OFFICE OF THE ATTORNEY GENERAL
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Lisa Madigan
ATTORNEY GENERAL

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Mr. Mario Bohorquez
Illinois Power Agency
180 N. LaSalle Street
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Re: Illinois Power Agency 2015 Draft Procurement Plan

Dear Mr. Bohorquez:

Pursuant to Section 16-111.5(d) of the Public Utilities Act ("the Act"), the People of the State of Illinois, ex rel. Lisa Madigan, Attorney General of the State of Illinois ("the People" or "the OAG"), hereby file their Comments on the Illinois Power Agency's ("IPA" or "the Agency") 2015 Draft Procurement Plan ("the Draft Plan"), presented to stakeholders and made available on the Agency's website on August 15, 2014. The People appreciate the opportunity to comment on the Draft Plan and the Agency's willingness to consider the points and arguments presented below as it crafts its final Procurement Plan for the coming year.

Overall, the 2015 Draft Plan continues the procurement approach used by the IPA over the last several years. That approach has resulted in rates that track market prices and that have limited price volatility. The People support the continuation of that approach, and limit their comments to (1) the discussion of "full requirements" procurement and (2) energy efficiency procurement. The OAG's Comments are presented by topic area, as discussed below.

Section 6.6 -- The IPA Should Continue Its Current Procurement Strategy and Avoid Full Requirements Contracts.

Section 6.6 of the 2015 Draft Plan refers to Consideration of a Full Requirements Procurement. The 2015 Draft Plan correctly rejects including full requirements contracts in the 2015 Draft Plan. In addition to the reasons set forth in the Plan, the IPA should also base its rejection of a full requirements procurement on the danger that a single procurement approach, i.e. full requirements contracts, will limit the market based strategies to the one primarily used by alternative retail energy suppliers (ARES). If only one strategy is used by ARES and by the IPA, consumers will lose the benefit of choice and the market will not produce an alternative approach to risk.

As the 2015 Draft Plan states, Illinois has a history with full requirements contracts that began in 2006. The General Assembly directed the IPA to procure electricity for Illinois consumers "to ensure adequate, reliable, affordable, efficient and environmentally sustainable electric service at the lowest total cost over time, taking into account any benefits of price stability." *E.g.*, 20 ILCS 3855/1-5(A) & 3855/1-75(b). In response to price spikes resulting from a procurement based solely on full requirements contracts, the General Assembly gave the IPA wide latitude to procure electricity, and specifically authorized the IPA to propose a "mix and selection of standard wholesale products for which contracts" can be executed, including but not limited to contracts for blocks of peak and off-peak energy. 220 ILCS 5/111.5(b)((3)(iv).

The IPA has been using the block approach, which sets a price for energy purchased while leaving the balancing of purchases and energy needs to the utility. The Purchased Energy Adjustment (PEA) allows the utility to assure full recovery of its costs given the fact that the energy contracts cannot be expected to perfectly match consumer demand. The IPA notes in its 2015 Draft Plan that while Ameren has had credits associated with its PEA, ComEd's PEA charges are more variable. 2015 Draft Plan at 48. The PEA charges or credits affect the ultimate price paid by consumers for energy.

ARES have complained that this approach to procurement does not match their approach, which has been to offer full requirements contracts to municipalities through municipal aggregation contracts, and as a result, the prices consumers see (unadjusted by the PEA) are not comparable to their offerings. They have requested that the IPA change its procurement methods to match their full requirements approach.

The People support the IPA's decision to not utilitize full requirements contracts in its 2015 Draft Plan. As the IPA notes, consumers have differing tolerance for risk, and today consumers who prefer a fixed price associated with a full requirements contract often have that option either through municipal aggregation or through individual contracts with an ARES. The IPA price, which is periodically adjusted by the PEA, represents another choice for consumers, and it should be preserved.

Another important reason to retain the IPA's current block approach is that it provides an independent means to determine the cost of risk. Full requirements contracts include the cost of demand volatility in the price. While the risk premium may be determined through various measures, ultimately the risk premium is not obvious or transparent. By contrast, while the block approach used by the IPA does not include a risk premium, the PEA effectively shows the cost of volatility of demand by reconciling cost and revenues. This allows an assessment of the cost of demand risk and is a more transparent method to assess the cost of risk.

The IPA should continue to procure energy using its current approach. If ARES and the IPA both use full requirements contracts exclusively, the cost of demand risk will become subsumed in single price contracts, reducing market choices and eliminating independent sources to determine reasonable market prices. Further, the opportunity for the IPA to develop and manage an energy portfolio to minimize the cost of demand risk will be lost.

Section 7.1 The IPA's Energy Efficiency as a Supply Resource Proposal

In its draft 2014 IPA Draft Procurement Plan, the IPA raises the idea of procuring energy efficiency as a supply resource (EEAASR), separate from its Section 16-111.5B procurement. In this draft 2015 Procurement Plan the Agency puts forward this idea again, and lays out some proposed key principles to guide a future EEAASR procurement, as well as suggest some specific actions and schedule for how this might be instituted in 2016. IPA Draft Plan at 63-67. The Agency explains: "The rationale for the proposal was straightforward: rather than viewing energy efficiency simply as reducing forecast load, demand-side resources could potentially constitute a lower-cost alternative than comparable supply at times when prices are highest or load is greatest. If less-expensive demand-side resources could be procured in lieu of conventional supply during periods of high cost or high load, the Agency could be better-positioned to meet its statutory objective of developing "electricity procurement plans to ensure adequate, reliable, affordable, efficient, and environmentally sustainable electric service at the lowest total cost over time, taking into account any benefits of price stability."[1]

The OAG generally agrees with and supports this rationale. Indeed, we assert that demand-side energy efficiency resources should *always* be allowed to compete on an equal footing with supply resources to meet energy service needs, and a mechanism to ensure this is necessary to ensure electric service is procured at the "lowest total cost over time." However, we disagree with the implied premise that such a mechanism would only be appropriate "when prices are highest or load is greatest."[2] While these "super peak"[3] periods may offer the greatest proportional benefits because supply costs are highest, there is substantial evidence throughout the U.S. and in Illinois that energy efficiency resources can and often are cheaper than supply available in even lower cost power periods, and can potentially compete even with base load power resources. We therefore cautiously support the EEAASR concept and IPA's intent to further explore this opportunity and its tentative schedule for soliciting EEAASR bids in late 2015 for deployment in 2016. However, below we raise some concerns about how the EEAAR can work in practice, and whether it will truly capture new additional net resources at competitive costs. Below we respond to the seven key principles IPA has articulated (Section 7.1.2) and summarize some key concerns that should be resolved in order for EEAASR to function effectively.

Response to IPA-Identified Key EEAASR Principles

At pages 63-64 of the Draft Plan, the Agency discusses seven "key principles" to guide an EEAASR procurement. The People's response to these principles follows below.

The Agency's first principle is that "any EEAASR procurement should be structured to provide lower expected total customer costs than a comparable supply-side procurement."[4] The IPA goes on to acknowledge that because "some degree of forecasting is required, the Agency does not believe that the procurement *must* produce lower costs, only that it is *more likely than*

[1] IPA Draft Plan at 63.
[2] *Id*.
[3] *Id.*
[4] *Id.*

not to do so."[5] The OAG supports this view and recognizes that planning should be based on the most likely expected outcomes rather than guarantees. We also recognize that the Agency already engages in various hedging strategies to protect against unforeseen negative circumstances. While EEAASR carries some risk, we believe additional energy efficiency resources also provide broad risk reduction to supply uncertainties by diversifying resources, and protecting against weather-related load variation and price volatility. Accordingly, these additional risk reduction benefits from EEAASR should be recognized and valued where possible.

The IPA's second principle is that an EEAASR procurement should be focused on "pre-designated 'super-peak' blocks."[6] It goes on to discuss that while demand response strategies can assist with providing benefits at highest cost peak periods, the active management of these strategies present challenges the Agency is not currently equipped to handle. As a result, the Agency believes segregating out these super-peak blocks in advance will provide greater clarity and certainty to allow EEAASR to compete. The OAG agrees that the Agency is not currently set up to actively manage DR programs, and tentatively supports the concept of segregating out blocks of power by time period and/or cost in a way that allows for the full value of demand-side resources to be reflected. This can allow bidders with unique time dependent strategies to focus on the best and most economical supply or demand resources for each given period.

The OAG disagrees, however, with the Agency's implied premise that only super-peak blocks of the highest cost power should be eligible for EEAASR. It is highly likely that there are demand-side resource solutions at other times and price blocks that are still lower cost to ratepayers than traditional supply. The People suspect that part of the Agency's rationale is that the Section 16-111.5B procurement mechanism in theory already solicits all cost-effective demand-side resources that are cheaper than supply on an annual basis, and therefore captures the cost-effective demand-side resources covering other periods. But this assumption is only partially true. The Total Resource Cost test used by Ameren Illinois Company and Commonwealth Edison Company in screening competitive bids under the 16-111.5B mechanism is a rather blunt instrument. Effectively, it screens programs based on average avoided costs, with some differentiation by time period and some benefits for peak demand impacts. However, specific resources can certainly be devised that might fail an average annual screening, but still be cost-effective when designed to compete specifically against more costly supply blocks. Further, the Section 16-111.5B process does not allow for a full accounting of risk benefits and potential reductions in hedging costs and reduced market clearing prices that might come from more targeted demand-side resource solutions and more sophisticated analysis.

It appears that the approach the Agency is envisioning might in practice be similar to a forward capacity market auction, which already exists for PJM. Permitting bidders to only capture the super-peak capacity benefits, and have them only measured against a three-year period rather than based on the full lifetime benefits of demand side management ("DSM"), is problematic. Effectively, it could balkanize funding streams in a way that makes it difficult to promote all cost-effective DSM resources because the EEAASR by itself may not be sufficient to fund broader, more comprehensive resources. As envisioned for the super-peak period only, it

[5] *Id. at*. 64, footnote 104.
[6] *Id.* at 64.

may be most appropriate as simply an additional funding stream to help support the Section 8-103 programs through additional capacity payments. However, broadening the block periods that could be pursued through DSM resources and creating a mechanism that can compensate for all lifetime DSM benefits could better capture all achievable cost-effective DSM resources more efficiently than the required Section 16-111.5B DSM purchases, or in concert with it.

The Agency's third principle is that all EEAASR products should at least initially be resources on the customer side of the meter. We believe this may be a prudent first step. However, we caution against creating barriers that do not permit all potential resources to compete on an equal footing. We can envision that there may be distribution system improvements undertaken by ComEd and Ameren, potentially including voltage control and reduction strategies, that might be competitive resources that could and should compete with traditional supply resources. Certainly the EEAASR is not the only way to fund and pursue these resources. However, thought should be given to how the Agency can ensure a level playing field for all cost-effective resources.

The Agency's fourth principle asserts that the "size of the individual blocks to be procured should be small enough to allow for small scale load reductions to compete." We agree. However, the Agency's proposed 100 KW blocks seem potentially too small. We encourage a careful balancing of the trade-offs between administrative burden of numerous very small procurement blocks vs. larger ones where some potential bidders may be discouraged or forced to aggregate resources. We do suggest that bidders should be allowed to aggregate combinations of supply and demand-side resources into single bids, if desired.

The fifth principle discussed is that contracts should be for longer than one year. The People support this conclusion. The OAG believes this has proven to be a barrier to the Section 16-111.5B procurement mechanism by preventing consistent and comprehensive DSM planning, and substantially increasing risk to bidders who are only assured of a single year of revenue at a time. We note however, that the Agency proposal for three-year contracts also presents its problems. A mechanism should be developed that can reward bidders with compensation for the full lifetime benefits of the efficiency resource, regardless of the duration of actual contracts. If some of these resources are voluntary and not ensured through hard-wired equipment (*e.g.,* demand response), then even a three-year period will likely not be sufficient to encourage all cost-effective resources.

The Agency's sixth principle is that contracts should protect ratepayers from non-delivery. The OAG agrees that some level of assurance is necessary. We also note that DSM resources provide risk reduction benefits from diversification, smoothing of other potential load variances, reducing price volatility, and putting downward pressure on market prices. The Agency already acknowledges that it is exposed to forecast load risk from weather and other parameters. The People believe DSM resources can be viewed as simply another "load risk" for which the Agency can effectively hedge. Because the Agency hedges risk already, it should, to the extent possible, recognize any ratepayer value from risk reduction that might come from EEAASR. That said, hedging through contractual mechanisms that might include "credit requirement and non-delivery penalties"[7] similar to supply contracts may be appropriate.

[7] *Id.* at 64.

The Agency's seventh and final principle is that EEAASR resources should be allowed to be procured from customers statewide, and not be limited to "eligible retail customers." It points out that traditional supply resources are unrestricted. The People concur that all cost-effective DSM resources within Illinois should be allowed to compete.

As discussed above, the OAG fully supports the concept of allowing demand-side and supply-side resources to compete on an equal footing. It is possible there may be opportunities for the EEAASR to enhance this important objective. However, we also recognize that it is unclear exactly how the EEAASR as proposed by the Agency can work effectively to capture new, net additional EE resources at competitive prices. We suggest a few key principles below that should be considered in any future EEAASR:

1. Any EEAASR mechanism should not directly compete with or undermine the successful 8-103 programs and the 16.111.5B procurement mechanism. It is not immediately clear how the EEAASR would work in isolation, and possible approaches to effectively integrate these three mechanisms in ways that promote the most comprehensive planning and procurement of all achievable and cost-effective demand-side resources should be considered. For example, if limited to the super peak period it seems likely that the EEAASR might mostly attract non-energy efficiency resources, such as short term load shifting and curtailment and emergency generation. The Agency notes that its intent is to "attract new resources" and not to compete with the other DSM mechanisms. However, it is not clear how the EEAASR, as envisioned, will do that. Potentially, broadening the period to include all hours of the year and allowing any additional resources that are not competing with or duplicating other resources could resolve this issue. Alternatively, simply creating additional funding based on tangible, super-peak load reduction benefits that can supplement 8-103 budgets may be preferable at this point.

2. As much as possible, mechanisms to fund and procure demand-side resources should strive to be comprehensive and provide fair compensation for all societal benefits, but at the lowest ratepayer cost possible. As articulated, we understand that the EEAASR would only compensate bidders for a small fraction of the overall benefits of DSM. As a result, this risks balkanizing the DSM market, or worse, simply providing additional payments for resources that will already be captured through other mechanisms. Further, there is a danger of overpayments for DSM resources if it is clear to bidders that higher cost supply resources will ultimately set the clearing price. It is important that any bidding mechanism effectively ensure competitive pricing. This could possibly be done through limits on different categories of resources. However, we believe that integrating procurement mechanisms in a way that encourages and facilitates long term planning and ensures all benefits are monetized is likely the most effective way to achieve this goal.

3. It is important that any mechanism have appropriate monitoring and verification, and that it be designed to encourage new net resources, as opposed to simply creating a new funding stream to enrich owners or providers of existing resources.

Part 7.2 Incremental Energy Efficiency

At pages 67-84 of the Draft Plan, the IPA discusses the incremental purchase of energy efficiency pursuant to Section 16-111.5B of the Act. Section 16-111.5B of the Act discusses both Illinois electric utility and IPA responsibilities in ensuring that "an assessment of opportunities to expand the programs promoting energy efficiency measures that have been offered under plans approved pursuant to Section 8-103 of this Act or to implement additional cost-effective energy efficiency programs or measures" have been included in the Agency's annual procurement plan. 220 ILCS 5/16-111.5B(a).

In its Draft Plan, the Agency briefly discusses the utility RFP process, designed to capture all cost-effective energy efficiency programs for inclusion in the Plan. The IPA asks, "Should the utilities be expressly encouraged to engage stakeholders in the review of third party program bids and "duplicative" program determinations?" Draft Plan at 73. The People note that such collaboration is not only appropriate, but required by the Act. 220 ILCS 5/16-111.5B(a) ("The utility shall develop requests for proposals consistent with the manner in which it develops requests for proposals under plans approved pursuant to Section 8-103 of this Act, which considers input from the Agency and interested stakeholders.") Indeed, that requirement mandates that such input be invited *early on* in the RFP process and throughout the utilities' analysis of bids received. Specific IPA support for such a requirement in the Plan (and in the Commission's final order approving the Plan) would contribute to its ability to ensure that all cost-effective energy efficiency resources have been captured in the Utilities' presentations.

Conspicuously absent from the IPA's Draft Plan's, however, is a discussion of the programs or measures that were deemed to be non-cost-effective by (1) the Utilities and, separately, (2) the IPA. While the IPA indicated concurrence with the Utilities findings, except where indicated, the IPA did not elaborate on what made the programs that did not make the cut non-cost-effective. For example, are utility administration add-on costs added to some bids? If so, the question arises, were such add-on costs appropriate? Further, if so, what percentage add-on was applied? If such an add-on is the difference between a program or measure being deemed non-cost-effective and cost-effective, a detailed analysis by the IPA justifying such an add-on should be presented. Such elaboration is consistent with the fact that all bids are presented to the Agency for review, and that the IPA "shall include in the procurement plan prepared pursuant to paragraph (2) of subsection (d) of Section 16-111.5 of this Act energy efficiency programs and measures *it determines* are cost-effective and the associated annual energy savings goal included in the annual solicitation process and assessment submitted pursuant to paragraph (3) of this subsection (a)." 220 ILCS 5/16-111.5B(a)(4) (emphasis added). That statutory language makes clear that the IPA has ultimate responsibility to ensure that all cost-effective energy efficiency has been procured, notwithstanding the Utilities' role in securing bids.

Inclusion of such an analysis is also critical to satisfying the statutory requirement that the Commission approve the energy efficiency programs and measures …"if the Commission determines they *fully* capture the potential for all achievable cost-effective savings, to the extent practicable, … ." 220 ILCS 5/16-111.5B(a)(5). The People request that the IPA modify its 2015

Plan to include a discussion of such variables that may have impacted whether a program or measure is, in fact, included in the IPA's 2015 portfolio.

Respectfully submitted,

PEOPLE OF THE STATE OF ILLINOIS
By Lisa Madigan
Attorney General

By: _____/s/_____
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