Energy Choice Matters

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Diversity Gets Direct Over Slump in Mass Market

Despite challenges in its Ontario and ERCOT mass market businesses, Direct Energy operating profits rose 17%, driven by robust larger C&I business, wholesale operations and home services.

The Centrica subsidiary posted operating profit of $373 million on revenues of $8 billion, a 7% rise year-over-year.

"One-off" incidents hurt mass market profits, Direct Energy CEO Deryk King told analysts.

In Ontario, Direct had a wealth of five-year contracts from the initial market opening expire, and faced significant customer churn. Residential sales in the province ticked up after a third-quarter sales push and volumes started to rise again in November as new customers started flowing.

King always expected ERCOT margins to fall but not as drastically as they did when TXU Energy slashed its mass market prices 15% in response to political pressure as it was bought out by a private equity firm. Those price cuts left Direct Energy contracts out of the market, increasing churn and bad debt, King explained.

Direct has stabilized its Texas business, King told investors.

Mass market revenue fell 4% to $4.9 billion while operating profit was down 16% to $244 million for the year.

Direct's larger C&I business transitioned from its initial build phase and posted its first full-year operating profit, King reported.

Larger C&I revenue was up 25% to $2 billion with volumes up 13% in natural gas and 24% in electricity. Operating profit hit $2 million overall on the strength of Canadian and ERCOT business which offset expansion costs in new markets. King touted the "increasingly active" Northeast U. S. as a growth area for Direct.

Home services saw "significant improvement," added Nick Luff, parent Centrica's finance director, as customer count grew 3.5% to over 2 million and operating profit rose to $34 million on

... Continued Page 6

PJM's New CONE Still Too Low, Generators Claim

CONTINUING COVERAGE

Not only does PJM need to update Cost of New Entry (CONE) figures in its Reliability Pricing Model to reflect higher costs, but PJM's proposed numbers are too low, generators told FERC (ER08-516).

PJM proposed new CONEs of $106,904/MW-year in eastern PJM, $105,414/MW-year in central PJM, and $104,260/MW-year in western PJM, prompting a protest from the Virginia SCC (Matters, 2/14/08).

But the PJM Power Providers Group (P3) supplied an analysis showing PJM's calculations understated rising costs by 10.6% to 28.1%.

P3's study "further underscores the concern previously raised by the PSEG Companies that the assumed rate of return of 12% was too low for this type of business," PSEG argued.

PSEG also complained that CONE does not include environmental requirements some states impose on generators, and cautioned that without an environmental adder in CONE, RPM will not "fully realize the promise of providing generation with the correct price signal to encourage construction in the right locations."

Not updating the CONE figures before the May 2008 auction would be "detrimental to the long-term viability of RPM and put at risk the expectations of parties willing to take on new investment

... Continued Page 6

Surges and Circuits

A weekly review of what's up and down in energy markets.

Power Surges

Connecticut Mass Market Customers: Draft price disclosure rules and a new pricing website (Matters, 2/18/08) should make shopping for power more transparent, and thus easier. Although it might take some refinement to standard service, we see Connecticut ready to leapfrog New York as the clear second-best market behind ERCOT, because of policies that empower customers such as the disclosure rules. We do not think it is a coincidence that the market with the most active mass market also has the longest-running price discovery website, despite complaints from retailers about reporting burdens or limitations on dynamic and custom products. While those concerns may be valid, retailers cannot complain about customers refusing to migrate from standard service when retailers make the process overly difficult by not enabling a clearing house for mass market offers and instead expecting customers to undertake the arduous task of calling several retailers for quotes, or unwisely taking the first offer they get in a solicitation. If shopping isn't simple, customers simply won't shop.

Short Circuits

Critics of Wholesale Competition: It hasn't been a good week for those opposing wholesale competition. First the Supreme Court appears skeptical of overturning contracts between sellers and Western utilities struck during the region's energy crisis. Next, generators develop what we think is a convincing record to dismiss a complaint from the Maryland PSC to end price cap exemptions for certain generators in PJM, at least on a retroactive basis. Yesterday, FERC's review of organized markets provided only modest reforms and its policy to take mitigation away from market monitors will probably upset critics of competition. Finally, APPA's CEO, while listing a host of problems with today's markets, claimed he did not want a return to ratebased generation.

IPPs: MISO Reactive Power Plan Would Give Transmission Owners License to Discriminate

Generators hammered a Midwest ISO proposal that would give transmission owners the power to favor their generation affiliates when it comes to reactive power (FERC docket ER08-15).

MISO proposed adopting new Schedule 2-A under its Transmission and Energy Markets Tariff which would eliminate compensation to generators providing Reactive Supply provided within a 0.95 leading and 0.95 lagging "deadband."

Transmission owners (and in some cases, non-transmission owning distribution utilities) would get to pick whether they would use the Schedule 2-A, or the current Schedule 2 which compensates generators for the service.

"The discriminatory impact could not be clearer," Reliant Energy warned.

"[T]he most troubling aspect of this proposal is that this discrimination occurs not because of the independent judgment of the Midwest ISO, but at the discretion of the utilities that are direct competitors of the independent generators that will be deprived of compensation," Reliant added.

"Comparability requires that all generators in the Midwest ISO be compensated under either one regime or the other," Exelon noted.

"It is even more egregious, however, if, as it appears, generation owners within a given zone are determining whether their generation competitors will be compensated for supplying reactive power within the deadband," Exelon cautioned.

First Energy Solutions cautioned that the MISO's proposal could harm resource adequacy.

"The disparate methods of compensating generators to supply reactive power in different regions of the Midwest ISO may result in a lack of incentives for generators to build new capacity in certain regions. In turn, the failure of generation owners to develop capacity in places where it is most needed may have an adverse effect on the reliability of the Midwest ISO transmission grid," First Energy argued.

FERC "First Step" on Wholesale Market Reform Rejects Radical Changes

FERC proposed modest changes in RTOs to make competition work better but resisted radical change some parties have been calling for (AD07-7 and RM07-19).

FERC focused on reforming four areas of RTOs: demand response, long-term contracting, market monitoring and RTO governance and responsiveness.

Stressing that the NOPR issued Thursday was not the "final step" in FERC's review of markets, Chairman Joseph Kelliher assured stakeholders FERC is continuing to evaluate other reforms but did not want to delay these improvements in the interim.

While FERC boosted the independence of market monitoring units, it also removed market monitors from tariff administration, including mitigation -- a proposal which caused some split among Commissioners and will likely generate heated debate in comments from state regulators and consumer advocates.

Commissioner Suedeen Kelly argued the conflict of interest in having RTOs and not their monitoring units administer mitigation presents a greater conflict of interest than having the monitoring units perform mitigation.

FERC would require RTOs to have market monitors report directly to the RTO's board, rather than management, and require RTOs to provide market monitors with access to market data, resources and personnel necessary to fulfill their duties.

The Commission would shorten the time period for posting market bid and offer data and require RTOs to provide market monitoring reports to state regulators.

Commissioner Philip Moeller stressed that consumers need to understand that just and reasonable rates from competition do not mean the lowest possible rate at all times.

He reminded customers of the "long" and "painful" transition into telecommunication competition, but noted the wealth of benefits it has brought consumers.

Moeller also noted complaints from green power and demand response providers who face challenges in unorganized markets, suggesting the grass isn't always greener on the other side.

FERC's proposal would make RTOs accept bids from demand response for certain ancillary services comparable to how other resources are treated, and would allow an aggregator of retail customers to bid demand response on behalf of those customers.

The Commission would also eliminate a charge to a buyer for taking less energy in the real-time market than it purchased in the day-ahead market when a system emergency exists.

Moeller stressed that demand response should be treated comparably in RTOs but should not receive a subsidy.

FERC also ordered RTOs to implement scarcity pricing during operating reserve shortages. Kelly objected to that proposal, since all the RTOs except SPP either have scarcity pricing or, in the case of the Midwest ISO and California ISO, have a timeline to implement it. Kelly argued that SPP should be allowed to adopt scarcity pricing when it feels ready.

The NOPR does strengthen consumer protections during scarcity pricing from the original advanced rulemaking, though, by requiring an adequate record demonstrating that provisions exist for mitigating market power and deterring gaming behavior, including use of demand resources to discipline bidding behavior to competitive levels.

To promote long-term contracting, FERC would require RTOs to create a bulletin board on their website for buyers and sellers to post offers.

FERC ordered RTOs to adopt principles to ensure inclusiveness and fairness in balancing diverse interests.

FERC is to hold two technical conferences – one on barriers to demand response and the second on proposals from the American Forest and Paper Association and Portland Cement Association to modify the design of organized markets.

PJM's Flawed Credit Fix Would Not Have Prevented Recent Default

CONTINUING COVERAGE

Financial marketers told FERC (ER08-520) that PJM's fix for defaults in the Financial Transmission Rights (FTR) market would not have protected members from the default of Power Edge and thus inappropriately raises costs to traders without benefiting members (Matters, 2/21/08).

DC Energy explained that during the 2007-2008 Annual FTR Auction, Power Edge acquired 35 MW of FTRs along the Atlantic to Trenton path at a weighted average price of $250/MW-year. Although that path cleared positively, and thus would not have been subject to the additional collateral requirements established by the proposed amendments and PJM's definition of "counterflow," the value of the path plummeted drastically during the 2007-2008 planning year. The path alone accounted for $1.9 million of Power Edge's losses, yet, because the Atlantic to Trenton FTR cleared positively, the Proposed Amendments would not have applied.

Epic Merchant Energy and SESCO Enterprises criticized PJM's reliance on the overall clearing price of a market participant's FTR portfolio to determine whether the participant is at risk of default.

"The cleared value of an FTR portfolio has little relation to the relative risk that a particular Market Participant has assumed, and cannot reliably be used as the basis for imposing additional collateral requirements," Epic and SESCO said.

The PJM proposal would not even result in additional collateral requirements for many Market Participants engaging in high risk transactions, they added.

PJM's rules would instead unnecessarily inhibit access to the marketplace while not materially decreasing the risk of default, the traders claimed.

DC Energy urged FERC to hold a technical conference on PJM credit rules.

FERC Asserts Capacity Jurisdiction

FERC affirmed its ability to regulate capacity in two orders yesterday (ER05-715, ER07-429).

FERC accepted on remand ISO New England's 2005/2006 Installed Capacity Requirements (ICR), telling the Connecticut DPUC that FERC has authority to approve the ICR because the ICR is one of the principal determinants of the price of capacity and therefore falls within the Commission's jurisdiction to review "any rate, charge or classification" charged by a public utility for electric transmission or sales subject to Commission jurisdiction.

The Federal Power Act charges FERC with the responsibility for ensuring that jurisdictional rates and charges are just and reasonable -- including any rule, regulation, practice or contract affecting them.

Similarly FERC rejected a protest from the New York PSC over the New York State Reliability Council's ICR for the New York Control Area for the 2007-2008 Capability Year.

FERC had approved a reduction in the associated installed reserve margin from 18% to 16.5%.

In a separate docket (ER08-414), the Independent Power Producers of New York told FERC the 2008-2009 IRM should be adjusted back to 18% because the New York ISO now expects 500 MW of added wind generation to come online, which would increase the IRM due to wind's intermittent nature and "significantly lower equivalent availability during peak periods."

Briefly:

Large C&Is with Nstar to Get Price Break

Second quarter larger C&I prices at Nstar are to fall 3% April 1 upon DPU approval of the latest basic service RFP results. Medium and large commercial customers using more than 25,000 kWh/month will see the price of power drop from 11.024¢ to 10.657¢. About 1,000 larger C&Is remain on Nstar basic service rates.

NRG Loses Conn. Court Fight

A Connecticut Superior Court judge rejected NRG Energy's appeal of a DPUC decision that awarded ratepayer-backed, long-term contracts to several new power plants. NRG had claimed the DPUC picked a more expensive plant over its 630-MW Montville proposal.

New CEO for Commerce

Commerce Energy named Gregory Craig CEO after Steven Boss resigned Feb. 20. Craig was formerly CEO at Macquaire Cook Energy (previously Cook Inlet Energy Supply), an energy supply service company.

Focus on Fixing Grid, EPSA Tells Entergy

Entergy's weekly procurement process (WPP) should not start May 17 as scheduled because of its "troubled development" and last summer's rash of curtailments, service interruptions, and transmission loading relief events on Entergy's system, EPSA told FERC (ER08-513). "EPSA believes that Entergy's resources would be better spent on shoring up its system, rather than submitting complex proposals that may or may not result in better transmission operations," the IPP group said. The WPP is intended to optimize Entergy's native load dispatch by integrating IPPs into the dispatch.

BGE, Constellation Again Called Before Md. PSC

CONTINUING COVERAGE

The Maryland PSC has set another hearing to ask questions about Baltimore Gas & Electric ratepayers' decommissioning liability, and this time it explicitly requested representatives from parent Constellation Energy to attend (Matters, 2/7/08). The Commission's Order 81860 specifically orders company reps who can discuss the specifics of the nuclear fund and other issues to attend the Feb. 26 hearing.

UI RFP Approved

The Connecticut DPUC approved United Illuminating's January/February RFP for standard service and SOLR service. UI can now execute contracts and translate the results into retail rates for 2009 standard service and second-quarter 2008 SOLR service.

ISO New England Must Fix Long-Term Grid Rights

FERC has ordered ISO New England to change parts of its plan to implement long-term transmission rights, concluding that the ISO's plan doesn't allow customers to buy rights outside of an auction, as required by law. The ISO's plan also does not accommodate various length supply contracts, FERC noted (ER07-476, RM06-8).

PUCT Staff Can Start Investigation, It Reminds Luminant

CONTINUING COVERAGE

The PUCT staff told the Commission that P.U.C. PROC. R. 22.144(a) expressly allows the staff to request initiation of a formal investigation and initiate discovery after it files its request (docket 34996). Luminant had argued that discovery in a case concerning an inaccurate ERCOT resource schedule was inappropriate since the Commission had not yet initiated an investigation (Matters, 2/14/08), but the staff pointed out rules do not require a formal order from the Commission to be issued. The staff also objected to Luminant's proposal to continue the investigation informally, as staff reported that, "Luminant itself is thwarting Staff's efforts to obtain key documents by claiming they are privileged, and the Company has not agreed to allow Staff to interview key employees under oath."

FERC OKs Cross-Subsidization Rules

FERC approved new cross-subsidization rules that restrict affiliate transactions between franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities, and their market-regulated power sales affiliates or non-utility affiliates. Commissioners noted states' jurisdiction in protecting retail customers from cross-subsidization and said that FERC would only aggressively act where states do not have power to prevent cross-subsidization or wholesale customers were otherwise not being protected in state proceedings.

WSPP Rate Cap Not Just and Reasonable

Wholesale traders without market-based rates (MBRs) will have to justify their use of a Western Systems Power Pool Agreement demand charge ceiling rate if they wish to use the rate instead of their own specific cost-based rate, FERC ruled yesterday.

FERC found the WSPP Agreement to no longer be just and reasonable where the seller applying to use the rate cap doesn't have market-based rate authority.

Many wholesale sellers have proposed mitigating their market power by selling at the WSPP cap, prompting a FERC investigation.

The WSPP cap doesn't have a nexus to the seller's own costs, and allowing its continued use for sellers without MBRs "would effectively let those sellers sidestep the more rigorous market-based rate test that we have put in place in recent years," FERC Chairman Joseph Kelliher said.

Though the WSPP rate is cost-based, its flexibility could allow a seller with market power use the rate cap to sell above the seller's own cost-justified charge.

NY Still Needs More Power By 2012

New York still needs additional resources by 2012-2013 meet reliability needs, as the clock ticks away on market solutions filling the gap, the New York ISO's Power Trends 2008 report found.

Still, that's one year later than when the state was to need more capacity according to the NYISO's 2007 report, a result of upgrades and additions made by generation and transmission owners in response to the planning processes, the ISO said.

By 2012 New York City will need 500 MW, or a total of 750 megawatts with 250 megawatts each in the Capital region, the mid-Hudson Valley, and New York City.

The state needs 2,750 MW by 2017. Stakeholders including New York City have argued the looming power shortage compels the state's PSC to mandate utility long-term contracts for power supplies to get generation built. But the "past two cycles of the Planning Process have produced more than sufficient market-based project proposals to meet the identified reliability needs and the NYISO expects that trend to continue in this year's cycle," the ISO said. The reliability need is driven by load growth in excess of 2% per year in the lower Hudson Valley, New York City and Long Island as well as generator retirements, and thermal transmission constraints into those regions.

Direct Energy ... *From 1*

flat revenue, thanks to aggressive cost-cutting.

Direct's upstream wholesale businesses were "very strong," Luff noted, with operating profit up 164% at $93 million.

King emphasized Direct's diversity among mass market retail, larger C&I retail, wholesale and home services as mitigating impacts from the economic downturn. He stressed Direct will continue to build its upstream business and focus on the larger C&I market to enhance this diversity.

Direct is well positioned to offer energy efficiency to customers who are economic minded and climate change aware, Centrica CEO Sam Laidlaw added.

RPM CONE ... *From 1*

risk," Reliant Energy added.

Rockland Electric, though, thinks the proposed CONE isn't justified and its two-year basis is too short of a time window to view changing costs. Rockland noted that the 21% rise in CONE overall is a "sharp" increase over the inflation rate of 2.5% that PJM used in the analysis of CONE in 2004-2005. The proposed inflation rate overstates the magnitude of likely cost increases, Rockland explained.

"PJM offers no economic theory as to why the equipment and installation costs, which have increased sharply over the past two years, would continue to increase at the annual rate experienced over the last two years," the utility said.

"Past experience shows that equipment cost increases are sometimes followed by cost decreases or stabilization as manufacturing capacity bottlenecks are eliminated or demand for equipment decline," Rockland added.

Noting the economy is slowing, Rockland suggested construction activity will falter over the next two years and suggested using a longer period to view inflationary trends and to avoid a single extreme point distorting results.

The Ohio Consumers' Counsel argued that PJM's proposed change, "unravels a significant element of the settlement – CONE – when the RPM market has been implemented *less than a year*."