ICEA RESPONSES TO IPA FULL REQUIREMENTS QUESTIONS

1. At the June 5th workshop some participants suggested that an analysis of a potential full requirements procurement should be for a product that includes capacity, ancillary services, etc., not just a load following energy product (as the IPA had analyzed in the 2014 Procurement Plan). Please comment on the advantages and disadvantages of this product definition, and explain which ancillary services should, or should not, be included (e.g., active power reserves but not voltage support).

ICEA Response: As ICEA explained during the June 5, 2014 workshop hosted by the IPA ("IPA Workshop"), ICEA's **general concept** is that market-based products should be part of a fixed price full requirements product, while non-market based products should not. Market based products include energy, capacity, ancillary services, and renewable energy credits ("RECs"). Examples of non-market based charges are listed on ICEA's third slide, labeled "FPFR Product Definition – Exclusions." The rationale is that suppliers take on the risk for market based (fluctuating and hedgeable) products but there is no value added for suppliers to procure component products where there is no market and thus no risk to mitigate. However, with ComEd's move to individual network service peak load (NSPLs) and peak load contributions (PLCs) for residential customers in 2015 and the rollout of smart meters and smart meter benefits in ComEd's territory, ICEA supports including all market based charges except capacity. Given that capacity is a largely a "pass through" demand charge from PJM that is largely known three years in advance and with the importance of providing customers in a smart meter environment with price signals for capacity usage, ICEA supports the continuation of the current policy that capacity is procured from PJM by ComEd for eligible customers.

2. A participant at the workshop indicated that suppliers of fixed-price full requirements products assume price risks associated with capacity, ancillary services, etc. How would one quantify the anticipated costs of including the non-load following energy components (capacity, ancillary services, etc.) in the product described in question 1?

ICEA Response: As explained in Response number 1 above, ICEA supports the exclusion of capacity from a full requirements product. As explained in further detail in Questions 6 and 7, ICEA believes that the best way to anticipate fixed price full requirements pricing is to review historical fixed price full requirements products with contemporary market information while translating for other relevant factors. Responding further, to anticipate the costs of the non-energy components, ICEA recommends that the IPA and other stakeholders look at forward market prices and historical costs if no forwards exist—much like the IPA would for block energy.

When NorthBridge has examined these questions, NorthBridge has looked at the capacity forward market for an appropriate period (in their judgment), and historical RTO or utility billing information for ancillaries. Instead of looking at simple dollar values, NorthBridge has at times calculated the price of ancillaries as a percentage of energy prices.

3. Bids for full requirements contracts include compensation for various costs and risks borne by the product supplier (i.e., "residual compensation" as described in the ICEA presentation). Please comment on what factors influence the level of this cost and how it should be estimated. Other discussions of full requirements procurement (e.g., the IPA's 2014 Procurement Plan) discuss the concept of a "risk premium." Please also comment on the differences in definition between "residual compensation" and "risk premium" and how the two concepts should be differently understood.

ICEA Response: As NorthBridge explained during the IPA Workshop, residual compensation is not a cost component that is calculated using a "bottom-up" analysis. Instead, assuming that capacity is not included in the supply product, residual compensation is the difference between the "all-in" winning bid price and the costs of: (1) around-the-clock energy, (2) a load shaping adjustment, (3) ancillary services, (4) RECs to meet the RPS, and (5) a netting of certain credit allocations (auction revenue rights credits and marginal loss credits). Residual compensation represents compensation to the supplier for bearing various costs and risks associated with factors such as customer migration, usage and price uncertainty, unexpected congestion, adverse selection, adverse developments in energy markets during the time a bid is held open, potential changes in laws and regulations, administrative and legal costs, and credit-related costs.

Responding further, ICEA notes that the main distinction between "residual compensation" and "risk premium" is the loose definition and negative connotation for the latter. ICEA is concerned that some stakeholders equate "risk premium" with profits taken directly from eligible retail customers, or apply other definitions that do not fit ICEA's use of the term. As explained in the NorthBridge presentation at the IPA Workshop and above, fixed price full requirements suppliers provide significant risk-management services to customers—beyond those that Ameren and ComEd are currently allowed to provide. Akin to buying any other insurance product, fixed price full requirements suppliers completely shelter eligible retail customers from commodity cost fluctuations and other costs and risks. In return, fixed price full requirements suppliers include compensation within their bids to cover these costs and risks. Residual compensation also may include small but quantifiable other costs that are not included in other buckets. The IPA's bidding structure that focuses on price only puts potential suppliers under tremendous competitive pressure to minimize residual compensation or risk not supplying eligible retail customers.

4. For the purposes of modeling the full requirements approach, there was discussion at the June 5th workshop about modeling for the 2015/16 delivery year an implementation of full requirements that would account for the existing block contracts as well as separately modeling (for the 2015/16 delivery year or future implementation years) an approach consisting entirely of full requirements contracts. Please discuss any limitations or adjustments to those two models, and how the existing contracts should be treated in the first model.

ICEA Response: As NorthBridge explained during the IPA Workshop, an effective way to integrate fixed price full requirements into the IPA's portfolio is to essentially divide

the portfolio into two cross sections. The first would be served by block procurements supplemented with spot purchases. The second would be fully served by full requirements.

To visualize and supplement the NorthBridge presentation during the IPA Workshop, imagine that a particular day's load is cut into cross sections. As part of the procurement planning process, the IPA will decide on a certain percentage of the load (likely matching the amount that the IPA believes it is hedged for that year) to be served by block and spot. In advance of a fixed-price full requirements procurement, the IPA will divide the remaining load into equal cross-sections as individual full requirements products for bid. As a result, to the extent that a utility had some component of the portfolio procured using block and spot and another component with a fixed price full requirements product, the two components would not interact.

ICEA believes it is important that the IPA consider this approach at minimum when the IPA designs its models. However, ICEA would be happy to discuss other scenarios, including 100% fixed price full requirements in 2015/16.

Finally, the IPA notes that implied in this Question (and explicitly mentioned in Question 5) is how fixed price full requirements would be implemented in the Ameren service territory. Although ICEA's recommendation last Procurement Plan focused on ComEd because of the limited expected energy procurements on behalf of Ameren, Ameren and ComEd should be treated in a consistent manner.

5. Please suggest models for how full requirements procurement could be phased into the existing ComEd and Ameren portfolios previously procured by the IPA.

ICEA Response: Please see ICEA's response to Question 4 above. ICEA recommends integrating fixed price full requirements into the IPA's 2015/16 delivery year portfolio, and further integrating fixed price full requirements in future years in the same manner. As noted above in Question 4, ICEA believes that Ameren and ComEd should be treated in a consistent manner.

6. The analysis conducted by PA Consulting for the IPA as part of the 2014 Procurement Plan included assumptions that suppliers bidding in a full requirements procurement would hedge their price exposure with forward contracts. Please provide input on what models suppliers use for estimating the costs and risks (including, but not limited to, price and load risk) that they bear as a full requirements product supplier and what inputs the IPA should consider when modeling supplier bidding behavior in a full requirements procurement.

ICEA Response: ICEA respectfully notes that each supplier's model is highly confidential and competitively sensitive. Each supplier's risk model is what allows it to price its retail products, including retail fixed price full requirements products. Because the confidentiality of these models is so paramount to each supplier, even revealing the exact inputs would be a concern to individual suppliers.

Responding further, if one wants to know about the price of a gallon of milk, one could perform that analysis based on an analysis of the market prices of a wide range of inputs to the cost of producing milk. Alternatively, one could walk to the grocery store and look at prices milk for sale on the shelf. In last year's Procurement Plan, the IPA took the former approach, while the NorthBridge Report (particularly with regard to the PECO service territory, a territory which had price data for both full requirements products and block products) took the latter approach. ICEA believed, and continues to believe, that the best way to determine the residual compensation or otherwise benchmark fixed price full requirements offers is to look at other fixed price full requirements procurements and evaluate using contemporary market prices and other relevant context.

Finally, ICEA recommends that the IPA make sure that whatever factors the IPA models that the IPA does not arbitrarily cut off the "tails" of the modeled value. As ICEA noted in the discussion surrounding the last Procurement Plan, the highest price outcomes were not considered by the IPA's model, but those scenarios are exactly the scenarios where fixed price full requirements provides the most value to customers.

7. To what degree, and how, could the potential benefits of procuring full requirements products (as compared to a block procurement approach) be quantified rather than qualitatively described? What are some of the relevant risk metrics that should be included in such an analysis, and how should they be compared to known procurement costs? Additionally, what are some of the inputs and variables that must be appropriately captured in order to quantitatively assess potential benefits? Are there benefits of the block procurement approach (as compared to a full requirements approach) that could also be assessed and quantified?

ICEA Response: In the 2014 Procurement Plan, ICEA provided a detailed study by the NorthBridge Group ("NorthBridge Report") that explained how NorthBridge compared the relative performance of fixed price full requirements and block-and-spot. Although available on eDocket and the IPA's website, ICEA attaches the NorthBridge Report as Appendix 1 to these Responses. In addition, NorthBridge identified the following inputs and variables that must be appropriately and robustly incorporated in order to quantitatively assess and compare the two approaches:

- Volatility in forward and spot energy prices
- Mean reversion in forward and spot energy prices
- Variability in load forecasts and subsequent forecast error
- Correlations between movements in load/energy price forecasts
- Correlations between load/price outcomes
- Cost and variability associated with intra-month load-weighted energy costs, and their correlations with overall price and load levels
- Characterization of customer migration behavior, including its relationship to savings opportunities
- Realized non-energy costs/credits (e.g., ancillary services, MLC, ARR) and their variability
- Fluctuation in customer load factors
- Timing of rate setting; period for which rates are set

- Mechanisms for deferred cost under/over recovery
- Costs of maintaining collateral to support deferred cost recovery balances
- Market evidence of residual compensation embedded in Fixed Price Full Requirements (FPFR) contracts after accounting for energy-related costs, ancillary services, ARRs, MLCs, RECs
- Market evidence of pricing of block products relative to contemporaneous market forwards

ICEA further wishes to clarify that fixed price full requirements serves as an insurance policy to eligible retail customers against adverse impacts of customer migration and other factors. As with any insurance product, an adverse outcome (against which someone insures) may or may not actually occur. Additionally, the value of the insurance is not solely determined by whether the anticipated risk actually occurs. To illustrate, purchasing fire insurance for ten years is not a poor investment simply because one's house did not burn down during that time period.

One effect that ICEA believes will be difficult to quantify is the effect on the retail market and customer confusion of the current block and spot approach. Because the PEA fluctuates monthly and is not possible to predict over the course of a year (especially as utilities have proposed changes to how they deal with positive or negative balances in the PEA account), end users may become confused, and it is more difficult for suppliers to present a comparison. ICEA believes that eliminating this confusion will be a benefit of adopting a fixed price full requirements approach.

Finally, as ICEA noted in its response to Question 2 above, the definition of fixed price full requirements products should only include component products where there is a market—and thus price uncertainty. Mitigating market uncertainty is where suppliers add value to eligible retail customers.

8. The IPA's traditional procurement approach hedges in the forward market a percentage of expected load taking into account market conditions. In the 2014 Procurement Plan, the IPA hedged 106% of average load for the summer months to mitigate shaping risk, and for the first time, the IPA is planning a fall procurement for ComEd to adjust the balance of the current delivery year supply to balance an updated summer load forecast. The goal of this second procurement is to reduce load risk. Given the legislative mandate of the Agency to "develop 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," are there strategies other than full requirements procurement and the IPA's current approach that the IPA could consider for managing risks?

ICEA Response: ICEA is not aware of any procurement approaches that manage risk as well as or better than fixed price full requirements.

9. During the workshop the idea was raised that there may be ways to achieve rate stability other than utilizing a full requirements supply strategy. How could the utilities provide firm prices for a defined period through a tariff mechanism? Could the utilities adjust the PEA on an annual

basis, as opposed to a monthly basis? Would a "rate stabilization account" approach add unnecessary costs? Are there ways to achieve additional utility price/rate certainty while utilizing the IPA's current competitively-bid block procurement strategy?

ICEA Response: Please see ICEA's Response to Question 8.

Responding further, ICEA opposes the two specific examples in the question as potential mitigating strategies. First, adjusting the PEA yearly (to the exclusion of monthly adjustments) would simply delay the price signals of spot procurements further, and at times artificially deflate the price to compare relative to the retail market. Second, the only "rate stabilization account" that ICEA is aware of in Illinois is in Section 9-220(h-2) of the Public Utilities Act. ICEA is further unclear who would pay into or receive benefits from the rate stabilization account identified in this question, who would administer the account, the event(s) that would trigger a payout, and the effects (if any) of the account holding insufficient funds for the intended effect. In addition, ICEA is concerned about potential cross-subsidies, muting of market signals, or the potential for the account to be insufficient to meet its stated purpose.

10. Please provide examples of studies or other evidence that assesses or quantifies the interest of Illinois residential (and/or small commercial) customers in firm rates. To the extent available, please correlate those examples to evidence of customer choice and switching. Please also provide examples from other retail markets.

ICEA Response: As an initial matter, ICEA respectfully suggests that the focus of this question should be on those eligible retail customers who will not shop in the retail electric market. This is because other end users have either expressed their preferences already by choosing a supplier rate, or will access the retail market in the future and select the product with their optimal level of price stability, savings potential, and green/value added options. Thus, the level of interest by residential and small commercial customers generally in firm rates is not relevant because such a large percentage of those customers have selected or will select a product that meets their preferences on the retail market.

ICEA understands that there currently are some customers who—virtually without regard to market options or education efforts—cannot or will not explore different market rates. ICEA respectfully recommends that the IPA consider these customers in deciding how to propose balancing rate stability with volatility that mechanisms like the block-and-spot approach bring. ICEA is not aware of any recent studies, especially in Illinois, that seek the preferences of this population.

Finally, while there are a wide range of retail products available on the market today, ICEA's members anecdotally understand that fixed price products to be popular in Illinois and elsewhere. The experience of ICEA's members is that a significant segment of customers appreciate the certainty. ICEA notes that in spite of significant outreach and consumer education, the "opposite" product from fixed price full requirements—utility residential real-time pricing—is significantly less popular even though

retrospective studies have found that residential real-time pricing customers have saved over time versus the bundled rate.