

**ILLINOIS COMMERCE COMMISSION
DOCKET NO. 06-0448**

**DIRECT TESTIMONY
OF
ROBERT CHILTON**

**Submitted On Behalf
Of
AMEREN ILLINOIS UTILITIES**

August 17, 2006

1 **ILLINOIS COMMERCE COMMISSION**

2
3 **Docket No. 06-0448**

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5 **DIRECT TESTIMONY**

6 **OF**

7 **ROBERT CHILTON**

8
9 **I. INTRODUCTION**

10 **Q. Please state your name, position and business address.**

11 A. My name is Robert Chilton. I am Executive Vice President of Gabel Associates, an
12 energy, environmental and public utility consulting firm with its principal office
13 located at 417 Denison Street, Highland Park, New Jersey 08904.

14
15 **Q. Please describe your present responsibilities at Gabel Associates.**

16 A. Gabel Associates provides consulting services to a broad range of energy industry
17 participants, including private commercial and industrial end users, governmental end
18 users, public utilities, generators, renewable power producers, on-site power
19 producers, wholesale market participants and public utility commissions. My
20 responsibilities include: managing the firm's retail power and natural gas
21 procurement activities in which Gabel Associates acts as a buyer's agent for private
22 and governmental end users; preparing and sponsoring testimony on various utility
23 ratemaking matters; assisting clients in developing regulatory strategies; developing
24 strategic energy plans for end users; and assisting generator clients in marketing

1 power and negotiating power sales agreements. I joined Gabel Associates in
2 February 2000.

3

4 **Q. Please describe your educational and professional background.**

5 A. I received a Bachelor of Science degree in Environmental Science from Rutgers
6 University in 1982, and a M.A. degree in Economics from Rutgers University in
7 1989.

8 Prior to joining Gabel Associates, I was employed by the New Jersey Board of
9 Public Utilities (“NJBPU”) for approximately 15 years in various analyst,
10 management and senior management positions. From 1990 through 1997 I served
11 as Director of the Electric Division of the NJBPU, and from 1997 until my departure
12 in February 2000 I served as the Director of the NJBPU’s combined Energy Division
13 (electricity, natural gas, and energy planning). In those senior management positions
14 I was responsible for overseeing the review, litigation and negotiation of public utility
15 rate cases, fuel clause proceedings, generation, transmission and distribution plant
16 construction filings, and demand side management plans.

17 From 1997 through January 2000 my principal responsibility at the NJBPU
18 was to serve as the technical and policy advisor to the NJBPU with respect to electric
19 industry restructuring, to oversee the review, litigation and negotiation of electric
20 utility rate unbundling, stranded cost and restructuring filings, and to support the
21 passage of NJBPU-sponsored electric industry restructuring legislation, including
22 participating in drafting and negotiating legislative language and testifying before
23 New Jersey State Assembly and Senate committees considering the legislation. The

1 Legislature ultimately passed, and the Governor signed into law in February 1999, the
2 Electric Discount and Energy Competition Act (“EDECA”), P.L. 1999, c.23, N.J.S.A.
3 48:3-49 et seq.

4 In 1987, I also served as an economist and rate analyst for the New Jersey
5 Department of the Public Advocate.

6

7 **Q. On whose behalf are you testifying?**

8 A. I am testifying on behalf of Central Illinois Light Company d/b/a AmerenCILCO,
9 Central Illinois Public Service Company d/b/a AmerenCIPS and Illinois Power
10 Company d/b/a AmerenIP (collectively, the “Ameren Illinois Utilities”).

11

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

13 A. The purpose of my testimony is to: (i) give an overview of electric industry
14 restructuring in New Jersey, (ii) explain the important role that securitization played
15 in the initial industry restructuring as well as the subsequent transition to market-
16 based power supply rates, and (iii) discuss the benefits to New Jersey ratepayers
17 achieved as a result of securitization, which may serve as an indicator of the benefits
18 that can be achieved for customers in Illinois.

19

20 **Q. Please summarize the benefits of securitization that have been experienced in**
21 **New Jersey.**

22 A. As I will discuss, securitization has been used throughout the electric industry
23 restructuring process in New Jersey as an important tool in accomplishing the

1 transition from regulated, monopoly markets to competitive markets. Securitization
2 has provided an important means for accomplishing various stages of the transition --
3 first, by helping to maximize the magnitude of rate reductions during a rate cap
4 period through the refinancing of stranded costs, and later by mitigating the rate
5 impacts associated with expiration of the rate caps by providing for long-term
6 financing of deferred Basic Generation Service (“BGS”) costs. Securitization is also
7 providing direct long-term (net present value (“NPV”)) cost savings as compared to
8 alternative cost recovery mechanisms. Moreover, through the use of proceeds to
9 refinance or retire electric utility debt and/or equity, securitization has improved the
10 balance sheets of the electric utilities, which translates into a lower long-term cost of
11 a capital that benefits customers, and an improved ability for utilities to finance
12 infrastructure improvements and fund other public benefit programs and initiatives.

13

14 **II. ELECTRIC INDUSTRY RESTRUCTURING IN NEW JERSEY**

15 **Q. Please describe the overall framework for electric industry restructuring in New**
16 **Jersey.**

17 A. The overall framework for the restructuring of the electric industry in New Jersey is
18 set forth in the 1999 restructuring legislation known as EDECA. In general, EDECA
19 required each electric utility in New Jersey to unbundle rates into separate delivery
20 and power supply components and to introduce retail choice for all customers by
21 August 1999, and to implement phased-in rate reductions coupled with overall rate
22 caps over a designated four-year “transition period” from August 1999 through July
23 2003. (N.J.S.A. 48:3-52 and 53.). EDECA required that for at least the first three

1 years of the transition period the utilities would be responsible for providing BGS to
2 those retail customers who did not obtain power supply from a third party supplier.
3 EDECA required that power for BGS be purchased at “prices consistent with market
4 conditions,” and BGS charges to customers were to be set based upon this market-
5 based cost of power, subject, during the transition period, to the constraints of the rate
6 caps (N.J.S.A. 48:3-57). The utilities were nonetheless ultimately entitled to recover
7 all reasonable and prudent BGS power supply costs, so they were permitted to defer
8 for future recovery the associated costs to the extent they exceeded the rate caps.

9 EDECA provided strong incentives for the vertically-integrated electric
10 utilities to divest generating assets (through either outright sale or transfer to an
11 unregulated affiliate). EDECA provided electric utilities with the opportunity to
12 recover stranded costs associated with transitioning generating assets from a
13 regulated/rate base-rate of return model to a competitive model. Moreover, EDECA
14 provided authorization for the issuance of so-called transition bonds (i.e.
15 securitization) for purposes of recovering a portion of the stranded costs associated
16 with industry restructuring and in order to facilitate compliance with the mandated
17 rate reductions and rate caps (N.J.S.A. 48:3-62). EDECA was later amended to
18 clarify the NJBPU’s authority to permit securitization of deferred power purchase
19 costs to the extent that such costs could not be recovered under the capped rates
20 during the four-year transition period, as discussed in more detail below.

21 **Q. How was this restructuring framework implemented?**

22 A. Each of the four investor-owned electric utilities had a specific restructuring plan
23 approved by the NJBPU, and each plan had some unique aspects within the overall

1 framework. Each utility was required to implement a minimum 5% reduction in
2 overall rates immediately effective August 1999, and the various utilities were
3 required to phase-in additional rate reductions over the ensuing four years totaling
4 anywhere from 10% to 14%. The utilities were also authorized to securitize varying
5 amounts of generation stranded costs to support the minimum rate reduction required
6 by EDECA and, in some cases, additional rate reductions.

7 As part of rate unbundling, each electric utility had established for each of the
8 four years of the transition period a specific schedule of BGS rates, or “shopping
9 credits,” which were negotiated but which were generally based upon the then-
10 forecasted market prices for power over the ensuing four-year period. As part of their
11 commission-approved restructuring plans, during the four-year transition/rate cap
12 period each electric utility was permitted to defer, for future recovery or return to
13 customers any accumulated under or over recovery. Under or over recoveries
14 resulted from any difference between the cost of power incurred by each utility to
15 meet its BGS responsibilities, and BGS revenues received from retail customers
16 under the capped BGS rates. Under the NJBPU-approved restructuring plans, if
17 actual BGS power costs during the transition period exceeded the price being charged
18 to retail customers, the resulting under-recovered deferred balance was to be
19 recovered from customers after the expiration of the rate caps. Similarly, if actual
20 BGS power costs during the transition period were less than the price being charged
21 to retail customers, the resulting over-recovery was to be returned to customers after
22 the expiration of the rate caps.

1 Each of the electric utilities divested most or all of their generating assets,
2 through either outright sales to unaffiliated buyers or via a transfer to unregulated
3 affiliates. As such, without generating assets, each of the utilities was required to
4 develop plans for obtaining power to meet its obligations to provide BGS to
5 customers for at least the first three years of the transition period. The specific plans
6 for each electric utility varied, but all involved wholesale purchases.

7 EDECA required the NJBPU to make a determination by the end of the third
8 year whether to make the opportunity to provide BGS available on a competitive
9 basis. As a result, the NJBPU approved the use of the statewide simultaneous
10 descending-clock auction for the procurement of BGS power for service beginning
11 August 2002, which was the beginning of the fourth and last year of the transition
12 period. The first BGS auction was conducted in February 2002, with power from the
13 auction flowing in August 2002.

14 **Q. Please explain the impact on utility deferred balances during the transition**
15 **period.**

16 A. As I mentioned, during this period, all of the utilities were subject to the rate caps,
17 including the fixed retail BGS rates. As a result, as market prices started to rise above
18 expected levels, utilities to varying degrees began to accumulate deferred BGS power
19 cost balances because the average price paid for power by the utilities exceeded the
20 rates they were permitted to charge customers for the power. In some cases, actual
21 and forecasted deferred balances began to reach substantial levels.

22 Some consideration was given to suspending additional scheduled rate
23 reductions and/or lifting the rate caps in order to stem the flow of the metaphorical

1 “red ink”, actually the accumulation of growing balances of deferred costs.
2 Ultimately, it was determined that the rate caps should remain in place for the full
3 four-year transition period and, as a result, other mechanisms began to be explored to
4 mitigate the financial impact of growing deferred balances on certain utilities and to
5 mitigate the ultimate impact of deferred balance recovery on ratepayers once the rate
6 caps expired.

7 Securitization, which had already been used by the State as a tool to recover
8 stranded costs and help achieve rate reductions during the initial industry
9 restructuring, began to be considered as a means of addressing the growing BGS
10 deferred balance issue. There was debate as to whether or not the original EDECA
11 language provided authorization for the use of securitization bonds for recovery of
12 deferred BGS power costs, and in 2002 a legislative initiative (Senate Bill 869) was
13 undertaken to amend and clarify EDECA to provide specific authorization for the use
14 of securitization for this purpose. Also in 2002, then-Governor McGreevy signed
15 Executive Order No. 25 forming a Deferred Balances Task Force consisting of
16 industry experts to study the issue of deferred balances and to report back to the
17 Governor with, among other things, a specific recommendation with respect to
18 pending Senate Bill 869.

19 The Deferred Balances Task Force Report submitted to the Governor in
20 August 2002 contained actual reported statewide deferred balances of \$560 million as
21 of May 2002, and estimates of statewide deferred balances by the end of the four-year
22 transition period of nearly \$1 billion. Recognizing the customer benefits of
23 securitization, the Deferred Balances Task Force Report recommended that the

1 Governor sign Senate Bill 869, as it would provide the NJBPU with another tool to
2 help ease the impact of deferred balances on ratepayers.

3 S-869, amending N.J.S.A. 48:3-62, was signed into law by the Governor in
4 September 2002 (P.L. 2002, c.84). The law explicitly authorizes recovery of
5 prudently-incurred BGS transition costs (i.e., the amount by which power
6 procurement costs exceeded recovery under capped rates during the transition period)
7 through the issuance of securitization bonds. The proceeds from the securitization
8 bonds are to be used to reduce the amount of BGS transition costs through the
9 refinancing or retirement of electric public utility debt or equity, or both. The cost
10 savings from securitization, whether as a result of a reduction in capital costs or a
11 lengthened recovery period, are to be passed on to customers in the form of reduced
12 rates or mitigated rate increases.

13

14 **Q. Is it anticipated that securitization of deferred BGS costs will be necessary on an**
15 **ongoing basis?**

16 A. No. The legislation (S-869) provides for the securitization of BGS “transition” costs.
17 As the definition suggests, the deferred costs in question are the product of the
18 transition from rate caps, which expired in August 2003, to market-based BGS rates.
19 As described above, the rate caps were in place for a four-year period from August
20 1999 through July 2003. As also discussed above, as market prices rose above the
21 capped BGS rates, deferrals began to be incurred. During the last year of the
22 transition period (August 2002 through July 2003), power was procured via the first
23 statewide descending clock auction that had been conducted in February 2002. While

1 the auction prices were favorable in light of market conditions and the resultant
2 deferrals were less than what had been expected, the auction prices still somewhat
3 exceeded the capped BGS rates that had been set four years earlier. As a result, some
4 additional BGS cost deferrals were incurred during that last year of the transition
5 period.

6 Beginning in August 2003, with the expiration of the rate caps, BGS rates
7 were and are set going forward consistent with market conditions, as dictated by the
8 annual auction results. As such, since August 2003, the BGS rates charged to
9 customers have been equal to the market cost of power being paid by the utilities to
10 BGS suppliers. As such, there are no further BGS deferrals being accrued.
11 Accordingly, the BGS deferral is a static and fixed amount for each utility, and is
12 thereby regarded as a “transitional,” rather than a permanent, issue. Securitization
13 provides an important tool for helping address this one-time, transitional issue by
14 providing for cost recovery in a manner that mitigates or “smooths out” the overall
15 rate impact associated with the transition to market-based power supply rates.

16
17

18 **III. THE BENEFITS OF SECURITIZATION BONDS TO**
19 **NEW JERSEY CUSTOMERS**

20 **Q. Have New Jersey utilities sought and received authority to securitize deferred**
21 **BGS costs since the passage of S-869?**

22 **A.** Yes. In May 2004, the NJBPU approved a request by Rockland Electric Company
23 (“RECO”) for the issuance of approximately \$46.3 million in bonds, comprised of

1 \$44.3 million of deferred BGS costs (\$75.2 million in deferred costs calculated net of
2 tax) plus an estimated \$2 million in upfront transaction costs. In June 2005, the
3 NJBPU approved a request by Public Service Electric and Gas Company (“PSE&G”)
4 for the issuance of up to \$102.7 million in bonds, comprised of \$100 million of
5 deferred BGS costs (the estimated net of tax balance) plus an estimated \$2.7 million
6 in upfront transaction costs. In June 2006, the NJBPU approved a request by Jersey
7 Central Power & Light Company (“JCP&L”) for the issuance of up to \$183.5 million
8 in bonds, comprised of \$180 million of deferred BGS costs (the estimated net of tax
9 balance) plus an estimated \$3.5 million in upfront transaction costs

10

11

12 **Q. What are the benefits associated with the securitization in New Jersey?**

13 A. As described above, securitization has been utilized throughout the electric industry
14 restructuring process in New Jersey as an important tool in accomplishing the
15 transition from regulated, monopoly markets to competitive markets. Securitization
16 has provided an important means for accomplishing various stages of the transition --
17 first, by helping to maximize the magnitude of rate reductions during the rate cap
18 period through the refinancing of stranded costs, and later by mitigating the rate
19 impacts associated with expiration of the rate caps by providing for long-term
20 financing of deferred BGS costs. Securitization is also providing direct long-term
21 (NPV) cost savings as compared to alternative cost recovery mechanisms. Moreover,
22 through the use of proceeds to refinance or retire electric utility debt and/or equity,
23 securitization has improved the balance sheets of the electric utilities, which translates

1 into a lower long-term cost of a capital that benefits customers, and an improved
2 ability for utilities to finance infrastructure improvements and fund other public
3 benefit programs and initiatives.

4

5 **Q. Can the magnitude of direct ratepayer savings be quantified?**

6 A. Yes. The magnitude of securitization savings have been quantified and/or estimated
7 in various NJBPU Orders. It is important to point out that there can be no
8 generalization made regarding the magnitude of ratepayer savings typically
9 associated with securitization, and each transaction must be evaluated on its own.
10 The overall impact of savings and related rate impact will depend, among other
11 things, on the total amount of costs being securitized, the relative proportion of those
12 total costs to the overall size (i.e., total revenues, number of customers, etc.) of the
13 utility, the term of the securitization bonds and the interest rate market conditions at
14 the time of the issuance of the bonds. That said, however, direct ratepayer savings
15 associated with securitization are typically derived by comparing bond debt service
16 and related tax payments to alternative utility cost recovery mechanisms, i.e., the
17 utility's overall cost of capital.

18

19 **Q. Why is it appropriate to use the utility's overall cost of capital as a basis for**
20 **comparison?**

21 A. There are several reasons. First, traditional utility debt is simply not rated as high as
22 securitized debt, meaning that, for a given debt term, utility's pay higher interest rates
23 than can be obtained via securitization. Second, to the extent appropriate at all, the

1 use of a debt-only interest rate on a deferred balance is more appropriate for a
2 relatively short-term deferred balance amortization. The longer the amortization
3 period (and the larger the deferred balance) the more of a financial burden the
4 deferred balance places on the utility. Thus, a higher carrying cost is appropriate, not
5 only to reflect the higher cost of long-term debt but also to provide the utility a return
6 reflective of its overall capital structure. The appropriate use of the utility's overall
7 cost of capital as the benchmark for quantifying securitization savings is bolstered by
8 the fact that bond proceeds are required to be used to refinance or retire existing
9 utility debt and equity.

10 Certainly, absent a special financing mechanism such as securitization, for an
11 extended amortization period used to mitigate rate impacts a rate of return
12 commensurate with the utility's overall capital structure (i.e., at the utility's overall
13 allowed rate of return on rate base) is appropriate.

14 With this dynamic, of assuming for the "alternative" recovery mechanism a
15 higher carrying cost the longer the assumed amortization period, there is typically a
16 trade-off between immediate rate reductions (greater rate relief is accomplished via a
17 long amortization period) and long-term NPV savings (NPV savings are typically
18 associated with a short amortization at a low interest rate). Conversely, securitization
19 provides the ability to reasonably achieve a long amortization period at a relatively
20 low carrying cost, enabling the achievement of both immediate rate relief and long-
21 term NPV benefits.

22

1 **Q. Please provide some specific examples of the benefits of securitization in New**
2 **Jersey.**

3 A. The first issuance of securitization bonds in New Jersey was implemented by
4 PSE&G, in which it was authorized as part of its approved restructuring plan to
5 securitize approximately \$2.4 billion in stranded costs. The anticipated securitization
6 provided the basis for an additional 3% in overall rate reductions (on a total revenue
7 base at the time of approximately \$4 billion annually) above and beyond the
8 mandated minimum rate reductions required by EDECA during the four-year
9 transition period. Moreover, it was projected that over the life of the bonds there
10 would be about \$300 million in NPV savings to customers as compared to the
11 standard revenue requirement treatment.

12 In February 2002, the NJBPU approved the issuance of up to \$325 million in
13 securitization bonds by JCP&L to securitize \$320 million in stranded costs (net of
14 tax) plus up to \$5 million in transaction and other costs. The actual rate reduction
15 benefits associated with the securitization of stranded costs had been anticipated and
16 incorporated into JCP&L's rates at the time JCP&L's restructuring plan was
17 approved in 1999. The NJBPU Order accepted JCP&L's calculation of the NPV rate
18 reduction benefits associated with the stranded cost securitization, amounting to
19 approximately \$190 million.

20

21

22 **Q. Does this conclude your direct testimony?**

23 A. Yes.

