Energy Choice Matters

March 3, 2009

Reliant Selling Texas Retail Unit to NRG, Seeking Buyer for Remaining Illinois Book

Reliant Energy announced yesterday it is selling its Texas retail business to NRG Energy for $287.5 million in cash plus working capital. As of December 31, 2008, working capital was approximately $111 million.

NRG will acquire the Reliant brand name. Reliant's fleet of 14,000 MW of generation, mostly in PJM, will assume a new name upon closing, undetermined as of yet.

The sale leaves only a relatively small Illinois non-residential book as the remaining Reliant retail assets. Reliant says it is actively seeking to sell the Illinois business.

The sale comes as Reliant posted a loss from continuing operations before income taxes for 2008 of $873 million, and shareholders questioned the ongoing value of the retail business. With a concentration of former incumbent load in the Houston zone, Reliant was particularly hit by the ERCOT congestion during the spring and early summer, and then Hurricane Ike.

Reliant's strategy of expanding into the Northeast large C&I markets was cut short by the loss of cheap credit, and it had previously sold its Northeast book to Hess. With the Texas sale, Reliant will eliminate $2 billion in collateral requirements under its credit sleeve with Merrill Lynch. The closing of the NRG sale, which is expected to occur in the second quarter of 2009, will also

Continued Page 4

O'Malley Proposes "Rational" Re-regulation for Maryland

Maryland Governor Martin O'Malley has introduced legislation to apply "rational" re-regulation of the state's energy markets, but thus far, many of the provisions appear to simply codify authority the PSC claims to already have, although the Commission would receive added authority to direct new development at current generation sites.

Legislation would allow the PSC to determine when to build new power plants, when it is in the interest of customers to do so. "Today, we announce that the days of blind faith in broken, deregulated markets are over in Maryland," O'Malley said, as new build decisions will no longer be made based on the private economic interests of energy suppliers. The Commission would have authority to adopt cost-based, rate of return regulation for such new capacity.

The PSC has asserted it already has authority to require IOUs to build, own and operate plants under cost-of-service regulation or to issue competitive solicitations for new plants, but recommended in a final report on re-regulation to the Legislature that it be given additional flexibility on such arrangements (Matters, 12/12/09). The PSC had already said it intended to initiate an investigation this year to determine whether, and on what terms, it should build additional generation for economic reasons.

The legislation, however, would broaden such authority to allow the PSC to direct owners of current generation assets or other brownfield sites to build (or have another party build) new generation at those locations when it is in the public interest, and the Commission determines that

Continued Page 6

Capacity Charges Weigh Pepco Energy Services 4Q Results

Pepco Energy Services fourth quarter operating income declined versus the year-ago period on capacity charges related to the unit's generation, as well as higher operation expenses. Operating income at Pepco Energy Services was $14 million for the three months ending December 31, 2008, versus $24 million a year ago.

Gross margin for the quarter fell to $43 million from $47 million a year ago on the capacity charges. Retail electric sales were flat at 4,900 GWh.

On an annual basis, net income for Pepco Energy Services was flat at $39 million versus $38 million a year ago. The modest gain in yearly results was primarily due to higher volumes in the retail gas supply business. Pepco Energy Services' retail electric load served at Dec. 31, 2008 was 4,388 MW, compared to 4,294 MW at Dec. 31, 2007.

Wholesaler Conectiv Energy's operating income for the fourth quarter fell to $3 million from $32 million a year ago, on lower generation output and lower spark spreads, as well as a lower-of-cost-or-market adjustment to oil inventory. Gross margin was down at $54 million from $76 million in the year-ago quarter, reflecting lower results from the merchant generation and load service category. Merchant generation and load service, which includes supplying load following SOS contracts, posted gross margins of $41 million in the fourth quarter, versus $66 million a year ago.

For the year, Conectiv Energy net income was up at $122 million from $73 million a year ago, as it took advantage of price volatility given its units' operating flexibility and dual-fuel capability, and firm natural gas transportation and storage positions. Higher capacity prices and mark-to-market gains related to economic fuel and power hedges also contributed to the increase in earnings.

On a consolidated basis, Pepco Holdings posted 2008 earnings of $300 million, down from $334 million a year ago.

Calif PUC to Wait Until At Least 2010 on Next Phase of Direct Access Investigation

Phase II(b) of the California PUC's investigation into lifting the suspension on direct access would begin immediately after the conclusion of Phase II(a)(2), if Phase II(a) 2 concludes by January 1, 2010 as targeted, PUC President Michael Peevey ordered in a scoping ruling (R. 07-05-025).

Phase II(a)(2) involves extricating the Department of Water Resources from its supply role through contract assignment or novation. Phase II(b) is to address the public policy merits of lifting the Direct Access suspension, including the applicable wholesale market structure and regulatory prerequisites for lifting the suspension.

Phase II(b) will be conducted "expeditiously," Peevey said. Furthermore, it is currently anticipated that, in any event, both Phase II(b) and Phase III will conclude no later than 18 months from the date of Peevey's ruling -- that is, by September 1, 2010. Phase III is to examine rules governing a reinstituted direct access market (e.g., entry/exit/switching; default arrangements, and cost recovery issues). Exact dates for Phases II(b) and III will be set in a future ruling.

AmerenCILCO Seeks to Assign Cogen Obligations to Affiliate

AmerenCILCO has applied at the Illinois Commerce Commission to transfer obligations from agreements with Caterpillar and Medina Valley Cogen relating to Medina's cogeneration facility to affiliate Ameren Energy Marketing, in a move that will place AmerenCILCO solely in the role of a default service company, by shedding obligations to a customer and affiliate that may be inconsistent with that role.

Medina is a subsidiary of Ameren Energy Resources Company, and runs a 40 MW cogen facility providing service to various Caterpillar facilities. Currently, AmerenCILCO has a service agreement with Medina that obligates it to provide maintenance and other services to the cogen facility. AmerenCILCO also has a tolling agreement with Medina, and pays for its cost for supply and transportation of natural gas.

Effective January 1, AmerenCILCO assigned all these agreements to Ameren Energy Marketing so that it could cease all remaining power supply functions and related obligations. Given Illinois' restructured market, it is no longer in the customer interest for AmerenCILCO to be the intermediary for an unregulated retail contract for electric supply, the utility said. Customers currently bear the risk of the supply arrangement, which in 2008 produced a net loss to customers, AmerenCILCO said.

CenterPoint To Host April AMS Workshop

CenterPoint Energy will host an Advanced Metering System Educational Workshop in April for REPs, as it confirmed in a market notice it will begin smart meter deployment this month, as previously reported.

The advanced meters will reduce time for service connections starting in September 2009, for meters that will allow remote connect and disconnect of electric service. Most residential meters will allow connect and disconnect of electric service, though only meters with 200 amp service or less have the remote capability, and there are some residential services with higher amperage service. No commercial services will have this capability. CenterPoint will be able to support prepaid service by September 2009 for customers with advanced meters with such remote connect/disconnect capability.

As smart meters are deployed, REPs will receive various transactions during and after meter deployment, including:

- 814_20 (Maintain): TxSET Transaction will be sent when a meter has been changed. This transaction will include the new meter number.

- 867_03 (Usage): TxSET Transaction will be sent on next scheduled meter read date. This transaction will include the final reading from the old meter and the new reading from the new meter.

Once ERCOT's enhanced systems are ready for the Interim Settlement Solution, a final 814_20 (Maintain) TxSET Transaction will be sent specifying a Load Profile Change allowing the market to identify the advanced meters. This will indicate that the meter has actually been "provisioned" and is available for the functionality required by the market at that time. Full functionality will not be available until the Texas Common Portal has been developed.

Briefly:

MISO Files Tariff Changes to Disclose More Info on Defaults

The Midwest ISO has applied at FERC to revise its tariff so that in the notice to market participants regarding the default of a MISO market participant, the MISO will disclose the identity of the defaulting party, the amount and type of the default, and any additional available information that is deemed relevant. The clarification is necessary to allow affected market participants to assess potential liabilities and the effect of the default on the Midwest ISO's Energy and Operating Reserve Markets, as well as to provide guidance to the MISO on what details of the default may be disclosed, MISO said. Due to a FERC decision on Revenue Sufficiency Guarantee (RSG) cost allocation, MISO has already experienced multiple defaults recently by financial marketers, and said it expects to encounter ongoing defaults by other market participants, especially as a result of the Midwest ISO's resettlement of RSG charges scheduled to begin on March 10, 2009. Market participants have asked MISO to make more information regarding potential liabilities from default public, but MISO's tariff is currently silent on what information can be released at the time of default.

Ohio to Investigate RTO Participation

PUCO has opened a docket (09-0090-EL-COI) for an investigation into the value of continued participation in RTOs.

Suez Marketer Names New CEO

Suez Energy Resources NA has named Robert Wilson as its new president and CEO. Wilson has been with GDF Suez for 12 years, most recently as senior vice president of strategy, risk and portfolio management, and senior vice president of business development for GDF Suez Energy North America.

CNE Confirms Harm from Delayed AEP Ohio ILR Certifications

AEP's Ohio utilities have refused to verify the demands of several standard service offer customers seeking to enroll in PJM's Interruptible Load for Reliability Program, Constellation NewEnergy confirmed in a PUCO filing. CNE was supporting a motion for AEP to cease and desist such delays filed by Integrys Energy Services (Only in Matters, 2/27/09). CNE acts as a curtailment service provider for the following customers, who have been affected by AEP's refusal to verify demands: Airgas Merchant Gases, LLC; Amsted Rail Company, Inc.; Cox Enterprises, Inc.; Gander Mountain Company; Hanson Aggregates Davon LLC; TJX Companies, Inc.; and Staples, Inc. CNE said it has additional customers affected by the delay that it could not publicly disclose.

Total Gas & Power to Supply Duke PIPP Customers

Duke Energy Ohio applied at PUCO to enter into an agreement with Total Gas & Power North America to provide competitive natural gas to Percentage of Income Payment Plan customers. Duke received two bids for the one-year contract starting in April: one from BP Energy Company with a Supplier Bid Credit of -$0.013/Dkt, and the other from Total Gas & Power North America with a Supplier Bid Credit of -$0.0151/Dkt.

Edison Mission Results Down in Q4

Edison Mission Group reported lower fourth quarter earnings of $81 million versus $99 million a year ago due to a loss arising from the termination of a natural gas turbine supply agreement, lower results from the Big 4 projects, lower interest income, and lower trading income at Edison Mission Marketing & Trading. These factors were partially offset by higher operating income at Midwest Generation, positive results from new wind projects in operation, and lower corporate expenses. Earnings for the full year 2008 for Edison Mission Group were up at $561 million versus $412 million a year ago on higher operating income at Midwest Generation, positive results from new wind projects in operation, and higher trading income. Parent Edison International posted higher yearly net income of $1.2 billion versus $1.1 billion a year ago.

PJM Files to Pay Regulation Providers More Opportunity Costs

PJM submitted tariff revisions at FERC to change how the Regulation market clearing price, and the credit to a Generation Market Buyer providing Regulation, are determined, to allow for recovery of lost opportunity costs in the shoulder hours immediately preceding and proceeding the hours the unit provides Regulation service (so-called regulating hours). PJM also proposed to add a reasonable tolerance around a generation resource's Regulation Set Point to ensure owners are made whole even if the unit does not operate exactly as requested.

NYISO Affirms Reliability Outlook

The New York ISO released its Power Trends report for 2009, which, among other things, repackaged its finding from the January Reliability Needs Assessment that New York’s bulk electric power system will continue to meet accepted federal and state reliability standards through 2018 (Matters, 1/13/09).

***Reliant** ... from 1:*

resolve the litigation regarding Reliant’s credit arrangements with Merrill Lynch.

NRG negotiated a transitional credit sleeve facility with Merrill Lynch under which NRG will inject $200 million of cash into the retail entity. The credit sleeve will provide collateral support at the retail enterprise for up to 18 months while an orderly transition to NRG supplying the retail entity’s power requirements occurs, with limited ongoing collateral requirements.

"Matching NRG's generation with Reliant's retail load reduces the need for third party power contracts and collateral support for the retail business," noted Robert Flexon, NRG Chief Financial Officer. "Merrill Lynch's credit support allows this transformation to happen in a structured and rational way."

NRG said backing Reliant's load-serving requirements with NRG's 11,000 MW of ERCOT generation significantly reduces the need to sell and buy power from the remaining financial institutions and other intermediaries that trade in the ERCOT market, which will result in reduced transaction costs and credit exposures.

In addition to avoiding transaction costs, Reliant has said the bulk of its customers in its incumbent Houston territory earn higher margins than those acquired in competitive territories, creating an opportunity for higher margins than NRG could obtain for its generation at wholesale.

The sale would also be something of a re-integration, as NRG controls much of the former Houston Lighting and Power generation assets after acquiring Texas Genco.

Reliant Energy's 1.75 million customers in Texas will continue to be served under their existing contracts. As of December 31, Reliant said it had 1.5 million residential and 150,000 small business customers in Texas. About 65% of customers are in the Houston region.

Reliant said that as of February 13, the company had available liquidity of $2.0 billion, comprised of $1.5 billion in cash and $0.5 billion of unused credit facilities capacity. On a pro-forma basis, gross debt is expected to be approximately $3 billion.

NRG currently holds an Option 2 REP certificate in ERCOT, to serve its own facilities. Exelon, which is currently pursuing NRG in a hostile bid, said greater due diligence is required so it can evaluate NRG's acquisition of the retail unit on its takeover attempt.

Reliant employees who primarily support the retail business will be transferred to NRG. As of December 31, Reliant reported about 1,200 employees on the retail side.

Reliant Earnings

Reliant's retail unit, weighed by the impacts of ERCOT congestion and Hurricane Ike, posted contribution margin (an adjusted metric excluding unrealized effects from hedging) of negative $7 million for the year 2008, versus positive margin of $504 million a year ago. Retail contribution margin when including unrealized losses from hedging was negative $789 million for the year, a $1.7 billion reversal from positive $942 million a year ago.

Though down from the year-ago period, Reliant's retail business did improve in the fourth quarter versus the summer. Retail contribution margin for the fourth quarter was $67 million, down from $104 million a year ago, but reflecting recovered margins versus the third quarter.

Reliant COO Brian Landrum reported a change in the competitive dynamic in ERCOT, as the higher cost of capital, tighter credit, and greater supply risk increased the cost of doing business substantially. Retail gross margins rose accordingly to compensate for the increased costs and risks, Landrum said.

Indeed, Reliant's fourth quarter gross margin from mass market sales was $32.54/MWh, up over the year-ago gross margin of $25.58/MWh. However, gross margin for large C&I sales fell to $4.12/MWh from $7.23/MWh a year ago, producing consolidated retail gross margin for the quarter of $172 million versus $204 million a year ago.

On a yearly basis, retail gross margin was down at $451 million versus $952 million a year ago. For the year, mass market gross margins shrunk to $14.59/MWh from $27.29/MWh a year ago, while large C&I gross margins were down at $2.45/MWh versus $5.86/MWh in the year 2007.

At its wholesale unit, Reliant's fourth quarter results were hurt by lower margins and decreased generation. Open energy unit margin was down at $16.30/MWh from $29.74/MWh in the year-ago quarter. Open wholesale contribution margin fell to $79 million from $139 million a year ago. For the year 2008, wholesale results were up, with open wholesale contribution margin rising to $655 million from $617 million a year ago.

On a consolidated basis, Reliant posted a fourth quarter pre-tax loss from continuing operations of $455 million, versus earnings of $313 million a year ago. For the year, the pre-tax loss from continuing operations was $873 million, versus income of $493 million a year ago.

Reliant Customer Data

	December 31, 2008	December 31, 2007
	(In thousands, metered locations)	
Retail Customers:		
Mass:		
Residential:		
Houston	975	1,016
Non-Houston	543	555
Small Business:		
Houston	107	109
Non-Houston	43	38
Total Mass	1,668	1,718
C&I[1]	86	93
Total	1,754	1,811

(1) Includes customers of the Texas General Land Office for which Reliant provides services.

Maryland ... from 1:

an energy company is not developing a generating site due to private economic interests. O'Malley alleged that, despite the "urgent" need for new generation, some energy companies are not building new plants, even when they have land on which to build. The legislation would grant the PSC the authority to direct the development of a plant on those sites when it is in the public interest to do so, using eminent domain and other authority.

So-called prospective re-regulation is needed to provide greater price predictability for consumers, and more certain guarantees of adequate supply, O'Malley said.

O'Malley noted that the "prohibitive cost and risk" to taxpayers rules out a return to full, retrospective re-regulation, such as through re-purchase of former utility plants. Such retrospective re-regulation would wipe out $1.5 billion in benefits from a settlement with Constellation Energy since ratepayers would re-assume decommissioning costs. Returning current merchant plants to regulation could also jeopardize the development of Calvert Cliffs 3 and the thousands of jobs it will create, the Governor said.

It should be noted that much of the talking points surrounding the Governor's plan centered on the need for the PSC-directed generation in order to combat potential reliability shortfalls that could be seen as early as 2011. However, several stakeholders, including the Maryland Office of People's Counsel, have noted that the economic slowdown and attendant lower demand have alleviated such needs, so much so that numerous parties are advocating that the PSC should not direct utilities to procure demand response contracts via previously approved RFPs (Matters, 2/20/09).

Constellation Energy Group CEO May Shattuck noted the Governor’s approach differs greatly from the other proposed legislation. Shattuck said the other proposals, which include buying former utility plants, "are unworkable attempts to reach into the past, change the regulatory assumptions surrounding existing ownership of power plants and would lead to further destabilization of the Maryland energy markets."