COMMENTS BY THE STAFF OF THE ILLINOIS COMMERCE
COMMISSION ON THE ILLINOIS POWER AGENCY’S DRAFT POWER
PROCUREMENT PLAN – DATED AUGUST 16, 2010

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September 15, 2010

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Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, respectfully submits these Comments on Draft Power Procurement Plan to the Illinois Commerce Commission (“Draft Plan”) circulated by the Illinois Power Agency (“IPA”) on August 17, 2010, pursuant to Section 16-111.5 of the Public Utilities Act (“PUA”), 220 ILCS 5/1-101 et seq. 220 ILCS 5/16-111.5.

I. Introduction

The Draft Plan constitutes a blueprint for procuring electrical energy, renewable energy credits (“RECs”), and various other related commodities needed to comply with the PUA, as well as the Illinois Power Agency Act, 20 ILCS 3855/1-1 et seq. (“IPA Act”), and to provide power to eligible retail customers, namely certain residential and small to medium sized non-residential customers of Commonwealth Edison Company (“ComEd”) and the three Ameren operating companies providing utility service in Illinois, i.e., Central Illinois Light Company d/b/a AmerenCILCO, Central Illinois Public Service Company d/b/a AmerenCIPS, and Illinois Power Company d/b/a AmerenIP (collectively, “the Ameren Illinois Utilities,” “AIU”, or “Ameren”). However, some parts of the Draft Plan contain errors, and some require revision, as described below.

II. Incremental Procurement Events

The Draft Plan states “To mitigate the risk of price decline, the IPA recommends that the ICC allow for optional procurements. These optional procurements would be limited to only an additional 10% of projected portfolio requirements in any month
covered by the Final Procurement Plan that is below the 100% subscription level. The optional procurements would be triggered only when market indices demonstrate that prices for energy supply contracts for the target months are below the average weighted price of fixed price contracts already secured by the Utilities for those months. The optional procurements would be limited to participation by bidders qualified in and the terms and conditions agreed to in the spring 2011 solicitation, and allowed only with the authorization of the Commission.” (Draft Plan, pp. 17-18) (Also see “Incremental Procurement Events” on pages 33 and 51; and “Timing” on page 3.)

The “average weighted price of fixed price contracts already secured” is a bit vague, but Staff assumes this is meant as the “average weighted price of fixed price contracts already secured for any given on-peak or off-peak sub-period within any given month within the next two plan years (i.e., the current plan year + 1 and the current plan year + 2), weighted by the number of MW of each contract. Staff disagrees with this proposal for four reasons. First the proposal does not “mitigate the risk of price decline.” A price decline only poses a risk if the utility is hedged beyond 100% of its requirements. Second, if there had been no trend over the last few years and a flat forward curve at each procurement event, there would be a 50% chance that, the day after the spring 2011 procurement event, the market price of forwards would be below the average weighted price of fixed price contracts already secured. However, for any given contract that is specific to a given month and to either the on-peak or off-peak hours of the month, that chance is much greater than 50%, since for the last three years, forward prices generally have been declining over time while forward curves at any point within the last two years have been upward sloping. On the other hand, if the
“average weighted price of fixed price contracts already secured” for a given month and sub-period is going to include any of the various multi-period contracts that are in the existing portfolio, then it is even more likely that that average will exceed current forward prices. For example, a good portion of the existing portfolio for June 2012-May 2013 will consist of around-the-clock annual energy swaps at a single fixed price of approximately $53 per MWH. In contrast, at last spring’s procurement event for ComEd, the average price of off-peak contracts for individual months ranged from about $21 to $32 per MWH, while NYMEX futures for off-peak NI-HUB contracts currently show settlement prices of approximately $26 and $28 per MWH for 2012 and 2013 contracts respectively. More generally, as these data imply, the average price of existing contracts cannot be considered a reasonable barometer of what a “good deal” looks like for future periods. Third, to the extent that the proposal would lead to more than the otherwise planned additional 35% of expected load being hedged for each of the last two years covered by the plan, Staff suggests that the planned hedging levels may already be too high if the contracts entail substantial risk premiums. In this regard, Staff notes that NYMEX futures prices for later-year electricity contracts have been considerably higher than for early-year contracts. For example, see Table I below, showing average prices for PJM Northern Illinois real-time energy swap contracts. Whether this is evidence of substantially higher risk premiums for latter years may be difficult to assess, but should be considered by the IPA. Finally, while it is unclear just how many of these incremental procurement events might be held under the IPA’s proposal, it is nonetheless true that each such event would add considerable costs to the entire procurement process, in the form of time and money spent for procurement
administrator, procurement monitor, Commission, and utility services. For all the above reasons, Staff recommends that the IPA remove all the above-cited portions of the plan dealing with “optional procurements” and “incremental procurement events.”

Table I: Average NYMEX Settlement Prices Reported on September 7, 2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Average of UM</th>
<th>Average of UO</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>$37.54</td>
<td>$24.45</td>
</tr>
<tr>
<td>2012</td>
<td>$39.53</td>
<td>$25.81</td>
</tr>
<tr>
<td>2013</td>
<td>$42.19</td>
<td>$28.00</td>
</tr>
<tr>
<td>2014</td>
<td>$49.88</td>
<td>$28.75</td>
</tr>
</tbody>
</table>

### III. Energy Efficiency as an Alternative Resource

The Draft Plan states “The IPA recommends consideration of the purchase of Energy Efficiency as Alternative Resource (“EEAR”) for the Ameren portfolio. The purpose of this is twofold – first, to establish whether energy efficiency can be cost competitive with more traditional resources; and second, to establish additional benefits such as price stability can be gained through the expansion in the type of resource products placed into the Ameren portfolio. In order to assure valid results in an EEAR
procurement, the IPA recommends holding workshops during the fall of 2010 to establish the scope and nature of the EEAR event with the input of interested parties. The IPA believes that the appropriate sources for EEAR bids would be the existing Energy Efficiency Portfolio Standard (“EEPS”) programs offered to eligible retail customers in the Ameren service region. The IPA notes that the results of the EEPS programs have been factored into the Ameren load forecasts in a manner similar to that of other pre-existing supply contracts for the past two cycles. Additionally, the EEPS programs are in their third year of operation and operate under an evaluation and oversight regime supervised by the ICC. These two factors lead the IPA to determine that resources provided by the EEPS are reliable. The IPA proposes that EEAR assets should only be procured when the cost of the EEAR is less than the combined cost of the energy swaps, capacity, and renewable energy resource contracts held by Ameren for the contract period offered by the EEAR provider. As such, the EEAR contracts should be considered after the spring 2011 procurement events. Contracts would be secured through direct negotiation between the IPA and Ameren subject to oversight and authorization by the ICC. If EEAR assets are not cost competitive, then no contracts shall be executed.” (Draft Plan, p. 32 and analogous language pp.48-49 for ComEd.)

Staff’s position is that the EEAR proposal is contrary to the PUA and IPA Act. The purchase of EEAR products is beyond the scope of products the IPA is allowed to procure on behalf of the utilities according to Section 16-111.5 of the PUA. Pursuant to 5/16-111.5(d)(2) the portfolio of products to be included in the IPA’s procurement plan is limited to demand response products and power and energy products. (220 ILCS 5/16-
111.5(d)(2)) 20 ILCS 3855/1-75(a) provides that procurement plans are to be in compliance with Section 16-111.5 of the Public Utilities Act (“PUA”) Clearly, EEAR or energy efficiency products are not listed as a product that is allowed to be purchased by the IPA. In addition, the purchase of EEAR would be subject to the spending limits imposed by Section 8-103(d), which the IPA apparently proposes to ignore.

Apart from that legal infirmity, the proposal presumes that the utilities’ efficiency programs are far more mature and reliable than Staff is willing to concede. While the first 3-year plans are currently in their third year of operation, evaluations have been completed for only one of the three years. Furthermore, since Section 8-103 does not include any penalties for poor first-year performance, these evaluations were not the subject of a docketed investigation and were not subjected to as rigorous a review as Staff intends to perform on the second and third year evaluations. Staff recommends that the Plan be modified accordingly to remove all references to the purchase of EEAR products.

IV. Energy Block Time Spans

The Draft Plan states: “Given these facts, the IPA will issue solicitations for monthly on-peak and off-peak standard wholesale block energy products (or their equivalent volumes in seasonal or varietal strips) for delivery during the June 2011-May 2014 period.” (Draft Plan, pp. 28 and 44.)

Staff supports the IPA’s proposal to solicit energy products in monthly blocks, as well as “seasonal or varietal strips,” but believes that this proposal can be restated for clarity and to make sure that it would permit the procurement of annual strips. Staff would also delete the word, “varietal,” as it is not defined in the plan nor commonly
recognized as a term of art in the power marketing industry. Staff’s revised sentence would be as follows:

Given these facts, the IPA’s procurement administrator will issue solicitations to lock-in fixed prices for fixed quantities of energy supply, using single-month, multi-month, and/or annual contracts for on-peak, off-peak, and/or around-the-clock blocks during the period between June 2011 and May 2014, in whatever combinations are deemed appropriate by the procurement administrator, given the objectives described in this plan.

Finally, Staff notes that the draft plan is silent on the time spans of the capacity contracts that the IPA proposes to secure on Ameren’s behalf. In Staff’s view, this silence implies that there are no restrictions on what combinations of single-month, multi-month, and annual capacity contracts might be utilized by the procurement administrator. Staff supports that policy, but would not object if the IPA wished to make the plan more specific in this regard. For example, Staff would not object to adding the following somewhere on pages 34-36:

The IPA’s procurement administrator will issue solicitations to lock-in fixed prices for fixed quantities of required capacity resources, using single-month, multi-month, and/or annual contracts during the period between June 2011 and May 2014, in whatever combinations are deemed appropriate by the procurement administrator, given the objectives described in this plan.

V. **Financial Swaps**

As in previous plans, the current draft plan proposed to solicit, on Ameren’s behalf, financial swap contracts rather than contracts for physical delivery of electric energy. (Draft Plan, pp. 27-28.)

While Staff has no objection to this, in principle, the use of financial swap contracts in the future may not be as practical as it has been, due to recent legislation. The Dodd–Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, H.R. 4173) was signed into law on July 21, 2010. Among other things, the Act may
lead to a shrinking of various over-the-counter swap markets, such as the energy swap market referenced in the draft plan. In addition, the Act may lead to changes in the manner in which gains and losses on unsettled swap contracts must be computed for tax purposes. Whether or not this law will render Ameren’s continued use of financial swap contracts impractical or not is currently unknown. Therefore, Staff recommends that the plan be modified to provide additional flexibility to the procurement administrators to switch from financial swap contracts to physical delivery energy contracts, or, in the alternative, to fashion the swap contracts to allow for conversion to physical delivery contracts if at some point in the future such conversion is seen to be advantageous to both buyer and seller. Specifically, Staff recommends the addition of the following paragraph somewhere on page 28 of the plan:

> However, due to uncertainty concerning the viability and practicality of financial swap contracts, primarily due to the recent passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, H.R. 4173), the IPA shall authorize the procurement administrator to issue contracts for the physical delivery of energy, instead of a financial swap contracts, if during procurement preparations it becomes clear to the procurement administrator that contracts for the physical delivery are more likely to be in the interests of the utility and ratepayers. Furthermore, if the procurement administrator determines that financial swap contracts are still preferable to contracts for physical delivery of energy, the procurement administrator will still be instructed to fashion the swap contracts to allow for conversion to physical delivery contracts if at some point in the future such conversion is seen to be advantageous to both buyer and seller.

VI. The Illinois Preference

The Draft Plan includes the following: “Preferences. Section 1-75 (c) (3) of the IPA Act requires that until June 1, 2011 cost effective renewable energy resources be procured first from facilities in the State of Illinois, then from facilities located in states adjacent to Illinois, then from facilities located elsewhere.” (Draft Plan, pp. 38 and 54.)
The IPA appears to be taking the position that any procurement event for renewable resources prior to June 1, 2010 must allow for an Illinois preference regardless of the period covered by the renewable energy resources. The IPA Act specifically provides that "After June 1, 2011, cost-effective renewable resources located in Illinois and in states that adjoin Illinois may be counted towards compliance with the standards set forth in paragraph (1) of this subsection (c)." 20 ILCS 3855/1-75(c)(3) Given that the IPA will be procuring renewable energy resources for the period of June 2011 to May 2012 (Draft Plan , p. 4), the Illinois only preference does not apply but the Illinois and adjoining states preference does apply. The plan should be revised accordingly to correctly state and account for the fact that the Illinois and adjoining state preference applies to the renewable covering the period June 2, 2011 to May 2012.1

VII. REC Tracking Systems

The Draft Plan states: “PJM Environmental Information System's ("EIS") Generation Attribute Tracking System ("GATS") and the Midwest Renewable Energy Tracking System ("M-RETS") will be utilized to independently verify the location of generation, resource type and month and year of generation. GATS tracks generation attributes and the ownerships of the attributes as they are traded or used to meet renewable portfolio standards ("RPS") and other programs, typically for generators whose energy is settled in the PJM market or whose facility is located in the PJM footprint. M-RETS tracks renewable energy generation and assists in verifying compliance with individual state/provincial RPS requirements or voluntary programs,

1 Given that any renewable energy resource that applies to June 1, 2011 must have an Illinois preference, Staff recommends that no renewable resources with an Illinois and adjoining state preference be procured for June 1, 2011. (i.e. Resources with an Illinois and adjoining state preference should only be acquired for days subsequent to June 1, 2011)
typically for generators located in the MISO footprint and other RTOs outside of PJM.”

(Draft Plan, p. 39.)

The adequacy of these two tracking systems alone is still an open issue. Hence, Staff recommends adding language to authorize the procurement administrators to allow other tracking systems, provided that the procurement administrators believe that the benefits of the additional tracking system (e.g. greater competition and variety of bidders, potentially lower prices) are likely to outweigh the costs (e.g. fixed fees paid by the utility to the additional tracking system). It is noteworthy that, during one of the public hearings held by the IPA at the Commission’s offices in Chicago, a representative of the North American Renewables Registry claimed that this REC tracking system would entail no significant fixed fees for the utilities, IPA, or Commission, and that the bulk of fees are stated on a per REC basis.\(^2\) If there were no fixed fees for the utilities, IPA and Commission, and all winning bidders were required to absorb all per unit fees, they could be included in bid prices and the above-described benefit-cost analysis effectively would be performed automatically during the bid selection process.

VIII. Modification to Renewable Energy Resources

Staff proposes the following addition to page 4 of draft plan:

\textbf{Renewable Energy Resources} – Renewable Energy Credits (“REC”) for a single compliance year (June 2011 through May 2012). The IPA proposes to continue the consolidation of REC procurement processes and procedures started in 2010, and seek to unify standard terms and conditions between Ameren and ComEd with regard to REC contracts. Therefore, the utilities’ REC contracts should include (1) collateral

\(^2\) Examination of the North American Renewables Registry website on September 8, 2010 (http://narecs.com/resources/index.htm#account-registration) shows that ComEd and Ameren would need to have a General Account, which would entail non-volumetric fees of $750 (once) plus $2000 per year, unless a waiver or reduction in these fees can be negotiated.
requirements that equal 10% of remaining contract value; and (2) unsecured credit limits for creditworthy REC suppliers.

Staff has made similar recommendations in the post-procurement comments it submitted in June 2009 and June 2010. Now, Staff recommends the procurement plan specify REC collateral requirements and require that the utilities’ contracts include unsecured credit limits for suppliers because it appears to Staff that further negotiations during the procurement implementation process are unlikely to achieve the IPA’s goal of unification (or harmonization) between the utilities’ one-year REC contracts with respect to collateral requirements.

In the spring 2009 REC procurement, ComEd contracts required $5 per REC collateral from suppliers, and did not include any unsecured credit to reduce suppliers’ collateral requirements. Following the spring 2009 REC procurement, Staff recommended modifying ComEd’s one-year REC collateral requirements to equal a percentage of remaining contract value rather than $5 per REC. Staff explained that using a percentage of contract value could result in lower winning bid prices due to relatively lower collateral requirements. Moreover, a dynamic collateral requirement would be beneficial because it would adjust as the market price for a REC changes. Staff’s comments indicated Staff had no objection to Ameren’s REC collateral requirement that equals 10% of remaining contract value and viewed that as a reasonable substitute for the five dollars per REC requirement that ComEd used during spring 2009.³

In the spring 2010 REC procurement, the collateral requirements in ComEd’s one-year REC contracts equaled 15% of remaining contract value, and did not include any unsecured credit to reduce suppliers’ collateral requirements. In contrast, the collateral requirements for Ameren’s one-year REC contracts equaled 10% of remaining contract value, net of any unsecured credit granted to creditworthy suppliers. On May 18, 2010, each of the utilities held a separate REC procurement event. Several aspects of the contracts were harmonized, but not the credit requirements. Even so, ComEd’s REC prices exceeded Ameren’s REC prices, as shown in the table below:4

<table>
<thead>
<tr>
<th>Product</th>
<th>ComEd</th>
<th>Ameren</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illinois Wind</td>
<td>$5.00</td>
<td>$4.06</td>
</tr>
<tr>
<td>Illinois Non-Wind</td>
<td>$4.40</td>
<td>$3.90</td>
</tr>
</tbody>
</table>

In Staff’s view, ComEd’s REC collateral requirements are unnecessarily costly. Therefore, Staff would support amending ComEd’s REC contract as follows: 1) reduce the collateral requirements to 10% of remaining contract value; and 2) grant unsecured credit limits to creditworthy REC suppliers. Adopting those collateral requirements would reduce costs for ComEd’s REC suppliers. Moreover, incorporating those collateral requirements into ComEd’s one-year REC contracts would move ComEd’s and Ameren’s one-year REC contracts even closer together, which may be beneficial in the event the IPA decides that a single REC procurement event would be preferable to simultaneous REC procurement events.

Staff presented its recommendation in its June 2010 post-procurement comments. The People of the State of Illinois, Constellation Energy Commodities Group, Inc., and the Procurement Monitor supported Staff’s recommendation.

IX. Modification to Contract Terms

Staff also recommends the following addition to page 17 of the draft plan:

**Contract terms.** Contract terms present risk to the portfolio to the extent that the underlying credit requirements for the bidders and the Utilities may increase direct and indirect costs due to the premiums associated with providing credit facilities that are ultimately borne by the end-use customer.

Contracts entered into as a result of the procurement process shall be through either an International Swaps and Derivatives Association (“ISDA”) agreement for financial instruments such as fixed/floating rate swaps or an Edison Electric Institute (“EEI”) agreement for physical products such as energy or capacity. Individual transactions shall be memorialized utilizing standard transaction specification sheets, such that, to the extent practicable, purchasing decisions shall be made on the basis of price, rather than non-price factors.

Collateral Thresholds should remain at the levels used in the utilities’ existing energy contracts unless there is consensus among the utilities, Procurement Administrators, Procurement Monitor and Staff that a compelling reason warrants new Collateral Thresholds. Under no circumstances should implementing new Collateral Thresholds require retroactive changes that lower the Collateral Thresholds in existing contracts entered into during past or current procurement processes.

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6 Specifically, the Attorney General’s reply comments stated, “The People support this recommendation in the absence of an expressed reason for ComEd collateral requirements to be more stringent than the Ameren collateral requirements.” See Reply Comments of the People of the State of Illinois on the Spring 2010 Electricity Procurement, July 9, 2010 – resubmitted July 12, 2010, p. 1.


8 Boston Pacific’s reply comments also stated, “By supporting these limitations on collateral requirements, we recognize that some suppliers may not have to post any collateral at all. However, we still want to ensure that suppliers are presented with a disincentive for default. As a result, we support adding a non-monetary penalty for failure to supply, such as banning defaulting suppliers from future REC procurements.” See Reply Comments on the 2010 Procurement Process Pursuant to Section 16-111.5(o) of the Public Utilities Act, Presented to the Illinois Commerce Commission, by Boston Pacific Company, Inc., July 9, 2010, p. 3.
To clarify, Collateral Thresholds ("Thresholds") are unsecured credit limits that the utilities grant creditworthy suppliers. All else being equal, raising Thresholds reduces supplier risk because it lowers the amount of collateral suppliers must post with the utilities. Conversely, lowering Thresholds increases supplier risk because it raises the amount of collateral suppliers must post with the utilities. With the exception of ComEd’s one-year REC collateral requirements, Staff does not propose to reduce collateral requirements.

For the past two procurement cycles, ComEd and Ameren contracts have included identical Threshold amounts, with both utilities granting counterparties with the highest credit ratings an unsecured credit limit of up to $80 million. In Staff’s view, changing Thresholds absent a compelling reason could cause suppliers to view the utilities’ Thresholds as arbitrary and uncertain. Currently, energy and capacity contracts have terms up to three years; hence, changing Thresholds affects existing contracts as well as participation levels in future RFPs. Therefore, Staff avers that under no circumstances should Thresholds used in future contracts affect Threshold levels under existing contracts. As with all risk factors, suppliers will make bids that include a price for this uncertainty (i.e., risk) and utility customers will pay the price for such risk.

Staff initially presented this recommendation in its June 2010 post-procurement comments.\(^9\) Constellation Energy Commodities Group, Inc. supported Staff’s recommendation.\(^{10}\)

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\(^{10}\) The reply comments of Constellation Energy included one exception – unsecured credit should be extended to bidders with BB-/Ba3 equivalent ratings. Reply Comments of Constellation Energy Commodities Group, Inc. Concerning Recent Procurement Events Held on Behalf of Commonwealth
X. Clerical/Typographical Corrections

Staff recommends the following corrections to typographical errors be made to the Draft Plan.

First, the title of the Table on page 30 should read:

TABLE I: PROPOSED AMEREN OFF-PEAK ON-PEAK LOAD VOLUMES TO BE SECURED IN 2011 PROCUREMENT

Second, the following edit should be made to Attachment 3, p. 3:

| January-13 | 2222 | 0 | 800 | 1422 | 750 | 400 | 0 |

The fifth column should be “750”, not “0”. 

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Edison Company and the Ameren Illinois Utilities (AmerenCILCO, AmerenCIPS, and AmerenIP), July 9, 2010, pp. 8-9. Staff’s recommendation is limited to current collateral thresholds. Staff has no recommendation regarding extending unsecured credit to non-investment grade suppliers.
XI. Conclusion

Staff respectfully requests that the Illinois Power Agency revise its Draft Plan consistent with Staff’s Comments.

Respectfully submitted,

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