Energy Choice Matters

May 16, 2008

Higher Margins Mitigate Continued Churn, Lagging Acquisitions at Energy Savings

Energy Savings Income Fund is considering short-term products and more asset acquisitions, plus selling to more mid-sized C&I customers, the Canadian-based marketer of long-term fixed-priced gas and electricity contracts reported in posting annual net income of C$153 million for the year ending March 31, 2008, up from C$94 million in the prior year.

Annual sales revenues hit C$1.7 billion, up 13% from C$1.5 billion despite relatively flat customer count, as Energy Savings signed new customers at higher margins. When measured by residential customer equivalents, customer count was up 2%.

The acquisition of Just Energy Texas in May of last year drove U.S. electric customer count 160% higher, for a 68% rise in combined gas and electric U.S. customer count.

While Just Energy's customers were on short-term contracts, they still generated "attractive" margins for Energy Savings, and are renewing at a rate that makes them as valuable as a U.S. customer on a five-year product.

Based on those results, and in order to meet customer needs, Energy Savings is reviewing the potential for offering shorter-term products in other U.S. markets.

The success of the Just Energy acquisition also has Energy Savings "actively" reviewing other possible purchases in both the U.S. and Canada.

Energy Savings is planning to start marketing to certain larger volume C&I customers, but not truly large C&Is. The marketer thinks a number of profitable C&Is are only available by offering flexible price and flexible term contracts, and those customers' lower attrition rate creates a return on investment similar to mass market customers on five-year contracts.

... Continued Page 6

National Power Backs Down on Breaking Fixed-Price Contracts

National Power Company of Houston backed away from a shocking attempt to raise fixed-price contracts by some 4¢/kWh after PUCT pressure and customer outrage, but the PUCT isn't ready to close the matter yet.

Last week, National Power starting sending letters to customers on fixed-priced contracts of up to 18 months that it was exercising the "material change" clause in its contracts to raise the rate to 15.3¢/kWh, from the supposedly fixed 11¢ or so price most of the contracts contained. In the letters, National Power as required by PUCT substantive rules, gave customers 45 days to end their contract without penalty if they didn't want to pay the higher rate, but of course with gas prices much higher now, they would not be able to find a plan as cheap as the National Power rate they had originally contracted for.

Receiving nearly 200 complaints in a few days, the PUCT Wednesday pulled National Power's prices from the Power to Choose website and initiated an investigation. The PUCT reported concern that it could not initially reach or receive a response from high-level executives at National Power.

After meeting with the Commission yesterday, National Power stated all fixed-rate pricing and terms would remain as originally agreed, though the PUCT is not going to end its review until satisfied.

The PUCT sent a strong signal to other REPs that similar ploys would not be tolerated, and that fixed rates should indeed remain static.

The Commission may review refinements to its substantive rules relating to material change clauses, perhaps specifically limiting any such changes to legislative or regulatory changes.

Surges and Circuits

Power Surges

ERCOT Retail Market: Six new entrants apply for REP certificates in past two weeks, including heavy hitters Lehman Brothers and Credit Suisse.

Maryland PSC: Compiling quite a winning record at FERC.

Organized Markets: DOE report on wind integration stresses organized markets as providing effective tools for dealing with wind's variability.

Short Circuits

National Power Company of Houston: REP's apparent and later rescinded attempt to abrogate fixed prices using the "material change" clause is simply outrageous, especially given the Starlight-TriEagle case in 2005, and the ongoing GHRA-Tara dispute. The controversy also highlights an unreasonable amount of legalese in residential REP contracts which puts consumers at a severe disadvantage by creating informational asymmetries. Headings such as Limitations of Liability, Representations and Warranties, Provisions that Survive, Change of Law, Attorney Fees, Governing Law, Assignment, Waiver, Amendment, Severability, and Risk of Loss and Indemnity are meaningless to the typical mass market customer, and only serve to protect REPs from performance. The National Power debacle provides legitimate concern for legislators to exert greater control over terms and conditions in the next session.

RPM Price Tumbles 37% on More Generation and Less Load

RPM prices decreased on the exclusion of Duquesne Zone load and the addition of 4,238 MW of new generation and demand response, PJM reported yesterday in announcing results from the first three-year RPM auction.

The auction produced a uniform price across the RTO of $110 per MW-day, 37% lower than the last auction's price.

Total results include 176,055 MW of generation and 2,035 MW of demand response. The over 4,200 MW of new resources was the largest increase in new supply across the auctions held to date.

The additions include over 1,000 MW of baseload capacity, including one large coal plant, and 2,333 MW of entirely new generating units. New demand resources totaled 662 MW.

"Forward capacity auctions are creating incentives, and the marketplace is responding with investments," noted Andrew Ott, PJM senior vice president for markets.

Generators are reinvesting capacity revenues to maintain and enhance units, Ott added, with 1,243 MW of new capacity from upgraded existing units.

PJM reported that the five auctions to date have added 16,000 MW of capacity compared to what would have been available without RPM.

Ott claimed the current RPM auction would have attracted more capacity if the Cost of New Entry (CONE) figures had been increased as PJM and generators had requested. FERC denied the petition because PJM failed to follow procedures in the RPM Settlement for asking for revised CONE numbers.

"The results announced today speak for themselves: new generation resources, new demand resources, uprates to existing resources and power imports from other regions all increased to produce a fuel diverse 18 percent reserve margin," EPSA said in reaction to the results.

FERC Ends Offer Cap Exemptions in PJM

FERC granted in part a complaint by the Maryland PSC by ruling that exemptions for certain generators from offer caps in PJM are unjust and unreasonable. Text of the order was not available yesterday but according to FERC's external affairs office, the Commission concluded applying the same mitigation measures to all generators results in just and reasonable rates.

PSC Chair Steven Larsen hailed the decision as another "big win" for Maryland consumers at FERC, with the PSC"s strategy of greater intervention at the federal commission clearly paying off. Previously, FERC sided with the PSC and other load representatives in refusing to allow PJM to raise Cost of New Entry values for the most recent RPM auction. The PSC also recorded a partial win when FERC directed PJM to specifically address load concerns in its upcoming RPM review, though FERC denied an immediate request for a technical conference.

The lack of offer caps on some 43 exempt generators cost consumers nearly $88 million in 2006, PJM's market monitor reported.

FERC, though, refused to grant retroactive relief as the PSC had requested, citing the filed rate doctrine.

The Commission established a section 206 proceeding to examine whether PJM's existing market power screen has become unjust and unreasonable, noting that PJM's stakeholders are currently re-evaluating the three-pivotal-supplier test and its application in PJM's energy and capacity markets.

FERC thus held hearing in abeyance until Sept. 2, 2008 to allow the stakeholder process to continue.

California PUC Refuses Changes to Non-Discretionary Direct Access Service Fees at SCE

The California PUC rejected Southern California Edison's proposed new costs of "non-discretionary" services provided to energy service providers (ESPs) and direct access customers, citing doubts about the accuracy and reliability of some of SCE's cost data, and finding that the advice letter process is not the appropriate forum for new non-discretionary fees (A 07-01-045).

Non-discretionary services are those that can only be provided by SCE, such as direct access switches and EDI testing.

Discretionary services, such as utility consolidated billing and installation of IDR meters, are analogous to competitive services because they can be provided by ESPs themselves or other vendors.

Pricing of both types of services is a concern to marketers and the PUC because essentially SCE is setting a price to be paid by its competitors.

The PUC is allowing SCE to change its fees for discretionary services, despite some doubts about cost calculations, because ESPs and customers have a choice in those services and a decade has passed since the fees were first set. The static fees may be undermining the PUC's policy of sending accurate price signals that would allow a competitive market to develop, the Commission reasoned.

SCE based many of the proposed costs on employee interviews, which the Alliance for Retail Energy Markets (AReM) considered less reliable compared to more a rigorous analysis including independent experts and time-and-motion studies.

The PUC agreed and also pointed to inconsistent cost estimates as casting doubt on the accuracy and reliability of SCE's cost data. Still, the PUC's concerns about updating decade-old costs outweighed its skeptical view of SCE's proposed costs for discretionary services.

But setting costs for non-discretionary services has statewide implications for direct access that should be addressed in a proceeding involving a broader spectrum of interested parties than those involved in the advice letter, the PUC noted. Thus it rejected the proposed changes in non-discretionary service fees.

The PUC believes that further improvements can be made in the cost-effectiveness of SCE's direct access processes. AReM had argued SCE, as a competitor ESPs, doesn't have incentive to keep the costs of direct access processes down.

Thus the PUC directed its Energy Division to convene a conference including SCE, AReM, the California Manufacturers and Technology Association (CMTA), and other interested parties to consider improvements to SCE's direct access processes, including recommended improvements that may not be cost effective now at the presently low direct access volumes but which may become cost effective if the suspension on enrolling new direct access customers is lifted. Parties are to submit a joint report on potential improvements in proceeding R.07-05-025.

The PUC considered, for example, whether it would be more efficient to e-mail direct access switch notifications to customers rather than mailing letters, a suggestion made by AReM, though the Commission determined it didn't currently have enough information to adopt the policy.

Aside from rejecting changes in non-discretionary fees based on procedure, the decision discussed at length certain faults with many of SCE's proposals for non-discretionary fees. The PUC cited the Monthly Account Maintenance Fee (MAMF) as one of the biggest problems, because the flat fee would depart from incremental cost causation principles that SCE had properly been using to set other fees.

The flat MAMF would include several costs that may vary by ESP, such as how many billing exceptions the ESP requires and other "as requested" services. Since some ESPs may not use billing exception services, collecting those costs equally from all ESPs in a monthly flat fee would result in ESPs not causing the costs to pay for them, contrary to the policy of assigning costs to parties creating them.

SCE claimed it would be too burdensome to break out the MAMF into line items that could be assigned to individual ESPs, but the PUC rebuked that, "SCE's assertion that it is administratively burdensome to break out each component of the MAMF into separate fees implies that cost causation principles should be followed, except when it is administratively burdensome to do so."

Calif. PUC Scolds PG&E Over Non-Standard RPS Contract

California PUC Commissioners sharply criticized Pacific Gas & Electric for requesting authority to execute an RPS contract that patently ignored the RPS procurement guidelines' non-modifiable standard terms and conditions, and the Commission accordingly rejected the contract on those grounds (E-4170).

PG&E wanted to execute a 50-MW contract for wind from Public Utility District No. 1 of Klickitat County, Washington.

However, as a public utility district, Klickitat argued that disputes regarding its powers must be determined under Washington law, and PG&E included such terms in the contract.

But the RPS standard, non-modifiable terms require all PPAs to be governed by California law.

While the PUC noted the ultimate impact on ratepayers would be unknown from granting the change to Washington law, the Commission mostly based its rejection of the PPA on the non-standard provision being in direct conflict with a prior Commission order, which stated the PUC would reject all contracts changing the non-modifiable standard terms.

The PUC stressed that it was not rejecting the PPA because it was a firming and shaping contract, which are currently eligible for RPS compliance under both SB 107 and the California Energy Commission's Guidebook.

Rather, PUC President Michael Peevey harshly criticized PG&E for not following the PUC's process regarding standard terms, while Commissioner Dian Grueneich noted the Commission had been abundantly clear, and that PG&E needed to take Commission orders "seriously."

The Commission clarified in its order that RPS contract structures that rely on firming and shaping of out-of-state resources and meet the criteria identified in the CEC's Guidebook shall be accepted for RPS compliance, and noted PG&E could re-apply using standard terms and conditions.

Issues related to the use of unbundled and tradable RECs for RPS compliance are being considered in proceeding R.06-02-012 and the Commission did not want prejudge the outcome of that proceeding.

Commissioner John Bohn urged the Commission to get its REC policy out so that investors can make decisions and plan around it.

FERC Backs ISO-NE on Composite Bid Complaint

ISO New England properly rejected a "composite" offer TransCanada Power Marketing submitted in the Forward Capacity Auction and rejected the marketer's complaint against the ISO (EL08-43).

A composite offer combines separate capacity resources into a single bid, and TransCanada had argued the ISO improperly excluded one of its composite bids on the grounds of double counting, even though the capacity would not have been used twice in FCA (Matters, 3/18/08).

Procedurally, FERC found TransCanada's complaint to address issues settled in EL08-11 and denied TransCanada another bite at the apple, but FERC also concluded the ISO acted properly.

TransCanada argued that the capacity the ISO considered to be double-counted would only be bid once, since an earlier composite bid relying on the capacity should have been disqualified for a lack of import rights.

However, FERC noted the FCA rules do not allow ISO-NE to reject qualified import capacity resources given knowledge that the relevant interface has insufficient space.

Since the previous composite offer could not be rejected, it remained qualified and TransCanada's subsequent bid would result in capacity being bid twice.

Briefly:

Constellation Selling Procurement Consultant

Constellation Energy is selling energy procurement consultant Fellon-McCord & Associates to the company's co-founder, Andrew R. "Drew" Fellon. The sale of Fellon-McCord will allow it and Constellation NewEnergy to pursue independent growth strategies, Constellation said, permitting NewEnergy to concentrate on its commodity risk management expertise. "These lines of business are complementary but distinct, and this restructuring allows each company to focus on what it does best," said Mark Huston, co-president of Constellation Energy's Customer Supply Group. The companies will maintain a strategic alliance, allowing each to meet the needs of current customers and pursue joint opportunities and cross-selling prospects. Constellation acquired Fellon-McCord in 2003. NewEnergy's retail gas unit will maintain its headquarters in Louisville, Ky and be led by Co-Chief Commercial Officers Kevin Watson and Bret Feller.

EFH Loss Widens

Energy Future Holdings recorded a $1.27 billion loss in its first quarter, versus a year-ago loss of loss of $497 million, it reported in an SEC filing. An analysts call is set for May 19. Residential customer count at TXU continued a slow trend of recovery which started in the final quarter of 2007, rising to 1.89 million for Q12008 from 1.85 million a year ago. Total customers reached 2.17 million from 2.15 million a year ago.

FERC to Hear on New Plant Construction Costs Next Month

FERC will devote a part of its next open meeting (June 19) to staff presentations regarding the cost of new generation, and upward pressure on input prices. The update was suggested by Commissioner Philip Moeller.

DRCC Honors Smitherman, Peevey, Kelly

The Demand Response Coordinating Committee tabbed California PUC President Michael Peevey, PUCT Chairman Barry Smitherman and FERC Commissioner Suedeen Kelly as winners of the group's 2008 Demand Response Leadership Awards.

FERC Gives More Insight into Enforcement Approach

FERC offered stakeholders greater transparency on enforcement with a refined policy statement, expanded no-action letter policy, annual statistical summaries, and proposed clarification to ex parte communications during non-public investigations. Since FERC evaluates the strength of internal compliance measures when determining civil penalties, FERC added to the policy statement suggestions for strenuous compliance programs, including: creating an independent compliance officer reporting directly to the CEO; tying regulatory compliance to personnel assessments and compensation; frequent mandatory training programs with real world examples; and an internal anonymous compliance hotline. FERC also updated the policy statement to consider, when reviewing penalties, the risk of serious harm even if actual harm was slight and the impact on the efficient and transparent operations of markets. A NOPR (RM08-8) would ensure that the rules limiting contact with Commissioners and decisional staff apply in the same manner to outside parties as it does to litigation staff during enforcement proceedings. The NOPR would also clarify that intervention is not available as of right in proceedings arising from non-public investigations, though the Commission may decide to permit interventions. FERC clarified (RM08-10) that in all but extraordinary circumstances the Commission will notify an entity when Enforcement staff intends to seek an Order to Show Cause. Subjects will have 30 days to respond.

FERC Accepts Transmission Planning Policies Under 890

FERC conditionally approved the first set of six compliance filings regarding transmission planning under Order 890, including filings from PJM, the Midwest ISO, and ISO New England. Each RTO needs to tweak its local planning proposal under FERC's orders. FERC will convene regional technical conferences beginning in 2009 to determine the progress and benefits realized by each transmission provider's planning process, obtain customer and stakeholder input, and discuss any areas that might need improvement.

Energy Savings ... from 1

The retailer plans to enter at least one new U.S. state in fiscal year 2009. It started marketing electricity in Niagara Mohawk last month.

Energy Savings endured another slow year of acquisitions, adding only a net of 28,000 customers, well shy of its 125,000 customer target. Gross additions were 1% lower year-over-year at 342,000, short of the retailer's target of 415,000.

Heavy competition in the newly opened British Columbia residential gas market and tight labor markets in Ontario and Alberta, which hampered recruitment of sales contractors, hurt acquisition efforts and, combined with churn, led to a net loss of 47,000 residential equivalents in Canadian gas customers, Energy Savings said.

U.S. attrition, particularly in New York and Illinois, was higher than expected on "adverse news coverage" surrounding perceived high fixed prices and aggressive independent sales contractor practices which resulted in cancellations. In addition to a lawsuit from the Illinois attorney general and complaint from the Illinois Citizens Utility Board, Energy Savings disclosed that it was in "discussions" with the New York attorney general about its contracts and practices, and that it anticipates making changes to business operations as a result of the discussions.

Still, gross U.S. gas additions at 119,000 customers beat expectations of 110,000.

Over 20,000 customers signed up for the marketer's Green Energy Option for either partial or full renewable power, and 29% of new customers picked the product. Average green usage is 60%. Energy Savings expects the renewable product to increase sales receptivity and improve renewal rates by boosting customer loyalty.

Energy Savings recorded higher per-customer marketing and acquisition costs to renew existing customers and replace lost customers, as well as higher general and administrative expenditures, during the year.

The number of customers up for renewal in fiscal 2008 was 151% higher than the previous year, with the largest number of renewals in Ontario electricity.

Energy Savings spent C$39 million on marketing and acquisition expenses to maintain its current level of gross margin, which represents 69% of the total marketing expense for fiscal 2008. Total marketing and acquisition costs, which include commissions paid to sales agents, rose to C$56 million from C$43 million last year.

Acquisition costs for U.S. electric customers (excluding those acquired from Just Energy) were C$141 per residential customer equivalent, and C$160 per residential equivalent on the gas side.

General and administrative costs increased by 23% in the current year due to infrastructure investment and additional employees for Texas operations.

Bad debt expenses decreased 36% due to effective credit and collection processes implemented during fiscal 2008. Energy Savings is exposed to bad debt in Texas, Illinois and Alberta, where bad debt collectively was $7 million for fiscal 2008, or 1.5% of revenues for those markets. A year ago, bad debt was 3.3%.

Energy Savings reported its percent of customers up for renewal by product in the coming years:

Fiscal Year	Canada Gas	Canada Electric	U.S. Gas	U.S. Electric
2009	17%	15%	2%	26%
2010	24%	6%	13%	19%
2011	24%	23%	21%	10%
2012	19%	23%	18%	17%
2013	14%	31%	43%	24%