Energy Choice Matters
August 13, 2008

PNM To Shop First Choice Power

First Choice Power, "may have more value to another participant" in the market, PNM Resources CEO Jeff Sterba announced in reporting another disappointing quarter for the retailer.

PNM will consider strategic alternatives for First Choice in the next 120 days, including a sale or possible transfer into its EnergyCo joint venture. Sterba stressed, however, that PNM won't sell at any price and sees First Choice as a viable business, but challenges faced in restoring financial health to the PNM utility subsidiary are warranting the parent's immediate attention. In the meantime, First Choice will execute a conservative business strategy that focuses on margin preservation and customer retention.

First Choice Power GAAP losses were $60.4 million for the quarter, compared with earnings of $6.4 million a year ago. Ongoing losses were $13.0 million, compared with earnings of $5.3 million, in the year-ago period.

Quarterly average retail margins cratered from $21/MWh a year ago to $3/MWh due to ERCOT volatility and incremental power costs, a change in customer mix to lower-margin customers, higher bad-debt and increased operational costs.

Executives also cited significant basis differentials, ineffective seller's choice contracts, higher uplift costs from congestion management, high ancillary service costs and stagnant customer growth for the results. First Choice has since liquidated its seller's choice positions.

Customer count inched to 253,800 from 249,500 a year ago. Legacy incumbent customers in the Texas New Mexico Power territory account for 40% of First Choice's customer base.

Quarterly residential sales grew 11% to 709.1 GWh, but mass market sales fell 39% to 68.2 GWh and mid-market sales dropped 8% to 304.5 GWh.

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Proposals for REP Financial Standards Include $5 Million Credit Requirement; TDU Imposed Curbs

Proposals submitted to the PUCT to enhance financial standards applicable to REPs and to protect customers from REP defaults ranged from increasing the needed security to $5 million, annual re-licensing of REPs, allowing TDUs to impose their own credit requirements, and posting greater financial data publicly for customers to evaluate (35767, Matters, 8/12/08).

First Choice Power recommended that all REPs should be required to post, at a minimum, a Stand-By Letter of Credit (LOC) with a cash value of $5 million instead of the current standard of $100,000, unless the REP has investment grade credit (defined by First Choice as no less than A- from Standard and Poor's).

Reliant Energy argued that changes to REP financial standards are not necessary if the Commission posts additional information publicly about REPs' financial conditions. Reliant suggested listing a few key metrics that are understandable to the average person on PowertoChoose to allow customers to evaluate a REP's financial strength, such as:

- Total assets;
- Net worth (assets minus liabilities);
- Amount of cash on hand;
- Amount of customer deposits currently held;
- How many years the REP has been certified, and
- Number of customers

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Briefly:

ERCOT M&A Chatter

Market chatter says a mid-sized REP solely in the ERCOT market is soon to be purchased by a power company with a multi-billion dollar market cap, with an announcement possible as early as today.

Former Nicor Marketer Execs Lead Start-up AGS in Illinois

Progressive Energy Group (PEG), a start-up led by two former Nicor Energy Services executives, has filed to become an Alternative Gas Supplier in Illinois. Current energy procurement consultant Progressive Energy Solutions has already objected to the application on the basis of Progressive Energy Group's name, though that filing was made in Nicor's rate case (where Progressive Energy Group had filed as an intervenor). PEG would initially sell to commercial and residential customers at Nicor, Peoples Gas, and North Shore Gas. PEG co-founder and president Chris Childress spent over two decades at Nicor, first on the regulated side, then as President of its unregulated marketer Prairie Point Energy. Co-founder and managing partner Arnold Schramel would lead PEG's commodity operations, and held various positions at Nicor before serving as COO of Prairie Point Energy. PEG is currently running website DitchCarbon.com.

Another Rulemaking Session Set for RM17

In the never-ending saga of RM17, the Maryland PSC set for Oct. 7 a rulemaking session to consider revised proposed COMAR 20.53.05, Competitive Electricity Supply, Supplier-Utility Coordination and Utility Consolidated Billing, including POR and proration of partial payments. The PSC invited stakeholders to comment on Staff's latest draft by Sept. 9 (Matters, 7/16/08). The Commission also set a rulemaking session for Oct. 2 on electronic delivery of customer rights pamphlets and regulations regarding unclaimed deposits in RM33 (Matters, 3/6/08). Comments are due Sept. 4. A rulemaking session for RM32, related to RPS and solar RECs, was set for Sept. 4 (Matters, 6/2/08).

Comverge Loss Grows on PJM Rule Change

Comverge's net loss widened to $9.6 million for the quarter, from $4.4 million a year ago, on rule changes in PJM which imploded revenues from economic demand response. Comverge's Enerwise unit posted a meager $100,000 in revenue from economic demand response programs in Q2, compared to $2.8 million in the second quarter of 2007. Comverge blamed regulatory changes in PJM which eliminated an incentive payment for economic demand response, as well as operational changes which made it harder for customers to respond, which have combined to reduce customer participation. Due to the challenges, Comverge lowered its revenue outlook for the full year to $80-90 million, below the previous full-year outlook of $95-105 million. Enerwise's total revenues were $2.6 million for the quarter, and it added 94 MW in the quarter, for a total of 897 MW under contract. It also manages an additional 437 MW for a fee. Comverge now has 2,075 MW under management (including 40 MW subject to regulatory approval), with more than $375 million in future contracted revenues.

Glacial Energy to Pay $34,000 to Settle REC Shortfall

Glacial Energy entered into an agreement with PUCT Staff under which the REP would pay $34,050 for failing to retire 681 of the RECs it was required to retire for 2007 by the March 31, 2008 deadline (35990). Glacial has agreed to purchase and retire the 681 RECs as well.

Two Mich. AES Licenses Relinquished

The Michigan PSC approved the voluntary relinquishment of AES licenses by Suez Energy Resources NA and Dillon Energy Services f/k/a EMC Gas & Electric. Dillion cited pending legislation and current market conditions for its decision.

DPUC Sets Comment Date for IRP

Comments on the draft Connecticut integrated resource plan are due to the DPUC by Aug. 29 (08-07-01, Matters, 8/4/08).

Michigan Churn Keeps Universal Customer Count Relatively Flat

Universal Energy Corp. GAAP net income grew to Cdn$27.7 million, compared with a loss of Cdn$22.0 million a year ago, and the Canadian-based retailer recently completed a "small deal" to acquire a book of customers, though executives would not provide further details.

Executives on an analysts call had earlier told investors that Universal would not enter into any new markets in the next quarter, but could do so thereafter. Executives see additional opportunities to buy both small and large books.

Net income from this year's quarter included unrealized hedging gains of Cdn$31.0 million, while the prior-year quarter included a Cdn$32.2 million unrealized hedging loss. Customer growth compared with the prior-year's quarter accounts for the earnings gain as well.

However, customer count compared with the quarter ending March 31, 2008 fell by nearly 2,100 residential customer equivalents (RCEs) as Michigan natural gas churn was higher due to negative press coverage relating to Universal's marketing as well as a PSC investigation. Gross customer additions were around 20,000. U.S. annualized attrition was 21.4%, while the Canadian market experienced annualized attrition of 12.2%.

Universal has pruned its acquisition efforts to focus on enrolling customers meeting its target margins. As a result, it has cut its Canadian sales staff to 300 from a peak of 500, and its Michigan sales staff to 50 from a peak of 200. The Michigan cuts were also a result of ramping down sales while the PSC investigates Universal's marketing.

The retailer ended the quarter with 427,131 RCEs, much higher than the year-ago period, as Universal had 363,000 RCEs as of September 2007. Executives are targeting 600,000 to 650,000 RCEs by the end of fiscal 2010.

Universal has been able to substantially offset the financial impact of the higher U.S. attrition by realizing a gain of Cdn$3.8 million on the saleback of excess gas previously procured for the Michigan market.

Nevertheless, "Universal continues to monitor all markets to minimize attrition and follows a policy of diligently enforcing collection of liquidated damages from customers attempting to exit their contracts," as stated in management discussion and analysis.

Total revenue was Cdn$91.5 million versus Cdn$52.4 million a year ago. U.S. gas revenues were Cdn$29.8 million, up from Cdn$8.1 million. Consumed U.S. gas volume was 2.80 million Mcf, up from 801,000 Mcf.

Gross margin was Cdn$28.2 million, up from Cdn$20.8 a year ago. U.S. gas gross margin was Cdn$4.3 million, up from Cdn$1.1 million in the prior year's quarter. Operational margin, an adjusted metric, was Cdn$18.2 million compared to Cdn$10.4 million a year ago.

U.S. gas operational margin was US$1.4722/Mcf, down from US$1.5656/Mcf a year ago. On a per residential customer equivalent basis, U.S. gas margin was Cdn$150.27/RCE, down from Cdn$159.96.

Customer acquisition costs fell to Cdn$2.1 million from Cdn$5.9 million a year ago, but general and administrative costs rose to Cdn$6.2 million from Cdn$4.0 million.

For the quarter, average acquisition cost excluding direct mail costs was Cdn$136/RCE, or Cdn$152/RCE when including direct mail costs.

Operational income after customer acquisition was Cdn$8.9 million compared to Cdn$593,000 in the year-ago period.

Geographically, Canada accounts for 70% of total RCEs and the U.S. for 30% of total RCEs. In Canada, residential customers account for 73% of RCEs and commercial customers account for 27% of RCEs. In the U.S. residential customers account for 69% of RCEs and commercial customers account for 31% of RCEs. On a product distribution basis, gas customers account for 52% of total RCEs and electricity customers account for 48% of total RCEs.

Universal's new home services division, National Home Services, enrolled 2,400 customers in its water heater rental program in its first eight weeks of sales. National Home Services recorded a loss of $405,000 for the quarter, as it is in startup mode, and anticipates earning revenue from the installations in the next quarter.

PUCT Issues Written SWEPCO CCN Order

The PUCT issued a written order that, in a 2-1 vote, conditionally grants a CCN for SWEPCO's ownership in the 600 MW Turk Plant based on obtaining all of the necessary environmental permits, limiting the costs that may be included in ratebase to Texas's jurisdictional allocation of SWEPCO's ownership share of total plant cost of $1.522 billion, and placing other limitations and requirements on SWEPCO (33891, Matters, 7/16/08).

The cap on the capital costs of the Turk Plant limits the financial risk to Texas ratepayers arising out of uncertainties identified in the case's testimony including, but not limited to, increased material and labor costs because of delays; costs as a result of changes in certification or approval of the Turk Plant by other jurisdictions; changes in the currently proposed ownership participation; and additional costs of plant construction, including those associated with the use of ultra-supercritical technology, the Commission found.

The Commission also limited the carbon mitigation costs placed on the Turk Plant borne by Texas ratepayers to $28/ton of CO2 emissions through the year 2030.

The order finds that the purchased power option for baseload power in a volatile fuel market is likely to result in substantial increases in fuel costs, against which there will be little protection for Texas consumers.

Coal prices are most likely to be less volatile than natural gas for the foreseeable future, the Commission noted, adding that it is ideal to maintain a balanced mix of fuel sources.

SWEPCO's self-build proposal is the most reasonable approach to meeting the identified future power needs given the current estimates for costs, the Commission added. "If the projected costs for building and operating this plant were higher, the Commission would be unlikely to find that the plant would provide the necessary benefits to consumers and would be likely to find that building the plant would place undue risks to the financial standing of the company," the order states.

The conditional approval of the CCN amendment does not waive the Commission's rights in subsequent rate cases, fuel reconciliations, rulemakings, or other proceedings to make determinations as to the appropriate allocation of costs related to contracts that SWEPCO enters into with wholesale customers, the order finds.

Conditional approval also does not constitute pre-approval of the appropriate Texas retail treatment that might be applied to any arrangements in which SWEPCO sells power to wholesale customers for resale, directly or indirectly, to other wholesale customers.

The Commission disallows any allocation of the Turk Plant base-rate costs that are not used for retail purposes to Texas retail ratepayers.

The order finds that because customer choice in SWEPCO's service area is likely to be delayed beyond 2011, construction of the Turk Plant will not delay customer choice, and construction will not necessarily result in SWEPCO having stranded costs.

Commissioner Julie Parsley filed a separate dissent which was not available at press time.

TOs, TDUs Reiterate Damage to MISO from Market Services Offering

As long as Market Services customers of the Midwest ISO can enjoy energy market benefits of organized markets while free riding on Regional Expansion Criteria and Benefits transmission upgrade costs paid by others, the "RTO lite" offering will discourage stakeholders from becoming full transmission owning MISO members, and would even encourage current members to exit to avoid upgrade costs, a variety of stakeholders told FERC (ER08-637, Matters, 6/16/08).

Great River Energy argued that Regional Expansion Criteria and Benefits cost allocation for new transmission is a primary driver discouraging non-MISO transmission owners from becoming MISO TOs. The Market Services proposal, one facet of the Western Markets Plan (Matters, 4/8/08), would allow market participants to escape paying for upgrade costs while enjoying energy market benefits -- which could have far-reaching impacts on the composition of MISO and the long-term viability of MISO as an RTO, Great River said.

The Midwest TDUs went a bit further, claiming that the Market Services option could "potentially fatally" undercut the principal achievement of a decade's worth of ISO policy work -- independent grid planning and a level, de-pancaked market field that, uniquely among market-operating RTOs, encompasses numerous states which were not historically a tight power pool.

The Midwest ISO Transmission Owners shared concerns about existing transmission owners being encouraged to leave MISO as transmission-owning members due to cost allocation, and urged FERC to order that existing Transmission Owners must not incur additional charges or face any additional obligations relative to Market Services customers.

In particular, the Commission should require the Midwest ISO to ensure that its proposed Market Integration Transmission Service does not provide preferential treatment to Market Services customers, either through rates or terms and conditions of transmission service as compared to Network Integration Transmission Service used by existing Transmission Owners, TOs suggested. Further, the existing Transmission Owners should not be allocated a disproportionate share of costs associated with facilities under the Midwest ISO's Regional Expansion Criteria Benefits program, TOs added.

The Market Services proposal appears to give companies at the Western edge of the Midwest ISO the ability to sell excess baseload generation into the Midwest ISO market, while avoiding taking on the most significant burdens of membership, Indianapolis Power & Light concluded.

"The Commission should not allow the Midwest ISO to give a significantly better deal to one particular company on the Western edge of the Midwest ISO border, while not making the same deal realistically available to existing members," IP&L said.

But MISO defended the program and disagreed with the implicit suggestion that the Market Services option is so superior to full membership that the existing Transmission Owners would queue up to leave the Midwest ISO in order to take advantage of that option.

"[T]here is no escape from the conclusion that it is still a transitional, and severely truncated, service option, particularly when compared to full RTO membership," MISO said.

Market Services customers will not receive the "substantial" benefits of MISO tariff administration and centralized regional planning services, which have become more complex and thus expensive for non-RTO transmission owners under Order 890, MISO noted. MISO also provides full members with coverage of overhead costs for compliance with various NERC standards, which Market Services members will not enjoy.

Iberdrola Renewables maintained that while it is preferable for all transmission owning utilities in the region to join MISO, "it is not realistic to expect that transmission owning utilities that are not currently MISO members will join MISO any time soon."

Adoption of the proposed Market Service provisions is clearly preferable to the status quo in the Midwest region, in that the availability of Market Service would result in an expansion of access to MISO's markets to regional utilities that are unwilling or unable to participate in MISO, Iberdrola said.

First Choice Power ... *from 1*

While PNM expects significant improvement at First Choice Power, the best executives can hope for in 2009 is to dig out of the hole that was created, they conceded.

PNM's equity in the GAAP net losses of joint venture EnergyCo was $1.9 million, compared with earnings of $1.4 million, in 2007. EnergyCo has decided not to pursue another unit at its coal-fired Twin Oaks plant, which would have added 305 MW of capacity, due to uncertain carbon regulation.

Overall, PNM Resources reported GAAP losses of $143.5 million, compared with earnings of $20.2 million a year ago.

REP Standards ... *from 1*

The REP certification process should provide some standard rating of the business that consumers can use to build an expectation for quality of service, and that the REP could use as a marketing tool, Texas Legal Services Center and Texas Ratepayers Organization to Save Energy recommended. "Such a system also provides an incentive for a competitive business to work to achieve a higher designation or rating while building customer confidence in choosing a REP," and thus may improve the quality of service throughout the industry, the consumer groups reasoned.

The Office of Public Utility Counsel suggested that the amount of financial security should correlate directly to the number of customers a REP is permitted to serve. For example, a REP that has $100,000 cash reserves would be permitted to serve 1,000 customers; a REP that has an investment grade credit rating would be permitted to serve a greater number of customers, OPC said. TXU Energy also favored scaling the financial requirements based on a REP's size, probably best measured by some proxy for load.

The Steering Committee of Cities Served by Oncor cautioned against any type of tiered system for financial requirements as it may discriminate against smaller, new entrants. The benefits of a tiered system have to be weighed against the potential for increasing the advantages held by REPs which already hold a dominant market share position -- an action that in the long run could undermine the competitiveness of the retail market, the Cities said.

Direct Energy argued that a REP (or parent company) with investment grade credit should have no financial conditions or credit qualifications with respect to obligations to refund customer deposits and advance payments or obligations to TDUs. OPC agreed with an exemption for investment grade REPs in terms of deposits, as long as they maintain customer deposits in restricted cash accounts.

The Alliance for Retail Markets concurred with Direct's recommendation on deposits, but also suggested that REPs that do not have a credit rating because they are privately held entities should likewise not be required to post cash-like assets to cover customer deposits and prepayments if the REP can provide proof that customer deposit and advanced payment monies are set aside in a restricted cash account kept separate from the REP's operating expense and capital accounts. All REPs should be given this option, along with the option to set up an escrow account in which monies will be appropriately held, ARM said.

ERCOT could be designated as a central repository for all funds paid in advance for security deposits and prepaid service, TLSC and ROSE suggested as an alternative to LOCs and surety bonds.

"The advantage of this proposal is that it would allow security deposit funds and billing credits to be transferred from one REP to another when a customer switches REPs," TLSC and ROSE noted.

TDUs should be able to obtain security from REPs pursuant to rules prescribed by the Commission, the Joint TDUs urged. "Permitting the TDU to manage the risk of REP non-payment between itself and its REP trading partners by applying credit standards as it would do in any other commercial relationship, results in the Commission not having to monitor REP compliance on an ongoing basis or disburse funds to TDUs after a REP default," the TDUs argued.

TLSC and ROSE favored giving TDUs latitude to manage REP credit risk, contending that TDUs should be able to manage the credit risk of REPs to the same extent that REPs are permitted to manage the credit risk of residential customers. Credit worthy REPs would be exempt from TDU deposit requirements and unsecured credit could be offered to a REP based on payment history, TLSC and ROSE suggested. But TDUs reported that defaulting REPs often have no prior history of missed payments, and insisted that payment history should not used as a method to relieve REPs of credit obligations to TDUs.

TDUs pointed out that cash, or cash-like assets used as security, must not only be of sufficient amount, but must also be segregated in a manner that ensures they will not be spent elsewhere, and must be unavailable to other creditors of the REP upon default.

An investment grade credit rating does not provide the same immediate ability to attach funds to repay customer deposits or to satisfy TDU obligations as does an LOC or cash deposit, TDUs said, suggesting that should an investment grade exemption be granted, rules must be in place to determine security requirements upon degradation of such rating.

First Choice Power believes it would be detrimental to the competitive market to give TDUs the ability to set their own credit standards. Reliant agreed, noting that TDUs would most likely require 90 days' charges for collateral, which would put REPs at risk with the costs associated with obtaining collateral passed on to consumers. "In short, establishing additional protections for the TDUs provides little incremental value to the market or to retail customers, while likely increasing costs to REPs and their customers," Reliant said.

TDUs also suggested that they be allowed to prompt ERCOT to initiate a mass transition due default on TDU obligations.

The Joint TDUs urged the Commission to

allow them to recover actual losses from REP defaults through rates, either through creation of a regulatory asset or some other mechanism, in addition to applying appropriate credit standards.

TXU also suggested that POLRs receive full recovery of bad debt should TDUs be permitted to use deferred accounting treatment to recover bad debt related to REP defaults. REPs acting as POLRs have been exposed to unexpectedly higher levels of bad debt which undermines an important goal of POLR service - to quarantine the financial strain of the defaulting REP and prevent any "domino-type" series of REP defaults, TXU said.

TDUs also suggested that the substantive rules should clearly require that, "any change in ownership or control of the REP should require either the amendment to or transfer of a certificate." It's currently unclear whether formal transfer of a REP's certificate or the amendment of the original certificate is needed when a REP transfers its customers or operations to another entity, or brings in a new financial partner and changes its management team, TDUs said.

A certified REP should not be allowed to act as a surrogate for an uncertified party who acts as a REP in the market but is not itself certified, TDUs added.

Few stakeholders supported a shorter monthly billing cycle, though TDUs suggested it should be considered in the future. TXU and Direct noted that changing the billing cycle would require significant IT, billing transaction, and other costs for all market participants, as well as significant rulemaking changes. TLSC and ROSE also opposed including more than one billing cycle per month for residential consumers.

TDUs explained a shorter cycle will be practical once transition charges are no longer in effect, and should be considered then. Currently, due to the nature of transition charge collections, shortening the billing period would be too cumbersome, TDUs said.

ARM does not advocate the use of shorter billing cycles for TDUs or REPs, and also clarified that if the shortening of billing cycles simply means that invoices are due on an earlier date (e.g., earlier than the current 35-day window in the standard delivery tariff), rather than multiple invoices per month, such a proposal would also be inappropriate because it would restrict the cash flow of REPs that rely upon existing cash flow to allow customers more options to pay their bills, to extend due dates on bills, and to provide payment assistance funds to customers. An earlier due date will potentially expose REPs to increased TDU late fees, will require re-tooling of some of the REPs' accounting software, and/or will create the need for additional REP staff to implement such a change. "Given that TDUs do not bear the bad debt risk for end-use customers, ARM does not see the benefit in imposing shorter billing cycles."

TLSC and ROSE recommended that REPs be licensed every year, which would permit adjustments to be made for growth and other factors that would alter the measurement of risk.

TXU also suggested some type of "early warning system" that can be used to identify REPs that may be imperiled or at risk of failure, and/or a probationary period on all new REPs. While the rule should consider careful use of an early warning system to ensure there is not a "run on the bank" (i.e., unfairly alarming customers, driving them to switch and actually precipitating REP failure), REPs meeting the early warning system criteria or subject to a probationary period could confidentially be subjected to more stringent requirements, review, and supervision to protect customers who might be affected, without burdening all REPs (and the Commission) with the onus of unnecessary regulation and scrutiny, TXU suggested.

For a minimum probationary period, perhaps two years, a new REP could be required to file confidential reports (15 days after the end of a month) on products sold, the prices, their procurement strategy, perhaps even including purchases info, customers and finances, TXU noted.