

**ILLINOIS COMMERCE COMMISSION**

**DOCKET NO. 06-0800**

**REBUTTAL TESTIMONY**

**OF**

**CRAIG D. NELSON**

**Submitted On Behalf**

**Of**

**CENTRAL ILLINOIS LIGHT COMPANY d/b/a AmerenCILCO**

**CENTRAL ILLINOIS PUBLIC SERVICE COMPANY d/b/a AmerenCIPS**

**ILLINOIS POWER COMPANY d/b/a AmerenIP**

**(The Ameren Illinois Utilities)**

**April 6, 2007**

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**OF**

**CRAIG D. NELSON**

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

A. My name is Craig Nelson. My business address is 1901 Chouteau Avenue, St. Louis, Missouri 63103.

**Q. Are you the same Craig Nelson that filed direct testimony in this proceeding?**

A. Yes.

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

A. The purpose of my rebuttal testimony is to respond to the direct testimony of:

- the Coalition of Energy Suppliers' ("CES") witnesses Katie Papadimitriou and John Domagalski in regard to their objection to a shortened enrollment window for large customers,
- CUB witnesses Christopher Thomas and Geoffrey Crandall in regard to energy efficiency and demand response and
- AG witness Kenneth Rose in regard to benchmarking auction results against wholesale market prices and production costs, as well as his suggestion for a change in the auction process.

**Q. CES witnesses Mr. Domagalski and Ms. Papadimitriou recommend that "(t)he Commission should not adopt measures that unnecessarily limit the flexibility of customers [to] exercise their choices beyond those currently**

24 **included in the Illinois Auction Structure,” and go on to assert that “Staff’s**  
25 **enrollment window recommendations would unnecessarily limit customer’s**  
26 **flexibility and freedom to choose competitive service.” (CES Ex. 1.0, lines**  
27 **355-359.) Do you agree with this assertion?**

28 A. No. This assertion suggests that in the absence of a lengthy enrollment window  
29 customers will be more captive to utility supply. I can find no evidence of this.  
30 First, customers have demonstrated their ability to make decisions in a time frame  
31 much shorter than the existing enrollment window. As detailed in my direct  
32 testimony, a significant portion of customers made their enrollment elections  
33 within 20 days, even though the window was obviously much longer.  
34 Additionally, a significant number of notices were received in the final three days  
35 of the window. I believe it is reasonable to assume that some decision-makers  
36 will leave this seemingly “free option” open as long as possible, regardless of the  
37 length of the window. Further, the uncertainty related to actions in the Illinois  
38 General Assembly may have caused some customers to delay making any  
39 decision until absolutely required to do so. Finally, BGS-LFP customers clearly  
40 were not captive to this rate as evidenced by the fact that only 5% of eligible  
41 customers enrolled. These customers were obviously able to make this decision  
42 despite having an enrollment window substantially shorter than a CES panel  
43 (including Mr. Domagalski) testified was necessary, in Dockets Nos. 05-0160, 05-  
44 0161 and 05-0162, (cons.). In those dockets, at lines 249-252 of CES Ex. 6.0, the  
45 CES panel claimed:

46 “A 30-day enrollment window, as proposed by Ameren, would not  
47 provide customers with sufficient time to decide which option best suits

48 their needs. Accordingly, Ameren's proposal, if adopted, would certainly  
49 hamper customer choice in the Ameren service territories."

50

51 At lines 257-260, the panel stated:

52

53 "Our experience strongly indicates that a 30-day window may work only  
54 in limited instances in which the auction price meets customer  
55 expectations and for the rare customer who does not have the inclination  
56 to shop for alternatives."

57

58 And finally, at lines 266-268, the panel stated:

59

60 "In instances in which auction prices are materially different than  
61 expected, customers require more time than the "plug-and-chug" scenario  
62 potentially contemplated by Ameren."

63

64 The panel then used an example in which prices were higher than expected and  
65 customers were unable to act.

66 **Q. Do you have any observations on Mr. Domagalski's prior testimony quoted**  
67 **above?**

68 A. Yes. Each of his predictions was wrong.

69 **Q. CES witnesses Mr. Domagalski and Ms. Papadimitriou also state, "No one has**  
70 **clearly articulated the "problem" associated with giving customers added**  
71 **flexibility to choose that is provided under the current Illinois Auction**  
72 **Structure." (CES Ex. 1.0, lines 363-365.) What is your response?**

73 A. The "problem" is rather obvious – it's an auction price of about \$85 /MWH for  
74 BGS-LFP supply, as compared to a price in the \$65-range for smaller customer  
75 supply. It's also obvious that the vast majority of potential BGS- LFP customers  
76 did not consider \$85/MWH to be an economic alternative, with 95% of them  
77 clarifying the problem by not choosing the BGS-LFP alternative.

78 **Q. What is particularly significant about the level of customer rejection of BGS-**  
79 **LFP supply?**

80 A. Beyond the obvious - that this level of switching is an indication that eligible  
81 customers did not view this as an economical supply option – it is important to  
82 recognize that this now changes the dynamic from one in which a vast majority of  
83 the eligible group must make a decision in a certain time frame or be locked out  
84 of all other options to one in which 95% of eligible customers must now make a  
85 positive election (opt-in) to receive the service.

86 **Q. Why is this significant?**

87 A. First, as noted by IIEC witness, Mr. Stephens (IIEC Ex. 1.0, 333-335), there may  
88 be customers who have already entered into supply contracts with RESs, and thus  
89 do not need to make a decision within the enrollment period, reducing the  
90 potential marketing contacts for RESs. More importantly, a customer who fails to  
91 opt-in, is not shut out of all of the other market offerings available to that  
92 customer. The fixed-price utility offering is simply one choice. The  
93 consequences of failing to act within the enrollment window are not as limiting as  
94 they were in the first auction.

95 **Q. What are these other market offerings that you reference?**

96 A. The first of these is the utility's own hourly-priced product. Additionally, as aptly  
97 illustrated by the CES panel (CES Ex. 1.0, Lines 253-258): "Competitive RESs  
98 offer a wide range of products and service to consumers ranging from fixed price  
99 to real-time or hourly-priced products. The competitive retail market also offers  
100 renewable energy, demand response, and curtailment type products."

101 **Q. Even with all of these other offerings, wouldn't it benefit customers to have a**  
102 **longer enrollment window?**

103 A. No. These long enrollment windows result in a time-based risk premium which  
104 has increased the price for this supply option above that which most eligible  
105 customers are willing to accept. Mr. Stephens (IIEC Ex. 1.0 line 84-85) states  
106 that "IIEC companies were disappointed in the outcome of the first auction, as it  
107 relates to fixed price supply for Ameren's BGS-4 (above 1 MW) customers."  
108 Clearly these customers did not find a benefit in the BGS-LFP product due to its  
109 price, which was driven upward by this time-based risk premium incorporated by  
110 suppliers.

111 It must be remembered the only customers actually paying for that risk premium  
112 are those that elect BGS-LFP supply. For all of the other customers eligible for  
113 the service that select alternative supply, this is a seemingly free option, but one  
114 for which, if the embedded risk premium is too high, is of little use. Having 95%  
115 of eligible customers reject this offering is a clear indication that its price was too  
116 high for customers.

117 **Q. Assuming the Commission approves the continuation of BGS-LFP supply, as**  
118 **recommended by Staff, is it important that BGS-LFP should be an**  
119 **economical supply alternative?**

120 A. Yes, otherwise there would be no reason to incur the cost of offering the product  
121 in auction in the first place. Having a supply alternative unacceptable to the vast  
122 majority of eligible customers does not benefit customers.

123 **Q. If customers and suppliers do not benefit from these longer enrollment**  
124 **windows, who does?**

125 A. RESs.

126 **Q Why do you believe RESs benefit?**

127 A. BGS-LFP supply in effect provides a price to beat alternative to RES supply. The  
128 higher the price, the easier it is to beat. It is in the RESs' best interest to have  
129 long enrollment windows and the associated high embedded risk premiums.

130 **Q. Other than the enrollment statistics provided in your direct testimony, is**  
131 **there other support for your belief that customers are able to make such**  
132 **decisions in less than 30-45 days.**

133 A. Yes. While stating some reservation regarding certain governmental and  
134 institutional customers, IIEC witness Stephens indicates his belief that certain  
135 customers could comply with an enrollment window as short as five days.  
136 More importantly, I would expect that customers are able to compare alternatives  
137 from RESs in less than 20 days. Remember, this is not their first exposure to  
138 negotiating with third-party suppliers. Many had entered into RES supply  
139 contracts well before the auction, and, as indicated above, the vast majority also  
140 negotiated contracts with RESs during the enrollment window. They are not the  
141 novices CES makes them out to be. Many are sophisticated energy purchasers. It  
142 is my understanding that RESs do not make binding, fixed-price, full-  
143 requirements offers that are left open for 20 days, let alone 30 or 45 days. It is my  
144 understanding that it is common for RESs to provide indicative offers, which are  
145 not binding, and to update these during the course of negotiations. A binding

146 offer – one which the customer can accept and to which the RES would be  
147 obligated – is left open for only a brief period. Clearly, customers have been able  
148 to make decisions in a short time frame once firm information is known.

149 **Q. Did you review the testimonies of CUB witnesses Geoffrey Crandall and**  
150 **Christopher Thomas?**

151 A. Yes, I did. In large part both witnesses focus on the need to use energy efficiency  
152 and demand response in Illinois as a part of a procurement strategy.

153 **Q. Do you have any initial observations to make?**

154 A. Yes. Both witnesses candidly note there may not be enough time to implement  
155 their strategies—they are correct. It will take every bit of the time after the  
156 Commission enters its order in this docket to implement changes to the auction,  
157 prepare for the auction and have it run in January 2008 without burdening the  
158 process with substantial changes required to implement a complex solution such  
159 as those proposed by these witnesses. To their credit, they offer this observation  
160 and recommend in the alternative the Commission initiate a docket to consider  
161 these options.

162 **Q. Are you in agreement?**

163 A. Yes, in fact I believe that is what the Commission is planning in any event. Last  
164 year, three dockets were opened for the purpose of examining demand-side  
165 resources, energy efficiency, and renewable resources. The Commission  
166 eventually closed these dockets, and it is my understanding the Commission  
167 intends to begin an active dialogue and workshops to review these topics.

168 **Q. Please continue.**

169 A. Both Mr. Crandall and Mr. Thomas speak to the benefits of energy efficiency and  
170 demand side resources. While I don't necessarily disagree that such benefits exist  
171 at some level, I differ as to their immediate bearing on the upcoming auction  
172 itself. For example, Mr. Crandall states that the most efficient way to select  
173 resources is to have state agencies and utilities involved in planning energy  
174 efficiency and demand response programs, and that the programs would reduce  
175 the total and peak amounts of generation. Without commenting on the veracity of  
176 this assertion, I would question what this would tell us about our continuing  
177 obligation to buy power and energy in the wholesale market.

178 **Q. Does Mr. Crandall offer another suggestion?**

179 A. Yes, he suggests a three-tier bid approach where we would first ask for bids on a  
180 block of energy efficiency options, then conduct an auction for dispatchable,  
181 peak-reducing demand resources and then conduct an auction for the remaining  
182 load.

183 **Q. How do you respond?**

184 A. First, it is important to acknowledge that there is no feasible way to introduce this  
185 as part of the 2008 auction. Further, I have doubts as to its merits. Even  
186 assuming there are suppliers that will offer energy efficiency options, there is no  
187 guarantee how and to what degree customers' actual load requirements or usage  
188 patterns will be changed, especially lacking any historical context. The second  
189 auction for peak products provides no assurance of cost benefits as Mr. Crandall  
190 implies. In fact, I would suggest the suppliers attempting to formulate bids for  
191 such a product would be faced with great uncertainty on what they were actually

192 obligated to serve and would price such uncertainty into their bids. As a  
193 consequence, the resulting price could include premiums which significantly  
194 reduce any potential benefit gained by such an energy efficiency program.

195 **Q. Mr. Crandall proposes an auction that calls for peak, base and intermediate**  
196 **load products to be bid separately. Is this workable?**

197 A. Conceivably, it is possible to design an auction that includes these separate  
198 products, or a large number of products, but I am uncertain as to benefits and to  
199 the ultimate cost borne by customers. One of the benefits of the current auction  
200 design is that it has been structured to encourage supplier participation. The  
201 competitiveness of the process is enhanced by having many suppliers competing.  
202 Further segmenting the auction as Mr. Crandall proposes may result in fewer  
203 suppliers competing for a given product, which could increase the price for that  
204 product.

205 Further, I am concerned about the lack of interchangeability among these products  
206 in the auction. Another feature of the current auction is that products are designed  
207 to be interchangeable – so that suppliers can shift their bids round by round  
208 among very similar products – helping all the products to settle at market. It is  
209 unlikely that suppliers would view peak, base-load and intermediate-load products  
210 as interchangeable.

211 **Q. Mr. Thomas claims in several places that the auction results were not least**  
212 **cost. Please respond.**

213 A. The Ameren Illinois Utilities disagree. The declining price auction is a workable  
214 means to bring the lowest overall cost to consumers. I would note that the use of

215 these auctions as a viable means of competitively procuring products and services  
216 is recognized beyond the limited scope of the Illinois Auction. For example,  
217 Senate Bill 1620 was recently introduced in the 95th General Assembly. It would  
218 amend the Illinois Procurement Code and authorize state agencies to use a reverse  
219 auction as the means by which to procure needed supplies—how ironic. In any  
220 event, while Mr. Thomas quibbles with the results of the auction, I do not recall  
221 that he or CUB put forth any credible alternative.

222 **Q. You also indicated at the outset that you intended to respond to AG witness**  
223 **Kenneth Rose. What do you understand to be the essence of his testimony?**

224 A. Mr. Rose recommends what he terms “appropriate benchmarks” for the  
225 Commission to use to evaluate the auction results. Specifically, he would rely  
226 upon comparisons of the wholesale market prices and production costs of  
227 electricity. He largely supports this position because Mr. Rose asserts the auction  
228 clearing price is higher than (1) the wholesale market price he selected and (2)  
229 some (but not all) of the costs of producing, marketing and delivering electricity  
230 to the point of sale.

231 **Q. But, doesn't Mr. Rose also state the cost of capacity, transmission, and**  
232 **ancillary services be considered?**

233 A. Yes, however, such cost components would only account for a portion of the  
234 difference in the auction-clearing price and wholesale price upon which he  
235 focuses.

236 **Q. How do you respond to his comparisons?**

237 A. Mr. Rose's comparisons are practically meaningless, and really do nothing to  
238 enhance the auction process. His is the proverbial "apples to oranges"  
239 comparison. The auction price certainly includes his "wholesale market price"  
240 but necessarily also includes costs or premiums associated with switching risk,  
241 load following, MISO charges, the risk of laws or rules changing, the risk of  
242 change in fuel prices, utility credit risk, administrative costs, transactional costs  
243 and other charges suppliers have to incur to market and deliver the product.  
244 These charges would still be reflected in the end price paid to suppliers even in  
245 bilateral transactions. Further, if products are restructured to remove these risks  
246 from suppliers, it does not mean that these risks no longer exist. To the contrary,  
247 they are simply transferred to the Ameren Illinois Utilities and then ultimately to  
248 end-use customers.

249 It is critical to recognize that we are dealing with reality and not theory. While  
250 Mr. Rose may wish that wholesale suppliers would willingly sell at production  
251 cost and ignore their other costs and the many volumetric and operational risks  
252 associated with supplying full requirements, this is not the reality of the  
253 marketplace from which the Ameren Illinois Utilities must procure supply to  
254 fulfill their obligations.

255 I am unaware of any requirement that any wholesale entity is obligated to offer to  
256 sell any product at any particular price to the Ameren Illinois Utilities at all, let  
257 alone an obligation to offer to sell at Mr. Rose's expectation of what the price  
258 should be.

259 Furthermore, whether supply is obtained from BGS Suppliers, through bilateral  
260 contracts, or from the MISO-administered LMP markets, someone bears these  
261 risks. Risks which are not transferred to suppliers will be borne by the Ameren  
262 Illinois Utilities and their customers. Transferring certain risks from suppliers,  
263 such as that which is done with a shortened enrollment window, can be expected  
264 to result in a price benefit which exceeds any incremental risk borne by  
265 customers. However, this is not true of all risks. While the price of the auction  
266 product may indeed be lowered by transferring from suppliers all of these risks,  
267 this does not necessarily suggest that the overall total cost to consumers is  
268 reduced.

269 **Q. Mr. Rose also would rely upon the generation or production cost as an**  
270 **appropriate benchmark. Notably he comes to this conclusion without**  
271 **providing any rationale. Is this an acceptable metric?**

272 A. No. It completely ignores the realities of the market place. Imagine General  
273 Motors being compelled to sell its cars based solely on certain production costs.  
274 “How soon it would go out of business” would be the immediate talk of the  
275 business world, as the inability to make a profit would be evident.

276 **Q. What change in the auction process does Mr. Rose recommend?**

277 A. He wants to use his benchmark(s) to set a “reserve price” for the auction. Then, if  
278 the auction price results are higher than his reserve price, the auction evidently  
279 fails and supply must be procured in the wholesale market.

280 **Q Is the use of such a benchmark or “reserve price” appropriate for the Illinois**  
281 **auction?**

282 A. First, it goes without saying, but I will say it anyway, the auction is a mechanism  
283 to procure supply from the wholesale market. Expecting a much different result  
284 in a second procurement attempt from that same wholesale market doesn't make  
285 any sense to me. Second, for the reasons noted above, setting a "reserve price"  
286 that does not include all supplier costs or consider all supplier risks does not make  
287 any sense either. Failing to factor volumetric and operational risks, and all other  
288 costs, into this reserve price will necessarily guarantee that the reserve price is  
289 invalid and unachievable. Setting an unachievable price as the benchmark will  
290 doom the auction to failure and result in the entire supply requirement being  
291 acquired via contingency purchase plans, thus exposing customers to other major  
292 risks (e.g., price uncertainty and resource adequacy).  
293 Finally, setting a "reserve price" only makes sense if one knows that one or more  
294 suppliers will serve the load at that price. In reality, there is no way to determine  
295 at what price suppliers will serve a particular load without going to the market and  
296 soliciting bids – and that is exactly what we are doing with the transparent,  
297 competitively-bid, auction procurement process.

298 **Q. Does this conclude your rebuttal testimony?**

299 A. Yes.

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