

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
Investigation of Rider CPP of	:	
Commonwealth Edison Company, and Rider	:	
MV of Central Illinois Light Company d/b/a	:	No. 06-0800
AmerenCILCO, of Central Illinois Public	:	
Service Company d/b/a AmerenCIPS, and	:	
of Illinois Power Company d/b/a AmerenIP,	:	
pursuant to Commission Orders regarding	:	
the Illinois Auction	:	

Rebuttal Testimony of

CHANTALE LACASSE, PH.D.

Senior Vice President, NERA Economic Consulting

and

Auction Manager for the 2006 Illinois Auction

Submitted on Behalf of

COMMONWEALTH EDISON COMPANY

and

CENTRAL ILLINOIS LIGHT COMPANY
CENTRAL ILLINOIS PUBLIC SERVICE COMPANY
ILLINOIS POWER COMPANY

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1 **I. Introduction**

2 Q. Please state your name and business address.

3 A. My name is Chantale LaCasse. My business address is 1166 Avenue of the Americas,
4 New York, NY 10036.

5 Q. By whom and in what capacity are you employed?

6 A. I am a Senior Vice President with National Economic Research Associates, Inc.
7 (“NERA”). I was also retained, with the approval of the Illinois Commerce Commission
8 (“Commission” or “ICC”), to serve as the Auction Manager for the 2006 Illinois Auction.

9 Q. Are you the same Dr. Chantale LaCasse that previously filed direct testimony in this
10 proceeding?

11 A. Yes, I am.

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

13 A. The purpose of my rebuttal testimony is to evaluate and consider the detailed
14 recommendations for improvement regarding certain aspects of the Auction process.

15 Q. Which recommendations will you be evaluating?

16 A. In my rebuttal testimony, I will respond to the following recommendations:

17 1) recommendations put forward by Staff witnesses Kennedy and Zuraski regarding
18 tranche size (ICC Staff Exhibit 1.0, lines 316-386);

19 2) recommendations and comments on term structure by Dr. Kennedy and Mr. Zuraski
20 (ICC Staff Exhibit 1.0, lines 387-424); and

21 3) a proposal that the notional quantity language found in the second paragraph of
22 Section 5.4.a be made optional at the Supplier's discretion.

23 I will respond to AG witness Rose's comments regarding the auction format and
24 the evaluation of its results. In particular, I will evaluate and respond to Dr. Rose's
25 comments on a reserve price and on other benchmarks that he suggests the Commission
26 use to assess the results of the Auction (AG Exhibit 1.0, lines 39-41 and 213-216).

27 With regard to the application process, I will explain why I continue to oppose
28 Staff witness Phipps' recommendation for bidders to provide their own assessment of
29 tangible net worth in the application process (ICC Staff Exhibit 2.0, lines 48-56).
30 However, I will offer an alternative recommendation that may improve the application
31 process in the way desired by Ms. Phipps while still aiming to minimize the risk that a
32 prospective supplier will submit a deficient application and be unable to remedy the
33 deficiencies in the time required.

34 I will also evaluate recommendations to improve the auction timeline and to
35 further define the confidentiality of bidder and auction information. These include:

36 1) the recommendation put forward by Dr. Kennedy and Mr. Zuraski regarding the
37 timing of the Confidential Report of the Auction Manager (ICC Staff Exhibit 1.0, lines
38 487-505);

39 2) the provision proposed by Dr. Kennedy and Mr. Zuraski for inclusion in Rider CPP
40 and in Rider MV to provide further definition to the treatment of confidential bidder and
41 auction information (ICC Staff Exhibit 1.0, lines 153-155 and 509-532); and

42 3) the proposal to change the timing of future auctions.

43 Q. How is your rebuttal testimony structured?

44 A. The sections of my rebuttal testimony follow in the order of the areas listed above. I will
45 comment on the definition of the product, the auction format and criteria to judge the
46 results of the Auction, the application process, and finally the timeline and confidentiality
47 of bidder and auction information.

48 **II. Product**

49 Q. In the context of the Illinois Auction, what is a tranche?

50 A. In the context of the Illinois Auction, a tranche is a percentage of the load for a load
51 category served under the auction contracts. For example, in the 2006 Auction, there
52 were 278 tranches for the CPP-B load category (ComEd's residential and non-residential
53 customers at or under 400 kW, except for self-generating customers). Each tranche
54 represented 0.36% of the load for that category.

55 Q. You just stated that there were 278 tranches for the CPP-B load category. How is the
56 number of tranches set for a load category?

57 A. The number of tranches for each load category is set so that each tranche is
58 approximately 50 MW of peak demand on an eligible basis. This means that if all
59 customers eligible to take CPP-B (the utility service) do take it, a tranche would be 50
60 MW of peak demand (by which I mean PJM peak load contribution). This methodology
61 was accepted by the Commission in Docket Nos. 05-0159, 05-0160, 05-0161, and 05-
62 0162 (the "Procurement Dockets").

63 Q. Dr. Kennedy and Mr. Zuraski (ICC Staff Exhibit 1.0, lines 351-371) recommend that this
64 methodology be modified. What is the rationale put forward by Dr. Kennedy and Mr.
65 Zuraski for this recommendation?

66 A. Dr. Kennedy and Mr. Zuraski point out that although all tranches in the Auction are the
67 same size on an eligible basis, the tranche size on an expected load basis varies
68 significantly between, on one hand, the tranches of residential and smaller non-residential
69 customers (CPP-B customers for ComEd and BGS-FP for the Ameren Illinois Utilities)
70 and, on the other hand, the tranches of larger non-residential customers (CPP-A
71 customers for ComEd and BGS-LFP for the Ameren Illinois Utilities). Larger customers
72 are more prone to choosing service from an alternative retail electric supplier (“RES”).
73 On an expected load basis, a tranche of CPP-A will be smaller than a CPP-B tranche and
74 a BGS-LFP tranche will be smaller than a BGS-FP tranche. These expectations are borne
75 out by the facts. Dr. Kennedy and Mr. Zuraski report (ICC Staff Exhibit 1.0, lines 337-
76 340) that currently, for ComEd, a tranche of the CPP-A load category is 7 MW in actual
77 size while a CPP-B tranche is 44 MW in actual size (i.e., measuring only customers that
78 do take the service).

79 Dr. Kennedy and Mr. Zuraski argue that this disparity in expected load associated
80 with the various products reduces the willingness of suppliers to switch between
81 products. Modifying the methodology of how the number of tranches is set so as to have
82 tranches of more similar sizes across load categories will, in their opinion, increase the
83 willingness of suppliers to switch across the products and thereby increase competition
84 afforded by the simultaneous descending clock auction format.

85 Q. Do you agree with this rationale?

86 A. Yes. I believe that tranches of similar size promote the willingness of suppliers to switch
87 across products and favor competition in the Auction.

88 Q. How do Dr. Kennedy and Mr. Zuraski propose to determine the number of tranches?

89 A. They recommend that the Auction Manager be authorized to redefine the size of the
90 tranches. They propose that the Auction Manager take into account switching statistics to
91 set the number of tranches so that each tranche is 50 MW on an expected load basis
92 rather than on an eligible load basis (ICC Staff Exhibit Ex. 1.0, lines 351-371). The
93 details of the methodology, like the details of the methodology for price decrement
94 formulas, would be determined prior to the release of the final Auction Rules.

95 Q. Is determining expected load a simple task?

96 A. No. As a general matter, determining the “expected load” is not a simple task and it
97 would yield at best a potentially wide range of reasonable estimates. The expected load
98 for a load category will depend importantly on the price of utility service determined
99 through the Auction – a price that is not known several months before the Auction when
100 the expected load is estimated. The expected load in each load category will depend on
101 load growth and general economic conditions. The expected load in each load category
102 will also depend on a number of other factors that are not knowable with much accuracy
103 at the time the estimate is made, such as the price of offerings by RESs, the ability of
104 RESs to market to different types of customers, and the features of the service offered by
105 RESs. The expected load may also depend on the number of customers that have
106 already secured service from a RES on a multi-year basis, as such customers may not be
107 free to return to utility service during the next enrollment window. I note that, should a
108 pre-qualification for larger non-residential customers be adopted, the revised proposals

109 by witness Blessing (Ameren Illinois Utilities' Exhibit 6.0) on behalf of the Ameren
110 Illinois Utilities and by ComEd witness McNeil (ComEd Exhibit 2.0) may provide
111 information in this regard.

112 Q. Is it clear to you what Dr. Kennedy and Mr. Zuraski mean by "expected load"?

113 A. For larger non-residential customers, I believe the concept is clear. The expected load is a
114 forecast or estimate of the load that would be anticipated during the one-year supply
115 period starting on June 1 after the Auction. All proposals regarding the term structure for
116 these larger non-residential customers are for a one-year term. Given the proposals by
117 ComEd (ComEd Exhibit 1.0, lines 63-71, lines 444-462) and the current customer
118 switching rules for the Ameren Illinois Utilities, the load is basically constant throughout
119 the year. Once CPP-A and BGS-LFP customers are on the service at the beginning of the
120 supply period in June 2008, they will have to remain on the service to the end of the
121 supply period, barring exceptional circumstances such as a customer leaving the utility
122 territory because it is going out of business. There is a single quantity to be forecasted
123 for each of the CPP-A and BGS-LFP categories. The determination of this forecasted or
124 expected load likely would yield a wide range of reasonable estimates because of the
125 uncertainty surrounding the factors that I identified above – but the concept is certainly
126 clear for these large non-residential customers.

127 The concept is not as clear for residential and smaller non-residential customers,
128 for two reasons. First, a CPP-B or a BGS-FP customer can leave during the supply
129 period to take service from a RES, and a customer currently taking service from a RES
130 can return to CPP-B or BGS-FP service (subject to them remaining on the service for one
131 year). Unlike larger non-residential customers, the pool of customers taking the service

132 is not fixed during the supply period. The load could vary with migration. There is no
133 single quantity to be forecasted. It is then not so clear what expected load is – it could
134 mean the average load over the entire supply period, the average load over the next year,
135 the mid-point of some range of minimum or maximum load, or some other measure.
136 Second, supply for these customers is procured beyond a one-year horizon. Under all
137 proposals for the term structure of the CPP-B and BGS-FP products, whether it be the
138 proposal that I supported in my direct testimony (Auction Manager Exhibit 1.0, lines
139 1167-1175) of a mix of 1-year and 3-year contracts, or Staff’s two alternatives (a mix of
140 1-year, 2-year, and 3-year contracts, and consecutive one-year contracts), there are
141 multiple product terms in the Auction and the 2008 Auction procures a portion of these
142 customers’ needs up to May 2011. With various product terms, it is again not clear to me
143 what expected load is – it could be determined separately for each contract term included
144 in the Auction, there could be a single measure that applies to all customers in this load
145 category, or something in between. I would note that determining expected load –
146 however defined – to cover a three-year horizon is likely problematic. Retail markets can
147 be expected to continue to develop and customers can be expected to become more aware
148 of their choices; quantifying these trends is likely to be a difficult task.

149 Q. Given the concerns you express, do you have suggested modifications to the Staff’s
150 proposal that will, in your view, make it more effective at achieving its goals?

151 A. Yes. My first proposed modification is in setting the target for tranches for residential
152 and smaller non-residential customers of the CPP-B and BGS-FP load categories. I
153 propose that the tranches for residential and smaller non-residential customers target 50
154 MW of actual load (by which I mean PJM peak load contribution for the CPP-B

155 customers and the actual MISO peak load for the BGS-FP customers). This calculation
 156 would be made shortly before tranche targets are finalized (by September 17, 2007
 157 according to the timeline in Auction Manager Exhibit 1.9b). The calculation would use
 158 the actual load for each of the CPP-B and BGS-FP load categories and would apply to all
 159 terms or products associated with the load category. This avoids the necessity to define
 160 expected load (i.e., to define the quantity to forecast) and it avoids the necessity to
 161 consider this notion over a several-year horizon.

162 My second proposed modification is in setting the target for tranches for larger
 163 non-residential customers. I agree with Staff that the target for these tranches should use
 164 an expected load notion that would account for switching statistics, as well as any other
 165 relevant information. I propose that this information be used to obtain a range of
 166 reasonable estimates of the expected load for the CPP-A and BGS-LFP load categories. I
 167 propose using the highest of these reasonable estimates to set the number of tranches for
 168 the CPP-A and BGS-LFP load categories. The number of tranches would be set so that
 169 the target for the tranche size is 50 MW (in terms of the PJM peak load contribution for
 170 the CPP-A customers and the actual MISO peak load for the BGS-LFP customers). For
 171 example, suppose that the data was the following:

Table 1. Alternative proposal					
1		CPP-B and BGS-FP Load Categories		CPP-A Load Category	BGS-LFP Load Category
2	Actual load (9/07)	5,100 MW	Expected Load Estimates	400 to 3,200MW	50 to 1,200MW

3	Number of tranches	102	Number of tranches	64	24
4	MW per tranche (actual basis)	50 MW	MW per tranche (expected basis)	50 MW	50 MW
5	MW per tranche (eligible basis)	63 MW	MW per tranche (eligible basis)	75 MW	75 MW

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With a target of 50 MW of actual load, there would be approximately 102 tranches for the CPP-B and BGS-FP load categories ($5,100 \text{ MW} / 50 \text{ MW} = 102$). There would be 64 tranches for the CPP-A load category so that the CPP-A tranche is 50 MW ($3,200 \text{ MW} / 64 = 50 \text{ MW}$) using the highest estimate in the range of reasonable estimates of expected load. Similarly, there would be 24 BGS-LFP tranches ($1,200 \text{ MW} / 50 \text{ MW} = 24$) of 50 MW on the basis of the highest estimate of expected load.

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Q. How is your proposal an improvement over setting tranches based on eligible load or over Staff's proposal?

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A. Staff rightly points out that if tranches are set based on eligible load, this is likely to lead to tranches for residential and smaller non-residential customers being significantly larger than tranches for larger non-residential customers on an expected and actual load basis. My proposal addresses this concern by matching the expected size of the tranches for larger non-residential customers to the size of the tranches of the residential and smaller non-residential customers. (This is illustrated below: row 5 of Table 2 illustrates the potential disparity when setting the tranches on an eligible basis while row 4 of Table 1 shows how this disparity is absent in the alternative.) Staff's proposal addresses this concern as well.

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Table 2. Tranches set on eligible basis (2006 method)				
1		CPP-B and BGS-FP Load Categories	CPP-A Load Category	BGS-LFP Load Category
2	Eligible Load	6,400 MW	4,800 MW	1,800 MW
3	Number of tranches	128	96	36
4	MW per tranche (eligible basis)	50 MW	50 MW	50 MW
5	MW per tranche (actual and expected basis)	39.8 MW	4.2 MW to 33.3 MW	1.4MW to 33.3 MW

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My proposal, however, also addresses the opposite concern, that tranches for residential and smaller non-residential customers would be significantly smaller than tranches for larger non-residential customers. It addresses this concern by using the highest reasonable estimate of load to set the tranches for larger non-residential customers. This minimizes the risk that the estimate of expected load used for larger non-residential customers is mistakenly low, so that there would be fewer tranches for larger non-residential customers than there should be, and the tranches for larger non-residential customers would end up being too large. (This is illustrated above in row 5 of Table 1: if the estimate of expected load was too low so that in fact all eligible CPP-A and BGS-LFP customers were to take the service unexpectedly, the actual size of tranches would be 75 MW).

202 Q. You propose using actual load for residential and smaller non-residential customers.
203 Wouldn't it be simpler to target 50 MW of actual load for larger non-residential
204 customers as well?

205 A. It certainly would be simpler, but I do not believe that this would be advisable. Taking
206 actual load as the expected load for larger non-residential customers has an inherent and
207 recognizable bias. It assumes that there will be minimal changes in the decisions of
208 customers on the basis of the 2008 Auction results or as a result of any further
209 development of the retail market. However, several proposals have been put forward by
210 various parties in this proceeding related to the CPP-A and BGS-LFP products with the
211 goal of making these options more economical for consumers. Should the Commission
212 approve some or all of these improvements, and should they have the hoped-for effects,
213 the actual load in September 2007 will underestimate expected load in June 2008. If the
214 number of tranches were set on the basis of actual load for larger non-residential
215 customers, there would almost certainly be too few tranches in the Auction for the CPP-A
216 and BGS-LFP load categories, with the result that these tranches would almost certainly
217 be too big.

218 In fact, given current migration statistics, there would be a single tranche for the
219 BGS-LFP load category since there is approximately 50 MW of load currently on this
220 service (Ameren Illinois Utilities' Exhibit 1.0, lines 116-117). This highlights the
221 concern opposite from the one that prompted Staff to make its proposal on tranche size.
222 If, following the 2008 Auction, customers were to return to utility service, the tranches
223 that suppliers would have to serve could potentially be much larger than the 50 MW of
224 expected load targeted by Staff. At the extreme, if all larger non-residential customers

225 were to return to Ameren Illinois Utilities' service, the tranche would be approximately
226 1853 MW (Ameren Illinois Utilities' Exhibit 1.0, lines 116-117). The risk that the actual
227 tranche size would be substantially larger than the target of 50 MW is a risk that suppliers
228 would take into consideration in making their bids and is a risk that would tend to put an
229 upward pressure on the price for these customers.

230 Q. How do you propose that the reasonable range of expected load and the maximum bound
231 of the range be determined?

232 A. I agree with Staff's proposal that this methodology could be set, as for the decrement
233 formulas, by the Auction Manager in consultation with Staff and the Utilities, before the
234 finalization of the Auction Rules. It is appropriate for the details to be set before tranche
235 targets are calculated are announced on September 17, 2007, in advance of the Part 1
236 Application.

237 Q. In the current tariffs, the next Auction would procure supply for each utility's residential
238 and smaller non-residential customers for a single three-year term, from June 2008 to
239 May 2011. Dr. Kennedy and Mr. Zuraski recommend that the Auction feature multiple
240 terms for serving residential and smaller non-residential customers (ICC Staff Exhibit
241 1.0, lines 129-137). Did you address this issue in your direct testimony?

242 A. Yes. In my direct testimony, I note that the proposal from ComEd and the Ameren
243 Illinois Utilities to procure a blend of one-year and three-year contracts responds to
244 Staff's objective to procure supply for this load category using multiple terms. As
245 discussed in more detail in my direct testimony (Auction Manager Exhibit 1.0, lines
246 1164-1228), I support this proposal because having a variety of contract terms is likely to
247 attract a wider pool of suppliers compared to having a single term. The wider pool of

248 suppliers that a blend of one-year and three-year contracts would attract serves to
249 heighten the competition at the Auction. This in turn serves to deliver reliable supply to
250 customers at competitive market prices.

251 Q. Dr. Kennedy and Mr. Zuraski propose two different structures of multiple terms in the
252 Auction: a mix of 1-year, 2-year and 3-year terms, or multiple consecutive one-year
253 terms. Can you explain the nature of the Auction products in Staff's favored approach,
254 consecutive one-year terms, and in the Staff's alternative, which involves a mix of 1-year,
255 2-year, and 3-year terms?

256 A. Certainly. Staff's favored approach is to break the single three-year term to provide
257 supply for residential and small non-residential customers from June 2008 through May
258 2011 that is envisaged by the current tariff into three consecutive terms, each term being
259 of one year in duration. The first contract would be to provide supply from June 2008 to
260 May 2009 ("Year 1"). The second contract would be to provide supply one year hence for
261 a one-year term, from June 2009 to May 2010 ("Year 2"). The third contract would be to
262 provide supply two years hence for a one-year term, from June 2010 to May 2011 ("Year
263 3"). In the Auction, there would be an equal number of tranches for each term.

264 Staff's alternative is to have the same mix of terms as in the 2006 Auction. There
265 would be three contracts for different terms. The first contract would be to provide
266 supply from June 2008 to May 2009 (the "1-year" product or term). This contract term is
267 common to both approaches. The second contract would be to provide supply again
268 starting in June 2008, but this time for a two-year term, from June 2008 to May 2010 (the
269 "2-year" product or term). The third contract would be to provide supply for a three-year
270 term, again starting in June 2008 and ending in May 2011 (the "3-year" product or term).

271 In Staff’s alternative, the terms are overlapping while in Staff’s preferred
 272 approach, the terms are consecutive. This is illustrated in the figure below.

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Staff’s Preferred Option						
		Jun-08	Jun-09	Jun-10	Jun-11	Jun-12
January 2008		1-year	1-year	1-year		
January 2009			1-year	1-year	1-year	
January 2010				1-year	1-year	1-year
Staff’s Alternative						
		Jun-08	Jun-09	Jun-10	Jun-11	Jun-12
January 2008		1-year				
		2-year				
		3-year				
January 2009			1-year			
			2-year			
			3-year			
January 2010				1-year		
				2-year		
				3-year		

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275 Q. From a bidding perspective, is it significant that, in Staff’s preferred alternative, the
 276 structure is one of consecutive terms rather than being a structure with overlapping terms,
 277 as is the case in Staff’s alternative and as was used in the 2006 Auction?

278 A. Yes, it is quite significant. Most bidders will consider consecutive one-year terms to be
 279 “complements.” Products that go together are complements, like a right shoe and a left
 280 shoe. Having an extra right shoe might occasionally come in handy, but generally a right
 281 shoe is much more valuable if one has the left shoe to go along with it. In an Auction
 282 with consecutive one-year terms, a bidder wanting to supply over, say, a two-year period
 283 (from June 2008 to May 2010) must win in fixed proportions the two different terms in
 284 the Auction: Year 1 (June 2008 to May 2009), and Year 2 (June 2009 to May 2010). The

285 consecutive one-year terms are complements for this bidder. In an Auction with a mix of
286 1-year, 2-year, and 3-year terms, the bidder can bid to supply a two-year term directly by
287 bidding to win tranches of the 2-year contract.

288 Essentially, then, the difference is this. An Auction with consecutive one-year
289 terms forces the bidder to buy right shoes and left shoes separately, with the possibility of
290 getting the odd right shoe without its mate. An Auction with a mix of 1-year, 2-year, and
291 3-year terms allows bidders to buy shoes in pairs.

292 Q. A bidder in an Auction with a mix of overlapping 1-year, 2-year, and 3-year terms may
293 also bid to win different terms. Is the situation of a bidder bidding to win a multiple-year
294 contract in an Auction with consecutive one-year terms, like the one you just described,
295 really so different from a bidder bidding to win tranches of different terms in an Auction
296 with overlapping terms?

297 A. Yes, it is. Let's take for example a bidder in an Auction with a mix of 1-year, 2-year, and
298 3-year terms that aims to supply mainly 3-year tranches but that also aims to win some 1-
299 year tranches. This means that the bidder is bidding to win a given amount of the 3-year
300 contract and a smaller amount of the 1-year contract if its expectations of the price
301 differences between these terms are accurate.

302 The similarity between this bidder and a bidder bidding to win a multiple-year
303 contract in an Auction with consecutive terms is that the bidder that we are considering
304 here also is bidding to win multiple terms. The much more significant difference
305 between these two situations is that the bidder wanting to bid on a combination of 1-year
306 and 3-year terms sees these products as substitutes rather than complements. Products are
307 substitutes when one can be used instead of another, like Coke[®] and Sprite[®]. Someone

308 who likes both Coke[®] and Sprite[®] might like to buy cans of both, but if the price of
309 Sprite[®] were to triple, this person conceivably would turn to buying only Coke[®].
310 Similarly, should prices in the Auction be different from the bidder's initial expectations,
311 for example because the difference in prices unexpectedly favors the 1-year term over the
312 3-year term, the bidder will likely adjust its bidding strategy to supply more on a one-year
313 horizon and less on a three-year horizon. Practically speaking, the bidder will switch
314 tranches from the 3-year contract into the 1-year contract. With prices sufficiently
315 different from its initial expectations, the bidder could change its mind entirely, switching
316 all its tranches into the 1-year term to bid to supply only the 1-year contract.

317 Q. What is the importance of this bidder's incentive to switch from one term to another in an
318 Auction that has a mix of 1-year, 2-year, and 3-year terms?

319 A. It is the ability and incentive of bidders to switch that establishes prices for the 1-year, 2-
320 year, and 3-year terms that are consistent with the market's view of differences in cost of
321 serving these different terms. Bidders can and do respond to a price differential between
322 two products that is larger than what they believe is warranted by the difference in costs
323 or in risk. Bidders respond by switching tranches to the higher-priced product.
324 Switching to the higher-priced product makes the price of this product tick down faster
325 and closes the differential in price. At the end of the Auction, the prices of the different
326 terms and products are consistent with the market's views.

327 Q. In an Auction with consecutive one-year terms, would switching occur in the same way
328 to establish prices that are consistent with the market?

329 A. The incentives to switch are damaged and diminished in an Auction with consecutive
330 one-year terms. Consider this time a bidder interested in serving a three-year contract in

331 an Auction with consecutive one-year terms. The bidder bids on each of the three
332 consecutive one-year terms. These contracts are complements for such a bidder. Just
333 like having only one right shoe, this bidder may place little value on obtaining only a
334 Year 2 contract without also obtaining a Year 1 and a Year 3 contract. Stated another
335 way, the price at which the bidder would be willing to serve the Year 2 contract alone
336 may be high compared to the average price at which the bidder would be willing to serve
337 the Year 1, Year 2, and Year 3 contracts together. Should prices in the Auction be
338 different from the bidder's initial expectations, for example because the difference in
339 prices between the Year 2 and the Year 3 contracts unexpectedly favors the Year 2
340 contract, the bidder will not have the same incentive to switch tranches from the Year 3
341 contract toward the Year 2 contract. The bidder is interested in obtaining all three
342 contracts together and will not systematically bid to substitute one contract for another.
343 The bidder does not press the lever that would bring the price of the Year 2 contract
344 down. What is relevant to this bidder is the average price that the bidder could obtain
345 from serving all three years, and the price for any one of these terms is of much lesser
346 relevance. Although the bidder has the ability to switch, the bidder does not have an
347 incentive to switch from one contract term (or product) to another in response to the
348 prices of these two terms.

349 Q. Are you saying that there would be no circumstances in which a bidder would switch
350 from one contract term to another in an Auction with consecutive contract terms?

351 A. No, there is a sharp lessening in the incentives to switch among products, and the
352 incentives to switch are damaged, but they are not totally absent. For example, our
353 bidder wanting to supply over a three-year term may reconsider its strategy when it sees

354 that the difference in prices between the Year 2 and the Year 3 contracts unexpectedly
355 favors the Year 2 contract. This outcome could be unexpected to the bidder because a
356 one-year contract a year further into the future should carry more risk and everything else
357 equal should command a higher price. On that basis, the bidder could decide to supply a
358 two-year term instead, covering only Year 1 and Year 2. The bidder could simply
359 withdraw its tranches of Year 3 to accomplish this. Alternatively, the bidder could also
360 switch its Year 3 tranches into Year 1 and Year 2 tranches. It would switch into both the
361 Year 1 and Year 2 tranches because the bidder would consider these two terms as
362 complements and would want to supply both together. The bidder would switch from
363 Year 3 into Year 1 even if, everything else being equal, the difference in price between
364 Year 3 and Year 1 favored Year 3; in other words, the bidder could be willing to switch
365 toward a less favorable product as long as the combination of Year 1 and Year 2 was
366 sufficiently attractive. This is what I mean when I say the incentive to switch is
367 “damaged”: bidders can no longer be expected to behave by systematically switching
368 toward products and terms that are higher-priced when the price differential between
369 these products is too wide and putting downward competitive pressures on the prices of
370 these higher-priced products.

371 Q. If this lessening of the incentives to switch among products or terms in an Auction with
372 consecutive one-year terms occurs, what is the consequence?

373 A. The consequence is that the prices in the Auction may not be as competitive or as fully
374 reflective of the market.

375 Q. Do you expect a structure with consecutive one-year terms to have other effects on
376 bidding behavior, especially on the bidding behavior of bidders seeking multiple-year
377 contracts?

378 A. Yes. I expect a given bidder that seeks a multiple-year contract (i.e., a term of two years
379 or three years starting in June 2008) to bid less aggressively in an Auction with
380 consecutive one-year terms. By “less aggressively,” I mean that I expect such a bidder
381 would be unwilling to offer as high a quantity into the Auction and/or would be unwilling
382 to accept as low a price. Such a bidder is seeking to win tranches of several terms in a
383 given proportion – buying right and left shoes separately and trying to assemble them into
384 pairs – but the bidder realizes ahead of time that it may not succeed. There is a risk that
385 the bidder will not win the different terms in its preferred proportions and/or that it will
386 win only one component of its preferred combination at a price that is unattractive. For
387 example, a bidder could withdraw from bidding on both Year 1 and Year 2 once it can no
388 longer compete at the average price of Year 1 and Year 2, but it nevertheless wins
389 tranches of Year 2 at a price that it believes is unattractive. The bidder will anticipate
390 these risks and will devise its bidding strategy to avoid these risks. For example, instead
391 of withdrawing from bidding on both Year 1 and Year 2 only once it can no longer
392 compete at the average price of Year 1 and Year 2, the bidder may withdraw from
393 bidding earlier, when it still finds the price for Year 2 attractive on a stand-alone basis.
394 This results in a lessened downward pressure on prices. This may also result in an
395 inefficient allocation of load. This would occur if the bidder bidding on both Year 1 and
396 Year 2 would have been willing to offer a lower price than bidders that won the Year 1
397 and Year 2 contracts separately if it had an assurance of winning the tranches in the

398 desired proportion. But without that assurance, the bidder bidding on both Year 1 and
399 Year 2 withdrew from bidding earlier, and other bidders won the Year 1 and Year 2
400 contracts separately at higher prices.

401 A bidder's bidding strategy in an Auction with consecutive one-year terms is
402 necessarily more complicated for several reasons. First, it must evaluate a number of
403 additional risks and potential outcomes, such as winning a contract for only one piece of
404 its desired combination. Second, a bidder will base its decisions not only on the prices
405 for each one-year contract, but on various weighted averages of these prices that the
406 bidder will need to calculate round by round. Third, it is also necessarily more
407 complicated because bidders have an opportunity to bid on the same contract term in
408 multiple auctions. For example, the contract term of June 2010 to May 2011 is bid out in
409 the 2008 Auction (as "Year 3"), and in the 2009 Auction (as "Year 2"), and in the 2010
410 Auction (as "Year 1"). A bidder that wants to bid on the contract term from June 2010 to
411 May 2011 not only can decide how much to bid, but can also decide when (in which
412 Auction) to bid. These complications will result in higher preparation costs for bidders
413 and, I would expect, additional requests for extensions and pauses, increasing the time
414 required to complete the Auction.

415 Q. Have professional economists specializing in auctions and game theory studied auctions
416 in which bidders bid on products that are complements, as in the Auction with
417 consecutive one-year terms?

418 A. Yes, they have, particularly auctions in which bidders acquire licenses to use certain
419 frequencies of the electromagnetic spectrum to provide a communication service, such as
420 cell phone service. Sometime in these auctions, some bidders will seek to establish a

421 geographic footprint by acquiring several licenses for different cities or regions. A bidder
422 in this case sees the licenses for the various regions as complements. The issue
423 associated with a bidder winning some but not all of its preferred combination – just as
424 our bidder in the Auction with consecutive one-year terms winning only Year 2 – has
425 been dubbed the “exposure problem”. Professor Klemperer defines it as follows: “some
426 bidders may therefore end up stuck with objects that are worth very little to them because
427 they failed to win complementary objects (this is called the *exposure problem*), while
428 other bidders may quit the bidding early because of fear of this. Thus inefficiencies are
429 likely.” (Auctions: Theory and Practice, Princeton University Press, 2004, p. 63). In
430 general, these economists recognize that inefficiencies could occur in these contexts and
431 recognize the new risks that bidders face. Auction theorists also point out that these
432 problems of inefficiency in allocation and pricing are exacerbated if some bidders view
433 the products as complements while others view the products as substitutes (Paul
434 Milgrom, Putting Auction Theory to Work, Cambridge University Press, 2004 p. 278).

435 Q. Is there a way to resolve these inefficiencies and risks?

436 A. Perhaps. Professional economists specializing in auctions and game theory have been
437 studying auctions with “package bidding.” Package bidding means that bidders can bid
438 on any combination of products that they like without the risk of winning only some (but
439 not all) of the products in their preferred combination. Package bidding in the case of
440 consecutive one-year contracts would mean that a bidder wanting to supply a three-year
441 contract would be able to specify that it is bidding on Year 1, Year 2 and Year 3 contracts
442 in fixed proportions, but that it does not want to win any one of these terms without the
443 others. Studying these auction formats involves the development of various rules to

444 evaluate bids and determine winners. This design seeks to eliminate the risk faced by
445 bidders that I mentioned earlier, where bidders would bid less aggressively to avoid the
446 possibility of winning one-year terms in a suboptimal combination.

447 Q. Are you advocating combining Staff's structure of consecutive one-year terms with
448 package bidding?

449 A. No. Package bidding is still under study and the Federal Communications Commission
450 has not yet conducted auctions with package bidding as described above. There is an
451 easy way to approximate package bidding, which is to offer bidders the packages or
452 combinations that they are likely to want. The ComEd and Ameren Illinois Utilities
453 proposal, in offering 1-year and 3-year terms to bidders, does exactly this. This is also
454 what Staff's alternative proposal does, adding a 2-year term into the mix.

455 Q. What do you conclude?

456 A. Staff puts its preferred approach forward with the objective of enhancing competition.
457 Staff rightly observes that "some suppliers have a comparative advantage in making
458 shorter-term commitments while other bidders have a comparative advantage in making
459 longer-term commitments" (ICC Staff Exhibit 1.0, lines 399-401). However, what the
460 structure of consecutive one-year terms does is prevent bidders that have a comparative
461 advantage in making longer-term commitments from being able to offer prices that are
462 fully reflective of this comparative advantage. Such bidders face new risks through this
463 structure, risks that they do not face with a mix of 1-year, 2-year and 3-year products, and
464 risks that I expect will cause them to bid less aggressively. I conclude that Staff's
465 preferred approach may not achieve Staff's goal of improving the Auction as it would

466 result in less aggressive bidding, as it may fail to deliver competitive prices that are fully
467 reflective of the market and may lead to an inefficient allocation of load.

468 Q. How do you respond to Staff’s belief that the structure of consecutive one-year terms
469 would enhance competition?

470 A. I believe that this analysis may be too narrow. Staff’s first reason to believe that the
471 structure of consecutive one-year terms would enhance competition is that this structure
472 would “facilitate direct competition between suppliers.” This appears to mean that Staff
473 believes that the Year 1 contract will benefit from all bidders (bidders with a comparative
474 advantage in making shorter-term commitments and bidding with a comparative
475 advantage in making longer-term commitments) competing to win this contract. Even if
476 all bidders did compete for the Year 1 contract, it would not be a benefit to customers.
477 First, as I explained above, bidders with a comparative advantage in making longer-term
478 commitments will not bid as they would have if they were bidding on a single three-year
479 term. They will bid less aggressively and potentially offer less into the Auction. Second,
480 there is no free lunch. The bidders with a comparative advantage in making longer-term
481 commitments will continue competing with bidders with a comparative advantage in
482 making shorter-term commitments at lower Year 1 prices only if the prices on Year 2 and
483 Year 3 – averaged in with the Year 1 price – are high enough to compensate them for the
484 supply they are offering. What is gained on the price of the Year 1 contract would be lost
485 on the prices of the Year 2 and Year 3 contracts.

486 Staff’s second reason to believe that this structure enhances competition is that
487 bidders with capacity tied up for the first and/or second 12 months would participate in
488 an Auction with consecutive one-year terms but would not participate in an Auction with

489 a mix of 1-year, 2-year, and 3-year terms. Of course this is possible. However, I would
490 expect any effect on competition to be small, for two reasons. First, many bidders in the
491 Auction are sophisticated traders that are able to assemble the various components of the
492 full-requirements service, including capacity, in the wholesale markets; the fact that a
493 bidder cannot hedge with its own generation would not prevent its participation in an
494 Auction with a mix of 1-year, 2-year, and 3-year terms. Second, a bidder with capacity
495 tied up for the first and/or second 12 months would have the choice of participating in the
496 2008 Auction and bidding on a contract term starting more than one year hence, or of
497 participating in the 2009 Auction and bidding on a contract term starting in a few months.
498 Bidding closer to the supply period means less uncertainty for the bidder regarding future
499 price movements. I do not see it as a foregone conclusion that the bidder would
500 participate in the 2008 Auction and compete vigorously for the Year 2 or Year 3 product
501 when such a bidder has the opportunity to wait and bid with better information in the
502 2009 Auction.

503 Q. Do you have additional data on how suppliers are likely to view Staff's preferred option?
504 A. Yes. In the prospective supplier survey, submitted as Auction Manager Exhibit 1.8 in my
505 direct testimony, we asked respondents their opinions regarding various term structures
506 for the CPP-B and BGS-FP products for residential and small non-residential customers.
507 Responding suppliers ranked three options: a ladder of three-year contracts (option A),
508 three consecutive one-year contracts (option B), and a blend of one-year and three-year
509 contracts (option C).

510 Option B was most preferred by three respondents and least preferred by six
511 respondents (Auction Manager Exhibit 1.8, p. B-1). This is compared to no respondents

512 who ranked option C (the mix of 1-year and 3-year contracts) as the least preferred
513 option. While no respondent believed that option B would preclude them from
514 participating in the 2008 Illinois Auction, 4 respondents believed that they would reduce
515 their level of participation.

516 Most of the respondents that disliked option B provided lengthy comments to
517 explain their position. These respondents maintained that option B would be more
518 difficult to price due to the awkward possibility of having a gap in the supply period.
519 They also maintained that option B would create risks that could not be actively managed
520 and would create difficulties in hedging due to the fact that the supply period could begin
521 one to two years after the auction. One respondent wrote “Option B does not provide for
522 enough interplay with retail markets and will likely result in more price volatility,
523 jeopardizing both the auction process and results” (Auction Manager Exhibit 1.8, page 3).

524 Q. You have testified at length on the negative consequences of the structure of consecutive
525 one-year terms. Do you think that Staff’s alternative proposal, a mix of 1-year, 2-year,
526 and 3-year contracts suffers from the same flaws?

527 A. No. As I testified above, a mix of 1-year, 2-year, and 3-year contracts will not be seen as
528 complements by bidders in the way that consecutive one-year terms would be seen as
529 complements. This mix of 1-, 2- and 3-year contracts present bidders with combinations
530 that are likely to be their preferred combinations. Staff’s alternative proposal avoids the
531 negative consequences of their preferred alternative.

532 Further, I believe that the Staff proposal for a term structure mix of 1-year, 2-year,
533 and 3-year contracts would have benefits for the 2008 Auction that are similar to the
534 benefits of ComEd and the Ameren Illinois Utilities’ proposal for a term structure mix of

535 1-year and 3-year contracts. Staff's alternative structure, compared to having a single
536 contract term, would lead to a wider pool of suppliers, which serves to deliver reliable
537 supply to customers at competitive market prices.

538 Q. Do you have any further information regarding how bidders would view a mix of 1-year,
539 2-year, and 3-year terms compared to a mix of 1-year and 3-year terms?

540 A. Yes. Based on the results of the prospective supplier survey (Auction Manager Exhibit
541 1.8, page B-9), the response of prospective suppliers is mixed. While no supplier is
542 averse to a 2-year term, few suppliers (5 respondents) believe that there are definitely
543 benefits to adding a 2-year term to a mix of 1-year and 3-year terms (Auction Manager
544 Exhibit 1.8, pages B-8 to B-9).

545 Q. Mr. McNeil in recommending a blend of 1-year and 3-year products provided an
546 illustration to show how the product term structures in the next few Auctions could be
547 designed to achieve a transition to the recommended term structure (ComEd Exhibit 1.0,
548 lines 477-488). Would this transition be complicated by the presence of the 2-year term?

549 A. Not necessarily. There are several options available to achieve a transition to a state
550 where the load of residential and smaller non-residential customers would be divided
551 equally between a 1-year, a 2-year, and a 3-year term. I provide two simple examples
552 below of how this transition could occur. Under option 1, only a 1-year and a 3-year
553 term would be offered in the 2008 Auction and the number of tranches would be the same
554 for each of these two terms. Starting in the 2009 Auction, the load of residential and
555 smaller non-residential customers would be divided equally between a 1-year, a 2-year,
556 and a 3-year term and the number of tranches would be the same for each of these three
557 terms. Under option 2, a 1-year, a 2-year, and a 3-year term would be offered starting

558 with the 2008 Auction. However, it would take until the 2010 Auction for the number of
 559 tranches offered to be the same for all products.

560 Option 1:

Auction Year	%B/FP Load Procured	% Load Allocated to Each Contract								% Load Served Under 36 Mo. Contracts Annually
			2007	2008	2009	2010	2011	2012	2013	
2006	100%	33.33% 33.33% 33.33%	17 Mo.							33.33%
2008	33%	16.67% 16.67%	B/FP-17 expires 33.33% load at auction							16.67+33.33=50%
			1-year	[.50*33.33%]						
			3-year	[.50*33.33%]						
2009	50%	16.67% 16.67% 16.67%	B/FP-29 expires 33.33% + 16.67% from 2008 Auction = 50% load at auction							16.67+16.67+33.33=66.67
			1-year	[.33*50%]						
			2-year	[.33*50%]						
			3-year	[.33*50%]						
2010	50%	16.67% 16.67% 16.67%	B/FP-41 expires 33.33% + 16.67% from 2009 Auction = 50% load at auction							16.67+16.67+16.67=50%
			1-year	[.33*50%]						
			2-year	[.33*50%]						
			3-year	[.33*50%]						

561

Option 2:

Auction Year	%B/FP Load Procured	% Load Allocated to Each Contract								% Load Served Under 36 Mo. Contracts Annually
			2007	2008	2009	2010	2011	2012	2013	
2006	100%	33.33% 33.33% 33.33%	17 Mo.	29 Mo.	41 Mo.					33.33%
2008	33%	6.67% 10.00% 16.67%	B/FP-17 expires 33.33% load at auction 1-year [.20*33.33%] 2-year [.30*33.33%] 3-year [.50*33.33%]							16.67+33.33=50%
2009	40%	6.67% 16.67% 16.67%	B/FP-29 expires 33.33% + 6.67% from 2008 Auction = 40% load at auction 1-year [.16*40%] 2-year [.42*40%] 3-year [.42*40%]							16.67+16.67+33.33=66.67%
2010	50%	16.67% 16.67% 16.67%	B/FP-41 expires 33.33% + 16.67% from 2009 Auction = 50% load at auction 1-year [.33*50%] 2-year [.33*50%] 3-year [.33*50%]							16.67+16.67+16.67=50%

563

564

565 Q. The Issues List includes the proposal that the notional quantity language found in the
 566 second paragraph of Section 5.4.a of the Supplier Forward Contracts be made optional, at
 567 the supplier’s discretion. Do you support this recommendation?

568 A. No, I oppose this recommendation. The 2006 Auction had a single standard contract that
 569 was used by all suppliers to a given utility. All bidders know the terms under which
 570 supply will be provided because the terms are standardized and are set forth in an
 571 agreement that is made available well in advance of the Auction. Given that all
 572 prospective bidders accept these terms before the Auction, and given that all prospective
 573 bidders are required to meet the same standard qualification requirements, bids can be
 574 compared strictly on a price basis. The determination of the final prices and of the

575 winners at the auction can then be made in a transparent way through the clock auction
576 format. A standard contract is also essential for ensuring fairness to all bidders; a process
577 that is known to be fair in turn promotes participation in the Auction.

578 The proposal that this provision be optional is tantamount to proposing that the
579 contract for the 2008 Auction not be standard and suppliers would potentially be
580 competing on different terms. While the proposal is described as an optional choice by
581 the seller, any contract alteration that a supplier desires could be made optional. The fact
582 that it is optional does not change the fact that it makes the contract non-standard.

583 Q. Could accepting optional language in the Supplier Forward Contracts associated with the
584 2008 Auction have other implications for future Auctions?

585 A. Yes. Despite the fact that the option or change is portrayed as innocuous, if this
586 recommendation for optional language in the Supplier Forward Contracts is adopted, this
587 would set a precedent by which the Supplier Forward Contract could be tailored to
588 different situations. This could encourage demands by suppliers for more supplier-
589 specific terms at the “supplier’s option.”

590 **III. Auction Format and Benchmark**

591 Q. Dr. Rose recommends that wholesale market prices be used as an appropriate benchmark
592 to evaluate the auction results (AG Exhibit 1.0, lines 39-41). Do you agree with Dr.
593 Rose?

594 A. No, I do not agree with his recommendation.

595 First, at a basic level, the products that are procured through the Auction – i.e.,
596 fixed-price full requirements service for Illinois utilities’ customers – do not have an
597 analogue in the wholesale markets. There is no visible product that is traded in the

598 wholesale market upon which a direct comparison can be made. Any wholesale market
599 price benchmark is therefore at best imperfect.

600 Second, the proposal for a benchmark appears to ignore the fact that goals for the
601 Auction process were established in the Procurement Dockets, and that specific criteria
602 were established to conclude whether or not these goals were met. These are discussed
603 extensively in my direct testimony (Auction Manager Exhibit 1.0, lines 248-295). The
604 Commission has the ability to consider all information regarding the Auction process in
605 its entirety, including the evaluation of how the Auction process has or has not met its
606 goals. The Commission has the ability to consider any wholesale market information it
607 wishes in reaching its conclusions. There is no reason for the Commission to ignore this
608 wealth of its information and make its decision on the auction results by sole reference to
609 a benchmark.

610 Q. Does Dr. Rose have a proposal for what benchmark to use?

611 A. No. Dr. Rose's recommendation, in addition to being conceptually flawed, also suffers
612 from lack of detail. Dr. Rose does not define what an appropriate wholesale market price
613 "benchmark" would be or how differences between this benchmark and the auction
614 product would be considered.

615 Q. Dr. Rose recommends that the Commission consider a reserve price based on the
616 wholesale market price (AG Exhibit 1.0, lines 213-216). Do you agree that this
617 recommendation is an improvement for the Auction process?

618 A. No, I do not believe a reserve price as he recommends would be an improvement for the
619 Auction process.

620 By reserve price, I understand that Dr. Rose means the highest price that the
621 Commission will accept. If a supplier bids above the reserve price, the Commission
622 would automatically reject the bid, and conversely, if the final auction price were at the
623 reserve price or below, the Commission would automatically accept the bid.

624 Dr. Rose does not cite any literature or evidence to support his proposal that
625 setting a reserve price would lead to an improvement. I discussed this issue in my
626 testimony in the Procurement Dockets (ComEd Exhibit 19.0 lines 2216-2338 in Docket
627 05-0159, and Resp Ex. 19.0 lines 1836-1957 in Dockets 05-0160, 05-0161, and 05-0162).
628 There is a well-established result that, under very specific conditions, the best way to sell
629 an item is to use a standard auction (like the one used at Christie's) with an announced
630 reserve price. This result is shown by Riley and Samuelson (Riley, John G & Samuelson,
631 William F, 1981. "Optimal Auctions," American Economic Review, American Economic
632 Association, vol. 71(3), pages 381-92) and Myerson (Roger Myerson, "Optimal Auction
633 Design", Mathematics of Operations Research, 1981, 6, pp. 58-73). These studies are
634 couched for an item for sale – they can be translated for procurement to say that the best
635 way to procure an item (in terms of getting the best price for the buyer) is to use a
636 standard auction with an announced reserve price.

637 Q. Why do you specify that the reserve price is "announced"?

638 A. According to these studies, for the best price to be achieved under those specific
639 conditions, generally speaking the buyer has to: 1) set a reserve price below the amount at
640 which the buyer would personally be willing to purchase; 2) announce this reserve price
641 to the sellers; and 3) absolutely commit to buying if the reserve price is met and to not
642 buying if it is not. In the context of procurement for the Illinois Utilities, it would mean

643 that the Commission would pre-announce a price and would relinquish any other ability
644 to review the bids. As long as the announced reserve price was met, the Commission
645 would not have the ability to reject the bids.

646 Q. What are the “very specific conditions” that you refer to above?

647 A. The specific conditions needed are the following:

- 648 1. There is a fixed number (“ n ”) of bidders at the auction.
- 649 2. The bidders bid independently.
- 650 3. The bidders are risk-neutral.
- 651 4. The “independent private values” model describes the uncertainty faced by
652 bidders.

653 These conditions mean the following. The first condition means that the number of
654 bidders is given; in particular, the number of bidders cannot be influenced by the choice
655 of qualification criteria or auction format. The second condition means that bidders are
656 not colluding and are competing vigorously against one another. The third condition
657 means that bidders would neither be willing to pay to avoid risks nor would they be
658 willing to pay to be allowed to take risks. The last condition means that the evaluations
659 of the n bidders for the tranches at auction can be usefully modeled mathematically as n
660 independent draws from a given probability distribution. When this condition holds, it is
661 not valuable for a bidder to learn another bidder’s evaluation of the item in the auction.

662 Q. Do you find that these conditions are applicable in the case of the procurement of full-
663 requirements tranches?

664 A. There are association rules that ensure that bidders bid independently, but the other
665 conditions named above are unlikely to apply to the procurement of full-requirements
666 tranches in the Illinois Auction. Most obviously, the last condition is unlikely to hold
667 because many bidders in the proposed auction will make an assessment of the same
668 future market opportunities and risks in putting together their bids. When assessing a
669 common market opportunity, one bidder's evaluation is useful information to another
670 bidder, and the last condition discussed above would fail.

671 Q. Dr. Rose states that "allowing the direct procurement of power through a sealed bidding
672 process may result in lower prices, if direct negotiation with suppliers is used to
673 determine a price" (AG Exhibit 1.0, lines 202-204). Do you agree that this proposal can
674 lead to an improvement in the Auction process?

675 A. Dr. Rose's testimony in this regard is entirely vague and cannot be considered a proposal.
676 Dr. Rose is considering some combination of direct negotiations with suppliers and a
677 sealed bidding process and it is not even clear what his proposal is let alone whether it
678 would lead to an improvement.

679 **IV. Application Process**

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681
682 Q. Ms. Phipps recommends to supplement the current review process for the Part 1
683 Application to require applicants to provide their calculation of Tangible Net Worth
684 ("TNW"), or the guarantor's TNW, depending on the entity fulfilling the financial
685 requirements, to show how they calculated it, and to provide citations to their financial
686 statements for each component of that calculation (ICC Staff Exhibit 2.0, lines 50-56).
687 What rationale does Ms. Phipps present for this recommendation?

688 A. Ms. Phipps noted that Intangible Assets (e.g., goodwill, patents, copyrights and
689 trademarks), which are needed for the calculation of TNW, are not always provided in a
690 uniform format in financial statements. Ms. Phipps believes that asking applicants to
691 provide an estimate of TNW against which the credit and application team can compare
692 its own estimate would help determine the sources of any differences and lead to a more
693 accurate estimate (ICC Staff Exhibit 2.0, lines 58-67).

694 Q. What recommendation did you make in your direct testimony on this issue?

695 A. In my direct testimony (Auction Manager Exhibit 1.0, lines 1247-1261), I opposed
696 Staff's recommendation to require each prospective supplier to provide in its application
697 a calculation of the entity's TNW with citations to financial statements to support their
698 calculation. I stated that this requirement to provide a calculation of the TNW is likely to
699 be prone to error and can only increase the number of deficiencies associated with the
700 Part 1 Application. Also, prospective suppliers will need to devote additional resources to
701 completing the application, while the team that reviews the applications continues to
702 perform their own calculation from the suppliers' financial statements.

703 Q. Having reviewed the arguments from Ms. Phipps, are you prepared to agree with her?

704 A. No. I still believe that requiring applicants to provide a detailed calculation of the TNW
705 has more disadvantages than advantages. However, I am prepared to support an
706 amendment to Ms. Phipps' recommendation, which may accomplish her objectives while
707 failing to increase significantly the number of deficiencies associated with the Part 1
708 Application. I would propose that applicants have the option to provide the entity's TNW
709 with supporting citations to their financial statements. If an applicant were to provide this
710 information with all supporting citations, the applicant would be assured that their

711 calculation would be considered by the credit and application team in coming to their
712 own determination. If the credit and application team came to another conclusion, the
713 reason for this difference would be provided to the applicant. If an applicant did not
714 provide this information, the Auction Manager team would prepare the TNW ahead of
715 time with references to financial statements so that the credit and application team can
716 work more efficiently. In this latter case, the applicant would not be provided with the
717 credit and application team's calculation and would not have an opportunity to present its
718 own calculation for consideration by the credit and application team.

719 This amendment provides an incentive for applicants to provide the information
720 and submit accurate information while at the same time allowing entities that must
721 expend considerable resources (perhaps in obtaining internal approvals for the
722 calculation) not to provide this information. It is then likely that the applicants that do
723 provide this information with all supporting documentation will do so accurately, thereby
724 minimizing the deficiencies at the Part 1 Application stage. Further, the credit and
725 application team will always be working with an estimate of the TNW as the Auction
726 Manager team will prepare this estimate if it is not provided by the applicant.

727 **V. Timeline and Confidentiality**

728 Q. Dr. Kennedy and Mr. Zuraski recommend either: (a) for Staff to be granted an additional
729 day for providing its Confidential Report to the Commission and thus extend the review
730 period for the Commission from five to six days; or (b) for the Auction Manager's report
731 to be produced in one business day rather than two business days (ICC Staff Exhibit 1.0,
732 lines 142-152). Do these options accord with your own recommendation in your direct
733 testimony?

734 A. Yes. As discussed in my direct testimony (Auction Manager Exhibit 1.0, lines 1233-
735 1246), I recommend that the Auction Manager provide the Confidential Report of the
736 Auction Manager one business day after the close of the auction. This recommendation
737 will provide Staff with an additional day to review the Auction Manager's report and
738 maintain the overall five-day Commission review period.

739 Q. Dr. Kennedy and Mr. Zuraski propose that the term "confidential bidding data" be
740 clarified in both ComEd's Rider CPP and the Ameren Illinois Utilities' Rider MV to
741 include all bidding data except for: (1) the names of the winning bidders; (2) the precise
742 number of registered bidders, the ranges of excess supply for each section and the going
743 prices for each product reported to bidders during the auction, and the number of tranches
744 of each product won by each of the winning bidders; and (3) any other information that
745 the Auction Manager and the Staff deem necessary to convey in their public reports on
746 the auction as described in the CPP Documents section and the CPA Documents section
747 of ComEd's Rider CPP and the Ameren Illinois Utilities' Rider MV, respectively (ICC
748 Staff Exhibit 1.0, lines 509-532). Do you agree with this recommendation?

749 A. Yes. I agree with Staff's recommendation.

750 Q. The Issues List contains a proposal to move subsequent Illinois Auctions up to early
751 December in each year. This would allow more time for bidders to prepare between the
752 largest wholesale full requirements statewide load auctions (in Maryland, New Jersey and
753 Illinois). Would you like to comment on this?

754 A. Yes. I believe that this proposal cannot be incorporated for the 2008 Illinois Auction but
755 should be considered for future Auctions. It will be important to the success of future

756 Auctions to make sure that the Illinois Auction takes place at a time when suppliers are
757 able to prepare adequately and commit the resources necessary for participation.

758 Q. Does this conclude your rebuttal testimony?

759 A. Yes.