Energy Choice Matters

May 21, 2008

Cross-Subsidization Contemplated in Mitigation for New Type II Customers

The Maryland PSC's decision to mitigate rates for "new" Type II customers (pushed into the class due to a definition change) will create, "winners and losers," Frank Lacey, Director of Government and Regulatory Affairs for Direct Energy, told us.

As first reported here yesterday (Matters, 5/20/08), the PSC directed Baltimore Gas & Electric, Delmarva Power and Allegheny Power to limit June 1 rate increases for new Type II customers to 15%, with the mitigation paid for by non-residential customers through a distribution charge. The mitigation is to be applied to the non-distribution portion of bills, so would only be available to bundled customers.

Since the PSC adopted Pepco's definition of Type II customers, Pepco isn't impacted by the change.

We wanted to get a second opinion on the letter orders' language and mechanics before judging its impact on the market.

Lacey agreed with our reading that PSC's order contemplates cross-subsidization among non-residential customers. Although a final order on revised tariffs is to come May 28, the PSC's guidance would essentially charge all non-residential customers to finance a generation services charge reduction for about 15,000 new Type II customers.

That's a departure in two respects from how other recent mitigation plans and rebates have been implemented in Maryland. The infamous SB1 from 2006, which mitigated BGE's move to residential market-based rates, was a deferral program. That meant while residential consumers had the option to pay less than full prices immediately, they eventually had to pay the full increase, plus interest if they elected to defer the increase. The full market price was also reflected on bills to give customers an accurate price to compare, and a non-bypassable distribution charge/credit was used. Pepco and Delmarva developed similar competitively neutral phase-in plans.

... Continued Page 4

Dip in MXenergy Profits from Lower Gas Margins, Higher Costs

MXenergy suffered through a "disappointing" quarter with lower net income from reduced gas volumes and lower gross profit per MMBtu sold (excluding the GasKey acquisition) and higher operating costs, CEO Jeffrey Mayer told investors yesterday.

Net income was $25 million for the quarter ending March 31, 2008, down from $34 million a year ago.

Adjusted EBITDA, which excludes unrealized gains or losses from risk management activities, was $31 million for the quarter, down $17 million from $48 million in the year-ago period. Adjusted EBITDA included a $16.4 million decrease in natural gas gross profit.

Operating costs were higher from integrating legacy backoffice platforms onto the system acquired in the 2006 Shell Energy Services Company purchase, as well as investment in financial controls to be fully Sarbanes-Oxley compliant by June 30.

Although Mayer reported that growth in Residential Customer Equivalents (RCEs) over the past six months has offset attrition, customers weren't added quickly enough to offset higher expenses in the quarter.

In-contract customer attrition improved to 19% for the nine months ended March 31, 2008, down

... Continued Page 5

PSC Staff Sees Smart Meters, Grid Key to EmPower Maryland

Smart meter and smart grid technologies, "could make the difference," in the successful achievement of EmPower Maryland energy conservation targets, the Maryland PSC staff reported in responding to a list of questions ahead of a two-day public conference starting May 29 (PC12).

"Staff concludes that smart meter and grid technologies significantly increase the likelihood that the EmPower Maryland peak load reduction targets can be achieved or even exceeded."

Even if advanced metering infrastructure (AMI) demand reduction estimates were discounted 25%, AMI enabled demand response could still represent a significant share (perhaps 40% or more) of EmPower Maryland's peak load reduction goal, staff calculated.

Utility filings estimated approximately 120 GWh of energy savings as a result of AMI enabled technologies, approximately half the energy savings of a statewide Energy Star new construction building code, staff observed.

Smart metering allows costly customer incentives for participation in direct load control programs to be replaced by time-of-use based pricing, time-of-use based rebates or some other variation of electric pricing based on actual capacity and energy costs at peak times, staff added.

Essentially, all customers would become demand response customers, not just voluntary participants in load control programs, staff explained.

"This has the potential to reduce or eliminate direct customer incentive payments and increase effective customer demand response," staff argued.

Staff favors including smart meter and grid technologies in utilities' EmPower Maryland plans so that all potential costs and benefits related to energy and peak demand savings will be evaluated on a consistent basis

The Commission should approve Baltimore Gas and Electric's energy efficiency and conservation (EE&C) programs subject to previously filed staff recommendations, while proceeding with consideration of Pepco's and Delmarva's programs, which are comprehensive for residential and smaller commercial customers and ready for Technical Advisory Group (TAG) review.

Staff recommended deferring consideration of the Allegheny Power's EE&C programs since they are modest and have raised enough questions that TAG resources could be better spent focusing on Pepco's and Delmarva's programs to permit Commission action on them by the end of July.

Because Allegheny's current programs are so far behind those at the other IOUs, benefits of reviewing Allegheny's programs now would be minimal compared with the resources it would take from TAG and the Commission, staff reluctantly concluded.

FERC Approves Change to Put External Resources on Equal Footing in FCM Obligation

FERC accepted a reservation flexibility proposal from ISO New England and the NEPOOL Participants Committee to allow market participants to submit transmission reservations associated with a priced external transaction supporting a capacity obligation up to an hour before it is to be scheduled in the real-time energy market, in order to put external resources on equal footing with internal resources in regards to the Forward Capacity Market (ER08-697).

Under FCM, any market participant with a capacity supply obligation must submit a supply offer for a resource's available capacity in the day-ahead energy market.

Internal resources are not required to reserve transmission service on Pool Transmission Facilities (PTF), but external resources are required to reserve transmission service in advance -- by noon the day before the operating day.

Market participants with capacity obligations must submit supply offers in both the real-time energy market and the day-ahead energy market. Since ISO-NE does not determine whether external transactions for a particular hour will be scheduled until an hour before the delivery hour, market participants with priced external transactions are required to reserve and submit transmission reservations well in advance of knowing whether such transmission will ultimately be needed.

The change would allow external resources to compete more fairly in the capacity and energy markets with internal resources by allowing external resources to determine whether their transaction might be scheduled in real-time before deciding whether a transmission reservation will be necessary.

FERC accepted the modification since it will lead to a more uniform treatment of external and internal resources.

While several distribution utilities opposed the change, FERC found FCM settlement language, "to be unequivocal in its direction that market rules, procedures, and manuals be changed in order for external resources to compete on an equal basis with internal resources."

FERC dismissed claims from utilities that the proposal led to unfair treatment of internal resources since they've paid interconnection costs to PTF facilities to ensure that their capacity is deliverable, while external resources would be allowed "a la carte" transmission payments.

The Commission noted that neither the FCM Settlement nor capacity market rules address whether energy delivery must be supported by PTF or non-PTF infrastructure, contradicting the utilities' claims of inequitable treatment.

FERC explained that the old reservation process for external resources likely increased the price of external resources' energy offers to account for "excess" transmission reservations resources' may have procured since reservations had to be made well before the delivery hour.

Briefly:

ERCOT Delays Nodal Market Start

ERCOT reported yesterday that it will not start the nodal market Dec. 1 as planned due to later-than-expected software deliveries. ERCOT has not determined a new date for nodal implementation, though a PUCT order contemplates operation by Jan. 1, 2009.

Riverway Removed from PUCT's Power to Choose Site, REP Cites Change in EDI Provider for Issues

The PUCT last week removed offers from Riverway Power from the Power to Choose website after customer complaints and the Commission's inability to reach high-ranking officials at Riverway about the complaints. The complaints mostly concerned a delay in the time it took Riverway to enroll customers, which was caused by a change in EDI providers, Riverway CEO Ed Lateef told us. The issue has been resolved and Riverway is no longer experiencing delays in enrollment, Lateef said. Lateef reported that the PUCT had informed the REP of the complaints, but he was unaware of any inquiry from the PUCT to contact Riverway at a high level. Riverway said it would contact the PUCT, and also discuss returning its offers to Power to Choose with its enrollment issue now corrected.

Mich. PSC Initiates Contested Case for Staff Complaint Against Universal

The Michigan PSC commenced a formal complaint proceeding against Universal Gas & Electric, creating a contested case to consider arguments made by staff regarding UG&E's alternative gas supplier license. The Commission, without elaboration at yesterday's open meeting, directed PSC staff to file a single, unified complaint against UG&E by Aug. 1 that covers all matters the staff believes to be pertinent to the issue of whether the company's alternative gas supplier license should be revoked. Staff had previously stated it intended to seek revocation of UG&E's license if the marketer did not stop marketing while addressing staff concerns, and had also asked for a formal complaint proceeding to be opened regarding UG&E's alleged failure to timely send enrollment confirmation letters to customers (Matters, 5/7/08).

Pre-Buy Electric Customers Moved to POLRs

ERCOT dropped Pre-Buy Electric's 8,400 customers onto POLRs after the REP defaulted on payment obligations to ERCOT. The prepaid marketer's book included 8,394 residential customers and 36 small non-residential customers, using approximately 255 MWh/day. It's the first mass transition since early 2006, the last time gas prices were so volatile. ERCOT used its automated switching process for the first time. The system allowed the process to be completed in just 3 days.

Texpo Power Argues New REP's Name Confusing

Texpo Power intervened in the docket concerning the REP application of Nooruddin Investments d/b/a Texan Energy (35659), arguing there is considerable risk that customers will confuse Texpo's legal name and certified trade name of Texpo Energy with newcomer Texan Energy, due to the high degree of similarity between the two names (Matters, 5/12/08). Texpo Energy, "seeks to intervene in this proceeding to protect the value of its names and to prevent ... substantial market confusion," citing Substantive Rule 25.107 which prohibits deceptive, misleading, vague or duplicative REP names.

Oncor Accepts REP Tweaks to Service Quality Plan

Oncor accepted a recommendation from the Alliance for Retail Markets that service quality rebates passed to customers through REPs should be identified by and flow to specific ESI IDs, rather than to customers occupying the premises involved (35546). That change, prompted by ARM's observation that customers associated with ESI IDs may not be the same as individuals occupying a premises, should also alleviate a similar concern from TXU Energy, Oncor noted (Matters, 5/8/08). Oncor agreed to use Texas SET code CRE027 to pass through the service quality rebates related to the agreed upon reliability standards and code CRE030 to pass through payments related to the agreed upon customer service standards, providing clarification requested by TXU and Reliant Energy. Oncor submitted a revised compliance filing for Commission adoption, noting no parties oppose the modified plan.

FERC Says Tariff Already Prevents CAISO Discretion on WECC Reliability Charge Adjustments

FERC rejected a protest from the Alliance for Retail Energy Markets regarding invoicing of NERC/WECC reliability charges based on metered demand (ER07-805-003 et. al.). AReM was concerned language in the CAISO tariff and ISO-WECC Billing Services Agreement gave the ISO the option of accepting WECC-approved changes in the metered demand associated with a particular LSE, rather than compelling the ISO to accept any changes. FERC concluded the disputed language was meant to give CAISO administrative flexibility in drafting reports for WECC and is not determinative of what load will actually be reflected in the invoices issued to Scheduling Coordinators. FERC stressed that the tariff states that CAISO must include WECC-approved adjustments to metered demand in preliminary and final invoices; the tariff gives CAISO no discretion in the matter.

Michigan PSC Approves Stricter Deposit Rules for Utilities

The Michigan PSC approved new rules governing utility billing practices for electric and natural gas business customers, which include lower deposits limits for small business customers (U-14852). Utility is defined as a person, firm, corporation, cooperative, association, or other legal entity that is subject to the jurisdiction of the Commission and that distributes or sells electricity or natural gas for non-residential use. Utility deposits for business customers using 15,000 kWh or less per year or 200 Mcf or less per year cannot exceed 15% of the customer's annual electric or gas bill, a change from the 25% threshold which remains for larger customers.

Constellation NewEnergy Is Official REC Supplier of Green Alliance

Constellation NewEnergy has entered into a pact with the Green Business Alliance, under which NewEnergy is the official REC supplier of green alliance. The relationship with the Green Business Alliance provides a new channel for NewEnergy to market RECs and build green product awareness. The alliance advises businesses on a range of eco-friendly measures that can be implemented in daily business practices. Separately, NewEnergy is supplying RECs to match 100% of the electricity usage at ConnectivityWeek, a conference highlighting the role of information technology for smart energy products and services.

Type II Mitigation ... *from 1*

In contrast, mitigation for new Type II customers would be socialized across customers not receiving the benefits of the mitigated rates. While it avoids carrying costs, it also means the bulk of the rate increase for new Type II customers will be paid for by Type I customers, existing Type II customers, and Type III customers.

While the PSC's mitigation for new Type II customers would exclude shopping customers, recent mitigation plans or rebates have been competitively neutral, to the extent possible. For example, Allegheny Power's residential transition plan, designed to prevent rate shock when market pricing begins, uses a non-bypassable distribution surcharge/credit to preserve the price to compare. The recent $170 BGE rebate which was part of a settlement between Constellation and the state will go to all residential distribution customers, regardless of their commodity supplier (Matters, 3/31/08).

Lacey expects that mitigation for new Type II customers will create a lot of confusion since market participants won't have any time to educate customers about the unique circumstances, as the changes are to occur June 1 with a final order not issued until May 28. Having two sets of Type II customers (current and new) paying different prices may prompt some head scratching among customers.

Lacey suggested that the rate mitigation runs counter to energy efficiency goals of EmPower Maryland by blunting price signals during the summer, when peak load needs to be reduced most.

MXenergy Earnings ... *from 1*

from 27% in the year-ago period, due to a concerted effort to improve customer care.

Combined gas and electric RCEs were up 8% from the year-ago quarter, but excluding the GasKey acquisition, were down 8% from the year-ago period.

The challenge has been on the gas side, where RCEs were down 10% year-over-year when excluding the GasKey book, due to "normal" customer attrition as described by executives. Gas RCEs have been relatively flat since the second quarter of 2008, however.

MXenergy's electricity business has seen "strong growth" with RCEs up 169% year-over-year on organic growth and the acquisition of Vantage Power Services in Texas. Electricity revenues reached 9% of total revenues year-to-date.

Electricity growth in Texas and the Northeast has been with C&I customers, however, which carry lower margins. Much of GasKey's book was lower-margin C&Is as well.

Bad debt is at historic levels.

While rising gas prices had squeezed margins as utility rates lag the market, Mayer reported a "pleasing" increase in the ability to market long-term contracts during the quarter, as utility rates have started catching up with the market, making price protection plans more attractive.

Aside from introducing an Energy Star rebate product (Matters, 4/23/08), MXenergy has added a guaranteed savings-type product dubbed Save-or-We-Pay.

MXenergy has also seen "good results" with an expanded door-to-door marketing effort, executives reported.