Energy Choice Matters

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REPs Say Future Won't Include Volumetric Profits

Retail power is a low margin business and it only makes sense to develop solutions that customers are willing to pay for, TXU Energy CEO Jim Burke told attendees at KEMA's 19th Executive Forum in Frisco, Texas.

TXU is investing $10 million over the next five years on smart energy and energy efficiency, Burke revealed.

While that may lower throughput to customers, TXU's business model has to change to adapt to creating and selling value rather than MWhs.

TXU in pilot programs has been putting simple energy management monitors in customers' homes which reflect their consumption and price, but don't have the sophisticated controls and communications of advanced meters.

Nevertheless, customers with the simple monitors lowered annual consumption 5-7%, Burke observed, noting the potential is much higher when usage information can be linked to automated controls.

Making more money by selling less energy is the future, added Reliant Energy Senior Vice President for Business Development Jim Ajello.

But right now it's still largely a commodity business, he noted.

Eventually someone is going to give customers energy efficiency solutions, added

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Retailers Suggest Industry Solution to Complaints, Suspect Marketing

Deceptive marketing among competitive retailers is a "big issue" and retailers need to address the reputation risk threatening not only individual suppliers, but the industry as a whole, Energy Plus CEO Richard Vague told KEMA's Executive Forum.

We asked a panel of growing retailers whether recent, headline-grabbing actions against two separate gas marketers in Michigan (Matters, 2/27/08) and Illinois (3/4/08) indicated whether retailers needed to spend more resources on customer acquisition to make sure they booked quality sales.

The lack of supervision in the marketplace is, "glaring," Vague reported, and he sees "appalling" practices on a "routine basis."

State regulators don't have the budget to chase down all those potential violations, Vague added, warning that the lack of corrective action could backfire.

Vague started Energy Plus (focusing on the New York mass market) last year after a successful stint in the credit card and financial services sectors, where he most recently founded and led Juniper Financial which was later bought by Barclays.

His experience in the credit card world, with similarly complex contracts and consumer confusion, led him to suggest a self-certification program among marketers to confront the problem. Of course, there's already a voluntary statement of principles for the New York market (first developed by Strategic Energy) but just by looking at the New York PSC's complaint database, even firms pledging to follow the rules face customer complaints.

Vague cautioned that the credit card industry had stringent, specific procedures imposed on it to the "n^{th} degree" because of unchecked and uncorrected marketing behavior. Similar

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Regulators Must "Supplement" Markets When Needed, Garry Brown Argues

Although New York PSC Chair Garry Brown favors markets, he recognizes that markets have limitations and sometimes regulators have to supplement what markets do.

Price signals in New York are working to encourage generators to build new coal and nuclear plants, Brown insisted.

It's the lack of an expedited siting law which has prevented additions, aside from a proposed expansion to an existing nuclear plant in upstate New York. As a result, the new generation that is getting built by the market is gas-fired, but that's creating headaches for fuel diversity and generation diversity (baseload, intermediate, peaking) policy goals, Brown noted.

That's why the PSC has taken a look at planning – not an old-style IRP, but charting the course of where markets are headed and what supplements are needed.

Brown noted the "important" role for ESCOs in the Energy Efficiency Portfolio Standard (EEPS) the state is creating. ESCOs have to think creatively on designing programs to participate because the state would give them money for bringing services to customers if ESCOs had concrete offers.

The 15x15 efficiency goal is so dramatic there's room for everyone, Brown insisted – NYSERDA, the utilities and ESCOs.

Good competition beats good regulation on any day, Brown said. But bad competition doesn't beat good regulation, he cautioned.

He urged ESCOs to be good citizens and lamented what would happen to competition if customers' first experiences with choice were negative ones.

Developing a code of conduct for ESCOs is "extremely important," he added.

ESCOs have to remember they are selling the industry at the same time they are selling their product.

When policymakers suggest rolling back choice, he wants customers on the phone with policymakers, asking them how could they dare to take away customers' choice of an ESCO.

Hudson: Judging Competition Premature, But REPs Must Innovate, Communicate

"The era of inexpensive power is coming to an end," PUCT Commissioner Paul Hudson proclaimed at KEMA's Executive Forum.

It's competitive retailers' job to be nimble enough to avoid customer backlash over that looming fact, Hudson argued.

Hudson cautioned that the industry was entering an era of "extraordinary" risks that threatens customers.

Opponents of competition calling markets a failure are premature in their assessment, Hudson said.

But Hudson challenged REPs to innovate and communicate, noting that the contrast between regulated territories and competitive markets was not strong enough to convince customers of the benefits of choice.

He fears REPs will be too slow to adopt a vertical services model where they make money by selling add-ons rather than throughput, because REPs will be caught up in implementing a nodal market and fighting off legislative attacks on competition. But if REPs don't innovate quickly and bring that vertical services model to customers, Hudson sees increased pressure for government interference in the sector.

Hudson urged REPs to focus on viable markets and those on the edge of viability.

The Commissioner reiterated his view, not shared by us, that the number of REPs in ERCOT (at some 100 with 25 active in the residential market) will inevitably decline due to consolidation. He thinks the long-term viability of having some 100 products offered in the residential marketplace is "dubious."

Hudson shared his top priorities for the year, including:

1. Energy Efficiency and Demand Response
2. Renewable Transmission Access / Competitive Renewable Energy Zones
3. Advanced Metering
4. The nodal market, which can still be on scope and on time, but no longer on budget (Matters, 3/7/08), and
5. Increasing his knowledge of carbon regulation.

IDT Weighing Expansion From N.Y. Base

IDT Energy, which continues to generate “nice” profits, is eyeing expanding from its New York focus into new markets, CFO Steve Brown told investors on a conference call.

Quarterly customer growth rates have slowed “significantly,” Brown added. That dropped second quarter 2008 profits to $1.9 million from $3.6 million in the year-ago quarter. Profits were up $200,000 from the first quarter of 2008. Revenues grew to $65 million from $51 million in the year-ago quarter.

IDT’s meters served grew 17.3% year-over-year to 318,000 at the end of the second quarter of 2008. The growth was driven by a 25% increase in gas meters and a 12% increase in electric meters. IDT added 6,000 meters since the first quarter of 2008.

Brown told investors that IDT has identified new regions where it may be able to execute on its minimum risk model, but would not elaborate on specifics. Last year IDT twice filed for a Texas REP certificate but did not complete the application process. IDT also plans to focus on adding incremental customers in several upstate N.Y. regions.

Customers Stress Service in Finding Right REP

Price isn’t everything when it comes to choosing a retail electric provider, Bill Starnes, a consultant for the Cities Aggregation Power Project (CAPP) told suppliers at KEMA’s Executive Forum.

CAPP has tried REPs with good prices but bad customer service, and it isn’t worth the monetary savings, Starnes reported.

CAPP members often have high levels of churn in their ESI IDs as they open, close and relocate city offices or services, Starnes observed. REPs have to be able to process those changes quickly.

In the early days of ERCOT choice, a CAPP member had a transmission and distribution service provider about to perform a disconnect on city traffic lights in a Dallas suburb because a REP had not recorded the city’s payment, Starnes shared.

CAPP has since shifted its focus to dealing directly with wholesale suppliers and finding a REP willing to only transact for them in the ERCOT market, rather than supplying them with retail power. This arrangement lets CAPP fire unsatisfactory REPs without impacting its wholesale supply deals.

Now CAPP uses the “eHarmony” approach to finding the right REP, Starnes joked. The pool bombards REPs with specific, detailed questions and even performs on-site visits to the REPs’ offices to see how they would perform some of the unique needs requested by CAPP.

Chris Hendrix, General Manager of Competitive Energy for Wal-Mart, added that what he looks for in a REP (outside of ERCOT since Wal-Mart runs its own REP there) is responsiveness, price, and a REP’s ability to keep him informed of what’s going on in the marketplace.

Ron Johnson who buys for Marathon Oil agreed, informing REPs that he values their ability to share analysis of market conditions across the country.

Moeller Urges Retailers to Educate Regulators on Good Old Days

FERC Commissioner Philip Moeller, addressing KEMA’s Executive Forum, reminded retail marketers that many state regulators now setting energy policies were not in the industry 15-20 years ago for the last build-out under regulated cost-plus rates, and did not experience first-hand the associated ratepayer burdens.

Moeller urged stakeholders to remind regulators of the costs imposed on customers by inefficient and wasteful generation planning, construction and operations under the old regime.

Moeller also called carbon the strangest debate he’s ever seen in the energy industry. It’s become a pop-culture phenomenon, he noted, and it is not going way.

He’s “very concerned” that coal generators in a carbon-regulated world could simply shut down and pose “major” reliability risks to the bulk power system.

Moeller pointed to the uncertainty

surrounding carbon as one of the main reasons that long-term bilateral contracts are not more common in RTOs, one of the frequent criticisms of organized markets.

Although FERC has embraced capacity markets, Moeller admitted they've shown the Commission a few surprises so far, but he stressed it's early and he intends to stick with them.

Bowring Report Favors End of PJM Offer Cap Exemptions

PJM market monitor Joseph Bowring suggested ending the offer cap exemptions for certain generators in PJM in his 2007 State of the Market Report which found the RTO's markets to be competitive with LMPs that sent appropriate signals and incentives for investment in resources.

Bowring urged consistent application of local market power rules to all constraints and to all generating units, including those currently exempt from offer capping (Matters, 3/11/08).

Targeted, flexible real-time market power mitigation in the Regulation Market is needed as well, Bowring said. The Regulation Market results cannot be determined to have been competitive or noncompetitive, the report concluded.

The report found competitive results for PJM's Energy, Capacity, Synchronized Reserve and Financial Transmission Rights Auction markets.

Bowring also favors enhancements to PJM's scarcity pricing rules to create stages of scarcity and corresponding stages of locational scarcity pricing.

The report concluded that prices in PJM are set, on average, by generating units operating at or close to their marginal costs -- strong evidence of competitive behavior.

Generators enjoyed significantly higher net revenues in 2007 versus 2006, but it was the first time in eight years revenues grew.

Higher revenues stemmed from much higher locational capacity prices as well as higher energy prices.

Bowring found that the fixed costs of constructing a new combustion turbine, combined-cycle or coal-fired steam generation resource were fully covered in some, but not all, PJM control zones.

KEMA Notebook:

TXU Energy CEO Jim Burke stressed that the REP needs to focus on winning more customers in ERCOT before expanding into other areas. He cited New York, Illinois and Massachusetts as having TXU's interest when it's ready to expand after exhausting its opportunities in Texas.

Constellation NewEnergy President Michael Kagan argued that ISOs don't seem to recognize that retailers exist sometimes. Kagan pointed to the problems caused by retroactive price adjustments made by ISOs, noting it hampers transparency for customers.

Retailers need to pay attention to what happens at state legislatures and governors' offices because PUCs are creatures of each, **former Michigan Public Service Commissioner David Svanda**, who now runs his own consulting firm, told retailers. For years after the markets opened, retailers mainly focused on regulatory dockets to create market designs, rules and implementation, rather than maintaining higher-level lobbying efforts on competition.

Briefly:

Light at the End of the RM17 Tunnel?

The long and winding road for Maryland PSC RM17 (enrollment timelines, payment processing order, etc) may finally be coming to a close, with a rulemaking session set for April 8 to consider final adoption of the proposed changes to COMAR Section 20.53. RM17 was officially docketed way back on July 5, 2005 but working groups were developing the proposed changes long before that.

Another Addition to ERCOT Queue

ERCOT's market structure continues to attract new generation investment (despite the lack of EDCs able to sign long-term supply contracts) as Panda Energy announced it intends to build a 500-MW combined-cycle gas-fired power plant in Sherman, Texas.

Md. Lawmakers Hear More on Deregulation

Maryland lawmakers heard more of the same yesterday in more hearings on a slew of bills designed to protect customers from deregulation and rising energy costs. PSC Commissioner Susanne Brogan told legislators that giving the PSC more oversight over utilities, including greater reporting requirements, could lower prices while ensuring reliability. AARP again supported any bills which would re-regulate the state's market, while suppliers urged lawmakers to give the market more time to develop.

NewEnergy, Entergy to Pay FERC Gas Fines

Constellation NewEnergy-Gas Division will pay a $5 million civil penalty and disgorge unjust profits of almost $1.9 million, plus interest, for violating FERC's capacity release policies, including circumvention of the competitive bidding requirement for discounted released capacity, violations of the shipper-must-have-title requirement and violations of the prohibition on buy-sell transactions. New Energy self-reported the violations. In a separate action, Entergy New Orleans will pay $400,000 in civil penalties for self-reported violations of the shipper-must-have-title requirement.

Strategic Wins Conn. Deal

Strategic Energy inked a 25 million kWh deal won via consultant Tradition Energy to supply the Merritt 7 Corporate Park in Norwalk, Conn., with 100% renewable power.

REPs' Future ... From 1

Lois Hedg-peth, COO for Direct Energy.

Either you're the company that does it for them, or customers are going to go to someone else, she noted.

Competition forces companies to drive value to customers or risk losing them, Burke argued, asking KEMA attendees whether they thought Apple could have garnered 5 million customers for its iPhone in just six months under regulation. And the $400 iPhone is a product that attracted customers accustomed to getting free phones bundled with their cellular plans, Burke noted.

Apple would still be in the early stages of a rate case if it operated in a regulated world, Burke suggested, explaining that competitive markets unleash rapid innovation.

That innovation, particularly as it puts pressure upstream on the generation side of the business, can save customers money while addressing environmental challenges in a least-cost manner, Ajello added.

Ajello noted that the electric generation industry's capacity utilization of 44% over the last decade lags far behind other industries. Refining had a 93% capacity utilization, while utilization was 89% for the iron and steel industry, 84% for pulp and paper and 77% for chemicals.

Of course, those products can all be stored, Ajello conceded, but two other non-storable goods still outpace electricity.

The airline industry had a 72% capacity utilization over the last decade (versus 52% prior to deregulation) while the hotel industry had a 67% utilization.

Ajello explained that in both of those industries consumers with the right incentives drove out inefficiencies in capacity utilization by forcing new business models, such as pricing plane seats or hotel rooms at different levels depending on when they are booked.

Utilities, on the other hand, have a perverse incentive to maintain an inefficient capacity utilization, Ajello reminded.

Regulated utilities make more money through their rate base when lower capacity utilization prompts them to build new power plants, granting them more assets to earn a return on.

Turning to the success of the ERCOT market, Burke reported TXU's latest research which found that over 90% of residential customers in Texas are aware of their right to pick an REP.

More importantly, 83% of customers in the Oncor area support electric choice. That number is 81% is CenterPoint's territory and 84% in AEP Texas Central

Some 80% of residential customers have

made an active choice since the market opened in 2002, Burke reported, including a decision to stay with their incumbent provider.

Although some 77% of customers are satisfied with competition, satisfaction is not as strong as Burke would like to see it.

Unless customers can see changes in the marketplace and see competition working for them, retailers' measures of success just won't be important, Burke noted.

Burke reported that 72% of Texans say they are at least somewhat concerned over climate change. But the industry doesn't yet know whether customers will pay a higher cost to deal with it, Burke added.

One thing is clear, Burke stressed. Customers expect more than their REP just passing through new wholesale costs. That approach won't work in the long-term for either competitors or the industry as a whole, he said.

Complaints ... From 1

prescriptive burdens would be an undesirable outcome for ESCOs.

Liberty Power CEO David Hernandez pointed to efforts underway by retailers to offer their own set of marketing protocols for PSC codification in New York as an industry response to the problem, urging that an industry solution is needed to avoid a regulated mandate from "bureaucrats" that would ultimately raise consumers' costs.

Panelists debated what the end state of competition would look like, and how retailers would battle expected smaller margins.

Energy Plus is trying to find a niche to make customers "sticky" and retain accounts as the business becomes more competitive on price. Vague pointed to rewards programs, demand management and other services as concepts ESCOs have tried to help retention.

Deryl Brown, CEO of Hudson Energy, is still pursuing aggressive growth in New York electricity and gas and New Jersey gas. He divided the industry into three phases, starting with a "land rush" into new markets, and ending with electricity becoming another commodity with small margins. That's when retailers will have to win customers on brand and value-adding products.

In the middle is Phase Two with better margins, and Brown sees Texas, Illinois and New York on the front end of that phase.

Eventually, Brown sees retailers sharing virtually the same contracts for their commodity in Phase Three, and at that point sees a decreased role for aggregators, brokers and consultants due to the contracts' uniformity.

But today, sales via third-party channels are the only way some customers will buy power, and some customers aren't comfortable sifting through 14-page contracts without outside guidance, Brown added.

Gateway Energy Services (formerly Econnergy) now stresses its own employee sales agents over ABC channels, CEO Steven Maslak reported.

But with shrinking margins, retailers won't be able to afford direct sales forces and will have to rely on ABC channels more, countered Jeff Weiser, President of First Choice Power.

Econnergy's name change to Gateway Energy Services (Matters, 2/07/2008) represents the retailer's move into its third phase of operations and growth, Maslak said.

One of the early movers in competitive retail electric markets, Econnergy for its first seven years experienced quick, albeit haphazard, customer growth, Maslak reported.

Over the last three years or so it has fine-tuned its products and strengthened its balance sheet, building on supply relationships with Credit Suisse and Sempra Energy Trading.

Now Gateway, at 310,000 accounts, is positioned to expand into new markets as quickly and prudently as possible.

It's going to keep the Econnergy brand name for some New York marketing, due to its brand strength.

We asked the five marketers on the panel (Hudson, Gateway, Liberty, Energy Plus and First Choice) point blank when they were going to enter the Connecticut mass market (under 100 kW), given that the DPUC has given retail suppliers POR, a marketer referral program and market-based SOS.

We didn't get a response, not even a, "We like Connecticut and are working on it." We turned our question around and asked what in the Connecticut market was wrong and was keeping them out. Still no answer. Gateway's Maslak finally noted that retailers have a "plethora" of opportunities and can only grow in so many markets at once. We think plethora is overstating it, though do understand there may be other attractive markets (e.g. Illinois) and will address the issue in Surges and Circuits on Friday.

But for now, we'll note only two electric markets offer statewide POR, marketer referral and market-based SOS. New York, and Connecticut (while noting Illinois is on its way, but needs utilities to develop UCB systems to accommodate POR). We applaud the four marketers that have so far entered the Connecticut mass market (Matters, 3/11/08) and agree Illinois is setting up a strong retail market as well, we're just not sure why retailers are flocking to one but ignoring the other, especially since that valuable headroom in Illinois may vanish starting June 1.