Energy Choice Matters

February 17, 2009

REPs Quietly Unwinding Business to Exit ERCOT Market

Although it might not be as apparent as the POLR mass transitions during the summer, several smaller REPs continue to quietly exit the ERCOT market, due to lingering effects of ERCOT congestion, Hurricane Ike, and the lack of affordable credit, Rob Potosky, executive vice president at AEG Affiliated Energy Group, told Matters recently.

AEG is currently shopping a 100,000 meter book on behalf of a client on a blind basis (Matters, 2/3/09).

Despite what was on all accounts a shock to REPs' bottom line from Hurricane Ike in September, due to loss of load, long power positions, bad debt, and in some cases, temporary relocation costs, the events have not led to any public exits in the REP community. Although Ambit Energy acquired Commerce Energy's ERCOT book during the fourth quarter, with Ike undoubtedly hastening a transaction, the writing had been on the wall at Commerce for some time. And there have yet to be any POLR mass transitions in the ERCOT market since the summer.

With so few REPs publicly traded (and due to consolidated financials even among those that are) putting hard numbers behind the costs is difficult. While PNM Resources reported a sharp rise in bad debt at retailer First Choice Power (Matters, 2/9/09), the parents of several other REPs (including established mass marketers Cirro Energy and Gexa Energy) did not address ERCOT market activity in their earnings releases (see below).

Although most of the activity may be behind the scenes, some REPs are working to unwind their business in an orderly fashion given today's challenges, Potosky confirmed. The market has seen several smaller REPs stop renewals and enrollment of new customers -- both large C&I and

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Columbia Gas of Ohio Files SSO Auction Plan as Step in Exit from Merchant Function

Columbia Gas of Ohio would begin serving sales customers under a Standard Service Offer (SSO) auction in April 2010 under a transition plan recently filed with PUCO, which represents the first step towards a possible exit from the merchant function. Although Columbia has been working with stakeholders on a transition plan for several years, the filing does not represent a consensus proposal, though one may be forthcoming (Docket 08-1344-GA-EXM).

Columbia is the latest Ohio gas utility to file an SSO auction plan. Auctions are currently used to set the SSO at Dominion East Ohio (which is now moving to a Standard Choice Offer) and Vectren Energy Delivery, while Duke Energy Ohio is studying an auction with stakeholders. The SSO auctions procure wholesale supply to remove the utility's role in managing gas procurement, and the associated Gas Cost Recovery mechanism. Columbia expects that the auction process will increase supplier efforts to compete in Columbia's market and will provide a greater variety of products to address customer needs.

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WMECO Would Recover Utility-Owned Solar Costs via Nonbypassable Surcharge

Western Massachusetts Electric Company proposed recovering costs from up to 50 MW of utility-owned solar via a nonbypassable, kWh-based charge on all customers, in a DPU filing requesting approval of the program (09-05, Matters, 2/13/09).

The unavoidable Solar Program Cost Adjustment would be set annually, although under its proposal WMECO could file to change the factor adjustment at any time should "significant" over- or under-recoveries occur. As proposed, the initial solar surcharge would be 0.13¢/kWh in 2010. It is projected to grow to 0.176¢/kWh in 2012 and 0.151¢/kWh in 2013, due to growth in solar installations.

Under the utility's proposal, WMECO said it would take title to electricity generated from the solar facilities, and resell it in the wholesale markets. All value generated from such sales, including the RECs generated, would be applied to customers' benefit. However, WMECO later said in testimony that it is reviewing specific options for monetizing the energy output, including (a) the direct sale of each facility's output in the ISO New England energy markets and (b) using the energy output to offset system losses. WMECO is "likely" to use the direct sale option, it said.

Based on WMECO's initial 6 MW solar deployment, the annual revenue requirement for its solar installations would be $4.9 million in 2010, $6.6 million in 2011, $5.6 million in 2012, and $4.9 million in 2013. The revenue requirements are calculated using WMECO's composite installed cost of $6,800/kW.

Oncor Launches Solar Incentive Program

Oncor yesterday launched a solar photovoltaic incentive program offering cash to qualified homeowners, businesses and governments to install solar photovoltaic power systems. Oncor expects to install about 1,400 new solar systems through the $16 million, four-year program.

Oncor will pay an incentive of $2.46 per DC watt up to a maximum of $24,600 for each residential installation and up to $246,000 for all other installations. Most residential solar panel projects range from 1 to 10 kilowatts, while business and government installations may receive incentives for projects up to 100 kilowatts. Larger installations will be considered.

As with other Oncor efficiency programs, service will be provided by a registered competitive provider, who owns the customer relationship. Any provider meeting various eligibility criteria (relating to solar experience) can be registered, and providers compete for the Oncor grant money.

The solar PV program is one of 12 new renewable and efficiency programs Oncor plans to offer this year to bring its total to 31 programs. Texas TDUs have been attempting to increase REP participation in the efficiency programs, but REPs have cited several barriers, such as the boom-bust cycle of grant funding which is quickly used in some program years. No REP is listed as a registered service provider for the solar PV program on Oncor's website.

Oncor's solar PV program is officially named the Take A Load Off, Texas Solar Photovoltaic Incentive Program.

MISO Proposes Credit Changes Reflecting Voluntary Capacity Auction

The Midwest ISO proposed several revisions to its credit policy procedures in Attachment L of its tariff to account for the operation of the monthly voluntary capacity auction associated with its Module E Resource Adequacy construct (known as the RAR Auction).

Under Module E, the Midwest ISO plans to conduct a voluntary capacity auction five days prior to the Resource Plan Deadline to allow LSEs the opportunity to obtain the necessary capacity to meet their resource adequacy requirement (RAR) for a given month, and to permit Market Participants desiring to sell capacity to submit offers through the RAR

Auction. Suppliers of capacity will submit Planning Resource Offers (PR Offers) and LSEs desiring capacity will submit RAR Bids. The total of an LSE's RAR Bids may not exceed the portion of their Total Credit Limit allocated to the RAR Auction, thus implicating the Midwest ISO's credit policy procedures.

Under the changes filed at FERC, participants that submit RAR Bids in the RAR Auction would be required to allocate a portion of their Total Credit Limit to the RAR Auction. The Total Credit Limit is the sum of the Unsecured Credit Allowance and the Financial Security provided by the RAR Auction Participant. The RAR Auction Participant's RAR Auction Credit Allocation must be approved by the Midwest ISO prior to its participation in the RAR Auction, under the proposal.

The RAR Auction Participant's RAR Bid may not equal or exceed its RAR Auction Credit Allocation and its Total Potential Exposure may not equal or exceed its Total Credit Limit. If the credit exposure does exceed the credit allocation, the RAR Bid may be rejected by the Midwest ISO. An RAR Participant may request to reduce its RAR Auction Credit Allocation two business days after a given RAR Auction clears, but such requests must be approved by the Midwest ISO.

Attachment L would also be modified to include the formula for calculating Module E Potential Exposure, which is the potential exposure to non-payment associated with Module E transactions. Specifically, the Midwest ISO determined that it was necessary to add details as to what is to be included in the Module E Potential Exposure, namely, RAR Auction transactions and Financial Settlement Charges under Module E.

The Midwest ISO requested an effective date of April 15, 2009 for the changes, to enable the revisions to become effective prior to the first RAR Auction, which will be conducted on April 25, 2009.

Briefly:

Gateway's Steve Maslak, NEM's Craig Goodman Featured on 21st Century Business Television

Gateway Energy Services will be featured on a segment of the paid program 21st Century Business Television which airs on CNBC and Fox Business. In the four-minute spot, Gateway CEO Steven Maslak, along with National Energy Marketers Association President Craig Goodman, discuss energy deregulation and ways customers can save money. According to Gateway, the spot is scheduled to air on February 19 at 2:30 a.m. EST on CNBC, and on February 22 at 2 p.m. EST on Fox Business Network.

Publication Note:

Energy Choice Matters did publish an issue for Feb. 16 if you were out of the office.

ERCOT Market *... from 1:*

mass market accounts -- as REPs eye leaving the business as their contracts rolloff. For customers not on term contracts, REPs looking to exit will often raise the price to an unattractive level compared to competitor offers to push the customer off of its service.

While in the immediate wake of the Lehman Brothers bankruptcy, and associated credit crunch, longer-term contracts for the largest C&I customers were the first casualties as many REPs could not support the credit obligations of serving such large load, the contagion has trickled down to the mass market, including residential sales. Potosky characterized the current cost of hedging as "crazy" due to the illiquid capital and credit markets, with 12-month contracts being the longest for which most REPs can obtain somewhat reasonable financing. AEG is offering bridge loans and other arrangements for REPs looking for reasonable facilities.

However, as a few REPs look to exit, they aren't shopping their books around, because of their small size. Typically small books of only a few thousands customers are unattractive targets for other REPs, because

of the effort needed to perform due diligence on such a small book.

Millions of dollars of REP working capital is also being tied up in margin calls, caused by the precipitous drop in ERCOT wholesale prices, Potosky noted. REPs that prudently entered supply hedges have been "hammered" by the associated margin calls, and the use of working capital to meet such calls is stifling retailer growth, Potosky observed.

Potosky also said that REPs, particularly new entrants, are simply "scared" at the PUCT's pending new collateral requirements, which could require REPs to hold liquid assets in the neighborhood of $1-3 million. Several new entrants which have been certified but have yet to serve load will most likely relinquish their certificates if a final rule is adopted containing such requirements, Potosky said. New entrants are also spooked about the PUCT changing the rules of the game again a year or so down the road.

As noted above, fourth quarter earnings from REP parents released to date have not given much detail on the challenges faced by ERCOT market participants in the fourth quarter, aside from the aforementioned First Choice Power results. Gexa parent FPL Group, ConEdison Solutions parent Consolidated Edison, Inc., dPi Energy parent Rent-A-Center, Inc., and Hess Corporation did not address competitive retail marketing in their earnings reports, and have not yet filed their 10-Ks which may include greater specificity. Dominion Retail reported lower earnings from competitive retail marketing, but gave no specifics by market, and its parent has yet to file its 10-K. Just Energy parent Energy Savings Income Fund reported higher adjusted earnings but did not address any ERCOT issues on its conference call as it had earlier in the year.

More color may be forthcoming in the next few weeks as more players report on the fourth quarter. Constellation NewEnergy parent Constellation Energy is scheduled to release earnings February 18. Integrys Energy Group is set to release earnings after the market close on February 25. Direct Energy parent Centrica is due to report 2008 results February 26. TXU Energy parent Energy Future Holdings and Pepco Energy Services parent Pepco Holdings are scheduled to release results on March 3. Reliant Energy and Sempra Energy Solutions parent Sempra Energy have not announced earnings release dates yet. MxEnergy, which operates on a fiscal year ending June 30, has also not scheduled an earnings release date.

Columbia *... from 1:*

Under Columbia's proposal, it would conduct two annual SSO auctions during a two-year transition period, for the annual delivery periods beginning April 2010, and April 2011. Auctions would be held in the February preceding the delivery date, and would be similar to the descending clock auctions in place at Dominion East Ohio and Vectren.

As with the SSO in effect at other LDCs, the auction would set a fixed retail price adjustment to be added to the NYMEX final settlement price each month during the SSO period to determine the monthly SSO price.

Columbia would divide the forecast SSO requirements into 16 equal tranches for the auction. Based on current estimates, each tranche would equal approximately 5.3 Bcf per year. A maximum of four tranches would be awarded to any individual bidder. The four tranche limit would also apply to bidders that are affiliated with and/or have an interest equal to or greater than 10% in other bidders.

Potential bidders in the SSO suction would be pre-qualified, including a creditworthiness evaluation. Bidders would have their creditworthiness assessed against exposures that include 150% of the tranches that they express the intent to bid on. The 150% level is required to allow for sufficient credit to enable an SSO Supplier to accept an increase in its tranche volumes in the event of an SSO or Choice Supplier default, up to a level equal to 150% of the design day demand of the original tranche level.

Winning bidders would also be required to provide Columbia with a cash deposit in the amount of 50¢ per Mcf multiplied by the initial

estimated annual delivery requirements for the SSO period of the tranches won by that SSO Supplier. Such financial security shall be held and administered by Columbia exclusively for the benefit of the other SSO Suppliers who may be called upon to cover for a defaulting SSO Supplier.

SSO and Choice suppliers would pay a fee of 5¢ per Mcf delivered by Columbia to their Choice customers and/or their share of the SSO customers each billing month to provide for recovery of incremental program costs and lost opportunity revenues from, but not limited to, information technology; call center; billing; reports; educational programs; investment(s) in supply line infrastructure; lost opportunity revenue; and other program related costs.

Columbia would release upstream transportation and storage capacity to the winning SSO bidders, and filed a proposal for such releases.

The SSO rate would apply to Columbia sales customers on the Small General Service Sales Rate, Small General Service Schools Sales Rate, General Service Sales Rate, General Service Schools Sales Rate, and Large General Service Sales Rate.