Energy Choice Matters

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Retailers, Consumer Groups Urge REP Collateral be Tied to Load or Customers

A cross section of REPs and consumer groups disagreed with the PUCT's proposal to tie financial requirements to length of time in the market, and suggested that collateral postings should be linked to either load or customers served, in comments on draft new REP certification standards (Matters, 10/9/08).

A key part of the proposal for publication would hold that non-investment-grade REPs would be required to possess $3 million in liquid capital, but the amount could be reduced to $1 million if the REP has operated for three years without sanction or default. Both REPs and consumer advocates found flaws in that proposal.

The Office of Public Utility Counsel did not see a correlation between the length of time a REP has operated and financial requirements. OPC noted that National Power, which ceased operations and lost its REP certificate earlier this year, had been in operations since 2005. Assuming it had not been sanctioned since certification, National Power would only have been required to have $1 million in liquid capital at the time of its default, which would not cover its debts to customers, ERCOT, and the TDUs, OPC said.

OPC favors linking capital needs to load or customers served, since the potential harm to the market depends on the size of a defaulting REP's book. Texas Legal Services Center and Texas Ratepayers' Organization to Save Energy made similar arguments, noting the length of time a company is in business is not a valid measure of its financial strength, citing contemporary examples

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IDT Energy Gross Margin Swells on Lower Spot Market Prices

Gross margin at IDT Energy grew to 30.1% for the quarter ending October 31, 2008 (first fiscal quarter 2009), based on advantageous spot market pricing.

However, executives noted during a conference call that such gross margins are not sustainable, and were the result of favorable spot market price declines during the quarter, compared to customers' contracted rates. IDT Energy posted $11.1 million in income from operations during the quarter, compared to $1.7 million in the year-ago quarter.

IDT Energy relies heavily on the spot market for its gas and electric supplies, and also reported that competitors did not drop their prices as significantly, allowing IDT to enjoy higher margins as wholesale prices fell. Year-ago gross margins were 12.9%.

IDT had 392,000 meters as of October 31, up 26% year-over-year. Gross meter acquisitions grew by over 25,000 per month during the quarter, versus 14,000 per month during the same period a year ago.

Consumption per meter for electricity was driven higher in Q1 2009 compared to Q4 2008 by favorable changes in customer demographics, as acquisition efforts targeted small commercial customers with higher consumption histories. Churn was slightly higher than the sequential and year-over-year quarters.

Revenues for the quarter grew to $67.2 million, up 59.6% (56.5% for electric, 73.9% for gas) year-over-year.

Selling, General & Administrative costs more than doubled to $8.7 million from $3.7 million a year

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Proposed Order Backs Three-Year Laddered Supply in Illinois

The Illinois Power Agency's proposed laddering of supply procurement over three years would ensure adequate, reliable, affordable, efficient, and environmentally sustainable electric service at the lowest total cost over time, a proposed decision by an Illinois Commerce Commission ALJ would find (08-0519, Matters, 10/22/08).

The foundation of the plan is an annual RFP which would procure:

- 35% of projected energy needs two years in advance of the year of delivery;
- 35% of projected energy needs one year in advance of delivery, and
- 30% of projected energy needs in the year in which power is to be delivered.

The proposed decision would omit the IPA's statement that a single procurement event may increase portfolio risk and the potential for the exercise of market power. The ALJ found that there is not sufficient analysis to support the statement, which the IPA originally discussed in connection with a future move for more frequent -- and eventually continuous - procurements (Matters, 11/13/08).

The draft order would prohibit the IPA from procuring multi-year or long-term renewable resources in its 2009 procurement, as it's unclear whether potential risks from long-term renewable contracts outweigh potential benefits. The conclusion is not intended to foreclose the consideration of multi-year or long-term renewable resources in future procurement periods.

Benchmarks for REC prices, which would be used to reject offers above such prices, should not be used in the 2009 procurement, the draft order would find. The ALJ agreed with Staff, noting benchmarks could inhibit achievement of renewable goals, as well as carve-outs for certain resources.

The draft order would provide that the number of megawatts awarded for each contract type and for each contract term will be publicly disclosed after a Commission vote accepting a procurement administrator recommendation to accept certain bids for future procurement events, provided there are at least three winning bidders in the entire procurement event. Winning quantities and average prices for all products, and not just the 24 basic building block products, would also be publicly released.

Such aggregate numbers would not constitute "supplier and bidder information" which by statute must remain confidential, the ALJ said. The public disclosure will increase transparency while not increasing the risk or cost to participating suppliers and ultimately customers, the ALJ noted.

NorthBridge Study Says Past Regulation Failed to Solve Problems Similar to Today's

Electric regulation failed to meet the challenges of higher fuel costs, substantial capital cost escalation, serious environmental concerns, and unanticipated changes in customer demand in the 1970s, and there is no reason to believe similar command-and-control policies will meet today's similar challenges, the NorthBridge Group said in a new study released yesterday.

The analysis, Embrace Electric Competition Or Its Déjà Vu All Over Again, was first reported by Matters (11/25/08, 11/19/08), and was released at a Compete Coalition forum.

NorthBridge concluded that the regulated response to the challenges of the 1970s amounted to a mistake on the order of $200 billion, or more, in today's dollars, from the "massive" overbuild of baseload generation. The overbuild, as well as well huge cost overruns, resulted in excess supply and high rates that were felt for decades, NorthBridge said. Lower than expected load growth in the 1970s meant that the costs of power plants, which were more expensive than originally estimated, were spread over a smaller than expected customer base.

Nominal electric rates rose by over 300% from 1970 to their peak in 1985, while real rates rose by 60% in the same time period, due to the flaws inherent in regulation, NorthBridge said.

Among the problems inherent in regulation is a lack of clear price signals, which contributed to a slow regulatory response that failed to curb the over-building of baseload nuclear and coal capacity as costs spiraled and the need for capacity evaporated, NorthBridge reported. "As a result, the total U.S. reserve margin peaked at 42 percent in 1982, more than twice the 15 to 20 percent level generally deemed necessary to maintain system reliability," NorthBridge found.

Regulatory "fixes" also tend to overcompensate, and in the 1970s led to administratively mandated qualifying facilities which burdened electric utilities and their customers with a $50 billion overhang of mandatory long-term contracts established at prices well above their actual avoided cost or any reasonable proxy of market prices, NorthBridge noted.

NorthBridge contrasted the 1970s overbuild, paid by ratepayers, with the glut of gas-fired generation in the early 2000s. When prices and over-building made gas-fired generation uneconomic, competitive builders cancelled 78% of capacity planned or under construction with a planned in-service date of 2003 or later, while regulated builders cancelled only 37% of capacity, NorthBridge found. "Unlike in the 1970s and 1980s, these uneconomic investments did not adversely impact customers in non-regulated states since unregulated investors - not ratepayers - bore the risk of these investments," NorthBridge pointed out.

NorthBridge dismissed criticisms of competition, especially comparisons of rates in restructured and non-restructured states, such as those done by Power in the Public Interest. NorthBridge concluded that had natural gas prices remained at the $3/MMBtu level as in the late 1990s, the rates in non-restructured states would have risen 18% from 1997 to 2007, compared to a 22% rise in restructured states. The small difference is primarily caused by the variation in fuel inputs used to produce electricity combined with differences in how electricity is priced to end-use customers in regulated and restructured states, NorthBridge said.

NorthBridge cautioned against returns to command-and-control regulation cloaked as portfolio management or long-term contracts procured under new forms of integrated resource planning.

"[T]hese actions are nothing more than a return to the central planning of the past - the same central planning that tried to select the right amount and the right mix of technologies in the 1970s and failed," NorthBridge argued.

Re-entry of regulated utilities into the generation business, whether through direct utility ownership or allowing utilities to enter into long-term contracts with new generators, is risky for customers, NorthBridge contended, since a centrally planned risk is transferred to retail customers. Furthermore, re-entry of utilities into the generation business is incompatible with wholesale competition and will deter - and perhaps even eliminate - market-based entry of new generation, NorthBridge argued. "It is not likely that rate based investments could coexist with competitive generation," NorthBridge said.

BlueStar, Brokers Trade Pleadings at ICC

BlueStar Energy Services opposed a petition from three Illinois brokers for interlocutory review of an ALJ's decision which allowed BlueStar's complaint under the new ABC law to proceed (Matters, 12/2/08).

American Energy Solutions, Affiliated Power Purchasers International and Lower Electric had argued that the only relief the ICC can grant under statute is the suspension of a license, which none of the brokers can even obtain yet, since the ICC has not finalized licensing rules.

However, BlueStar countered by calling it "absurd" that the Legislature would make the law effective as of October 2007, but would preclude the ICC from taking action (via a prospective licensing suspension) against brokers who violate the law before licensing rules are finalized.

BlueStar also argued that the documents at the heart of the complaint, which do not list remuneration to the broker, are clearly not preliminary materials since each contains specific prices. One of the documents even provides that the customer can sign and return the document to proceed with the proposal, BlueStar said.

Meanwhile, the brokers objected to BlueStar's motion for an entry of default (Matters, 12/8/08). BlueStar had argued that the brokers failed to file an answer to an amended complaint, and that the petition for interlocutory review did not suspend the proceeding.

However, brokers countered that while ICC rules of practice specifically hold that petitions for interlocutory review do not suspend hearing procedures, the rules of practice do not address other deadlines in a case. The interlocutory review filing stays the need to file an answer to the amended complaint, brokers said, because the petition is meant to relieve parties from dedicating resources to a case that, on its face, should not be before the Commission. Thus requiring an answer while the petition is pending would defeat its purpose, brokers argued.

Briefly:

Shell: ABACUS Report to be Released this Week

Shell Energy North America said in comments on the PUCT's REP certification proposal that the latest Alliance for Retail Choice Baseline Assessment of Choice in the United States (ABACUS) report will be released this week.

Constellation Board OKs Talks with EDF

Constellation Energy's Board of Directors has authorized the company to begin immediate discussions and exchange of information with Électricité de France (EDF) related to EDF's unsolicited proposal, which would pay $4.5 billion for a 50% stake in Constellation's nuclear business (Matters, 12/3/08). The Board has not withdrawn, modified or qualified its recommendation that shareholders vote in favor of the merger with MidAmerican Energy Holdings. The special meeting of shareholders to vote on the merger with MidAmerican remains scheduled for 8 a.m. on Dec. 23, 2008.

FERC Denies Rehearing of Interventions in Edison Mission Case

FERC has determined to take no action on rehearing requests from the Illinois Attorney General and other parties regarding the Commission's denial of intervention in a case which approved a settlement between FERC Staff and Edison Mission Energy regarding Edison Mission's high-offer strategy (IN08-3, Matters, 10/8/08). With no Commission action, the requests for rehearing are denied by operation of law.

Allegheny Files Updated Warrior Run Charge

Allegheny Power filed with the Maryland PSC updated rates for the Warrior Run surcharge to recover above-market costs of the facility's power which had been bought on a long-term PURPA contract, but is now sold into the PJM market. The 2009 surcharge, in aggregate, is 23% lower than the 2008 surcharge due to the sale of reactive power from the plant into the PJM market (in addition energy and capacity), and also due to prior over-collections. The surcharge by rate class can be seen in Case 8797.

PUCT Staff Backs Occidental in Big Country Complaint

Occidental Power Marketing is lawfully providing retail electric service to the customer-owned distribution system of an affiliate managing the Cogdell Unit oil field, PUCT Staff said in Statement of Position (35690). Service is at a single point of interconnection which is dually-certificated to Oncor and Big Country Electric Cooperative, Staff said, and thus Occidental Power Marketing and Oncor are not violating Big Country Electric Cooperative's exclusive right to provide service in its certified area. Big Country had filed a complaint regarding the service provided by Oncor and Oxy (Matters, 6/12/08).

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such as Bear Sterns, Lehman Brothers, AIG, and General Motors.

Several REPs warned that the new requirements, which greatly boost the current $100,000 threshold, would create barriers to entry, and would unfairly advantage larger, former incumbent, REPs (Matters, 11/25/08).

REPower, which focuses on marketing prepaid service with an in-home meter, was among the REPs arguing that the proposed rule is ill-suited to address REPs which serve a niche or only a subset of the retail market. REPower suggested that liquid capital requirements be set at not less than two times the ERCOT collateral requirements, not to exceed $1 million.

En-Touch Systems, which markets to customers in a planned solar "hybrid" community with at least 1 kW of installed solar in each home, reported that it currently serves only 25 premises, and has a measured plan for controlled growth. Yet as a relatively new entrant, it would need to post $3 million to serve 25 customers, which would force it to raise prices -- potentially driving away customers and putting it out of business.

The proposed rule's $3 million requirement, "operates as a barrier to entry to new REPs and could easily result in an exodus from the market of existing REPs that would be forced to maintain a reservation of millions of dollars of liquid assets that may neither be used nor borrowed against," Tara Energy concurred.

"Such provisions give the largest REPs an advantage by allowing them to demonstrate access to capital simply by showing sufficient net worth or relying on an investment-grade credit rating, that they have accrued over years, if not decades, as incumbents," Tara added.

Tara found it inconsistent that the proposed rule removes the current higher credit standards for REPs with over 1 million customers, such as a higher minimum credit rating of "BBB" as rated by S&P. Investment-grade REPs would also not have to post deposits with TDUs, unlike non-investment-grade REPs using liquid capital for certification. Non-investment-grade REPs, which are possibly subject to posting new deposits with TDUs, will have higher costs from such deposits, thereby giving larger, investment-grade REPs a competitive pricing advantage, Tara warned.

Tara doubted newly certified REPs would be able to find a guarantor willing to commit $3 million in cash equivalent assets in today's credit markets, meaning the proposed rule, "may result in larger POLR transitions resulting from the exit or failure of some REPs unable to satisfy the burdensome and unpredictable capital requirements on REPs in an economic environment where credit markets are largely closed for business."

"With fewer competitors, a new set of issues could arise, related to the potentially higher market power of each remaining entity," added the REPs for Competitive Markets (RCM). The group includes Simple Power, Discount Power, Frontier Utilities, Gateway Power Services, and Potentia Energy.

"Almost as a rule, the most competitive offers listed on the PUC 'Power to Chose' website are those by the very REPs most likely to be negatively affected by the rule, as currently proposed," RCM added.

RCM suggested that investment-grade ratings may not produce added protection from default, and contended that, "large REPs are more likely to have access to complicated financing arrangements, such as credit sleeves, which allow them to shift liabilities off-balance sheet in order to gain investment grade credit ratings."

"These financing arrangements are likely to contain credit triggers to protect the lenders from deteriorating financial performance of the REP ... As has been seen numerous times in the energy and financial services markets, these credit triggers are tripped at the most damaging time for the borrower. In the case of REPs, the credit triggers would likely be tripped in times of unusually high prices (such as this summer) or unexpectedly absent load (such as during Hurricane Ike). Tripping a credit trigger could potentially require the REP to assume all of the liabilities that have been shifted off-balance sheet, thereby dramatically accelerating the deterioration of the REP's financial position and increasing the likelihood of a credit downgrade," RCM said.

RCM suggested removing the "arbitrary" collateral criteria that divide REPs into categories, and instead proposed matching financial obligations to the growth of business. Financial requirements should be tied to the average price of natural gas, RCM added.

RCM proposed that the current $100,000 threshold be raised to $300,000, and that the ratio between liquid capital and TDU billings be increased to 60%. "In this way, the initial liquid capital on hand would be sufficient until the REP's monthly TDU billings exceed $500,000," RCM explained. RCM would also limit the total liquid financial requirement to $1 million.

However, TXU Energy suggested that a requirement for $3 million in liquid cash resources, "might be too low a hurdle," while not specifying an alternate threshold. TXU further proposed that the collateral requirements for non-investment-grade REPs be in the form of a cash deposit or letter of credit to the Commission.

Finally, with respect to the variable liquid capital requirements, REPs opposed tying any reduction in the amount to a REP's record of generic sanctions in the market. The term sanction could cover any violation of law or Commission order, including findings unrelated to financial wherewithal, such as REC compliance failure.

TDU Deposits

REPs opposed giving TDUs additional authority to collect deposits from REPs, especially since the rule also proposes allowing

TDUs to recover REP-related bad debt through a regulatory asset.

Additional deposit requirements for REPs would simply "doubly-insulate" TDUs while creating a financial hardship for REPs, particularly in light of other new financial requirements in the rule, TXU said. Additional TDU deposits would amount to "overkill" that will create a significant barrier to participating in the ERCOT market, the Alliance for Retail Markets added.

Customer Deposits

Reliant Energy argued that escrow accounts or letters of credit are not necessary to insulate customer deposits from bankruptcy, citing case law that held that rent deposits held by landlords who have filed for bankruptcy protection are not property of the estate when state law specifically provides that the deposits are held on behalf of the tenants. Thus Reliant suggested that REPs be required to keep deposits in segregated accounts for the benefit of customers, without the need for escrow accounts which would be more costly.

TLSC and ROSE proposed that REPs be required to place customer deposits in insured escrow accounts under the Transaction Account Guarantee Program, which allows non-interest-bearing accounts and Negotiable Order of Withdrawal (NOW) accounts earning no more than 0.5% interest to be insured beyond the FDIC $250,000 limit. Any interest could be contributed to the non-profit agencies that administer REPs' bill payment assistance programs.

Under TLSC and ROSE's suggestion, a designated ERCOT official (or the PUCT's executive director) would be an account cosigner to the REP's escrow account. The PUCT would have a standard agreement with each REP that would detail the circumstances under which the cosigner would exercise the legal authority to transfer funds to the POLR or other acquiring REP.

Defining Net Worth, Capital

An alternative to the investment-grade criteria in the rule would allow REPs with tangible net worth greater than or equal to $100 million (when meeting other requirements) to enjoy the same certification status of investment-grade REPs. TXU opposed the proposed exclusion of intangible assets, including goodwill, when evaluating a REP's net worth.

TXU reported that its net worth would be, "substantially, unnecessarily, and inappropriately reduced," by excluding intangible assets, "because REPs do not typically rely heavily on tangible assets."

"Instead, REPs derive much of their worth and value from intangible assets such as brand and customer relationships," TXU claimed.

Reliant and TXU both contended that when considering net worth and assets/liabilities, the effect of derivatives and mark-to-market accounting should be excluded. "[H]edging is part of good risk management, not a sign of financial vulnerability," TXU said, and REPs should not be punished for engaging in prudent hedging activities.

TXU further suggested that REPs should enjoy the same status as investment-grade REPs by recording 24 months of timely payments to TDUs. "There is anecdotal evidence that a REP's payment practices with TDUs can be indicative of the REP's financial health," TXU claimed, though in earlier comments TDUs had reported they often have no early warning of REP defaults through late payments or other indicative behavior.

Transfer of REP Certificates

OPC argued PURA § 39.352(a) calls for Commission approval of REP certificate transfers, since a person may not provide retail electric service unless the person is certified by the Commission as a REP. Furthermore, OPC argued that transferring a REP certificate without Commission approval constitutes slamming since PURA § 39.101(b)(2) provides that customers are entitled to, "choose the customer's retail electric provider consistent with this chapter, to have that choice honored, and to assume that the customer's chosen provider will not be changed without the customer's informed consent."

Reliant countered that there is no statutory basis to limit the ability of a REP to transfer a certificate, while other REPs pointed to legislative history showing lawmakers did not intend for Commission pre-approval of certificate transfers. Furthermore, the purchase of stock in a REP or its parent would not require a "transfer" of a certificate, nor would the Commission have authority to approve or deny such a stock purchase in a REP or its parent, Reliant said.

TLSC and ROSE suggested that REP certificates expire after one year, similar to New Jersey.

Other Rulemakings

While some REPs urged that certification requirements, while still needing revisions, should be less draconian than proposed due to the pending POLR rule which will ease concerns about REP exits and mass transitions, OPC argued that the certification rule has a more significant impact on the market and consumers. "The market begins with certification; the rule guides the standards for the caliber of entities that enter the market. If a REP is sophisticated and has the tools necessary to succeed in this business, then it will, and the POLR rule will be only needed as 'belts and suspenders' protection," OPC said.

Option 2 REPs

NRG Texas opposed the additional requirements imposed on current Option 2 REPs, which only serve designated customers. The proposed rule would subject such REPs to new financial reporting requirements, in contravention of PURA §39.352(d), which specifically allows REPs serving customers with 1 MW or more load who acknowledge their service by affidavit to be certified without demonstrating financial capability or technical capacity, NRG contended.

Technical Capability

ROSE and TLSC proposed that REPs be required to have an employee that has five years of experience managing a substantial energy portfolio of $3 million, as opposed to $100,000 in the proposed rule. ARM suggested the figure should be $10 million.

TLSC and ROSE proposed that REPs be required to provide customer service at fully staffed levels at least five days a week from 8 a.m. to 9 p.m.

Compliance Deadline

TLSC and ROSE proposed that current REPs be given three months to meet any new financial standards, as opposed to six months in the draft rule. The joint TDUs suggested that REPs be required to meet new collateral requirements by July 1, 2009 regardless of the rule's effective date, since the summer is when most problems arise. REPs would have to inform the PUCT by May 1 whether they could meet the new requirements, or otherwise start winding down their operations, under the TDU proposal.

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earlier, from an expanded sales program including higher per customer acquisition costs, and increased purchase of receivables fees charged by incumbent utilities.

Parent IDT Corp. posted a $37.3 million net loss for the quarter, versus a year-ago net loss of $33.2 million (when excluding a $40 million arbitration award).