Energy Choice Matters

December 23, 2008

FirstEnergy Withdraws Electric Security Plan, Issues RFP for Interim Supplies

The FirstEnergy utilities yesterday withdrew their Ohio Electric Security Plan and said they would conduct a competitive solicitation for power for supplies from January through March 2009, after PUCO made several major modifications in approving the ESP (Matters, 12/22/08).

As reported yesterday, SB 221 gives utilities the right to withdraw an ESP that is modified by PUCO, with the ability to submit a new ESP or a Market Rate Offer (MRO). FirstEnergy has not submitted a new application for either option, but did file for rehearing of its rejected MRO.

Among the major changes to the ESP were the removal of generation rate increase deferrals, a 10% decrease in proposed base generation rates, rejection of a nonbypassable minimum default service charge of 1¢/kWh, and a decision to not act on various distribution rate adjustments sought by FirstEnergy in the ESP, leaving such matters to other pending cases.

"Following a comprehensive review of the modifications, the companies determined the plan no longer maintains a reasonable balance between providing customers with continued rate stability and a fair return on the companies' investments to serve customers," FirstEnergy said in withdrawing its ESP.

However, without an approved supply mechanism from PUCO, FirstEnergy said it would use a competitive RFP to supply customers from January 5, 2009 through March 31, 2009. Rates would remain at their current levels, FirstEnergy said.

Given PUCO's rejection of the MRO, and modification of the ESP, the process to set post-2008

... Continued Page 2

Socializing POLR Bad Debt, Rate Mitigation Becomes Flashpoint in Texas Rulemaking

"Socializing the risk of choosing a dubious REP threatens to steer customers toward dubious REPs and imposes the cost of those choices on everyone else," TXU Energy said in opposing socialized bad debt and POLR price mitigation proposals which have been suggested in connection with a PUCT rulemaking to change several aspects of the current POLR rule (35769, Matters, 11/6/08). Consumer groups and industrials echoed TXU's comments with respect to subsidizing POLR-related bad debt.

The Commission asked whether two aspects of POLR service should be socialized -- bad debt incurred by POLRs, and the difference between the POLR rate and any mitigated rate charged by the POLR as part of a transition period intended to give customers a chance to switch off POLR service before the MCPE-based POLR rate takes effect.

While customers in mass transitions may be victims, "customers are clearly not helpless," TXU said.

"For example, if a customer chooses a REP offering a price that appears to be too good to be true, and the price turns out to be too good to be true, should the customer who instead chose a REP with a higher price that did not go out of business help pay for the failure of the first customer's REP," TXU asked.

TXU noted that it has suggested in the REP certification rulemaking (35767) that higher levels of REP collateral could be used to fund recovery of POLR bad debt, rather than socializing such costs across the market.

The Texas Industrial Energy Consumers believe that the proposed cost socialization, "could entail tremendous costs, and could seriously undermine the proper functioning of the competitive market in

... Continued Page 3

Briefly:

Md. PSC Adds Unfilled Load to January Procurement

The Maryland PSC approved Staff's recommendation to fill unawarded SOS blocks at Baltimore Gas and Electric and Delmarva by adding the blocks to the January 12, 2009 procurement for Type II service. High prices exacerbated by the financial crisis led to 17 BGE residential blocks and 2 Delmarva combined residential/Type I blocks being unfilled even after a reserve auction (Matters, 11/17/08). Adding the unfilled blocks to the January 2009 procurement will given the utilities an opportunity to procure supply without resorting to the PJM spot market, which is the ultimate backstop required by rule. The PSC accepted Staff's recommendation to refresh inputs in the Price Anomaly Threshold for the January 2009 solicitation, but held that the PAT design and mechanism will remain unchanged. The Commission declined to adjust the Transaction Cost and Risk Adder as proposed by Staff, and rejected a request by the People's Counsel to start work on another backstop procurement in case the load remains unfilled after the January event.

Satori Energy Seeks Md. Broker License

Satori Energy applied to the Maryland PSC to broker C&I customers at Baltimore Gas and Electric and Pepco. Satori intends to focus on customers 750 kW and up and does not plan to advertise in Maryland, but expects new business from customer referrals. Satori, which also operates in Texas, Illinois and Massachusetts, has served a small number of Maryland clients for about two years, but was unaware, as many brokers have been, that a license was needed if the broker was not "on the ground" in Maryland. President David Wiers launched Chicago-based Satori in 2006 after holding senior positions at Power Brokers and Choice Energy Services. Wiers was a past President of the Texas Electric Professionals Association and founded the Illinois Energy Professionals Association.

Amerex, Armstrong Form Alliance to Combine Energy Procurement, Management

Broker Amerex Energy Services has entered a partnership with Armstrong Service, a firm specializing in energy/utility system management, to provide full-service energy offerings designed to reduce both physical usage and the price of the energy commodity. The alliance will give C&I customers the opportunity to combine energy procurement with other bill-lowering measures, such as demand response.

Integrys Names New CEO

Integrys Energy Group named Charles Schrock, currently CEO of its Wisconsin Public Service subsidiary, as CEO of the holding company effective January 1, 2009, replacing the retiring Larry Weyers.

PG&E Signs Solar PPA with Sempra

Pacific Gas and Electric has entered into a long-term agreement with Sempra Generation subsidiary El Dorado Energy to purchase 10 MW of photovoltaic solar energy from the new El Dorado facility in Nevada. Power deliveries to PG&E are expected to begin by January 1, 2009.

FirstEnergy ... *from 1*

rates, "has become far more uncertain and far less manageable for customers," FirstEnergy said.

The competitive solicitation for the interim power differs materially from the solicitation FirstEnergy applied to use for its MRO, which was rejected by PUCO (Matters, 11/26/08).

The interim solicitation is a competitive RFP for load-following energy and capacity only. The FirstEnergy utilities will be responsible for transmission and ancillary related costs, as well as for any alternative or renewable energy mandates. The interim RFP, to be run by CRA International, is a pay-as-bid solicitation under which the price paid to the winning bidders in $/MWh will be the average price of the tranches that the winning bidder has won.

Under FirstEnergy's rejected MRO, the solicitation would have been a full requirements (including ancillaries and transmission), descending clock auction with a uniform clearing price. Brattle Group would have acted as an independent administrator, which PUCO found did not meet the statutory guidelines for independence, given Brattle's work for other FirstEnergy utilities in preparing expert testimony.

For the interim RFP, SSO load will be divided into 100 identical tranches, each representing 1% of the actual hourly energy required for the SSO load for the delivery period, as well as 1% of the required Designated Network Resources for the delivery period. Nominally, each tranche represents 88 MW of maximum hourly energy, but this value could change each hour. The RFP will limit winning bidders to no more than 75% of total SSO load. Bids will be due December 31.

FirstEnergy is also seeking rehearing of its MRO as it believes the MRO is in compliance with SB 221 and the law's "specific criteria" needed to implement an MRO. PUCO, FirstEnergy argued, failed to recognize those specific provisions, and instead established new requirements and criteria for approval of an MRO that are not included in the law. PUCO, FirstEnergy added, "failed to identify specific deficiencies or provide remedies, as required under Senate Bill 221, making it impossible for the companies to address the PUCO's issues except through a full rehearing process."

PUCO denied the MRO for, among other reasons, its use of a full requirements, slice of system, descending clock auction, and concerns about market power, particularly with respect to affiliate FirstEnergy Solutions. The full requirements approach, PUCO held, does not provide a clear product definition as required by SB 221 since the size of the load following tranches will vary hourly. Furthermore, PUCO concluded SB 221 requires the utility's RTO to have a market monitor that has the ability to take actions to identify and mitigate market power or company conduct. However, with the removal of certain types of market monitors from tariff administration (due to FERC order), PUCO found the Midwest ISO did meet the statutory requirements.

POLR Rulemaking ... from 1

ERCOT." Mitigating POLR rates via a market uplift and socializing bad debt, "will promote poor contracting, and encourage customers to be less vigilant in evaluating the economics of a potential REP," TIEC agreed.

"Such a rule would penalize successful REPs and customers who selected lower-risk providers, likely at a higher price, to avoid the costs associated with REP failures," TIEC added.

The Commission should not adopt a rule that would burden other REPs and their customers with costs they played no part in creating, and from which they receive no benefit, TIEC said in opposing any market uplift mechanism to pay for the costs.

The Steering Committee of Cities Served by Oncor noted that since the POLR rate is not truly cost-based, "the concept of subsidizing costs encompassed by that rate is dubious." Any bad debt reconciliation, if allowed, should compare POLR revenues with actual costs, rather than administratively set POLR rates, the Cities said.

The Office of Public Utility Counsel recommended any bad debt recovery be funded from a fee on REP certifications and/or certificate amendments, since exiting REPs create the need for the fund and therefore should be responsible for contributing to the fund. OPC is opposed to using money that would otherwise be appropriated as a low-income discount, such as the system benefit fund, for bad debt recovery.

Socializing bad debt and mitigation costs was supported by a joint proposal from the Alliance for Retail Markets and Reliant Energy. Under the ARM/Reliant POLR design, ERCOT would charge QSEs representing competitive load and competitive resources a fee to develop a $50 million fund related to paying POLR rate mitigation and bad debt expenses.

As proposed by ARM/Reliant, residential and small non-residential customers transferred to POLRs charging MCPE-based rates ("Large" POLRs under the proposed rule) would have a 15-45 day "buffer" period (depending on billing cycle) in which the POLR rate would be based on 120% of the one-year average of MCPE (plus TDU fees and a customer charge as under the current rule). The ERCOT fund would be used to offset the difference between this price and the standard POLR rate which would be set at 125% of actual hourly MCPE (plus current TDU/customer fees). After the buffer period, customers would pay the standard, 125% hourly MCPE-based POLR rate if they remained on POLR service.

Large POLRs could not request deposits under the ARM/Reliant proposal until at least 20 days after the start of POLR service, and customers would have at least another 10 days after a deposit request to post any deposit, if required.

The ARM/Reliant proposal would not offer bad debt recovery for voluntary POLRs, which would continue to charge a monthly market-based rate as under the PUCT proposal.

First Choice Power suggested other, market-wide changes to address POLR bad debt, such as a rule change that would allow REPs to delay the execution of a pending switch or move-out until all past due balances are paid in full. Customers who have been disconnected for non-payment would be required to pay all past due balances before a TDU could establish their service with another REP, First Choice said. First Choice also favored the creation of a customer payment history database to assist in achieving a reduction in bad debt for REPs and more affordable pricing for all consumers.

"Mandatory" POLRs

Under the PUCT proposal, three types of POLR providers would be established -- Voluntary POLRs, Mandatory POLRs (a new class), and Large POLRs (analogous to the current non-volunteer POLRs). Mandatory POLRs would be all REPs eligible to provide POLR service, and would assume customers in smaller mass transitions if customers remain after assignment to Voluntary POLRs. Mandatory POLRs would charge a market-based monthly rate for POLR service, and not the MCPE formula in the current rule. For larger transitions (more than 2% of customers in a class), Mandatory POLRs would be passed over, with customers transitioned to Large POLRs, which are the five largest REPs in the particular service area and customer class. Large POLRs would charge a rate tied to MCPE.

Numerous REPs opposed the creation of the new Mandatory POLR class, citing the burden to all REPs and the confusing nature of the process.

ARM noted that under the current rule, non-volunteer POLRs can anticipate with a large degree of certainty that they will be required to provide POLR service in the event of a mass transition. However, with Mandatory POLR service, that certainty is undermined for several reasons. First, as all eligible REPs could be designated as Mandatory POLRs, Mandatory POLRs may not pick up a large group of customers (due to the spread of obligations over many POLRs). Second, for very large transitions, Mandatory POLRs would be bypassed in favor of Large POLRs. Thus, the obligation to serve will vary greatly from one mass transition event to the next, requiring all eligible REPs to incur administrative costs to prepare for their obligation to serve even though there is little certainty they will serve (unlike the current rule where only a few REPs bear this obligation, and are more certain to serve)

ARM also objected to the requirement for Mandatory REPs to serve customers at a monthly market-based rate (rather than MCPE), as REPs may not be able to serve a large group of new customers at an otherwise available market price. The real-time cost of energy and ancillary services in the spot market may easily exceed the embedded costs of those components in any of the competitive retail offerings the REP currently makes available to new customers, ARM said.

Citing possible customer confusion from the three POLR categories, First Choice Power supported continuing the current structure of voluntary emergency providers and default, non-voluntary providers, and saw no benefit in further dissecting the non-voluntary provider pool. The National Energy Marketers Association agreed, suggesting that the PUCT instead provide greater incentives for REPs to volunteer as POLRs if the goal is to avoid customers moving to the MCPE-based rate of Large POLRs.

TXU was one of the few stakeholders supporting the proposed Mandatory POLR category. The Mandatory POLR mechanism, "provides an important second level of protection or buffer," against customers being transferred to POLRs charging MCPE-based rates, TXU said. TXU also recommended utilizing Mandatory POLRs in all transitions (with Mandatory POLRs acquiring customers up to a certain cap), rather than bypassing Mandatory POLRs completely in larger transitions where the cap is exceeded as proposed in the rule.

The Texas Energy Association for Marketers suggested the proposed 2% threshold, above which Mandatory POLRs would be bypassed, should be increased to at least 5%, to give REPs a chance to recover the costs required to stand ready to serve. The administrative and backoffice costs of preparing to serve as a POLR are significant, and typically are not dependent on the size of the entity, TEAM noted.

But the proposed rule would require all eligible REPs to stand ready as Mandatory POLRs, while limiting the likelihood REPs will actually be called on to serve and given an opportunity to recover costs.

POLR Rates / Other Alternatives

Rather than creating a POLR rate mitigation or buffer period for POLR customers served on MCPE, as suggested in one of the PUCT preamble questions, First Choice Power simply recommended that all POLR customers be served on a variable month-to-month price plan with no cancellation fee. The price should be one that is generally available to all customers in the respective service area and within the respective customer classes, First Choice said. First Choice Power does not believe that the Commission should engage in setting prices, even for a transitional period following a POLR event, as most REPs already have variable month-to-month plans that are used for competitively acquired customers as well as for customers who are transitioning away from expired, fixed-price term plans who have not responded to the REP's renewal efforts.

Texas Legal Services Center and Texas Ratepayers Organization to Save Energy recommended that for residential customers, the Commission should appoint the largest REP in a service area as the POLR and require the POLR to charge the rate taken by the majority of the REP's residential customers.

The Oncor Cities opposed any MCPE-based rate using an MCPE multiplier to recover margins, since a reasonable rate of profit should not be based on the commodity input prices and quantities. "Instead, the reasonable level of profit is based on the capital investment of the owners and more closely resembles a fixed cost," Cities said. Thus, Cities suggested that any MCPE POLR rate should use a flat adder for the required margin, rather than a multiplier (such as MCPE + $5/MWh).

However, Reliant Energy countered that the multiplier is needed because non-balancing energy costs also tend to increase when MCPE increases. The multiplier does not create a windfall for POLRs, Reliant said, but rather is needed to recover additional costs besides just energy, such as ancillary services and other load related charges. Other costs that a POLR needs to recover include: Unaccounted for Energy, Local Balancing Energy, Out of Merit Energy, Out of Merit Capacity, Black Start, Reliability Must Run, Regulation Service-Up, Regulation Service-Down, Responsive Reserve Service, Non-Spinning Reserve Service, and Voltage Support, Reliant said.

TIEC recommended that demand charges be removed from the large customer POLR rate. "The demand charge is not justified because the transitioned customer will already be paying market price plus a large premium for the energy it consumes," TIEC said.

Miscellaneous

TXU recommended that customers acquired in a mass transition not count towards the ERCOT credit requirements of the POLR's QSE (typically the POLR itself). Acquiring a large group of customers would normally raise ERCOT credit requirements, which could impose a "significant liquidity constraint" on POLRs. Because POLRs are providing a public service in preventing disconnection of customers in a mass transition, they should not be required to post additional security for transitioned customers, TXU said.

The Joint TDUs cautioned that eliminating the out-of-cycle meter read charge for customers leaving POLR service would take six months to develop. Switch requests currently do not identify the customer as being on POLR service, and building a system to allow for a comparison of switches to customers on POLR service would take a minimum of six months at "excessive" cost given its minimal use. Furthermore, TDUs noted uncertainty with respect to the waiver's application to customers who remain with the POLR, but move to a competitive rate, and thus should no longer be eligible for a waived out-of-cycle read fee. TDUs recommended continuing to charge the out-of-cycle fees, but suggested that REPs may waive the fees to customers.

TXU suggested changing the proposed requirement that all marketing materials sent from the POLR to customers about competitive offerings must include information reminding the customer they can choose another provider. Such information should be provided by the POLR in its initial notice to the customer (as well as by the PUCT/ERCOT), TXU said, but should not be sent by the POLR after such initial notice because such information on marketing materials could inhibit quick customer migration away from POLR service. Marketing that contains the "somewhat unusual language" regarding the availability of other offers form competitors, "may be less persuasive to customers," and make customers concerned enough to decline whatever offer is in the marketing material, pending a review of other products. Such a result seems to be at odds with the goal of getting customers off the POLR rate as quickly as possible, TXU said. Additionally, since most marketing materials do not normally inform customers of the availability of competing offers, new materials would have to be developed, delaying the issuance of such materials to customers, which may delay their eventual switch, TXU said.

NEM sought greater clarity on the right of customers to request POLR service, especially as Voluntary and Mandatory REPs will be offering monthly market-based rates for POLR service, which may be attractive to customers.