Energy Choice Matters
December 11, 2008

Rankings of Retail Choice States Suggest SOS Structure Overrides Other Market Attributes

Default service considerations apparently dominate all other aspects of the retail market, including credit and collections and customer education, when determining the viability of retail competition. That's the conclusion we reach based on this year's Annual Baseline Assessment of Choice in Canada and the United States (ABACCUS), which ranks competitive retail electric markets in 23 states and provinces.

The Energy Retailer Research Consortium -- which is run by Distributed Energy Financial Group and includes Direct Energy, Hess and TXU Energy -- performed the analysis, and this year added a C&I report (20+ kW) along with its residential (and small C&I) assessment performed last year. Unsurprisingly, Texas retained its #1 ranking in the residential report, with New York jumping to #2 ahead of Alberta, which was second last year. Though falling to third, Alberta has the same numeric score as New York, but New York is rated with a higher qualitative assessment. On the C&I side, Texas, New York and Illinois were the top three markets (see complete tables page 7-8), in this the first year of the survey.

Though ranking the states, ERRC also gave states qualitative assessments, and noted there is not much material difference between states receiving similar rankings. For example, in the residential survey, fourth-place Maryland scored 53, while 10th-place Illinois scored 43, with a tight pack in between with very similar scores.

Although ERRC uses a variety of factors to rank jurisdictions, the inescapable conclusion from the

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Virtual Supply Offers Fall in MISO in Wake of FERC RSG Refund Order

Virtual Supply Offers (VSO) in the Midwest ISO plummeted by more than 60% the day after the issuance of a November 10 FERC order which made such offers liable for paying Revenue Sufficiency Guarantee (RSG) charges, both on a retroactive and prospective basis, Integrys Energy Services said in a rehearing request (EL07-86 et. al.).

RSG charges recover start-up, no-load and incremental costs of generation that are not recovered in the locational marginal price. Prior to FERC's order, real-time RSG charges were paid only by market participants that actually withdrew 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).

In its order, FERC found there was no cost causation basis for limiting RSG cost allocation to only entities actually withdrawing energy, and ended the exemption for Virtual Supply Offers (Matters, 11/12/08).

Integrys Energy Services, along with a cadre of financial marketers, petitioned for emergency rehearing, arguing that FERC erred in removing the "actually withdraws energy" language in the RSG formula, and in ordering retroactive refunds.

Virtual supply offer activity continues to be down about 35%-60%, Integrys Energy Services reported, potentially reducing price convergence. While data is extremely limited, the Integrys marketer did note that from October 10, 2008 through November 10, 2008, the divergence of the Day-Ahead and Real-Time Market at the Cinergy Hub was $0.08. From the period since the order

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Joint Proposal Outlines Iberdrola/Energy East Code of Conduct

Existing agreements among Community Energy, NYSEG, Rochester Gas & Electric and certain of NYSEG/RG&E customers would be allowed to continue in their current form for their remaining terms, under a joint proposal for a code of conduct among the Iberdrola companies submitted for New York PSC approval (07-M-0906). An updated code of conduct was ordered as part of the Iberdrola-Energy East acquisition.

Prior to Iberdrola acquiring NYSEG and RG&E, its Community Energy subsidiary had entered into agreements to market RECs to NYSEG and RG&E customers. Such agreements are scheduled to expire December 31, 2009, except for customer-specific agreements with two customers with expiration dates no later than June 30, 2010.

The joint proposal is supported by the Energy East utilities, PSC Staff, Energetix, NYSEG Solutions and Multiple Intervenors. Reliant Energy and Earth Kind Energy participated in the collaborative process to develop the joint proposal but did not sign it, due to concerns which were not previously raised in the Iberdrola-Energy East merger proceeding.

The joint proposal would not impose any restrictions on an affiliate's use of the same name, trade names, trademarks, service name, service mark or a derivative of a name, of Iberdrola, Energy East, NYSEG or RG&E, or in identifying itself as being affiliated with Energy East or the distribution companies.

If a customer requests from NYSEG/RG&E information about securing any service or product offered within the service territory by an unregulated affiliate, the distribution companies must offer to provide a list of all companies that are qualified and approved pursuant to governmental or utility standards (including retail access standards) as providers of similar products or services. While this list may include Iberdrola and Energy East affiliates, the list must provide information by company in alphabetical order, and in no way may place greater emphasis on or promote any company in which Iberdrola or Energy East has a financial interest.

The distribution companies would be prohibited from providing sales leads involving customers in their service territories to any unregulated affiliate, and would be prohibited from giving any appearance that they represent any unregulated affiliate.

Under the joint proposal, NYSEG and RG&E would not conduct competitive behind-the-meter energy services, although they would be permitted to provide solutions to customer reliability and deliverability issues related to transmission and distribution.

IP&L Blasts IMM Module E Plan as Changing Voluntary Nature of Auction

The Midwest ISO Independent Market Monitor's compliance filing regarding market monitoring of the Module E resource adequacy construct, "appears to seek through its intended market power abuse screens to turn what was designed to be a voluntary capacity auction into a mandatory quasi-socialist mechanism to redistribute capacity resources without material benefit to long-term resource adequacy," Indianapolis Power and Light Company charged in a FERC filing (ER08-394-008).

"The voluntary nature of the auction is unequivocal. The word voluntary appears no less than 100 times in the October 20 Order," on the Module E plan, IP&L said (Matters, 12/6/08).

However, the IMM's proposed screen for physical withholding, "is fundamentally at odds with the concept of a voluntary auction," IP&L argued. Physical withholding would be defined as capacity not offered into the auction that is not designated to satisfy any load serving entity's capacity requirement prior to or subsequent to the auction. "If the auction is voluntary, how can an entity reasonably be faulted for failing to participate," IP&L demanded.

A proposed economic withholding test also drew the ire of IP&L. The IMM has stated that it would identify resources that do not clear in the voluntary capacity market due to their offer prices, noting that the marginal cost of supplying capacity should be zero for most resources.

"The logical (if not undeniable) application of these statements is that the IMM would consider an offer above zero dollars that fails to clear in the market to be a presumptive exercise of market power. This approach leaves (allegedly voluntary) participants in the auction little choice but to offer at zero dollars, lest they be flagged for economic withholding and need to defend their actions," IP&L argued.

"Such 'compliance through fear' is not consistent with a voluntary market and could very well add too [sic] the growing incentives for Midwest ISO members to leave the RTO," IP&L warned.

IP&L suggested price caps would be a more effective mechanism for mitigation of withholding, rather than transforming the voluntary auction into a mandatory one.

IP&L also vigorously objected to the proposal from the Illinois Commerce Commission to expand the IMM's monitoring to bilateral capacity markets (Matters, 12/5/08).

"On information and belief, no RTO's IMM monitors bilateral markets, and for good reason. Such bilateral markets are beyond the purview of the RTO and, thus, should be beyond the purview of the those RTO's IMMs," IP&L said.

Turning to financial penalties for capacity shortfalls by LSEs, Reliant Energy argued MISO's new proposal for assessing deficiency penalties is insufficient to deter an LSE from being capacity deficient during the annual peak period (Matters, 11/20/08).

FERC had rejected MISO's original proposal to assess the full the Cost of New Entry value for each deficiency as excessive. In response, MISO revised penalties so that 100% of annual CONE is assessed on the first penalty, but that only 25% of CONE is charged for the second deficiency, if it occurs in July, August, December, January or February (with the percent even lower in shoulder months).

However, Reliant found that the revised plan provides insufficient incentives for less-responsible LSEs to procure capacity for the remaining months of the Planning Period (particularly the peak summer months), once they have been subjected to the Financial Settlement Charge for the first time in a Planning Year.

"Thus, a LSE that has already 'sunk' the cost of an initial Financial Settlement Charge during June may have an incentive to under-procure capacity during July or August because the subsequent Financial Settlement Charges under the Midwest ISO's proposal may be less than the cost of procuring the generation or demand response capacity," Reliant explained.

Reliant favors a stakeholder straw proposal that would assess a charge of 150% of Annual CONE for the first month of a capacity deficiency if that month is June, July, August, September, December, January or February; and 125% of Annual CONE for a subsequent deficiency during the months of June, July or August. Charges for shoulder-month deficiencies would start at 25% of Annual CONE, and decrease for repeat deficiencies.

However, Constellation Energy opposed MISO's proposal to charge 100% of annual CONE for an initial monthly deficiency, since the fee fails to properly reflect the appropriate risks of deficiencies for the periods throughout the year, and bears no relation to market realities, Constellation said.

The "excessive" CONE charge would artificially constrain the capacity market as LSEs will likely try to purchase (or hold onto) more capacity than they expect to need, for fear of being caught short, Constellation contended. Additionally, the MISO proposal would drive up the capacity price, since capacity sellers will know LSEs will be willing to pay high prices in order to avoid penalties, particularly an initial penalty, Constellation argued.

Such higher costs could prompt competitive LSEs to return customers to POLRs, Constellation suggested. That, in turn, could raise POLR prices as POLRs would not be assured of being able to obtain additional capacity quickly at reasonable prices to serve their new obligations.

Briefly:

Broker Energy Advisory Service Seeks Md., D.C. Licenses

Broker Energy Advisory Service, which specializes in procuring energy for multi-family dwellings, applied for aggregation and brokering licenses for electric and gas service in Maryland. Energy AS applied to serve commercial customers at the four electric IOUs, and C&I gas customers at Washington Gas Light, BGE, Columbia Gas, Chesapeake Utilities and Elkton Gas. Energy AS, which is active in Texas and Georgia, is also pursuing a broker license in Washington, D.C.

DPUC Grants Dominion Retail Extension

The Connecticut DPUC granted Dominion Retail an extension until January 16, 2009 to file updated customer-relation plans in light of ordered changes in its relationship with aggregator Levco Tech (Matters, 12/4/08).

ABACCUS ... from 1

rankings is that default service structure -- particularly the length of procurements and frequency of price changes -- is most important to retailers. Indeed, on the residential side, default service design (including available products, rate design, procurement mechanism, etc.) were weighted a combined 52% of the rankings. Factors grouped under facilitation of choice (such as POR/billing issues, EDI functionality, etc.) were weighted at 25%, with the status of retail choice (measured by switching and number of competitors) weighted at 15%. The C&I survey used different weights for various factors, but default service was still the most important category, though weighted only at 32%.

While it is hardly surprising default service is important to retailers, the emphasis placed on it, and in the recommendations from ERRC, does not bode well for the value-adding argument for retail choice. It's unfair to expect retailers to be able to compete in jurisdictions with rates capped at levels from the 1990s, but an over-emphasis on getting default service to provide "realistic" or "market-based" prices (closer to spot market) suggests retailers have no value-adding services which are worth paying more for versus the old basic default service product.

Undeniably, from the residential rankings, states with what critics call "uglier" default service -- that is, SOS rates that provide less of a hedge against price volatility -- fared better than other states that have undertaken other market reforms (such as POR, marketer referral programs, etc.) to facilitate choice, while still having a "market-based" SOS rate, though simply procured less often.

For example, Connecticut, which has arguably done more since 2007 since any other state to create a workably competitive market (Illinois has taken many similar measures but has been slower to implement them), only placed seventh in the residential survey, though it did jump three spots. Since 2007 legislation, Connecticut has implemented POR at both utilities, has instituted a marketer referral program, and has revamped its choice website and disclosure labels to promote price transparency. While all the developments have not gone the way retailers would like (particularly this spring's authorization of long-term contracts for slices of SOS), it's hard to argue with Connecticut's progress, or an increasingly active residential market.

ERRC could not provide us with the metric-by-metric breakdown of each state's score, so we cannot ascertain why Connecticut ranked where it did. Nor were ERRC members able to cite specific issues leading to Connecticut's ranking versus other states during a conference call. Nonetheless, panelists suggested that Connecticut's three-year laddered SOS for customers under 500 kW was the main reason for its ranking, though that was a panelist's personal assessment rather than a finding from the report.

But attributing Connecticut's ranking to its SOS does fit with the states ahead of it -- particularly Maryland, Massachusetts, and Maine, all three of which ladder SOS over shorter periods. Again, while we were not provided with each state's breakdown, we can see no reason why these three states would fare better than Connecticut in any metric other than in default service, specifically, in default service being a shorter-term product than Connecticut's three-year laddered price. And despite more favorable SOS, these three states, on our knowledge and belief, have less active residential markets than Connecticut, which not only boasts five residential suppliers (per the CT Energy Info website) actively seeking customers, but is seeing several suppliers make significant monthly gains in residential customers.

While a lack of market transparency makes definitive statements difficult, we'd be surprised if there were similar levels of residential activity in Maryland and Massachusetts. While the Maryland Office of People's Counsel reports offers from six residential suppliers based on calls to suppliers, we doubt that many are actively soliciting customers. In Massachusetts, Dominion Retail's recent resumption of active marketing this fall, and offers from a local start-up competitor, are the only active marketing we've seen, although there is also some municipal aggregation which includes residential customers.

This is all to isolate default service as the area where Connecticut falls short in comparison with some of the other states above it, which suggests that other market enhancements, while beneficial, are not viewed as importantly as short-term SOS pricing.

Illinois provides another strong example of the emphasis placed on default service, though, again, we were not provided with individual metric scores. In the C&I survey, Illinois is ranked third, but in the residential survey, Illinois is 10th. Since default service is one of the few areas of difference in the Illinois market when it comes to customer classes, we must conclude that placing customers above 400 kW on hourly priced service (eventually ticking down to 100 kW) is what surged Illinois to the top tier in the C&I rankings. In contrast, Illinois SOS for residential customers is a mix of legacy contracts from the original descending clock auction, bilaterals negotiated as part of rate relief legislation, and utility-led portfolio procurements used to fill the remainder of the current SOS year. Eventually, Illinois' mass market default service will likely mirror Connecticut with three-year laddered contracts, pending ICC approval, which apparently hurt its residential score.

ERRC recommends that default service be a transitional mechanism, with a clear end date. ERRC favors moving default service to a more market-reflective rate in the near term, to provide more efficient pricing signals.

However, the move to short-term procurements in the mass market has seemingly stalled, despite continued expansion of hourly pricing to more mid-merit C&Is in several states. Additionally, though ERRC did not address the form of SOS supply in its recommendation, short-term procurements typically go hand-in-hand with full requirements, load following products, which have become a four-letter word to certain stakeholders in several states. Fierce opposition to full requirements service, whether short or longer-term, has been seen in Maryland, Ohio, Pennsylvania, and Illinois.

Because we don't see any state moving towards, say, quarterly or even six-month full requirements SOS for customers under 25 kW in the near-term, we asked ERRC panelists about alternate SOS structures which may accomplish the same goals.

In particular, we questioned whether retail load auctions, in which retail suppliers would bid for specific customer blocks and serve those customers under their name (instead of utility provided SOS), are a better mechanism for moving customers off default service, and a solution to criticisms of current full requirements SOS as including too many risk premiums for migration and unknown load obligations. Though retail load auctions lost out to wholesale full requirements service in most jurisdictions, Washington Gas Energy Services recently resurrected a similar idea in the District of Columbia (though marketers would not win specific customers, see Matters 12/3/08), and Dominion East Ohio will be auctioning off the right to serve specific gas customers next year (Matters, 6/19/08).

Predictably, retailers didn't want to touch the question of retail load auctions, though they noted the mechanism remains an available tool for regulators. Concerns about locking-away customers with winning retailers, and the ability of larger retailers to dominate the retail auctions, are typical opposition from some retailers. Still, given the low levels of residential migration from utility provided SOS in most areas, it does not seem that winning a customer away from a competitive SOS provider would be any harder than winning one away from utility SOS, assuming that the retail load auction held that customers have the right to exit, without fee, at any time.

In fact, given the anemic levels of residential migration at some of the near-top states in ERRC's residential survey (particularly Maine, Massachusetts [sans aggregation] and Maryland), it suggests that even a one-to-two year laddered SOS product with twice annual price changes is hindering residential migration. Given the slim possibility of making such SOS rates more market responsive (as most states are evaluating the opposite), retailers should reconsider the optimal SOS structure if short-term wholesale procurements are unobtainable.

We also thought it worth noting that the second-ranked state in both surveys -- New York -- currently has a significant amount of utility supply hedged on both legacy contracts and new hedges.

Chris Kallaher, Director of Government & Regulatory Affairs for Direct Energy, was quick to point out that the New York hedges do not impact customer choice, because of the bifurcation of the Market Supply Charge (MSC) and Monthly Adjustment Clause (MAC). Kallaher also noted that New York utilities do not hedge to beat the market, as is the suggestion by some stakeholders in other states, nor do N.Y. utilities actively manage a supply portfolio.

ERRC's complete report can be found at: http://www.defgllc.com/content/Publications/reports.asp

Aside from ERRC members Direct, Hess and TXU, the C&I survey was sponsored by ConEdison Solutions, Constellation NewEnergy, Green Mountain Energy, Liberty Power, Shell Energy North America, Wearthy Ideas, LLC, and Wood3 Resources.

MISO VSOs ... from 1

(Nov. 13 thru Dec. 1, 2008), the delta at the Cinergy Hub was $1.09 Real-Time over Day-Ahead.

Several financial marketers told FERC they would either drastically reduce their virtual supply offers in MISO, or cease operations altogether, because of the costs imposed by the order. Power marketer JPTC said it was considering eliminating all virtual supply trading, while Solios Power said it is "extremely hesitant" to enter virtual supply transactions in the MISO under the current climate.

Aside from reducing price convergence, the drop in virtual transactions, "threatens enormous harm to other market participants," Edison Mission Energy told FERC.

As virtual transactions decrease, RSG costs will be allocated among a decreasing level of deviations, causing the RSG charges to increase even further for those fewer remaining market participants that cannot control deviations, Edison Mission said.

"[T]he two biggest losers will be less sophisticated load serving entities that are unable to accurately estimate their load in the day-ahead market and scheduled generators that trip offline after the day-ahead market closes," Edison Mission noted.

Integrys called the order's impact on the market and market participants who engage in virtual supply offers "devastating." The Independent Market Monitor estimated that the average profit of a virtual trader in 2007 was $0.43/MWh. But the RSG charge that will be applicable to the same transactions will be approximately $2.57/MWh, the Integrys marketer reported.

"As a result, VSO transactions back to August 10, 2007 will be reflected as massive losses to the Market Participants ... The losses that would be sustained are significant and, in some instances unsustainable," Integrys Energy Services said.

Integrys' marketing unit, reciting previous testimony (Matters, 10/14/08), argued that there is no cost support or cost causation analysis that supports applying RSG charges to entities that do not actually withdraw energy.

Furthermore, the express language of Section 206(b) of the Federal Power Act does not authorize the Commission to require parties to pay a rate when such parties neither provided the relevant jurisdictional services nor collected the excessive charges, Integrys Energy Services said. Since traders offering virtual supply without withdrawing energy have never been subject to the RSG charge, FERC cannot apply retroactive cost allocation.

Financial marketers also cautioned against the regulatory uncertainty created by FERC's order, with Integrys Energy Services stating that, "Market Participants will not be able to rely on the Tariff, wondering whether an economic decision could be undone by some future Tariff revision applied retroactively."

If FERC fails to reverse its decision on removing the "actually withdraws energy" provision, the Commission should at least include all Real-Time load (not just Real-Time load deviations) in the denominator or billing determinants used to develop the RSG rate, DC Energy said. The Interim Rate adopted by the Commission exempts load from the allocation of RSG costs, and instead applies the charge exclusively to deviations.

DC Energy also urged the Commission to adjust the Interim Rate by applying RSG charges to cleared Virtual Supply Offers only during those hours that cleared Virtual Supply Offers exceed cleared Virtual Demand Bids, and by applying RSG charges only to each participant's net cleared Virtual Supply Offer.

Residential ABACCUS Scores and Rank

Jurisdiction	2008 Score†	2008 Rank	2008 Assessment	2007 Rank	2007 Assessment
Texas	83	1	Excellent	1	Excellent
New York	61	2	Excellent	3	Good
Alberta	61	3	Good	2	Good
Maryland	53	4	Good	4	Medium
Massachusetts*	51	5	Medium	6	Medium
Maine*	49	6	Medium	5	Medium
Connecticut	45	7	Good	10	Medium
New Jersey*	44	8	Medium	7	Medium
Pennsylvania	44	9	Good	9	Medium
Illinois	43	10	Good	8	Medium
District of Columbia	39	11	Medium	12	Medium
Delaware	37	12	Medium	13	Medium
Ontario	36	13	Medium	11	Medium
New Hampshire	33	14	Medium	18	Marginal
Rhode Island	33	15	Medium	14	Medium
Ohio	33	16	Marginal	17	Marginal
California*	24	17	Marginal	21	Unsatisfactory
Michigan*	NA	18	Unsatisfactory	15	Marginal
Montana*	NA	19	Unsatisfactory	19	Unsatisfactory
Virginia*	NA	20	Unsatisfactory	16	Unsatisfactory
Oregon*	NA	21	Unsatisfactory	22	Unsatisfactory
Nevada*	NA	22	Unsatisfactory	23	No Progress
Arizona*	NA	23	Unsatisfactory	20	Unsatisfactory

† Scoring is very tough and there is no "grading on a curve." No jurisdiction will ever score 100 because perfect scores for particular ABACCUS elements may not be ideal or even practical in a particular jurisdiction given its history of regulation and restructuring.

* Several states received a qualitative assessment inconsistent with the quantitative score. This is intentional. It is possible to score points with certain reasonable policies, yet limit the success of retail choice as a result of other policies.

Commercial and Industrial ABACCUS Scores and Rank

Jurisdiction	2008	2008 Rank	2008 Assessment
Texas	75	1	Excellent
New York	57	2	Good
Illinois	56	3	Good
Maryland	53	4	Good
Alberta	49	5	Good
Maine	47	6	Good
Massachusetts	45	7	Good
Connecticut	44	8	Good
New Jersey	44	9	Good
Pennsylvania	42	10	Medium
Delaware	41	11	Medium
District of Columbia	40	12	Medium
Ohio	31	13	Medium
Rhode Island	31	14	Medium
New Hampshire	29	15	Medium
Ontario	28	16	Medium
California*	25	17	Marginal
Virginia*	NA	18	Unsatisfactory
Michigan*	NA	19	Unsatisfactory
Arizona*	NA	20	Unsatisfactory
Oregon*	NA	21	Unsatisfactory
Montana*	NA	22	Unsatisfactory
Nevada*	NA	23	Unsatisfactory

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