

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company)
)
Notice of transfer of generation assets to a)
subsidiary and entry into various agreements) Docket No.
pursuant to Section 16-111(g) of the Illinois)
Public Utilities Act.)

DRAFT ORDER

I. PROCEDURAL HISTORY AND INTRODUCTION

On November 30, 2001, pursuant to Section 16-111(g) of the Illinois Public Utilities Act ("Act"), 220 ILCS 5/16-111(g), Central Illinois Light Company ("CILCO") gave the Commission notice of CILCO's intent to transfer substantially all of its generation assets (the "Generation Assets") to a wholly-owned subsidiary, Central Illinois Generation, Inc. ("CIGI," and collectively with CILCO, the "Companies"), and to enter into certain agreements. This transfer of Generation Assets ("Transfer") will become effective subsequent to the receipt of all regulatory approvals.

In its "Notice of transfer of generation assets to a subsidiary and entry into various agreements pursuant to Section 16-111(g) of the Illinois Public Utilities Act" ("Notice"), CILCO stated that, subsequent to the date on which the Transfer becomes effective, CILCO will continue to operate as an electric utility in Illinois, and will continue to offer electric power transmission and delivery service. CILCO also provides gas utility service which will be unaffected by the transfer of the Generation Assets.

II. LEGAL STANDARDS

Section 16-111(g) of the Act provides in pertinent part:

During the mandatory transition period, an electric utility may, without any obtaining approval of the Commission other than that provided for in this subsection and notwithstanding any other provision of this Act or any rule or regulation of the Commission that would require such approval: . . .

(3) sell, assign, lease or otherwise transfer assets to an affiliated or unaffiliated entity and as part of such transaction enter into service agreements, power purchase agreements, or other agreements with the transferee; provided, however, that the prices, terms and conditions of any power purchase agreement must be allowed into effect by the Federal Energy Regulatory Commission; . . .

In order to . . . sell, assign, lease or otherwise transfer assets pursuant to this Section, the electric utility shall comply with subsections (c) and (d) of Section 16-128, if applicable, . . . and provide the Commission with at least thirty days notice of the proposed reorganization or transaction, which notice shall include the following information:

(i) a complete statement of the entries that the electric utility will make on its books and records of account to implement the proposed reorganization or transaction together with a certification from an independent certified public accountant that such entries are in accord with generally accepted accounting principles and, if the Commission has previously approved guidelines for cost allocations between the utility and its affiliates, a certification from the chief accounting officer of the utility that such entries are in accord with those cost allocation guidelines;

(ii) a description of how the electric utility will use proceeds of any sale, assignment, lease or transfer to retire debt or otherwise reduce or recover the costs of services provided by such electric utility;

(iii) a list of all federal approvals or approvals required from departments and agencies of this State, other than the Commission, that the electric utility has or will obtain before implementing the reorganization or transaction;

(iv) an irrevocable commitment by the electric utility that it will not, as a result of the transaction, impose any stranded cost charges that it might otherwise be allowed to charge retail customers under federal law or increase the transition charges that it is otherwise entitled to collect under this Article XVI;

(v) if the electric utility proposes to sell, assign, lease or otherwise transfer a generating plant that brings the amount of net dependable generating capacity transferred pursuant to this subsection to an amount equal to or greater than 15% of the electric utility's net dependable capacity as of the effective date

of this amendatory Act of 1997, and enters into a power purchase agreement with the entity to which such generation plant is otherwise sold, assigned, leased, or otherwise transferred, the electric utility also agrees, if its fuel adjustment clause has not already been eliminated, to eliminate its fuel adjustment clause in accordance with subsection (b) of Section 9-220 for a period of time equal to the length of any such purchase power agreement or successor agreement, or until January 1, 2005, whichever is longer

(vi) In addition, if the electric utility proposes to sell, assign, or lease . . . an amount of generating plant that brings the amount of net dependable generating capacity transferred pursuant to this subsection to an amount equal to or greater than 15% of its net dependable capacity as of the effective date of this amendatory Act of 1997 . . . the electric utility shall provide, in addition to the information listed in subparagraphs (i) through (v), the following information: (A) a description of how the electric utility will meet its service obligations under this Act in a safe and reliable manner and (B) the electric utility's projected earned rate of return on common equity, calculated in accordance with subsection (d) of this Section, for each year from the date of the notice through December 31, 2004 both with and without the proposed transaction. If the Commission has not yet entered an order initiating a hearing on the proposed transaction within 30 days after the date the electric utility's notice is filed, the transaction shall be deemed approved. The Commission may, after notice and hearing, prohibit the proposed transaction if it makes either or both of the following findings: (1) that the proposed transaction will render the electric utility unable to provide its tariffed services in a safe and reliable manner, or (2) that there is a strong likelihood that consummation of the proposed transaction will result in the electric utility being entitled to request an increase in its base rates during the mandatory transition period pursuant to subsection (d) of this Section. Any hearing initiated by the Commission into the proposed transaction shall be completed, and the Commission's final order approving or prohibiting the proposed transaction shall be entered, within 90 days after the date the electric utility's notice was filed.

III. CILCO'S NOTICE OF THE PROPOSED TRANSFER

A. Description of the Parties to the Proposed Transfer

CILCO. CILCO was incorporated under the laws of Illinois in 1913. CILCO's principal current business is the generation, transmission, distribution and sale of electric energy in an area of approximately 3,700 square miles in central and east-central Illinois, and the purchase, distribution, transportation and sale of natural gas in an area of approximately 4,500 square miles in central and east-central Illinois. CILCO furnishes electric service to over 193,000 retail

customers in 136 Illinois communities and gas service to over 201,000 customers in 128 Illinois communities. CILCORP Inc. ("CILCORP") owns 100% of the common stock of CILCO.

CIGI. CIGI is a wholly-owned subsidiary of CILCO. CIGI's principal business will be the generation of electricity. Under the Power Supply Agreement ("PSA"), CIGI will supply CILCO with power through December 31, 2004.

CILCORP. CILCORP was incorporated as a holding company in the state of Illinois in 1985. CILCORP owns 100% of the common stock of CILCO. CILCORP is a wholly-owned subsidiary of AES Corporation.

AES. The AES Corporation ("AES") is a global power company whose primary lines of business are electricity generation and distribution. AES' electricity generation business consists of sales to non-affiliated wholesale customers (generally electric utilities, regional electric companies, or wholesale commodity markets) for further resale to end users. AES' electricity distribution business consists of direct sales to end users such as commercial, industrial, governmental and residential customers. AES now operates and owns, entirely or in part, a diverse portfolio of electric power plants with a total capacity exceeding 40,000 megawatts (MW) worldwide. AES acquired 100% ownership of the common stock of CILCORP in 1999 to carry out this transfer ("Transfer").

B. Description of the Proposed Transfer

CILCO intends to separate from most of the electric generation function all Illinois regulated utility operations. Upon the transfer of CILCO's Generation Assets, CIGI will succeed to CILCO's major generation operations. After the transfer, CILCO will continue to provide the electric power transmission and delivery services currently provided pursuant to CILCO's tariffs.

Mechanics of the Transfer

Following Commission and Federal Energy Regulatory Commission ("FERC") approvals, CILCO will transfer to CIGI, in the form of a capital contribution, the Generation Assets and related liabilities pursuant to a Contribution Agreement between the Companies. In addition, CIGI will execute an intercompany note in favor of CILCO in the amount of \$75 million; the periodic cash proceeds to CILCO will be used to serve CILCO's general cash requirements, including the payment of CILCO's mortgage bond obligations. To facilitate the Transfer, CILCO and CIGI will also enter into the ancillary agreements described in detail below. These agreements include a Power Supply Agreement, under which CIGI will supply power and energy to CILCO until December 31, 2004, which will have to be approved by the FERC.

Assets and Obligations to be Transferred

CILCO will transfer to CIGI the Generation Assets, which include: (1) the Duck Creek and Edwards electric generating units, the Sterling Avenue peaking units, the land on which the Duck Creek and Edwards generation units are located, and the equipment and other tangible personal property used in the operation of the those generating units; (2) CILCO's rights under various agreements, including fuel supply agreements, leases, licenses and contracts related to the generation operations; and (3) all government permits or other authorizations used in or necessary to the generation operations. CILCO's transmission and distribution facilities and assets will continue to be owned, managed and maintained by CILCO. Easement Agreements between the Companies will allow CILCO access to the Duck Creek and Edwards plant sites to maintain the distribution and transmission assets located at those sites, and will allow CIGI access to the Sterling Avenue plant site to maintain its generation assets. CILCO will also assign

various obligations to CIGI, including liabilities and obligations under transferred contracts, under environmental laws, arising out of the employment of transferred employees, and liabilities associated with the generation operations. The specific assets and obligations to be transferred are described in the Contribution Agreement that accompanied the Notice as Appendix A.

Result of the Transfer

The effect of the transaction will be that CILCO will no longer provide substantial electric generation services. CIGI will own substantially all of the generation assets that CILCO possessed prior to the date of the Transfer and will be responsible for supplying CILCO with the services required under the Power Supply Agreement through 2004. The minor generation assets retained by CILCO will be managed by CIGI pursuant to the terms of the PSA.

C. Description of the Ancillary Agreements

As indicated above, there are various agreements that will be involved in the transfer of the Generation Assets to CIGI.

The Contribution Agreement

Under this agreement, CILCO will transfer to CIGI the assets and liabilities discussed above. A copy of the form of this agreement was attached as Appendix A to the Notice.

The Services and Facilities Agreement

Through the Services and Facilities Agreement, CIGI, CILCO and other CILCO affiliates will agree to provide each other with certain necessary or desired services and facilities at a price equal to the cost of such services and facilities. A copy of the form of this agreement was attached as Appendix B to the Notice.

The Power Supply Agreement

Under the Power Supply Agreement, CIGI is obligated to provide to CILCO the full requirements of power and energy necessary to serve the needs of CILCO's retail customers. Until the PSA expires on December 31, 2004, CIGI will provide CILCO with its full requirements. As of January 1, 2005, CILCO will obtain its full requirements from market sources. Such "market sources" could include CIGI or another affiliate, if any of these entities offered the most economical and reliable source of power and energy. There should be ample capacity to supply CILCO's future needs at a reasonable, competitive rate.

Under the PSA, CILCO pays fixed demand and energy charges for bundled load. The effect of setting the demand and energy charges for bundled service load requirements in this way is to insulate CILCO from risk that those charges could increase. Even if, for example, purchased power costs were to increase, or if maintenance or fuel costs were to increase for any one of numerous reasons, the same, fixed demand and energy rates would apply.

The PSA is subject to the jurisdiction of, and will be approved by, FERC. A copy of the form of this agreement was attached as Appendix C to the Notice.

The Interconnection Agreement

The Interconnection Agreement would be entered into between the Companies and is a form agreement that is and has been used by CILCO to specify the rules for a generator to be interconnected to the CILCO distribution/transmission system. At the appropriate time, the Interconnection Agreement may be replaced by an Independent System Operator ("ISO") agreement, as necessary. A copy of the form of this agreement was attached as Appendix D to the Notice.

The Easement Agreements

The Easement Agreements between the Companies allow CILCO to access the Duck Creek and Edwards plant sites to maintain and install transmission and distribution components and will allow CIGI access to the Sterling Avenue plant site to maintain its generation assets. Copies of the form of these agreements were attached as Appendices E, F and G to the Notice.

D. Satisfaction of Notice Requirements

As noted in Section II, supra, Section 16-111(g) of the Act provides that an electric utility intending to transfer assets to an affiliated entity and, as part of that transaction, to enter into various agreements, must provide the Commission with at least 30 days notice of the transaction and include certain information in that notice. Under Section 16-111(g), CILCO was required to provide the following information:

- (i) a complete statement of the entries that the electric utility will make on its books and records of account to implement the proposed reorganization or transaction together with a certification from an independent certified public accountant that such entries are in accord with generally accepted principles and, if the Commission has previously approved guidelines for cost allocations between the utility and its affiliates, a certification from the chief accounting officer of the utility that such entries are in accord with the cost allocation guidelines

CILCO attached the complete statement of the entries together with the required certifications as Appendices H, I and J to the Notice respectively.

- (ii) a description of how the electric utility will use proceeds of any sale, assignment, lease or transfer to retire debt or otherwise reduce or recover the costs of services provided by such electric utility

The Transfer will be accomplished by CILCO making a capital contribution of the Generation Assets to CIGI, its subsidiary. CIGI will execute an intercompany note in favor of CILCO in the amount of \$75 million; the periodic cash proceeds to CILCO will be used to serve

CILCO's general cash requirements, including the payment of CILCO's mortgage bond obligations.

(iii) a list of all federal approvals or approvals required from departments and agencies of the State, other than the Commission, that the electric utility has or will obtain before implementing the reorganization or transaction

CILCO attached the list of required approvals as Appendix K to the Notice.

(iv) an irrevocable commitment by the electric utility that it will not, as a result of the transaction, impose any stranded cost charges that it might otherwise be allowed to charge retail customers under federal law or increase the transition charges that it is otherwise entitled to collect

CILCO irrevocably committed that it will not, as a result of the Transfer, either impose any stranded cost charges that it might otherwise be allowed to charge retail customers under federal law or increase the transition charges that it is otherwise entitled to collect under Article XVI of the Act.

(v) elimination of electric fuel adjustment clause

On October 24, 2001, the Commission, in Docket No. 01-0599, eliminated CILCO's FAC under Section 9-220(b) of the Act.

(vi) (A) a description of how CILCO will meet its service obligations under the Act in a safe and reliable manner

As indicated in the testimony of Robert Sprowls and Robert G. Ferlmann, attached as Appendices L and M to the Notice, respectively, following the transfer, CILCO will continue to provide safe and reliable electric service. As discussed above, CILCO will obtain its electricity from CIGI under the PSA. CIGI will own or manage the identical resources that CILCO currently employs and has available to provide service. CIGI will own and operate two coal-fired base load generating plants, and two natural gas combustion turbine generators. The combined capability that will be at CIGI's disposal will exceed 1130 MW. CILCO will continue to own and maintain a natural gas fired cogeneration plant, supplemented by 26 MW of electric

power capacity provided by 16 diesel-fueled power modules currently located at various CILCO substations, which will be managed by CIGI. Accordingly, the Transfer will not limit or reduce the resources available to serve CILCO's needs.

CILCO will own and maintain all of its distribution and transmission assets. The Easement Agreements will allow CILCO to access the generation sites to maintain and install transmission and distribution components. Additionally, the management of CILCO will remain intact, as will the management that currently oversees the operation of the generation assets.

The PSA provides for the same type of load and resource planning that CILCO presently has available to it. The terms of the PSA call for CILCO and CIGI to routinely engage in a planning and review process to allow CIGI to procure whatever resources may be necessary to satisfy CILCO's needs. Upon the expiration of the PSA on December 31, 2004, CILCO will obtain its necessary supply from market sources. It is expected that, through deregulation and other variables, the power supply market will then include many more supply options than it does today, and procurement of adequate supply at adequate rates will not be problematic.

(vi) (B) CILCO's projected earned rate of return on common equity, calculated in accordance with Section 16-111(d) of the Act, for the period 2000 through 2004, both with and without the Transfer

Section 16-111(g) requires that CILCO submit analyses of its return on common equity, both with and without the Transfer, for each year subsequent to the Transfer through 2004 in order to determine if the Transfer will result in CILCO's rate of return being so low that there is a strong likelihood that CILCO would qualify for an exception to the base rate freeze. Section 16-111(d) authorizes electric utilities to request an increase in electric base rates where the utility's two year average return on equity falls below the average return on 30-year treasury bonds for the same period. The projections of CILCO's annual returns on common equity, both with and without the Transfer and the accompanying joint panel testimony of Brenda Freeman

and Tom Bramschreiber, were set forth in Appendix N to the notice. The analyses provided by CILCO demonstrate that the Transfer will not produce a strong likelihood that the Transfer will result in CILCO being entitled to request an increase in base rates during the mandatory transition period.

(vii) effect on current employees

Section 16-111(g) provides that an electric utility transferring ownership of electric generating assets must comply with the provisions of Section 16-128(c) and (d) of the Act, as applicable, and provide the Commission with certain information. Because CIGI is a wholly-owned subsidiary of CILCO, Section 16-128(d) is applicable. Accordingly, CIGI committed to continue to employ all of CILCO's generating-station employees under the same terms and conditions of employment for as long as required by Section 16-128(d).

IV. PUHCA ISSUES

Section 32 of the Public Utilities Holding Companies Act ("PUHCA") provides an exemption from the provisions of PUHCA for owners or operators of facilities used exclusively for the generation of electric energy for sale at wholesale. 15 U.S.C.A. 79z-5a. A company satisfying the provisions of Section 32 is an exempt wholesale generator ("EWG"). In order for an electric utility to enter into a contract, like the PSA, to purchase electricity from an affiliated EWG, Section 32 requires, among other items, that the Commission make certain technical findings and also find that the contract will benefit customers, will not violate state law, will not result in any unfair competitive advantage to the EWG, and is in the public interest. The Notice contains ample information for the Commission to make these required findings.

Sufficiency of regulatory authority, resources, and access to CILCO's and CIGI's books.

The Act, and in particular the Illinois Customer Choice Law and Rate Relief Law of 1997 ("Customer Choice Law"), provide the Commission with sufficient regulatory authority and access to CILCO's and CIGI's books to make the other required findings. The Commission's Staff has sufficient resources to examine CILCO's and CIGI's books to make the required findings.

The Power Supply Agreement will benefit consumers. The Illinois General Assembly determined that the restructuring of the electric utility industry in Illinois would benefit consumers. Hence, the General Assembly adopted and the Governor signed into law the Customer Choice Law. The Customer Choice Law contains many interrelated provisions, among which is Section 16-111(g), which permits a utility satisfying its requirements to quickly restructure to meet new competitive challenges. This and other provisions permit and encourage competition for the benefit of consumers. Thus, where the terms of the Transfer satisfy the statutory requirements of Section 16-111(g), it conclusively follows that the Transfer will benefit consumers. The Power Supply Agreement is an integral component of the Transfer.

The Power Supply Agreement does not violate State law. The Transfer complies with State law. All requirements of the Public Utilities Act (and, in particular, the Customer Choice Law) have been completely satisfied.

The Power Supply Agreement does not provide CIGI with any unfair competitive advantage. CIGI will not have any unfair competitive advantage as a result of its affiliation with CILCO. The Transfer merely allows CILCO to use a form or corporate organization freely used by other competitors. The Services and Facilities Agreement ensures that CIGI will compensate CILCO for any services provided by CILCO. Moreover, the Commission's oversight of affiliate

transactions will ensure that CIGI receives no unfair competitive advantage as a result of the Power Supply Agreement.

The Power Supply Agreement is in the public interest. As noted above, the Illinois electric market is being deregulated and competition implemented. Because the Transfer and the Power Supply Agreement will promote competition, they are in the public interest.

V. COMMISSION'S CONCLUSIONS

Based on its review of CILCO's November 30, 2001 Notice, the Commission concludes that the proposed transfer of Generation Assets should be approved. CILCO's Notice is in compliance with the requirements of Section 16-111(g). In addition, evidence establishes that the proposed transaction will not render CILCO unable to provide its tariffed services in a safe and reliable manner. The Notice also established that there is not a strong likelihood that consummation of the proposed transfer will result in CILCO being entitled to request an increase in its base rates during the mandatory transition period pursuant to Section 16-111(d) of the Act.

Additionally, the Commission makes the findings required under Section 32 of PUHCA to qualify CIGI as an EWG. The Commission has sufficient regulatory authority, resources, and access to CILCO's and CIGI's books, and the PSA will benefit consumers, does not violate state law, does not provide CIGI with any unfair competitive advantage, and is in the public interest.

VI. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having reviewed Central Illinois Light Company's November 30, 2001 Notice and being fully advised in the premises, is of the opinion and finds that:

- (1) Central Illinois Light Company is an Illinois corporation engaged in the production, transmission, sale and delivery of electricity to the public in the State of Illinois, and is a public utility as defined in Section 3-105 of the Public Utilities Act and an electric utility as defined in Section 16-102 of the Act;

- (2) the Commission has jurisdiction over CILCO and the subject matter of this docket;
- (3) the statements of fact set forth in the prefatory portions of this Order are supported by the evidence of record and are hereby adopted as findings of fact;
- (4) CILCO's November 30, 2001 "Notice of transfer of generation assets to a subsidiary and entry into various agreements pursuant to Section 16-111(g) of the Illinois Public Utilities Act" is in compliance with the requirements of Section 16-111(g) of the Act;
- (5) the proposed transfer set forth in the Notice will not render CILCO unable to provide its tariffed services in a safe and reliable manner;
- (6) there is not a strong likelihood that the proposed transaction set forth in the Notice will result in CILCO being entitled to request an increase in its base rates during the mandatory transition period pursuant to Section 16-111(d) of the Act;
- (7) Central Illinois Generation, Inc. will comply with the requirements of Section 16-128 of the Act;
- (8) the transfer of the Generation Assets, as described in Section III of this Order and in Appendix A to the Notice, should be approved;
- (9) CILCO shall file with the Commission the final accounting entries for the transfer, showing the actual dollar values of the assets and liabilities transferred from CILCO to CIGI at the time of the transfer, within 45 days after the date of the transfer and should provide a copy of this filing to the Director of Accounting; and
- (10) the Commission has sufficient regulatory authority, resources, and access to CILCO's and CIGI's books, and the Power Supply Agreement will benefit consumers, does not violate state law, does not provide CIGI with any unfair competitive advantage and is in the public interest.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the transfer of the Generation Assets from CILCO to CIGI, as described in Section III of this Order and in Appendix A to the Notice, is approved.

IT IS FURTHER ORDERED that CILCO shall comply with Finding (9) of this Order.

IT IS FURTHER ORDERED that subject to the provisions of 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.800, this Order is final; it is not subject to the Administrative Review of Law.

By Order of the Commission this _____ day of _____, 2001.

Chairman