Energy Choice Matters

November 7, 2008

Md. PSC Orders RFP for Demand Response as Initial Solution for Reliability Gap

The Maryland PSC ordered utilities to develop RFPs for demand response resources to fill a potential reliability gap in 2011, and will also investigate using distributed generation resources to prevent potential load shedding (Matters, 9/23/08).

"[T]his shortfall requires a series of incremental solutions rather than a single, comprehensive one," the PSC said, stating that the Commission will, "need to remain nimble as we continue to monitor and study the broader supply-and-demand backdrop."

Thus, while the PSC first ordered using any potentially available demand response and distributed generation resources before ordering other steps, the Commission's Order issued yesterday in Case 9149 is "far from" a final order, nor is the Commission limiting its response to potential future shortfalls to only demand response and distributed generation. "The record of this case shall remain open for further consideration of other actions that may be required to address potential capacity issues faced by the State of Maryland," the Commission said.

Specifically, the PSC ordered the state's four IOUs to develop RFPs to procure resources that meet the requirements of PJM's Emergency Load Response Program for the planning years 2011-2016, to serve as insurance against the possibility that the in-service dates of the Trans-Allegheny Interstate Line (TrAIL) and Potomac-Appalachian Transmission Highline (PATH) projects are delayed past June 2011 and June 2013, respectively.

The RFPs shall be designed to identify and procure resources above and beyond those proposed in the IOUs' pending EmPower Maryland filings, which are already under review.

The RFPs will solicit any and all load resources, including those aggregated by curtailment service

... Continued Page 6

Integrys Marketer Reports "Best Ever" Third Quarter But Puts Expansion on Hold

Integrys Energy Services posted its "best ever" quarter in terms of economic value growth, executives told investors yesterday, but the results were masked on a GAAP basis due to hedging losses.

A 40% decline in forward energy prices provided attractive buying opportunities for customers who began to return to their longer-term contracting norms instead of month-to-month deals, Integrys Energy Services President Mark Radtke said, although the price decline also led to accounting losses.

Integrys Energy Services reported quarterly "managerial gross margin," an adjusted metric which excludes hedging impacts, of $102.5 million, up from $56.6 million a year ago. GAAP gross margin was negative $98.9 million, down from positive $66.8 million in the year-ago quarter.

The marketer posted a GAAP loss of $94.5 million for the quarter, down from earnings of $13.2 million a year ago. The large decline in energy prices during the quarter resulted in a $79.6 million net negative non-cash impact on Integrys Energy Services' GAAP accounting results due primarily to accounting mismatches.

Realized retail electric margin decreased $300,000 in the quarter to $22.3 million, driven by reduced margins from Texas operations. Integrys Energy Services blamed higher ancillary costs and reduced load from Hurricane Ike for the decline.

Radtke reported customer growth during the quarter in existing markets, as well as gains from signing current customers, who had previously opted for month-to-month contracts during renewal periods earlier this year, to new longer-term contracts.

... Continued Page 6

TXU Energy Continues Steady Residential Growth

TXU Energy customer count continued to inch higher during the third quarter mostly due to residential growth, with a net gain of 63,000 customers across all classes.

Total customer count reached 2.21 million, up from 2.15 million a year ago. Residential customer count grew to 1.93 million from 1.86 million a year ago. The growth, TXU estimated, pushed its share of the ERCOT residential market to 37% from 36% a year ago. Commercial customer market share dipped 1% year-over-year to 26%.

Average revenue per residential MWh dipped slightly to $138.32, versus $138.96 a year ago.

Quarterly selling, general & administrative expenses increased $10 million, or 6%, to $172 million year-over-year for Energy Future Holdings' competitive segment (retail and wholesale). The increase reflects $7 million in higher retail customer bad debt expense and $11 million in higher expenses in retail operations, primarily from increased employees and labor costs to support customer growth initiatives and computer system enhancement costs. The increases were partially offset by lower administrative costs from cancelled generation projects from 2007.

TXU recorded a $20-25 million pre-tax impact from Hurricane Ike from having to resell purchased power at lower prices, reporting that it has a 13% share of the affected South Texas market.

Despite recent price cuts on some 300,000 month-to-month contracts, TXU is exceeding its target gross margin range of $25-35/MWh on those sales, TXU Energy CEO Jim Burke said, as the price cuts merely reflect drops in natural gas prices (Matters, 10/31/08). Burke would not say what TXU intends to do with the price for the majority of its residential customers, which was cut by 15% last year as part of its leveraged buyout, once the obligation to keep prices at the reduced level expires at the end of the year.

Burke said TXU prices remain a little bit above average in North and South Texas, which he believes reflects its brand proposition and service levels.

Luminant may be unable to offer the 24-year, 150-MW supply agreement reached with the Cities Aggregation Power Project on the original terms, due to delays in cities approving the plan (Matters, 9/19/08). Cities are having difficulties obtaining financing for the required pre-payment in today's credit environment.

Net income for the EFH competitive electric segment (wholesale and retail) was $3.61 billion, reflecting a $6 billion gain in hedging.

EFH reported GAAP earnings of $3.62 billion for the quarter, compared to earnings of $992 million for the third quarter of 2007. The 2008 quarterly results included $3.96 billion after tax in unrealized mark-to-market net gains.

Adjusted EFH operating earnings totaled a net loss of $21 million for the third quarter of 2008 compared to net earnings of $655 million for the third quarter of 2007, due to a $412 million (after tax) increase in interest expense and related charges driven by merger-related financings and non-cash depreciation, and amortization expenses of approximately $151 million (after tax) due to the application of purchase accounting for the merger. The

Energy Future Holdings Competitive Segment Sales, Customer Data

	3Q08	3Q07	Change %
Sales volumes:			
Retail electricity sales (GWh):			
Residential	9,098	8,789	3.5
Small business (< 1 MW)	2,241	2,313	(3.1)
Large business and other customers	4,038	3,902	3.5
Total retail electricity	15,377	15,004	2.5
Wholesale electricity sales	12,472	9,938	25.5
Net sales (purchases) of balancing electricity to/from ERCOT	145	(4)	—
Total sales volumes	27,994	24,938	12.3
Average volume (kWh) per retail customer			
Residential	4,757	4,764	(0.1)
Small business	8,732	8,969	(2.6)
Large business and other customers	145,802	109,115	33.6
Customer count (in thousands):			
Retail electricity customers			
Residential	1,927	1,858	3.7
Small business (< 1MW)	258	256	0.8
Large business and other customers	27	35	(22.9)
Total retail electricity customers	2,212	2,149	2.9
Average revenues per MWh:			
Residential	$138.32	$138.96	
Estimated share of ERCOT retail markets:			
Residential	37%	36%	
Business markets	26%	27%	

remaining $113 million decrease related primarily to the competitive electric segment, from high fuel and purchased power costs.

Constellation Selling Downstream Gas Unit, Cutting Commodity Trading

Constellation Energy is selling its downstream gas trading business amid a series of moves to boost liquidity and reduce collateral requirements.

Constellation is reducing the scale and scope of its global commodities business, and is shrinking portfolio management to a size appropriate for hedging generation and customer supply. While the downstream gas business, which includes wholesale supply and trading, remains "attractive," the unit is not a core strategic fit, executives said. Constellation has seen "strong initial interest" in the unit, and expects to sign a deal to sell the Houston-based unit by mid-December.

Constellation reported a net loss of $225.7 million for the quarter, compared with net income of $251.4 million a year ago.

Adjusted earnings for CEG's merchant segment were about $107 million, down from $233 million a year ago. Generation earnings were up about $70 million due to higher energy and capacity pricing. Global Commodities was down $195 million from lower new business results in portfolio management and trading. Customer Supply results were down about $12 million, primarily driven by unfavorable mark-to-market results in retail gas, and lower rates and volume at retail power, partially offset by strong performance at wholesale power due to favorable variable load risk.

Customer Supply gross margin was $119 million, down 50% on a comparable basis to last year's quarter. Retail power as-priced margin was $3.46/MWh.

Retail power retention rates were steady at 88%, and customers have begun locking in fixed term contracts, rather than month-to-month deals, executives said. Retail gas posted a retention rate of 94%. The Customer Supply backlog stands at $113 million.

Constellation has adjusted pricing in its Customer Supply unit to reflect higher credit costs. It has also purchased financial and physical swaps to reduce physical shorts at ISOs and reduce working capital requirements. Additionally, Constellation is to sell load contracts and derivative hedges to reduce asymmetric collateral. Still, Constellation has seen a $1 billion increase in collateral posting requirements since the end of June 2008 primarily due to a decrease in credit lines and adequate assurance calls by ISOs and commodities business counterparties.

Constellation's commodities business is prioritizing lower collateral deals with lower risk, and foregoing near-term profits in exchange for the reduced collateral burden. Total portfolio risk has been reduced by approximately 30% since June 30, Constellation said.

Downgrade credit requirements have fallen from $4.6 billion to $2.2 billion as of October 17. Downgrade collateral could be further reduced by $650-700 million from the downstream gas asset sale, and reduced by another $400-450 million from the previously announced international business sale.

MidAmerican Energy Holdings has committed to provide Constellation Energy up to $350 million of additional liquidity resources. Constellation could also sell its share of the Safe Harbor hydro plant in Pennsylvania and West Valley gas-fired plant in Utah to MidAmerican to raise liquidity.

Adjusted Dynegy Earnings Fall on Lower Sales

Milder weather, lower sales and compressed realized spark spreads trimmed Dynegy's adjusted EBITDA to $268 million for the quarter, down 23% from a year ago.

GAAP earnings were $605 million, primarily reflecting $542 million in mark-to-market gains, versus $220 million a year ago. Adjusted EBITDA from the power generation segment was $306 million for the third quarter of 2008, compared to $379 million for the third quarter of 2007.

Milder weather mostly hurt Midwest sales, especially off-peak. Midwest results were also negatively impacted by a wider basis between liquid market and power delivery point prices. Dynegy reported its cost to dispatch electricity from its Midwest coal fleet is around $20/MWh, while it estimated the market average is $31/MWh. That pricing advantage allowed

Dynegy to avoid dark spread compression. Midwest Generation adjusted EBITDA was $182 million for the quarter, down from $220 million a year ago.

Dynegy saw compressed spark spreads in the Northeast and West. West adjusted EBITDA was up at $82 million, versus $76 million a year ago. Northeast adjusted EBITDA fell to $42 million from $83 million a year ago.

Dynegy reported that it acquired financing earlier this year before the credit crisis and has little exposure to the current turmoil.

Calif. PUC Defers Question of Rate Caps' End in SDG&E Decision

The California PUC approved an alternate decision that prevents San Diego Gas & Electric from rolling off residential rate caps under AB 1X for the time being, but refuses to determine when those rate protections may expire. An original draft would have found that rate caps cannot expire until 2022 when Department of Water Resources bond charges are paid off (Matters, 6/25/08).

The alternate, authored by PUC President Michael Peevey (Matters, 10/3/08), finds that SDG&E's application to raise residential rates cannot occur as DWR is still supplying power to the IOUs. Since DWR still has a supply role, ruling on when the rate caps may end is moot, the decision finds.

AB 1X holds that rate protections must remain in effect until all of DWR's costs of procuring power are paid off. The question which the PUC left open is defining such costs. While the original draft defined the costs of power as including bond charges (which last until 2022) associated with DWR's power contracts, SDG&E and other parties have argued that the costs of power only include supply costs associated with DWR's physical delivery of power, and that rate caps can end once DWR exits the supply business (2016 or potentially earlier).

Peevey said that the PUC will revisit the issue and take a "hard look" at when the rate caps should end. Peevey noted that a 20-year rate cap creates an inequitable subsidy paid by other customers and hides the true cost of power in frustration of other state energy policies. Commissioner Rachelle Chong agreed, noting that the rate caps make achieving greenhouse gas reduction goals and energy efficiency targets more difficult to achieve. The Peevey alternate was approved unanimously.

FERC Sees Increase in Market Manipulation Investigations

FERC has seen an increase in investigations conducted by its Office of Enforcement related to allegations of market manipulation, the Commission said in a report on its enforcement arm.

Investigations involving allegations of market manipulation rose to 20 in fiscal 2008 versus 12 in fiscal 2007. FERC has also seen a rise in the number of investigations into allegations that entities violated FERC regulations that require market-based rate power sellers to provide accurate, factual and complete information in communications with the Commission and RTOs. Most of these investigations involve allegations that entities have provided inaccurate information to FERC-approved market operators in connection with bidding, scheduling or unit availability, FERC said. Investigation referrals from RTO market monitors grew to 15 in 2008 versus two in 2007.

In total, enforcement staff opened 48 investigations in 2008, up from 35 a year ago. Self-reported violations grew from 31 in 2007 to 68 in 2008. The vast majority of the self-reported violations involve capacity release rules, while FERC has seen a large decrease in self-reported Standard of Conduct violations versus prior years, possibly to due Commission rulemakings to clarify the rules.

Of the 68 self-reports received in 2008, staff closed 25 of them after an initial review and without opening an investigation, and three more were closed without penalties after conducting an investigation. Staff 's initial review is pending for seven of the self-reports, with 33 pending as investigations.

One investigation conducted by staff was to review conduct by certain ISO market participants who bid supplemental energy at inter-ties and then "declined" predispatch instructions. Staff's investigation revealed that the declines were attributable to an ambiguous (and therefore unenforceable) tariff provision which did not adequately define the terms used in the provision.

World Energy Solutions Cuts Loss by One-Third

World Energy Solutions trimmed its quarterly loss by 33% while posting record revenue and C&I customer bookings.

The online broker's net loss was $1.2 million in the third quarter, down from $1.8 million a year ago. Its cash burn rate fell 70% compared with the second quarter of 2008, on higher revenues and lower costs.

Revenue was a record $3.3 million versus $2.7 million a year ago. World Energy's annualized backlog grew to $8.8 million.

General and administrative expenses fell from $1.9 million to $1.0 million, while sales and marketing expenses decreased from $3.0 million to $2.4 million.

World Energy signed 18 new channel partners for a total of 54. Wholesale customers grew five-fold to 38 year-over-year.

Aside from conducting the RGGI auction, World Energy said it has conducted its first online auctions for RECs as well.

Calif. PUC OKs Use of Debt Equivalence in All-Merchant RFOs

The California PUC yesterday approved the use of debt equivalence to compare PPAs from IPPs when no utility-owned generation is involved in an RFO, but continued the prohibition on using debt equivalence to compare IPP and utility projects (R. 06-02-013, Matters, 10/7/08). The order grants several petitions for modification of Decision 07-12-052, which established rules for RFO solicitations.

Using debt equivalence is appropriate in comparing merchant-only bids, the Commission said, because the bids are similar enough that using debt equivalence does not prompt the need to measure other countervailing risk-related effects of each bid. However, because utility-owned bids carry their own risks, the decision finds it inappropriate to single out and consider only one specific risk-related effect of a bid, such as debt equivalence, while not considering other risks. Thus, debt equivalence cannot be considered when utility bids are included in an RFO.

The decision also finds that using engineering, procuring and construction (EPC) bids for projects to later be assumed by utilities is not meant to be a loophole for utility-owned generation. The PUC further ordered that utility-owned generation can no longer be chosen outside of a competitive solicitation based solely on the synergies associated with the expansion of existing facilities.

The Commission changed 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 still need an Independent Evaluator.

Briefly:

Discount Power Would Get Conn. License Under Draft

The Connecticut DPUC would grant start-up marketer Discount Power a retail electric license in a draft decision (Matters, 9/19/08). The draft did not mention charges from Public Power & Utility alleging Discount Power used confidential information obtained from Public Power & Utility under a prior consulting agreement (Matters, 9/24/08).

Calif. PUC Dismisses PG&E Tesla Application

The California PUC granted motions from competitive marketers to dismiss Pacific Gas and Electric's application to build the Tesla Generating Station, finding that the application did not present evidence of an extraordinary circumstance warranting utility-built generation selected without use of an RFO (Matters, 9/23/08). PG&E did not produce facts showing that the short-term reliability shortfall identified in the application could only be met with the Tesla resource procured outside of any competitive process, the decision says.

TAC Tables PRR 776

TAC voted to table consideration of PRR 776 and asked WMS to comment on the PRR to TAC. An informal group is meeting to discuss the PRR Nov. 11 before it is brought up again at WMS Nov. 19. PRR 776 was originally proposed by industrials to correct ex-post adjustment of the MCPE during times of Non-Spinning Reserve

Service (NSRS) deployment (Matters, 10/24/08).

ICC Rules No Hearing Needed for Procurement Plan

The Illinois Commerce Commission ruled that a hearing is not required for its review of the Illinois Power Agency's final default service procurement plan (Matters, 10/22/08).

Gap RFPs ... from 1

providers. The utilities, "should also feel free to propose further demand response programs of their own," the Commission said.

Qualifying resources must not have offered into and cleared PJM's 2011-2012 RPM Base Residual Auction and cannot participate in PJM's Economic Load Response Program for the time period during which the resource is offering a commitment pursuant to the RFP.

Bidders can offer proposals for single or multiple year commitments, and such resources need not be available for the start of, or full duration of, the supply period.

The utilities are to submit the RFPs for Commission Staff approval by December 1, with Staff submitting revisions by December 31. The Commission expects to promptly approve the RFPs so IOUs can quickly issue them.

The Commission will also form a distributed generation working group to identify distributed generation resources that may be available to serve as additional demand response, and to address the regulatory and logistical barriers that may discourage them from serving as demand response resources. The working group is to submit a report on its findings by March 30, 2009.

The Commission arrived at the need for action by finding, contrary to its original understanding, that benefits from the TrAIL line would only be short-lived, and that any reliability gap would re-appear in 2013 unless the PATH line was also in service by then. The PSC noted that PATH has pushed back its in-service date to June 2013, citing an updated PJM study (Matters, 11/3/08), leading the Commission to conclude that, "we now know with certainty that PATH will not be available to address 2012's capacity challenges, and will be available as required in 2013 only if all goes exactly as planned."

The Commission also noted that market forces have failed thus far to resolve the reliability gap. The PSC pointed to CPV Maryland, which said during hearings that it would not begin construction in Maryland without a long-term contract for the output from its new plant, regardless of the level at which the one-year-at-a-time capacity prices might clear.

While load growth may slow due to the current economic climate, the Commission doubted if it would reduce the entire gap, and stated it is, "loathe to root for or count on a lengthy recession as a solution to the State's capacity challenges."

Integrys ... from 1

Retail and wholesale electric forward contract volumes grew to 122.4 million MWh from 81.3 million MWh at the end of the third quarter of 2007. Retail and wholesale forward gas volumes grew to 602.3 bcf from 600.3 bcf a year ago.

Physically settled retail electric volumes in the third quarter were 4,552.9 GWh, down from 4,708.1 GWh a year ago. Retail gas volumes settled physically were 71.1 bcf, compared to 66.0 bcf a year ago.

Expansion into new markets is "on hold" for the competitive retailer, which will instead focus on being more selective in customer acquisitions in existing markets, in order to better manage growth in today's chaotic financial market. "The energy marketing business climate has changed dramatically for us as well as our peers, increasing operating costs, business risks, and cash margin requirements for our economic hedging activities," Radtke noted. Integrys Energy Services has adjusted pricing to reflect increases in operating costs, business risk and cash margin requirements.

Realized gains on structured origination contracts increased $2.0 million to $6.2 million year-over-year, due to growth in existing markets in the Midwest and Northeast, as well as expansion into in Texas and western markets. Origination contracts are physical, customer-based agreements with municipalities, merchant generators, cooperatives, and regulated utilities.

Operating and maintenance expenses for Integrys Energy Services increased from $38.2 million a year ago to $45.7 million in the third quarter, driven by a $7.3 million increase in bad debt expense as a result of the bankruptcy of Lehman Brothers.

Integrys Energy Services capitalized on opportunities to optimize its natural gas in storage and related hedges during the quarter, in order to create additional margin in the forward book. The spread between this summer and the coming winter's natural gas price was sufficient to justify the injection of additional natural gas into the ground, the marketer said.

Radtke reported that Integrys Energy Services' REC business completed over four times the business volume of last year's total during just the first three quarters of 2008. The marketer's green unit expects to add 7 MW of solar capacity before year-end.

Parent Integrys Energy Group reported a GAAP loss from continuing operations of $58.4 million compared with income from continuing operations of $11.6 million a year ago.