Reply Comments of Constellation Energy Commodities Group, Inc.
Concerning Recent Procurement Events Held On Behalf of
Commonwealth Edison Company and the
Ameren Illinois Utilities (Ameren-CILCO, Ameren-CIPS, and Ameren-IP)

Constellation Energy Commodities Group, Inc. ("CCG" or "Constellation") provides these reply comments to certain comments submitted on May 15, 2008 by the Procurement Monitor, Boston Pacific Company, Inc. ("Boston Pacific"); Commonwealth Edison Company's ("ComEd") Procurement Administrator, NERA Economic Consulting ("NERA"); and the Illinois Attorney General's Office (the "AG"). In summary, Constellation recommends that the Illinois Power Agency (the "IPA") and the Illinois Commerce Commission (the "Commission"):

- Accept Boston Pacific's recommendation to consider full requirements products in future procurement events;
- Reject NERA's apparent suggestion that the Procurement Administrator be permitted to alter the volume of a bidder's submission;
- Reject Boston Pacific's and NERA's recommendation to consider eliminating bi-lateral credit requirements for the utilities;
- Accept Boston Pacific's proposal to further standardize the RFP process and documents;
- Accept Boston Pacific's recommendation that benchmarks be structured so as to close at the same time that the relevant markets close, and that they further be set as close as possible to the actual events;
- Reject the AG's call for arbitrary stricter benchmarks;
- Reject the AG's recommendation that benchmarks be imposed for products that lack an established and liquid over-the-counter ("OTC") market;
- Accept NERA's recommendation that the Commission only accept bids first recommended by the Procurement Administrator;
- Accept NERA's proposal for a post-procurement meeting in the event of under-subscription, so long as there is no secondary negotiation;
- Reject the AG's "apples to oranges" comparison of the recent procurement events to the former competitive auction;
- Reject the AG's and NERA's suggestion for public release of information beyond the information identified for public release in the IPA; and

- Promote private investment if Boston Pacific's recommendation for monitoring of Illinois' energy future is adopted.

I. PRODUCT DEFINITION AND PROCUREMENT DESIGN

Full Requirements

It is naïve to assume that market surprises will *not* occur. Load and costs can change over projections for a number of reasons -- fuel costs changes, demand charge changes, or weather events, just to name a few. The key in analyzing the various procurement alternatives therefore is who bears those risks. As Boston Pacific correctly noted, one of the central advantages of the full requirements model is the fact that suppliers bear a good portion of the risks, which would otherwise lie with ratepayers.

> With a full requirements product, the winning bidders shoulder a great deal of risk, instead of that risk being shouldered by ratepayers. These winning bidders agree to supply all elements of the service needed by a ratepayer – block energy, dispatchable energy, capacity, ancillary services, and actions to meet renewable portfolio standard requirements (if any). They agree to provide this full requirements service at a fixed price for the term of the contract. Suppliers also agree to take on market risk; they guarantee to serve a percentage share of a customer class's need regardless of how many or how few of those customers choose an alternative supplier.

(Boston Pacific Initial Comments, p. 3.)

Requiring the limited staff of the IPA to perform analysis, or hire outside consultants and expend resources to assess the changes in the market and the "optimal" products to offer in procurement events, is an inefficient way to attempt to achieve competitive prices for consumers. Given that load for ComEd, Central Illinois Light Company (d/b/a AmerenCILCO), Central Illinois Public Service Company (d/b/a AmerenCIPS), and Illinois Power Company (d/b/a Ameren IP) (collectively, the "Illinois utilities") must always be met with full requirements products (regardless of the type of procurement process the Commission adopts), in order to actively manage its load obligations, the IPA (or its consultants) would at a minimum have to retain individual experts who understand and follow not only electric energy and other commodity markets, but also ancillary services, capacity and renewable products markets.

Wholesale suppliers are specialists in the area of portfolio management, and have greater resources, expertise and ability to appropriately utilize this data to manage portfolios of supply at the least possible cost, by allocating the costs for their operations over much larger load obligations throughout the country. Moreover, such suppliers are able to draw from their substantial experience throughout PJM, MISO, and in other jurisdictions to develop proprietary models of customer behavior and switching patterns, to refine these models, and to better analyze the local data provided by the Illinois utilities. These wholesale suppliers will pass on the efficiencies they achieve due to their sophisticated risk management skills and experience in the form of more competitive bids for full requirements products.

Moreover, their costs are driven down through competition. As such, as articulated in Constellation's Initial Comments and above, customers can benefit during the next procurement event from a full requirements product offering.

Bid Quantities

NERA suggests that in future competitive procurement events, the Procurement Administrator should be given some flexibility in deviating in small amounts from the exact target by product. (NERA Initial Comments, p. 3). It is not entirely clear whether NERA is advocating that the Procurement Administrator should be permitted to increase or decrease the volume of a participant's bid, or whether NERA's recommendation is limited to authorizing a Procurement Administrator to procure more than is called for under the specific procurement plan, while adhering to the bid quantities submitted. The former suggestion causes serious problems for bidders, and ultimately the procurement event. As expressed by Boston Pacific, the three keys to the most successful competitive procurement event are: (1) a well-defined product; (2) a standard contract in which all non-price requirements are set; and (3) a price-only bid evaluation. (Boston Pacific Initial Comments, p. 1) NERA's suggestion eliminates two of those keys: having a well-defined product and evaluating/accepting bids based on price alone. It should be known up front exactly what is being bid, and bidders should be able to rely on the fact that their bids will be evaluated and accepted/rejected as offered, without any deviation. In this sense, limiting flexibility is positive, in that it provides certainty to bidders, thereby decreasing the risks for which bidders must account for in their bids.

Credit Requirements

Boston Pacific suggests updating the assessment of credit requirements for the 2009 RFPs, including reciprocal obligations. (Boston Pacific Initial Comments, p. 5) Similarly, NERA suggests re-examining whether bilateral credit is justified, as credit ratings of the utilities improve. (NERA Initial Comments, p. 4) Of course, suggesting that bilateral credit requirements should be reassessed to potentially be removed presupposes that the utilities are in, and will remain in, a sound financial position. The need for bilateral credit provisions in the RFP Master Agreements (the "Master Agreements") is stronger than ever, as suppliers and the market as a whole may perceive more risk than ever that a utility may face financial difficulties, based in part on negative assessments of ComEd and the Ameren utilities by the leading ratings agencies over the past calendar year and a half.[1] Credit ratings agencies and market participants see these types of changes to utilities' credit outlooks in Illinois in recent history and may perceive even more risk in entering into contracts with utilities in *any* jurisdiction which do not contain bilateral credit provisions.

Regardless of the financial strength of the Illinois utilities, there are several reasons why reciprocal obligations should continue in future years. First, competitive wholesale procurement processes are being considered and implemented in multiple jurisdictions. As wholesale competitive procurement processes become more widespread as a best practice for utility load procurement, wholesale suppliers are likely to have an increasing number of opportunities to compete to serve wholesale load to utilities. As these opportunities increase, wholesale suppliers will be required to carefully manage their portfolios and develop effective risk management strategies to provide cost effective service. In particular, credit ratings agencies will be carefully watching wholesale suppliers' risk exposure as their obligations under contracts with utilities increase. When a significant portion of a wholesale supplier's transactions are subject to counterparty credit risk, without the benefit of appropriate credit protection within the contract, credit ratings agencies are likely to view the wholesale supplier as having more risk, and the supplier's credit ratings could suffer. If and when this occurs, wholesale suppliers' costs to serve load will increase and, in turn, customers' costs will increase. Moreover, if

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[1] Fitch downgraded the ratings of ComEd in March 2007, and placed it on Rating Watch Negative. *Fitch Downgrades ComEd's Ratings; Remains on Rating Watch Negative*, Fitch Ratings (Mar. 9, 2007). Contemporaneously, Moody's downgraded ComEd to "junk status". *ComEd's Debt Rated 'Junk'*, Chicago Tribune (Mar. 26, 2007). Near the same time, Moody's downgraded each of the Ameren Illinois Utilities. *Moody's Release on Ameren Corp.*, Reuters News (Mar. 12, 2007).

wholesale suppliers begin to limit their own participation in the procurement events in order to limit their exposure in Master Agreements without the benefits of bilateral credit protection, customers will not receive the benefits of the most competitive process possible, further increasing the chances that customers' costs may increase.

Furthermore, even if a utility does not suffer or otherwise face the possibility of a credit ratings downgrade, the supplier still must manage its credit risk due to exposure to the utilities without appropriate bilateral credit under the Master Agreements. Suppliers' credit risks due to each utility's financial status may be managed in one or both of two ways: the supplier may limit its participation in bidding opportunities, thereby deterring the most competitive prices from the RFP process, as explained above, and/or the supplier may increase its bids to reflect the increased credit risk that it faces. In either instance, consumers may face additional costs because cost-effective energy supply depends on robust wholesale competition. Thus, it is a mistake for the IPA or the Commission to presume that consumers avoid credit related costs simply because there is no bilateral credit requirement. The risks that suppliers face in the absence of reciprocal credit are real, and no amount of oversight of the utility's financial status can eliminate such risk.

Having the utilities be subject to the same credit and collateral requirements as suppliers under the Master Agreements will be less costly for consumers. When a supplier prepares its bids and knows that it will not have reciprocal credit provisions, it must include in its bids a cost to reflect the risk that in a market environment where prices have declined after the contracts are awarded, a declaration of bankruptcy by one of the utilities, due to credit downgrades and/or other business failures, may result in a bankruptcy court's rejection of the applicable Master Agreement. A cost for that risk component is factored into suppliers' bids and thus charged to customers for each and every megawatt-hour of energy delivered.

In contrast, rather than having to pay such additional costs at all times, for all energy delivered, regardless of the utility's financial status, if the Master Agreements included bilateral credit provisions, suppliers would no longer include costs for managing the credit risks due to changes in the utility's financial status, and consumers may pay additional credit costs *only if* an utility's credit rating actually is downgraded. To be clear, if Illinois' utilities are financially sound, applying the credit and collateral provisions of the Master Agreements to them would result in their having an unsecured credit threshold that would prevent them from having to post any collateral under most market conditions. In these circumstances, customers avoid the costs that the wholesale supplier would have included in its bid, and are not exposed to additional costs from the utilities. When the credit ratings conditions warrant a collateral posting by an utility, those costs will be incurred by the utility and may be passed on to consumers only in the circumstances when they are truly warranted

To conclude, as described above, reciprocal credit obligations should continue to be a part of the Master Agreements in future procurement events. To the extent that the creditworthiness of the Illinois utilities improves in the future, that financial strength would naturally lead counterparties to accept a lower credit guarantee. However, in no event should a reciprocal credit obligation be removed.

Standardization

Boston Pacific advocated further standardization of the RFP process and documents as a means of potentially attracting additional bidders in future procurement events. Constellation agrees that standardization between and among the various procurement events may encourage participation of additional bidders in future procurement events, and may encourage bidders who may otherwise participate in a single procurement event to participate in multiple procurement events. In addition, as reflected in Constellation's Initial Comments, standardization removes unnecessary administrative burdens on potential bidders, as well as those potentially on the Procurement Administrator(s), the Procurement Monitor, and the Commission, thereby improving the efficiency of the procurement events, overall.

II. PROCUREMENT RESULTS

Benchmarks

Boston Pacific and the AG each made specific recommendations regarding benchmarks. Boston Pacific recommended that further attention be given to benchmarks, and that they be structured to support benchmarks by closing at same time that the relevant markets close. (Boston Pacific, Initial Comments, p. 2) Constellation agrees that the benchmarks should be set consistent with the time of day of the market when bids will be due. In addition, those benchmarks should be set as close as possible to when bids are due. Setting the benchmarks in such a manner will establish benchmarks that provide the clearest picture of what is consistent with the market, and give the greatest assurance that bids received are appropriate. Finally, Constellation recommends that the process for setting benchmarks be explicitly stated. Constellation recognizes the value in maintaining the confidentiality of the actual benchmarks that are established, and is not suggesting that the benchmarks should be released. However, it may be helpful for prospective bidders to understand the general guidelines regarding the benchmarks, or the process by which the benchmarks are established. An understanding of the guidelines and process can give prospective bidders the greatest certainty that the Procurement Administrator will accept their bids. As stated in Constellation's Initial Comments, greater regulatory certainty translates into the best prices for customers.

The AG's recommendation of stricter benchmarks for the energy procurements (AG Initial Comments, p. 14) is without merit, and should be rejected, for a number of reasons. First, the AG provides no rationale for a stricter benchmark. The benchmark itself is already designed to reflect prices that are to be expected in the competitive market. Narrowing the benchmark arbitrarily simply means that it is no longer representative of the competitive market. Second, narrowing the benchmark will not affect the bids that will be received. The bids that are recommended by the Procurement Administrator and approved by the Commission are already the lowest bids submitted. Narrowing the benchmarks will not result in any additional savings to consumers. Third, the AG's proposal to arbitrarily narrow the benchmarks greatly increases the risks to consumers. Stricter benchmarks may lead to less energy being procured through the competitive procurement process, despite the fact that bids were in keeping with the market. In such a case, the IPA would have two choices, either to re-run the event (assuming there was sufficient time) or obtain the remaining needed energy in the RTO-administered markets. Both of those options have risks. Running another procurement event not only carries a financial cost for the activity itself, but risks that bidders will fail to participate based on the demonstrated regulatory uncertainty, and further risks that market prices will be higher at that second event. If the same rationale is used in the second procurement event to disqualify bids that were in fact within the competitive range, Illinois could find itself on an endless "loop". Alternatively, the remaining energy could be purchased in the RTO-administered markets, but doing so places increasing risks on consumers as they will be subject to all the volatility of real-time purchases in those markets. As discussed above, the focus should be on ensuring the accuracy of benchmarks, and establishing those benchmarks at the proper time, rather than arbitrarily setting benchmarks that are not an accurate reflection of competitive market-based rates.

The AG's recommendation that renewable procurements use regional market-based benchmarks (AG Initial Comments, p. 16) may reflect a lack of understanding of such products. First, in order to set a benchmark, there must be an active trading market on which that benchmark is based. There is no established and liquid OTC trading market specifically for Illinois wind energy. Moreover, to suggest that wind energy generated in Illinois is or should be valued the same as wind energy generated in other parts of PJM does not hold true. Likewise, wind energy generated in other parts of MISO may not be valued the same as that generated in Illinois. We see in the energy markets that prices can vary, sometimes significantly, between different locations within the same region. In the RTO-administered energy markets, we have the benefit of locational marginal prices (LMPs) by which to evaluate the market. There is no such evaluation mechanism for wind energy. Attempting to establish a false benchmark where there is no established and liquid OTC trading market for a specifically-defined product would not improve the procurement process nor be a commercially reasonable alternative that is available to the Procurement Administrator or the Commission. Given those limitations, the procurement event should be narrowly tailored, and evaluated in accordance with the established priorities.

Approval Guidelines

NERA recommends that the Commission should only accept a bid recommended by the Procurement Administrator. (NERA Initial Comments, p. 2) NERA points out that this "would enable the Procurement Administrator to inform bidders definitively with respect to their maximum supply exposure and reduce bidder risk resulting from uncertain open obligations." *Id.* Constellation supports that recommendation, for the reasons stated in Constellation's Initial Comments. Constellation Initial Comments, pp. 3-7.

Under-subscription

NERA recommends a post-procurement meeting between the Procurement Monitor, the Procurement Administrator, and Staff, if the procurement event fails to meet the load requirements. It is not clear what the result of such a meeting would be. If NERA is suggesting that a lessons-learned meeting be held, there is certainly benefit in that. However, there should not be a secondary negotiation in the event of under-subscription. In accordance with the Public Utilities Act (the "Act"), the two choices provided are either to re-run the competitive procurement event, or to procure the shortfall in the RTO-administered markets.

Analysis of Procurement Results

Much of the AG's initial comments were spent comparing the results of the recent competitive procurement events to the competitive full requirements auctions run in 2006. (AG Initial Comments, pp. 3-14). In doing so, the AG concludes that the recent procurement events were more successful than the prior auctions. One should be cautious in drawing conclusion about the results of those events, given the fact that they involved very different products, with different contracts and terms and condition of service, and were separated by a period of years. Any comparison of full requirements products' prices to block products' prices is not "apples to apples." With a fixed price full requirements product, there are several embedded insurance policies in that product involving, for example, market price risk, weather risk, migration risk, and the interactions among them. Second, the value of insurance cannot be measured through a hindsight comparison of prices.

For example, a hindsight comparison of full requirements purchases versus the portfolio management approach using actual historic load instead of what the forecasted load was at the time, or using a year for the analysis in which there were no abnormal weather occurrences or spikes in natural gas prices, will ignore insurance benefits. If instead of what actually happened, there had been an abnormally hot summer and wholesale prices had spiked, then customers being served by full requirements suppliers would have been protected because the full requirements supplier would be obliged to serve the higher volume at the fixed price. Without the full requirements "insurance," utilities' consumers' prices would have risen. Or consider the converse circumstance: if there had been an abnormally cool summer and wholesale prices dropped sharply, full requirements suppliers would be responsible for liquidating excess supply commitments. Without the full requirements "insurance," a utility could be left in a long position in its portfolio which it would have to sell at a loss. The fact that wholesale prices did not actually spike or drop in a particular year does not mean that it was not valuable to have protection in place against that risk. If we don't get sick in a year, we don't look back and say "we shouldn't have bought health insurance last year; that was a bad decision."

In essence, the AG makes an "apples to oranges comparison", looking only at market prices and not accounting for any other differences between the products being offered. Moreover, as noted by Boston Pacific, it is only over the course of the year that we will see the full price to ratepayers of the most recent procurement events for energy and capacity, and any real assessment must necessarily evaluate the risks borne by the different parties. (Boston Pacific Initial Comments, p. 3) While that final, "all-in" price after a year has passed may provide some useful insight, it still will not allow for a fair comparison to full requirements prices from the 2006 auction, because of the lack of consideration for the value of the insurance that those 2006 full requirements contracts provide, as explained above.

III. MISCELLANEOUS

Information Release

Both NERA and the AG advocate information release beyond what is required under the Act, though the substance of their recommendations differs. NERA recommends that specifically the volumes of each product procured be released (along with the average prices for each product and the names of winning bidders, which already are released as per the Act). (NERA Initial Comments, p. 2) The AG goes further, recommending that all information not expressly designated as confidential be released. (AG Initial Comments, p. 18) According to the AG, a party desiring protection from release would be required to overcome a legal presumption in favor of disclosure, through an express finding by the IPA or the Commission that the specific information should be treated as confidential or proprietary. The recommendations should be rejected, and the IPA and the Commission should publicly release only that information that is called for under the Act. The AG's familiar refrain of public dissemination of any and all information pertaining to electric power and energy, is contrary to the law and to the rules, serves no useful purpose, and will have a detrimental effect on future procurement events.

Applicable laws, rules, and regulations require that bidder information be maintained as confidential. The Act specifically states that following information is to be protected from public disclosure: (1) the market-based benchmarks, 220 ILCS 5/16-111.5(c)(1)(ii) and (e)(3); (2) the report from the Procurement Administrator to the Commission, 220 ILCS 5/16-111.5(c)(1)(ix); (3) the report from the Procurement Monitor to the Commission, 220 ILCS 5/16-111.5 (c)(2)(iii); and (4) supplier and bidding information, 220 ILCS 5/16-111.5(c)(1)(viii) and (c)(2)(v). The Administrative Rules of the Commission recognize that parties to Commission proceedings have a right to protect from public disclosure information that is confidential, proprietary, or a trade secret. (83 Admin. Code 220.605), and protective orders are a common element in proceedings before the Commission. Entities that choose to participate in competitive procurement events in Illinois should have at least those rights afforded to jurisdictional entities. The competitive procurement rules themselves confirm this.[2] Bidders provided information, and participated in the recent competitive procurement events, with the understanding that the information they provided would be protected from disclosure according to the rules of the various procurement events.

The AG does not identify what specific information should be released, nor does the AG indicate what can be gained from the release. Rather, the AG appears to advocate release of information for its own sake. The procurements already provide for a variety of publicly available information. Both Procurement Administrators established web sites which may be accessed by the general public through hyperlinks from the Commission website. The sites include the particular utility's procurement plan, Frequently Asked Questions, credit requirements, RFP process and rules, the Master Agreement, the confirmation sheets, bidder training session handouts, and a wide variety of other documents. Essentially, all of the information that provided the basis for the procurement event, and which was provided to bidders, has already been made available to the public. The only information not accessible are documents that contain confidential or propriety information such as the bids themselves, the market-based benchmarks, and the confidential reports.

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[2] Commonwealth Edison Company 2008 Standard Products Request for Proposals Process and Rules (February 8, 2008), p. 41; Commonwealth Edison Company 2008 Renewable Energy Resources Request for Proposals Process and Rules (February 29, 2008), pp. 39-40; Request For Proposals For Standard Wholesale Energy Products, Levitan & Associates, Inc. Procurement Administrator on behalf of Ameren Illinois Utilities AmerenCILCO Peoria, IL AmerenCIPS Springfield, IL AmerenIP (February 11, 2008), p. 12; Request For Proposals For Capacity, Levitan & Associates, Inc. Procurement Administrator on behalf of Ameren Illinois Utilities AmerenCILCO Peoria, IL AmerenCIPS Springfield, IL AmerenIP (February 11, 2008), p. 11; Request For Proposals For Renewable Energy Credits, Levitan & Associates, Inc. Procurement Administrator on behalf of Ameren Illinois Utilities AmerenCILCO Peoria, IL AmerenCIPS Springfield, IL AmerenIP (February 11, 2008), p. 12.

Maintaining the confidentiality of bidder information promotes the efficiency of the market, promotes qualified participation in the market, and protects the integrity of the market. Confidentiality of bidder information ensures that a bidder's submission reflects the market price based on their own assessment, without regard to the behavior of another participant. Moreover, such a release would most certainly have a chilling effect on bidder participation in future procurement events. Bidders will be reluctant to participate in future events if their bid price, or other elements of their bidding strategy, is made available to their competitors. As discussed above, entities have a choice in what competitive procurement processes they participate. Lack of rules, or acting in a manner that is inconsistent with the established rules, will undoubtedly cause bidders to go elsewhere with their competitive supply options. Such an outcome would ultimately harm Illinois consumers.

Although NERA identifies a single type of information recommended for release – the volumes of each product procured – public release of such information can still unwittingly have the effect of disseminating confidential business information. It is not uncommon to see the same entities participate in competitive procurement events throughout the country. The names of the winning bidders and average prices have already been released, pursuant to the Act. Release of the specific volumes of each product may enable a bidder to identify the prices of other bidders for particular products, particularly in procurement events in which there were only a handful of winning bidders. Knowledge of this type may affect bidding behavior and the results of future procurement events. The IPA and the Commission should release only that information specifically called for under the Act – average prices and names of winning bidders.

Promotion of investment

Boston Pacific recommends that monitoring be done separate from the RFP events to asses whether investments in generation, transmission, energy efficiency, demand response, renewable energy, and other technologies will ensure adequate electricity supply to Illinois in the future. (Boston Pacific Initial Comments, p. 6) To the extent that the results of such an evaluation indicate the need or desire to promote additional investment, a concerted effort should be made to encourage private investment in particular. Private investment carries two important but distinct benefits.

First, private investment insulates consumers from risks associated with the construction of new generation facilities or investment in other technologies and services. For instance, a new generation facility in and of itself is a significant capital investment, and is subject to increasing project estimates prior to project initiation, and to cost overruns during the course of the project. Once that investment is made, if utilities and their customers are responsible for such investment, then consumers are required to foot the bill, even in those circumstances in which the facility is later determined to be unnecessary. In contrast, permitting and encouraging *private* investment in the building of generation insulates customers from the associated risks, shielding them from costs for such facilities. Private investment also encourages sound decision-making and fiscal responsibility. Private investors can evaluate risks and, because they are in a business, exercise keen discipline in controlling costs. In contrast, a utility's ability to "rate base" its expenditures leave it with less incentive to implement tight budget controls and the most efficient business practices.

In addition to protecting consumers from the costs of new facilities or technology, private investment brings customers innovative technologies. While utilities are constrained by their public utilities commissions to provide a "base line" of service offerings, private investors are off working on advances that can offer customers improvements over the *status quo*. Private investors are entrepreneurial in nature, and are searching for ways in which to build a greater number and better quality of products and services.[3] Any assessment of how to meet Illinois' future energy needs should seek to include this very important segment of the industry.

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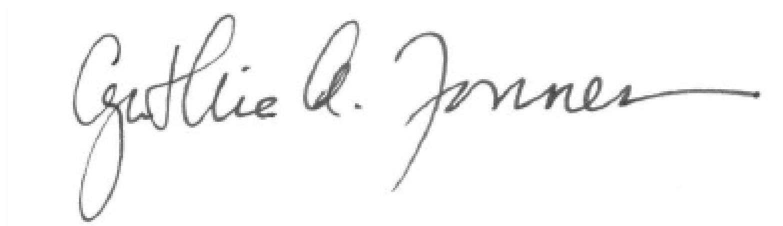
[3]*Innovation in Retail Electricity Markets: The Overlooked Benefit*, National Economic Research Associates, Inc., March 2008.

IV. CONCLUSION

Constellation recommends that future procurement plans and procurement events conducted by the Illinois Power Agency and evaluated by the Commission reflect these improvements to the procurement process.

Respectfully Submitted,

CONSTELLATION ENERGY COMMODITIES GROUP, INC.



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