Energy Choice Matters
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Retail Execs Talk Consolidation, National Footprints

The ERCOT market is ripe for consolidation, StarTex Power CEO Bob Zlotnik told the Gulf Coast Power Association's spring conference.

But while that's a common view in the market, ERCOT continues to see more new entries than consolidation, observed Scott Gahn, CEO of Energy Savings Texas, who was involved in one of the few big consolidations in ERCOT when Energy Savings Income Fund bought out Gahn's Just Energy last year.

The market is almost becoming de-consolidated, he noted, with a mix of "true" new entrants starting retail operations from scratch, and expansions from competitors from other retail markets.

The ERCOT market appears to have low barriers to entry, Zlotnik added. Entrepreneurs see the minimal $100,000 credit requirement to get a REP license and think it will be easy. But entry is actually a lot harder when you consider the credit needed to procure and schedule power and hedge appropriately. The sheer number of people needed to run a well-oiled REP is not insignificant either, he noted.

The retail electric space is one of the more attractive industries for consolidation, Zlotnik added, because of the vast synergies a merger could produce. Zlotnik reported StarTex spends $2.5-3 million on billing, a cost that could be wiped out in a merger. Credit, scheduling, EDI and general administrative costs would also benefit from synergies as well, he noted.

Zlotnik reported buyers need to pay on average eight to 12 times EBITDA to entice competitors to sell. StarTex had recently received an unsolicited takeover offer for one times EBITDA, and Zlotnik was not enamored with the bid.

Direct Energy's recent acquisition of Strategic Energy appears to be 13 times EBITDA before

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FERC Has No Interest in Trimming Day-2 Markets, Kelly Says

Competitive markets are here to stay, FERC Commissioner Suedeen Kelly told the Gulf Coast Power Association, because those who could take markets away aren't inclined to do so, and because markets are doing a "very good" job at what they're supposed to do.

Despite some federal legislation aimed at RTOs, Kelly noted Congress has twice recently upheld wholesale competition as the law of the land, and doesn't see that changing. Nor does FERC intend to rollback competitive markets.

In answer to what she meant by "competition," which ostensibly could only include non-LMP day-1 RTOs, Kelly stressed that there's no interest at FERC to get rid of the current day-2 markets.

Kelly also affirmed that FERC has no desire to integrate ERCOT into its jurisdiction and assured Texans that the Commission would look at every available legal justification for not exercising added oversight of ERCOT as the intrastate grid possibly expands via integrating new territories (such as Entergy Texas) or building lines to new areas via the Competitive Renewable Energy Zone process.

Kelly argued competitive markets were driving generators to site their plants at the optimal,

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Surges and Circuits

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

Power Surges

New England, Mid-Atlantic Load: Two FERC decisions this week should help keep prices in check in PJM and ISO New England. FERC denied PJM's petition to raise Cost of New Entry figures for the May RPM auction, which would have raised capacity prices. The Commission also approved a higher price floor for ISO New England's Day-Ahead Load Response Program to protect customers from paying for phantom demand response.

Descending Clock SOS Auctions: After being battered by every consumer group imaginable for causing price spikes in Illinois, Kaye Scholer's report on Maryland's SOS procurement noted the descending clock approach forces bidders to keep offering lower prices, while that incentive may not be present in an RFP-type or negotiated bilateral procurement.

Short Circuits

Day-1 RTO Advocates: Commissioner Suedeen Kelly basically closed the book on any move back to day-1 RTOs in the existing day-2 markets.

Allegheny Proposes Tweaks to Residential SOS Procurement Timeline

Based on direction from the Maryland PSC, Allegheny Power has requested to buy a portion of its residential SOS load for 2009 (the first year of market-based rates) in its April 21 SOS solicitation, which was originally scheduled to procure C&I power. Allegheny has already secured five 17-month contracts and two 5-months contracts for residential SOS. That leaves seven blocks of load to be bought, plus three blocks to cover 5-month contracts which expire May 31, 2009. Allegheny proposed the following schedule to procure the 10 blocks:

Allegheny Residential SOS Proposal

Bid Date	Blocks to be Bid	Duration
April 21	1 5-month block	1/1/09-5/31/09
	2 29-month blocks	1/1/09-5/31/11
June	1 5-month block	1/1/09-5/31/09
	1 12-month block	6/1/09-5/31/10
	1 29-month block	1/1/09-5/31/11
October	1 5-month block	1/1/09-5/31/09
	2 12-month blocks	6/1/09-5/31/10
	1 29-month block	1/1/09-5/31/11

Generation Developers Discuss Carbon-Free Plans

It's hard for merchant generators to build "serial number one" of a new type of power plant without price protection, Eddy Daniels of NRG Energy told the Gulf Coast Power Association.

That's why in Texas NRG is pursuing new nuclear and gas-fired plants rather than a coal plant which captures carbon. NRG is pursuing an integrated gasification combined cycle (IGCC) coal plant in New York because the project is backed by NYPA.

Tenaska is preparing to build a clean coal plant in Texas which captures carbon on the "back end" of the process, rather than pursuing IGCC technology, David Fiorelli, CEO of Tenaska's Business Development Group reported.

One of the reasons for not pursuing IGCC is Tenaska intends to use Powder River Basin coal, which hasn't been used widely with IGCC. Tenaska also prefers the economics of putting carbon capture technology on the back end and using a commercially proven process to produce power, rather than experimenting with removing carbon prior to combustion.

The economics of Tenaska's clean coal plant require carbon legislation, however. If federal legislation on carbon regulation passes by 2009, Tenaska could have its plant in operation by 2014.

Wind power's variable output should not mean policymakers view wind as less reliable, argued E.ON Climate & Renewables NA CEO Declan Flanagan. There is a learning curve to wind, he conceded, but it can be forecast, Flanagan insisted, pointing to the successful integration of wind in Europe.

Flanagan thinks wind integration in the U.S. can move forward more seriously now that traditional generators and utilities are promoting wind. The industry has "grown up" and it's not just activists pushing for more wind megawatts on the grid; it's engineers with years in the industry. That makes wind's case much more credible, Flanagan noted.

NYISO Ignoring FERC Guidance on ICAP Reform, Generators Claim

Generators protested the New York ISO's implementation of FERC's ICAP market reforms, arguing the ISO is not following Commission directives (ER08-695).

In its March order (Matters, 3/10/08), the Commission explained that to determine whether a pivotal supplier controls capacity, its guiding principle is that, "an entity controls the facilities when it controls the decision-making over sales of electric energy including discretion as to how and when power generated by the facilities will be sold."

However, the ISO has proposed a much broader view, the Independent Power Producers of New York reported, by concluding a right to revenue or other financial benefits from capacity confers control of that capacity on an entity.

The reference to "financial benefits" is unduly vague, IPPNY argued, and could result in banks holding mortgages on power plants being considered to control that capacity, since the mortgage may be paid from sales of the facility's capacity.

"Clearly, that would be an absurd result, and certainly not the Commission's intent in approving the new market power mitigation measures for the in-City ICAP market," IPPNY suggested.

Astoria Generating Company also noted the ISO's broad view could inhibit pivotal generators from bilaterally contracting. Under the ISO's proposal, capacity sold under bilateral contract would still be counted in that supplier's total due to the supplier receiving financial benefits from the contract, even though the supplier could not make decisions with regard to that capacity.

The ISO's compliance filing also gives the ISO too much discretion in determining whether economic exit constitutes physical withholding. The ISO's tariff would also allow the ISO to impose penalties for physical withholding on a generator for simply proposing to retire a unit, IPPNY claimed.

"It is wholly unreasonable for suppliers to be forced to continue to operate their generating facilities at a loss and suffer substantial economic harm because the NYISO disagrees with the suppliers' calculations of their going forward costs," IPPNY argued.

IPPNY suggested that a disinterested arbiter, rather than the ISO, should determine whether a retirement is economic or constitutes withholding, with the right of generators to appeal to FERC's dispute resolution process.

FERC had ruled that suppliers should be permitted to include exporting their capacity as an opportunity cost in their bids, IPPNY reminded, but the ISO continues to oppose allowing suppliers to include exports as an opportunity cost.

Smitherman Gives Advice to Parties Before PUCT

PUCT Chairman Barry Smitherman follows statutes as closely as possible in rulemakings, he told the Gulf Coast Power Association in his first time addressing the assembly since taking the Chair of the Commission.

Smitherman doesn't think it's the Commission's job to parse out whether lawmakers should have used "may" or "shall" in statutes and told stakeholders unhappy with Commission decisions that strictly follow statutes to take their positions up with lawmakers.

The Chairman also told stakeholders he gives great dereference to staff in rulemakings, since staff have developed positions from stakeholder input and consensus.

Smitherman urges stakeholders to participate early and often in PUCT rulemakings, noting that approach will give them a bigger impact in influencing policy.

The ERCOT community is close knit because everyone lives and dies by the collective stakeholder process, since the ISO is an island, Smitherman noted. That's produced a collegial atmosphere which should be respected. While stakeholders don't have to always agree with the consensus, Smitherman doesn't want to see market participants thrown under the bus.

Smitherman urged parties to settle contested cases wherever possible, because the Commission will exercise its power to make a decision, and it may be one nobody likes. He also supports a larger and broader amount of discovery where possible.

The Chair urged practitioners to bring their "A" game when coming before the Commission. While the PUCT in the past may not have been as exciting as other areas, it's now routinely dealing with multi-million dollar policies. That means when you argue before the Commission, you have to know to effectively cross examine, how to enter evidence into the record, and how to make a cogent closing statement.

When it comes to Notices of Violations, Smitherman thinks the Commission should be, "merciless." Not only is punishment warranted for bad actors, it also rewards market participants who have followed the rules and thus encourages compliance. Punishment also reassures the public someone is watching out for them.

ALJ Rules Against Central Hudson Decoupling and Rate Adjustment

Implementing revenue decoupling in the middle of a rate plan for the sole purpose of accounting for lost revenues would be "unreasonable" because other mechanisms can accomplish the same purpose without disrupting the rate plan, an ALJ ruled in response to a petition from Central Hudson Gas and Electric (07-M-1139).

"Central Hudson has not made a persuasive case that its rate plan should be reconsidered, and no such reconsideration will be conducted in this proceeding," the ALJ ruled. "Moreover, if such reconsideration were to be conducted in this proceeding, additional public notice would be required."

The ALJ noted that the joint proposal setting Central Hudson's rates does not provide for revisiting the sales forecasts in the event the utility finds that its return on equity is lower than anticipated. Central Hudson agreed to the negotiated settlement which did not include a weather normalization clause, leaving weather-related risk with the utility.

"It is not clear from the Company's filings whether its declining sales are caused by weather or some other factor. Although the Company refers several times to 'unforeseen' and 'changed' circumstances, those circumstances are not described. The Company negotiated a rate agreement and voluntarily undertook the risk that sales forecasts might be inaccurate," the ALJ observed.

The only provision of the settlement that could support revisiting the sales forecast is a section which provides that Central Hudson may bring a petition if the current plan jeopardizes its ability to provide safe, adequate and reliable service. Central Hudson has not alleged that its ability to provide reliable service has been jeopardized, the ALJ noted.

Central Hudson had argued that the decoupling issue was not severable from its proposal for expedited approval of its energy efficiency measures, but the Commission, "is not precluded from taking further action regarding the aspects of the Petition that do not involve [revenue decoupling]," the ALJ noted. A procedural conference will be scheduled to determine whether the utility's proposed gas and/or electric efficiency programs should be considered further in the proceeding.

Briefly:

PUCT Issues Prepaid Questions

The PUCT asked for stakeholder comments on a variety of questions relating to prepaid electric service which does not use an in-home meter to facilitate prepayment (35533). Staff wants to know what changes to the current PUCT Substantive Rules and/or ERCOT Protocols and Guides would help to facilitate the development of pre-pay products.

Questions asked whether prepaid customers should be subject to different enrollment, rescission, disclosure, deposit, termination, billing/payment, and disconnect rules. Specifically, the staff asked whether there should be different requirements for disclosures to prepaid customers, particularly relating to estimating consumption for prepayments and truing up estimated consumption to actual consumption. The PUCT consumer division has cited inaccurate estimations and subsequent unexpectedly large true-ups as a big problem with some prepaid REPs (Matters, 3/27/08). Comments are due May 26.

PJM, MISO Close to Portability Solution

PJM and the Midwest Independent System Operator have reached an agreement in principle on the concept of "portable" capacity (Matters, 2/19/08), or capacity currently used to meet PJM resource adequacy mandates that will be needed to meet MISO requirements once Duquesne joins MISO, PJM revealed in a FERC filing (ER08-194). The RTOs intend to put this issue squarely before the Commission in the near future, which will initiate a new proceeding that will afford Duquesne and other interested parties ample notice and opportunity for comment. Thus PJM doesn't see the need for FERC or other parties to speculate or prejudge the concept of portability in docket ER08-194, the Duquesne exit docket. FERC should accordingly grant PJM's request and discontinue any future unfocused consideration of the portability issues in ER08-194, PJM urged.

FERC Sets Demand Response Conference

FERC set for May 21 a technical conference (AD08-8) to consider issues related to demand response in organized electric markets as discussed in its wholesale competition NOPR. Topics include the value of demand response in organized markets; comparable compensation of demand response in organized markets; barriers to comparable treatment of demand response that have not previously been identified; solutions to eliminate such barriers; and the need for and the ability to standardize terms, practices, rules and procedures associated with demand response.

Midwest ISO Answers RSG Criticisms

The Midwest ISO is "amenable" to changing its proposed definition of "Asset Owner" in its latest Revenue Sufficiency Guarantee (RSG) proposal to clarify that the term should include virtual suppliers, the ISO reported in an answer at FERC (EL07-86 et. al.). MISO noted, however that such a change was never offered in the stakeholder process. The ISO also addressed comments regarding the need for the RSG proposal to be prospective, rather than retroactive, and noted that while some commenters wanted a more immediate solution to RSG disputes, no stakeholder has offered an alternative (Matters, 3/25/08).

DC PSC Issues RPS Reporting Form

The DC PSC has issued an RPS compliance reporting form and instructions to retailers in Formal Case 945. Reports, the first required under DC's RPS, are due May 1. The form is to be only used as an interim tool, as the PSC intends to start a rulemaking at a later date to develop a form to be used in subsequent years.

Ontario Approves ECS

Energy Curtailment Specialists' PowerPay program has been approved by OPA. ECS is to provide 25 MW of demand response under a contract with OPA. Under PowerPay ECS customers do not pay any penalties for non-performance.

FERC OKs Dominion Queue Pact

FERC approved a contested settlement which resolves Dominion's complaint against PJM over the interconnection queue (EL08-36). Competitive Power Ventures was the only party to initially oppose the settlement (Matters, 3/20/08), and FERC found that CPV did not raise any genuine issues of material fact. FERC noted that CPV's system impact study agreement with PJM does not set a rate for interconnection service; it merely provides that a developer has applied for interconnection service. Thus there is no rate on file which the Commission is changing. CPV's costs concerns arising from the pact are speculative at best, the Commission ruled.

ERCOT Consolidation ... From 1

certain adjustments, Zlotnik calculated, and FPL's buyout of Gexa Energy was in the range of 15-20 times EBITDA, although it's been hard to track due to after the fact adjustments.

Of course, buyers need to perform due diligence when considering a takeover, including evaluating customer complaints, churn and retention, contract lengths and conditions, and the hedging and risk appetite of the target REP.

Gahn stressed the local scale needed to win market share as preventing true national competitors from emerging, especially at the mass market level. Retail power just isn't a national market, Gahn argued.

Although ERCOT does have uniform processes, it still has distinct markets where a REP's acquisition model may work better, he noted. But in most states, where operations are different by utility, local scale is even more important and harder to achieve, which is why a fragmented market can be sustained. Gahn noted that while Direct Energy is considered a national retailer, its acquisition of Strategic was driven by Strategic's local scale in places such as California, Illinois and Pennsylvania.

Zlotnik agreed on the importance of feet on the ground in local markets, noting his company is run by Texans, and Texans talk differently.

Since hurricanes Katrina and Rita, Gahn has seen the retail industry become a lot healthier, and argued that if entrepreneurs haven't prospered over the past two years then they should consider another business.

While volatility persists, it's been manageable, Gahn explained. REPs have figured out how to do retail power right, Gahn noted, but he questioned whether it was cyclical, or a permanent evolution. He's seen a similar pattern in gas marketing since the 1980s, where a shock leaves the healthier marketers standing, but over time new entrants will come in who view risk differently, repeating the cycle the next time a shock happens.

No matter how much push marketing a REP does, customers ultimately self-select their REP, Gahn reported, although that hasn't prevented his firm from a major commitment to push marketing. But all the push marketing in the world won't entice customers to switch if the REP does not offer a solution that is the right fit for that particular customer.

Gahn stressed enhanced vertical relationships, integrating wholesale power marketing and generation with retail operations, as one of the ways REPs can strengthen their positions by improving their risk management and credit portfolio.

Gahn sees the tightening credit markets as a challenge for REPs without investment-grade backing.

ERCOT has entered the market phase where the rubber meets the road, First Choice Power President Jeff Weiser said. REPs must provide tangible benefits above price discovery. That could be prepaid service or "full" demand response with home automation, he suggested.

Zlotnik has two to three employees working more than 15 hours a week getting ready for the nodal market, he reported. Gahn questioned whether nodal will make ERCOT a wholesaler's market instead of a retailer's market, noting PJM and other eastern RTOs are not retailer friendly.

Will customers be happy with the nodal change?

It depends what node they're on, Zlotnik cracked.

Kelly on Markets... From 1

lowest cost location for interconnection, something not seen under traditional regulation.

She called renewables the biggest innovation from competitive markets, citing the American Wind Energy Association's affirmation that RTOs promote wind power.

Smart grid and microgrid deployment are also more achievable where the distribution utility doesn't have an interest in generating and selling power, Kelly added.

Kelly commended Texas for its innovative CREZ process to not only build more renewable power but build it in the most efficient manner. She noted stakeholders in ISO New England are informally studying a similar process to find the optimal sites for renewables.