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AN EXELON COMPANY

September 14, 2022

VIA EMAIL

Mr. Anthony M. Star
Illinois Power Agency
105 West Madison Street, Suite 1401
Chicago, Illinois 60602

Re: Commonwealth Edison Company's Comments on the Illinois Power Agency's Draft 2023 Electricity Procurement Plan

I. Introduction

Pursuant to Section 16-111.5(d)(2) of the Public Utilities Act (“PUA”), Commonwealth Edison Company (“ComEd”), by its counsel, respectfully submits these comments on the Illinois Power Agency’s (“IPA” or “Agency”) Draft 2023 Electricity Procurement Plan (“Draft Plan”). In creating the IPA, the General Assembly found that “the health, welfare, and prosperity of all Illinois residents require the provision of 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 As a result, the IPA must develop procurement plans that are designed 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.”² This includes an obligation to “continue to review its policies and practices to

¹ 20 ILCS 3855/1-5(1).

² 20 ILCS 3855/1.5(A).

determine how best to meet its mission of providing the lowest cost power to the greatest number of people, at any given point in time, in accordance with applicable law.” 20 ILCS 3855/1.5(F).

A critical focal point of the Draft Plan is the IPA’s hedging strategy, which the Agency concedes “has been challenged by high energy prices and increased volatility in the most recent energy and capacity procurements.”³ ComEd shares the IPA’s concerns regarding the current instability of energy prices, and below offers comments on the Agency’s hedging strategy – specifically, how the carbon mitigation credits (“CMCs”) procured for ComEd customers can function as a price-risk hedge for default customers. ComEd also highlights strategic opportunities that can be leveraged to ensure the State’s clean energy policies and goals are aligned and consistently implemented across all IPA procurements, which includes giving full effect to the statutory directive to procure “environmentally sustainable” electricity.

Consistent with other IPA procurement processes, ComEd has no financial interest of its own in the outcome of the electricity procurement because it recovers the cost of the energy procured – without markup – from eligible retail customers. However, ComEd is interested in how the results of the IPA procurement processes impact its bundled-service customers and the achievement of Illinois’ energy policy goals. ComEd brings to these comments decades of experience as well as learnings gleaned from cross-cutting participation in the numerous and varied IPA procurements held to procure energy, capacity, renewable energy resources and credits, and other tradeable clean energy credits.⁴

³ Draft Plan at 73.

⁴ ComEd’s silence at this time regarding any particular issue should not be interpreted as agreement with all statements, approaches, calculations, or recommendations made in the Draft Plan pertaining to that issue.

II. Comments on the Draft Plan

A. Chapter 6: Managing Supply Risks

The IPA’s portfolio must be designed to achieve a variety of objectives – adequate, reliable, affordable, efficient, and environmentally sustainable electric service – “at the lowest total cost over time, taking into account any benefits of price stability.”⁵ To address the cost and price stability considerations, each IPA electricity procurement plan devotes considerable attention to managing supply risks, which include three broad categories: (i) volume (risks associated with identifying the volume and timing of energy delivery to meet demand; (ii) price (uncertainty in the cost of energy and costs associated with energy delivery in real time); and (iii) hedging imperfections (mismatches between the types of available hedge products and the nature of customer demand).⁶

As suggested by item (iii), one of the principal tools that the IPA has employed over the years to manage price risk is “hedging,” which is a risk mitigation strategy designed to moderate the harmful effects of price volatility. This is accomplished by procuring an interest in another (secondary or derivative) product or position that has an offsetting effect when the price changes on the primary product or position. Because the Climate and Equitable Jobs Act (“CEJA”) mandated a new CMC procurement that requires payments from or to ComEd retail customers based on movements in energy prices, the IPA solicited feedback from stakeholders over the summer regarding the extent to which the CMC contracts could function as a financial hedge in the context of electricity procurement on behalf of ComEd’s eligible retail customers. While the Draft Plan declines to incorporate the CMC contracts’ impacts into the IPA’s supply hedging

⁵ 20 ILCS 3855/1.5(A).

⁶ Draft Plan at 64.

strategy, ComEd respectfully requests that the IPA reconsider its decision for the reasons discussed below.

1. Leveraging the CMC hedging opportunity

As the Draft Plan acknowledges, the CMC procurement includes a consumer protection mechanism associated with the monthly calculation of CMC prices – “[i]f the monthly CMC price calculation results in a net negative value, such as is likely to be the case during periods of high wholesale electricity prices, the CMC supplier makes payments that benefit all of ComEd’s retail customers.”⁷ Indeed, through the CMC contracts executed by ComEd and the supplier pursuant to the IPA’s CMC procurement plan approved in 2021,⁸ customers pledge to purchase CMCs to preserve clean nuclear generation when the combination of energy and capacity prices are low. Conversely, the nuclear generators are obligated to pay the customers when capacity and energy prices are high. As a result, CMCs materially impact the amounts that customers pay for electric service overall. Analyzing and accounting for the extent to which CMCs require payment either from or to customers is essential to assessing the price risks for those retail customers on whose behalf the IPA procurements are conducted.

In order to allow the CMCs to hedge energy price risk, a portion of the load must remain “open.” – *i.e.*, it is not procured through a fixed-price contract and instead must be procured in the day-ahead energy spot market. To maximize the hedge, the volume of forward block products to be procured must be reduced by an amount equal to the load covered by the CMCs. This means that the amount of forward products procured plus the total CMCs equal 100% of the load requirement. Under this approach, the remaining (or “open”) amount of energy not secured

⁷ Draft Plan at 82.

⁸ See *In re Illinois Power Agency*, ICC Docket No. 21-0718, Final Order (Nov. 10.2021).

through a fixed-price contract is purchased in the PJM Interconnection, LLC day-ahead energy market at the same prices that are used to set the CMC payments. If the market price for energy goes up, the CMC payments to customers also increase. Likewise, if the energy price goes down, the CMC payment will decrease. Importantly, because the size of the CMC payments is tied to the market price, spikes in energy prices will trigger a corresponding CMC payment to customers that will serve to offset the risks of energy price volatility to the cost of the total basket of energy supplying eligible retail customers. If the procurement targets are not reduced to allow for an open position equal to the CMC quantities, then customers will be exposed to price volatility for 100% of the load without a corresponding offset through the CMC payments.

To preserve the opportunity that the CMC construct provides to mitigate customer price risk, it is critical that the IPA reduce its target procurement quantities for the ComEd eligible retail customer load in an amount equal to the CMCs. Indeed, if the proposed block procurement targets remain unchanged, customers' price risk actually increases and could result in customers paying more than they need to pay. For example, this could occur in a highly volatile market where a fixed-price energy contract is executed when energy prices are high but then energy prices abruptly drop such that the CMC does not provide payments to customers to offset the high prices under the contract. Because the volumes to be procured through CMC contracts equal approximately 65% of all ComEd deliveries, it follows that roughly 65% of the default supply load is effectively price hedged by the CMC contracts. To ensure this price hedge can effectively provide price protection to default supply customers, it is important that the IPA limit the amount of energy procured under fixed-price contracts to 40-50% of the projected load. Absent this limitation, the

IPA's proposed hedging strategy would result in an over-hedged position of nearly 170% for Delivery Year 2023/2024.⁹

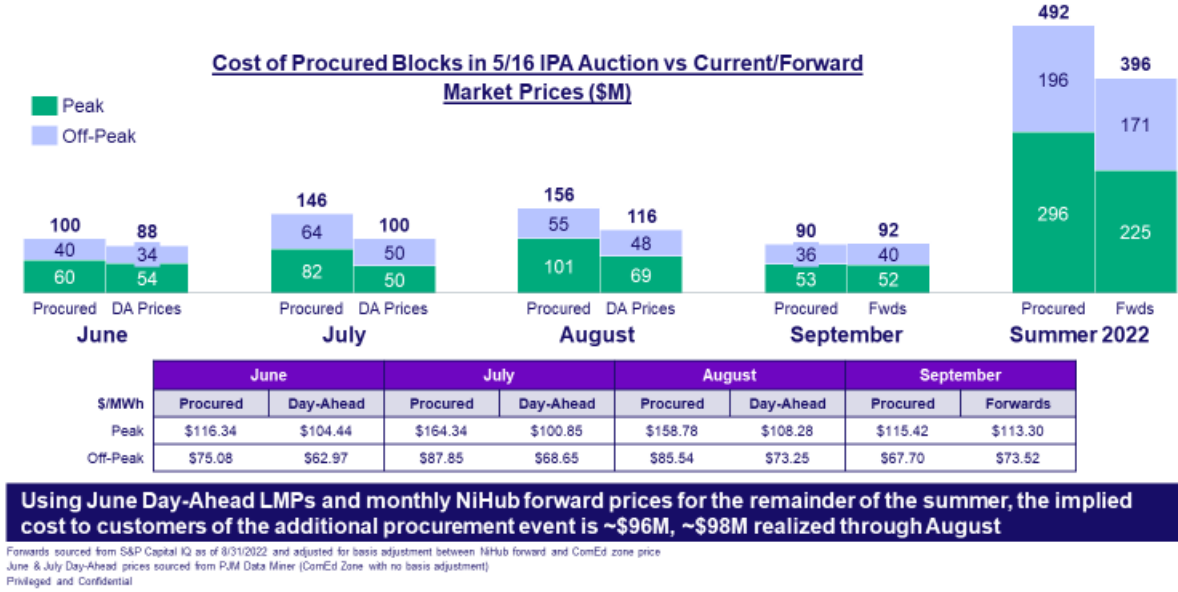
The very real benefits to be realized by utilizing the CMC contracts as a hedge are not mere speculation. Prior to the IPA's Supplemental Procurement event held on May 16, 2022 ("Supplemental Procurement"), ComEd's eligible retail customers were approximately 50% hedged for the summer months when the existing block procurement quantities and the CMC quantities were considered. As a result, their exposure to future changes in spot prices was minimal. However, the Supplemental Procurement added additional block purchases that provided fixed price energy for approximately 90% of the forecasted default supply load. This additional procurement increased customers' price exposure by limiting the ability of the CMC to offset downward price movements after the procurement.

Figure 1 below – "*5/16 Procurement Settlement Results for June-August*" – illustrates the movement in energy prices in June, July, and August compared to the cost of the procured blocks in the Supplemental Procurement. As shown in the June column, the cost of the procured blocks was \$100 million while the cost for the same number of blocks at the same time if they would have been left open and procured through the day-ahead market would have been \$88 million. Likewise in July and August, the cost of the procured blocks was \$46 million higher and \$40 million higher, respectively, than the cost would have been if the July and August energy were purchased in the day-ahead market. Through August, default supply customers would have saved \$98 million in energy costs through a day-ahead procurement strategy, because energy prices fell below the prices procured in the Supplemental Procurement.

⁹ Appendix A presents a snapshot of the IPA's current hedge position following the Fall 2022 procurement and assuming the Draft Plan's proposed subsequent procurements are conducted. This demonstrates that the IPA's proposed hedging strategy would result in a materially over-hedged position because it fails to take into account the effect of the CMCs.

FIGURE 1

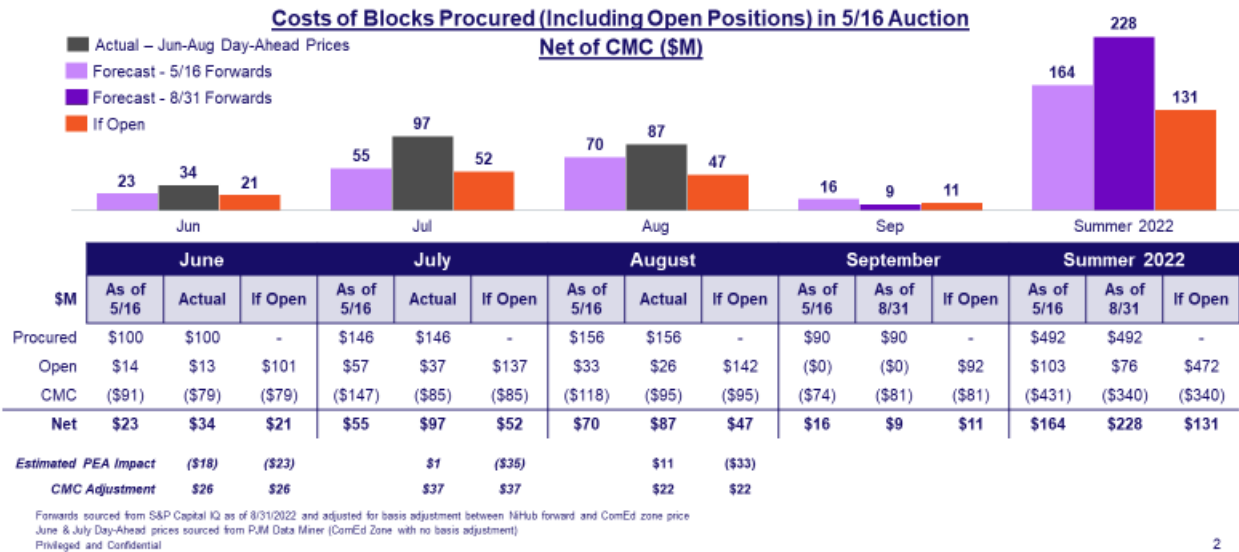
5/16 Procurement Settlement Results for June-August



A strategy where a material portion of the load (*i.e.*, > 50%) is left open for procurement in the day ahead spot market is only effective if an instrument like the CMC is present to mitigate the volatility in energy prices and offset the price exposure that customer would face with a substantial open position. Figure 2 below – “*Cost Tracking of Summer 2022 Energy Acquired in 5/16 Procurement and CMC Settlement*” – illustrates how the CMC and a day-ahead market procurement strategy would operate together as an effective price hedge, regardless of which way prices move after a procurement, due to the fact that both the energy and CMC would be settling against the same hourly price. It includes several important data points: (i) the blocks procured during the Spring Procurement cost \$100 million; (ii) the open position left after the Spring Procurement was expected to cost \$14 million at the time of the Procurement; and (iii) the CMC was expected to provide a \$91 million credit to default supply customers.

FIGURE 2

Cost Tracking of Summer 2022 Energy Acquired in 5/16 Procurement and CMC Settlement



Because prices fell during the months of June, July, and August, the following occurred:

- June 2022:** In the first month of the summer period, the procured block cost stayed unchanged at \$100 million while the open block cost dropped to \$13 million and the CMC dropped by \$12 million to \$79 million. This resulted in a net cost of \$34 million for the month of June, which was \$11 million higher than expected and \$13 million higher than if the Spring Procurement blocks would have been left open. The June “If Open” column illustrates how the energy costs would have been \$14 million lower offsetting the decline in payout related to the CMC.
- July and August 2022:** The same dynamic observed in June occurred in both July and August – but to a much larger degree. The July price drop resulted in a \$62 million decrease in the CMC payment while August saw a \$23 million reduction to the payment. Likewise, the actual cost of energy – net of the CMC – was \$45 million higher in July and

\$40 million higher in August than it would have been if those blocks would have been open. These numbers are almost exactly the same variances illustrated in Figure 1, which illustrates how effective the CMC is in offsetting the price risk inherent with open positions for the energy.

2. Response to the IPA's CMC concerns

While the Draft Plan indicates that the IPA considered the use of CMCs as a hedge for ComEd's eligible retail load, the Agency ultimately declined to update its hedging strategy to account for the presence of CMC contracts over the next five years.¹⁰ Instead, the IPA proposes only to monitor the impact on ComEd's customers of the implementation of the CMC Procurement Plan. ComEd responds to the concerns articulated in the Draft Plan below, and believes the IPA should look anew at the CMCs as a potential price risk mitigator.

Benefits (or costs) of CMCs for eligible retail customers compared to those for customers served by alternative retail electric suppliers ("ARES"). The Draft Plan notes that "[t]he IPA is not yet convinced that the benefits (or costs) of CMCs for eligible retail customers is sufficiently different from that of customers served by ARES, such that CMCs should be used to leave such a large a portion of eligible retail customers' supplied load unhedged."¹¹ ComEd understands the Draft Plan to be confirming the fact that CMCs are procured on behalf of, and paid for by, all ComEd retail customers (*i.e.*, both eligible retail customers supplied by ComEd and competitive supply customers served by ARES). This means all such retail customers will be impacted by adjustments to CMC payments. While true, this is not a basis for dismissing the CMCs' use as a hedge for eligible retail customers. The CMCs create a long (or fixed) position for both ComEd-

¹⁰ Draft Plan at 82.

¹¹ Draft Plan at 82.

supplied customers and ARES-supplied customers over a five-year period. Nothing precludes the IPA from considering and incorporating the benefits of this position for the former group of customers who are the subject of the Draft Plan. Indeed, high market volatility and prices compel an approach that maximizes the CMCs' benefits.

Risks associated with large open positions. The Draft Plan also expresses concern “with potential unintended consequences to volatility in spot markets that would result from [] large open positions.”¹² However, this statement indicates a misunderstanding of the relationship between the financial hedge provided by the CMCs and the financial hedge provided by block energy procurements. Far from there being a disconnect, these two protective mechanisms work in concert to shield customers from undue risk. Under the CMC position, customers are not subject to volatility in spot markets because every MWh that is hedged through the CMC is equivalent to a MWh that would have been hedged through a physical block procurement.

Conversely, customers are exposed to increased risk if the physical block energy procurements leave no room (or open position) for the CMC position to do its work. In other words, when all blocks are purchased physically despite the existence of the CMCs, then customers can only benefit when prices fall. Any hedging strategy that only protects customers when prices move in a singular direction is speculative and should not be incorporated into any default supply procurement plan.

Timing and arbitrage issues. The Draft Plan also observes that “the timing between the monthly variation of the Purchased Electricity Adjustment that would reflect [] spot market purchases and the adjustment to the level of the CMC charge/credit could also create arbitrage

¹² Draft Plan at 82.

issues for customers who switch between default service and ARES offers.”¹³ While ComEd does not dispute this possibility, this scenario is not one created by CMCs. In fact, arbitrage issues and opportunities have long been present in Illinois since the State began the move to retail electric competition some 25 years ago.

The timing issue cited by the Draft Plan is a creation of the overall regulatory framework, which includes a timing mismatch between the determination of default service rates, default service costs, and default service reconciliation. If default service rates must be estimated in advance, with a difference between estimated and actual recouped in future periods, it is possible that a savvy customer could switch to an ARES to avoid reconciliation charges. However, this lone possibility does not outweigh the fact that the IPA’s recommended approach would leave default service customers with a financially long position that has already proven detrimental to customers.

In sum, while ComEd appreciates the IPA’s concerns, none justifies the proposed “do nothing” approach vis-à-vis the CMCs’ hedging opportunity. The IPA should reevaluate its approach to minimizing energy supply price risk for eligible retail customers by taking full advantage of the CMCs functioning as an effective financial hedge.

3. Additional hedging strategy comments

The Draft Plan specifies that the IPA seeks to “shift the procurement volume for the summer months in the prompt Spring procurement from approximately 50% to 25% by increasing procurement volumes in prior procurements.”¹⁴ To the extent that the IPA adopts the proposed CMC hedging strategy (and it should), the portion of block energy products to be procured (*i.e.*,

¹³ Draft Plan at 82.

¹⁴ Draft Plan at 42.

the 40-50% portion not left open) should be procured in equal quantities across multiple events to further mitigate volatility risks in a given year. The IPA's proposal in the Draft Plan results in a reduction of 50% (45% for July and August On-Peak periods that are 106% hedged) in the remaining block energy products to be procured for the prompt summer months (*except September*) in the initial delivery year. Approximately 80% of that reduction comes from the IPA's proposed hedging strategy increase from 50% to 75% in the second delivery year of the two procurement events held in the prior year and the remaining 20% reduction comes from the proposed hedging strategy increase from 25% to 30% in the third delivery year of the two procurement events held two years before. While this proposal may mitigate volatility risk for the prompt summer months in the initial delivery year, it also increases the volatility risk in prior years with such increases under the IPA's proposed hedging strategies.¹⁵

* * *

In light of these concerns, ComEd suggests that the IPA consider a hedging strategy similar to that used by an investor – dollar-cost averaging. Dollar-cost averaging involves investing the same amount of money in a financial security at regular intervals over a certain period, regardless of price. By using dollar-cost averaging, investors may lower their average cost per share and reduce the impact of volatility on their investment portfolios. The result is a strategy that can make it easier to deal with volatile markets by making purchases automatically and regularly. In effect, this strategy eliminates the effort required to attempt to time the market to buy at the best price.

To implement a strategy based on a dollar-cost averaging approach, the IPA could divide up the targeted block energy products for all summer months, *including September*, into fifths across the five procurement events (20% per procurement event of the targeted physical hedge

¹⁵ Extending the time period between the procurement event and the delivery date may also increase risks to suppliers, which in turn may be reflected in increased bid prices.

amount). Because block energy products for the non-summer months are currently procured over six procurement events during a three-year period, yet another option would be to also include the procurement of block energy products for the summer months over six procurement events such that both summer and non-summer block energy products would be divided equally across six procurement events (16.67% per procurement event of the targeted physical hedge amount). The result is a hedging strategy that mitigates volatility risk by procuring the same amount of block energy products at regular intervals (*annual Spring and Fall procurement events*) over a certain period (*36 months*), regardless of forward electricity prices, with the intent to procure the lowest average cost per megawatt hour.

B. Chapter 7: Resources Choices

The IPA is statutorily required to “[d]evelop 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.”¹⁶ As explained below, ComEd recommends that the IPA give full effect to the statutory requirement to procure “environmentally sustainable” electricity, which will harmonize the electricity procurement plan and the products procured thereunder with the State’s overarching clean energy policies and goals, as most recently articulated in CEJA.

Because this is the first electricity procurement plan developed by the IPA following CEJA’s enactment, it provides a meaningful opportunity to ensure that the energy products procured under the plan complement and support Illinois’ clean energy goals. To be sure, the General Assembly has long articulated a State policy that emphasizes the procurement of

¹⁶ Draft Plan at 1-2 (citing 20 ILCS 3855/1-20(a)(1)) (emphasis added).

“environmentally sustainable electric service,”¹⁷ which is also reflected in the legal standard applicable to the IPA’s development of electricity procurement plans.¹⁸ Correspondingly, the PUA also directs the Commission to approve electricity procurement plans only “if the Commission determines that it will 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.”¹⁹ Given CEJA’s new mandate to “rapidly transition to 100% clean energy by 2050,”²⁰ it is critical that the requirements for “environmentally sustainable electric service” are faithfully implemented in each electricity procurement plan. Indeed, the increasing severity of climate change coupled with recent limitations on federal action to combat carbon emissions bring increased urgency and clarity to the need for environmentally sustainable energy.

ComEd accordingly recommends the IPA explore an approach designed to align the electricity procurement plans with the statutory criteria and ensure that the Commission has the information required to make the required determination regarding environmental sustainability. For example, electricity procurements could require bidders to include the fuel mix of the power that is the subject of the bid being submitted. To the extent that a procurement plan includes electricity procured from carbon-emitting resources, the associated cost of carbon value could be calculated and included to ensure that the actual full cost of procuring carbon-emitting resources is transparently identified. The electricity procurement plans could analyze options to mitigate or avoid procurement of electricity from carbon-emitting resources, and propose procurement of

¹⁷ See, e.g., 20 ILCS 3855/1-5(1), (5), (A); 220 ILCS 5/16-101A(d).

¹⁸ 20 ILCS 3855/1-20(a)(1)).

¹⁹ 220 ILCS 5/16-111.5(d)(4) (emphasis added).

²⁰ 20 ILCS 3855/1-5(1.5).

clean energy products when their cost is equal to or below the cost of a carbon-emitting resource (inclusive of the cost of carbon value).

Given the local and global urgency in addressing the climate crisis, ComEd urges the IPA to consider options like these. It is critical that each plan furnish the Commission with the information required to (i) satisfy the statutory standard on the issue of environmental sustainability and (ii) enable the Commission to make express findings regarding the extent to which a given electricity plan advances environmentally sustainable electric service or promotes further dependence on carbon-emitting resources. CEJA's clarion call to rapidly transition to 100% clean energy requires that Section 16-111.5's prioritization of environmental sustainability be given full effect.

III. Conclusion

ComEd respectfully requests that the Draft Plan be revised according to the recommendations articulated herein.

Respectfully submitted by,

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APPENDIX A

The following charts present a snapshot of the IPA’s current hedge position (i) following the Fall 2022 procurement and (ii) assuming the Draft Plan’s proposed subsequent procurements are conducted.

	With Fall 2022 Procurement			With Draft Plan's Proposed Subsequent Procurements		
	Volume Hedged by Blocks (%)	Volume Hedged by CMC (%)	Effective Total Volume Hedged (%)	Volume Hedged by Blocks (%)	Volume Hedged by CMC (%)	Effective Total Volume Hedged (%)
Jun-23	50%	60%	110%	100%	60%	160%
Jul-23	50%	61%	111%	103%	61%	164%
Aug-23	50%	55%	105%	103%	55%	158%
Sep-23	50%	72%	122%	100%	72%	172%
Oct-23	50%	74%	124%	100%	74%	174%
Nov-23	50%	71%	121%	100%	71%	171%
Dec-23	50%	71%	120%	100%	71%	171%
Jan-24	50%	61%	112%	100%	61%	161%
Feb-24	50%	62%	113%	100%	62%	162%
Mar-24	50%	73%	123%	100%	73%	173%
Apr-24	50%	73%	123%	100%	73%	173%
May-24	50%	76%	126%	100%	76%	176%
Delivery Year 23/24	50%	66%	116%	101%	66%	167%