Energy Choice Matters

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Direct Energy Mass Market Results Better Than Expected

Direct Energy posted mass market results that were better than expected, Centrica Finance Director Nick Luff reported on an earnings conference call yesterday, as colder weather and higher margins experienced late in the year mitigated effects of Hurricane Ike and ERCOT volatility.

Yearly operating profit for Direct's mass market unit was $245 million, relatively flat on a constant currency basis versus 2007.

Customer count in the U.S. Northeast and Midwest grew by 20% to more than 400,000 as of year-end, with particular growth in New York electric and gas, and increased market share in Ohio and Connecticut. While it will not ignore opportunities that arise, Direct said its focus would be on the key geographic markets of the U. S. Northeast, Texas and Canada.

Texas mass market customer numbers fell by 4% during 2008, and total demand dropped by over 15% as mild weather and conservation efforts by customers in the face of higher prices impacted average consumption per customer. Lower pricing from competitors put pressure on the Texas business towards the end of the year, and forced Direct to reduce prices early in 2009. Texas operations posted operating margins of 9% in 2008.

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PUCT Commissioners See Problems with $1.5 Million LOC Standard for REPs

The latest Staff proposal to allow REPs to post a $1.5 million letter of credit for REP certification still raised concerns from PUCT Commissioners, who worried that the amount may be too high and would not achieve its intended result (35767, Matters, 2/23/09).

Commissioner Kenneth Anderson noted that while the letter of credit would be less than the previously proposed $3 million in liquid assets, it would still either require a very large upfront guarantee, or a high cost to purchase and maintain.

Commissioner Donna Nelson noted the letter of credit would increase costs to the REP, and thus ultimately to customers. While a tradeoff of slightly higher prices may be acceptable in exchange for certainty that customers would not see their REP fail and receive the benefit of their bargain, Nelson was not sure if the proposal would accomplish that, and thus would only serve to impose higher costs on REPs without any guarantee of reducing REP exits.

Still, the current $100,000 in unused cash threshold generates laughter from legislators and needs to be increased, Chairman Barry Smitherman said. Requiring REPs to commit a larger portion of cash for certification would show a serious commitment to the market on behalf of such REPs, Smitherman noted, attracting the type of long-term players desired.

Anderson added that the final certification rules must recognize the current practice of REP creditors (who often act as the REP's QSE as well) establishing "lockboxes" for the REP's accounts receivables, which allow the creditor to take over operation of the REP should the REP

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PUCT Commissioners Question Mandatory POLR Concept, but See Little Alternative

PUCT Commissioners expressed continued skepticism about the proposed "Mandatory REP" step in draft new POLR procedures, while at the same time conceding a better solution to give customers an added level of protection against MCPE-based POLR rates after transfers to voluntary REPs are exhausted is not apparent (35769, Matters, 2/23/09).

Mandatory REPs (or MREPs) would be drafted into POLR service in certain smaller mass transitions after volunteer POLRs reached their voluntary customer cap. MREPs would charge a competitive, month-to-month rate for their POLR service, which is meant to shield customers from the MCPE rate. Any REP eligible to provide POLR service could be called upon to serve as an MREP. Under the latest draft, MREPs would have their customer obligation during a transition capped at 1% of their customer base.

Commissioner Donna Nelson said she wasn't crazy about the MREP tier, though not vehemently opposed. Nelson suggested that a 0.5% customer cap might be a better option for limiting the obligations of MREPs.

Commissioner Kenneth Anderson was concerned that while the rule provided that MREPs would serve customers on a "competitive" rate, there was nothing preventing that rate from being the current MCPE-plus-adder rate, or even MCPE with a higher adder. MREPs may seek to charge a higher rate to recover the bad debt associated with POLR service, Anderson noted.

In an updated proposal filed yesterday, Staff revised a few points from its draft issued last Friday. First, MREPs would be assigned customers randomly under the new draft, instead of customers being assigned to MREPs in order of ascending price. This change is meant to address concerns that MREPs would intentionally provide a higher price during the POLR process to avoid taking on customers.

Staff also clarified that, as noted in a memo issued last week, MREPs would not assume any POLR obligations if the mass transition involved so many customers that all the MREPs could not handle the load, and so-called Large Service Providers (or POLRs charging an MCPE-based rate as the ultimate backstop) had to be called upon. Staff recommended bypassing MREPs in large transitions for simplicity, since the five Large Service Providers designated for an area would otherwise also be acquiring customers first as an MREP, and thus charging two different prices.

Commissioners agreed that the MCPE adder for Large Service Providers would be in the "area" of 125%, versus the current 130% and Staff's proposed 120%.

Anderson recommended that a proposed customer payment history database be examined in a separate rulemaking, so it does not delay action on the new POLR rules.

Realized Electric Margins Up at Integrys Energy Services

Realized per-unit electric margins increased nearly $1/MWh in the fourth quarter at Integrys Energy Services, as a "prudent" decision to limit deployment of capital during the fourth quarter sacrificed volume for margins, the unit's President Mark Radtke reported during an earnings call yesterday.

"While there was tremendous opportunity to grow our customer base in the fourth quarter, it was a time to exercise restraint," Radtke said. With parent Integrys Energy Group deciding to divest or shrink the unit due to capital requirements (First reported in Matters, 2/26/09), such growth was not pursued.

As a result, realized retail electric margins in the quarter increased to $4.60/MWh from $3.61/MWh in the fourth quarter of 2007. For the year 2008, electric margins were $4.34/MWh, up from $3.46/MWh in the year 2007. Retail natural gas margins were relatively flat at 20¢/Dth for the fourth quarter and 17¢/Dth for the year 2008, each down 2¢/Dth from the comparable prior period.

Retail electric margins including unrealized losses were negative $42.8 million in the fourth quarter, versus positive $36.6 million a year ago. Retail gas margins including unrealized gains were $24.9 million for the fourth quarter of 2008, versus $18.1 million for year-ago quarter.

Retail electric delivered volumes were also flat at 4.0 billion kWh for the fourth quarter of 2008. Delivered retail gas volumes dipped from 88.4 bcf in the year-ago quarter to 84.0 bcf.

Forward contracted electric volumes in the fourth quarter were 136.7 million MWh versus 91.0 million MWh a year ago. Forward contracted natural gas volumes in the quarter were 606.7 Bcf versus 551.3 Bcf a year ago.

A full divestiture of Integrys Energy Services is the parent's preference, Integrys Energy Group CEO Larry Weyers told investors. Alternatives include divestiture of portions of the business or scaling back farther by modifying the scope of products offered or markets served. J.P. Morgan has been retained as an advisor.

Failing a full divestiture, Integrys aims to reduce the corporate guarantees to Integrys Energy Services to a maximum of $1.1 billion by the end of the year, versus the $2.6 billion in guarantees as of December 31, 2008. Integrys also plans to trim $400 million of capital deployment at the energy services unit, from about $1 billion to $600 million or less by the end of this year

Should Integrys retain the unit, it should be substantially wound down by the end of 2010, with a good portion unwound in 2009.

Lower Spark Spreads, Wider Basis Differentials Reduce Dynegy Yearly Earnings

Compressed spark spreads resulted in a net loss of $7 million at Dynegy in the fourth quarter of 2008, though results were narrowed from a net loss of $46 million in the year-ago quarter. Adjusted EBITDA in the fourth quarter of 2008 was $129 million, compared to $249 million for the fourth quarter of 2007.

Yearly earnings were $174 million, down from net income of $264 million for the year 2007. Full-year results reflected lower sales volumes and lower margins from the company's power generation fleet primarily due to lower realized prices and compressed spark spreads, milder weather, and outages. Specifically, Dynegy was negatively impacted by wider basis spreads between the Cin Hub and Illinois Hub, and PJM and the Cin Hub. These factors were partially offset by a $50 million increase in capacity revenues versus 2007.

Dynegy lowered its outlook for 2009, forecasting a net loss of $65 million to $140 million. Dynegy had previously estimated 2009 net income between a loss of $20 million to profit of $85 million.

Dynegy has expanded its hedging efforts to extend two years forward, rather than its previous strategy of one. Since December, it has increased its hedged 2009 volumes from 55% to 95% in the Midwest, and from 40% to 95% in the Northeast. Dynegy remains largely open beyond two years in hopes of taking advantage of eventual price recovery.

Briefly:

AEP Blocking ILR Registration, Integrys Unit Claims

AEP's Ohio utilities are notifying applicants to PJM's Interruptible Load for Reliability (ILR) program that the PUCO has addressed AEP's proposed ban on such participation, and AEP is unilaterally refusing to process ILR applications for any of its standard service customers, Integrys Energy Services claimed in a motion for AEP to cease and desist such actions. AEP had proposed limiting customer participation in the PJM programs in its electric security plan (Matters, 1/2/09). "Although the Commission has not ruled on AEP's proposal to ban PJM demand response participation, AEP is notifying ILR applicants that the Commission has addressed the issue and is unilaterally refusing to process applications for any of its standard service customers to enroll in the ILR program," Integrys Energy Services claimed. "AEP simply does not have any authority to prohibit its customers from participating in the ILR

Program," the Integrys unit said.

Ameren Marketer Seeks Single Billing Authority in ComEd Territory

Ameren Energy Marketing applied to offer a single billing option to customers in the Commonwealth Edison territory with use in excess of 15,000 kWh.

PUCT Approves Extension of Current Nodal Surcharge

The PUCT approved an extension of the current ERCOT nodal surcharge of 16.9¢/MWh through March, although it removed the monthly $12 million cap on nodal expenditures to accommodate scheduled software purchases. ERCOT is to file for a new permanent fee before April 1. Commissioners again criticized ERCOT management, with Chairman Barry Smitherman noting the "wildly incorrect" assertions made by ERCOT in testimony filed last fall regarding the nodal schedule. ERCOT CEO Bob Kahn said his prior testimony on the schedule was the result of relying on ERCOT Staff who misrepresented the situation, who have been dismissed. Smitherman wasn't so sure that ERCOT has entirely dealt with the Staff problems and said if he were Kahn he'd clean house. Repeating comments made at the last ERCOT board meeting, Commissioner Donna Nelson scolded ERCOT's "non-responsive" approach to lawmakers' request for renegotiation of nodal vendor contracts. Renegotiation is scheduled to occur in June, some seven months after lawmakers made their request, Nelson said (Matters, 2/18/09).

Taylor Consulting Receives Pa. Broker License

The Pennsylvania PUC awarded Taylor Consulting and Contracting an electric broker license for all sizes of C&I and governmental customers throughout the state. Taylor Consulting currently runs online auctions and offers other consulting services, but sought the license so it could broker for an aggregated pool of customers and act as exclusive agent on behalf of such customers. Taylor Consulting, which bills itself as, "the fastest growing energy services organization on the East Coast," recently formed the Boston Buying Power Pool for small C&Is in conjunction with the city government.

PUCT Approves ETT Battery as Transmission Asset

The PUCT approved Electric Transmission Texas' request that a 4.8 MW sodium sulfur storage battery to be installed in Presidio, Texas, for reliability purposes will be granted eligibility for inclusion in the company's transmission cost of service, which sets transmission rates for various market participants such as REPs. Commissioner Kenneth Anderson stressed that the unique facts surrounding the case, in which the battery was proposed as a backstop since no merchant generation was forthcoming, should not be construed as precedent, and said that the issue of storage batteries as regulated transmission assets (as opposed to treatment as a merchant generation resource) will likely need to be addressed in a rulemaking.

ERCOT Revisions Delay Entergy Transition to Competition Study

Entergy Texas will not be able to file its updated transition to competition plan today as originally scheduled, as ERCOT discovered that a list of multiple-element contingencies in its updated study was incomplete, and is revising the figures. The revisions could affect reliability transmission projects required (and economic projects suggested) for integration of Entergy Texas into ERCOT, one of the possible scenarios for introducing customer choice into the region (33687).

Exelon Tender Offer Receives 51% of NRG Shareholder Support

Over 51% of outstanding NRG Energy shares have been tendered in support of Exelon's hostile acquisition of the merchant generator, as Exelon extended the exchange deadline and said it will move forward with its plan to seat directors on NRG's board if NRG does not move forward as its shareholders desire. Maintaining its previous stance, NRG said the tender results merely show shareholders want to see the Exelon process continue, but said Exelon must make a better offer.

Pa. PUC Approves Lower Bond for Reliant
The Pennsylvania PUC approved Reliant Energy's application for an alternative level of bonding in the amount of $250,000 to maintain its electric generation supplier license. Although Reliant sold its Northeast books including its Pennsylvania customers to Hess Corporation last year, Reliant intends to maintain its Pennsylvania EGS license at this time.

PUCT Staff Recommends Approval of Hudson Energy JV REP Application
PUCT Staff recommended approval of Hudson Energy JV's REP application (Matters, 2/20/09). Hudson Energy JV is a subsidiary of current REP certificate holder Hudson Energy Services.

Rigby to Lead Pepco Holdings
Current Pepco Holdings COO Joseph Rigby will succeed the retiring Dennis Wraase as Pepco Holdings CEO effective March 1, 2009. PHI also announced Conectiv COO Gary Morsches will move into the CEO role, as current CEO David Velazquez moves to the regulated side of the business.

Stream Energy Adds Efficiency Info to Website
Stream Energy has added an energy efficiency calculator and information portal to its website, known as WattZone.

Pa. PUC Approves Met-Ed/Penelec Voluntary Pre-pay Plans
The Pennsylvania PUC approved a settlement that will allow mass market Penelec and Met-Ed customers to enroll in a Voluntary Pre-payment Plan to decrease potential rate shock when rate caps expire January 1, 2011.

D.C. PSC Approves Updated Pepco GPC Rider
The District of Columbia PSC approved Pepco's application to update its Generation Procurement Credit (Rider GPC) for commercial customers to equal $0.000056/ kWh (Matters, 9/24/08). The credit reflects reconciliations remaining to be paid to commercial customers from the sale of Pepco's generating plants (FC 945).

***Direct** ... from 1:*

In Canada, competitive mass market customer numbers grew by 11% as Direct gained market share in Alberta where it has now switched 250,000 customer accounts from the regulated tariff to competitive products. Operating margins expanded in both Ontario and Alberta.

U.S. customer count stood at 1.2 million while Canadian customer count stood at 1.9 million at year-end.

At Direct Energy's C&I business unit, the acquisition of Strategic Energy and organic growth led to substantial growth in yearly operating profits at $20 million, about a 10-fold increase versus 2007. Customer count stood at about 200,000 meters. Direct said it made "significant progress" in the second half of the year in increasing margins to recover the higher cost of credit support. Integration costs for Strategic Energy cancelled out synergy benefits in the second half of the year, but Direct reported that the integration is now largely complete and said it is on target to exceed the $15 million of annual cost synergies announced at the time of the acquisition.

Direct Energy's home and business services unit "struggled" in 2008, particularly in the U. S. where it was hit by the slowdown in new home construction. Operating profit was down 11% at $29 million. U. S. customer service contracts stand at 100,000 as Direct tries to focus more on protection products than installations.

At Direct's upstream and wholesale energy unit, gains in its Canadian gas assets were mitigated by challenges in ERCOT, as operating profit was down slightly at $92 million. Higher capacity margins and lower spark spreads reduced generation volumes at Direct's ERCOT gas-fired plants, as did an unplanned outage. Transmission congestion from West Texas also negatively impacted its wind PPAs. Direct said it plans to pursue continued vertical integration by growing its North American upstream and wholesale assets.

As first reported by Matters yesterday (Matters, 2/26/09), Chris Weston, Managing Director at British Gas Services, has been tapped to replace the retiring Deryk King as President and CEO of Direct Energy. Weston joined Centrica when it acquired the since-divested telecomm provider Onetel in 2001, where Weston was managing director. Weston has a PhD in Quantitative Finance, and previously held positions at Cable & Wireless Communications.

Consolidated profits at Direct for the full year 2008 grew 3% to $383 million.

REP Certification *... from 1:*

fail. Such an arrangement allows the guarantor to provide continuous service to customers in place of the REP if the REP fails, not only preventing a POLR transition, but preserving the customer's original bargain or fixed-price contract. Such lockbox or bankruptcy remote arrangements with creditors is why some REPs seek multiple certificates from the Commission, so the separate customer books can be preserved by different creditors if the need arises.

In terms of proposed quarterly financial reporting requirements, Smitherman again stressed that a cost should not be imposed on the REP if the Commission is not going to be able to review all the reports, or, even if reviewing them all, unable to act on anything that makes the Commission "nervous" -- such as a alarming financial condition that might not yet rise to a level of a rules/certification violation. Thus, the reporting requirement may ultimately rest on whether legislators increase PUCT staffing levels and expand its oversight authority.

Anderson also noted in the commodities business, the value of monthly reporting is diminished, since companies can get upside down in just a matter of days.

Smitherman suggested the Commission should work towards receiving audited REP financials once a year, with continued consideration of more extensive filing requirements. Reporting requirements will ultimately depend on what type of financial requirements are needed for certification, whether cash or a letter of credit is needed, Smitherman noted.

Anderson said he would take the lead on the certification rulemaking and present some alternate language in the near future.