

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	:	Docket No. 06-0800
Illinois Light Company d/b/a 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.	:	

JOINT REPLY BRIEF OF MIDWEST GENERATION EME, LLC
AND EDISON MISSION MARKETING & TRADING, INC.

Rebecca Lauer
6529 Bentley Avenue
Willowbrook, IL - 60527
Phone: 630.323.4874
Fax: 312.788.5263

Mark J. McGuire
Carlin R. Metzger
Blair B. Hanzlik
McGuireWoods LLP
77 West Wacker Drive
Suite 4100
Chicago, IL 60601
Phone: 312.849.8100
Fax: 312.849.3690

June 7, 2007

TABLE OF CONTENTS

	Page
I. INTRODUCTION AND SUMMARY	1
II. THE ATTORNEY GENERAL’S PROPOSED “RESERVE PRICES” OR “PRICE BENCHMARKS” SHOULD BE REJECTED.....	2
III. THE DEFINITION OF “CONFIDENTIAL BIDDING DATA” SHOULD NOT INCLUDE AN EXCEPTION THAT WOULD ALLOW UNLIMITED DISCRETION TO RELEASE AUCTION PARTICIPANTS’ CONFIDENTIAL BUSINESS INFORMATION.....	7
IV. THE PROPOSAL OF DIRECT ENERGY SERVICES AND COMMERCE ENERGY TO SHORTEN CONTRACT LENGTH TO LESS THAN ONE YEAR SHOULD BE REJECTED.	10
V. THE COMMISSION SHOULD ADOPT BILATERAL CREDIT PROVISIONS IN THE SUPPLIER FORWARD CONTRACTS.....	11
IV. CONCLUSION.....	12

**JOINT REPLY BRIEF OF MIDWEST GENERATION EME, LLC
AND EDISON MISSION MARKETING & TRADING, INC.**

Pursuant to Section 200.800 of the Illinois Commerce Commission's ("Commission") Rules of Practice (83 Ill. Admin. Code §200.800) and the schedule established by the Administrative Law Judges, Midwest Generation EME, LLC ("MWGen") and Edison Mission Marketing and Trading, Inc. ("EMMT") (collectively, "MWGen") hereby submit their Reply Brief in the above-captioned proceeding.

I. INTRODUCTION AND SUMMARY

In this Reply, MWGen will address four issues raised by the Initial Briefs. First, the Commission should disregard the Attorney General's misguided criticism of the 2006 auction results as the Attorney General's contentions lack evidentiary support and take an overly simplistic view of the auction process. The Commission should also reject the Attorney General's proposal to set reserve prices based on wholesale prices and generation cost. Second, the definition of "confidential bidding data" should not include a provision that would allow Staff or the Auction Manger unlimited discretion to release the bidding information of auction participants. Third, the Commission should reduce the risk faced by suppliers by adopting bilateral credit provisions in the Supplier Forward Contracts ("SFCs"). Finally, the Commission should reject the vague proposal by Direct Energy Services and Commerce Energy to shorten the length of contracts available through the auction. The mix of 1, 2 and 3-year contracts proposed by Staff should provide stability for Illinois consumers.

II. THE ATTORNEY GENERAL’S PROPOSED “RESERVE PRICES” OR “PRICE BENCHMARKS” SHOULD BE REJECTED.

The sole proposal articulated in the Attorney General’s Initial Brief is that the Commission should use wholesale market prices and generation costs as benchmarks to set a reserve price at the start of, and to assess clearing prices at the end of, a procurement process.¹ While the Attorney General states that these benchmarks could be used in combination with others, no specific proposals are offered other than wholesale market prices and generation costs. No other participant in this proceeding has supported the Attorney General’s proposed price benchmarks.

The Attorney General presented the testimony of Dr. Kenneth Rose, who recommended that price benchmarks should be used to evaluate the success of the energy procurement auction and, further, to set the starting or “reserve” price for the auction. (A.G. Ex. 1.0.) Specifically, Dr. Rose contends that the appropriate benchmarks are wholesale market price and electricity generation costs. (A.G. Ex. 1.0 at 2.)

The Attorney General argues that using wholesale market prices to assess the clearing price of the auction is appropriate “because there is a clear relationship” between wholesale prices in the market and the retail price offered to customers. (A.G. Brief at 4.) In support of generation costs as a benchmark, the Attorney General also argues that “a relationship between the price charged for a product and the cost for producing that product” is sufficient to use generation costs to evaluate auction results and set a reserve price. (A.G. Brief at 5.) Lastly, the Attorney General concludes that the difference

¹ The Commission should disregard the Attorney General’s generic contention that the 2006 Illinois auction is an invalid rate-setting mechanism. As the Commission recognized in the order initiating this docket, this proceeding is not a forum for the re-litigation of the issues disposed of in the Procurement Dockets.

between the wholesale prices and the auction prices cannot be explained as risk premium and, therefore, the auction failed to produce competitive prices. (A.G. Brief at 6.)

The Attorney General's argument is wholly unconvincing. The Attorney General acknowledges that competition drives the price down and that the seller with the lowest cost makes the sale. (A.G. Brief at 5.) Indeed, auctions are an embodiment of a competitive market place, efficiently producing a clearing price at which the sellers are willing to sell and which the buyers are willing to pay. (MWGen Ex. 1.0 at 14.) The Attorney General's witness, Dr. Rose, testified that a competitive auction is an effective way of procuring power supply at a reasonable price. (Tr. at 398-99.)

As a successful procurement mechanism, auctions are used in a variety of markets. Thus, the ultimate determinant of an auction's competitiveness is whether the auction involved "active, persistent and aggressive bidding unaffected by process problems or external events." (MWGen Ex. 1.0 at 12.) The Illinois energy auction was easily accessible and functioned as one procurement mechanism alongside other energy markets. (*Id.* at 14.) Dr. Rose testified that he found no evidence whatsoever of anti-competitive behavior at the Illinois auction and, significantly, that the auction results were consistent with market conditions. (Tr. at 392-93; *see also* testimony of Dr. LaCasse, Tr. at 446, concluding that the "auction result was consistent with market conditions.") Given the competitiveness of the auction and absence of even an allegation of anti-competitive behavior, the Commission should accept the auction outcome as reflective of efficient market pricing.

Moreover, the Attorney General's argument fails to consider the inadequacy of the proposed benchmarks. As witness Graves testified, reliance on spot market energy

prices as a benchmark for auction results is inappropriate because auction prices depend on expectations about *future* energy prices. Future energy prices are influenced by many factors, “including forward prices for power and fuels and the perceived uncertainty in future market conditions and regulatory rules over the service-contract horizon.” (MWGen Ex. 1.0, ln. 69-71.) Additionally, looking at energy prices alone is misleading because auction participants consider predicted prices for capacity, transmission, and ancillary services that have to be provided as part of the SOS supply obligation. Then, suppliers must consider fuel-cost risk as well as volumetric risk with respect to the amount of energy that must be provided. (*Id.*, ln. 72-76; *see also* Ameren Ex. 5.0 at 11.) A winning supplier’s obligation does not change even if prices during the slated delivery period differ from historical prices, if its costs of acquiring the power change, if the market price rises, or if its load changes. (Tr. at 375-376.) Yet while proposing wholesale market prices as a benchmark, Dr. Rose acknowledged that he did not conduct any study or analysis comparing spot market prices to long term shaped, full retail requirements products. (EMMT & MWGen Cross Ex. 1, ComEd/AG 2.12.)

Similarly, generation cost alone is not an appropriate “benchmark” to evaluate the success of an auction. Indeed, generation cost is only one variable that comprises a wholesale price. (ComEd Ex. 4.0 at 9; Tr. at 370, ln. 6-14.) Reliance solely on generation costs ignores other considerations that are included in the winning auction prices, such as migration risks and counterparty credit risks. (ComEd Ex. 2.0 at 27.) While offering up generation cost as a benchmark for a pass-fail analysis, Dr. Rose did not conduct any study of risk premiums in the market, or the effect on generator cost or market prices of load shape, load uncertainty, or optionality. (EMMT & MWGen Cross

Ex. 3, ComEd/AG 2.26.) The market price achieved in a competitive auction involves numerous factors beyond generation cost, and relying on generation cost to conduct a pass-fail analysis of auction results is inappropriate.

Even if generation cost is used as a reference point, the Attorney General's reliance on the "Argonne Report"² to analyze generation cost data is misplaced. The report itself recognizes that the study does not involve a current representation of the regional market structure, transmission configuration, or plant operating conditions. Thus, the Argonne Report is not an appropriate reference point for understanding recent auction results.

The ICC Staff report³ reviewed how the 2006 auction prices compared to forward prices at hubs near Illinois, adjusted for load shape and additional costs of transmission, ancillary services, and capacity. The ICC Staff report found only a 7-12 percent difference between the adjusted prices and the auction results for the fixed price ComEd auction product. The ICC Staff report points to volumetric risk and other sources of risk as a possible basis for such premiums, and witness Frank Graves testified that a risk premium of 7-12 percent is perfectly plausible. (MWGen Ex. 1.0 at 7, ln. 187-88.) The Auction Manager's report similarly notes:

The risks that a bidder faces include the risks of customers switching due to market conditions, risks of customers returning, weather risks, volatility in fuel markets, utility credit risk, risk of market changes, and regulatory risk. The small amount to cover

² Argonne National Laboratory and University of Illinois at Urbana-Champaign, "Evaluating the Potential Impact of Transmission Constraints on the Operation of a Competitive Electricity Market in Illinois," April 2006. The Commission allowed the Argonne Report to be entered on the record by the Attorney General only for purposes of cross-examination. Dr. Rose did not conduct an independent validation or evaluation of the data or methodology used by, or of the conclusions concerning generation costs reported in, the Argonne Report. (EMMT & MWGen Cross Ex. 2, ComEd/AG 2.15.) Therefore, the Commission should reject the Attorney General's attempt to rely on the Argonne Report as substantive evidence.

³ ICC Staff (assisted by Boston Pacific Company), *Post-Auction Report of the Staff*, December 6, 2006.

the additional services and risks appears to indicate that bidders aggressively competed down concerns over these risks.⁴

Finally, the Attorney General does not offer any concrete suggestion on how price benchmarks or reserve prices would be effectively implemented. As Mr. Graves pointed out in his testimony, “If . . . a reserve price . . . is low relative to most market participants’ beliefs about a fair price, then the auction may not be fully subscribed.” (MWGen Ex. 1.0 at 11, ln. 228-231.) On the other hand, “an inadvertently high reserve price . . . could lead to a higher auction price than might have resulted if there had been no reserve price at all.” (*Id.* ln. 246-252.) Thus, the Commission should reject the Attorney General’s proposal to utilize a pre-announced reserve price. Instead, the current approach where the Auction Manager establishes a liberal but clearly non-binding starting price for the auction (in consultation with ICC staff) should be maintained for the next Illinois auction.

In summary, the Attorney General failed to produce any evidence in support of the suggestion that reserve prices would improve the auction process. (*See* Auction Manager Ex. 2.0.) The Illinois auction was competitive and consistent with the established auction rules and produced efficient and competitive results. On the other hand, price benchmarks ignore significant elements of auction prices and are inappropriate to use in assessing the previous auction or in setting the reserve price in the future. The implementation of price benchmarks or reserve prices as suggested by the Attorney General poses a significant risk of precluding or overturning a competitive auction result, and deterring participation in future power auctions in Illinois.

⁴ NERA Economic Consulting, “Public Report Presented to the Illinois Commerce Commission,” December 6, 2006, p. 128.

III. THE DEFINITION OF “CONFIDENTIAL BIDDING DATA” SHOULD NOT INCLUDE AN EXCEPTION THAT WOULD ALLOW UNLIMITED DISCRETION TO RELEASE AUCTION PARTICIPANTS’ CONFIDENTIAL BUSINESS INFORMATION.

The principal goal of this proceeding is to improve on the auction process and promote participation in future auctions. A universal concern shared by all parties is the confidentiality of competitively sensitive information, and the impact that the potential disclosure of competitively sensitive information will have on participation in future auctions. (*See, e.g.*, Auction Manager Ex. 1.0 at 32-39, ln. 700-858; ComEd Ex. 1.0 at 12, ln. 269-272.) Staff and the Auction Manager presented testimony recognizing that participation in future auctions may be deterred if potential participants are concerned that competitively sensitive information might be released. Suppliers participating in the Illinois auction need the assurance of the Commission that their participation will not undermine their business in future Illinois auctions, RFP’s, and elsewhere. The Commission has an opportunity to provide this assurance by adopting an appropriate definition of “confidential bidding data” that will protect competitively sensitive information and encourage participation in future auctions.

The definition of “confidential bidding data” as currently proposed by Staff includes a provision that would allow unlimited discretion on the part of Staff and the Auction Manager to release confidential information. MWGen believes that the fourth segment of the definition currently proposed by Staff should be modified to eliminate the unlimited discretion provided to the Auction Manager and Staff to release confidential information to the public. In its current formulation, the definition of confidential bidding data proposed by Staff includes a “catch-all” provision, which states:

4) any other information that the Auction Manager and the Staff, to fulfill their respective responsibilities, deem necessary to convey in their public reports on the auction, as described in [the CPP Documents section of the Competitive Procurement Process part of this Rider [for ComEd] or the CPA Documents section of the Competitive Procurement Auction Process part of this Rider [for the Ameren Illinois Utilities]].

(ICC Staff Ex. 4.0 at 12-13).

This definition is too vague to provide the necessary assurance to auction participants that information they deem competitively sensitive will not be released to the public by the Auction Manager or Staff.

The Auction Manager is sensitive to this concern and acknowledges that the release of sensitive information “can discourage participation by prospective suppliers and thus reduce competition at the auction.” (Auction Manager Ex. 1.0 at 33, ln. 707-709.) As examples, Dr. LaCasse identifies an auction participant’s bidding status and the quantity and type of tranches won by a supplier. The disclosure of an auction participant’s bidding status “could only harm the supplier’s bargaining position in the market when making supply arrangements to bid in the auction. Similarly, if shortly after the auction, the quantity and type of tranches that a supplier had won were to be made public, the supplier would be put in a worse negotiating position to make any needed supply arrangements as any counterparty would know the obligations faced by the supplier.” (*Id.* at 33, ln. 715-722)

Dynegy shares this concern. As Dynegy witness Mr. Huddelston testified,

Suppliers frequently compete with each other in many different contexts such as auctions, RFPs and bilateral deals. As wholesale markets become larger with the advent and growth of RTOs and ISOs, the geographic area in which suppliers can economically compete has grown. Releasing data that might allow a supplier’s competitors to divine its bidding strategies and commercial needs would put that supplier at a disadvantage come the next competitive

process, even if that process were neither in Illinois nor an auction. And because suppliers would have other places to sell their services in the expanded marketplace, they may well avoid any process in which there is any possibility of the disclosure of their data. Thus, to ensure the maximum participation in the auction, the rules regarding confidential treatment of supplier-specific bidding information must be protected.

(Dynergy Ex. 1.0 at 4, ln. 71- 81).

The current definition of “confidential bidding data” proposed by Staff risks undermining the confidence potential suppliers will have in the protection afforded their confidential information. The fourth section of this definition is essentially an unlimited “catch-all” that would provide Staff and the Auction Manger with unfettered discretion to make auction information public. While MWGen certainly expects that the Auction Manager and Staff would exercise that discretion judiciously, this definition weakens the auction participants’ confidence that their sensitive business data will not be publicly released, and should be modified by the Commission. Therefore, MWGen recommends that the Commission modify the definition of “confidential bidding data” as follows:

All bidding data except for: (1) the names of the winning bidders, which shall be revealed to the public when the Auction Manager issues a Declaration of Successful Auction Result; (2) the precise number of registered bidders, the ranges of excess supply for each section and the going prices for each product reported to bidders during the auction, which shall be reported by the Auction Manager and by the Staff to the public within the first part of their Public Reports 15 business days after the close of the auction; (3) the number of tranches of each product won by each of the winning bidders, which shall be reported by the Auction Manger and by the Staff to the public within the second part of their Public Reports 60 business days after the close of the auction; and (4) any other information that the Auction Manger and the Staff are required to convey in their public reports on the auction, as described in [the CPP Documents section of the Competitive Procurement Process part of this Rider [for ComEd] or the CPA Documents section of the Competitive Procurement Auction Process part of this Rider [for the Ameren Illinois Utilities]].

IV. THE PROPOSAL OF DIRECT ENERGY SERVICES AND COMMERCE ENERGY TO SHORTEN CONTRACT LENGTH TO LESS THAN ONE YEAR SHOULD BE REJECTED.

The parties' initial briefs addressed the issue of whether the contract lengths for the Fixed Price section of the auction products should be modified. MWGen continues to believe that the current structuring of contract lengths is appropriate; however, MWGen does not object to the proposals to alter the contract lengths in future auctions to provide a combination of one-, two-, and three-year contracts for the Fixed Price section of the Auction. Staff witnesses Kennedy and Zuraski supported the use of a blend of 1-year, 2-year and 3-year contracts. (ICC Staff Ex. 1.0 at 19; ICC Staff Ex. 4.0 at 19-20; Tr. at 648-649.) The Auction Manager, Ameren witness Blessing, and ComEd witness McNeil testified that they had no opposition to the ICC Staff's Proposal. (Tr. at 328-330, 488, 543.) According to ICC Staff witnesses Kennedy and Zuraski, the mix of contract lengths will help to generate bidder interest, increase competition, and lower supply costs. (ICC Staff Ex. 4.0 at 21.)

While several parties supported a combination of either a mix of one- and three-year terms or a mix of one-, two- and three- year agreements, Direct Energy Services, LLC ("DES") and Commerce Energy, Inc. ("CE") suggested that the Commission reject the proposals incorporating long-term contracts (any over one-year in duration). (Initial Brief of DES and CE at 5.)

DES and CE contend that contracts with short durations allow service to be more market-reflective. (*Id.* at 6.) However, the proposal to rely solely on contracts shorter than one-year in duration subjects customers to the possibility of drastic pricing changes. Longer-term contracts, such as three-year terms, benefit consumers by insulating the customers from short-term changes in pricing that may not reflect the longer-term trends.

Offering contracts of different lengths will allow pricing to be responsive to the needs of the market, while also providing suppliers with the opportunity to utilize longer term contracts to mitigate the risk from price variations. The proposal to limit contracts to durations of shorter than one-year would deprive suppliers of the flexibility to use their discretion in managing risk by negating their ability to adopt a mix of short and longer term contracts.

In summary, MWGen finds Staff's and ComEd's proposals to change contract lengths in the fixed price section of the auction to a combination of staggered one-, two-, and three- year contracts to be reasonable. Further, the proposal to eliminate contracts over one-year in duration should be rejected.

V. THE COMMISSION SHOULD ADOPT BILATERAL CREDIT PROVISIONS IN THE SUPPLIER FORWARD CONTRACTS.

MWGen supports of the positions set forth in Dynegy Inc.'s Opening Brief relating to bilateral credit. Dynegy has correctly noted that risk and uncertainty carry costs, which the Commission should seek to reduce by adopting changes to allocate risks in a more efficient manner. In particular, MWGen supports and joins Dynegy's position regarding credit risk and the need to make the credit provisions in the SFC's bilateral. Reciprocal credit provisions are a matter of fundamental fairness and, more importantly, should lead to lower prices in future Illinois auctions.

Risk is a considerable component of the auction price, which suppliers factor into their pricing to retail customers. (Dynegy Ex. 1.0 at 8; *see also* Auction Manager's Report at 123.) Allocating the risk to the party that can manage it most efficiently will lower the risk premium that is incorporated into the price paid by retail customers. While Staff has acknowledged that the utilities have more control over their credit risk than do

the suppliers, Staff nevertheless withdrew its support for bilateral credit agreements because the regulatory process imposes costs that reduce the efficiency of allocating risk to the utilities. (See Staff Initial Brief at 42-43.) However, MWGen supports Dynegy's position that this possibility of regulation will, in reality, be an incentive for the utilities to manage their own risk and costs efficiently and prudently. (See Dynegy Opening Brief at 12.)

The Commission should use this opportunity to help retail customers obtain a lower overall price by more efficiently allocating risk by including a bilateral credit requirement in the SFC's.

IV. CONCLUSION

MWGen respectfully requests that the Commission adopt findings consistent with the positions stated above.

Dated: June 7, 2007

Midwest Generation EME, LLC and Edison
Mission Marketing & Trading, Inc.

/s/ Carlin R. Metzger
One of Their Attorneys

Mark J. McGuire (mmcguire@mcguirewoods.com)
Carlin R. Metzger (cmetzger@mcguirewoods.com)
Blair B. Hanzlik (bhanzlik@mcguirewoods.com)
McGuireWoods LLP
77 West Wacker Drive
Suite 4100
Chicago, IL 60601
Phone: 312.849.8100
Fax: 312.849.3690

Rebecca Lauer (BLauer@mwgen.com)
6529 Bentley Avenue
Willowbrook, IL - 60527
Phone: 630.323.4874
Fax: 312.788.5263

\4599932.2