

# Energy Choice Matters

March 28, 2008

## No Answer on Competitive Neutrality of Maryland-Constellation Deal

We couldn't get an answer on whether a settlement between Constellation Energy and Maryland, which still needs legislative approval, will be competitively neutral.

Our queries regarding the \$170 bill credit Baltimore Gas & Electric residential customers are to receive, first reported yesterday (Matters, 3/27/08), were rebuffed by Constellation, the PSC and Governor's office.

Constellation stated the credits are to cost \$187 million and will go to, "BGE residential electric customers."

Since only 26,000 BGE residential customers shop for power, and since the press releases only gave approximate figures to the credits, it's difficult to tell, based on the math, whether the credit is intended for all distribution customers, or only bundled customers. For example, we'd expect, if the rebate was only for bundled customers, that the rebate would be slightly higher at \$173, but since press releases only said the credit would be about \$170, we can't draw any conclusions from that analysis. The credit to be paid by the end of the year.

While the pact would close the book on much of the Constellation-centered controversies in the state, don't bank on regulatory certainty returning completely to the competitive market just yet.

"What customers are losing every year dwarfs the credits," said frequent competition critic Sen. E.J. Pipkin. "If we're trading in regulatory reform for this, we're giving in," he added.

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## Tower Companies Defend FTR Strategies

The Tower Companies vigorously denied alleged manipulation of PJM's Financial Transmission Rights and day-ahead energy markets, arguing weather and transmission outages led to subsidiary Power Edge's default, and claiming that PJM is trying to "deflect" attention from its own shortcomings (EL08-44).

Power Edge defaulted because warmer weather and an extended transmission outage raised congestion along a relevant path above Power Edge's expectations, causing Power Edge to owe more in payments, Tower said. Such a result does not constitute manipulation, Tower reasoned, noting allegations of collusion between subsidiaries to game the FTR market are "factually unsupportable."

Accepting PJM's "theories," which don't show the Tower affiliates engaged in market activity for reasons other than seeking to profit from the market value as determined by normal forces of supply and demand, would, "chill market participants — particularly financial market participants — from taking speculative risks that help provide important liquidity and price discipline to these markets," Tower argued.

PJM's novel assertions that forfeiture under its tariff (section 5.2.1) is a basis for a manipulation charge have not been used against other traders triggering forfeitures, Tower pointed out (Matters, 3/10.2008).

"Indeed, PJM's invoices for December 2007 and January 2008, the months in which PJM claims that BJ Energy engaged in market manipulation by triggering Section 5.2.1's forfeiture

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## Surges and Circuits

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

### Power Surges

 **Maryland:** We'll give Maryland a thumbs up for a second week in a row based on the proposed settlement between the state and Constellation which should allow policymakers focus on prospective policies to benefit customers instead of re-litigating decade-old pacts. However, should the bill credit to be given to BGE customers only go to bundled, full service customers, we think that does a disservice to the 26,000 residential customers who have tried to mitigate their energy bills by shopping for a better deal.

 **Energy Only Resource Adequacy Approach:** FERC accepted the Midwest ISO's resource adequacy approach which rejects a centralized capacity market in favor of bilateral requirements. We'll also note that although ERCOT hit the new higher offer cap of \$2,250/MWh back on March 3, with a discussion at this week's PUCT open meeting, it (to our knowledge) hasn't made a splash in any of the big Texas news outlets yet, showing that scarcity pricing needed for energy-only resource adequacy does not automatically cause panic and tirades from politicians and the media.

 **ERCOT Market Prepaid Products:** PUCT staff indicated they are weighing a new rulemaking to resurrect interest in prepaid programs offered via a prepaid meter by perhaps taking another look at how customer protection rules can work with prepaid.

 **PUCT Staff:** Staff's electric choice guide is among the top three government-issued brochures in the nation.

### Short Circuits

 **Texas Solar Advocates:** A short-sighted email campaign on net metering did not make solar proponents many friends at the PUCT.

 **NERC:** Justification for treating competitive retailers as a subclass under the LSE category was convincingly dissected by stakeholders at FERC.

## REPs Cite Need to Talk With Customers about DRG During Solicitations

Neither PURA nor the PUCT's customer protection rules include Distributed Renewable Generation (DRG) ownership within the criteria upon which REPs cannot discriminate in the provision of retail service to customers, the Alliance for Retail Markets told the Commission (34890).

In a strawman, the staff proposed that REPs not be able to ask customers during solicitation whether customers are DRG owners (Matters, 3/13/08).

But a REP may have legitimate business reasons for not wanting to serve a DRG owner, ARM pointed out.

"A REP's business model may not include the accounting and other processes necessary for serving a customer with DRG facilities that wants to sell surplus electricity to the electric distribution network," ARM explained.

"Consequently, it would make little sense to preclude a REP from inquiring about DRG ownership in the course of processing a potential customer's request for service, given that the failure to make such an inquiry could easily be contrary to the customer's best interests," added ARM.

Under the strawman, a REP has the discretion to contract with a DRG owner to purchase surplus electricity from the owner at an agreed-upon, negotiated price.

But if a REP is precluded from engaging in any discussion with a prospective customer about ownership of DRG, the REP cannot communicate to the customer its interest or lack of interest in entering into such a contractual arrangement, ARM said.

From the perspective of a customer that owns DRG, such information may play a critical role in the customer's decision whether to take retail electric service from the REP, ARM observed.

ARM does not see a customer benefit in

the customer having to wait until after executing a contract with the REP to find out the REP has no interest in buying surplus electricity, as the customer may have chosen a different REP had the customer known that policy beforehand. The strawman's prohibition also prevents REPs willing to buy surplus power from promoting their programs to potential customers, ARM noted.

DRG owners will want to be served by REPs that value providing electricity service to such customers, Reliant Energy added in separate comments.

A REP may want to know if a customer has a DRG facility so the REP can offer the customer a differentiated product that recognizes the customer's use of DRG, such as a lower-priced product possible from using new load profiles with lower daily peaks for customers with DRG that ERCOT is currently developing, Reliant pointed out.

Reliant doubts that "fruitful negotiations" on surplus power prices can occur if REPs are prohibited from asking customers about DRG ownership during solicitation.

## **E.ON Says MISO RSG Fix Not Transparent**

The Midwest ISO's proposed RSG Transmission Constraint Management Unit Commitment charges fail to provide transparent price signals for congestion and thus result in "uneconomic and inefficient decisions" E.ON told FERC in a late filing (Matters, 3/25/08, 3/11/08).

Those decisions, "may exacerbate the Midwest ISO's reliance upon constraint management unit commitments and increase this portion of RSG costs," E.ON explained (EL07-86-003).

The costs of such unit commitments are not included in Midwest ISO's Day-Ahead or Real-Time LMPs, E.ON noted, and are first made public in settlement statements seven days after they occur.

"There is nothing 'market based' about these transmission constraint unit commitment charges," E.ON insisted.

The decisions about the commitments are made by the Midwest ISO, E.ON pointed out.

Market Participants do not receive any price signal about the impact of their proposed sales into the market on transmission congestion until the Midwest ISO sends them the RSG Constraint Management Unit Commitment Charge.

"Even the much derided Transmission Loading Relief ('TLR') procedure provides a curtailed transmission customer some meaningful notice and opportunity to mitigate the costs of congestion," E.ON scolded.

From the start of the market April 1, 2005 through the end of 2006, Midwest ISO transmission customers paid over \$660 million in congestion charges, 38% of which was non-transparently buried in the RSG charge, E.ON reported.

## ***Briefly:***

### **Ameren Competitive Retailer Asks for Single Billing Authority**

Ameren Energy Marketing has applied to offer a single billing option (supplier consolidated billing) to its customers in the ComEd territory (ICC docket 08-0237). Ameren Energy Marketing's ARES license permits it to sell to non-residential customers using more than 15,000 kWh annually.

### **Dominion Seeking Approval to Serve Illinois Residents**

Dominion Retail has asked to be certified to serve all electric customers in the ComEd and Ameren territories of Illinois, including residential customers, its ARES application revealed. Although filed last week (Matters, 3/20/08) the documents were not available until recently. Dominion, which is already an AGS in the state, asked that the trade name Prairie State Electric and Gas be approved in its ARES application, an alternative trade name it can market under as an AGS but which has not been used to date. Dominion does not intend to provide single billing services.

### **Third PPL SOS Procurement Approved**

The Pennsylvania PUC approved the third round of PPL's competitive solicitation for default service power for when market-based

rates start Jan. 1, 2010. The average generation supply price from the latest RFP for 850 MW is \$108.80/MWh for residential customers and \$108.76/MWh for small commercial and industrial customers, including state gross receipts tax and adjustment for line losses. Fourteen bidders responded to the RFP. Three more solicitations will be held, and if the average prices for the remaining purchases match the prices approved so far, the bill for a residential customer using 1,000 kWh/month would increase in 2010 by 34.4%, or about \$36.65. Monthly bills for small business customers would increase between 23.8% and 42.8%. The remaining purchases are scheduled for the fall of 2008, the spring of 2009 and the fall of 2009.

### **Luminant Again Asks for Penalty Clarity**

Luminant, in the PUCT's review of alleged market manipulation by the former TXU in 2005 (34061), moved for summary decision on whether each megawatt potentially sold in violation of market rules should be treated as a separate violation, or whether the number of violations should be based on the number of bids submitted by Luminant. Luminant essentially wants to know what the maximum penalty in the case could be, and needs to know how the ALJ will count the violations. Luminant had previously asked for a ruling on the question, but did so in a motion for dismissal which was rejected, and thus it never got an answer. Thus time Luminant is just asking for a ruling on the maximum penalty amount, a pure question of law, so it can effectively weigh the potential for settling the case. Staff favors treating each megawatt as an individual violation (Matters, 2/29/08), which could result in a maximum penalty of \$171 million. Luminant thinks under the bid approach the penalty could be, at most, \$7.9 million.

### **Babcock & Brown Eye Building Wires for CREZs**

Tejas Transmission, a subsidiary of Babcock & Brown, has filed a notice of its intent to establish a new regulated electric utility business unit to construct, own and operate transmission facilities in Texas, specifically to

build grid lines to access Competitive Renewable Energy Zones.

### **Reliant Gets Right to Buy Carbon Offsets from Wetlands Project**

Reliant Energy is providing \$300,000 to assist the U.S. Fish and Wildlife Service to preserve the Columbia Bottomlands forest in Brazoria County, Texas. Reliant will be allowed to buy the carbon credits created by the project's trees.

### **Prindle Moving to ICF**

Bill Prindle joined ICF International as a vice president with special focus on energy efficiency after serving as deputy director of the American Council for an Energy-Efficient Economy.

### **Two Technical Conferences Set in Texas**

ERCOT set for April 2 in Austin a technical conference regarding its request for a higher nodal surcharge (Matters, 3/7/08).

A second stakeholder meeting on the possible integration of Entergy Texas into SPP's power region is set for April 16 in Austin (PUCT docket 33687).

## ***Maryland ... From 1***

Gov. Martin O'Malley and PSC Chair Steve Larsen noted the deal does not resolve any broader questions of re-regulation, or related policies such as integrated resource planning, long-term SOS contracts, utility-built generation, and the like.

"Issues regarding re-regulation are still very much on the plate," Larsen said.

The PSC would close dockets 9137 (stranded cost review) and 9099 (BGE rate stabilization plan) under the pact, while affirming the 1999 restructuring settlement. Legislative mandates for the PSC to prepare reports on various aspects of the 1999 settlement would be revoked.

Ratepayers' obligations for decommissioning Calvert Cliffs would end, saving \$1.5 billion. Constellation does not anticipate the assumption of decommissioning liability will result in material incremental costs to the company when it's time to

decommission Calvert Cliffs.

Ninety percent of the decommissioning credits created in SB1, or \$346 million, will still go to customers. Both parties will drop their lawsuits over the original \$386 million in credits.

Maryland's rules for utility investment would be eased, allowing an investor to acquire up to 20% of the voting securities of a company owning a regulated utility without prior PSC approval. Maryland's laws regarding such investments are more restrictive than those in other states, and the changes are to boost investment and help build needed large-scale infrastructure, such as nuclear plants.

The settlement is boost PSC oversight of utilities by codifying federal authority for the PSC to examine the books and records of any Maryland utility and its affiliates. The pact would also require BGE to elect two independent directors to its board.

BGE won't file an electric distribution rate case until 2009, meaning base rates will remain at 1993 levels. Any increase won't be effective until October 2009 and would be capped at 5%.

### ***Tower Companies ... From 1***

provisions, show that other market participants placed virtual bids triggering over \$1.5 million of forfeitures under the same provision," Tower observed.

Tower explained the shortcomings of PJM's credit policies, and not manipulation by Tower Companies, led to the default.

"At the time Power Edge bid for and acquired its original portfolio of FTRs during the May 2007 annual auctions, it put up \$6.4 million in collateral. Exel Power Sources LLC, another PJM member, was allowed by PJM to acquire an even larger portfolio of FTRs in the same May auction without any pre-qualification of its creditworthiness. After Exel's bids cleared, PJM requested \$14.7 million in collateral from Exel. To the embarrassment of PJM, Exel could not and ultimately failed to post that amount. After learning of the large size of Exel's portfolio, Power Edge inquired about the possibility of acquiring 20% of the Exel portfolio. PJM,

however, resisted Power Edge's attempt to buy only 20% of the portfolio and indicated 'technical difficulties' in transferring Exel's portfolio unless the buyer purchased 100% of the portfolio. PJM offered Power Edge a deal: it would require the same amount of collateral to purchase the entire portfolio as it would have for 20% of the portfolio—\$3 million. PJM represented to Power Edge that the lower collateral was justified because PJM's own internal analysis showed that the Exel portfolio was negatively correlated with Power Edge's original portfolio," Tower claimed.

"As Power Edge's portfolio lost money during the summer months that followed, because of the nature of congestion during the peak season, PJM (in violation of its own procedures) allowed Power Edge to pay its FTR invoices for these months by subtracting funds from its collateral — a decision even PJM's Chief Financial Officer later admitted was a violation of PJM's own rules. During this period, PJM also waived other collateral requirements including requirements for working capital. If PJM had followed its own internal credit procedures, Power Edge would have had a clear understanding of its capital requirements and the need to liquidate its portfolio in whole or in part before the failures and outages in Fall 2007," Tower reported.

Tower also objected to PJM relying on an unjustified 10-day sample to prove BJ Energy submitted manipulative virtual bids. The days chosen are not a representative sample of BJ Energy's trading, Tower said, and were among the twelve days with the largest virtual trading volumes consummated by BJ Energy. Average trading volumes on the sample period days were approximately four times greater than other days in December and January, Tower claimed.

Tower also sought to dispel an automatic link between virtual bidding and manipulation.

"In deterministic, market-clearing electricity markets, any bid (including virtual bids) that clears the market can have a price effect. That does not mean that the bid was manipulative or that the price effect represents a distortion from appropriate levels. If that were true, virtual bidding would not be allowed. Instead, market participants like the

Tower Companies, and other hedge funds and financial participants, are encouraged to engage in such trading under the expectation that the markets will be made more efficient by participants that engage in such trading. While this bidding may have price effects, these effects tend to narrow differences between the day-ahead and real-time markets, increasing efficiencies. It is not reasonable to ignore such behavior as PJM has done. To do so only discourages trading by the very participants that PJM and others have long recognized as bringing liquidity and improved price discovery to these power markets," Tower told FERC.

Exelon, while strongly condemning any potential manipulation, urged caution when evaluating virtual bids as well, warning of the "danger" that PJM's allegations regarding virtual bidding could be misinterpreted.

PJM's complaint cited the Tower Companies for virtual bids which "distorted LMPs" and "increased LMPs significantly," language which Exelon found "troubling."

"Virtual bidding inherently causes changes in LMPs," Exelon reminded.

"That is the purpose of virtual bidding – to cause price convergence between the day-ahead and real-time market."

Such price changes are, "a legitimate function and not market manipulation," Exelon noted.

Exelon urged the Commission to, "remain cognizant that virtual bidding itself is a market activity that all market participants understand has a legitimate purpose."

Exelon also argued for maintaining the status quo pending resolution of the investigation. That would mean PJM, for now, would keep funds it has withheld from other Tower affiliates.

Maintaining the status quo, "will permit PJM to delay making congestion revenue payments to any member of the corporate family under investigation until the Commission determines whether the corporate family is guilty of manipulating the market," Exelon explained.

Should manipulation claims be supported, FERC could use the funds to offset the Power Edge default that otherwise will be borne by PJM members and consumers, Exelon

suggested.

The following is the full text of a letter sent from Tower Research Capital Managing Director Mark Gorton which accompanied the firm's answer:

Dear Secretary Bose,

PJM's Complaint is yet another attempt to disparage the Tower Companies and coerce PJM's members into condemning Tower without due process. In January, when several members reacted to Power Edge's default by encouraging PJM to "be creative" in pursuing Power Edge, PJM produced the retroactive affiliate set-off rule change. When PJM heard the strong voices of opposition to such creative lawyering, it came back with this Complaint knowing full well that a non-public investigation by the Enforcement Division into the Power Edge default was already in progress.

PJM is a market with significant structural problems. PJM needs to establish a sound set of policies and procedures to rectify this situation. Creative and arbitrary application of its rules and the law undermines the principles of sound market governance which are necessary for any market to thrive.

When Power Edge purchased Exel's large FTR counterflow portfolio last May, PJM violated its tariff and required only \$3 million in collateral to support potential losses. Months later, PJM's Chief Financial Officer asserted to members that the undiversified portfolio was so risky that \$268 million in additional collateral should have been required.

When Power Edge agreed to purchase Exel's portfolio and bail PJM out of an embarrassing default, PJM's Chief Financial Officer announced to members that she could sleep better at night. But when unprecedented and significant system failures on the New Jersey grid defied PJM's positive projections, PJM turned the members' attention away from its mistakes, miscalculations and missteps by inciting a witch hunt against Power Edge and the Tower Companies.

PJM has encouraged financial participants to trade virtuals and profit from price differences in the electricity markets. They now attempt to manufacture a charge of manipulation using routine trading and a regularly applied forfeiture calculation that participants see on every monthly

invoice.

The default of one of Tower's investment funds is a source of great shame for us. PJM's behavior in this matter, however, has also been shameful. Without the necessary care or investigation required, PJM has recklessly made a serious allegation in filing this Complaint. PJM did so despite being fully aware of the non-public investigations already underway by both the Market Monitoring Unit and the Commission, and without the results from either. Now, the widespread perception among members is that Tower has engaged in market manipulation. We will work hard to correct these misperceptions, but the harm to our reputation from PJM's malicious accusations may be impossible to undo.

Thank you for your time and consideration.

Sincerely,  
Mark Gorton