Energy Choice Matters

March 3, 2008

Maryland Sues Constellation in Preemptive Move Over $386 Million

Maryland preemptively sued Constellation Energy over $386 million in nuclear decommissioning credits from 2006's SB1.

Constellation had told investors in January that it intended to sue the state over the credits which were originally offered to gain favor for Constellation's since-withdrawn merger with FPL (Matters, 2/27/08). The legislature incorporated them into SB1 and Constellation considers them an illegal taking. Constellation plans to file its suit today.

"The $386 million rightfully belongs to Maryland ratepayers, and we will do everything in our power to make sure that this cost is not passed on to consumers," Gov. Martin O'Malley, D, said. O'Malley campaigned on promises to lower electric rates and protect ratepayers from deregulation.

"In this time of economic uncertainty for so many of our families, it is unfortunate that Constellation would seek to further boost its profits on the backs of the working people of our state," O'Malley added.

Maryland filed its suit in Baltimore City Circuit Court, since SB1 requires any suit over the law to be filed there. Constellation does not believe such a requirement is constitutional and intends to file suit in federal court.

Meanwhile General Assembly leaders are set to unveil measures aimed at recovering any costs from the 1999 Baltimore Gas & Electric deregulation settlement that policymakers feel may have been improperly charged to consumers. The PSC has been investigating whether it can force Constellation to refund to ratepayers any costs paid into decommissioning funds above what is needed to close that plants.

Mirant Still Eyeing Potential Growth at Right Time

Mirant is continuing to study adding new capacity at brownfield sites but CEO Edward Muller continued to stress the IPP was not going to invest until it's "prudent," meaning regulatory and market conditions support long-term investment.

On an earnings call, Muller noted declining reserve margins across the markets where Mirant has existing capacity and expansion capabilities, noting the IPP's focus will be on repowering or redeveloping sites near major metropolitan load centers.

The IPP is preparing to respond to Pacific Gas & Electric Requests for Offers and identified 2,500 MW to 3,000 MW of new capacity in California. Mirant has the potential to add 1,000 MW to 1,500 MW in New England and 4,000 MW to 5,000 MW in PJM.

Specifically, Mirant is examining turning peaking capacity into combined cycle capacity and building new gas-fired peakers in California.

Muller stressed he isn't considering adding any coal-fired capacity. Not because he doesn't believe it's a needed part of the bulk power system's mix, but because "political realities" mean building coal would leave Mirant, "tilting at windmills, which is not our business," Muller explained.

Muller also noted "rising concern" about higher power prices in Maryland stemming from the state's participation in the Regional Greenhouse Gas Initiative:

"I think in the beginning of this, as RGGI was coming along, there was a perception that it was a

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Calif. Moving Ahead on Studying Renewal of Direct Access Despite Need for DWR To End Supply Role

Phase II of the California PUC's investigation into lifting the suspension on direct access is to continue "expeditiously" despite the PUC's finding that direct access for all customers cannot resume until the Dept. of Water Resources stops supplying power under contracts to the state's IOUs.

In a decision made available Friday (R.07-05-025), the PUC said it will move ahead, "to consider permissible steps whereby DWR could be removed from its role as power supplier under AB1X on an expedited basis."

Approaches include assigning the DWR contracts to other parties, or terminating the DWR's ownership interests earlier than the contracts' current expiration dates, the PUC noted. The PUC could also alter the flow of power under the contracts so that the title to the power would move to a third party before any possible resale to retail customers.

Under the latter approach, an energy auction could open up access to the DWR contract power to all LSEs and the regional markets in a way that would negate the need for new or more complex non-bypassable charges.

The IOUs could make the DWR power available to the system by simply bidding the power into the California ISO integrated forward market based on each contract's underlying economics, rather than self-scheduling it without economic bids, retail market proponents observed.

Under such a system, the PUC would avoid negotiating with individual counterparties since terms of the existing contracts would not be changed.

Regardless of the approach, the PUC would need to consider whether retail prices, or service reliability, would be affected and whether IOU assumption of additional financial obligations could adversely affect their debt equivalence, credit ratings, or costs of capital. The potential effects on utility procurement planning would also be considered, and the PUC would need to protect the interests of DWR Bondholders.

The process of removing DWR from the supply business may be more manageable in 2010 when the remaining long-term DWR contracts are expected to cover only 15% of the IOU requirements, the PUC noted. The vast majority of DWR contracts are scheduled to expire by 2011.

Generators Fault Latest Calif. ISO Backstop Reliability Plan

A host of generators attacked the California ISO's proposed Interim Capacity Procurement Mechanism (ICPM) as discriminatory and blunting signals needed for new capacity investments (FERC docket ER08-556 et. al.).

The ISO's proposal, designed to be a backstop in case LSEs violate PUC resource adequacy requirements (RAR) or if ISO modeling is incorrect, "will undermine the existing capacity procurement programs ... and will ultimately work at odds with the MRTU [Market Redesign and Technology Upgrade] design that the CAISO is endeavoring to deploy," Constellation Energy and Mirant claimed.

Constellation and Mirant object to the ISO's proposed use of its backstop authority for "Significant Events," which the generators believed are not properly defined.

For example, a Significant Event could include loss of a power plant or transmission line, but those events are the, "precise types of specific, transitory events for which a Planning Reserve Margin exists," Constellation and Mirant explained.

Significant Events could also include changes to forecasts or established reliability criteria or laws. But those events should not impose new obligations during an existing planning period, the generators argued, in order to avoid disrupting markets. Such changes should be implemented in the next year's planning process.

Constellation and Mirant explained that for such short-term emergencies categorized as Significant Events, the grid actually needs energy, not capacity, and implementing backstop capacity procurements would only expose customers to higher capacity costs without enhancing reliability.

Additionally, the generators claimed that by procuring capacity under backstop authority during scarcity conditions (instead of procuring energy), the ISO would, "undermine market signals that influence investment decisions and the effectiveness of the demand response" because the ISO is essentially procuring capacity in place of energy and ancillary services.

The ISO proposed "very stringent" local and system mitigation under MRTU which prevents prices from rising sufficiently to reflect the value of energy and ancillary services when an emergency occurs on the system, Constellation and Mirant pointed out, arguing the ICPM is a hedge to account for that failure.

Constellation and Mirant also want FERC to ensure that if it does accept the ICPM, that the ISO is prohibited from entering into any new Reliability Must Run agreements.

The Independent Energy Producers Association sees the ICPM continuing the pricing discrimination present in the CAISO market. New and existing capacity are paid different prices for same capacity, IEP complained, pointing to the exorbitant, ratepayer-backed price of new peakers built by Southern California Edison. The ICPM is a mere band-aid that would not fix structural problems which disadvantage existing generation, IEP argued.

"The CAISO's proposed capacity payment does not reflect economic reality or current costs and, by the time MRTU becomes effective, the proposed capacity payment will be even more outdated and noncompensatory," Dynegy, NRG Energy, and Reliant Energy added.

Under ICPM, generators would be paid $41/kW-year, but Dynegy, NRG Energy, and Reliant Energy argue the payment should be $117/kW-year, with monthly payments shaped to reflect the higher reliability needs of summer months.

The generators see ICPM as the ISO's means to escape a permanent fix to the lack of a working capacity mechanism:

> "If the CAISO always has access to inexpensive, short-term, 'after-the-fact' reliability insurance through its backstop capacity procurement mechanism, there is no incentive to develop and enforce RA requirements that provide the CAISO with the capacity it really requires to maintain reliability. Conversely, there is little to no incentive for investors to risk capital in a market whose prices and requirements are undermined by such practices. Moreover, if the CAISO can continue to procure capacity reliability service – the exact same capacity reliability service provided by RA units, namely, remaining available to respond to CAISO instructions when required – from non-RA units and pay only a small fraction of their going forward costs and little or no return on a unit's capital cost for that service – then the owners of such units remain captive to the no-win choice of trying to earn their existing units' fixed costs out of the CAISO's highly mitigated markets or abandoning investment in new capacity – clearly a choice between two undesirable options," generators told FERC.

Dynegy, NRG and Reliant also called the CAISO interim proposal untimely, since they doubt MRTU will be implemented before this summer. A rushed FERC decision on ICPM is not needed, they explained.

But the Alliance for Retail Energy Markets (AReM) thinks the ICPM, though far from perfect, represents, "a balanced package that minimizes, but does not eliminate, the pricing effect of the backstop service on the RA capacity market."

AReM thinks the ISO's proposed pricing is appropriate given the short-term nature of the program (which would last until 2010) and ongoing discussions at the Calif. PUC on a long-term resource adequacy mechanism.

AReM wants to avoid a repeat of the its experience in the RA capacity markets from 2006 through 2008, in which prices established for capacity procured through the Reliability Capacity Services Tariff (RCST) drove prices in the RA market, adding millions of dollars in costs for consumers with no corresponding increase in reliability benefits.

The ICPM backstop prices, "should not be the proverbial tail wagging the RA dog," AReM added.

Prior to the RCST, capacity prices were

"relatively reasonable and met expectations," given contemporary energy prices, AReM told FERC.

But in 2007 capacity prices rose significantly because the PUC used an estimate of the price for the capacity portion of the RCST procurement ($40 per kW-year) as the trigger by which LSEs could request a waiver from meeting the Local RA requirements. Accordingly, capacity prices to, and in some cases, exceeded the trigger, AReM explained.

"While 'price signals' may be appropriate for the primary RA capacity market, they are not germane to backstop procurement, which is needed simply to fill-in small chunks of capacity from existing generation for a short period of time to meet transitory reliability needs," AReM argued.

AReM expects, based on history with the RCST, that backstop procurement will be small, topping out at a few hundred megawatts.

Procuring those few hundred megawatts cannot be allowed to drive prices for the 50,000 MW that LSEs must purchase under local resource adequacy rules, AReM said.

Briefly:

Pepco Energy Services Load Up More Than 20%

Pepco Energy Services' retail load served at the end of the year hit 4,294 MW compared with 3,544 MW to end 2006. Fourth quarter retail sales were up too, at 4,903 GWh for the fourth quarter of 2007 versus 3,769 GWh in the 2006 period. That 30% increase stems primarily from added C&I customer load in existing and new markets, Pepco said. Conectiv Energy's gross margin on Merchant Generation and Load Service was $66.5 million in the fourth quarter of 2007, compared with $49.1 million in 2006 quarter. A 95% increase in generation output, improved energy spark spreads, and higher capacity prices powered the gain, with some growth offset by hedges. Parent Pepco Holdings reported fourth-quarter earnings of $57.8 million versus $36.3 million a year ago. Pepco is holding an earnings call today.

Calpine CEO to Leave as Job is Finished

Calpine CEO Robert May, a turnaround specialist who led the IPP through two years of bankruptcy, is leaving and a successor has not yet been named. May saw the merchant generator turn its first annual profit since 2006 with $2.7 billion in earnings for 2007, compared with a $1.8 billion loss in 2006. For the fourth quarter, Calpine narrowed its loss to $142 million from $360 million a year ago. During an earnings call, Calpine touted its gas-fired fleet and said it was positioned to benefit from greenhouse gas legislation. The IPP also noted the weighted average age of its fleet at less than 10 years compares favorably to the age of competitors' plants. High costs of new construction are likely to contribute to tighter supply and demand balances, as well as improved long-term contracting opportunities for existing assets, Calpine added. Future nodal markets in California and ERCOT may also provide short-term upside to Calpine's assets, particularly those located in congested areas, the IPP said.

Maine Public Service Exploring Joining ISO New England

Maine Public Service has asked ISO New England to consent to MPS becoming an Additional Participating Transmission Owner, subject to certain conditions (Maine PUC docket 2006513). MPS would only join the ISO if the costs of a transmission upgrade to connect to the two systems (called the Maine Power Connection), and the costs of portions of MPS's existing grid, are included in the ISO's regional rates in a manner that benefits MPS customers. The Maine Power Connection would have to be built as a system reliability and market reliability upgrade included in the ISO's Regional Network Service rate, MPS added. A preliminary study of the Maine Power Connection found reliability and economic benefits would accrue to both Maine and New England from the grid connection.

CUB to File Energy Savings Complaint Today

The Illinois Citizens Utility Board and other consumer groups are holding a news conference today to announce the filing of formal complaint against U. S. Energy Savings at the ICC. CUB's complaint alleges deceptive marketing in Energy Savings' natural gas sales. State AG Lisa Madigan is suing the retailer over similar complaints (Matters, 2/13/08).

NY Reliability Margin Accepted at 15%

FERC accepted the New York State Reliability Council's installed reserve margin (IRM) of 15% for the 2008-09 year (ER08-414), the same day the New York PSC (07-E-0088) OK'd the figure. Both commissions agreed improvement in generator availability, updated transmission topology and improved emergency assistance measures from neighboring control areas justified the council's suggested lowering of the margin from 16.5%, over objections from generators.

FERC Sets Conference on Capacity Markets

FERC has set for May 7 a technical conference to discuss the operation of forward capacity markets in ISO New England and PJM (AD08-4). The conference will consider, among other topics, changes to market design as proposed by American Forest and Paper Association, Portland Cement Association and other parties in FERC's docket on improving wholesale competition in organized markets (RM07-19 et. al.)

ComEd Readies SOS RFPs

Commonwealth Edison this week is set to issue RFPs for 24 blocks of power (12 on-peak, 12 off-peak) to meet default service needs through May 2009 for the interim period before the new Illinois Power Authority runs SOS procurement. Depending on the months, ComEd needs 400 MW to 1,600 MW of power and already has several contracts in place. It plans to make up any difference in the wholesale market. NERA Economic Consulting will administer the RFP.

South Jersey Energy Gets Conn. License

The Connecticut DPUC granted South Jersey Energy's electric supplier license for C&I customers (07-08-23). The retailer will market under the name Halifax American Operating Company (Matters, 2/08/2008).

Md. Type II SOS OK'd

The Maryland PSC in letter orders accepted without modification the Type II SOS rates for all four IOUs that went into effect March 1.

ECS Entering Ontario

Energy Curtailment Specialists has entered the Ontario market with its PowerPay program.

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> free lunch, that it would not affect the consumer at all. There was a sense that there might be some price increase but demand would go down sufficiently so the net bill to consumers would be unchanged, they would use less. I think that notion is somewhat dissipating. I think you see this cap for half of what the in state generators would need as being a recognition that somebody's going to pay for this and by and large it's going to hit the consumer," Muller explained.

Mirant's fourth quarter profits declined sharply to $16 million from $1.3 billion in the year-ago period, mostly on unrealized losses (losses created by keeping an asset rather than selling it and taking the loss).

Adjusted earnings from continuing operations, a non-GAAP figure, grew to $191 million from $94 million in the year-ago period. The gains were attributed to higher energy and capacity prices in PJM.

For the year, earnings hit $2 billion, up from $1.9 billion in 2006.