transfer risk. To the contrary, ComEd has placed its procurement decision cards on the table and seeks a fact based finding that the criteria and process by which it proposes to acquire wholesale power and energy constitute prudent management decisions that, when implemented, will result in just and reasonable rates. Staff's Initial Brief fully articulates why – with certain modifications to ComEd's auction proposal -- the record supports the prudence finding that ComEd seeks with respect to its auction-based procurement proposal.

The AG also argues that the Commission cannot approve a blank rate, and cites Citizens Util. Bd. v. Illinois Commerce Comm'n, 275 Ill. App. 3d 329 (1st Dist. 1995) for the proposition that tariffs with “rates that do not exist” violate the PUA. (AG IB, pp. 13-14) The AG misapplies the holding in *Citizens* and mischaracterizes the proposed tariffs. *Citizens* involved the Commission's approval of ComEd's Rate CS (Contract Service), a tariff designed to allow ComEd to retain load that would otherwise leave its system by providing discounted rates to certain commercial and industrial users pursuant to negotiated agreements. (*Id.*, p. 332) Rather than setting forth criteria or formula by which the discounted rates would be determined, “the tariff merely indicated that revenues from the discounted rates could not be less than the incremental costs of

providing service to the customer, thereby ensuring a positive contribution to the utility's fixed cost." (*Id.*, p. 333) Although the contracts and workpapers deriving the negotiated rates were to be filed with the Commission for informational purposes, both the contracts and supporting work papers would be automatically treated as proprietary and thus would be neither published nor made available for public inspection. (*Id.*)

The Court in *Citizens* noted that Section 9-102 of the Act mandates that utilities file with the Commission and keep open for public inspection schedules showing all rates and other charges or classifications for all services provided by it. (*Id.*, p. 338) The Court found that these publication requirements require a utility to "file and publish a schedule of rates and charges, including any contracts which may affect the same." (*Id.*) The Court held that ComEd's Rate CS did not comply with these requirements because the actual charges were "not included in the proposed tariff on file with the Commission nor open to the public for inspection." (*Id.*, p. 339) Rather, the Court found that Rate CS simply granted ComEd "the prospective right to set rates in the future" based on contracts that did not yet exist, and thus did "not comply with section 9-102 of the Act." (*Id.*)

The Court also considered the argument that since Rate CS provided a "parameter' of possible rates" it satisfied the requirement for a schedule of rates. (*Id.*) The Court rejected this argument because Rate CS did "nothing more than limit Edison's otherwise unfettered right to establish any rate it so desires as long as that rate is not below its marginal cost." (*Id.*) The Court made clear, however, that it was not holding that the Commission did not have authority to approve a tariff that "truly contains a 'parameter of rates'", such as a rider "containing a mathematical formula under which

rates would fluctuate with the wholesale cost of natural gas”. (*Id.*, pp. 339-340) The Court also went on to find that even if the failure to contain a rate were not at issue, Rate CS still violated the Act because the rates negotiated pursuant to contracts would be treated as proprietary and not kept open to public inspection. (*Id.*, pp. 340-341)

The foregoing analysis of *Citizens* discloses that its holding is far more narrow than the AG and other parties suggest and, most importantly, inapplicable to the instant case which presents a tariff that is clearly distinguishable from the Rate CS tariff. First and foremost, although *Citizens* did strike down a tariff for the failure to contain a rate, *Citizens* did not involve the Commission’s authority to allow rider recovery of specific costs through a formula based rate. Indeed, the Court itself confirmed that it was neither presented with nor ruling upon the Commission’s authority to adopt formula based rates based on established parameters. (*Id.*, pp. 339-340) Thus, contrary to the AG’s assertion, *Citizens* in no way stands for the proposition that any tariff failing to state rates in terms of dollars and cents violates the Act. Indeed, the law in Illinois has long been held to be to the contrary. (*City of Chicago v. Illinois Commerce Comm’n*, 13 Ill. 2d 607, 611 (1958) (Rejecting challenge to Commission’s approval of automatic adjustment clause providing for changes in retail rates based on future changes in the price of wholesale gas because, *inter alia*, the Commission’s “statutory authority to approve rate schedules embraces more than the authority to approve rates fixed in terms of dollars and cents.”)) Second, unlike Rate CS, Rider CPP does contain clearly articulated parameters and does not allow ComEd the “unfettered right to establish any rate it so desires.” (See *Citizens*, 275 Ill. App. 3d at 339) Rather, the extremely detailed auction proposal establishes rules and procedures for the marketing of each solicitation,

bidder eligibility, credit requirements, contract terms, and bidder conduct to assure a fair and competitive auction; and requires ComEd to enter into supply contracts with the suppliers that offer the lowest prices for the needed supply. Finally, unlike Rate CS, both the formulas used to calculate retail rates pursuant to the resulting wholesale contracts as well as the retail rates so calculated will be open to public inspection.⁴

Response to ComEd

In this section of its Initial Brief, ComEd again addresses Section 16-111(i) of the Act. ComEd's brief again is not clear on whether ComEd is arguing that under the scenario where ComEd's cost to acquire electric power and energy is less than market, the Commission could allow ComEd to recover the market value plus 10%. (ComEd IB, p. 14) Under that scenario, for the same reasons as stated in Section III.A of this brief, ComEd can only be allowed to recover its cost and not the market value plus 10%.

C. Relationship of Illinois and Federal Law and Jurisdiction

Response to AG

The AG recognizes in this section of its Initial Brief that the Federal Energy Regulatory Commission ("FERC") has exclusive jurisdiction over wholesale electricity sales in interstate commerce. (AG IB, p. 14) Relying on Pike County Light & Power Co.

⁴ Staff has recommended that the informational filings containing the calculated retail rates as well as the supporting work papers be postmarked by the 20th of the filing month, and that any informational filing not meeting this deadline be accepted only if submitted as a special permission filing under the provision of Section 9-201(a) of the Act and 83 Ill. Adm. Code 255. (See Staff IB, pp. 170-175)

v. Pennsylvania Public Utility Comm'n, 77 Pa. Commw. 268, 465 A.2d 735 (1983), the AG also seeks to establish that states retain jurisdiction to examine the prudence of utility purchases of wholesale energy at FERC approved rates. (*Id.*) Staff agrees that states utility commissions are not prohibited from reviewing the prudence of a utility's purchases of wholesale power at FERC approved rates. However, as explained in more detail below, the ability of the Commission to review the prudence of wholesale power purchases subject to FERC jurisdiction is limited. The Commission should take this limitation into account in considering ComEd's proposal.

In this regard, the auction proposal tends to maximize the Commission's authority and jurisdiction to impact wholesale procurement decisions for inclusion in retail rates. This proceeding provides the Commission an extensive opportunity to have binding input into the rules, practices and procedures that will be utilized to procure wholesale power and energy for the provision of retail services. As these decisions will be made prior to the wholesale purchases, they necessarily avoid any conflict with the federal filed rate doctrine explained below. Further, these rules, practices and procedures identify the criteria ComEd's management will utilize to procure wholesale electric supply, and allow the Commission to engage in an upfront prudence determination. Conversely, rejection of the auction-based procurement process in favor of some other process that involves after-the-fact prudence reviews automatically raises the issue of whether there has been a violation of the filed rate doctrine whenever the Commission finds a wholesale purchase to be imprudent. While the Commission has authority to make such prudence determinations, those determinations must fit within the allowable parameters of the "Pike County" exception to the filed rate doctrine

discussed below. Staff submits that the Commission's ability to exercise its regulatory authority is likely to be more constrained and limited in the after-the-fact review and rejection process than under the upfront development and approval process proposed here.⁵

The federal "filed rate" doctrine is a rule of preemption that requires state utility commissions to give binding effect to wholesale rates filed with or approved by FERC. See Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 962 (1986); General Motors Corp. v. Illinois Commerce Comm'n, 143 Ill. 2d 407, 416-417 (1991), cert denied 504 U.S. 908 (1992), 112 S.Ct. 1936 (1992). Under the filed-rate doctrine, states are required to give effect to determinations made by FERC. Thus, state utility commissions may not question or alter a FERC approved wholesale rate or deny recovery of FERC-mandated costs that the utility cannot avoid. In setting intrastate rates, state public utility commissions must therefore permit regulated companies to recover costs and expenses that FERC has already established or approved. The court in Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n, 77 Pa. Commw. 268, 465 A.2d 735 (1983), recognized an important limitation on this aspect of the filed-rate doctrine, however, and determined that a state regulatory commission, in setting local rates, was not automatically required to use the cost of acquiring energy under a FERC-approved power purchase contract if the company had other supply options available to it. Cases applying what has been termed "the Pike County exception" have thus permitted state regulatory commissions to consider the prudence

⁵ The auction-based procurement process also provides the Commission an ongoing opportunity modify and improve that process based on experience and new developments.

of utility companies' decisions to enter into the underlying contracts and agreements, including transactions with affiliates.

In Nantahala Power and Light Company v. Thornburg, 476 U.S. 953 (1986), the United States Supreme Court held that under the filed rate doctrine, the North Carolina Utility Commission ("NCUC") could not reexamine in a retail rate proceeding the reasonableness of a FERC-mandated allocation to two affiliated companies of low-cost "entitlement" power from the Tennessee Valley Authority ("TVA"). The Supreme Court concluded that the filed rate doctrine applied to state action by virtue of the Supremacy Clause; and that once FERC sets a rate or makes a decision affecting such a rate, a State cannot conclude that the FERC-approved wholesale rate is unreasonable or interfere with FERC's plenary authority over interstate wholesale rates. Nantahala, 476 U.S. at 963, 966-967. Citing the Pike County decision, the Court noted that a utility's purchase of a particular quantity or power at FERC-approved rates could be deemed unreasonable if lower cost power were available from another source. Id., 476 U.S. at 972. However, because Nantahala's calculation of costs for retail rates already included all the low-cost power that FERC determined it was entitled to receive from the TVA, the determination that Nantahala had purchased an unreasonably large quantity of high-cost power from TVA conflicted with FERC's order no differently than a refusal to recognize a FERC-approved rate as reasonable. Id., 476 U.S. at 973.

The Supreme Court reaffirmed its view of the filed rate doctrine and the plenary authority granted FERC in Mississippi Power & Light v. Moore, 487 U.S. 354, 101 L.Ed 2d 322, 108 S.Ct. 2428 (1988). In Mississippi, a nuclear generating plant, Grand Gulf 1, was constructed to serve as a source of base load capacity for Mississippi Power and

Light Company ("MPL") and three other affiliated operating companies which participated in an integrated electric system. *Id.*, 487 U.S. at 358. FERC held that an agreement submitted to it by the affiliated companies for allocating the costs of Grand Gulf's power was discriminatory, and ordered MPL to purchase 33% of the output of Grand Gulf to achieve just, reasonable and non-discriminatory rates among the operating companies. *Id.*, 487 U.S. at 356, 361-363. The Mississippi Public Service Commission ("MPSC") subsequently granted MPL a rate increase to recover those costs, but was reversed on appeal by the Mississippi Supreme Court for not having first conducted its own review of the prudence of those costs.

The Supreme Court reversed the decision of the Mississippi Supreme Court and found that there was no room under the filed rate doctrine for the MPSC to make its own determination of reasonable costs after a mandatory allocation of those costs had been established by FERC:

... States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair. FERC-mandated allocations of power are binding on the States, and States must treat those allocations as fair and reasonable when determining retail rates.

Id., 487 U.S. at 371. The Court also held that it was not presented with the factual situation identified in Nantahala (i.e., the Pike County exception) where a state utility commission could find a utility's purchase of power to be unreasonable despite the fact that it was purchased at FERC-approved rates:

[I]t might well be unreasonable for a utility to purchase unnecessary quantities of high-cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for. Just as Nantahala had no legal right to obtain any more low-cost TVA power than the amount allocated by FERC,

it is equally clear that MP&L may not pay less for Grand Gulf power than the amount allocated by FERC.

Id. 487 U.S. at 373-374.

The Illinois Supreme Court has also endorsed the Pike County exception, but recognizes its limitation. In General Motors Corporation v. Illinois Commerce Comm'n, 143 Ill. 2d 407 (1991), the Illinois Supreme Court upheld the Commission's determination that it had no authority under the filed rate doctrine to conduct a prudence review of unavoidable FERC-mandated take-or-pay costs. The Court acknowledged, however, the ability of the Commission to conduct prudence reviews and deny recovery of gas costs incurred pursuant to FERC-approved rates in certain circumstances:

[Under the Pike County] exception to the filed rate doctrine [acknowledged by the Supreme Court] . . . States retain the authority to review the prudence of distributor's actions in incurring FERC-approved supply charges when the distributor had a choice whether to incur the charge. For example, a State regulatory agency could find that purchase of a particular quantity of power from a particular source was unreasonable if lower cost power was available elsewhere, even if the cost of the purchased power had been approved by FERC and therefore deemed reasonable.

That exception to the filed rate doctrine does not apply here, for the distributors in this case cannot avoid the current take-or-pay charges. As the appellate court acknowledged, the FERC-approved take-or-pay costs and the FERC-approved allocation of those costs are mandatory. Under orders issued by FERC, the distributors are liable to the pipelines for the take-or-pay costs regardless of any actions the distributors may take now or in the future, even if they cease purchasing gas from the pipelines imposing the charge.

General Motors, 143 Ill. 2d at 422 (citations omitted).

The Illinois Supreme Court subsequently considered the filed rate doctrine in United Cities Gas Co. v. Illinois Commerce Comm'n, 163 Ill. 2d 1 (1994), where the Commission had denied recovery of certain FERC-approved gas costs based on its finding that the utility's allocation of demand charges between its Illinois and Tennessee

service areas was imprudent. After reviewing its holding in General Motors, the Court rejected the argument that the Commission's decision violated the filed rate doctrine by trapping FERC-approved cost:

In the present case, the Commission did not rule that the Texas Eastern demand rate, which was approved but not mandated by FERC, was excessive or unreasonable. Rather, it was the percentage of that rate which United Cities allocated to its Illinois customers that the Commission did not approve. The filed rate doctrine does not require the Commission to allow United Cities to charge Illinois customers for costs exceeding those which are properly and prudently allocable to them. Had United Cities properly tracked its customers and sales, and updated the allocation percentages assigned in 1984, it would not face the potential of recovering less than 100% of its total costs of providing gas to its Tennessee and Illinois customers.

(*Id.*, p. 27)

The U.S. Supreme Court's decisions in Nantahala and Mississippi and the Illinois Supreme Court's decisions in General Motors and United Cities establish that state utility commissions have a limited ability to review the prudence of a utility's decision to purchase power at a FERC-approved rate. Federal Courts have also held that the filed rate doctrine applies to market based rates authorized by FERC. (See Town of Norwood v. New England Power Co., 202 F.3d 408, 419 (1st Cir. 2000)) While the AG is correct that the Commission is not prohibited by federal law from reviewing the prudence of ComEd's purchases of FERC approved wholesale costs, it is absolutely incorrect to suggest that the Commission's power to conduct such a prudence review is basically unfettered. (See AG IB, pp. 17-19) Indeed, to the extent that the AG is suggesting that the Commission should look at the costs of wholesale suppliers (including ComEd's affiliates) in determining whether wholesale supply costs were prudently incurred by ComEd, it is suggesting the very type of review (questioning the

reasonableness of the FERC-approved rate itself) that is prohibited by the filed rate doctrine and not encompassed within the Pike County exception.

An after-the-fact prudence review of wholesale power purchases as suggested by the AG would necessarily require some sort of proof that “lower cost power was available elsewhere” in order for a denial of recovery of wholesale power costs to pass muster under the filed rate doctrine. Staff submits that neither it nor any other governmental or consumer party will be particularly well-situated to present such evidence given that neither Staff nor any governmental or consumer party is likely to be directly involved in negotiating such arrangements or otherwise privy to such information. It would seem that such evidence would be hard to come by even for parties with access to that type of information. Ironically, the auction process itself is designed to determine the lowest cost power available to ComEd in a fair, open and transparent process. Staff submits that the foregoing analysis of the federal law and jurisdictional considerations submitted by the AG demonstrate that there are real concerns about the effectiveness of any process that embodies an after-the-fact prudence review of FERC-approved costs, and that the auction-based procurement process is better situated to effectuate effective Commission regulation of wholesale supply procurement decisions.

IV. SUFFICIENCY OF THE COMPETITIVE MARKET

Response to ComEd, AG, CCSAO and CUB

The AG, CCSAO and CUB all raise concerns with respect to the sufficiency of the competitive market. As Staff anticipated, ComEd tried to demonstrate in its Initial

Brief that many of these concerns were exaggerated or unfounded. Also, as Staff expected, the Company tried to demonstrate that the electric wholesale market is competitive enough that it can be relied upon as the sole source for utilities to obtain least-cost electric supply for retail customers. (Staff IB, p. 17)

However, Staff still believes that any deficiencies in the competitiveness of the **retail** electricity markets merely add to the urgency and importance of approving viable and appropriate procurement methods for electric utilities to implement. If consumers cannot rely on a competitive **retail** market, they should at least be able to rely upon their regulated public utilities to provide electric power. Deficiencies in the competitiveness of **retail** electricity markets, in and of themselves, are not useful in determining which procurement methods to implement. (*Id.*)

Thus, even if the concerns of AG, CCSAO and CUB with the competitiveness of the electricity market were fully justified, those concerns would not help the Commission choose a better method for procuring power and energy for retail customers. Further, the alternatives proposed by witness for the AG, CCSAO and CUB (i) still rely upon the same wholesale market, (ii) involve actions arguably outside the scope of the Commission's jurisdiction, (iii) involve actions arguably contrary to Illinois statutes, or (iv) are simply too vague and incomplete. (*Id.*, p. 19)

Finally, Staff recognizes that parties have concerns about the competitiveness of wholesale electricity markets. However, Staff does not see how those concerns eliminate the need for utilities to acquire power and energy from those wholesale markets. The concerns about the competitiveness of retail electricity markets only increase the need to approve viable and appropriate procurement methods for electric

utilities to implement. Thus, Staff recommends that the Commission ensure a viable procurement approach, and in Staff's view, the only viable approaches, at least in the near term, will rely on the wholesale market. (*Id.*, pp. 20-21)

C. Retail Market Conditions

Response to IIEC

The IIEC in its brief argues that "Illinois customers, and particularly large customers, currently are not getting full benefits of a competitive retail market." (IIEC IB, p. 10) The IIEC points to a disparity between the number of Retail Electric Suppliers ("RESs") serving customer in ComEd's service territory and the potential number of suppliers who might bid into the ComEd auction. (*Id.*). The IIEC argues then that until retail market conditions improve it is important that ComEd provide a fixed price option to customers 3 MW or greater pursuant to an annual auction. (*Id.*, pp. 12-13 and 38) Regardless of whether a customer is 3 MW or greater, Staff would point out again as it did in its Initial Brief that "any deficiencies in the competitiveness of the retail electricity markets merely add to the urgency and importance of approving viable and appropriate procurements methods for electric utilities to implement, since consumers who cannot rely on a competitive retail market should at least be able to rely upon their regulated public utilities to supply them with electric power. Deficiencies in the competitiveness of retail electricity markets, in and of themselves, say absolutely nothing about which procurement methods are appropriate for electric utilities to implement." (Staff IB, p. 17) With respect to any further discussion on customers 3 MW or greater, Staff discusses that issue in Section V., I., 3.

F. Market Characteristics, Including Supplier Concentration

Response to ComEd

ComEd in its Initial Brief criticizes Professor Sibley's claims that generation capacity in Illinois is concentrated. ComEd further argues that Professor Sibley erroneously concluded that a wholesale market problem exists. (ComEd IB, p. 53) ComEd goes on to argue that Professor Sibley's contentions about concentration are irrelevant. (ComEd IB, p. 54) While Professor Sibley's testimony on the state of the wholesale market and generation capacity is well supported in the record, Staff acknowledged in its Initial Brief that it does not see how some parties' concerns about the competitiveness of wholesale markets eliminate the need for utilities to acquire power and energy from those wholesale markets. Any concerns about the competitiveness of retail electricity markets increases, rather than decreases, the need to approve viable and appropriate procurement methods that electric utilities should implement. (Staff IB, p. 20) Therefore, Staff would reiterate that "[t]he Commission must ensure a viable procurement approach, and in Staff's view, the only viable approaches, at least in the near term, will rely on the wholesale market." (Staff IB, p. 21) ComEd also criticized Professor Sibley's position that auction rules, i.e., auction volume adjustments, could fix the market concentration concerns. (ComEd IB, p. 54) As stated in Staff's Initial Brief, while the proposal of Professor Sibley is well intentioned and theoretically correct, there is no practical method of implementing Professor Sibley's proposal. Therefore, "Staff is reluctant to imbue the Auction Manager (or the Staff) with the power to cut back auction volumes, unless it is extremely clear that such reductions

will benefit ratepayers.” Staff therefore, recommended to the Commission that it accept Dr. LaCasse’s position with respect to limitations in the use of volume cutbacks. (Staff IB, pp. 44-45)

V. AUCTION DESIGN ISSUES

A. General Effectiveness and Suitability

Response to AG

The AG claims that ComEd’s proposed auction is ill-suited for Illinois because (1) AG witness Reny’s proposal, which involves multilateral negotiations or an auction with a reserve price, could be expected to result in lower prices than ComEd’s proposal (AG IB, p. 53), (2) low cost generation producers, such as nuclear and coal, can obtain prices based on the costs of higher priced generation (*Id.*), and (3) ComEd’s auction format produces undue risks to consumers by holding a single, annual auction for multi-year supply (*Id.*).

With respect to the AG’s first argument, Staff addresses the flaws in Dr. Reny’s proposal in Section V.D.2. of its Initial Brief and continues to recommend that the Commission reject Dr. Reny’s proposal. (Staff IB, pp. 64-69) Staff once again notes that the AG did not file Dr. Reny’s testimony until the rebuttal stage, thereby depriving all parties, except ComEd, of the ability to respond to his proposal.

The AG’s second argument claims that low cost generation producers, such as nuclear and coal, can obtain prices based on the costs of higher priced generation. The implication is that the low cost providers are manipulating the market to obtain prices

based on the cost of higher-priced generation. However, that simply is not the case. As stated by ComEd witness Hogan:

The efforts to draw attention to the concentrations within the ComEd control area or Northern Illinois imply that Exelon would seek to exercise market power in the PJM spot markets through the generating units formerly owned by ComEd. But Exelon's generation in the Illinois region consists mostly of must-offer/must-run nuclear facilities. Nuclear plants are never offered for dispatch; in every RTO, nuclear plants are routinely self-scheduled with the RTOs in the day-ahead and real-time markets. As self-scheduled plants, they are price takers, not price setters. It would not be typical for them to bid as easily dispatchable plants, but if for some unknown reason they engaged in uncompetitive bidding behavior to raise market prices, they would risk not being dispatched and having to shut down. There are serious safety and operational reasons, as well as financial and regulatory consequences for any nuclear plant owner that engages in such behavior. Nor would it be reasonable for the owner of a nuclear unit to deliberately withhold its capacity from the day-ahead and real-time markets in an attempt to raise prices. In addition to losing revenues for energy (and having to purchase replacement energy from the market to cover its obligations), under the PJM rules any withholding would subject the owner to substantial penalties and loss of capacity payments for the withheld capacity.

(ComEd Exhibit 16.0 Revised, p. 23, lines 487-504) Further, there is nothing in the record to suggest otherwise.

Finally, the AG's argument that ComEd's auction format produces undue risks to consumers by holding a single, annual auction for multi-year supply must be rejected.

(AG IB, p. 54) As noted by ComEd witness LaCasse:

ComEd has a need to buy 100% of requirements for the period beginning January 1, 2007. This is an unavoidable result of the transition plan. The proposed auction provides for a transition to laddering. However it can't be changed that 100% of ComEd's position is open as of January 1, 2007.

(ComEd Ex. 19.0 Corrected, p. 95, lines 2080-2084) Dr. LaCasse further explains that there is no benefit to spreading out the risk over multiple auctions because it would impact how bidders bid leading to unpredictable results that do not reflect the economic value of the auction product. (*Id.*, lines 2136-2140) Further, it appears that the AG's

complaint is with the legislation and not the auction. Such a position is neither helpful nor useful in determining whether the Commission should approve ComEd's auction proposal.

Response to CCSAO and CUB

The CCSAO states that "it is not making any recommendations on auction design at this time." (CCSAO IB, p. 28) However, based on the conclusions of CUB/CCSAO witness Steinhurst, it does recommend that the Commission reject ComEd's proposal. It notes ComEd's failure to demonstrate what rates can be expected under either its own auction proposal or Dr. Steinhurst's proposal of active portfolio management (the implication being that ComEd does not know its proposal would result in the lowest rates). (*Id.*, p. 31) The CCSAO then states the auction has not been proven in this proceeding to meet the requirements of the PUA. In its Initial Brief, CUB recommends Dr. Steinhurst's proposal. (CUB IB, pp. 23-26)

Staff addressed the flaws in Dr. Steinhurst's active portfolio management approach in Section VI.A. of its Initial Brief. (Staff IB, pp. 126-133) Staff continues to recommend that the Commission reject this approach in favor of ComEd's auction proposal. In fact, CUB/CCSAO Steinhurst testified that competitive procurement processes can provide useful market intelligence to a utility. The benefits such processes provide include, but are not limited to, (1) stimulating demand for product, (2) stimulating supply of products, and (3) in some situations, reducing transaction costs. (Common Tr., p. 489)

Further, the record does not prove that better results would be achieved under active portfolio management. The record appears to show the opposite. As Staff noted in its Initial Brief (p. 131), Dr. Steinhurst indicated during cross examination that he had been the Director for Regulated Utility Planning at the Vermont Department of Public Service and was in charge of Vermont's energy planning (which Staff assumes is akin to active portfolio management) for 14 years before leaving in 2003. (Common Tr., pp. 466-467) When asked if at the time he left the Department, Vermont's retail electric rates were over ***"40 percent higher than the national average,"*** he admitted, "I don't remember the precise number, but they were well above the national average at the time." (Common Tr., pp. 469-470)

Further, Staff is concerned with the CCSAO's position recommending the rejection of ComEd's proposal without providing a well-defined alternative. With just a year before ComEd's existing supply contracts are to expire (December 31, 2006), the CCSAO recommends that the Commission should open a new docket to evaluate procurement alternatives. (CCSAO IB, p. 29) The CCSAO's recommendation to essentially defer the immensely important issue of how ComEd should and will procure its electric supply post-2006 creates pointless and ill-advised uncertainty. As the CCSAO argument is reminiscent of arguments made by the AG, see Staff's discussion in Section II above.

Finally, the Commission should reject the CCSAO statement that the auction has not been proven in this proceeding to meet the requirements of the PUA. Staff notes that the CCSAO makes this general statement without any legal support. Staff

addresses why ComEd's proposal meets the requirements of the PUA in Sections II and III above.

Thus, based on the foregoing, the Commission should reject the recommendation of the CCSAO and CUB, and approve ComEd's auction proposal with revisions supported by Staff.

B. Full Requirements Product

Response to AG

The AG argues that ComEd's proposal for full requirements, load following contracts would put "the risk of volume fluctuation exclusively on the supplier, and each supplier will build the risk of this uncertainty ... into their bids by including a risk premium." (AG IB, p. 55) The AG recommends a more diversified contract mix, which would minimize the risk premium and provide more flexible purchasing strategy. (*Id.*)

It appears that the AG is recommending active portfolio management as opposed to ComEd's proposed full requirements product. Staff addressed the active portfolio management approach in Section VI.A.3 of its Initial Brief. (Staff IB, pp. 126-133) Staff expresses several concerns with this approach, namely, (1) the amount of discretion that active portfolio management places with the utility company (*Id.*, p. 130); (2) the fact that there is no hard evidence to support the claims made by AG witness Salgo and CUB/CCSAO witness Steinhurst supporting active portfolio management (*Id.*, p. 131) and (3) the flexibility that is afforded by active portfolio management is available to all suppliers and is not just a utility advantage (*Id.*, pp. 131-132).

Although the AG asserts that risk premium could be more effectively managed (AG IB, p. 55), the fact is that CUB/CCSAO witness Steinhurst would not even firmly recommend the use of active portfolio management under a regulated plan process. (Staff IB, p. 128) The record fully supports the use of a full requirements product. (*Id.*, pp 30-31) Thus, Staff continues to recommend that the Commission approve the basic full-requirements product concept in this docket

C. Multiple Round Descending Clock Format

1. Load Caps

Response to IIEC

IIEC argues that the imposition of a load cap is that efficient suppliers, who are able and willing to provide large quantities of electricity at prices lower than their competitors, would be artificially constrained in the amount of low-cost power and energy they would be allowed to supply. (IIEC IB, pp. 13-14) However, as ComEd pointed out in its Initial Brief, IIEC's witness Collins acknowledged that different hypotheticals could be constructed under which the absence of a load cap would produce higher prices. (Common Tr., p. 151) (ComEd IB, p. 79) Staff's Initial Brief pointed out the rationale for a load cap, citing to the testimony of ComEd witnesses McNeil and LaCasse and Staff witnesses Salant and Sibley. (Staff IB, pp. 31-35) ComEd witness McNeil testified that a load cap promotes participation in the auction, is an essential element of attracting non-incumbent suppliers to compete; and it results in customers needs being served by a mix of suppliers and prevents gaming of the auction. (Staff IB, pp. 32)

The IIEC also disagrees with ComEd's assertion that a load cap is necessary to limit credit or performance exposure to any supplier. IIEC asserts that a load cap at any level would be ineffective in mitigating default risk. (IIEC IB, pp. 22-23) Staff disagrees. Similar to determining the proper level of credit requirements, imposing a load cap involves a risk trade-off, as illustrated by the following example. Imposing IIEC's proposed 100% load could result in one supplier providing 100% of ComEd's energy supply. Under ComEd's proposed SFC, a supplier rated BBB-/Baa3 by the credit rating agencies would be extended a \$15 million unsecured credit limit. As power prices fluctuate, ComEd's sole supplier would be required to post margin for the total mark-to-market exposure amount in excess of the \$15 million credit limit. In contrast, a 35% load cap requirement could result in three suppliers providing 100% of ComEd's energy supply. If credit rating agencies rate each of those suppliers BBB-/Baa3, then each supplier would be allowed a \$15 million unsecured credit limit under ComEd's proposed SFC. That is, a 35% load cap could result in ComEd extending \$45 million of unsecured credit to suppliers. Thus, under a 35% load cap, ComEd could have less collateral on hand should the suppliers default.

On the other hand, the risk that all three suppliers would simultaneously default is less than the risk of a single supplier defaulting. Since the credit requirements do not provide 100% protection to bundled service customers from rising energy prices in the event of a supplier default (ICC Staff Ex. 1.0, p. 95, lines 2148-2156), diversification against supplier default is valuable.

In summary, without a load cap, ComEd could have more collateral on hand than it would with three individual suppliers. However, there is greater risk that one supplier

would default than three would default simultaneously, as could occur under a 35% load cap. As far as risk is concerned, since there is a potential trade-off in benefits in imposing a load cap, judgment is required to determine which is the better policy for bundled service customers. Staff believes that diversification of supply is an important risk management tool.

For these reasons, Staff recommends that the Commission reject the IIEC's proposal for the elimination of the load caps, and that the Commission approve the use of a 35% load cap per auction.

2. Starting Prices

Response to AG

The AG argues that the failure to state starting prices “renders Rider CPP unlawful just as the CS proposal, which would have allowed ComEd to negotiate certain rates without stated standards or [sic] review, was found unlawful by the court in Citizens Utility Board v. Illinois Commerce Commission.” (AG IB, pp. 56-57)

In Section III.B., above, Staff addresses the AG's flawed application of Citizens Utility Board v. Illinois Commerce Commission and why it must be rejected. Further, the suggestion to develop starting prices or a range for the starting prices a full year prior to the auction is nonsensical and perhaps demonstrates the AG's lack of understanding of the auction process. As Staff witness Salant stated in discussing risks associated with a simultaneous multiple round auction format,

One example is the risk posed by limited bidder participation. **Bidder participation may be limited due to unrealistic starting prices** or poorly planned or executed promotion efforts.

(ICC Staff Exhibit 1.0, p. 21, lines 464-466) (emphasis added) As ComEd witness LaCasse stated with respect to the mechanics of determining starting prices:

- a. The minimum and maximum starting prices will be developed considering **recent** market data.
- b. These market data would include energy forward prices for standard products, capacity market data as available, congestion and wholesale transmission rates.
- c. The round 1 prices would take the indicative offer data into account.

(ComEd Ex. 11.0 Revised, p. 81, lines 1921-1927) (emphasis added) With respect to indicative offer data, Dr. Salant explains,

Prior to an auction, the Auction Manager publicly posts the following information: data pertaining to the supply to be procured (e.g., historical load profiles and customer switching data), the number and size of tranches in each auction, the load cap (i.e., the maximum number of tranches a bidder can bid on and win), and the maximum and minimum starting prices (for Round 1 of an auction) for each product.

...

The Auction Manager provides each qualified bidder with a list of all qualified bidders. All qualified bidders are required to file "Part 2" applications that include their "indicative offers" (i.e., the total number of tranches a bidder wishes to serve at (1) the maximum starting prices for all products and (2) the minimum starting prices for all products). Each bidder's indicative offer at the maximum starting price for all products determines its "initial eligibility," i.e., the maximum number of tranches that the bidder is able to bid for in any round of the auction.

...

The Auction Manager provides each registered bidder with a list of all registered bidders, a measure of the total initial eligibility in the auction, and the Round 1 prices (i.e., starting prices) for that auction.

(*Id.*, p. 22, lines 486-492; pp. 22-23, lines 498-506; p. 23, lines 514-516) Dr. Salant further adds that certain types of information disclosures prior to an auction may assist an auctioneer in determining the appropriate auction starting prices. (*Id.*, p. 47, lines 1072-1074)

Thus, to provide starting prices or a range of prices a year before the auction would not only be premature but also harmful to bidder interest and participation in the auction. Therefore, Staff recommends that the Commission reject the AG's argument.

5. Portfolio Rebalancing

Response to ComEd

ComEd argues against Dr. Salant's proposal to allow the Auction Manager to "readjust the auction product volumes, increasing volume for products with excess supply and decreasing it for products with limited supply offers." (ComEd IB, p. 82) Dr. Salant while acknowledging some disadvantages to portfolio rebalancing believed the advantages outweighed them (ICC Staff Exhibit 11.0 Corrected, pp. 52-57). Therefore, he recommended in rebuttal that the Auction Manager be authorized to utilize portfolio rebalancing only after consultation with Staff and that there be a consensus between the Auction Manager and Staff that such action would be appropriate. (Staff IB, p. 47) Given the above, Staff recommends that the Commission not reject Dr. Salant's portfolio rebalancing proposal but rather (1) authorize the Auction Manager to utilize the option only after consulting with Staff and that Staff and the Auction Manager must reach a consensus that its use would be appropriate and (2) direct the Auction Manager, Staff and the Auction Advisor to devise prior to the auction an appropriate protocol for carrying out portfolio rebalancing. (Staff IB, p. 48)

8. “Price taker” Proposal

Response to ComEd

ComEd in its Initial Brief recommended that Staff witness Salant’s “price taker” proposal be rejected given that it could jeopardize the openness of the auction and impact wide participation in the auction. (ComEd IB, p. 87) Staff in its Initial Brief stated that the price taker option was unlikely to have much of an effect on the auction, either in the positive or the negative, and therefore, that Staff was ambivalent toward the proposal at this time. Staff further added that since suppliers could sell their power to other bidders or into the PJM markets, or in other bilateral markets, the price taker option is not necessary for consumers to gain access to low-cost power. Staff therefore, recommended that the Commission not order ComEd to incorporate the price taker option into the auction at this time. (Staff IB, p. 58)

9. Other Format Concepts and Issues

Response to ComEd

ComEd in its Initial Brief states that ComEd has accepted many of Dr. Salant’s suggested changes to ComEd Ex. 10.1, the Content of the Confidential Staff Report concerning the auction results. (ComEd Ex. 19.0, as revised in ComEd Ex. 19.6) (ComEd IB, p. 88) While ComEd accepted many of the suggested changes to ComEd Ex. 10.1, there are two changes that Dr. Salant proposed that were not accepted by ComEd which Staff has concerns. Those changes appear in Section 2, question 10 and Section 4 of ComEd Ex. 19.6. While Staff’s Initial Brief stated that “Staff believes that the details of the Staff Report outline have been adequately resolved.” (Staff IB, p. 77),

Staff's understanding of the intent of the subject language contained in ComEd Ex. 19.6 has become greater after Staff reviewed the Initial Briefs of CCG and MSCG on this general subject matter. (See V.L.2, below) It is now clear to Staff that ComEd, CCG, and MSCG want to restrict the Commission's right to exercise discretion with respect to the approval of the auction results.

With respect to question 10 in Section 2, Dr. Salant recommended that the question read: "Did Staff receive the same access to data as the AM [Auction Manager]?" (ICC Staff Exhibit 11.0 Corrected, Appendix 1) ComEd in its surrebuttal testimony suggests the following question instead: "Did Staff receive the same round result data as the AM?" The reason for the change given by ComEd is "Staff will have full and timely access to necessary data, but it may not be practical to provide Staff with exact same method of data access." (ComEd Ex. 19.6) In order to be able to ensure the competitiveness and integrity of the auction process, Staff believes that it should have the same method of access to data as the auction manager. On cross examination, ComEd witness LaCasse agreed that Staff should be given access to data and that it was possible for Staff to have some sort of real time access to the same data as it is coming into the Auction Manager. (Common Tr., p. 943) ComEd's proposed change seems to be contradictory with that testimony. ComEd's proposed language would seem to prevent Staff and the Auction Advisor from having access to the same computer screens that the Auction Manager is looking at during the course of the auction process. Furthermore, the Auction Manager's opinion of what is necessary data may differ from Staff's and its Auction Advisor's opinion and therefore, the language

suggested by ComEd may impose a restriction on Staff and its Auction Advisor in their ability to assess the competitiveness and integrity of the auction process.

With respect to Section, 4, Dr. Salant recommended that the section read as follows:

The Staff will detail any issues or concerns and any recommendations the Staff has regarding further action by the ICC. The Staff will base its recommendations for further action upon the answers to the questions described in Sections 1 through 3, as well as any other answers to questions that Staff may incorporate into its report.

(ICC Staff Exhibit 11.0 Corrected, Appendix 1)

ComEd in its Surrebuttal suggested the following modifications:

The Staff will detail any issues or concerns and any recommendations the Staff has regarding further action by the ICC. The Staff will base its recommendations for further action upon the answers to the questions described in Sections 1 through 3, as well as any other answers to questions that Staff may incorporate into its report in connection with Section 2, the Evaluation of the Conduct and Competitiveness of the Auction.

If all questions are answered as to indicate a valid result it is expected that Staff will recommend no further investigation of auction. If some questions are not so answered, Staff will review the materiality of such exceptions in the context of the entire Auction and will have the authority to recommend for or against further action.

(ComEd Ex. 19.6, comments omitted) ComEd's reasoning for the proposed changes to Dr. Salant's language was "to avoid giving bidders [the] impression that approval criteria are wide open[,] added question limited to this section.." ComEd fails to recognize that it is the Commission, not Staff, that is the decision maker on whether the auction results should be accepted or rejected. Staff and its Auction Monitor are not the decisionmakers; however, Staff and the Action Monitor should have the flexibility to adopt its evaluation of the auction process as the circumstances warrant so that it can

provide the Commission with all potential relevant information. Such flexibility is acknowledged by ComEd in its acceptance of the lead-in language to Section 2's questions that "The questions shall include, but need not be limited to, the following:" (ComEd Ex. 19.6)

Despite ComEd's objection, ComEd's proposed language would prevent Staff from considering answers to questions that may arise during the auction process that are relevant but not in connection to Section 2 ("I believe that an open invitation to add any question as the language added by Dr. Salant to Section 4 extends, would create substantial uncertainty for bidders and that the change should be clarified to apply the questions that may be added in Section 2" (ComEd Ex. 19.0, p. 77)). It is impossible to foresee every circumstance that may arise during the pre-auction process and most certainly unknown outside events. As a result, Staff should have flexibility when preparing its report for the Commission. In addition, given the fact that it is the Commission, not Staff, that makes the final determination concerning the auction process, Staff cannot agree that adopting its language for Section 4 of the Staff Report would somehow "create substantial uncertainty for bidder" as ComEd suggests. Therefore, Staff's proposed language concerning Section 2, Q. 10 and Section 4 as set forth in Staff Ex. 11.0, Appendix 1 should be adopted.

D. Clearing Price: Uniform vs. Pay-As-Bid

Response to AG

The AG rejects both uniform clearing price and pay and bid auction formats in favor of Dr. Reny's recommendation of multilateral negotiations or a reserve price in an auction.

Staff addresses the flaws in Dr. Reny's proposal in Section V.D.2. of its Initial Brief and recommends that the Commission reject Dr. Reny's proposal. (Staff IB, pp. 64-69) Also, see Staff's response in Section V.A. above.

Response to BOMA

In its Initial Brief, BOMA sets forth seven reasons why its pay as bid auction as proposed by its witness Dr. Arthur B. Laffer is superior to ComEd's proposed uniform, market clearing price auction. First, after stating that the record evidence supports the pay as bid auction, BOMA claims that its "approach will result in the most competitive auction possible and therefore the lowest possible market-determined ComEd charges to customers." (BOMA IB, pp. 4-6) Second, BOMA argues that Dr. Laffer's pay as bid auction correctly allows bidders to bid as low as they desire as opposed to stopping the auction at the uniform, market clearing price. (*Id.*, pp. 6-9) Third, BOMA claims that Dr. Laffer's approach will provide sufficient electricity supply to ComEd. (*Id.*, pp. 9-10)

Fourth, BOMA argues that Dr. Laffer's approach correctly denies information to bidders relating to the amount of excess supply being bid in the auction, which will result in lower supply charges paid by ComEd and ultimately customers. (*Id.*, pp. 11-14) Fifth, BOMA claims that Dr. Laffer's pay as bid approach will reduce the opportunity for bidders to exercise market power. (*Id.*, pp. 14-15) Sixth, BOMA claims that such

auctions have been previously been used successfully for electricity and other products. (*Id.*, pp. 15-16) Finally, BOMA claims that ComEd's proposed auction violates the Illinois Public Utilities Act ("Act"). (*Id.*, pp. 16-17)

In its Initial Brief, Staff effectively addressed why BOMA's first six arguments must fail. (Staff IB, pp. 59-64) However, Staff would like to address several statements made by BOMA in its Initial Brief as well as BOMA's final argument. First, BOMA states

The record evidence establishes that in all likelihood Dr. Laffer's proposed pay as bid approach will result in ComEd paying a lower price for its electricity supply than ComEd's proposed uniform price method.

(BOMA IB, p. 4) Staff supposes that if the evidence that BOMA submitted in this proceeding is viewed in a vacuum, then such a statement would be accurate. However, the plethora of evidence in the record that BOMA fails to mention not only refutes Dr. Laffer's pay as bid approach but provides sound basis for rejecting it. (Staff IB, pp. 59-64) In fact, such evidence includes testimony by experts in economics, electricity markets and auctions and experts with experience in designing, implementing, monitoring and managing electricity auctions. (*Id.*, pp. 61-62) Dr. Laffer admits he is not an expert on either electricity markets or auctions. (*Id.*, p. 60)

Further, the record fails to include any scholarly articles or empirical studies to support Dr. Laffer's approach. (Staff IB, p. 62) As Staff witness Salant notes

Dr. Laffer fails to demonstrate that his proposal would lead to lower rates for Illinois ratepayers. In fact, the extensive literature on the type of auction suggested by Dr. Laffer tends to support the opposite conclusion. As noted above, Dr. Laffer's proposal is strategically equivalent to an auction where bidders submit supply functions. What the literature shows is that supply function auctions can result in indeterminate outcomes and in prices that can significantly exceed costs.

(ICC Staff Exhibit 11.0 Corrected, pp. 75-76, lines 1713-1726) (citations omitted) Thus, to the contrary, the evidence in the record does not establish in all likelihood that Dr.

Laffer's proposed pay as bid approach will result in ComEd paying a lower price for its electricity supply than ComEd's proposed uniform price method.

Second, in its Initial Brief, BOMA states

... it is clearly not necessary to protect bidders in the ComEd auction from so-called "winner's curse" by providing them information on the amount of excess supply being bid during the course of the auction.

(BOMA IB, p. 14) Let's reexamine the definition of winner's curse. According to *well known* auction literature, "bidders in common value auctions are subject to 'winner's curse,' whereby a winning bidder may discover it won because it had the most optimistic estimate of a product's value or a product's opportunity cost." (Staff Exhibit 11.0 Corrected, p. 73, lines 1659-1663) The common value in ComEd's auction is that bidders will likely have similar opportunities to sell power outside the auction. (*Id.*, p. 72, lines 1643-1646) Dr. Salant explains

Hence, the number of tranches a bidder offers in the auction depends, for example, on that bidder's expectation of future prices in other PJM markets since supply not sold via the auction may be sold in other PJM markets. Thus, a bidder may bid in the auction as long as the auction price exceeds the bidder's expectation of future prices in the PJM spot markets; once the auction price falls below a bidder's expectation of future prices in the PJM spot markets, that bidder may stop bidding in the auction. However, **different bidders may have different expectations about future prices in PJM spot markets, and information on other bidders' bidding (via the measure of excess supply reported to bidders under ComEd's proposal) provides useful information about other bidders' expectations regarding future prices in the PJM spot markets.**

(*Id.*, p. 73, lines 1647-1658) (emphasis added) Thus, bidding in the auction appears to go beyond labeling a bidder as being sophisticated. (BOMA IB, p. 13) Since sophisticated bidders such as Morgan Stanley perform such product analyses as to value and opportunity costs, they are not immune from the winner's curse. In fact when

asked at hearing whether sophisticated bidders like Morgan Stanley need to be protected from winner's curse, Dr Salant testified

A. I believe that these types of bidders could benefit from the protection or from the information disclosures in an open descending auction or a descending price auction.

Q. So to clarify, I just want to make sure that that's responsive, you agree that these types of bidders need to be protected from the so-called winner's curse -- yes or no?

A. Economists don't understand need. You know, there's always a price for need, so if I reinterpret your word need more in line with what we use in economics as having a positive benefit to those bidders, I'd say yes, it does have a positive -- an open simultaneous descending clock auction would have a positive beneficial effect for those bidders.

Q. And does this beneficial effect mean that they'll get a higher price from the auction?

A. No.

(Common Tr., p. 1083, lines 2-20)

To guard against the winner's curse, these bidders change their bidding behavior by reducing their estimate of a product's value or increasing their estimate of a product's opportunity costs. (ICC Staff Exhibit 11.0 Corrected, pp. 73-74, lines 1663-1666) Disclosing excess supply information to bidders during the auction mitigates the risk related to the winner's curse. As noted by Staff witness Salant,

... Dr. Laffer fails to consider that in an iterative, multiple round auction, bidders learn about other bidders' expectations regarding the opportunity cost participating in ComEd's auction over time (via reports of the excess supply in the previous round), and that this information helps mitigate bidders' concerns regarding the winner's curse.

(*Id.*, p. 74, lines 1667-1676) Providing the information and the opportunity to avoid the winner's curse, bidders will bid more aggressively under ComEd's proposed auction as opposed to Dr. Laffer's pay as bid approach. (*Id.*, lines 1672-1674) Thus, Dr. Laffer's

approach, which denies bidders the excess supply information during the auction, does not necessarily lead to lower final auction prices or lower rates for Illinois ratepayers. (*Id.*, lines 1674-1676) In fact, it may result in exactly the opposite.

ComEd witness LaCasse also explained the necessity of dealing with winner's curse at the auction when questioned by ALJ Wallace at the hearing:

Q. Are you familiar with Paul Klemperrer of, I believe, Oxford University?

A. Yes.

Q. Do you agree that he makes the statement in one of his papers that buyers must bid more conservatively the more bidders there are because there is a greater winner's curse? Number one, do you agree that there is a winner's curse in these types of auctions?

A. Yes. So when there is a larger number of bidders, that means that if you are winning, you get more bad news because it means you are the most optimistic of a bigger pool of bidders. And that's one. Number of bidders is an influence as a bidder that would make you more cautious. But also having more bidders means that you want to be more aggressive in bidding against them. So there is two influences in the number of bidders and Professor Klemperrer is right that one of those is the winner's curse that makes you a little bit more cautious.

Q. So then he goes on to say that adding more supply creates more winners and so reduces the bad news learned by winning. Do you agree with that?

A. Yes.

Q. And is that -- this is a really bad economic term -- is that figured into the proposal?

A. Yes. What he is alluding to is one of the reasons to provide bidders with information. Because to a certain extent having that information reduces their uncertainty and reduces to a certain extent or mitigates to a certain extent what he calls the winner's curse.

(Common Tr., pp. 988-989) Thus, Staff recommends that the Commission reject BOMA's proposal to not disclose excess supply information during the auction.

Third, BOMA states in its Initial Brief

As Commission Staff witness Dr. Salant testified, Dr. Laffer's pay as bid proposal could reduce the opportunity for bidders to exercise market power in the auction. (Joint Tr. Pg. 1078, ln. 5-11)

(BOMA IB, pp. 14-15) BOMA states that its conclusion regarding market power is another reason why the Commission should adopt Dr. Laffer's pay as bid approach. (*Id.*, p. 15) However, Dr. Salant qualifies his statement regarding market power as follows:

Although Dr. Laffer's proposal could reduce the opportunity for bidders to exercise market power in the auction, it does not necessarily follow that "[p]aying one single market clearing price to all winning bidders ensures that ComEd will procure its electricity supply at the highest price" [or that] ... to continue done the supply schedule, the cost will surely be lower to consumers." (BOMA Exhibit 1.0, p. 13, lines 284-287)

(ICC Staff Exhibit 11.0 Corrected, p. 75, lines 1699-1704) Dr. Salant explains that Dr. Laffer's conclusion does not follow from his analysis because he does not consider two key advantages of ComEd's proposal: (1) "bidders in common value auctions will bid more aggressively when their concerns regarding winner's curse are mitigated"; and (2) "allowing bidders to switch between products in order to arbitrage observed price differentials will likely lead to more efficient outcomes (i.e., lower auction prices)." (*Id.*, lines 1704-1712) In fact Dr. Salant states that Dr. Laffer does not demonstrate that his proposal would lead to lower rates for Illinois ratepayers and extensive literature on such an approach supports the opposite conclusion. (*Id.*, lines 1713-1715) Therefore, Staff in no way endorses BOMA's conclusions relating to market power.

Finally, BOMA argues that ComEd's uniform price approach violates the Act. (BOMA IB, pp. 16-17) Specifically, BOMA alleges that ComEd's approach violates the Act's least cost requirement contained in Section 8-401 (220 ILCS 5/8-401). Thus, the pass-through of these costs to customers would violate the Act's requirement that a

utility's rates be just and reasonable. (*Id.*) However, as indicated above, the record demonstrates that it is BOMA's pay as bid auction that would lead to a violation of the least cost requirement causing ComEd's rates to not be just and reasonable. Thus, as Staff stated in its Initial Brief, based upon the record, the Commission should reject BOMA's pay as bid auction proposal and find instead that Rider CPP (with modifications supported by Staff) would result in just and reasonable rates. (Staff IB, pp. 203-206)

E. Auction Management

1. Auction Manager

Response to ComEd

ComEd's Initial Brief set forth that Dr. Chantale LaCasse is recognized as an expert on auctions, has extensive experiences in the area and has acted as Auction Manager for each of the New Jersey Basic Generation Service auctions. ComEd also points out that ComEd and Ameren are jointly proposing that Dr. LaCasse be retained for that purpose. (ComEd IB, p. 96) Staff in its Initial Brief acknowledged that Dr. LaCasse is competent to be the Auction Manager. However, Staff notes that it has concerns over the independence of whomever ComEd and Ameren hires as the Auction Manager. The concern over the independence was due to the fact that both ComEd and Ameren would have affiliates who could be bidders in the auctions. (Staff IB, p. 69) However, Staff also states that the independence/conflict of interest problem would not go away if ComEd used some other type of approach to obtain power given that the same affiliates could be involved in those approaches as well. Notwithstanding its concerns over the Auction Manager's lack of complete independence from ComEd and

Ameren, Staff recommends that the Commission approve ComEd's proposal to hire an Auction Manager. Staff comes to this conclusion because, in many respects, the Commission (rather than the Auction Manager) is defining the auction process through this proceeding, and even where discretion can be exercised, Staff (along with its advisor) will be able to monitor and have input on various Auction Manager functions. (Staff IB, p. 74)

3. Role of Staff

See Section V.C.9, above.

4. Representation of Consumer Interests / Separate Consumer Observer

Response to ComEd

ComEd, citing to the significant regulatory oversight by the ICC and its Staff that would be present at all phases of the auction process to assure that the interests of consumers are promoted and protected, argues that the addition of a separate consumer advocate is unnecessary and duplicative. (ComEd IB, p. 97-98) While Staff accepts the responsibility for observing and assessing the auction as a neutral party, Staff takes no position on the proposal for a separate "Consumer Observer" (Staff IB, p. 79)

F. Date of Initial Auction

All parties, except, apparently the CES, support or do not oppose a September 2006 auction date. However, even CES now acknowledges that a "September auction

might be reasonable in light of ComEd's other proposed changes," and that "[g]iven ComEd's other revisions to the other portions of its proposal, it might be reasonable for the Commission to decide that the initial auction should be held in September, 2006." (CES IB, p. 17 and p. 22)

There are ample reasons to hold the initial auctions in September 2006. First, while ComEd and the Ameren Companies initially proposed different months for the initial auctions, the utilities now have agreed to hold a joint auction. A joint auction will likely result in the most efficient auction and the lowest rates for ratepayers. (ICC Staff Exhibit 1.0, p. 7, lines 157-160) Second, holding the auction later in 2006 will provide the Auction Manager and potential bidders additional time after the Commission's order in this proceeding to become familiar with auction rules and processes and to test auction software and hardware. (Staff IB, p. 81) Third, ComEd's proposal to allow CPP-A customers that have taken bundled for at least one year and all customers under 400 kW to switch to RESs during the supply period should mitigate concern that customers will not have sufficient time after the close of the auctions to evaluate their supply options.

For these reasons, Staff recommends that the Commission approve an initial auction date of the first ten days of September 2006.

G. Common vs. Parallel Auction

4. Common Deliverability Test Applicable to Illinois Generation

Response to IIEC

The testimony of IIEC witness Dauphinais' was not clear on his recommendation regarding a 'common deliverability test applicable to Illinois generation.' In his rebuttal testimony, witness Dauphinais recommended that

the Commission require ComEd to work with Ameren, PJM and MISO to establish a common deliverability test for capacity resources within the combined MISO and PJM footprint to the combined ComEd and Ameren load zones in Illinois. (Id. at 8-9) The continued lack of such a test will frustrate the promised improvement in the auction process. (IIEC Exhibit 5, p.8, lines 166-178)

(Staff IB, p. 90) However, on cross examination, IIEC witness Dauphinais testified that "I believe some type of initial auction could go forward without an accountability test. But at some point in the future at a date certain it should be there. (Common Tr., p. 126)." (Id.)

In its Initial Brief, IIEC argues that

[a]s a condition of approval of its Illinois Auction Proposal ComEd should be required to work with Ameren, PJM and MISO to remove, as soon as practicable, those impediments that preclude a single common market starting with the implementation as soon as practical of a single common deliverability test for delivery of resources in the combined PJM and MISO footprint to the combined load zones of ComEd and Ameren in Illinois. In addition, ComEd should be required to report on the status of the development of a single common deliverability test within 90 days of a Commission order in this proceeding and every 90 days thereafter until the single common deliverability test is implemented. (Dauphinais Dir. IIEC Ex. 2 at 2:34-57)."

(IIEC IB, p. 32) Based upon the foregoing it is now clear that IIEC wants conditional approval of the auction process for ComEd and Ameren. IIEC's recommendation should be rejected. As Staff pointed out in its Initial Brief, "[t]he testimony of numerous

witnesses indicates that there are benefits to a common auction, even if the seams between MISO and ComEd are not completely eliminated. (Staff IB, p. 91)

I. Fixed Price Auction Product and Tariffed Services for Larger Customers

1. Nature of Auction Product and Tariffed Services for 1 – 3 MW Customers

Response to BOMA

BOMA argues that the 1-3 MW customer group should become eligible for CPP-B service along with customers under 1 MW. (BOMA IB, p. 17) Under BOMA's proposal, the CPP-A product would be eliminated. (*Id.*, p. 19) Thus, 1-3 MW customers would not be subject to an enrollment window, and could leave CPP-B service at any time during the supply period.

BOMA notes that its proposal would give 1-3 MW customers the same price protection as customers of CPP-B service, which is based on a blend of annual and multi-year contracts. (*Id.*, p., 17) Undoubtedly, BOMA is correct that CPP-B prices would be less volatile than prices that change annually. However, it is the price volatility that BOMA seeks to avoid that contributes to customer interest in alternative supply options, as customers seek suppliers that offer more stable pricing. Thus, Staff does not agree with BOMA's contention (*Id.*, p. 19) that its proposal would not harm retail market development.

BOMA also does not acknowledge that eliminating the enrollment window for customers that have demonstrated a significant propensity to switch would result in large increases in the risk premium that bidders would add to their bids.

Based on the foregoing, Staff recommends that the Commission reject BOMA's proposal.

2. Nature of Auction Product and Tariffed Services for 400 kW – 1 MW Customers

Response to BOMA

BOMA argues that customers in the 400 kW to 1 MW demand category should be permitted to qualify for CPP-B service, as ComEd originally proposed, rather than the CPP-A product. (BOMA IB, p. 19) From a customer switching perspective, the propensity to switch among 400 kW to 1 MW customers is extremely similar to customers in the 1 to 3 MW group, which provides support, if not the basis, for including both customer segments in the same group. Staff therefore recommends that the Commission adopt ComEd's proposal to include 400 kW to 1 MW customers in the CPP-A customer grouping, and to reject BOMA's proposal to allow that customer segment to become eligible for CPP-B service.

3. Treatment of Customers (≥ 3MW) Taking Services Subject to a Competitive Declaration

Response to ComEd

ComEd states that

ComEd will continue to offer bundled service to customers with over 3 MW in demand, but the service would be supplied through hourly energy purchases. (McNeil Sur., ComEd Ex. 18.0, 44:968.971). That is not simply a disfavored option.

(ComEd IB, p. 107)

Staff completely disagrees with ComEd's apparent contention that ComEd's hourly service is a satisfactory supply alternative to a fixed-price option. Large customers have avoided hourly service almost to the fullest extent possible, as only 9 customers of the more than 350 customers eligible for the service had specifically selected Rate HEP, ComEd's current hourly service option. The other 54 customers taking Rate HEP were defaulted to that service as a consequence of taking another supply option, and no other service alternatives were available to them. (IIEC Exhibit 4, p. 6, lines 139-140) It is not hard to understand why customers have avoided the service in droves, even though, as ComEd contends, in some years, customers may pay less under an hourly option than under a fixed-price option. (ComEd IB, p. 107) Some customers simply cannot take the risk that spot prices will suddenly spike. They would prefer any fixed-price service, even if, as the IIEC and DOE note, the price derived from the auction is relatively high. (IIEC IB, pp. 42-45; DOE IB, p. 7)

The difficulty with ComEd's refusal to offer a fixed-price service to over 3 MW customers is that service from RESs has not been, and may not be, viable for a significant number of large customers. Despite their best efforts, as the testimony from the DOE witness Swann demonstrates (DOE Exhibit 1.0, pp. 7-10, lines 157-227), some customers may not find satisfactory offers from RESs, leaving potentially a sizable number of large customers exposed to the spot market. As a result of receiving hourly service, rather than fixed-price service, the planning capability of customers could be impaired. (IIEC Exhibit 1, p. 18, line 401) In the case of Argonne National Laboratory and Fermi Lab, relying on hourly service could restrict the number of scientific experiments that could be conducted. (DOE IB, pp. 8-9)

While Staff is sympathetic with DOE's and IIEC's concerns with the state of the retail market for 3MW customers and would welcome an offer by ComEd to offer them a fixed price contract, Staff is not aware of any provision in the law which would require ComEd to offer such a fixed price contract.

J. Continuation of CPP-H Auction

Response to IIEC

ComEd intends to acquire supply for its largest customers through the hourly CPP-H auction until the PJM Reliability Pricing Model ("RPM") or a functionally equivalent model is in place in PJM. ComEd provided assurances in its rebuttal testimony that it would continue the CPP-H auction until the PJM RPM has been filed and approved by FERC and the PJM forward centralized capacity auction is in effect (ComEd IB, pp. 107-108). The IIEC's issue with ComEd is that ComEd should not be allowed to deviate from its proposed CPP-H auction until the PJM RPM is operational and ComEd has shown that its proposed deviation from CPP-H auction is prudent to the extent that other capacity supply options or approaches are available. (IIEC IB, p. 57) The IIEC cites to Pike County an exception to the filed rate doctrine (77 Pa.Commw 268 (1983) and two Illinois cases (General Motors Corporation v. Illinois Commerce Commission, 143 Ill 2d 407 (1991) and United Cites Gas Company v. Illinois Commerce Commission, 163 Ill.2d 1 (1994) Staff is in agreement with the IIEC. As Staff noted its Initial Brief, Staff supports the IIEC's recommendation. (Staff IB, p. 108) Since the

RPM proposal was only recently filed by PJM at FERC,⁶ it has not yet been determined whether FERC will approve, modify, or reject the proposal. The Commission should not allow ComEd to use the RPM capacity procurement method until it has reviewed the FERC order.

Staff thus recommends that the Commission direct ComEd to hold the CPP-H auction unless the Commission determines that the ComEd should purchase capacity for CPP-H customers under some other procurement method. To enable the Commission to make such a determination, Staff recommends that, shortly following the issuance of FERC's order, ComEd submit a petition to the Commission describing the capacity procurement method it believes appropriate for CPP-H customers.

K. Contingencies

4. Subsequent Prudence Reviews of Actions in Response to Contingencies

Response to AG

All of the AG's arguments with respect to "contingencies" were made under this section of its Initial Brief. (AG IB, pp. 57-61) The AG indicates that it is addressing the regulatory review of rates and actions in response to contingencies, but does not address the actual operation of ComEd's contingency plans. (*Id.*, p. 58)

Because the AG is focusing on "regulatory review" it begins this section of its Initial Brief not with a review of "contingencies", but instead with comments on ComEd's

⁶ PJM filed its RPM proposal at FERC on August 31, 2005 in Docket Nos. ER05-1410-000, et al. (IIEC IB, p. 51)

proposal in general. The AG states that ComEd’s proposal “is premised on avoiding regulatory review of the rates it charges consumers for electricity.” (*Id.*) Staff fails to see how ComEd’s request for an upfront review rather than an after-the-fact review avoids regulatory review. As noted in Section III.B above, ComEd’s proposal fully articulates the criteria and method by which ComEd will enter into contracts for wholesale power and energy to serve its retail customers. ComEd’s proposal deprives neither parties nor the Commission of an opportunity to assess ComEd’s decisions. ComEd’s proposed Rider CPP was filed pursuant to Section 9-201, and the Commission has and will review that filing consistent with applicable requirements under the PUA. The AG’s real complaint appears to be its reluctance to be placed in the same position as utility management – i.e., having to make decisions based on the information available at the time of its decision. To that extent, Staff notes that prudence determinations with respect to management decisions must be based on facts and information “available at the time they occurred or were made.” (Illinois Power Co. v. Illinois Commerce Comm’n, 245 Ill. App. 3d 367, 371 (3rd Dist. 1993); see also Illinois Power Co. v. Illinois Commerce Comm’n, 339 Ill. App. 3d 425, 428 (3rd Dist. 1993) (“When a court considers whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible.”))

Moving on to contingencies, the AG similarly claims that ComEd’s proposal similarly prevents or avoids review of electricity purchases pursuant to the contingency provisions. (AG IB, p. 59) First, it is not true, as explained in Staff’s Initial Brief, that all contingency scenarios involve a determination of prudence in this docket or prevent a

subsequent Commission review of prudence. With respect to the contingency scenarios, ComEd is not seeking a prudence determination with respect to future discretionary action by it that could cause the need for such purchases or impact the net amount to be charged to ratepayers for such purchases. (Staff IB, p. 113) Further, ComEd is not seeking any type of prudence determination with respect to its proposal to develop a new supply plan in the event the Commission rejects the results of an auction. (Tr., p. 565, line 21 – p. 566, line 7; Staff IB, p. 114)

Second, as explained in Staff's Initial Brief, ComEd's proposed supply plans are reasonable, represent the least costly supply taking into account the amount of load to be procured and the cost of running the replacement procurement process, and further the goals of fostering bidder interest and competition at the auctions. (Staff IB, pp. 109-114) As with the auction proposal itself, ComEd's contingency proposals do not avoid regulatory scrutiny. ComEd has fully explained the basis for its decisions, including the criteria and parameters to be used, and those decisions are subject to full review in this proceeding. Further, as noted above, ComEd has clarified that it is not seeking a prudence determination with respect to future discretionary action by it that could cause the need for such purchases or impact the net amount to be charged to ratepayers for such purchases. As explained in Staff's Initial Brief, this clarification was developed as a result of Staff witness Dr. Schlaf's testimony, and resulted in a stipulation regarding appropriate language for inclusion in ComEd's tariffs. (Staff IB, pp. 116, 157-158)

The AG attacks the stipulated tariff language that Staff and ComEd have agreed upon to reflect Staff's recommendation to clearly preserve the Commission's ability to review the prudence of future discretionary actions that (i) cause the need for the

contingency purchases or (ii) impact the net amount to be charged to ratepayers for such purchases. (See AG IB, pp. 59-61) In particular, the AG recommends that Staff's initial proposed language – as reflected in Dr. Schlaf's rebuttal testimony – be adopted. (*Id.*, p. 60) The AG's recommendation should be rejected. Staff's intent as to the types of discretionary actions that should be subject to further Commission review has always been the same: actions giving rise to the need for a contingency purchase or actions with respect to the credit requirements that impacts the net amount to be paid for such a purchase. (See ICC Staff Exhibit 5.0, pp. 19-20, lines 436-461; ICC Staff Exhibit 15.0, p. 4, lines 64-81) The language originally proposed by Staff was not as specific as the language subsequently developed by Staff and ComEd, but both versions were designed to reflect the same intent. The AG offers no legitimate concern with respect to the stipulated language in terms of its consistency with Staff's underlying testimony or intent – and it would be both ill-advised and pointless in this docket to reject the more specific language.

The AG argues that ComEd's proposal violates the PUA requirement to file a schedule of charges and again relies on Citizens Util. Bd. v. Illinois Commerce Comm'n, 275 Ill. App. 3d 329 (1st Dist. 1995). (AG IB, p. 61) Staff has previously explained in Section III.B above (and incorporated herein by reference) that the AG's reliance on *Citizens* is misplaced, and that the holding in *Citizens* is inapplicable to the instant tariff proposal.

L. Regulatory Oversight and Review

1. Nature of Commission Review Before, During, and After Auction

Response to AG

In this section of its Initial Brief, the AG continues with its consistent refrain that ComEd's proposal improperly avoids regulatory review and exceeds the Commission's authority. (AG IB, pp. 62-65) Staff has previously addressed these arguments in Sections II and III. above, as well as in other sections of this Reply Brief, and will not repeat those arguments here.

2. Post-auction Commission Review of Results

Response to AG

The AG asserts that the three (3) day period for the Commission to determine whether to commence a formal proceeding to investigate the auction results, and thereby prevent implementation of the auction results, is too short. (AG IB, pp. 65-66) The AG's comments continue to ignore (i) the impact of its recommendations on the proposed auctions and (ii) the fact that this proceeding is the primary review of the auction-based procurement proposal. As testified by Staff witness Dr. Salant, a short review period will encourage bidder participation in the auctions. (ICC Staff Exhibit 11.0, pp. 78-81) Further, although the post-auction review is an important feature of ComEd's auction proposal that (i) further assures compliance with the approved process and (ii) provides a procedural mechanism to immediately address any unanticipated events or developments, the instant docket is the forum where ComEd's

proposal is subject to review and approval. The AG's comments ignore these important facts, and its position should be rejected.

The AG also raises issues concerning ComEd's contingency plans in this section of its Initial Brief. (AG IB, pp. 66-67) Staff has addressed these arguments in Section V.K above.

Response to CCG and MSCG

Both CCG and MSCG address the Post Auction Review of Results in their Initial Briefs. CCG suggests that the Commission should define the scope of the post auction review so that it focuses on ensuring the Commission's approved auction process is followed and that no "anomalies were found in the bids or process that would call into question the competitiveness of the bids received." (CCG IB, p. 16) CCG argues by defining the scope, the potential bidders will have confidence that the auction will result in executed SFCs and that in turn would encourage suppliers to participate in the auction. (Id.)

MSCG takes a similar position regarding the scope of the post auction review of results. MSCG argues that specific language should be included in ComEd's proposed original sheet No. 269:

The ICC will take formal action regarding the auction results as described herein only if the conduct or competitiveness of the Auction or outside events are believed to have compromised the Auction process.

(MSCG IB, p. 3) MSCG argues that "uncertainty associated with the Commission's acceptance of the results of a cleared auction puts bidders at risk of monetary loss."

(Id.) MSCG goes onto argue "the Commission can minimize this risk to bidders – and thus reduce the bidders' offer prices – by clearly affirming the scope of its review to

include only whether or not the competitiveness of the auction has been compromised.” (Id.) MSCG cites to Dr. Salant’s testimony and CCG witnesses testimony as support for its position that revisions to the tariff language are necessary. (Id. at 9)

The Commission should reject CCG’s and MSCG’s arguments. First, MSCG takes Dr. Salant’s testimony out of context. Dr. Salant never testified that ComEd’s tariff language needed to be revised so that the Commission’s scope of review was more defined. The testimony that MSCG relies upon, which actually appears at lines 1793 to 1795 of ICC Staff Exhibit 11.0 Corrected, was made in the context of a discussion that the Commission should not engage in some external benchmark assessment of the resulting auction process. (ICC Staff Exhibit 11.0 Corrected, p. 78) Clearly, Dr. Salant never testified that ComEd’s “rider” needed further direction in terms of the Commission’s options to review the auctions result as MSCG argues in its brief. (MSCG IB, p. 9)

Second, there would be a significant disadvantage to accepting CCG’s and MSCG’s general position that the Commission should limit its scope of review so that it is more defined. While it is true that Dr. Salant testified that “the Commission should focus on ensuring that the approved auction process was followed and that there were no anomalies in the bids or process that would call into question the competitiveness of the auction” (ICC Staff Exhibit 11.0, Corrected, pp. 82-83) he further testified that he did not believe “that the Commission can pre-specify all questions and contingencies that can arise during the auction that could have a material bearing on the acceptability of the auction results. There are also pre-auction activities as well as external events that also should be examined to gauge whether the auction results should be accepted or

rejected.” (ICC Staff Exhibit 11.0, Corrected, p. 77) In order for the Commission to have the flexibility that is necessary to address the unknown, CCG’s and MSCG’s arguments should be rejected.

4. Formal Proceeding(s) to Consider Process

Response to IIEC

The IIEC argues that there should be a formal annual review of the auction process given the novelty of an auction process in Illinois. (IIEC IB, p. 59) ComEd on the other hand argues for informal workshops after the conclusion of the auction rather than opening annual proceedings every year and a formal proceeding every three years. (ComEd IB, p. 114) Staff has no objection to ComEd’s proposal. The informal workshops proposed by ComEd would be sponsored by the Commission and led by Staff. Given that framework any party who wishes to comment on the conduct and result of the auction would have an opportunity to do so. In addition, parties would be able to petition the Commission to open proceedings to examine the auction process and such proceedings would be automatically opened every three years. (Staff IB, p. 118) Staff would note that in the Ameren Dockets (ICC Docket Nos. 05-0160/05-0161/05-0162 (Consolidated)), IIEC and Ameren reached an agreement on this issue, which Staff opposed.

M. Supplier Forward Contracts

4. Proposed clarifications and modifications not accepted by ComEd

Response to ComEd

ComEd in its Initial Brief acknowledges that while significant progress has been made in achieving agreed modifications to the SFCs, a small number of issues remain. ComEd then cites to the testimony of witness Juracek (ComEd Ex. 9.0, pp. 36-45; ComEd Ex. 17.0, pp. 33, 36-40) (ComEd IB, p. 118) Staff, in its Initial Brief, indicated that it agreed with the recommendation made in witness Juracek's testimony that a compliance filing should be required after entry of a final order. However, Staff's position is that the timing of such a filing should allow for an opportunity for consideration of supplier input. (ICC Staff Exhibit 11.0 Corrected, p. 17, lines 380-382) (Staff IB, p. 119) For that reason, Staff recommends that the compliance filing be due within sixty days of the posting of the draft contract on the auction web site, which should occur within seven days of the entry of the final order in this proceeding. (Staff IB, p. 119) Staff further recommends that the Commission's Order set forth additional details regarding the process for the compliance filing, such as identifying unresolved issues and directing ComEd, Ameren and the Auction Manager to file a petition with the Commission to resolve any open issues within 21 days of the compliance filing, with notice of such filing to the service list in Docket 05-0159. (*Id.*, p. 18, lines 394-402) (Staff IB, pp. 119-120)

ComEd Exhibit 17.3 is the most recent draft of ComEd's proposed SFC (ComEd IB, p. 118) ComEd Exhibit 17.3 does not include the credit provision in Section 6.1, which would allow the Company to unilaterally reduce its credit requirements. ComEd

eliminated this provision because it did not expect that it would move to establish less restrictive credit requirements without conferring with the Commission or Staff. As set forth in Staff's Initial Brief, Staff was persuaded by ComEd's original argument for the inclusion of the credit provision. In Staff's opinion, the provision could potentially benefit both customers and suppliers. (Staff IB, p. 123) For these reasons, the credit provision allowing ComEd to unilaterally reduce its credit requirements should remain in Section 6.1 of the SFCs and Ms. Phipps' proposed reporting requirement in connection with this credit provision should be adopted. In addition, ComEd should be required to revise its SFCs to clarify that following any reduction in credit ratings pursuant to Section 6.1 of the SFCs, ComEd may restore the credit requirements to their initial level as circumstances permit. (Staff IB, pp. 122-124).

Response to MWGen

MWGen objects to Section 9.3 of ComEd's proposed supplier contract because it does not restrict ComEd's ability to act arbitrarily and capriciously with respect to withholding from suppliers any disputed amount billed under a supplier contract. Under ComEd's proposed supplier contracts, if it is ultimately determined that the party withholding the amount in dispute did so improperly, then that party must pay to the other the amount due, plus interest at the lower of the Federal Funds rate or six (6) percent per annum, which MWGen asserts is "hardly a compensatory rate". Thus, MWGen recommends modifying ComEd's proposed SFC so that ComEd cannot withhold at its discretion without being required to justify that withholding promptly and paying a compensatory interest rate (*i.e.*, in Appendix B to its Initial Brief, MWGen

recommends using the prime rate, but the record contains no testimony supporting this proposal) if it is determined that the withholding was improper. (MWGen IB, pp. 24-26)

As an Illinois public utility, ComEd is subject to continuous scrutiny by the Commission, which will be closely monitoring the auction process, including ComEd's actions in connection with the auction process, as well as ComEd's financial condition in order to protect the interests of Illinois ratepayers, thereby reducing the likelihood of ComEd defaulting on supplier contracts. Hypothetically, if power prices would decline, then ComEd may withhold payment from a supplier in order to purchase cheaper power in the spot market than it would under supplier contracts.

However, under ComEd's proposed Rider CPP, if the Commission does not reject an auction, then ComEd charges its customers the cost of power purchased during the auction without any mark-up and ComEd does not earn a return on those power costs. Thus, it is unclear what motivation, if any, ComEd would have to withhold payments for power under a supplier contract in order to purchase cheaper power in the spot market. Moreover, should ComEd purchase replacement supply under the Rider CPP due to a supplier default caused by ComEd's actions (*e.g.*, withholding payments to suppliers), the stipulated language agreed upon between Staff and ComEd would provide an opportunity for the Commission to investigate and order appropriate relief, including refunds of amounts collected by the company that would not have been collected but for such imprudence and are not otherwise owed to ComEd. Specifically, the language that ComEd and Staff stipulated to for the Limitations and Contingencies part of Rider CPP allows the Commission to investigate (1) whether (a) the need for such purchases, was caused by an act or omission of ComEd; or (b) an act or omission

of ComEd in connection with its management of the credit requirements contained in the SFC caused an increase in the net amount charged to customers for such purchases; (2) if so, whether such act or omission of ComEd was imprudent; and (3) if so, whether the amount charged to customers for such purchases was unreasonable. (ComEd Cross Ex. 11) Thus, Staff recommends approval of the language provided in ComEd Cross Exhibit 11. Alternatively, if the Commission does not believe that the language agreed to by Staff and ComEd goes far enough in providing the Commission an opportunity to investigate and order appropriate relief, Staff then recommends that the Commission adopt the original language put forth by Staff witness Dr. Eric Schlaf in rebuttal testimony (ICC Staff Ex. 13, pp. 14-15), which also addresses MWGen's concerns regarding sanctions should ComEd wrongfully withhold payments to suppliers.

VI. PROCUREMENT PROCESSES ALTERNATIVES

Response to AG

The AG argues that ComEd's proposal for procurement must be rejected because (1) it presumes an effectively competitive market and (2) it ignores the reality that functioning markets are made up of buyers and sellers with opposing interests. (AG IB, pp. 69-70)

Once again, the AG raises the competitiveness of the markets as a reason to reject ComEd's proposal, Staff addresses this issue not only in Section IV above but in Section IV of its Initial Brief. (Staff IB, pp. 15-21) Staff continues to recommend the Commission approve ComEd's auction proposal with certain modifications advocated by Staff.

A. Active portfolio management

Response to ComEd

In response to the AG and CUB/CCSAO arguments for active portfolio management, ComEd points out that such proposal would “impose the costs and risks of assembling such a portfolio on ComEd’s customers, rather than on suppliers.” (ComEd IB, p 119) An additional weakness of this proposal is that it would rely on the discretion of ComEd to assemble the appropriate mix of energy products. ComEd disagrees with AG’s and CUB/CCSAO’s suggestion that ComEd may extract better offers from suppliers through active portfolio management than through an auction process. To the contrary, compared to active portfolio management, the auction proposes is likely to reduce prices “through the transparent, dynamic descending clock mechanism that tends to drive prices down. (ComEd IB, p. 121)

As set forth in Staff’s Initial Brief (pp.126-133), Staff concurs with ComEd that AG and CUB/CCSAO’s active portfolio management proposal lacks sufficient detail and is wrought with weaknesses. For this reason, Staff respectfully recommends that the Commission reject the active portfolio management concept

3. The case against active portfolio management

Response to AG

The AG appears to recommend that the Commission reject ComEd’s auction proposal in favor of active portfolio management or Dr. Reny’s multilateral negotiation approach. (AG IB, pp. 71-75)

Staff addresses the flaws of both active portfolio management in Section V.B. above and Dr. Reny's approach in Sections V.A. and V.D.2. above. (Also see Staff IB, pp. 126-133 and pp. 64-69) Staff continues to recommend that Commission adopt ComEd's proposal with certain modifications advocated by Staff and reject both active portfolio management and multilateral negotiation. However, Staff would like to address several statements made by the AG in its Initial Brief.

The AG contends that ComEd's current supply contracts expire on December 31, 2006 and "[t]his abrupt discontinuity is a significant risk factor for customers." (AG IB, p. 74) However, as noted by ComEd witness LaCasse:

ComEd has a need to buy 100% of requirements for the period beginning January 1, 2007. This is an unavoidable result of the transition plan. The proposed auction provides for a transition to laddering. However it can't be changed that 100% of ComEd's position is open as of January 1, 2007.

(ComEd Ex. 19.0 Corrected, p. 95, lines 2080-2084) Thus, it appears that the AG's complaint is with the legislation and not the auction. Such a position is neither helpful nor useful in determining whether the Commission should approve ComEd's auction proposal.

The AG further states that "[a]lthough no one can claim to know exactly when to buy to obtain [sic] the lowest long term price, spreading purchases over time minimizes the risk that any one purchase will have a major, disruptive impact on prices." (AG IB, p. 74) However, there is nothing in the record to support the AG's contention. In fact, the record supports the opposite. When addressing single auctions as opposed to serial auctions, ComEd witness LaCasse states,

There has been substantial research done comparing a single auction to serial auctions. This research identifies the strategic scope for gaming opportunities that exist with serial auctions and the problems that this engenders, which do not exist in the case of a single auction.

Serial procurements mean that suppliers have a choice of auctions and that suppliers can pass up the first procurement and have the same economic opportunity in a future procurement. The existence of multiple procurements for the same product creates confusion for bidders, and leaves them with uncertainty regarding *how to bid* and *when to bid* (i.e., in which auction). A NERA study on serial capacity auctions found:

A bidder will need to consider two opposing effects. On the one hand, in later auctions, other bidders may have already sold all, or some, of the capacity that they intended to sell; a bidder selling in later auctions can then face less competition and potentially be able to obtain a better price. On the other hand, in later auctions, there may be fewer or no future opportunity to sell capacity; a bidder selling in later auctions will then face more aggressive bidding and potentially get a worse price. (E. Meehan, C. LaCasse, P. Kalmus, and B. Neenan. "Central Resource Adequacy Markets for PJM, NY-ISO and NE-ISO: Final Report." NERA February 2004:40. Meehan et al., page 40.)

(ComEd Ex. 19.0 Corrected, pp. 95-96, lines 2085-2105) Dr. LaCasse concludes that such a complexity leads to "unpredictable bidding in serial procurements, which in turn leads to prices that do not necessarily reflect the economic realities of the market for the product being procured." (Id., lines 2106-2109) Further, as noted by Dr. Salant, nothing prohibits bidders in the auction from hedging risks associated with temporary market conditions. (ICC Staff Exhibit 11.0 Corrected, p. 69, lines 1555-1560)

The AG also alleges that as a result of the proposed auction, ComEd loses the economies of scale that a large utility like itself has traditionally captured for its customers. Thus, the AG concludes ComEd is failing to exercise its bargaining power. However, once again there is nothing in the record to support this allegation. In fact, CUB/CCSAO witness Steinhurst acknowledges that

Q. And in fact is that why you testify in your rebuttal at lines 690 to 692 that you were not opposed in principle to auctions as part of a procurement methodology and auction-based procurements can have benefits?

A. What was the line number again?

- Q. 690 through 692 in the rebuttal.
- A. That is correct.
- Q. Do those benefits include transparency?
- A. An auction or competitive procurement can include transparency as a benefit if done correctly.
- ...
- Q. What benefits did you mean besides transparency and diversity when you said that auction-based procurement can have benefits?
- A. Competition among vendors, with bidders.
- Q. Which will tend to have the effect of driving price down?
- A. Yes.
- Q. Any others?
- A. Competitive procurement processes can provide useful market intelligence to a utility. It can stimulate demand for product -- it can stimulate supply of products that the utility feels would be useful but might not otherwise appear on their own. It can in some situations with some products reduce transaction costs. I don't have a complete list in mind but that's a selection.

(Common Tr., pp. 487-489) As ComEd witness LaCasse notes "... the proposed Auction Process itself takes advantage of buying power by pooling all load purchases."

(ComEd Exhibit 19.0 Revised, p. 92, lines 2015-2017)

Finally, the AG argues that the ComEd's procurement process should be "reviewed in a cost of service filing, or in an after-the-fact prudence review... ." Staff addresses this argument in Section V.L. above.

Thus, based upon the foregoing, Staff continues to recommend that the Commission approve ComEd's proposal and reject the active portfolio management approach.

B. Request for proposal

Response to ComEd

ComEd agrees with Staff that the request for proposal (“RFP”) process was properly rejected by Staff in its Post-2006 Initiative: Final Staff Report to the Commission. ComEd evaluated the RFP process and likewise determined that the auction was a preferable procurement approach. (ComEd IB, pp.121-122)

C. Affiliate contract

Response to AG

The AG argues that the Commission should reject ComEd’s proposed auction and order ComEd to use its substantial buying power to negotiate with its Generation Affiliate, Exelon Generation, to purchase low-cost nuclear power from the generating plants in Northern Illinois that ComEd customers paid to build and maintain.

Staff addresses the AG’s argument in Section VI.C. of its Initial Brief. (Staff IB, pp. 135-137) Staff recommends that the Commission take no action to direct ComEd to acquire power from affiliates, but that the Commission recognize and accept that the proposed auction may result in ComEd affiliates supplying part of the Company’s full-requirement needs.

However, Staff would like to note once again the AG’s quarrel actually appears to be with the Restructuring Law. ComEd divesting itself of its generation assets was permitted by the Restructuring Law. In fact Section 16-111(g)(4)(vi) of the Act states:

The Commission shall not in any subsequent proceeding or otherwise, review such a reorganization or other transaction authorized by this Section, but shall retain the authority to allocate costs as stated in Section 16-111(i).

(220 ILCS 5/16-111(g)(4)(vi)) Therefore, the Commission cannot now in hindsight review ComEd's divestiture of its generation assets. The AG's argument is neither helpful nor useful in analyzing whether the Commission should approve ComEd's proposal. Further, it is unclear how the Commission can compel Exelon Generation to sell power to ComEd if Exelon Generation has a better opportunity to sell to another buyer.

Response to ComEd

In opposing the affiliate contract approach, ComEd emphasized the significant advantage that the auction process has (i.e., the auction's facilitation of the widest possible participation of all potential suppliers, including affiliated suppliers in the transparent process used to acquire supply for customers). (ComEd IB, p. 124) Staff similarly recommended against adoption of the affiliate contract approach. (Staff IB, pp.136-137)

VII. TARIFF AND RATE DESIGN ISSUES

A. General tariff and rate design issues

The discussion presented in the briefs filed by the parties to this case serve to underscore that the Staff rate design proposals in this proceeding are eminently reasonable and should be approved by the Commission.

One area of opposition to the Staff design proposal concerns the rate migration issue. CES, for one, continues to advocate a revised version of ComEd's original proposal for a rate migration factor. (CES IB, pp. 35-36) Although, in surrebuttal

testimony ComEd indicated that it that it was withdrawing its mitigation risk factor proposal, in its Initial Brief, the Company appears to leave the door open on this issue. That is, despite the fact that it has accepted a compromise auction plan that would both eliminate the migration risk factor and reduce the size of the CPP-B auction pool, the Company argues that the migration risk factor should be imposed in the event that the revision to the CPP-B auction is rejected. (ComEd IB, p. 142)

A second issue that drew dissent was the Staff rate mitigation plan. (See Staff IB, pp.196-201) Two parties, Constellation Energy Commodities Group, Inc. and Dynegy, expressed limited reservations about the plan. (CCG IB, pp. 19-20; Dynegy IB, pp. 22-23)

As discussed in greater detail below, the opposing arguments on both risk migration and rate mitigation issues are ill-timed, narrow and poorly conceived. Collectively, they provide no meaningful basis for the Commission to reject the Staff proposals on these rate design issues.

B. Matters concerning Rider CPP

4. Rider CPP – Retail customer switching rules

a. Enrollment window

The determination of the appropriate length of the enrollment period represents a trade-off between encouraging retail switching and recognizing that the longer the enrollment period, the larger the risk premium that bidders may add to their bids. If there were reasonable grounds to believe that no risk premium would be added to supplier bids, then an unlimited enrollment period might be feasible. However, Staff

witness Schlaf, the only witness to present empirical information about the potential size of the risk premium, demonstrated that suppliers can be expected to add about 0.4% of the forward to their bids for every 10 days of the enrollment period. (Staff IB, pp. 149-154) Thus, the difference between a 30-day enrollment period that is advocated by IIEC, and the 50-day enrollment period now supported by ComEd and the CES, is about 0.8% of the forward price. Staff would consider a 0.8% generation cost increase to be significant, and would be paid by the customers that are the least able to attract offers from RESs.

Staff therefore recommends that the Commission adopt an enrollment period of no more than 45 days, which, based on Dr. Schlaf's analysis, would result in a increase of only 0.6% above the risk premium associated with a 30-day enrollment window. As Staff noted in its Initial Brief, Staff also recommends that the Commission direct ComEd to study the issue of the appropriate length of the enrollment period prior to the next auction.

c. Other switching rule issues

(1) CPP-H issues

Staff and ComEd agree that CPP-H service customers should be able to terminate that service and move to another service by only satisfying the switching rules. These rules generally require customers to switch services only on the customer's regularly scheduled monthly meter reading date. There is disagreement, however, as to whether a CPP-H customer could move off that service on an "off-cycle"

or “non-standard” basis by paying a fee or whether customers could only move from CPP-H service on the customer’s switching date.

ComEd contends that there is potential that “General Account Agents” could move perhaps hundreds of customers between CPP-H service and other services and put an undue administrative burden on ComEd. (ComEd IB, p. 139) If suppliers were prone to move their customers between supply options in order to take advantage of price movements, then admittedly ComEd’s scenario could occur, potentially putting a strain on ComEd’s administrative resources. Nevertheless, Staff recommends that the Commission direct ComEd to allow switching from CPP-H service to other services on dates other than the customer’s regularly scheduled meter reading date. Requiring customers to remain on CPP-H service potentially could be very costly for some customers, who would eagerly pay a switching fee just to move from hourly pricing.

If General Account Agents even once actually park their customers on CPP-H service in such a way as to place an undue burden on ComEd, then ComEd should ask the Commission for permission to place switching restrictions on CPP-H service switches.

6. Rider CPP – Translation to retail charges

a. Customer Supply Group Migration Risk Factor

Response to ComEd

The Company’s Initial Brief makes a faint-hearted effort to defend its proposed migration risk factor. After expressing a willingness to withdraw this proposal if the Rider CPP-B auction is restricted to 0-400 kW customers, ComEd, nevertheless, insists

that without this change the Commission should approve the migration risk factor. (ComEd IB, p. 144)

However, the Company's Initial Brief offers no meaningful evidence beyond a statement that the migration risk factor should be approved in the event the CPP-B auction remains unchanged. (*Id.*, p. 144) This leaves the Commission with no basis for adopting the migration risk factor. Conversely, Staff has presented numerous compelling arguments explaining why the migration risk factor should be rejected (see Staff IB, pp. 160-163). These arguments give the Commission ample basis to reject the migration risk proposal whether or not the CPP-B auction pool is reduced.

Response to CES

The CES weighs in on the issue by repeating its arguments in testimony for its proposed revisions to the migration risk factor originally proposed by ComEd. Again, the starting point for the CES position is the assumption that the migration risk factor is reasonable and CES focuses its attention on why its proposed revisions should be adopted. CES recycles its argument that ComEd's calculation underestimates the amount of load that is likely to switch. According to CES, ComEd should have assumed that 100%, rather than 50%, of PPO load migrates to alternative supply. (CES IB, pp. 36-38) Furthermore, CES argues that ComEd should have assumed that forward price volatility should have been tied more closely to the auction date. (CES IB, pp. 38-41) The bottom line for the CES proposed changes is to increase the size of the migration risk factor and, thereby, increase the relative cost of power for larger customers within the CPP-B auction who are most likely to migrate to alternative supply.

The deficiencies in the CES arguments on this issue were fully explained in the Staff Initial Brief. (Staff IB, p. 163) As Staff noted, the arguments concerning the amount of PPO load that should be considered “at risk” of migration amount to speculation on the part of the witnesses about what drives customer decisions concerning PPO and RES service. Obviously, customers are concerned about price. However, the decision to receive RES service is about more than just price. It also about whether to rely on market forces, rather than regulation, to set the price and quality of the power received. In deciding to migrate to RES service, customers must have confidence that the market can meet their needs over the longer term. To argue that this decision is solely based on price oversimplifies a more complicated decision-making process.

The argument concerning price volatility is argument is flawed as well. The key factor for migration risk is not forward price volatility but rather relative power prices of bundled and RES-supplied power. The key question is how volatility impacts the relative prices of these two service options. Neither the Company, nor CES provide any meaningful answer to this question. The problem again lies with the estimation approach that supports the positions of both the Company and CES. This further demonstrates why the Commission should reject the concept of a migration risk factor in its entirety. (ICC Staff Exhibit 14.0, p. 13, lines 297-304)

For these reasons, the Commission should accept Staff’s recommendation not to adopt a risk migration factor in any form in this proceeding.

8. Rider CPP – Accuracy Assurance Mechanism

a. Issues That Have Been Resolved

(1) ComEd’s Identification of Accounts Used to Record Components of the AAF Calculation

ComEd’s Initial Brief and draft order are somewhat misleading to the extent they represent that Staff no longer disputes ComEd’s identification of the particular expense and revenue accounts within the Uniform System of Accounts (USOA) that should be used to record the components of the AAF calculations. (ComEd IB, p. 148 and 153) Staff is puzzled by ComEd in this regard, as the transcript reference provided (Tr., pp. 1123-1129) does not support the claim intended.

In rebuttal testimony, Staff witness Selvaggio maintained her position that tariff language should be modified to give the Commission authority to determine the revenue and cost accounts that are to be used to calculate the AAF. (ICC Staff Exhibit 16.0, p. 5, lines 136-138) And, during cross examination, Ms. Selvaggio did not change her position. She testified as having some difficulty understanding how some of the accounts identified by ComEd on ComEd Ex. 13.2 Revised were appropriate, but that she was unaware of any accounts that should be listed that was not included on ComEd Ex. 13.2 Revised. (Tr., pp. 1124-1125) When asked whether she agreed that ComEd had limited the number of accounts under the USOA to be considered in the calculation from hundreds down to 16, Ms. Selvaggio expressed concern that two of the accounts listed, Account 232 Accounts Payable and Account 234 Accounts Payable to Associated Companies, do not limit the expenses and cash disbursements that would be eligible to flow through the AAF Factor as all expenses of the Company run through those accounts including those costs that would be unrelated to the auction. (Tr., pp.

1125-1126) The only thing to which Ms. Selvaggio did agree was that Account 566 Miscellaneous Transmission Expenses seems to be appropriately listed on ComEd Exhibit 13.2. (Tr., pp. 1126-1128)

Staff continues to dispute the identification of particular expense and revenue accounts within the USOA that should be used to record the components of the AAF calculations. Absent an automatic annual reconciliation of costs and revenues included in the AAF, the Commission must have the authority to review the cost and revenue accounts that ComEd proposes to be considered in the AAF calculation.

Consistent with the above discussion, the following corrections should be made to the description of Staff's position as reflected in ComEd's draft proposed order, starting at page 144:

ii. **Commission Review of Identification of AAF component Accounts**

Staff

Staff has proposed further contested proceedings and Commission review of ComEd's identification of the Accounts that should be used to record the components of the AAF calculations, and of the specific sub-Accounts that ultimately will be created for use in those calculations. (Selvaggio Reb., Staff Ex. 16.0, pp. 5-8) tariff language that provides the Commission authority to approve the sub-accounts that the Company proposes to be included as components of the CPP Rider. The proposed changes to the tariff language will allow all parties to this proceeding to also have the opportunity to review the costs and revenues that are appropriately flowed through the CPP Rates and the AAF mechanism. The proposed tariff language follows:

The Illinois Commerce Commission will have the authority to approve the costs and revenue accounts and sub-accounts that the Company proposes to be included as components of the CPP Rider. The Company will make a compliance filing in ICC Docket No. 05-0159, with notice of such filing to all parties on the service list, within 30 days after the first auction is completed that is a list of the sub-accounts and sub-account descriptions to be used to record such billings and costs. If any party or Staff finds the list of

sub-accounts and sub-account descriptions to not be acceptable, they may file within 21 days of the Company's compliance filing a Notice of Objection to Compliance Filing in Docket No. 05-0159. In the event that a Notice of Objection to Compliance Filing is made by Staff or any party, the Company shall file a petition to resolve disputed compliance filing, with notice of same to the service list in Docket No. 05-0159, to establish the costs and revenue sub-accounts that should be considered in the development of the CPP Rate and AAF mechanism. Once the list of sub-accounts has been approved by the Commission, any changes to the sub-accounts and sub-account descriptions would need to be reapproved by the Commission.

(ICC Staff Exhibit 16.0, pp. 7-8, lines 192-213)

Staff submits that the proposed procedure is necessary in order for the Commission and all interested parties to know what revenues and costs are supposed to constitute the components of the AAF calculation. Unless there is an automatic annual reconciliation proceeding, the Commission may not have the opportunity to review the revenue and cost components that formulate the AAF rate each year. With the knowledge of what costs ComEd intends to recover as its true costs, the Commission would be assured that ComEd is recovering no more and no less of its true costs through the accuracy assurance mechanism. (ComEd Ex. 17.0, p. 24, lines 536-537)

Staff contends that the process it proposes would be the only opportunity that the Commission would have to determine exactly what costs and revenues should be considered in the development of the AAF rate. That information is not present in the record for this proceeding, and is necessary to pre-approve ComEd's proposal absent an after-the-fact reconciliation proceeding for the Commission to consider such facts.

Staff notes that ComEd implies that the identification of costs to be recoverable through the AAF will be readily apparent and without issue as ComEd intends to track the cost components of the AAF Algorithms by supplier, and perhaps by tranche, in sufficient detail as to be readily auditable by Staff. (ComEd Ex. 13.0, p. 37, lines 783-787) However, Staff maintains that the identification of costs to be recoverable through the AAF is not so readily apparent as more than just the cost of power supply will be recovered through the AAF. For example, in addition to power supply costs, certain ancillary transmission service expense recorded in Account 566, Miscellaneous Transmission Expense will be recovered through the AAF rate. (ICC Staff Exhibit 16.0, p. 5-6, lines 141-149) Further, Account 232, Accounts Payable, and Account 234, Accounts Payable to Associated Companies, listed on ComEd Exhibit 13.2 Revised encompass all expenses and cash disbursements made by ComEd and

do not narrow the number of expenses that could flow through the AAF Factor at all. (Tr. at 1125, lines 12- 21)

Staff points out that even ComEd's own witnesses admitted that from the evidence presented in this proceeding, one cannot determine what expenses and revenues ComEd intends to be included within the calculation to determine the AAF rate. ComEd witness Alongi testified that ComEd Ex. 13.2 (Revised) did not identify the expenses but only listed FERC Accounts in which the expenses would be recorded. (Tr. at 828, line 12-15) He further added that ComEd Exhibit 13.2 does not identify under what circumstances the expenses recorded in the listed Accounts would be included within the definitions and formulae for calculation of the AAF in Rider CPP. (Tr. at 829, lines 5-21) In addition, ComEd witness Waden testified that the presentation of ComEd Ex. 13.2 Revised was an attempt 1) to limit the accounts that ComEd would be using to determine the definitions and formulae for calculation of the AAF and 2) to allow Staff to see directionally where ComEd was going with respect to the definitions and formulae. (Tr. at 870, lines 11-19) He admitted that from ComEd Exhibit 13.2 Revised, it cannot be determined which expenses would be included within the definitions and formulae for the AAF calculation. (Tr. at p. 870, line 20 – p. 871, line 3)

Staff also asserts that ComEd's responsive suggestion is not adequate. In lieu of Staff's proposed procedure, ComEd has offered to meet with Staff when the necessary information is available (sometime after the first auction is completed) and ComEd has determined the appropriate sub-accounts in order to facilitate Staff's understanding and review of the decisions that ComEd made in setting up such accounts. (ComEd Ex. 13.0, pp. 37-38, lines 801-804) However, Staff responds that ComEd's proposal does not provide Staff or the Commission any process by which to contest the future decisions that ComEd makes in determining the appropriate sub-accounts to flow through the AAF mechanism.

Staff points out that ComEd Witness Waden testified that if Staff and ComEd could not come to an agreement, he "assumed" that Staff could start something more formal and set up a proceeding, if necessary. (Tr. at 868, lines 14-16) He also testified that any other party would have access to the public information filed on a monthly basis in the appropriate level of detail that has not yet been determined. (Tr. at p. 868, line 1-16) He testified that the Company would file the calculation on a monthly basis as public information; however, he could not specify the level of detail that would be provided only that it would be an appropriate level of detail. (Tr. p. 868, line 17 – p. 869, line 10) When asked whether the filing would indicate the sub-accounts to which the relevant revenue and expenses would be recorded, he testified only that if Staff thought it was valuable, ComEd would consider it in drafting the filing. (Tr. at 869, lines 12-15) Staff maintains that this informal and vague process is insufficient to

provide Staff and other parties assurance that ComEd would be recovering no more and no less of the procurement costs through Rider CPP.

b. Issues That Remain Open

(1) Further hearings to review ComEd’s Identification of Accounts to Record Components of the AAF Calculation

ComEd urges the Commission to reject Staff’s proposal for further hearings that would allow the Commission to review the accounts that should be included in the AAF calculations because the “unprecedented position” is unwarranted, unreasonable (ComEd IB, p. 152), and extraordinary (ComEd IB, p. 154). Staff agrees with ComEd that the proposal may be unprecedented, but Rider CPP is also unprecedented. The necessity of Staff’s proposal is clear. For without it, the Commission will be ignorant as to the costs and revenues ComEd intends to include in the AAF mechanism to be recovered from helpless ratepayers.

ComEd complains that sub-Accounts cannot be created prematurely as Staff proposes. (ComEd IB, p. 153) However, Staff *never* proposed that the sub-Accounts should be created before the Auction. Staff agrees that it is best to create the accounts after the Auction has occurred and has proposed tariff language that provides for ComEd to make a compliance filing in ICC Docket No. 05-0159, with notice to all parties on the service list, within 30 days *after* the first auction is completed. The compliance filing would include the list of sub-accounts and sub-account descriptions to be used to record such billings and costs. (ICC Staff Exhibit 16.0, p. 7, lines 192-199)

(2) Factor A vs Factor O of the CDU and CF Calculations

(a) Limit to Adjustments ordered by the Commission

ComEd would like Factor A/O to include adjustments that the Company deems to be appropriate without having to obtain Commission approval. (ComEd IB, p.154) In contrast, Staff advocates that Factor A/O should be limited to adjustments made pursuant to a Commission order. (ICC Staff Exhibit 16.0, p. 17-18, lines 441-448) ComEd complains that to require all adjustments to be made pursuant to a Commission order would be unnecessary, overly litigious, and administratively burdensome. (ComEd IB, p. 154) However, Staff maintains that it is imperative that only adjustments ordered by the Commission be allowed to impact the rate in order to preserve the integrity of the AAF mechanism. If the Company is allowed to inject unknown variables into the calculation, the AAF rates will be dubious. Only a Commission order provides the documentation that an adjustment was evaluated sufficiently to warrant recognition in the AAF rate. (ICC Staff Exhibit 16.0, p. 17-18, lines 442-448) It appears that ComEd would prefer the Commission not to be involved whatsoever in reviewing the costs and revenues that are included in the AAF mechanism.

(b) Authority to Amortize Adjustments

ComEd proposes to amortize adjustments included in Factor A/O as it sees fit. (ComEd IB, p. 155) This proposal should be rejected. It is Staff's position that the Commission should make that determination in its order that authorizes the adjustment

based on the particular circumstances of the adjustment. (ICC Staff Exhibit 16.0, p. 19, lines 466-470)

(c) Name of Factor: “A” or “O”

ComEd believes that naming the Factor “A” makes more sense but is willing to accommodate Staff by using another letter, provided that it should not be “O” unless the Commission approves Staff’s underlying substantive position on resolving all such matters through Commission Orders. (ComEd IB, p. 155-156) In Staff’s opinion, the answer to whether the Factor should be named “A” or “O” is dependent upon whether the Commission allows ComEd to make adjustments to the mechanism without Commission approval. If the Commission finds that only adjustments ordered by the Commission should be included in the AAF calculation to preserve the integrity of the AAF mechanism, the Factor should be named Factor O as an “ordered” adjustment. If the Commission finds otherwise, the Factor can really be called anything as there will be no integrity in the mechanism to attempt to preserve.

Consistent with the above discussion, the following corrections should be made to the description of Staff’s position as reflected in ComEd’s draft proposed order, starting at page 145:

iii. Addition of Factor “A” for CDU Factor and CF Calculation

Staff

Staff ~~wished~~ proposed that Factor A to be limited to adjustments made pursuant to a Commission Order in order to preserve the integrity of the AAF mechanism as only a Commission order provides the documentation that an adjustment was evaluated sufficiently to warrant recognition in the mechanism. (Selvaggio Reb., Staff Ex. 16.0, pp. 17-18) In addition, Staff objected that ~~the~~ only the Commission should determine the amortization

period for an adjustment it ordered based upon the particular circumstances of the adjustment. (Selvaggio Reb., Staff Ex. 16.0, p. 19)

Staff preferred the term “Factor O” because “O stands for ordered, and opposed “Factor A” because it is a term in 83 Illinois Administrative Code Part 525, Section 525.50, relating to purchase gas adjustment (“PGA”) clauses. (Selvaggio Dir., Staff Ex. 8.0, p. 16; Selvaggio Reb., Staff Ex. 16.0, lines p. 17) ~~ComEd disagreed with Staff’s position, as indicated above, and stated that it does not believe there is any actual likelihood of confusing it with a gas utility with a PGA clause.~~

Commission Analysis and Conclusion

ComEd and Staff are in partial agreement on the addition of a factor to the CDU Factor and CF calculations -- referred to by ComEd as “Factor A” and by Staff as “Factor O” -- to reflect adjustments for refunds or additional collections, but ComEd and Staff differ on both the substance, in two respects, and the name of this factor. The gist of the first substantive dispute is that Staff wishes Factor A to be limited to adjustments made pursuant to a Commission Order. The gist of the second substantive dispute relating to Factor A also is that Staff objected, arguing that the only Commission should determine the amortization period. The disagreement over the name of Factor A / Factor O reflects the underlying substantive dispute regarding whether the sole method of dealing with Factor A adjustments should be a contested case before the Commission.

~~The Commission agrees with ComEd that to assume, or require, that all such disputed issues be resolved through formal proceedings, when they might well be resolved by Staff and ComEd working together and reaching an accord, would be unnecessary, overly litigious, and administratively burdensome on ComEd, Staff, and the Commission, and potentially other stakeholders, and it could unnecessarily delay, possibly for extended periods, the correction of errors, which may have significant adverse consequences for customers and the utility. Therefore, the Commission finds that these issues need not be required to be resolved in a formal proceeding. Staff or another interested party can seek, or the Commission on its own motion can initiate, a formal proceeding when and if the circumstances warrant such.~~ Staff that the integrity of the AAF mechanism must be maintained. The Company must have restrictions on how easily it can inject variables into the mechanism in order to maintain confidence in the resulting AAF rates that are generated. ComEd’s proposed resolution through informal discussions with unidentified Commission Staff members does not provide all parties the opportunity to reach an accord on the disputed issue. The name “Factor AQ” and the amortization period language proposed by Staff are appropriate. In the

event of a formal proceeding, the Commission can direct the appropriate amortization period.

9. Rider CPP – Subsequent review / Contingencies

a. Monthly AAF Informational Filings

Staff's two recommendations concerning the filing of the monthly AAF informational filings continue to be disputed by ComEd. (ComEd IB, pp. 149-152)

Staff's recommendations are the following:

1. The monthly AAF filings should be postmarked by the 20th day of the filing month (Staff IB, pp. 171-174); and
2. Any AAF filings postmarked after the 20th of the filing month but prior to the first day of the effective date would be accepted only to correct an error or errors from a previous filing for the same effective month. Any other filings postmarked after the 20th day of the filing month would be accepted only if submitted as a special permission filing under Section 9-201 of the Act and the notice requirements pursuant to 83 Ill. Adm. Code 255. (Staff IB, pp. 174-175)

ComEd in its direct case proposed that the monthly informational filing be filed with the Commission three (3) business days prior to start of the effected month. (ILL. C.C. No. 4, Original Sheet Nos. 269 and 291) Staff has maintained throughout this case that a three-day review period does not allow sufficient time to review the monthly filings prior to the start of the effective month. In addition, if an error, or errors, were detected, there would not be sufficient time for ComEd to re-file a corrected filing prior to the start of the effective month. (ICC Staff Exhibit 10.0, p.4, lines 67-75).

As noted in the rebuttal testimony of Staff witness Knepler, ComEd offered various excuses, but no logical reasons, for why it could not file its monthly informational filing on the 20th day of the filing month:

First, ComEd states that the twentieth day of the filing month is too early to file the AAF computation because the components are not available.⁷ Second, the twentieth of the month is too late to file because according to ComEd it needs to extensively test its billing system.⁸ Third and finally, ComEd states once rates are entered into its billing system, those rates could not be changed until the next month's billing cycle because any revision to the rates must again be tested in the billing system.⁹ Thus, according to ComEd, a filing on the twentieth of month is not a viable filing date for ComEd and besides, once rates are entered into the billing system they cannot be changed until the next month's billing cycle.

(ICC Staff Exhibit 18.0, p. 16, lines 116-126)

On page 150 of its Initial Brief, ComEd presents what appears to be a response to Staff rebuttal solution to use a three month lag in actual data in performing the monthly AAF calculation. ComEd's Initial Brief states, "... the unfortunate fact is that Staff's position, if it were adopted, would cause serious practical problems for customers as well as the utility." (ComEd IB, p. 150) ComEd's overbroad argument must be read critically. The problem with this purported "fact" -- which is the basis for ComEd's position -- is that ComEd has failed to substantiate it in the record. That is, ComEd has yet to identify or discuss any of those "serious practical problems" it claims will result from the Staff proposal.

It is indeed curious that ComEd continues to oppose Staff's recommendations, when such proposal would resolve the problems that would, according to ComEd,

⁷ "Based on ComEd's current monthly closing process and the availability of the components of the calculation, we believe that ComEd proposed deadline (three business days prior to the start of the next billing period) represents a realistic timeframe..." (ComEd Ex. 13.0, p. 34, lines 730-733)

⁸ "...ComEd needs to extensively test any changes in rates in its billing system ...". (ComEd Ex. 13.0, p. 34, lines 738-739)

⁹ "Thus, a filing date of the twentieth of the calendar month would not create sufficient time for the error correction process Staff's proposal contemplates. (ComEd Ex. 13.0, p. 35, lines 744-746)

prevent it from filing on the 20th day of the filing month. (ComEd IB., 149-152) Notably, during cross-examination, the ComEd witness agreed that the use of Staff's proposed three month lag of actual data in performing the monthly AAF calculation would provide the following benefits:

- Allow additional time to complete its accounting close;
- Allow additional time to obtain the components of the monthly AAF calculation; and
- Allow additional time to extensively test its billing system.

(Tr., pp. 838-839) Furthermore, the use of a three month lag has been successfully used by four Illinois gas utilities in the computation of the monthly PGA rate. (Tr., pp. 838)

ComEd has failed to offer any alternative proposal to address the concerns expressed. Given that ComEd has provided no legitimate reason for opposing Staff's solution, the only conclusion to be drawn from ComEd's arguments is that ComEd is opposed to any review or verification, by any party, at anytime, of the charges billed and recoveries received under Rider CPP. Indeed, such conclusion would be consistent with ComEd's opposition to an annual docketed reconciliation proceeding (discussed later in this Reply Brief) – it does not want any review of its competitive auction process charges and recoveries. Thus, ComEd believes its charges, its AAF computation, and its reconciliation should be accepted on its face.

b. Annual Docketed Reconciliation Proceedings

ComEd continues to oppose Staff's recommendation for annual docketed reconciliation proceedings. (ComEd IB, pp. 159-162) Staff's proposal was modified in

rebuttal to include other pass-through costs billed under Rider PPO-MVM and Rider TS-CPP. (ICC Staff Exhibit 18.0-Revised, p. 15, lines 312-320)

The arguments in opposition to Staff's proposal for annual docketed reconciliation proceedings set forth in ComEd brief include two erroneous points that warrant a Staff response.

First, there is the misconception that Staff witness Knepler's proposal for annual docketed reconciliation proceedings and IIEC witness Collins' proposal for annual workshops to analyze the auction process are inconsistent with each other. Although Staff concedes that IIEC witness Collin's main focus is the post-auction workshops, there are overlapping areas of mutual concern. In addition to a preference for annual docketed proceedings (IIEC Ex. 3, p 14), both Staff witness Knepler and IIEC witness Collins have concerns about the following:

- The lack of Commission oversight;
- Prices charged to customers; and
- A forum for interest parties.

An additional point shared by Mr. Knepler and Mr. Collins – both had their recommendations rejected by ComEd. (ComEd Initial Brief, pp. 114-115) Staff maintains that annual docketed reconciliation proceedings will address these concerns (i.e., lack of Commission oversight, verification of prices charged to customers and a forum for interested parties).

Second, in testimony and in its initial brief, ComEd repeatedly states that Staff has not cited any basis for its proposal to hold annual docketed reconciliation proceedings. On page 151 of its initial brief, ComEd again cites the surrebuttal testimony of its panel witnesses, "In light of the fact that the purpose of the AAF is to

balance the **several billion dollars of revenue and expenses** that will be incurred annually, ComEd has proposed a process that would minimize the lag to the shortest period practicable (i.e., a two month lag).” ComEd Ex. 21.0, p. 31, lines 715-718 and ComEd I. Brief, p. 151).

ComEd overlooks the fact that it will annually bill and collect several billions of dollars through the Rider CPP and its AAF mechanism. Given the magnitude of pass-through costs involved, a required annual reconciliation is certainly reasonable.

ComEd further argued that there is no commonality between Staff’s original proposal for reconciling Rider CPP activities and its expanded proposal to include annual reconciliations for Riders PPO-MVM and TS-CPP. (ComEd IB, pp. 162-163) The commonality in Staff’s position is that Rider CPP, Rider PPO-MVM and Rider TS-CPP¹⁰ are all passing through costs. If ComEd is billing and recovering costs based upon pass-through costs, those pass-through costs and revenues should be subject to annual docket reconciliation proceedings. (ICC Staff Exhibit 18.0, p. 15)

¹⁰Rider CPP applies to those customers taking full requirements electric supply on a bundled or unbundled basis beginning January 2, 2007. (ComEd proposed tariff, ILL. C.C. No. 4, Original Sheet 245) Rider PPO-MVM is the group of customers that will continue taking services under this existing tariff after January 2, 2007, even though ComEd plans to eventually phase-out this tariff and will also be billed pass-through costs. (ComEd proposed tariff, ILL.C.C. No. 4, Original Sheet Nos. 296-297) Rider TS-CPP is that group of customers that will require transmission service beginning January 2, 2007 because this group is not taking bundled service, but will require transmission service, which is a pass-through costs recovered by ComEd. (ComEd proposed tariff, ILL.C.C. No. 4, Original Sheet No. 299)

c. Summary - Commission Oversight Recommendations

In summary, ComEd opposition of the Staff proposals appear inconsistent with the Procurement Working Group's first recommendation that a utility's procurement process **be highly transparent**. (ComEd Ex. 1.0, p. 8; See ComEd IB, p. 160) If ComEd were to truly advocate for a highly transparent procurement process, then (1) Staff should not be limited to three (3) business days to review its monthly AAF informational filings (i.e., Staff proposed that the filings be postmarked by the 20th day of the filings month), and (2) ComEd should be required to reconcile pass-through costs and revenues in annual docketed reconciliation proceedings. Staff believes ComEd's President's Frank Clark's testimony appropriately captures the essence of Staff's Commission oversight recommendations, "It's the right thing to do, and the right time to do it." (*Id.*, p. 12, line 274)

Lastly, in the companion procurement dockets for the three Ameren electric utilities, each company accepted Staff's recommendations to file its monthly informational filing by the 20th day of the filing month and to present its reconciliations in annual docketed proceedings. (Tr., p. 841, lines 12-20) Thus, the Commission should reject ComEd's arguments in opposition to Staff oversight recommendations and order ComEd to:

1. Modify the Accuracy Assurance Factor (AAF) mechanism so that monthly informational filings are postmarked by the twentieth day of the filing month, any report filed after the twentieth but before the first day of the effective month would be accepted only to correct a previously filed timely report. To better enable the Company to meet this deadline, it is further recommended that the Company use actual cost data from the third prior month when calculating the monthly AAF; and
2. Modify Rider CPP, Rider PPO-MVM, and Rider TS-CPP to require the Commission to initiate annual proceedings to reconcile the

cost of full requirements electric supply purchased with revenues recorded.

C. Matters Concerning Proposed Rider PPO-MVM

1. Supply Charge

a. The Supply Administration Charge and the Adjustment for Supply-Related Uncollectible Costs Should Not be Tracked Through the AAF

Response to CES

CES asserts that both the supply administration charge (“SAC”) and supply-related uncollectible costs should be tracked through the Accuracy Assurance Factor (“AAF”) to ensure that ComEd neither over nor under-collects for these expenses. (CES IB, pp. 44, 47)

The Commission should reject this proposal. Tracking the SAC and supply-related uncollectible costs through the AAF would not accomplish the stated goal of ensuring that ComEd neither over nor under-collects for these expenses. Staff explained in its testimony and initial brief how this approach would mismatch costs and recoveries from two different periods that reflect different levels of sales and costs. This kind of mismatch would not accomplish the kind of true-up of costs and recoveries that CES desires. (ICC Staff Exhibit 17.0, pp. 8-9, ll. 180-192; Staff IB, pp. 186-187) Staff also explained why the kind of true-up that CES seeks is not necessary, given that the SAC and adjustment for supply-related uncollectible costs will be set in a rate case. (ICC Staff Exhibit 17.0, pp. 9-10, ll. 193-200; Staff IB, p. 187)

Staff strongly recommends that the Commission reject CES’ proposal to track the SAC and supply-related uncollectible costs through the AAF.

2. Supply Administration Charge

- a. The Amount and Method for the Supply Administration Charge should be Determined in the Recently Filed Rate Case, Docket No. 05-0597**

Response to CES/ComEd

CES asserts that, in this proceeding, the Commission should address the types of costs that should be included in the SAC as well as the proper allocation method, and the manner in which the SAC is to be set. (CES IB, pp. 44-45) ComEd argues that CES' proposals are premature, and they should not be approved. ComEd further asserts that the actual charges are to be determined in ComEd's rate case, which now is pending as ICC Docket 05-0597; and, thus, the issues sought to be raised by CES and CUB/CCSAO are appropriately dealt with in that Docket, not here. (ComEd IB, pp. 165-166)

Staff believes ComEd is correct that this matter would be better addressed in the rate case. The rate case would present a more comprehensive set of facts and analysis upon which to base decisions about this matter. Further, the rate case would provide the context in which to review the costs of both the delivery and procurement segments and assign them appropriately. (ICC Staff Exhibit 17.0, p. 10, ll. 201-219; Staff IB, p. 189)

D. Additional tariff and rate design issues

1. Staff's rate increase mitigation proposal

The few concerns voiced about the Staff rate mitigation plan provide no substantive basis for the Commission to reject the proposal.

Response to CCG

CCG begins with a brief argument that: (1) there is uncertainty about the impact of the Staff plan because it must await the implementation of the auction; and (2) there is no need for such a plan. (CCG IB, p. 19) With regard to the uncertainty issue, clearly all aspects of procurement costs are uncertain before the auction is run. However, this uncertainty only underscores the importance of adopting a plan that limits the adverse impacts that may befall ratepayers. The Staff proposal limits the potential exposure to rate shock and, thereby, serves to reduce the uncertainty facing bundled customers. If, as CCG suggests, uncertainty is a concern, then the Staff rate mitigation addresses that concern by limiting the uncertainty that ratepayers face.

CCG's second argument is a simple, unsupported statement that the Staff plan is not needed. (CCG IB, p. 19) Staff's only response is that it disagrees strongly with this statement.

In sum, the arguments by CCG are unpersuasive and do not undermine in any way the reasons why the Staff proposed mitigation plan should be approved by the Commission in this proceeding.

Response to Dynegy

Dynegy makes a single argument regarding the Staff rate mitigation proposal. Dynegy claims that the process of adjusting power costs under the rate mitigation

process could raise prices for some groups and, thereby, cause them to migrate to alternative service. Dynegy goes on to claim that this additional switching risk could be regarded by suppliers as an additional cost and they would be inclined to raise their power cost bids as a result. (Dynegy IB, pp. 22-23)

This argument amounts to empty speculation by Dynegy. It is not clear at this time whose rates will rise and fall as a result of the Staff rate mitigation plan. Nor is the magnitude of any adjustment evident. It could serve to either raise or lower the power costs of the customers most susceptible to migrate to RES-supplied power. Thus, the uncertainty for suppliers could either rise or fall. In other words, there is no evidence for Dynegy to assert that the Staff mitigation plan will increase prices offered by suppliers in the auction process. That conclusion is pure guesswork on Dynegy's part. The fact remains that the benefits of the Staff rate mitigation plan far outweigh any drawbacks Dynegy might imagine could take place.

VIII. CONCLUSIONS AND MIXED LEGAL/FACTUAL ISSUES

A. Legality of Rider CPP

Response to AG

The AG first argues that Rider CPP not only violates the PUA by imposing market based rates on consumers but also by allowing the utility to charge rates that have not been subject to Commission review. Second, the AG argues that the Commission cannot lawfully approve Rider CPP because it does not contain rates but instead contains unlawful blank authorization to change rates.

With respect to the AG's first argument, Staff addresses why it is without merit and must be rejected in Section III.A. above as well in Section III.B. of its Initial Brief (Staff IB, pp. 7-14) With respect to the AG's second argument, Staff addresses why it is without merit and must be rejected in Section III.B. above.

Staff continues to recommend that the Commission find that Rider CPP (as modified by Staff) would result in just and reasonable rates.

B. Legality of Rider PPO-MVM

Response to CCSAO

The CCSAO indicates that its concern with ComEd's auction proposal is the fact that ComEd is seeking pre-approval of the process with very limited after-the-fact prudence review by the Commission.

The CCSAO appears not to come to a conclusion with respect to the legality of Rider PPO-MVM. However, it does raise a concern with respect to after-the-fact prudence reviews. Staff addresses prudence reviews as it relates to ComEd's proposal in Section III., B and C.

Response to BOMA

In its Initial Brief, BOMA argues that

... since the Supplier Forwards Contract resulting from the auction are not exchange traded or other market traded futures contracts and the auction price is not an exchange traded or other market traded index, ComEd proposed Rider PPO-MVM does not determine market value in a manner which meets the requirements of Section 16-112(a) of the Public Utilities Act.

(BOMA IB, p. 24)

Section 16-112(a) provides that:

... market value ...shall be determined in accordance with either (i) a tariff that has been filed by the electric utility with the Commission pursuant to Article IX of this Act and that provides for a determination of the market value for electric power and energy as a function of an exchange traded or other market traded index, options or futures contract or contracts applicable to the market in which the utility sells, and the customers in its service area buy, electric power and energy, or (ii) in the event no such tariff has been placed into effect for the electric utility, or in the event such tariff does not establish market values for each of the years specified in the neutral fact-finder process described in subsections (b) through (h) of this Section, a tariff incorporating the market values resulting from the neutral fact-finder process set forth in subsections (b) through (h) of this Section.

When interpreting a statute, one must first look to the plain language. See *e.g.*, *Davis v. Toshiba*, 186 Ill. 2d 181, 184-85 (1999) The plain language of 16-112(a) provides that market value, if it is not the result of the neutral fact finder process (Section 16-112(a)(ii)), must meet three requirements. The first requirement is that the market value must be the function of one of three alternatives. Market value must be the function of either: (1) an index; or (2) an options or futures contracts; or (3) contracts. The second requirement is that the index, or options or futures contracts, or contracts must be a function of exchange trading or market trading. The third and final requirement is that the index or the options or futures contract or the contracts must be applicable to the market in which the utility sells, and the customers in its service area buy, electric power and energy.

With respect to the first requirement, the Commission in the past has interpreted “function of” in a broad sense. The Commission in its order on reopening in ICC Docket Nos. 00-0259, 00-0395, and 00-0461 (Consolidated) rejected the IIEC’s argument that the use of bids and offers was inconsistent with the 16-112. The Commission found the use of bids and offers would produce a market value that was ’a function of’ a market

index.” (ICC Docket Nos. 00-0259, 00-0395, and 00-0461 (Consolidated), Order on Reopening, at 162 (emphasis added))

Based upon the plain language of Section 16-112 and the Commission’s prior orders concerning market value, ComEd’s proposed Rider PPO-MVM most certainly meets the three requirements. With respect to the first requirement, Rider PPO-MVM refers to the SFC which is the standard contract to which ComEd would enter into binding wholesale contracts with suppliers for the procurement of full requirements electric supply from suppliers for ComEd’s customers (Ill. C C. No. 4, Original Sheet No. 248). Therefore, there should be no dispute that the SFCs are contracts. BOMA’s argument that the SFC’s are not futures contracts and its argument that the auction closing price is not an exchange traded or market traded index is not determinative. Section 16-112(a) provides that Market value must be the function of either: (1) an index; or (2) an options or futures contracts; or (3) contracts.

With respect to the second requirement that the contract be a function of exchange trading or market trading, ComEd witness Juracek pointed out that “...the auction is itself a market in which wholesale energy suppliers vie with each other to sell energy to the procuring utility. The winning bid, or market-clearing price, is the lowest price generated by this competitive market trading process.” (ComEd Ex. 9.0, p. 52, lines 1228-1230) Staff witness Zuraski also testified that auction prices which result from a competitive procurement process would be the result of a market. (ICC Staff Exhibit 3.0, p. 6) Further, it logically follows that if the use of bids and offers produce a market value that was a function of a market then bids and offers that result in

contracts, such as SFCs, will most certainly produce a market value that is a function of a market.

Finally, with respect to the third requirement that the contract be applicable to the market in which the utility sells, since the SFCs are the contracts that will set forth the terms for the acquisition of electric power and energy supplied to ComEd's customers, there can be no dispute that the SFC contracts are "applicable to the market in which the utility sells, and the customers in its service area buy, electric power and energy" (220 ILCS 5/16-112(a)(i)). With respect to contingency purchases, i.e., those purchases in the PJM-administered markets (ILL. C. C. No. 4, Original Sheet No. 273), those purchases undoubtedly would produce a market value which meets the three requirements of 16-112(a) since the PJM purchases would result in contracts which are a function of market trading and the power and energy purchases would be for ComEd's customers.

Thus, the Commission should find that Rider PPO-MVM complies with Section 16-112(a) of the Act.

C. Issues concerning compliance of auction process details with Illinois law

Response to CCSAO

First, the CCSAO argues that ComEd fails to adequately consider the Illinois Open Meetings Act. (220 ILCS 5/10-102 and 5 ILCS 120/1) (CCSAO IB, pp. 42-43) The CCSAO's second and fourth arguments appear to raise a concern with ComEd's proposal as it relates to the Illinois Ethic Law (5 ILCS 430/5-50(e)) and the Ex Parte Communication rule (220 ILCS 5/10-103 and Section 10-60 of the Illinois Administrative

Procedures Act). (CCSAO IB, pp. 43-44 and 44-45) Its third argument concludes that ComEd fails to adequately consider the public records provision of the PUA (220 ILCS 5/10-101). (CCSAO IB, p. 44) Finally, the CCSAO appears to assert that any action on the auction needs to be based on record evidence under the Act (220 ILCS 5/10-103). (CCSAO IB, pp. 45-46)

With respect to the CCSAO's first argument (CCSAO IB, pp. 42-43), the ComEd proposal does satisfy the Open Meeting Act. As stated by Staff witness Salant when addressing why at least three days for a Commission review period of the auction results is required,

... it is my understanding that there is a potential timing issue concerning Section 2.02 of the Open Meetings Act. I am advised that absent a bona fide emergency, Section 2.02 of the Open Meetings Act requires Illinois public agencies such as the Commission to provide at least 48 hours notice for both regular and special open meetings. (5 ILCS 120/2.02)

(ICC Staff Exhibit 11.0 Corrected, p. 79, lines 1796-1801)

Section 2.02 of the Open Meetings Act provides

(a) Every public body shall give public notice of the schedule of regular meetings at the beginning of each calendar or fiscal year and shall state the regular dates, times, and places of such meetings. An agenda for each regular meeting shall be posted at the principal office of the public body and at the location where the meeting is to be held at least 48 hours in advance of the holding of the meeting. A public body that has a website that the full-time staff of the public body maintains shall also post on its website the agenda of any regular meetings of the governing body of that public body. Any agenda of a regular meeting that is posted on a public body's website shall remain posted on the website until the regular meeting is concluded. The requirement of a regular meeting agenda shall not preclude the consideration of items not specifically set forth in the agenda. Public notice of any special meeting except a meeting held in the event of a bona fide emergency, or of any rescheduled regular meeting, or of any reconvened meeting, shall be given at least 48 hours before such meeting, which notice shall also include the agenda for the special, rescheduled, or reconvened meeting, but the validity of any action taken by the public body which is germane to a subject on the agenda shall not be affected by other errors or omissions in the agenda. The requirement of

public notice of reconvened meetings does not apply to any case where the meeting was open to the public and (1) it is to be reconvened within 24 hours, or (2) an announcement of the time and place of the reconvened meeting was made at the original meeting and there is no change in the agenda. Notice of an emergency meeting shall be given as soon as practicable, but in any event prior to the holding of such meeting, to any news medium which has filed an annual request for notice under subsection (b) of this Section.

(5 ILCS 120/2.02(a), effective January 1, 2006)

As explained by Dr. Salant, the three-day review period allows sufficient time for the Auction Manager, Staff, the Auction Advisor, and the Commission time for their respective reviews and time for the Commission to call a meeting should it need to initiate a formal proceeding. (ICC Staff Exhibit 11.0 Corrected, pp. 78-80) Thus, Staff believes that ComEd's proposal complies with the Open Meetings Act.

The CCSAO's second and fourth arguments appear to be the same in that they address the ex parte communication rules. (CCSAO IB, pp. 43-44 and 44-45) Although not clearly stated in its Initial Brief, it appears that the CCSAO argues that under ComEd's proposal, it is not possible for the Auction Manager and Staff to interact without Staff violating the State Officials and Employee Ethics Act (5 ILCS 430/5-50(e)) (the CCSAO refers to this Act as "the Illinois Ethics Act") and the Ex Parte Communications provision contained in the Illinois Administrative Procedure Act (5 ILCS 100/10-60) (the CCSAO refers to this Act as "the Illinois Administrative Procedures Act"). The CCSAO's reading of these Acts is incorrect and must be rejected.

Section 5-50 of the State Officials and Employee Ethics Act provides in part:

(b) "Ex parte communication" means any written or oral communication by any person that imparts or requests material information or makes a material argument **regarding potential action concerning regulatory, quasi-adjudicatory, investment, or licensing matters pending before or under consideration by the agency.** ...

(b-5) An ex parte communication received by an agency, agency head, or other agency employee from an interested party or his or her official representative or attorney shall promptly be memorialized and **made a part of the record**.

(5 ILCS 430/5-50(e)) (emphasis added)

Section 10-60 of Illinois Administrative procedure Act provides in part

(a) Except in the disposition of matters that agencies are authorized by law to entertain or dispose of on an ex parte basis, agency heads, agency employees, and administrative law judges shall not, **after notice of hearing in a contested case or licensing to which the procedures of a contested case** apply under this Act, communicate, directly or indirectly, in connection with any issue of fact, with any person or party, or in connection with any other issue with any party or the representative of any party, except upon notice and opportunity for all parties to participate.

(c) An ex parte communication received by any agency head, agency employee, or administrative law judge **shall be made a part of the record of the pending matter**,...

(5 ILCS 100/10-60)(emphasis added)

Based on these Acts, unless there is a contested case before the Commission, an ex parte report need not be filed. In the case at hand, assuming the Commission approves ComEd's proposal in this proceeding, this docket will be closed and no longer contested. Under ComEd's plan, communications between the Auction Manager and Staff relating to the auction would occur outside of a contested proceeding and therefore, no communication need be made part of the record. Once the auction occurs and if during the three-day review period the Commission decides to initiate an investigation, at that point, Staff would again be obligated to report any communications with interested parties. In fact, if Staff were somehow in violation of 5 ILCS 100/10-60, Section 10-101 of the PUA states

No violation of this Section or the Illinois Administrative Procedure Act [5 ILCS 100/1-1 et seq.] and no informality in any proceeding or in the manner of taking testimony before the Commission, any commissioner or

hearing examiner of the Commission shall invalidate any order, decision, rule or regulation made, approved, or confirmed by the Commission in the absence of prejudice.

(220 ILCS 5/10-101) Therefore, the CCSAO argument must be rejected.

In its third “argument”, the CCSAO alleges that ComEd’s proposal does not adequately consider the public records provision (220 ILCS 5/10-101) of the PUA. (CCSAO IB, p. 44) The CCSAO provides no explanation for its conclusion and Staff will not speculate as to the unarticulated bases for the CCSAO’s contention. However, Staff will note that Section 10-101 of the PUA states in part:

All evidence presented at hearings held by the Commission or under its authority shall become a part of the records of the Commission. In all cases in which the Commission bases any action on reports of investigation or inquiries not conducted as hearings, such reports shall be made a part of the records of the Commission. **All proceedings of the Commission** and all documents and records in its possession shall be public records, except as in this Act otherwise provided.

(220 ILCS 5/10-101)(emphasis added) As noted above, once this docket concludes, there will be no pending proceeding before the Commission. Thus, the CCSAO’s argument must be rejected.

Finally, the CCSAO appears to assert that any action on the auction needs to be based on record evidence under the Act (220 ILCS 5/10-103). (CCSAO IB, p. 45-46) The CCSAO states

It would [sic] be challenging to see how ComEd’s post auction review and order comply with Section 10-103 and similar requirements.

(*Id.*, p. 46) However, this statement demonstrates the CCSAO’s lack of understanding of ComEd’s proposal. Under ComEd’s proposal, the Commission will only act during the three-day review period following the auction decides to initiate an investigation the

auction results. Thus, if the Commission decides not to initiate an investigation, there will be no proceeding, investigation or hearing and the CCSAO's argument is moot.

IX. OTHER ISSUES

B. Additional other issues

Response to CUB

CUB argues that “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.” (CUB IB, pp. 26-27)

In terms of the auction, Staff also expressed its concern with respect to the significant levels of executive compensation in the form of Exelon stock options received by certain ComEd witnesses. (Staff IB, pp. 74-75) However, as Staff noted, the Company has made a significant concession that addresses the conflict of interest issue. It agreed to not be present in the room during the actual conduct of the auction so that it cannot be permitted to direct or influence the Auction Manager's conduct of the auction. Further it agreed not to communicate with the Auction Manager during the conduct of the auction. (*Id.*, pp. 75-76) With this restriction along with the measures described to limit the discretion of the Com-Ed employed Auction Manager and to reinforce the Auction Manager's independence, Staff believes that the Company's role in the auction has been satisfactorily narrowed to minimize any undue influence over the auction. (*Id.*, p. 76)

X. CONCLUSION

WHEREFORE, for all the reasons set forth herein, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in this proceeding.

Respectfully submitted,

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