

Energy Choice Matters

December 19, 2008

PUCT Defers Action on REP Disclosure Rules, Suggests Automatic Renewals Longer than 31 Days

The PUCT held off on approving new REP customer disclosure rules at yesterday's open meeting as Staff will incorporate several Commissioner changes to the proposal, which will be considered at the January 14 open meeting (35768, Matters, 12/15/08).

One of the largest changes Commissioners agreed to would allow REPs to automatically renew customers for periods longer than 31 days under certain conditions -- an authority REPs have never possessed since the market opened. As proposed by Commissioner Kenneth Anderson, REPs could automatically renew fixed-price customers for periods in excess of 31 days, without a new authorization, if the new contract price is either the same or lower than the current price. The automatic renewal provision would have to be disclosed at enrollment, and REPs would also have to send a renewal notice to customers as they would normally do for other products, to inform the customer their automatic renewal date is approaching.

Commissioners also asked for changes to the proposal's prohibition on the imposition of termination fees 60 days before contract renewal, which is intended to give customers a window to shop. Commissioners expressed concern that 60 days was too long, and effectively made a 12-month product a 10-month product, although they agreed some period in which the termination fee is not applicable is needed.

The 45-day switching process will also be investigated by the Commission in a separate proceeding, with the goal of reducing the timeframe. Commissioner Donna Nelson said the switching

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FERC Orders Downward Adjustment to NYISO ICAP Curves

FERC yesterday ordered prospective adjustments sought by Transmission Owners that will lower the New York ISO ICAP demand curves, while denying requests from capacity suppliers to raise the curves in a separate proceeding.

In a rehearing order on its January decision to approve the ICAP demand curves for the 2008/2009, 2009/2010, and 2010/2011 capability years, the Commission ruled that NYISO erred in designing the demand curves so that the full amount of expected future revenue deficiencies from surplus capacity over the three-year period is recovered (ER08-283-002).

While it is reasonable to establish demand curve parameters that raise the height of the demand curves to account for the effects over time of surplus capacity on capacity revenues, the curves should be structured so that a levelized portion of such deficiencies are recovered, rather than the full amount.

The NYISO design which includes full recovery of lost revenues overstates the levelized price that a new entrant would need to obtain, given the expected level of surplus capacity over the useful life, in order to recover its net cost of entry, FERC determined.

NYISO was directed to recalculate its demand curve parameters so that they reflect a levelized portion of the revenue deficiency that would otherwise occur due to expected capacity surpluses over time. The resulting changes in the demand curves will only be prospective from the date of acceptance of a compliance filing, FERC said. Requiring a change in the demand curves for auctions that have already been completed would have an adverse effect on market certainty and the expectations of market participants, resulting in increased risks and costs for suppliers, and higher

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PUCT Approves \$15 Million Luminant Settlement

The PUCT approved a \$15 million settlement with Luminant regarding Staff's allegations of market manipulation in the summer of 2005 (Matters, 11/27/08).

Due to statutory limits on PUCT penalty authority, Commissioners doubted they could, even under a best case scenario, impose an appreciably greater fine that would withstand appeal. While Staff originally sought \$171 million in penalties, two ALJs ruled that the maximum penalties applicable ranged from \$7.9 million to \$15.5 million, because each MWh allegedly bid improperly did not constitute a "separate" violation which could be penalized. Rather, under the ALJs' ruling, a penalty could only be placed on each allegedly improper bid curve, rather than the total energy represented by each curve. Even the ALJs' ruling was not certain to withstand an appeal, as PURA also contemplates a maximum penalty per day of \$5,000, which, if interpreted as prohibiting separate fines for each bid curve submitted on the same day, would have resulted in a maximum fine of only \$610,000 (Matters, 7/23/08).

Chairman Barry Smitherman further noted that the PUCT had not yet adopted a definition of "market power" in 2005, and that the PUCT's ultimately adopted definition differs from the standard used by Potomac Economics, which evaluated Luminant's behavior. The PUCT definition of market power is, "The ability to control prices or exclude competition," but Potomac defined market power as "the ability for a market participant to profitably raise prices above competitive levels."

Smitherman further noted that Potomac excluded un-offered capacity from online units under its analysis. In other words, there were other suppliers of power that could have provided power but chose not to offer energy into the balancing energy market, which the Chairman attributed to the now-defunct \$300 shame cap in place at the time. Had those other suppliers offered energy into the balancing market, then Luminant would have been the pivotal supplier less of the time, Smitherman noted. It is unclear why Luminant should be punished for the inactions of others, Smitherman

said.

Potomac also based its findings on the belief that, in a competitive market, there is no basis for an entity to take into account sunk costs when designing a bidding strategy. Luminant's offers during the study period were designed to cover the full costs of owning, operating, and maintaining units expected to be needed to satisfy the forecasted load, including initial investment costs and other fixed costs such as leasing arrangements for gas turbines. But according to Potomac, Luminant's strategy should be the same regardless of whether it won the units in a lottery or it paid a large sum to buy the units.

Smitherman rejected that perspective, arguing that no companies would be in business if they only sought to recover short-run marginal costs. Generators must be able to recover long-run marginal costs, and pursue return on and return of capital investment, through the balancing energy market to incent new generation that may be needed, Smitherman noted.

FERC Approves MISO Ancillary Market Start-up for Jan. 6

FERC has authorized the start of the Midwest ISO ancillary services market (ASM) for January 6, 2009, conditionally accepting a series of compliance filings and tariffs changes (ER07-1372 et. al.)

Among the rulings is that FERC accepted the Midwest ISO's plan to limit the applicability of scarcity pricing to situations of "true" scarcity. Specifically, the Commission accepted the Midwest ISO's proposal to share ramp capability among energy and operating reserve products, similar to procedures used by other ISOs, and approved a reduction in the existing regulating reserve demand curve price of \$1,000/MWh. Instead of that cap, the regulating reserve price will be capped at the average offer cost of committing and running a peaking unit for one hour.

FERC disagreed with stakeholders who argued the lower scarcity price will send too low of a price signal to ensure adequate regulating reserve supplies. However, FERC recognized that if the lower scarcity price or other market rules create sustained periods of inadequate

regulating reserves resulting in deteriorating control performance results, the Midwest ISO would need to take appropriate actions to mitigate the reliability risk being placed on the system. In order to ensure that these problems are not realized, FERC required the Independent Market Monitor (IMM) to make an informational filing 180 days after the market start, to ensure that the lower scarcity price cap does not harm MISO's ability to perform regulating functions and provides proper price signals for the other energy and ancillary services products over the long term. In the informational filing, the IMM must assess: (1) how the reduced price cap has affected the volume and number of regulating reserve offers and their ability to comply with the control performance standards; and (2) the sufficiency of supplies in meeting regulating reserve requirements in the day-ahead and real-time markets.

The reduction in the scarcity price for regulating reserves should not interfere with efficient pricing during general capacity shortages, FERC concluded. When sufficient resources are not available to satisfy all energy and operating reserve requirements, the market would be short reserves and the other scarcity pricing demand curves could still set prices for energy and ancillary services in the co-optimized ASM market at scarcity levels based on the value of lost load.

FERC also affirmed that the IMM is an adequate safeguard to protect against physical withholding in the ASM, rejecting concerns about withholding raised by industrial customers (Matters, 10/24/08).

FERC Denies Blanket Exemption from Gas Price Reporting for Retail Marketers

FERC denied a petition to grant a blanket exemption to competitive retail gas marketers from new price reporting rules under Form No. 552.

The Commission's recent price reporting order (Order 704-A) exempted bundled retail sales by LDCs from the reporting requirements, which are meant to increase transparency and accuracy of prices reported to index publishers (Mattes, 9/19/08).

The National Energy Marketers Association asked that FERC clarify that retail commodity sales from competitive retail natural gas marketers pursuant to a state-approved retail access program should receive a similar exemption, because reporting would be burdensome and would raise equity concerns, as marketers' regulated competitors (the LDCs) will receive the exemption (Matters, 10/21/08).

FERC declined to grant retail marketers such a blanket exemption. Form No. 552 requires reporting of volumes associated with transactions that utilize, contribute to, or could contribute to a price index. Transactions made by marketers under state-sponsored retail access programs may or may not be reportable, depending on the terms of the transactions at issue, FERC said.

"If a particular retail marketer transaction does not utilize a price index, is not reported to an index publisher, and could not contribute to a price index even if reported to a publisher, then the transaction would not be reportable on Form No. 552," the Commission explained.

However, not all retail marketer transactions are structured in such a manner, and thus FERC declined to exempt all competitive retail sales from reporting requirements. FERC urged all potential respondents to review the terms of Form No. 552 and its orders to determine whether specific transactions are reportable.

FERC Accepts Southern Co. Auction Proposal

FERC conditionally approved a proposal from Southern Company Services to institute for a minimum of three years an hour-ahead and day-ahead auction under which the Southern Companies would offer all of their "available" capacity, and ordered that Southern open the auction to other sellers within 12 months of startup (ER09-88).

Southern had originally proposed that the auction be limited to its available capacity, but said it was amenable to expanding the auction to include other sellers. Available capacity excludes capacity reasonably expected to serve retail and captive wholesale load, capacity needed for operating reserves and existing third-party sales, and capacity otherwise unavailable for dispatch (Matters, 11/10/08).

The auctions include a must-offer obligation, with supply offers capped at cost-based rates. The Commission accepted Southern Companies' proposal that each of its selling resources limit its supply offers into the auctions to incremental cost, plus 10%, plus a demand charge of \$21.43/MWh.

The Commission also required that the independent auction monitor have the authority to verify Southern Companies' available capacity calculations, confirm that any transmission service necessary to accommodate a purchase under the auction is not unreasonably withheld, and report to the Commission regarding the auction process. FERC also ordered the independent monitor to report to the Commission every 12 months regarding the functioning of the auctions.

FERC Chairman Joseph Kelliher said the auctions have the potential to both prevent the exercise of market power and greatly improve price transparency in the Southeast.

Commissioner Suede Kelly dissented in part, raising concerns about the demand component of the cost cap. Kelly believes the demand charge and the single clearing-price auction format are directed at achieving the same objective, recovering a portion of fixed/capacity costs, and thus are duplicative.

Briefly:

Nodal Market Benefits Pegged at \$5.6 Billion over 10 Years

Completion of nodal market implementation in ERCOT would result in system-wide generation benefits of \$520 million on a net present value basis, CRA International said in an updated cost-benefit study requested by the PUCT. That compares to net present value costs of \$222 million. Generation benefits include \$339 million in generation cost savings and \$181 million from more optimal generation siting. The savings to consumers are estimated to be approximately \$5.6 billion over the first ten years of operation of the nodal market, more than twenty times the projected nodal cost. Additionally, the value of the nodal market is potentially higher because of the significant deployment of wind generation, given the nodal market's ability to alleviate limitations of ERCOT's current dispatch procedures and provide for rapid system

responsiveness, although this benefit was not quantified. Additional unquantified benefits include more limited use of scarcity pricing under a nodal market, as the zonal market may have greater difficulty in addressing some zonal congestion situations, resulting in high cost impacts. The cost of the market, which has been delayed at least two years, is expected to be \$660 million, double previous estimates.

Entergy Transition to Competition Case to Move Forward

The PUCT unabated Entergy's transition to competition docket (33687) after receiving updated analyses of three scenarios for the region (joining ERCOT, joining SPP, or remaining in SERC). A prehearing conference will be held January 8 to address the procedural schedule for the remainder of the proceeding, discovery, and other procedural matters. During the open meeting, Entergy said it would like the opportunity to update its transition to competition plan in light of the new analyses.

PUCT Approves CenterPoint Advanced Meter Deployment

The PUCT accepted a stipulation approving CenterPoint Energy's territory-wide advanced metering deployment plan (Matters, 12/12/08). Installation would be completed by January 2014, with a 144-month surcharge period (see previous story for surcharge amount by class).

Pa. PUC Issues POR Guidelines for Gas LDCs

The Pennsylvania PUC yesterday issued interim guidelines for the design and operation of purchase of receivable programs (POR) for natural gas distribution companies. LDCs have until March 31, 2009 to file POR plans, and must pursue unbundling of procurement costs from base rates if they do not (Matters, 9/12/08). The interim guidelines provide general direction to utilities for the design of purchase of receivables programs, but grants flexibility to each LDC on other design elements because of the LDCs' different demographics, billing and collection operations and system operating requirements. POR was cited as perhaps the best chance to increase effective competition in Pennsylvania's retail natural gas market in the PUC's report on removing competition hurdles.

Pa. PUC OKs New Default Supply Rates at Citizens', Wellsboro

The Pennsylvania PUC approved new default service rates for Citizens' Electric and Wellsboro Electric effective Jan. 1, 2009. Citizens' Generation Supply Service Rate (Fixed GSSR) will be 9¢/kWh, a decrease of 0.41¢/kWh. Wellsboro's GSSR will be 11¢/kWh, an increase of 1.30¢. The changes to the GSSRs reflect updated estimates to forecast costs and sales, which are then reflected in the rates. The GSSR is based upon the amount of quarterly estimated purchased power costs, plus the total quarterly estimated administrative charges associated with the purchasing of generation supply to serve the default service customers and the prior period's over/under collections, divided by the projected kWh sales for the application period.

PUCT Seeks Legislative Guidance on REP-Distributed Generation Interaction

The PUCT will ask the legislature to clarify the relationship between REPs and distributed renewable generation owners, and what obligation, if any, REPs have to purchase excess generation from such distributed generation, as part of its scope of competition report (Matters, 12/15/08). The Commission will also ask legislators whether they want the PUCT to develop a pool to fund POLR obligations, or some other form of POLR bad debt and cost socialization. Commissioners also discussed, arising from the Luminant settlement, whether lawmakers should grant the Commission authority to seek restitution in addition to penalty authority. Commissioner Kenneth Anderson also questioned whether the PUCT could implement a "no action" letter process that would allow market participants to seek informal PUCT advice on potential market transactions or developments (such as how to categorize a new product).

Illinois, California Open Smart Grid Dockets

The Illinois Commerce Commission has opened several dockets to consider new federal standards on gas and electric energy efficiency and smart grid initiatives (08-0675 through 08-0678). The California PUC also opened a rulemaking to consider smart grid technologies pursuant to federal legislation, to facilitate integration of new technologies such as

distributed generation, storage, demand-side technologies, and electric vehicles.

Pa. PUC Sets Conservation Service Provider Qualifications

The Pennsylvania PUC yesterday established the minimum experience and qualification requirements that conservation service providers (CSPs) must meet in order to be included as part of a service registry the Commission is compiling as part of Phase II of Act 129 implementation. Under the act, utilities' required conservation plans are to include a contract with one or more independent conservation service providers awarded through competitive bidding to implement the plan or a portion of the plan. Under the PUC's standards, each conservation service provider or its principals must have at least three years of documented experience in providing program consultation, design, administration and management services related to energy efficiency and conservation services. The Commission will require all applicants to provide information regarding their experience, technical qualifications and financial stability.

Exelon Files for NRG Merger Approval

Exelon has filed for regulatory approval of its hostile acquisition bid for NRG Energy with FERC, the Department of Justice and the Federal Trade Commission, but NRG called any action on the filings a waste of resources given the uncertainty of the potential transaction.

FERC Sets Paper Hearing for Remanded Calif. Contracts

FERC has ordered paper hearings to supplement the record of its review of Western electricity crisis contracts, which were remanded to the Commission per a June Supreme Court order (Matters, 6/27/08). Hearing procedures will be held in abeyance so that the parties can explore settlement. The paper hearing will focus on whether there was any evidence of a burden on consumers over the contract terms, and whether there was any market manipulation by sellers involved in the case that caused their contract rates to be unjust and unreasonable, the two areas which the Court requested FERC address.

Calif. PUC Approves Sunrise Powerlink

The California PUC approved San Diego Gas & Electric's Sunrise Powerlink Transmission Project which will improve access to renewable projects in the Imperial Valley.

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process is too lengthy, and suggested accelerating the timeframe in which the ERCOT postcard is sent out, or potentially eliminating it entirely. The 45-day switching cycle was cited as prompting many of the logistical problems with the rules, such as providing adequate customer notice of rate changes, and allowing customers time to switch. With a shorter switching cycle, customers would not need as much lead-time to switch. The PUCT will address accelerating switches via changes to out-of-cycle meter read policies, in an attempt to craft a solution that lets customers avoid extra fees for out-of-cycle reads while ensuring TDSP cost recovery for such service.

Chairman Barry Smitherman advocated for a return in distinguishing between types of fixed price products (as originally proposed), as he believes consumers desire, and REPs will offer, a true "guaranteed" fixed product in which the price will never change, regardless of any changes in TDSP/ERCOT fees or changes in law. Staff's most recent proposal for a "fixed" product, which allows price changes due to changes in TDSP/ERCOT fees and changes in law, is not truly fixed, and customers will not view it as fixed, Smitherman said. Staff's product is better described as "energy fixed" or "commodity fixed," though developing terminology was left to be worked out in the interim before the next open meeting. Fixed commodity products would not require REPs to send out a notice of price changes, since customers at enrollment would understand non-energy charges in the price could change (while the energy price cannot change by rule).

Nelson and Anderson sought changes under the current proposed "indexed" product definition, which currently only includes products directly tied to a formula that customers can follow. Nelson and Anderson noted REPs wish to offer products that are indexed to the previous month's price, and place a cap on any change in price, e.g., customers are assured that each

month, any price increase cannot exceed 15% from the previous month's rate. While Nelson said the plan would be beneficial for customers who are more risk averse than those who are willing to play the market in a formula-based index product, Smitherman was skeptical of calling such a product indexed rather than variable. Allowing such an indexed product would be "playing with dynamite" because customers would have no advance warning of any change in prices until they receive their bill, unlike with an index price where customers can track it via formula, or a variable price where customers must receive 45 days notice of price changes. Nelson and Anderson will develop language on the product to be presented at the next open meeting.

The Commission agreed to Nelson's proposal to prevent gaming of the required disclosure of historical variable rates by prohibiting REPs from changing a variable product's name in an attempt to not have to disclose the historical prices of the product to customers.

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prices in future auctions.

FERC denied a complaint from capacity suppliers in docket EL09-4 that sought to raise the demand curves to reflect to end of a New York City tax exemption for utilities. Suppliers had argued that factoring in the elimination of the tax exemption would result in an increase in the 2008-2009 New York City Demand Curves of \$47.74/kW-yr, or approximately 39% (Matters, 10/15/08).

The Commission, however, found suppliers failed to meet their burden of proof in demonstrating that the current rates are unjust and unreasonable. While the elimination of the tax exemption could have a significant impact on the estimated Cost of New Entry, the true impact on rates is not clear since offsetting factors may exist, such as other tax incentives available.

"To reopen and start anew the lengthy review process now would re-ignite the debate over all of the factors that determine the Demand Curves and would promote confusion and uncertainty rather than stability in the market with uncertain future benefits," FERC said.

"We note that adjusting the Demand Curve off-cycle to account for the elimination of a tax

exemption that does not apply to existing suppliers translates into immediately higher capacity payments for existing suppliers, not a higher payment for capacity for new entrants," FERC observed. Suppliers have not shown that it is reasonable to believe that developers of new capacity would base their decisions to build solely on capacity prices in effect for only the next couple of years rather than considering both current and expected future prices based on the expected triennial demand curve revisions, the Commission held.

Back to its rehearing order in docket ER08-283-002, FERC denied a rehearing request from KeySpan Ravenswood which had argued use of the LMS100 peaking unit as the reference technology was inappropriate. FERC affirmed that use of the LMS100 technology is reasonable, and that using the LM6000 as proposed by KeySpan would not accurately represent the costs for efficient new entry in light of the new, more efficient technology represented by LMS100.