Energy Choice Matters

October 3, 2008

Peevey Alternate Would Defer Question of Rate Caps' Expiration

California PUC President Michael Peevey has drafted an alternate proposed decision regarding San Diego Gas & Electric's petition to raise residential rates above the AB 1X price cap that would essentially defer a Commission decision on when the residential price caps end (A. 07-01-047). The Commission did not take up the original draft, or Peevey's alternate, at yesterday's Commission meeting.

Under the original proposed decision in the case (Matters, 6/25/08), an ALJ determined that SDG&E's application to phase-out the rate cap by 2016 should be denied because AB 1X residential rate protections must last until 2022, when Department of Water Resources bonds are paid off.

The ALJ concluded that since Water Code § 80110 requires the caps to remain "until such time as the [water] department has recovered the costs of power," the caps must remain until all the bond charges arising from the DWR contracts are paid off, even if DWR stops supplying power.

The ALJ reasoned that the bonds represent debt incurred, "for the purposes of paying the cost of electric power," and are specifically included as part of DWR's revenue requirement. Thus the phrase "costs of power" as used in Water Code § 80110 refers to both the power charges and the bond charges that are paid by utility customers to allow DWR to recover its revenue requirement.

Peevey's alternate decision would essentially decline to interpret Water Code § 80110, and would not address the question of whether the bond charges are a cost of power. The alternate reasons that since DWR is still currently procuring power on behalf of SDG&E's customers, the Commission

... Continued Page 5

Calif. PUC Staff Capacity Market Add-On Proposal a "Dead End"

The California PUC's proposed Modified Centralized Market Proposal is a "dead end" that does not have unconditional support from any stakeholders, which is one of the few things market participants agree on in the PUC's review of a resource adequacy construct (R. 05-12-013, Matters, 8/7/08).

The Modified Centralized Market Proposal (MCMP) was opposed by proponents of both a centralized capacity market and a bilateral market, for attempting to "split the baby" and grafting a limited market-like mechanism onto an integrated planning process.

Under the MCMP, each Local Regulatory Agency chooses what portion of its jurisdictional load would meet its resource adequacy requirement through a Preliminary Capacity Showing (PCS), and what portion would be procured through the Centralized Forward Reliability Market (CFRM).

The Bilateral Trading Group argued that by still requiring the development of a centralized capacity market, albeit limited, the MCMP would still expose California to losing jurisdiction over resource adequacy to FERC.

"[M]illions of consumer dollars should not be risked on an untried experiment with an unknown outcome, especially considering that the current RA [Resource Adequacy] program is working well and providing reliability to California consumers," the bilateral group said. The bilateral proponents noted that CAISO has reported zero expenditures in 2008 on commitment of units through the FERC Day-Ahead Must Offer Obligation, showing that the need for any Day-Ahead commitment of capacity has been completely covered by the current Resource Adequacy program.

The Alliance for Retail Energy Markets, which has not expressed a preference for either a

... Continued Page 6

NEM Says Choice Customers Should Share Benefits of MichCon Excess Gas Sale

The National Energy Marketers Association sought intervention in a Michigan docket in which Michigan Consolidated Gas has requested approval of the sale of excess system gas supply, as NEM seeks to oppose distortion of MichCon's bundled price.

As a result of storage facility enhancements, MichCon will be able to make available for sale in 2009 a total of 4 Bcf of native base gas, and proposed giving its GCR customers approximately 75% of the net present value of the total benefits. MichCon would also sell 1.3 Bcf of native base gas to its GCR customers at a drastically reduced price (defined as cost) estimated at $0.32/Mcf for the 2009-2010 GCR period. That compares to the projected prevailing market prices during that time period of $10.39/Mcf, NEM said.

MichCon stated that the sale would result in savings to GCR customers of approximately $12.3 million.

"Despite the fact that all customers pay for reliability-related storage gas and assets, MichCon does not propose a competitively neutral rate mechanism that would permit both GCR and Choice customers to share in the benefit of the proposed transaction," NEM argued.

"It also bears noting that MichCon previously proposed a similar transaction, where GCR customers alone received the benefit," NEM added.

MichCon implemented the results of that previous transaction during the peak winter 2007 season, significantly distorting pricing signals, confusing Choice customers and undermining the benefit of competitive offerings that those customers enrolled in or considered enrolling in, NEM contended.

If granted intervention, NEM would pursue discovery to show that all MichCon customers paid costs and fees associated with storing the base gas that was being held in inventory for deliverability and reliability purposes through their delivery rates. Choice customers have equally contributed to the excess gas storage since MichCon requires flat annual deliveries from suppliers, NEM said. With flat annual deliveries, suppliers are essentially contributing to storage injections during the summer injection season.

MichCon also proposed selling 2.7 Bcf of native base gas to "non-system supply customers" in 2009 at market prices, resulting in an income benefit to MichCon of approximately $15.6 million. NEM argued that revenue generated from such activities should be shared equally with the Choice customers, since the underlying assets are paid for by all base rate paying customers.

Generators Caution on Utility-Run GHG Allowance Auctions

The California PUC's proposed distribution of greenhouse gas allowances to deliverers based on a fuel-differentiated, output-based approach would perversely reward more carbon dioxide production in the power sector, NRG Energy argued in comments on a draft allowance allocation decision (Matters, 9/15/08).

The proposed proportion of allowances would be updated periodically, either annually or less frequently, to reflect changes in production.

That allocation approach would create incentives for carbon-emitting electricity generators to increase their output of electricity and of CO2 by making it possible for a generator to receive more allocations next year by increasing its power and CO2 output this year, NRG explained.

To achieve this increase in CO2 emissions, generators would be incentivized to bid below the sum of the direct cost of their electricity production and the market value of CO2 allowances, thus reducing or eliminating the market price signal for CO2 that is critical for a cap and trade system to function effectively and efficiently, NRG said.

In particular, the missing price signal would perversely reward more CO2 production in the power sector and fail to send price signals to the consumer side of the market, which are critically important for stimulating additional CO2 reduction measures and cost-effective use of energy efficiency and "smart grid" technologies, NRG contended.

Such a market structure runs the risk of creating gaming behavior and unintended consequences, NRG cautioned. "This risk is particularly high in a 'hybrid' market such as California's, where assets owned or controlled by a cost-regulated entity may face extremely strong incentives to bid at zero or very low prices in order to build up as large a pool of allocations as possible," NRG noted.

"California must be extremely careful that enthusiasm for untested and poorly supported policy innovation does not, once again, create market malfunction that results in a discrediting of markets - this time, carbon markets - at the very time that progress against climate change, on both the national and the international level, requires well-tested policies that comport with the most important precepts of good economic policy," NRG said.

NRG suggested an allocation mechanism based on the concept of "net compliance costs" as the most practical and feasible approach toward mitigating economic harm through emission allocation while at the same time establishing the wholesale price signals that will provide incentives for long-term investments in low emitting resources and technologies.

The draft's proposed "lopsided" allocation to retail providers introduces many anticompetitive issues that are not resolved by the requirement to auction the allowances, NRG added.

"The predominant reason is that retail providers, who are monopoly service providers with captive customers, and who thus already compete with merchant generators and other competitive businesses on a playing field tilted their way, will now also be in charge of distributing vast amounts of capital to support AB 32 goals," NRG noted, warning that, "the potential will exist for anti-competitive behavior and prejudicial outcomes that impair the potential for low emitting carbon control technologies and services."

"It is prejudicial to all businesses that compete with cost-regulated retail providers to supply low-carbon technologies and services to have to rely on these same entities for access to the funds needed to accelerate deployment," NRG added.

NRG suggested establishing a neutral, independent funding body that would receive the bulk of the auction revenue and would apportion it on a competitively neutral basis to developers of the most competitive new low-carbon technologies and services. The Independent Energy Producers Association made a similar recommendation to guard against an unintended tilt favoring utility-owned generation.

IEP also recommended establishing a de minimis exemption for the electric sector that excuses deliverers (generators) that emit 25,000 metric tons or less per year of fossil-based $CO_2(e)$ from GHG compliance obligations. The exemption is intended to reduce the burden of compliance with the GHG reduction program for small emitters who have little effect, particularly renewable generators using geothermal, biomass or biogas power.

To ensure reliability, IEP suggested that a mechanism be developed that allows the holders of existing contracts to recover the costs of allowances obtained through the auctions from their counterparties, and ultimately from ratepayers, since the only other means of mitigating carbon costs would be to reduce output.

The draft's determination to exclude voluntary renewables from the market-based cap and trade regime, by failing to provide for the allocation of GHG allowances to deliverers of renewable energy which do not emit GHG, serves to remove a prime motivator behind the voluntary market, the Solar Alliance argued.

"In other words, by not allowing renewables participating in the voluntary market to receive allowances, the Proposed Decision would result in new investment in this market making no contribution to GHG reduction - an illogical

Briefly:

First Choice Sees $10 Million Hit from Ike

The impact of Hurricane Ike is expected to reduce First Choice Power 2008 earnings before income taxes as well as EBITDA by approximately $10 million due to reduced sales volumes, the sale of excess power at prices that were lower than purchased prices, and an increase in bad-debt expense, parent PNM Resources disclosed in an SEC filing. As of September 30, approximately 10,000, or 4%, of First Choice Power's customers were still without power, PNM said. PNM's wholesale unit EnergyCo, a joint venture with Cascade Investments, estimates the hurricane's impact on both 2008 earnings before income taxes and

EBITDA will be $5 million to $7 million because of lost power sales opportunities. First Choice Power, EnergyCo, and PNM's utility Texas-New Mexico Power have sufficient liquidity from cash on hand and bank credit facilities to address financial issues as a result of the hurricane, PNM said.

Fourth PPL 2010 Procurement Approved

PPL received approval from the Pennsylvania PUC for its fourth RFP for mass market default service supply for 2010, when rate caps expire. The average generation supply prices from the fourth round of bids, representing 850 MW, are $112.51/MWh for residential customers and $111.94/MWh for small commercial and industrial customers, including Pennsylvania gross receipts tax and adjustment for line losses. If the average prices for the remaining two purchases match the prices approved so far, the 2010 residential price would be $107.04/MWh and the small C&I price would be $107.89/MWh. For a residential customer using 1,000 kWh/month, the monthly bill increase in 2010 would be 36%, or about $38.48. Monthly bills for small business customers would increase on average about 25%, while monthly bills for mid-size business customers would increase on average about 44.%. The final two purchases are scheduled for the spring and fall of 2009. Fourteen bidders competed in the most recent RFP.

AReM Still Sees Problems with IOU Demand Response Programs

Amended filings by California IOUs regarding proposed demand response programs do not answer objections raised by marketers in a July protest, the Alliance for Retail Energy Markets said in a supplemental protest (A. 08-06-001, Matters, 7/15/08). AReM remains concerned that direct access customers are precluded from participating in several of the demand response programs and urged a workshop to determine the necessity for such restrictions and possible solutions to ease the limitations. Utilities have not addressed requirements that make participation by direct access customers unnecessarily difficult or that hinder ESP's effective management of their direct access customers' accounts, including a lack of notification of ESPs' participating loads in demand response programs. The PUC should require the IOUs to justify the requirement for ESPs to submit Scheduling Coordinator-to-Scheduling Coordinator transfers to effectuate direct access customer participation in certain demand response programs, and, at a minimum, establish a uniform protocol such that scheduling can take place efficiently and in a secure and timely manner, AReM recommended.

Consultant I.C. Thomasson Expanding to Maryland

Multi-state broker-consultant I.C. Thomasson Associates is expanding into Maryland, submitting applications to broker electricity and gas at the PSC. I.C. Thomasson would broker for C&Is for electricity in the four IOU territories and would broker gas at Baltimore Gas and Electric, Washington Gas Light, Columbia Gas, Chesapeake Utilities and NUI.

Integrys Energy Services, Strategic Warn of Impact from AEP-MISO TOs SECA Settlement

Integrys Energy Services and Strategic Energy jointly protested a proposed settlement between several AEP subsidiaries and a host of Midwest ISO transmission owners regarding Seams Elimination Charge Adjustments (ER05-6-001), cautioning that the pact may be read to affect non-settling parties. The competitive suppliers argued that the settlement is meant to insulate transmission owners from providing refunds to non-settling parties by prohibiting further collection from settling parties to pay such refunds. Transmission owners must not be able to claim an inability to pay refunds to non-settling parties under a potential future Commission order due to their claimed inability to collect additional dollars from parties who have settled, the marketers said.

D.C. PSC Denies WGES Solar REC Waiver

The District of Columbia PSC denied Washington Gas Energy Services' request to waive a $9,900 compliance fee for solar RECs, finding that the legislature provided no exceptions to meeting the solar goal through either RECs or the fee, and that the PSC cannot simply read exceptions into law. WGES had argued that no solar RECs were available in the District for the 2007 reporting period.

CNE Offering Carbon Footprint Tool

Constellation NewEnergy is launching a carbon footprint solution to help C&Is manage their greenhouse gas (GHG) emissions, using Pace Global Energy Services' ecolink platform. To fit customers' budgets, CNE will offer an annual ecolink assessment as well as a pricier comprehensive and dynamic carbon and environmental sustainability management platform. CNE said the product would help businesses increase transparency of their sustainability practices, and help link REC purchases to GHG footprints.

Mich. PSC Staff Issues AMI Report

The Michigan PSC Staff released a report on its investigation into smart meters that was thin on details and specific recommendations, as Staff recommended deferring adoption of protocols until nationally accepted standards develop (U-15620, Matters, 8/5/08). Staff did recommend that meter information be available to customers simultaneously through the utility's web portal and through a HAN gateway inside a customer's premise, as well as endorsing smart meter general functional requirements of: remote software upgrade capability; remote shut-off and turn on capability; accommodation of net metering and distributed generation; prepaid service options; interoperability with future smart grid; two-way connectivity with intelligent appliances and other enabling devices; and customers' ability to monitor their energy use.

ICC Looking for AMI, SmartGrid Facilitators

The Illinois Commerce Commission is seeking stakeholder recommendations for a third-party facilitator for the advanced metering workshops required under its recent order on Commonwealth Edison's rate case. The ICC is also seeking a facilitator for a separate Smart Grid collaborative to cover both ComEd and Ameren.

FERC OKs RG&E, Ginna Settlement

FERC approved a settlement between Rochester Gas & Electric and the R.E. Ginna Nuclear Power Plant over a complaint from Ginna alleging that RG&E failed to comply with the parties' Interconnection Agreement (EL07-77). Ginna had argued that RG&E violated Appendix H of the Interconnection Agreement and the filed rate doctrine when, on two occasions, RG&E required Ginna to downpower below 590 MW during the planned maintenance of a single transmission line interconnecting the Ginna plant and the RG&E transmission system. Under the Settlement Agreement, RG&E agrees to construct certain transmission upgrades within certain specified timelines. The parties also agree that if, during construction and for other than an emergency condition, RG&E requires Ginna to reduce its output more than twice or for more than a cumulative 8,000 MWh, RG&E shall pay Ginna for the outages by amounts set forth in the settlement.

EnerNOC Inks Vermont Deal

The State of Vermont selected EnerNOC as a preferred demand response provider, allowing EnerNOC to enable and manage demand response capacity from government-related buildings into the ISO New England market.

CenterPoint Completes Emergency Operations

CenterPoint Energy concluded its emergency operations plan as of 9 p.m. Wednesday, while work continues to restore power to 4,600 customers whose premises cannot receive power due to physical damage. CenterPoint filed a plan to return to normal operations with the PUCT on Wednesday (Matters, 10/2/08), which includes the suspension of disconnections through October 24.

Calif. Rate Caps ... *from 1*

cannot grant the relief requested at this time, and there is no need to address the secondary question of when the rate cap ends.

The alternate recognizes that while the rate cap frustrates dynamic pricing policies of the Commission, further development of the record would be needed for the Commission to consider the significant policy implications of a rate cap phase-out proposal.

The legal question of how long the rate caps must remain in effect must be considered within the broader context of the economic and policy effects that the Commission's ruling on the question will have, Peevey said.

Calif. MCMP ... from 1

centralized market or bilateral market, warned that the "cold reality" of the MCMP would be that Electric Service Providers would be procuring nearly 100% of their Resource Adequacy Requirements in the illiquid and high-priced Centralized Capacity Market, while IOUs would be using the Preliminary Capacity Showing, under which IOUs could get credit for resources built or bought through the existing Long Term Procurement Plan process.

Such an outcome would severely disadvantage ESPs in the competitive retail market relative to their IOU competitors, AReM said.

"In fact, AReM finds the [MCMP] proposal to be the worst option for competitive retail markets of the various capacity market alternatives being considered by this Commission."

Generators, Southern California Edison and San Diego Gas & Electric, all proponents of a centralized capacity market, found the MCMP to distort competitive outcomes while not providing incentives for new capacity.

Constellation Energy said the MCMP would lead to market dysfunction and failure of market structures intended to support investment in new and existing capacity resources required to satisfy California's energy needs and environmental goals. "If this Commission fails to adopt a capacity market structure that supports competition, the energy investment paradigm in California will remain as it is now - dependent on regulatory guarantees for utility-backed tolling agreements and/or utility-owned generation," Constellation cautioned, foreseeing "lasting harmful impacts on competitive market formation" from the MCMP.

Calpine expressed doubts that auction pricing from the proposed implementation of the centralized capacity market within the MCMP would provide a meaningful signal for efficiency and investment, since most procurement will occur outside of the central market via the Preliminary Capacity Showing. "If the great majority of new resource procurement takes place outside of the centralized capacity market, it is hard to derive a scenario wherein [a] centralized capacity market will ever send a scarcity signal," Calpine observed.

The MCMP would also further institutionalize price discrimination between new and existing resources, blunting price signals that would otherwise bring demand-side market solutions, customer energy efficiency, and transmission solutions, Calpine added.

MCMP's bifurcated design is "fatally flawed," argued the California Forward Capacity Market Advocates, because it creates two parallel "markets" that would create, "serious risks of strategic behaviors and market failure." The group includes FPL Energy, NRG Energy, Reliant Energy, San Diego Gas & Electric, and Southern California Edison.

The MCMP would shift the ultimate costs of maintaining system reliability onto bundled IOU customers, exposing them to additional stranded costs, capacity market advocates noted. Bifurcation of the market would compromise customer choice by inevitably requiring IOUs to seek additional non-bypassable charges, they added.