Energy Choice Matters
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# All Options Open as Reliant Pursues Strategic Alternatives

Pressured by investors doubting the value of its retail business (Matters, 10/1/08), Reliant Energy announced it was evaluating "strategic alternatives," which will include a review of selling its retail supply business.

The announcement, prompted by investor unrest due to recent retail losses and tightening credit, puts two of the former affiliated REPs in Texas on the block, as PNM Resources previously announced a review of options for struggling First Choice Power (Matters, 8/13/08). As two of the top retailers in ERCOT, some 2 million customers are collectively in play, about 1.77 million at Reliant and 253,000 at First Choice Power.

With one of the strongest brand names in ERCOT, and a large share of "sticky" customers who have never shopped, Reliant is an attractive opportunity, especially for a new ERCOT entrant without any brand identity looking to gain scale quickly. With Reliant shares trading at $5.25, five times below its 52-week high of $28.74, it could also be another steal for a competitor with enough liquidity, akin to MidAmerican buying the nation's largest C&I retail book at a deep discount.

After Reliant disclosed that it was unwinding its credit sleeve with Merrill Lynch, and was obtaining a $650 million term loan from GS Loan Partners while issuing $350 million of convertible preferred stock to First Reserve Corp., investors questioned the value of the credit-intensive retail business. Reliant previously announced a comprehensive review of the unit, including the likelihood of scaling back low-margin, capital-intensive large C&I deals in favor for higher-margin, lower-credit mass

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# REPs, Consumers Agree Automatic Renewals Preferable to Post-Contract Disconnection

REPs and consumer advocates agree that REPs should not be forced to disconnect customers reaching the end of a contract term who have not taken an affirmative action to renew, as outlined in comments on proposed new rules governing REP disclosures (Matters, 8/8/08).

Although the PUCT's proposal for publication permits automatic renewal, including the potential for a price change from the original price through auto-renewal, the concept still generated much discussion in stakeholder comments. Any automatic renewal would have to be disclosed in the original terms of service, and stakeholders were apparently concerned with cases in which a terms of service does not call for auto-renewal, and customers do not take an affirmative action to renew in response to renewal notices, in which case customers would be disconnected.

Many customers, First Choice Power noted, do not respond to written or phone-based expiration notices. Requiring REPs to disconnect such customers would decrease satisfaction levels with the deregulated market, First Choice Power said.

The Office of Public Utility Counsel agreed. "Many customers, regardless of how many or what type of notifications they receive, will not take affirmative action to renew their contract or switch REPs," OPC noted.

"Rather than disconnecting those customers, the REPs should put those customers on a month to month plan," OPC said, in a recommendation shared by the Steering Committee of Cities Served by Oncor.

Reliant added that disconnection at the expiration of a contract conflicts with PURA §39.101 which

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## ICC Staff Questions Ability to Time the Market in SOS Procurement

Illinois Commerce Commission Staff cast doubts on the ability of the Illinois Power Agency to time the market during SOS procurements, in comments on the IPA's draft procurement plan (Matters, 9/5/08).

While initially proposing a three-year laddered procurement, the IPA suggested future plans would seek to take advantage of market opportunities at certain price triggers, and would also explore the use of long-term contracts.

"Staff has some doubts that trying to 'capture market opportunities' using 'market price triggers' will be successful in the long run," Staff said in comments.

"This strategy to beat the market is not explained. Furthermore, as a new agency, the IPA has no proven track record of successfully capturing market opportunities in this manner," Staff added, suggesting any such strategy should be initially limited to no more than plus or minus 3% of expected load for any given on-peak or off-peak monthly delivery period to evaluate its effectiveness.

Commonwealth Edison also questioned whether the IPA has statutory discretion to procure power at intervals not specified in the approved procurement plan in order to buy when the market is favorable.

"Subsections 16-111.5(d)-(g) of the PUA set out a precise process for procuring electricity. That process begins with the development of a plan that sets out the specific type and quantities of product proposed to be purchased, then proceeds with the approval of the Commission of those specific products and quantities, and continues with the conduct of an RFP, the development of a report by the IPA and the acceptance by the Commission," ComEd explained.

"The PUA does not authorize freelance purchases of power by the IPA, or require ComEd to execute contracts to effectuate such purchases," ComEd added.

The Citizens Utility Board, along with other consumer and green groups, contended that the terms of the contracts proposed in the draft IPA plan are too short for developers seeking to finance new facilities.

"Consequently, supply will be constrained and prices will be higher than would be the case if the Draft Plan included longer-term contracts," CUB said.

CUB suggested modifying the proposed three-year laddering process to accommodate a slice (perhaps 25%) of long-term procurements next year. The proposed exclusive reliance on one-year REC contracts will unnecessarily drive up the price paid by consumers for RECs from existing renewable energy projects and will result in missed opportunities for long term REC contracts with the most cost-effective new renewable energy projects, CUB added.

Midwest Generation and Edison Mission Marketing & Trading urged the IPA to include a comprehensive examination of the use of long term contracts of durations sufficient to support the financing of capital investments in environmental retrofit and new plant build as a means to ensure adequate and environmentally sustainable electric service at the lowest total cost over time, taking into account any benefits of price stability.

The Retail Energy Supply Association expressed concern over some elements of the plan that would weaken the delivery of market reflective price signals to consumers, but welcomed the IPA's intention to begin shortening the duration between the procurement event and delivery, the duration of the procurement contracts relative to the contracts procured through the Illinois Auction, and the move toward more frequent acquisition of power.

RESA was "encouraged" by the IPA's intention to transition to multiple procurement cycles, and eventually to a continuous procurement cycle. "Such procurement, if paired with a rate mechanism that promptly translates these new wholesale rates into retail rates, would move toward a market based procurement that uses similar timing of acquisition and contract lengths used in the competitive marketplace," RESA said.

Staff, however, noted logistical challenges associated with too frequent procurements, including decreased participation among bidders, procurement date conflicts, and higher administrative costs.

RESA noted that long-term contracts require bidders to recreate the premiums charged by bidders in the reverse auction structure which prompted many legislators to change the procurement structure to the current method. Long-term contracts would also repeat the unintended consequences of the rate freeze that kept competition out, as prices would be detached from market conditions, RESA added.

Constellation argued that laddering standard wholesale block products will make it more difficult to alter the product mix and move to a more traditional full requirements contract product. Procuring full requirements contracts "relieves" the IPA from active portfolio management responsibility, and places the planning responsibility into the hands of the winning full requirements suppliers, who have extensive experience in managing portfolios, Constellation said.

## PJM Suppliers Make Case Against Three Pivotal Supplier Test

PJM's three pivotal supplier (TPS) test is not just and reasonable because it is too restrictive and results in over-mitigation, a coalition of suppliers told FERC in a brief (EL08-47 et. al.).

"Leaving the TPS test in place without modification is a choice for low prices, not just and reasonable prices and certainly not for needed new investment in supply or demand response resources," Indicated Suppliers said, a group including subsidiaries of Constellation, Duke and PPL.

State regulators and consumers, however, downplayed the potential for over-mitigation and defended the soundness of the TPS test.

Suppliers contended that the TPS test suffers from several "systemic flaws" that regularly cause it to over-mitigate. First, the TPS test fails to define realistic geographic markets that are consistent with Commission precedent and antitrust policy, Suppliers said. Instead, PJM applies the TPS test to individual transmission constraints that can change frequently. Suppliers further claimed that the methodology used by PJM to determine the supply available to relieve such transmission constraints is significantly flawed.

The TPS test also ignores the requirements that market power must be sustainable over some period of time, Suppliers noted. Suppliers added that the TPS test focuses only on the ability to exercise market power and fails to measure whether a market participant actually has the incentive to exercise market power. Finally, the PJM Tariff lacks sufficient detail on the TPS test parameters, deployment and performance to allow for a thorough understanding of its application in the PJM market, Suppliers said.

The Suppliers urged FERC to direct PJM to institute shortage (scarcity) pricing provisions in the PJM OATT in a manner that permits energy market clearing prices to reflect scarcity while objectively protecting consumers from the exercise of market power. Scarcity pricing provisions similar to those already approved for use in the New York ISO should be implemented in PJM prior to the 2010 planning year, Suppliers urged. Such provisions feature a reserves demand curve concept that prices the value of energy and ancillary services in shortage conditions presented in either the day-ahead or real-time market consistent with the depletion of operating reserves and with respect to the quality of reserves remaining.

The PSEG Companies supported such a scarcity pricing mechanism that would identify multiple stages of increasing severe scarcity conditions, each of which would result in a particular price adder above the otherwise (mitigated) marginal price. The "price adder" approach is superior to scarcity pricing schemes that simply remove bid caps during periods of scarcity, PSEG said, because the latter approach requires the owners of generation and demand side resources to submit bids in excess of their marginal costs and to estimate an appropriate scarcity adder.

"At least until such time in the future that levels of real-time price responsiveness of load are much higher than at present, trying to determine appropriate levels of scarcity payments based on unmitigated bids would be haphazard and unpredictable," PSEG noted. "Further, to the extent that unmitigated bids in excess of marginal cost do clear the market, it may create the perception to some industry constituencies that market participants are acting improperly notwithstanding that the market design is intended to incent such behavior," PSEG observed.

PJM should also revise cost-based offer caps used for mitigation, when the TPS test is failed, to include all operating values, including opportunity costs and intrinsic option values, Suppliers argued.

The Maryland PSC, however, concluded that there is no reasonable basis for contentions that PJM "over-mitigates" suppliers' offers because rules permit suppliers to submit their actual marginal costs as a basis for developing a mitigation reference price that is at least 10% above marginal costs.

"Because offers are mitigated to rates that are marginal costs plus at least ten percent, no supplier's offer is mitigated below the price that would prevail in a competitive market," the Maryland Commission observed.

So long as the mitigated offer reflects what would occur in a workably competitive market, there should be a very low risk that the reference level used when applying mitigation could be punitive, the PSC added.

Data from PJM's market monitor does not support claims that mitigation is excessively applied, since data shows that offer capping in PJM's real-time energy markets has remained less than 2% of the unit hours capped and less than 0.5% of total megawatts, and offer capping in the day-ahead energy market has held below 0.6% of the unit hours and less than 0.2% of total megawatts.

"The frequency of mitigation does not matter, especially where PJM's mitigation rules cap offers at a price above what a supplier would submit if it faced substantial competition," added a group including the PJM Industrial Customer Coalition and several munis.

Industrials and munis further pointed to the "significant difference" between bid mitigation and price mitigation.

"The PJM energy-market clearing price is above, and often well above, the mitigated and unmitigated offers of all suppliers except the generation unit at the margin," industrials and munis said.

The consumers urged the Commission to be, "cautious not to confuse the potential for fixed cost recovery with a guarantee of fixed cost recovery," adding that suppliers also have revenue streams in capacity and ancillary markets.

The PSC further argued that scarcity pricing has not been set for hearing in the case and should not be addressed.

## Calif. Draft Would Allow Debt Equivalence Use in All-Merchant RFOs

A draft California PUC decision would allow the use of debt equivalence to compare PPAs from IPPs when no utility-owned generation is involved in an RFO, but would continue the prohibition on using debt equivalence to compare IPP and utility projects (R. 06-02-013). The draft grants several petitions for modification of Decision 07-12-052, which established rules for RFO solicitations.

An ALJ saw a need to evaluate the impact of debt equivalence when, "the bids included in the solicitation are sufficiently similar that a comparison of relative DE-effects would not in turn suggest the need to consider other, potentially countervailing risk-related effects of selecting one bid over another," because debt equivalence is a factor considered by rating agencies and is a factor the Commission evaluates when it determines an IOU's return on equity.

However, the complexity of the risk-related pros and cons associated with PPAs versus utility ownership suggests that it would be inappropriate to single out and consider only one specific risk-related effect (such as debt equivalence) when comparing merchant projects with utility projects, including utility purchase and sales agreements or engineering, procuring and construction bids.

The draft also stressed that allowing engineering, procuring and construction bids for projects to be assumed by utilities, "is in no way intended to provide the IOUs with a broad loophole that allows for what are essentially direct utility build projects." The purpose of engineering, procuring and construction bids is to acknowledge that certain extraordinary circumstances that are unpredictable may necessitate utility ownership of generation at a particular site, the draft states. Simply owning land on which generation could be built does not meet the extraordinary circumstances test, the ALJ notes. Generally requesting engineering, procuring and construction bids in an RFO as an alternative to PPAs, "certainly does not satisfy this requirement either."

The draft would also remove the "Expansion of Existing Facilities" exception that permits utilities to build generation outside of an RFO. The draft would change the types of RFOs requiring an Independent Evaluator to those seeking contracts two years or longer (rather than three months or longer), although all RFOs in which a utility project competes will still need an Independent Evaluator.

## Briefly:

### Ga. PSC OKs Catalyst-MXenergy Transfer

The Georgia PSC conditionally approved Catalyst Energy's request to transfer its customers to MXenergy, pending approval from a bankruptcy court which could come on Wednesday (Matters, 10/6/08). MXenergy said it would honor Catalyst's fixed-rate contracts.

### SAB Power Awarded REP Certificate

The PUCT granted SAB Power a REP certificate (Matters, 9/8/08).

### Comverge, TransCanada Partner on Energy Management Products

Comverge and TransCanada Power Marketing have entered an agreement whereby Comverge will provide energy management and demand response services to TransCanada for its C&I customers.

### Pepco Energy Services Inks WMATA Natural Gas Deal

Pepco Energy Services has been awarded a three-year contract by the Washington Metropolitan Area Transit Authority to supply 2.6 billion cubic feet of natural gas to WMATA's entire fleet of compressed natural gas buses in Virginia, Maryland and the District of Columbia.

### PECO Procures Wind RECs

PECO signed a five-year agreement with Iberdrola Renewables to purchase 240,000 megawatt-hours of wind energy credits. PECO said it is the first utility in the state to buy and bank renewable energy credits to meet its Pennsylvania's Alternative Energy Portfolio Standards (AEPS) requirements in 2011.

### Wendell Holland Joins Saul Ewing

Former Pennsylvania PUC Chair Wendell Holland has joined Saul Ewing LLP as a partner in its Business Department and Energy and Utilities Practice Group

## Reliant ... *from 1*

market deals.

Reliant previously cut the earnings outlook for its retail business by $300 million to $350 million. Although much of its problems can be traced to Hurricane Ike (about $200 million of the downward adjustment) and previous ERCOT price spikes, Reliant has also been facing increasing levels of churn. While it banked on getting a "substantial" number of customers to switch to one of its new Smart Energy products this year (Matters, 5/2/08), the effort was hampered in part by protracted consideration of CenterPoint's Advanced Metering Information Network, under which REPs can fund an accelerated installation of smart meters. Competitive concerns raised by other REPs led to PUCT approval being delayed by about two months as REPs negotiated a settlement. That prevented the anticipated installation of meters during this year's peak summer season.

A four-person committee, including former CEO Joel Staff, will make recommendations on the strategic review to Reliant's Board. Staff has also agreed to serve as executive chairman of the Board.

Morgan Stanley and Goldman Sachs & Co. are serving as financial advisors, and Skadden, Arps, Slate, Meagher & Flom LLP is serving as legal counsel to Reliant

## REP Disclosures ... *from 1*

states that customers have a right to choose their retail electric provider and to have that choice honored, and that the customer's chosen provider will not be changed without the customer's informed consent. Reliant does not believe that customers generally expect that their service could be disconnected at the end of a contract term simply because they do not take affirmative action to renew.

The Alliance for Retail Markets went a step further, suggesting that when a terms of service contains an automatic renewal clause with renewal pricing or renewal pricing methodology disclosed in the original Electricity Facts Label (EFL), REPs should not be required to send out an expiration notice informing customers of the contract's end.

Many REPs opposed the proposed ban on

termination fee applicability 60 days after a contract expiration notice is sent to the customer.

As first reported in our analysis (Matters, 8/8/08), "This 60-day clause could have the effect of shortening a customer's purchase obligation by 2 months, in essence creating a 60-day period of exposure for the REP," the Texas Energy Association for Marketers warned.

REPs also objected to the proposed proration requirement for termination fees when customers approach the end of their contracts, with First Choice Power arguing that a REP's risk exposure on any given contract is not necessarily a function of the amount of time that has elapsed under the contract term. Market swings can significantly increase or decrease a REP's exposure at any time during the contract term, First Choice Power noted.

**Product Types**

Few REPs endorsed the proposed four product categories as contained in the rule -- guaranteed fixed, limited fixed, indexed and variable.

"The proposed rule as drafted regresses away from competitive innovation, and instead would force products to conform to one of four product labels. This approach does customers a disservice and represents an unnecessary return to rate regulation," the Texas Energy Association for Marketers said.

OPC, on the other hand, was "very pleased" with the proposal, finding that the draft rules go a long way towards leveling the playing field between consumers and REPs.

Still, OPC opposed the permissibility of "variable" products whose prices could change at the REP's discretion without disclosing a method for customers to calculate the price. However, if the Commission permits such products, OPC urged that REPs offering such variable products should be required to either (a) provide customers with notice of the price change and allow them 45 days from receipt of notice in which to switch providers without penalty, or (b) limit the change in price each month and over the term of the agreement, and disclose to the customers in the EFL the amount of change that could take place.

Texas Ratepayers' Organization to Save Energy and Texas Legal Services Center opposed non-transparent variable pricing, and argued that for any variable products, REPs should make publicly available the price charged to consumers taking the plan over the previous 12 months. REPs should also provide the consumer with notice of any change in price of more than 5% in any given billing period for variable plans, ROSE/TLSC said.

TXU Energy also opposed variable products whose price changes are at the discretion of the REP, calling such products the "Wild West" plan, under which the REP maintains sole discretion to effectuate a price increase and is not required to provide notice to its customers of such an increase.

Under the current rules, "the market has spawned plans with prices customers pay for a short time (or might not ever pay), which are then replaced (without any advanced notice) by prices that the customer never meaningfully agreed to pay or had adequate opportunity to anticipate, plan for, and act upon in a timely and informed manner," TXU said.

Citing a recent example from the market, TXU argued, "It is hard to believe that customers signing up on a 9.9¢/kWh price in April 2008 would understand through a general disclaimer that their price might actually increase by almost 70% to 16.7¢/kWh in just a few months."

TXU recommended that the Commission should require REPs to provide 45 days' notice before increasing the price of variable price plans whose prices may increase according to a method that is not based on a verifiable formula. That's the minimum amount of time required to ensure customers can effectuate a switch to another price plan or provider in response to a price increase without being billed on the pending increase. Without any such notice, a customer could be stuck paying the new variable price for 75 days due to billing cycles and switching timelines.

TXU contended that the marketing materials for variable price products, as well as such products' enrollment documentation and EFL, should contain a "clear and bold" disclaimer that the price of the product may change without notice. Additionally, such disclaimer should state that the price disclosed is "for the first month of service" and that "the actual price for electricity may increase each month."

"This disclaimer is needed to address the fact that customers are often drawn to variable price products, not for the fact that such products are variable, but because the initial rate advertised for such products appear to be attractively low," TXU said.

But Tara Energy cautioned that by requiring REPs to disclose a specific pricing formula for variable contracts, REPs would have no incentive to invest in the development of sophisticated formulas that account for a variety of market factors and integrate years of industry experience, given that the investment will only result in disclosure, free-rider imitation, and underbidding by competitors.

Tara argued that REPs should be able to offer limited fixed products which have more than just TDU charges variable, noting the proposal "arbitrarily bars REPs from marketing products that offer to fix different price components."

"The Proposed Rule effectively eliminates risk-controlling products that could be offered for a lower initial price point than a Limited fixed price product by fixing what a REP currently perceives as smaller risks (e.g. by fixing only ERCOT fees and TDU fees rather than fixing everything except those fees," Tara said.

The proposed four-product market will "narrow competition to a few price components and homogeneous product types," Tara added.

"While the Proposed Rule strives to protect customers from price spikes with guarantees, it effectively prevents REPs from offering more affordable and more limited guaranteed pricing, much as an insurance policy might cover damages, but only up to an agreed-upon cap," Tara added.

OPC countered that the only product that the Commission should define as a fixed price product is one that includes TDSP charges and ERCOT fees. A product with a price that is subject to change (no matter what the change is based upon) is variable, OPC said.

OPC also favors itemizing charges, such as TDSP fees, on bills rather than bundling them into the kWh price, stating that any additional clarity and transparency that can be provided to customers is helpful.

Direct Energy recommended that REPs only be permitted to offered guaranteed fixed products if the product is backed by some financial instrument to ensure that customers have recourse to collateral that provides full compensation (including the cost of seeking the compensation) should the REP fail. Although such financial commitment would be substantial, a "guaranteed fixed" product is simply not guaranteed without a reasonable level of commitment from the REP through such an instrument. Absent such financial security for guaranteed products, "the likelihood that we will have another round of [unkept] promises ... will only increase," Direct said.

Echoing a comment recited by numerous REPs, First Choice Power doubted the practicality of proposed language requiring REPs to include all products in the average energy price on an EFL. New services bundling electricity with innovative products including smart thermostats, ZigBee controlled appliances, and home energy management services will "fundamentally change" a customer's energy usage, and an up-front average price would not accurately reflect the true value of such service, First Choice Power maintained. Costs of any such items should be listed on the EFL, First Choice Power said, but not in the bundled electricity price.

**Miscellaneous Provisions**

One shortfall of the proposed rule, in OPC's view, is that it does not require all REPs to post their terms of service and EFLs on the Power to Choose website. OPC claimed that the only REPs not currently using the website are, "those that appear to want to operate under the radar, the fly-by-night REPs operating out of a P.O. Box and the Greensheet."

ARM urged the Commission to restrict the rules to residential customers, instead of applying the rules to all customers, even large C&Is, as proposed.

Cities urged the PUCT to codify in the rules that failure of a REP to adhere to its contract may be grounds for a complaint at the Commission under the customer protection rules, given at least one REP has asserted that contractual disputes are the province of the courts under contract law and not subject to Commission jurisdiction.

Reliant Energy is concerned the proposal retains ambiguity regarding whether REPs can advertise that they have been in the market since before 2001. Specifically, proposed subsection (c)(1)(A)(ii) prohibits "suggesting, implying, or otherwise leading someone to believe that a REP or aggregator has been providing retail electric service prior to the time the REP or aggregator was certified or registered by the commission."

But Reliant noted that despite the Legal Enforcement Division's belief in Docket 30198 that it was inappropriate to imply that REPs served customers prior to 2001, slightly modified claims continue to be made.

Per Reliant, recent ads include:

• Advertising the lengthy history of a REP's parent company by a REP that became a subsidiary of another organization after its REP certification was issued.

• An advertising claim by a REP that touts industry expertise from a company with roots that date back over 100 years.

The Cities consider the current language regarding customer relocation "unworkable" because the proposal suggests that once customers document their move to a REP, the contract will terminate. That seemingly precludes customers from giving REPs advance notice of their move, Cities said, while it would also force customers to pay for service at a former premise if the documentation is received after moving out. Cities suggested removing the proposed language that, "The contract terminates on the day the REP receives reasonable evidence that the customer no longer occupies the location specified in the contract," which would expose REPs to serving premises after the customer actually moves.

TEAM opposed the proposed requirement for REPs to file EFLs and terms of service documents with the PUCT quarterly, citing both the burden as well as competitive concerns about making REP contracts with small businesses or commercial and industrial customers part of the public record. Individual commercial customers may not want such contracts filed with the Commission because the contracts themselves disclose competitive and confidential information about their business, TEAM pointed out.

OPC suggested that the Your Rights as a Customer document be modified to include information on the availability of energy efficiency programs provided through the TDUs.

Direct Energy argued that making wholesale changes to the existing disclosure rules is not necessary and does not warrant the cost of implementation that will be required. The root cause of recent problems, such as one REP attempting to change pricing under a fixed contract, actually result from REPs that are not financially sound who attempted to recoup losses by not honoring contracts, rather than from any flaw in the current disclosure rules. Thus, Direct urged the Commission to focus on the current review of the financial and technical requirements for REP certification, rather than imposing new, burdensome contracting and disclosure requirements.

Tara requested a public hearing on the Proposed Rule be held on October 10.