Energy Choice Matters

November 12, 2008

FERC Orders Virtual Suppliers to Pay Real-Time RSG Costs

Virtual suppliers will be subject to Midwest ISO real-time Revenue Sufficiency Guarantee (RSG) costs as FERC ordered MISO to resettle the RSG charges and refund affected market participants, in an order on a complaint filed by Ameren and other LSEs (EL07-86 et. al.). According to the Midwest TDUs, about $585 million in RSG costs have been improperly allocated due to a current exemption for virtual suppliers.

RSG charges recover start-up, no-load and incremental costs of generators that are not recovered in the locational marginal price. Under the current tariff that was the subject of the complaint, real-time RSG charges are paid only by market participants that actually withdraw energy on the relevant day, thus exempting market participants only making virtual supply offers without any physical transactions from the costs (Matters, 9/23/08).

FERC determined there is no cost-causation basis for charging certain market participants RSG charges because they withdraw energy on a certain day, while exempting other market participants. Thus the Commission found the current RSG tariff to be unjust and unreasonable, citing an analysis performed by the RSG Task Force, which did not find that withdrawal of energy was a factor in determining whether or not a market participant contributed to the incurrence of RSG costs. The task force did find that generator deviations and virtual offers were contributors to RSG cost incurrence, and that their impact was not a function of whether the market participant was withdrawing energy.

FERC further noted that the MISO Independent Market Monitor reached a similar conclusion in its 2007 State of the Market report. The IMM concluded that major drivers of RSG cost incurrence were

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NEM Wants N.Y. PSC to Examine Utility Exit from Merchant Function in UBP Case

The National Energy Marketers Association recommended that the New York PSC examine the utilities' exit from the commodity merchant function as part of its Phase II proceeding for its review of the Uniform Business Practices.

In its Phase I order (Matters, 10/16/08), the PSC deferred consideration of several items raised by parties until a second phase in the case, specifically citing remote customer access to utility account numbers, an ESCO "contest period" for enrollments, ESCO consolidated billing, timeliness of utility supply price reporting, and review of affiliate rules as items for future review.

In a subsequent notice, the Commission said a Nov. 13-14 technical conference will also address, among other things:

- Electronic Enrollments and Customer Verification - How do ESCOs protect against slamming allegations?
- Posting Complaint Rates
- Creditworthiness Requirements - Unbilled Accounts Receivables and Billing Services Agreements
- Joint communications with customers
- Bill Format
- Reverse Slamming/Transfer of Commercial Customers After Name Change
- Provision of Tax Data to ESCOs
- Direct Marketing Program

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CAISO Straw Proposal Would Implement Mandatory Use of Standard Capacity Product

A California ISO straw proposal suggests implementing a standard capacity product through the use of tags, and would impose a Must Offer Obligation on Resource Adequacy resources for those tags purchased by Load Serving Entities.

The proposed Resource Adequacy process utilizing a standard capacity product would closely track the current process, CAISO said. Rules for Net Qualifying Capacity, new capacity, and capacity exiting the market would not change.

The CAISO would begin the process by producing a Local Capacity Study, Deliverability Report and Net Qualifying Capacity as it currently does.

LSEs would submit tags to satisfy their Resource Adequacy requirement, which would contain information similar to the current Resource Adequacy plans.

Tags would represent capacity purchased by LSEs that is being submitted to CAISO in compliance with a Resource Adequacy obligation. Tags would be supported by a set of standard rules contained in a tariff, rather than individual contracts, to facilitate trading.

The tags would be identified by a resource ID, Net Qualifying Capacity MW, and the length of time the tag is valid. Including greater granularity in the tags would add complexity, CAISO said.

The tags' duration would expire at the next publication of updated Net Qualifying Capacity figures. Although the underlying bilateral agreements between LSEs and capacity sellers could be longer, the Net Qualifying Capacity in the tag would have to be validated and updated if needed.

The standard capacity product represented by tags would not be optional; LSEs must use tags to show compliance with Resource Adequacy standards. Retail marketers had argued during workshops that tags create a false sense of uniformity that is unnecessary.

Tags would also identify Resource Adequacy units subject to the Must Offer Obligation. Under the Must Offer Obligation, a resource would have to offer all of its energy and ancillary services in the day-ahead market and real-time for the tags that have been purchased by an LSE for the LSE's Resource Adequacy showing.

The Must Offer Obligation is required, CAISO said, because the FERC Must Offer Obligation will no longer apply at the start of the Market Redesign and Technology Upgrade. Additionally, in the Integrated Forward Market, CAISO will optimize energy and ancillary services to meet 100% of its forecast requirement, and there will need to be enough bids to perform such optimization, CAISO said. The Must Offer Obligation "enhancement" will help ensure supply sufficiency and market liquidity, CAISO argued, stressing the obligation will only apply to the limited pool of Resource Adequacy units.

LSEs' obligations are intended to end with the submission of tags, and capacity sellers would bear the burden of availability. The straw proposal sets guidelines to determine a target availability level for each unit, based on historical performance.

The straw proposal favors derating a unit's capacity to penalize unavailability, rather than financial fines. CAISO fears that financial penalties do not provide a strong incentive for availability, and that the costs will likely just be passed onto LSEs in capacity contracts. Should a financial penalty be preferred, CAISO invited comments on whether a uniform proxy price, or contract-specific penalty, would be appropriate, and how to implement each.

Comments on the straw proposal are due Nov. 21. A meeting will be held Nov. 18 with a conference call following Dec. 1. CAISO intends to file a standard capacity product tariff at FERC in February 2009.

Exelon Pursuing Hostile NRG Bid

Exelon is taking its bid for NRG Energy hostile after being rebuffed by the merchant generator, and also filed a lawsuit in Delaware Chancery Court against NRG and its directors, alleging each failed to give appropriate consideration to Exelon's proposal.

Today Exelon is to launch an exchange offer at the previously announced fixed exchange ratio of 0.485 Exelon shares for each NRG share. Exelon saw no need to sweeten the offer as it takes it directly to shareholders.

In responding to a detailed letter from NRG outlining the risky nature of the merger (Matters, 11/10/08), Exelon CEO John Rowe wrote in a letter to NRG that NRG's analysis ignores the fact that, "value is driven more by future growth prospects than by historical performance," and that Exelon's cash flow is stronger and growing faster than NRG's.

Rowe said Exelon was prepared to negotiate with the new NRG board following the 2009 NRG annual meeting of shareholders on May 14.

NRG told investors that Exelon has said that it intends to present a proposal at NRG's 2009 annual meeting to expand the NRG Board of Directors to 15, so that the directors to be elected at the meeting constitute a majority of NRG's directors. Exelon intends to nominate directors to fill the newly created directorships.

At EEI's financial conference, Exelon COO Chris Crane said that while Exelon had also looked at mergers with Mirant, Dynegy and Reliant, each would have raised significant market power concerns. The NRG combination would only require 3,200 MW of divestiture, from high heat rate gas and baseload coal plants (Matters, 10/21/08). About two-thirds of the divestitures would be in ERCOT, with the remaining one-third in PJM East. Exelon expects to realize $1 billion from such divestitures.

Pressed by an analyst about a potential merger with Calpine, Exelon said such a combination would be too dilutive, to the tune of 30-50¢ to earnings for shareholders.

Annual Earnings Up Nearly a Third at UGI Competitive Unit

A slower fourth quarter did not derail higher yearly results for UGI's Energy Services unit, which reported a 31% increase in net income for fiscal 2008, with earnings of $45.3 million versus $34.5 million in fiscal 2007.

The increase resulted from internal growth investments that expanded peaking facilities by 36%, as well as higher peaking rates charged and higher electric generation margin resulting from higher spot prices and higher forward fixed price sales contracts for electricity, UGI said.

Total margin for Energy Services grew 23% to $124.1 million in fiscal 2008 from $100.9 million in fiscal 2007. Operating income increased $19.9 million to $77.3 million for fiscal 2008, as the increased total margin was partially offset by slightly higher operating expenses.

Net income for Energy Services was down in the fourth quarter, at $5.6 million from $7.0 million a year ago, on mark-to-market losses.

UGI Corp. reported net income of $215.5 million for the year, up from $204.3 million a year ago.

Impairment Charge Weighs Comverge Results

Comverge's net loss for the third quarter ballooned on a one-time impairment charge related to its Enerwise unit, recording a loss of $81.8 million versus a loss of $5.3 million a year ago.

The Enerwise non-cash impairment charge was $75.4 million, and reflected a revised growth outlook given changes in PJM rules for economic demand response programs. Adjusted EBITDA loss for the quarter was $4.7 million compared to an adjusted EBITDA loss of $4.4 million in the prior-year quarter.

Comverge grew megawatts under management to 2,200 MW (including 165 MW awaiting regulatory approval), with more than $465 million in future expected contracted revenues. Total megawatt additions for the first nine months of the year were 878 MW, an increase of 66% compared to the start of the year.

Comverge's C&I business unit, formerly Enerwise, had 899 MW of commercial and industrial load under contract at quarter's end, with an additional 437 MW under management for a fee. Revenues for the C&I segment were $12.9 million in the third quarter, up from $4.6 million a year ago. Current quarterly revenue consisted of $11.6 million of demand response services and $1.3 million of software and energy engineering services.

About 90% of C&I megawatts are in PJM. Comverge is expanding its channel partners in the segment to focus on geographic expansion into New England, New York and Texas. Comverge is waiting for the Midwest ISO to open up.

Megawatts under long-term contract with utilities with regulatory approval were 701 MW at quarter's end, with 587 MW in long-term virtual peaking capacity contracts and 114 MW in long-term baseload capacity contracts.

Total selling, general and administrative expenses were $14.6 million for the third quarter, excluding the one-time impairment charge, compared to $8.9 million in the same period of 2007.

Briefly:

Detroit Ed Says Choice Sales Above 2% "Very Unlikely"

In addition to a recently enacted 10% cap on retail choice sales in Michigan, a number of other new legislative provisions make it "very unlikely" that Detroit Edison will see an increase in customer choice above the current 2% level, DTE Energy CEO Anthony Earley told investors at EEI's financial conference. The statement is seemingly at odds with Detroit Edison's stated position in its current rate case, where it has argued that the Choice Incentive Mechanism is still needed because choice sales may still be volatile despite the new 10% cap. In a reply brief, Detroit Edison disagreed with Constellation NewEnergy's proposal to end the Choice Incentive Mechanism, stating, "there is still substantial uncertainty regarding the factors that drive Choice sales levels ... and Choice sales level changes within the 10% cap can be substantial."

Dominion Not Tempted to Pursue IPP Purchase

Dominion is "not tempted at all" to go out and buy a merchant generator despite their current low valuations in the market, CFO Tom Chewning said at EEI's financial conference. Dominion is concentrating on investing in its regulated businesses and has plenty of opportunities for growth in those areas, Chewning said. Dominion has a "good mix" of merchant and regulated assets, and that model is no accident, Chewning noted. As exclusively reported in *Matters*, Dominion has also said it is not seeking to expand the ERCOT presence of its Dominion Retail subsidiary in the near term (Matters, 10/31/08).

FirstEnergy Tips RFP or Descending Clock Auction for Met-Ed/Penelec Procurement

FirstEnergy's Met-Ed and Penelec utilities will file "something like an RFP or like a descending clock auction" to procure post-rate cap default service supply needs, FirstEnergy CEO Anthony Alexander said at EEI's financial conference. FirstEnergy hasn't yet filed a procurement plan, and said it will ultimately choose a method that best matches the Pennsylvania PUC's rules. There will probably be some sort of phase-in associated with the 2011 move to market rates, Alexander said.

Constellation Names New Commercial COO

Constellation Energy named Kathleen Hyle, currently senior vice president, as its commercial business unit's new chief operating officer. Thomas Brooks, president of Constellation Energy Resources and executive vice president at Constellation Energy, resigned, as did George Persky, chief commercial officer for Constellation Energy Resources. Hyle has also served as CFO of Constellation Energy Nuclear Group and UniStar Nuclear Energy.

EnergyConnect Signs With DESC

The Defense Energy Support Center has entered into a master demand response agreement with EnergyConnect.

PPL Outlines Third Quarter Trading Position

A bet that power prices would continue to rise was responsible for the previously reported trading losses at PPL during the third quarter (Matters, 11/5/08), executives said at EEI's financial conference. PPL made the call that power prices would rise for the 2010-2012 period based on the observation that then-current capacity prices and energy prices, while high, were still not supporting new generation. Coupled with load growth in PJM, the possibility of true scarcity pricing coming to PJM as early as the summer of 2009, and higher environmental costs, PPL decided to take positions based on expected higher prices. As reported during its earnings discussion, power prices decreased, and the current lack of liquidity prevented PPL from unwinding the positions as quickly as it normally would have to mitigate its losses.

RSG Charges ... *from 1*

transmission congestion, generator and load deviations, and net virtual supply offers, with such factors not conditioned on whether the market participant withdrew energy. The Commission also agreed with testimony submitted from the Midwest TDUs showing that virtual supply offers create real-time RSG costs when they clear the day-ahead market, thereby displacing physical supply offered into the day-ahead market, and must be replaced in the Reliability Assessment Commitment process with physical units with production costs that are not covered by real-time energy market revenues.

The current exemption for virtual suppliers from paying RSG costs, "provides an incentive for these participants to engage in offer behavior that drives up Revenue Sufficiency Guarantee costs and shifts costs to others, thereby reducing the net benefits of their market activity," FERC found. "Given the high level of Revenue Sufficiency Guarantee costs, this detrimental impact on market efficiency is an important consideration," the Commission said.

FERC found two alternative cost allocation proposals to be just and reasonable -- the first simply removes the "actually withdraws energy" stipulation in the current RSG cost allocation formula, while the other is an "indicative" proposal for a new methodology submitted by MISO. The indicative proposal allocates RSG costs based on three major reasons for the commitment of units after the day-ahead market closes: (1) managing a transmission constraint or addressing a local reliability concern; (2) addressing intra-hour demand changes; and (3) adjusting to deviations from day-ahead schedules.

However, the indicative solution cannot be implemented before the start of the Ancillary Service Markets, FERC noted, and MISO needs at least 60 days to conform the proposal to the Ancillary Service Markets tariff.

Thus, until MISO makes such adjustments, FERC ordered MISO to modify the current RSG tariff to remove the "actually withdraws energy" language and associated virtual supply exemption. The modified tariff has an effective date of August 10, 2007, and is to be used to provide refunds, with interest, to affected market participants.

FERC found that refunds of RSG charges based on the modified tariff dating to August 10, 2007, are appropriate due to the inequities caused by the current tariff. Market participants have had 15-months notice of potential refunds, the Commission noted -- sufficient time and notice to adjust their activities to avoid incurring potential refund costs. For that reason, FERC does not consider refunds to be an undue burden on those market participants who owe them.

The refunds mean resettlement of RSG costs paid by market participants, with some market participants paying for the difference between the billed costs and the costs assigned under the revised cost allocation, and others receiving a refund equal to the difference between the billed costs and the costs assigned under the revised cost allocation.

FERC was not persuaded that refunds should be waived because they may make virtual trading unprofitable or cause virtual bidders to cease trading.

"We do not find a basis for the conclusion that the proposed cost allocation will eviscerate the virtual energy market or will nullify the price convergence benefits of virtual transactions," FERC said. The Commission pointed to a number of market participants that are currently being allocated RSG costs for their virtual transactions. Even with this allocation, virtual activity has been increasing through 2007 and price convergence in the Midwest ISO is consistent with price convergence in other ISOs, FERC said.

Commissioner Philip Moeller did not participate in the Commission's decision.

N.Y. UBPs ... *from 1*

NEM recommended that Phase II also include an examination of the utility's exit from competitive functions, consistent with the 2004 Policy Statement, including exit from the commodity merchant function.

Phase II should also include a review of ESCO referral programs, including consideration of extension of referral programs to new service customers, which is currently being examined at Consolidated Edison on a utility-specific basis. The proceeding should also address competitive issues resulting from assigning dual fuel customers to only dual fuel ESCOs.

Improving marketer access to capacity and storage should also be considered in Phase II, NEM said. NEM suggested that customer assets should follow the customer, as is the practice in the Ohio and Georgia markets.

A budget billing review would also be appropriate, NEM recommended, since at least one utility requires a "settle up" for budget billing customers who elect to enroll with an ESCO. For customers in a negative balance situation, the settlement imposes an immediate charge and can unnecessarily discourage them from participating in choice, NEM noted.

ESCOs should also be provided with access to customer lists (at a minimum, access to customer names and addresses) to facilitate consumer participation in choice and to allow marketers to more effectively conduct marketing campaigns, NEM added.