Energy Choice Matters

November 13, 2008

Universal Would Acquire Commerce Books in Five Markets Under Proposed Agreement

Commerce Raises Doubts as a Going Concern Absent New Credit

In the continued firesale of Commerce Energy, it and Universal Energy Group have signed a letter agreement for a potential sale of several customer books, which accounted for nearly one-third of Commerce's revenue as of April 30, for $16 million. Commerce said that absent the credit that Universal would arrange for it as part of the proposal, there is "substantial doubt" Commerce could continue as a going concern given its inability thus far to arrange replacement credit needed by the end of December.

The potential sale, now subject to an exclusive negotiation period, would include Commerce's Ohio gas customers and Pennsylvania, New Jersey, Maryland and Michigan electricity customers.

The $16 million price would also include an equity stake in Commerce as Universal would acquire newly issued shares of Commerce Energy's common stock amounting to 49% of the issued and outstanding shares of Commerce's common stock. Universal would also receive a warrant to acquire an additional number of newly issued shares of Commerce Energy's common stock. When taken together, the stock purchases and warrant would amount to 66.7% of the issued and outstanding shares of Commerce Energy's common stock (after giving effect to the issuance of the shares to be purchased and the shares underlying the warrant).

Commerce would retain its customers in its few remaining markets, principally California.

The customer books involved accounted for nearly one-third of Commerce's $105.5 million net revenue for the quarter ending April 30, 2008, the most recent quarter with granular data available.

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CCAs Say Cost Responsibility Surcharge a Natural Hedge Against Re-entry Fees, Bonds

The California PUC must net any re-entry fees or bonding requirements developed for Community Choice Aggregation (CCA) against amounts paid by CCA load under the Cost Responsibility Surcharge (CRS), a coalition of community choice aggregators said in advance of a PUC workshop (R. 03-10-003).

The Cost Responsibility Surcharge is a fee imposed on departing load meant to prevent cost shifting to remaining utility customers, and to pay the departing load's portion of hedged Department of Water Resource supply contracts.

Cost Responsibility Surcharge payments provide an appropriate and legislatively required means of mitigating re-entry risks and costs, the CCA coalition said, which included the San Joaquin Valley Power Authority and City and County of San Francisco among other aggregators.

The community choice aggregators argued that, in the early years of a CCA program, Cost Responsibility Surcharge payments provide a "nearly complete" hedge against risks associated with the involuntary return of CCA customers to utility service. This hedge can permit the Commission to assure that customers will be protected against re-entry costs, and assure that the CCA bond requirements do not serve as an impediment to the development of CCA programs.

The community aggregators pointed out that when the utility's already-procured resources are above-market, departing CCA customers must pay the Cost Responsibility Surcharge to keep bundled customers indifferent, and thus they contribute to the cost of the utility's resources.

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RESA: Keep Procurement Frequency Discussion in Illinois Power Agency Supply Plan

The Retail Energy Supply Association opposed Commonwealth Edison's attempt to remove a discussion of increasing the frequency of default service supply procurements from the Illinois Power Agency's Procurement plan.

A draft plan had originally called for an annual procurement, but contemplated moving towards more frequent procurements and eventually continuous procurements (Matters, 9/5/08). The final plan submitted by the IPA, however, removed the IPA's stated intention to move to more frequent procurements, and mentioned it only as an area for future assessment. However, the final procurement plan did still state the IPA's belief that a single annual procurement event increases portfolio risk by relying on market timing, and raises the risk of market power.

ComEd objected to the inclusion of that belief in the final plan, since no analysis is provided in the plan to substantiate it, and because the plan ultimately calls for a single annual procurement.

RESA, however, favors keeping the IPA's statement, because the statement, "puts all parties on notice of its intentions and the reasons for those intentions," regarding procurement timing.

But Illinois Commerce Commission Staff agree with ComEd, reasoning that the timing issue raised in the Plan should be analyzed more fully, and that it is unnecessary for the Plan to reach any conclusions at this time.

"Staff is particularly concerned with the Plan's contention that single procurement events (per year) increase the potential for the exercise of market power. The IPA presents no data or even a theory to support this contention," Staff said in reply comments.

Another alternative would be for the Commission's order adopting the Plan to make clear that it is not making any findings at this time associated with the Plan's contention that single procurement events increase portfolio risk and the potential for the exercise of market power, Staff suggested.

RESA reiterated that a supply procurement method which fails to reflect market prices will recreate one of the unintended consequences of the rate freeze that Illinois has experienced over the past several years: competition cannot develop in the face of utility default service rates which are lower than market.

Moreover, more frequent procurements (and refreshing of retail rates) would promote more efficient use of electricity, RESA added.

Kelliher: Harm to Transmission Service, Planning Too High a Price for MISO Market Service

Compromising effective transmission operations, planning, and expansion would be "too high a price" to pay for implementing the Midwest ISO's Market Services proposal, FERC Chairman Joseph Kelliher said in opening a technical conference on the plan (Matters, 6/16/08).

The Market Services proposal would open MISO LMP markets to external transmission owners without requiring the owners to cede control of their grid operations to MISO.

Existing MISO transmission owners and several other market participants have cautioned the proposal could harm RTO participation by allowing vertically integrated transmission owners to receive the energy price benefits from RTOs for their generation, while avoiding the transmission expansion costs associated with full membership.

Kelliher noted the Market Services proposal may be inconsistent with Order No. 2000 in some respects.

"The Commission must ask itself which is more important: expanded market access or the core transmission functions envisioned for RTOs in Order No. 2000," Kelliher said.

Tara Energy Moves to Close Dormant Complaint Docket

Tara Energy again moved for a pending PUCT docket (33508) concerning complaints from the North Texas Trade Association to be dismissed given the lack of any outstanding claims.

The vast majority of complaints were dismissed in July of 2007, with most remaining complaints resolved and jointly asked to be dismissed in September 2007. The Commission has yet to rule on the September 2007 petition, and the docket was dormant until this summer when Tara moved for a final ruling to dismiss the proceeding.

Tara now reports that only one complainant has not settled, and said that the sole complainant sold the relevant business some time ago. Based on its review of documents related to the conveyance, Tara has reason to believe that the sale of the business also transferred "intangibles" that would encompass any business-related claim such as might be asserted in the complaint proceeding, and argued the remaining complainant now lacks standing.

As no complainant continues to prosecute or otherwise actively participate in the case which has been inactive for roughly one year, Tara renewed its motion to dismiss.

Briefly:

N.Y. PSC Makes Change in ConEd Gas Bill Processing Fee Permanent

The New York PSC approved on a permanent basis tariffs from Consolidated Edison implementing an ordered change in Billing and Payment Processing charges for gas customers (06-G-1332). Under the new tariff, when ConEd issues a consolidated bill on behalf of an ESCO who is participating in the Purchase of Receivables program, the ESCO will be responsible for paying the Billing and Payment Processing charge to ConEd, and the customer will avoid such payment. The Billing and Payment Processing costs include the cost of printing and mailing a customer's bill and for processing the payment, and had previously been paid directly by customers.

N.Y. PSC Lengthens Time Period for Environmental Disclosure Labels

The New York PSC has changed the settlement period used to calculate ESCOs' environmental disclosure labels from six months to a 12-month cycle corresponding with the calendar year. With the change, distribution of the labels to customers will only have to occur annually.

CL&P Names Standard Service Suppliers

Conectiv Energy Supply, Consolidated Edison Energy, Constellation Energy Commodities Group, FPL Energy Power Marketing, PPL EnergyPlus and Sempra Energy Trading each won slices of Connecticut Light and Power's standard service load for the first half of 2009 as awarded over several laddered procurements, the utility reported to the DPUC.

NUS Consulting Seeks D.C. Broker License

National Utility Service applied for a broker license for C&I customers in the District of Columbia after two years of operating without a license in the District. NUS said it was unaware a license was required for brokering, and suspended D.C. operations upon learning of the requirement. NUS is currently licensed in Texas, Maine and Massachusetts, with a pending application in Maryland.

PUCO Defers Action on FirstEnergy SSO Plans

PUCO deferred scheduled consideration of FirstEnergy's electric security plan and market rate option at yesterday’s Commission meeting. PUCO said it would give the ESP thorough review, but did not say when a decision would be issued. PUCO said it intends to vote on the MRO at its meeting next week.

CenterPoint Reports Billing Transaction Delay

CenterPoint Energy reported yesterday that billing transactions delivered to the Market will be delayed approximately 24 hours. The delay, blamed on "minor system issues," involves Meter Reading Cycles 18, 19 and 20. Transactions that are delayed are the 867_03 Monthly Usage Transactions (delivered to ERCOT) and the 810_02 Invoice Transactions (delivered to the Competitive Retailer). All transactions are expected to be current prior to the end of this weekend.

Mich. ALJ Favors MichCon Uncollectible Reconciliation

A Michigan ALJ recommended that the PSC approve MichCon's request of $34.4 million for recovery of its Uncollectible Expense True-Up Mechanism (UETM) computation as proposed by the LDC, including the request for a $1.6 million underrecovery for 2005 (U-13898). The Attorney General had cautioned that MichCon's application of the Uncollectible Expense True-Up Mechanism computation would result in endless reconciliations continuing into the future for years even after the Commission removes the Uncollectible Expense True-Up Mechanism should it ever so decide. But the ALJ is convinced that MichCon's method of recovery will not result in endless reconciliations, noting that recovery of $1.6 million in the present case will exhaust all 2005 claims and discontinue the 2005 mechanism. The ALJ believes that the same scenario would prove true for the 2006 surcharge in the next reconciliation period, and that the pattern would follow for successive filings. "While this issue of timing is confusing at the offset, it clearly explains MichCon's approach once it is understood," the ALJ said.

New Brunswick Power Generation Gets Maine Retail License

The Maine PUC granted New Brunswick Power Generation Corp. a Competitive Electricity Provider license to serve C&I customers as a competitive retailer, and all customer classes as a Standard Offer Provider (Matters, 11/11/08).

Commerce ... *from 1*

Although Commerce reported earnings yesterday (see following), it has yet to file an updated 10-Q/10-K.

Revenues from the involved books for the April-ending quarter were $13.9 million for Ohio gas, $12.8 million for Pennsylvania/New Jersey electric, $6.3 million for Maryland electric, and $1.6 million for Michigan (plus undefined "other" markets) electric.

Revenue from Commerce's old ERCOT book, recently sold to Ambit Energy (Matters, 10/28/08), was $30.8 million for the quarter ending April 30. Combined with the potential Universal sale, Commerce will have shed some 62% of its quarterly revenue from the quarter ending April 30, not including the impact of some smaller asset sales (such as Commerce's sale of its Maryland residential gas book to MXenergy, Matters, 8/6/08).

Under the proposal, Commerce's board would consist of no more than seven members, with three to be named by Universal.

Within 10 days of signing a definitive agreement, Universal would replace Commerce's credit support currently provided by Wachovia Capital Finance under Commerce's existing credit facility for an initial fee of $250,000.

For Canadian-based Universal, the acquisition would mark a big expansion into the U.S., where it thus far has limited marketing to Michigan gas sales, which has proven to be a rocky experience given a current marketing complaint proceeding instituted by Michigan PSC Staff (Matters, 10/23/08). Universal's U.S. strategy to date has been selling five-year price protection gas contracts. The pending case, in which Staff has suggested license revocation, could potentially cloud necessary regulatory approvals for the acquisition in some jurisdictions.

Universal has been open to opportunistic acquisitions, and earlier this year acquired Wholesale Energy Group in the British Columbia natural gas market and the Ontario natural gas and electricity markets from SemCanada (Matters, 8/21/08). Universal anticipates that the $16 million purchase price for Commerce would be funded through existing cash on hand.

Universal would retain the right to use the Commerce trade names in the markets where it is purchasing books, and would receive Commerce's "1 800 ELECTRIC" phone number and, seemingly, Commerce's www.electric.com web address (The letter agreement identifies the address as www.electricity.com which does not currently direct to Commerce, nor is registered by Commerce). However, Universal would grant Commence an exclusive license for the use of the phone number and website for the purpose of acquiring customers in California.

Commerce's exclusive commodity marketing arrangement with Upromise would be assigned to Universal for all territories excluding California and Texas.

Upon closing, and after an initial transition, Universal would provide, for five years, backoffice support (including IT systems, human resources, legal and regulatory staff) for Commerce's existing California marketing business. Commerce would pay $1 million for the first year of the services, and $1.5 million annually thereafter. Universal would also arrange for supply of Commerce's California customers, on terms mutually agreed between Universal and Commerce.

Commerce and certain of its executives would sign non-compete clauses with Universal in the market territories covered by the proposed agreement.

Universal is being advised by NBF Financial. The exclusive negotiation period runs through

Nov. 26, and the proposal includes various non-completion terms.

Commerce 2008 Earnings

Bad debt produced a steep decline in Commerce earnings in the fiscal year ending July 31, 2008, as Commerce reported a net loss of $31.8 million versus net income of $5.5 million for fiscal 2007. Bad debt during fiscal 2008 was $23.0 million, primarily from the Texas market. With Commerce's fiscal year ending in July, the results do not include impacts from Hurricane Ike which have weighed retailers.

Net revenues for fiscal 2008 rose 34% to $459.8 million from $371.6 million a year ago on a 36% increase in electric sales and a 7% increase in natural gas sales. Higher electricity sales reflect the impact of retail sale price increases and a 79% increase in sales volumes in Texas due to customer growth, partly offset by lower retail sales in the Pennsylvania/New Jersey and Michigan markets resulting from customer attrition.

Customer count fell to 156,000 from 196,000 year-over-year. Customer count was 165,000 as of April 30, 2008.

Gross profit for fiscal 2008 decreased to $56.7 million from $57.2 million in fiscal 2007. Gross profit from electricity rose slightly to $47.2 million from $46.6 million for fiscal 2007, reflecting the impact of higher retail prices and usage of electricity as compared with the prior year. Gross profit for natural gas totaled $9.5 million for fiscal 2008 compared with $10.6 million for fiscal 2007.

Selling and marketing expenses increased to $14.1 million from $10.6 million last year, reflecting higher telemarketing costs from increased customer acquisition initiatives in the early part of fiscal 2008. General and administrative expenses rose to $64.5 million from $37.3 million in fiscal 2007 because of increased bad debt and restructuring and severance costs.

Net loss for the quarter ending July 31, 2008 was $20.0 million, versus net income of $1.1 million a year ago. The 2008 quarter included $5.2 million in bad debt. Net revenues for the fourth quarter increased to $140.3 million from $107.9 million for the same period in fiscal 2007.

Quarterly gross profit decreased to $6.9 million from $15.0 million for the fourth quarter of fiscal 2007. Gross profit from electricity fell to $9.8 million, compared with $13.8 million a year ago, on lower gross margins in the Texas market, partially offset by higher gross margins in Maryland and Pennsylvania. Gross profit from natural gas was a loss of $2.9 million for the quarter, versus a profit of $1.2 million in the year-ago quarter. Lower gross margins in Ohio and in the former HESCO commercial and industrial customer book contributed to the loss.

Fourth quarter selling and marketing expenses were lower at $2.6 million, versus $3.3 million a year ago, from lower advertising and payroll expenses related to workforce reductions. General and administrative expenses rose to $16.4 million in the quarter from $10.3 million, principally because of higher bad debt expense and increased restructuring costs,

Commerce reported that Wachovia has notified Commerce that it does not intend to extend a current credit facility beyond the December 22, 2008, expiration. Commerce anticipates it will continue to require a credit facility of $20 to $25 million over the winter season for letters of credit to energy suppliers, assuming current pricing.

As of November 12, 2008, Commerce does not have a firm commitment for a replacement credit facility or other financing, as the retailer blamed the unprecedented global credit crisis for adding to the uncertainty of finding a replacement credit facility.

"Accordingly, these factors raise substantial doubt about Commerce Energy's ability to continue as a going concern," the retailer said.

While Universal would provide credit under the proposed transaction, there can be no assurances that any definitive agreement will be approved or consummated between the parties, Commerce noted. If the proposed transaction with Universal is consummated and Universal provides credit support for Commerce Energy's remaining operations in its other markets, Commerce expects to sell its natural gas inventory and reduce its cash deposits with energy suppliers, which it believes would provide enough liquidity for 12 months.

CCAs ... *from 1*

Accordingly, legislation requires utilities to exclude any amounts previously determined and paid pursuant to the Cost Responsibility Surcharge when calculating re-entry fees, the CCA coalition argued.

In order to properly reflect the legislative mandate, the aggregators contended that a credit must be given to CCA customers that reflects the value of the utility's hedged resources - resources that CCA customers have paid for.

In contrast, if the re-entry fee was determined by only considering the market price benchmark upon the return of CCA customers, an inequity would exist because no effect would be given to the Cost Responsibility Surcharge payments made by CCA customers, aggregators reasoned.