

Energy Choice Matters

April 4, 2008

DPUC Final Decision Allows Long-Term Bilaterals for Standard Service

Changing course from its draft, the Connecticut DPUC yesterday found that, “long-term bilateral contracts may be used to supply standard service power,” without specific restrictions on the length of the contracts (07-06-58, 06-01-08RE01).

Additionally, the DPUC explained that it was, “inclined to use the power to supply standard service,” although it remains open on the issue. Bilaterals could not make up more than 20% of standard service load.

Passing the costs or benefits of bilaterals through the nonbypassable FMCC charge, “would not be understood by most ratepayers, generation rates would not change and the link to gas prices would remain,” the DPUC determined.

The final decision departs from the draft which found bilaterals to be appropriate only when lasting less than four years in length (Matters, 3/18/08). Utilities and load representatives had hammered that finding as placing the interest of retail suppliers ahead of customers (Matters, 3/27/08).

Although not explicitly addressing the change in the written decision, the final decision places more emphasis on the need to break the link between natural gas prices and standard service rates, and stressed the need to mitigate the state’s high power prices.

While noting the risks of stranded costs and potential harm to the retail market, the Department, “believes there may [be] advantages to the use of bilateral contracts.”

“Electric rates for customers of CL&P and UI are among the highest in the United States. The option to use bilateral contracts has been brought forth as a potential method to improve electric rates and reduce the burden on Connecticut families and businesses,” the DPUC observed.

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Pipkin Re-Regulation Amendment Could Derail Constellation-Md. Settlement

The future of a \$2 billion settlement between Constellation Energy and Maryland (Matters, 3/28/08) was thrown into question yesterday as frequent competition critic Sen. E. J. Pipkin, R, won support to tack an amendment onto the settlement legislation (SB 1013) that requires new Maryland generators to offer their power to one of the state’s utilities first, under regulation by the PSC.

“Tonight, the Senate went on record saying it wants to take regulatory action for [ratepayer] relief,” Pipkin said.

The amendment would nullify the settlement agreement, Constellation confirmed.

The House favors the settlement bill without the amendment and Democratic Sen. Thomas Middleton, Finance Committee chair and sponsor of the settlement bill, noted the amendment won’t make it through conference.


Supporters of the pact argued a review of re-regulation could be taken up after getting ratepayer relief from Constellation. PSC Chair Steven Larsen noted that while re-regulation should be studied, it has to be done at the right time and place.


The amendment could risk other planned generation developments in the state, he added, worsening the state’s market.

Surges and Circuits


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

Power Surges


 **Direct Energy:** Buying Strategic Energy vaults Direct into the upper echelon of large C&I electric retailers and gives its gas business exceptional sales leads via acquired Strategic electric-only customers.


 **BGE SOS Auctions:** Kaye Scholer finds no problems with SOS procurement.

Push

 **Michigan Electric Market:** PSC draft would bring POR to Consumers territory, but burden shoppers with paying subsidies to residential customers.

Short Circuits

 **Illinois Retail Energy Markets:** Although an amendment which would end retail gas choice is in a holding pattern as opponents of competition weigh their options, gas marketers can't be sleeping easy. Electric retailers have to be concerned, too, with the fierce opposition to energy competition the amendment shows.

 **Maryland:** It would've been too simple for the Constellation settlement to sail through the legislature without being jeopardized, and not at all in line with the circus of the past two years.

Mich. PSC Staff Urges Universal to Voluntarily Suspend Acquisition Efforts

The Michigan PSC Staff wants Universal Gas & Electric to voluntarily suspend all marketing activities to enroll new customers until Universal presents a satisfactory report and action plan on recent complaints (Matters, 3/27/08).

Staff was unimpressed with Universal's first report as required by the Commission (U-15509), and asserted that Universal's report, "raises serious questions as to Universal's

commitment to the Michigan Customer Choice Program and does not provide Staff with confidence that the company can responsibly enroll and serve Michigan natural gas customers."

"Universal's report has significantly shaken Staff's confidence in the company's understanding of the problems it is facing and its appreciation of the urgency necessary to correct its deficiencies," staff told the Commission.

Labeling Universal's report, "unresponsive to the Commission's Order," staff asserted that Universal, "took a largely defensive posture in its report," and, "attempted to downplay its problems by challenging Staff data and blaming the media."

"Universal has spent precious time trying to convince the Commission all is well, while the customers, in unacceptably large numbers, continue to experience problems and contact the Commission for assistance," staff argued.

In the staff's view, Universal did not present a well thought out root-cause analysis and action plan.

"Staff has repeatedly informed Universal that Staff has longstanding, major concerns about the product Universal is offering. Staff believes the design of the product is a significant contributor to Universal's current customer service and marketing problems. Customers do not understand the product and, as they report in their complaints to the Commission, do not receive sufficient explanation from Universal's marketing agents to understand it. Despite Staff's persistent urging that Universal include a remedy for this problem in its report, it failed to do so," staff wrote.

"Universal provided little meaningful discussion about market misrepresentation issues and virtually no discussion on a course of action to remedy them," staff added.

"This discrepancy is particularly frustrating to Staff because marketing misrepresentation was a major factor in prompting this investigation."

"Staff believes that contacts from Universal customers remain at an unsatisfactory level and reflect continued problems with Universal's marketing and customer service

activities. Unless Universal takes immediate action to correct the problems addressed by the Commission and Staff, the level of complaints will continue to remain high into the future. What remains crystal clear to Staff is that, whether the Universal customers contacted the Commission prior to, during, or after the extensive media coverage, the complaints these customers are reporting remain consistent: they have significant problems with Universal's product, marketing practices, and customer service," staff wrote.

Staff proposed that Universal immediately develop a meaningful action plan to fulfill its obligation to the Commission, to be filed in 30 days.

"In preparing its action plan, Universal must focus upon and fully address Commission and Staff concerns covering: contract terms and conditions; marketing activities and materials; response to Commission tariffs, rules, and orders; Staff customer contacts sent to the company for resolution; and marketing agent management," staff suggested.

Staff proposed giving Universal seven days to accept its offer. Should Universal reject the staff proposal, staff will proceed with a motion for a Commission hearing to consider revocation of Universal's Alternative Gas Supplier license.

Markets' Success Depends on Shifting Price Volatility Risk to Suppliers, AF&PA Argues

The short-term risk of energy price volatility has to be placed on suppliers instead of customers to make markets work and prevent customers from making rational decisions to pursue regulation, the American Forest & Paper Association told FERC in further explaining its "Financial Performance Obligation" design for capacity markets (AD08-4).

As previously proposed in FERC's review of competition (RM07-19), Financial Performance Obligations would require every power plant which receives a capacity payment to financially guarantee the delivery of energy to the real time market at or below a specified strike price in any hour in which it is

dispatched by the RTO to provide service.

The Financial Performance Obligation is designed to link the revenue streams from capacity and energy to better reflect the product that has value to consumers, AF&PA stated.

Under a Financial Performance Obligation approach, LMP continues to drive efficient dispatch and manage congestion, but LMP also becomes a tool for allocating the risk of, and preference for, dispatch among suppliers who each have a settlement obligation to supply energy to load at a specific fuel indexed strike price in return for receiving a competitively bid capacity payment.

"From the consumer point of view, this recreates an important aspect of the obligation to serve that traditional return on rate-base (now, capacity payments) was meant to secure. Further, it recreates in the organized market structure the common sense cost relation that would exist in any rational bilateral contract for long term supply between capacity and energy components," AF&PA observed.

The Financial Performance Obligation is best viewed as a real time, unit specific, and precisely accurate Energy and Ancillary Service (EAS) adjustment mechanism to assure that ratepayers do not pay twice for capacity, AF&PA suggested. But in addition to performing the same role as the EAS adjustment, Financial Performance Obligations will shift supplier and consumer frames of reference for economic decisions in a fashion which incents long-term hedging, demand response, strong operational incentives for on-peak performance, and market power mitigation, AF&PA noted, without any "mathematical" increase in the risk of loss to suppliers.

"It is an axiom of market design that the most efficient way to allocate risk is to give it to the party that can hedge it most effectively," AF&PA reminded. But the only means for customers to hedge price risk are demand response, entering into long-term contracts or, paradoxically, regulation, AF&PA explained. Due to market design challenges, the current market does not properly support either demand response or long-term contracting, the association argued.

Suppliers, though, “have a multitude of avenues readily available to hedge this risk.”

Although such risk will be paid in the capacity clearing prices, the price should be “far lower” than going without the hedge or leaving risk with consumers, AF&PA claimed.

Shifting risk to suppliers will encourage additional physical supplies since that is one of the ways to hedge against excessive price volatility (i.e. scarcity), AF&PA reasoned.

“By creating the physical, financial, and product infrastructure to efficiently allocate and hedge the risk of market volatility among suppliers, any particular supplier’s exposure to such risk should be reduced. As these hedging tools become more common at the wholesale level, risk premiums associated with long-term contracts for consumers should also go down. No longer will LMP represent only a series of short-term decision points and profit maximization opportunities for suppliers. LMP will also represent a potential ‘risk of loss’ that can be effectively hedged,” AF&PA explained.

“If the current short-term dynamic in the LMP market is not changed, it is doubtful that consumers will ever be able to effectively hedge this risk in a reliable fashion through long-term contracting,” AF&PA warned.

FERC should realize that unless suppliers share some responsibility to hedge future scarcity, “there are truly few alternatives left open to customers [...] to assure reliability,” AF&PA claimed.

“The most effective response for consumers who need to assume this risk is to aggregate their loads, nominate a particular supplier (usually a utility) to build specific capacity to meet their future needs, and to enter into a long-term contract for service which guarantees to the supplier recovery of investment and to consumers cost-based rates. If the market continues to put the full risk of scarcity on consumers, this may be the only practical response,” AF&PA noted, explaining that proposals to establish Power Authorities and other governmental procurement options, “are rational responses if the market truly leaves this problem purely as a consumer risk to hedge.”

In other words, “regulation is an economically rational response to a

competitive market that does not allocate some risk of scarcity to the supply side,” AF&PA observed.

“Allocating some portion of the risk of scarcity to suppliers in a fashion which incents them to respond may, therefore, be necessary in order for competitive models to have a fighting chance at providing resource adequacy at reasonable cost,” the paper association concluded.

The Financial Performance Obligation would also encourage demand response because generators confronting short-term risk of market volatility would view demand resources as part of an energy hedging strategy to avoid paying out-of-pocket expenses for not meeting their obligations, AF&PA claimed.

“Further, the provision of an effective energy hedge to load may enable the Commission to design markets that do not rely on capped energy prices at all, thus increasing the ability to use scarcity pricing,” AF&PA noted.

NYISO Acts to Improve Wind Forecast

The New York ISO is to incorporate a centralized wind forecasting system to better accommodate wind power in New York’s grid, with implementation slated for this summer.

The ability to more accurately forecast wind is to allow NYISO to gauge how much wind power is likely to be available throughout a given day, enabling maximum use of wind resources while enhancing reliability by anticipating variations in generator output.

“As more wind power projects are connected to the grid, they will require enhanced attention. The advance forecasts will allow us to accommodate wind power more accurately and reliably,” said Robert Hiney, a NYISO Board member and interim President.

NYISO has also suggested market rule changes, subject to FERC approval, including:

- Increasing the amount of wind generation eligible for exemption from under-generation penalties and full compensation for over-generation;

- Requiring wind projects to finance the costs of the centralized forecasting service, and
- Establishing penalties for wind generators who continually fail to deliver meteorological data to the NYISO forecaster.

Briefly:

PUCT Staff Prepares for New Prepaid Rulemaking

The PUCT staff requested a control number (35533) for a rulemaking relating to prepaid service. At the last open meeting (Matters, 3/27/08), staff suggested reviewing prepaid rules to encourage more REPs to offer prepaid plans with in-home meters. Christine Wright, Lauren Damen and Shawnee Claiborn-Pinto from the competitive markets division are key staffers on the project.

CL&P: Making Retailers Parties to Billing Docket Would Cause Delay

Competitive retailers should not be made parties to a DPUC investigation into billing errors at Connecticut Light & Power that saw over 2,000 customers not receive January bills (Matters, 2/21/08). The Department made retailers parties to the case (08-02-06) in an April 1 hearing to make sure retailers followed regulations for backbilling. CL&P argued that adding more participants in the case will delay a final decision, further impacting repayment durations. Retailers aren't needed to resolve the issues at hand, CL&P noted, and if the DPUC is concerned about compliance with backbilling rules it can open individual proceedings for retailers, CL&P suggested.

DPUC Wants Input on RFP Data Releases

The DPUC asked stakeholders for comments regarding a joint proposal by utilities, their consultants and the Office of Consumer Counsel (Matters, 3/18/08) to make data public from default service RFPs more quickly (06-01-08RE02). The Department asked whether it should release two weeks after approving procurements:

- a) For service terms that are 100% awarded, the weighted average contract prices by customer class; and
- b) For service terms that are not 100%

awarded, the cumulative percentage of load that has been awarded for that term, but no mention of weighted average contract prices.

DPUC Accepts Amended NewEnergy RPS Report

The DPUC accepted Constellation NewEnergy's corrected RPS report showing complete compliance (Matters, 3/20/08), and NewEnergy won't have to pay an alternative compliance payment (07-09-14). The DPUC also clarified from its draft decision on RPS obligations that default service wholesale suppliers, and not the utilities, are responsible for RPS compliance and the ACPs levied on the utilities are to be paid, as specified in SOS contracts, by the wholesalers. CL&P's suppliers are to pay \$3,104,200, UI suppliers are to pay \$372,130 while Sempra Energy Solutions is to pay \$11,850 in ACPs.

ComEd Soliciting RECs for Default Service

ComEd and RFP administrator NERA asked REC suppliers for proposals to supply ComEd's default service REC needs for the 2008-09 delivery year. ComEd is seeking up to 796,040 MWh of RECs and bidders must be qualified by April 11 with proposals due April 22 (<http://www.2008-rfp.com/renewables.asp>).

ERCOT Corrects CREZ Grid Costs

ERCOT submitted an errata to the cost figures in its Competitive Renewable Energy Zone (CREZ) Transmission Optimization study (Matters, 4/3/08). The corrections, with the largest adjustment involving \$300 million, did not appreciably change the multi-billion dollar pricetags for the grid assets (33672).

Conn. Bilaterals ... From 1

"At this point there does not seem to be a consensus to return to regulation but their [sic] does appear to be general agreement that action should be taken to lower electric rates in Connecticut," the Department found.

The DPUC in its final decision welcomed growing residential migration but stressed residential shopping, "still represents less than 5% of UI's and CL&P's residential customers on standard service."

"Today the prices for standard service full

requirements contracts are directly related to the forecasted prices for natural gas,” the DPUC explained.

“For bilateral contracts to provide meaningful benefits they must break the link between natural gas prices and electric rates,” the DPUC reasoned. Contracts may need to be longer than three years, and perhaps even 15 or more years, to entice generators to offer more “cost based contracts.”

“Longer term contracts would provide a more assured revenue stream to generators which could encourage more cost based contracts particularly for non gas projects or new generation facilities. This would reduce our dependence on shorter term energy markets and smooth out price fluctuations over longer periods. This could result in lower prices than the current procurement but will further remove prices from current spot market trends,” the DPUC concluded.

Bilateral contracts would have to be approved by the DPUC prior to execution.

The final decision kept the draft’s position that a portfolio manager for standard service would not bring benefits to customers.

The Department also left unchanged its position on hedging, allowing utilities to use hedging as insurance.

Shorter term hedging, “does not pose risks to competition or stranded costs, and could be used if potential benefits exist,” the DPUC found.

“However, hedging should only be used to reduce risks faced by ratepayers, as opposed to pure speculative purposes which would increase the risks faced by ratepayers,” the Department ordered.