

Energy Choice

Matters

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Consensus Builds Around \$500K Liquid Capital Requirement for REPs

PUCT Commissioners are coming to consensus around the major points of new REP certification rules, including a revised proposal that would require all REPs to maintain \$500,000 in liquid capital (35767, Matters, 2/27/09).

At yesterday's open meeting, Commissioners generally agreed on using the \$500,000 figure going forward absent information that would sway their views in a final decision. Commissioners said that the definition of liquid capital should be fairly broad, and should include cash, cash equivalents, credit facilities, credit provided by a wholesale power provider or QSE, cash in a lockbox with a credit provider, or use of a letter of credit.

Under the Commissioners' latest thoughts, all REPs, including current certificate holders, would be subject to the \$500,000 requirement, though they would be given a "generous" time period for compliance, perhaps 12 months. REPs with investment grade credit ratings or tangible net worth of \$100 million would not have to carry the \$500,000 in liquid capital.

Additionally, new applicants would be required to possess minimum shareholder equity of \$1 million to receive a REP certificate. Under a proposal from Commissioner Kenneth Anderson, the equity could not be reduced during a specified time frame, perhaps two years, to prevent REPs from receiving their certificate then immediately issuing distributions or dividends.

Existing REPs that have served load as of some yet undetermined date (perhaps Jan. 1, 2009, or an earlier date when the proposal was first published) would be grandfathered from the \$1

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PJM Net Revenues Fail to Cover New Entrant Fixed Costs in Most Zones

Despite persistent structural market power issues, PJM's capacity market was found to be competitive by the Market Monitoring Unit (MMU) in 2008, as the capacity market (combined with other revenue streams) failed to produce revenue adequacy to cover the fixed costs of new entrants in all but a few zones.

The MMU concluded that the Energy, Capacity, Synchronized Reserve, Day Ahead Scheduling Reserve, and Financial Transmission Right Auction markets were competitive, as reported in the 2008 state of the market report. The MMU could not determine whether the Regulation Market results were competitive or noncompetitive.

Consistent with prior reports, market power remains a "serious concern" in the capacity market based on the structure of the market, including high levels of supplier concentration, frequent occurrences of pivotal suppliers, and extreme inelasticity of demand. Furthermore, the relatively small number of nonaffiliated LSEs and supplier knowledge of aggregate market demand makes the potential for the exercise of market power high. Due to the very design of the RPM market, "[m]arket power is and will remain endemic to the existing structure of the PJM Capacity Market," the MMU said.

"The Capacity Market is unlikely ever to approach the economist's view of a competitive

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DPUC Says Aggregators May Not Act as Supplier's Agent

Electric aggregators in Connecticut must act as the customer's agent, due to the statutory requirement that aggregators pool customers for purposes of, "negotiating the purchase of electric generation services from an electric supplier," the DPUC said in comments following a technical meeting on the relationship between Levco Tech and Dominion Retail (Matters, 12/4/08).

As customers' agents, aggregators may not simultaneously be agents or representatives for electric suppliers, the DPUC said. Accordingly, the DPUC said that a supplier is not permitted to use any registered or licensed electric aggregators to represent it or market on its behalf on any matters; and an aggregator is not permitted to market or represent any electric supplier in any capacity.

The DPUC directed Levco to inform the Department whether it wishes to remain a registered electric aggregator. Although Levco may select one electric supplier to serve Levco's customers for a specified period of time, Levco must structure its aggregation program such that it is very clear to customers that Levco may designate or choose another supplier to serve Levco's aggregated customers at a certain time in the future, and that Levco is not any one supplier's agent, the DPUC said.

The Department noted that if Levco wishes to continue to act as a supplier's agent or broker, it is free to do so, and such actions do not require a license from the DPUC. However, such actions would require Levco to rescind its aggregator registration, the DPUC said.

Entergy Transition to Competition Plan Delayed for Months

A revised ERCOT study on integrating the Entergy Texas area into ERCOT won't be available for several months after ERCOT discovered data related to reliability contingencies was incomplete due to Entergy providing data in accordance with a NERC

standard rather than a more rigorous ERCOT standard for contingencies.

The error came to light while reviewing another contingency inconsistency that required ERCOT to revise its study (Matters, 2/27/09).

The delay will push back Entergy's revised transition to competition plan for months, probably until after the legislative session ends. Entergy's status has attracted considerable interest from lawmakers. Chairman Barry Smitherman noted Entergy's original transition to competition plan remains before the Commission, and put parties on notice that the Commission may elect to visit the issue before Entergy files a new plan.

The uncertainty about its future is impeding Entergy's ability to make investment decisions on generation and transmission, Smitherman noted, since Entergy faces an uncertain industry structure. Furthermore, the open transition to competition docket prevents Commissioners from speaking substantively with parties about the issues due to ex parte rules.

Commissioner Donna Nelson expects that the legislature will likely answer the question of Entergy's future before the session ends.

Smitherman noted, as the Commission approved an Entergy rate increase, that the average residential rate at Entergy will now be about 13.2¢/kWh, while a 12-month product in Houston is 11.2¢, and 10.5¢ in Dallas.

Ohio Industrials Object to Ormet Reasonable Arrangement

Ohio industrials balked at a proposed reasonable arrangement between Ormet Primary Aluminum and the AEP utilities because, among other reasons, the arrangement contains no price floor, and could result in Ormet not even paying the variable costs of its generation service.

For most of the duration of the reasonable arrangement, the generation price would be tied to London Metal Exchange price for aluminum. Ormet would be permitted to set a target price of aluminum, based upon its determination of a price needed to sustain its Ohio operations. If the price of aluminum is

lower than its target price, Ormet would receive discounted electricity. If the price of aluminum is higher than the target price, Ormet would pay a premium; however, the premium would be capped at 5% above AEP tariffed rates. Other AEP customers would have to fund any under-recovery resulting from below-tariff rates.

The Ohio Energy Group called Ormet's ability to set the target price, "an abdication of the ratemaking function to itself."

Furthermore, the proposed pricing formula could, under some circumstances, produce a very low price or even a zero price for electricity, Industrial Energy Users-Ohio noted. Thus, the proposed arrangement may result in a price that is less than the variable cost of production.

"This means that Ormet proposes that other residential, commercial and industrial customers may be required to pay for the fuel, environmental (emission allowance costs for SO₂, NO_X and very likely in the near future CO₂) and other out-of-pocket variable costs to serve its 540 MW load over the period 2010-2018. We are aware of no power contract anywhere in the United States where the consumer did not have to pay at least for the out-of-pocket variable costs to serve its load," the Ohio Energy Group added.

IEU-Ohio also noted that the proposed arrangement seems to relieve Ormet of any obligation to provide a deposit, which effectively places other AEP customers as involuntary financial guarantors for Ormet.

IEU-Ohio added that similar electricity pricing arrangements in other states tied to the price of aluminum have failed to result in the continued viability of smelters, while OEG estimated that the subsidy to Ormet for 2010 under the arrangement would be \$89,679 per Ohio job, or more than more than the value of the jobs.

Briefly:

FERC Rejects MBR Application of Discount Power

FERC has rejected without prejudice the application of Connecticut retail provider

Discount Power for market-based rates, based on deficiencies in the MBR application (ER09-438). Discount Power was recently licensed by the DPUC, and intends to focus on serving the retail mass market (Matters, 9/19/08). FERC said Discount Power's MBR application failed to provide a description of Discount Power and any affiliates as well as the business activities of any owner; failed to affirmatively state that Discount Power has not erected barriers to entry and will not erect barriers to entry in the future; and failed to properly identify its category status.

TAC Vote to Reject New CREs Fails

A vote at TAC to reject ERCOT's two new North-to-Houston Closely Related Elements (CREs) failed to receive a needed supermajority for passage by a single vote (Matters, 3/10/09). Under ERCOT rules, the failed TAC vote constitutes a failure to act within a specified deadline, and by rule ERCOT will automatically implement the two CREs (the Peters-Flewellen 138kV and Hockley-Tomball 138kV lines).

Nelson to Lead Drafting of POLR Rules

Commissioner Donna Nelson volunteered to take the lead on pushing the PUCT's new POLR rules over the finish line, though Commissioners expect a final rule won't be ready for the next open meeting (Matters, 2/27/09). During yesterday's open meeting, Nelson again expressed her reluctance to tell REPs in a competitive market how to price their products, which is what the Commission would be doing if it instituted a new "mandatory" POLR category that would require all eligible REPs to assume up to 1% of their customer base during a mass transition, and to serve such customers at a monthly competitive rate. Nelson worried that REPs would be forced to hedge supplies for the possibility of acquiring such customers, raising the price on all customers, despite the possibility that the REP may never be called upon as a POLR.

PUCT Approves 15.5% LIDA Discount

The PUCT approved Staff's recommended low-income residential summer discount of

15.5% (Matters, 3/6/09). At the current average POLR rate of \$0.191/kWh, the discount would equal \$0.0296/kWh. Noting that the discount is based off higher POLR rates, Commissioner Donna Nelson said the discount will go a lot further on the currently low rates in the market, and said customers on the LIDA program should be encouraged to switch due to the recent price decreases. Staff said it will be developing radio ads on the low-income program and said it would incorporate a message about choice as part of the spots.

PUCT Approves Reliant Energy Trade Name Change

The PUCT approved Reliant Energy Retail Services' application to add the trade name Reliant Energy Solutions to its REP certificate #10007. Reliant Energy Solutions has applied to relinquish its current REP certificate (#10006), and intends to serve customers under the same name under certificate #10007 (Matters, 2/16/09).

Curtailment Service Providers Withdraw Motion Against AEP-Ohio

Integrus Energy Services and Constellation NewEnergy withdrew their motions at PUCO for a cease and desist order regarding the AEP utilities' treatment of customers applying to participate in PJM's Interruptible Load for Reliability program, stating PJM is overriding AEP's denial of the end user registrations, making the motions moot (Matters, 3/4/09). With two exceptions, all of the applications for the 2009-2010 ILR program filed by Integrus and Constellation for customers in the AEP Ohio service areas have been certified. The two outstanding applications involve a dispute regarding the end user's curtailment service provider. Integrus and Constellation said AEP-Ohio has taken the position that if an interruptible retail customer is permitted in the ILR program, then AEP-Ohio must be the curtailment service provider for the interruptible portion of the committed load. That issue is currently being resolved at PJM.

South Jersey Energy Wins Contract for 400 School Districts

South Jersey Energy was selected by the Alliance for Competitive Energy Services, the school district buying cooperative sponsored by the New Jersey School Boards Association, for a two-year electricity contract covering some 400 school districts and a total of 2.5 million megawatt-hours. According to South Jersey Energy, the contract is priced \$36 million lower than the applicable default service rates.

SDG&E Seeks Approval of 15-Year Contract with EnerNOC

San Diego Gas and Electric applied at the California PUC for approval of a 15-year demand response contract with EnerNOC, covering up to 40 MW. EnerNOC was one of two top bidders in a competitive solicitation, and SDG&E said negotiations continue with the other top bidder. Under the contract, EnerNOC would provide up to 25 MW of dispatchable load reduction during the 2010 capacity delivery season, which will increase to 35 MW during the 2011 capacity delivery season and finally to 40 MW starting with the 2012 season and every year thereafter.

Harvill Joins ITC

Former Illinois Commerce Commissioner Terry Harvill, most recently of Constellation Energy, has been named vice president of energy policy at ITC Holdings Corp.

Md. PSC Orders Disconnect Moratorium

The Maryland PSC yesterday ordered a moratorium on electric and gas disconnections due to increased levels of arrears as well as customer complaints about abnormally high bills, until further notice. A working group is to determine the specifics of the moratorium and associated payment plans to be made available to all residential customers, subject to Commission approval (Case 9175).

REP Certification ... from 1:

million in shareholder equity requirement, although they would still be subject to the \$500,000 in liquid capital requirement.

Commissioner Donna Nelson said such grandfathering is appropriate because imposing the shareholder equity test on existing REPs could force companies out of business simply due to PUCT rule changes, not because they've run their business poorly. Given that the smaller players in any industry tend to offer the cheapest prices, Nelson cautioned against any action that would force smaller REPs out of the market. Grandfathering existing REPs from the \$500,000 liquid capital requirement would be less appropriate, Commissioners said, since the requirement would be ongoing, as opposed to the equity test tied directly to the market entry process.

At the same time, Commissioners said that REPs that have merely been certified to sell the certificate to another entity should not be grandfathered from the \$1 million requirement, since a change in ownership would occur. However, Chairman Barry Smitherman noted that while such REPs that merely "warehouse" certificates to later be flipped should not be grandfathered, the provision also must be squared with his view that PURA does not permit the Commission to review the transfer of REP certificates.

Smitherman also said REPs should not be required to use escrow accounts to protect deposits, instead allowing REPs to create accounts that would prevent the REPs from drawing upon the accounts without PUCT approval in cases of default. Commissioners further agreed that the priority of proceeds from any letter of credit or liquid capital should be rearranged so that payments to ERCOT or TDUs come before Commission penalties, to avoid market uplifts to the extent possible.

REPs would be required to report financials at six month intervals. Commissioners debated how to deal with the mark-to-market requirement under GAAP, which can either inflate or deflate a REP's worth. Commissioners don't want to consider

unrealized gains/losses related to legitimate hedging in determining a REP's worth, but also think the effects of derivative accounting should be considered if the positions were taken for speculative purposes. Commissioners also debated requiring REPs to report their balancing energy market exposure, since REPs' open position is considered a leading indicator of viability.

Nelson recommended removing language in the rule which states a REP cannot own generation, since the language is already explicit in PURA.

Smitherman, noting he is getting tired of working on the rule, encouraged parties to resolve their lingering concerns and come to a consensus on rules, or the Commission may conclude it can't fix the rules and would let the legislature and State Affairs Committee Chair Burt Solomons take the lead.

Smitherman hopes to vote on a final proposal for adoption at the next open meeting. Anderson will continue to take the lead on drafting language and meeting with stakeholders.

PJM ... from 1:

market structure in the absence of a substantial and unlikely structural change that results in much more diversity of ownership," the MMU added.

Nonetheless, the MMU said the RPM market allows competitive prices to reflect local scarcity without relying on the exercise of market power, and RPM explicitly limits the exercise of market power via the application of the three pivotal supplier test. The MMU found no exercise of market power in RPM during 2008.

According to the MMU, RPM rules could be improved by ensuring:

- That capacity payments are made only to units that perform;
- That the must-offer requirement does not permit either physical or economic withholding;
- That the requirement for capacity resources to make offers in the Day-Ahead Energy Market explicitly requires competitive offers, and

- That locational price separation is determined by market fundamentals rather than by rule.

Net Revenue

No PJM zone produced net revenue to a new entrant combustion turbine to cover 20-year levelized fixed costs in 2008, though revenues were up versus 2007 due to increased capacity revenue. The fixed costs of constructing a combustion turbine were 99% covered by net revenues in the Atlantic Electric Company (AECO) and Pepco control zones and 93% covered in the Baltimore Gas and Electric zone. On a PJM wide basis, net revenue to a new combustion turbine was only 41% of fixed costs.

Several congested eastern zones produced net revenue adequate for a new entrant combined cycle plant, while western zones did not, reflecting surplus generation in the west. The AECO, BGE, Delmarva Power and Light (DPL), JCPL Pepco, PSEG and Rockland Electric (RECO) zones all produced adequate or excess net revenue for the reference combined cycle plant, while the Dominion and PECO zones produced net revenue above 90% of fixed costs. On a PJM wide basis, net revenue to a new entrant combined cycle plant was 61%.

There were no PJM zones with revenue adequacy for a new reference coal plant, due to increased fuel costs. On a 10-year average basis, several eastern zones provided adequate or near-adequate net revenue for the reference coal plant. The PJM wide net revenue to a new reference coal plant was 44% for the year 2008.

For those zones producing net revenue adequacy, the MMU noted that such adequacy was the result of capacity market revenues, as energy market net revenues alone are insufficient to recover capital costs in any control zone.

The MMU noted that there have been some units in PJM, which are needed for reliability, with revenues less than annual going-forward costs. If such results persist, it is a signal to retire, the MMU noted. "This suggests that market price signals and reliability needs have not been fully

synchronized," the MMU concluded.

Observations and Recommendations

In the Regulation Market, the MMU found structural market power in 82% of the hours for 2008. As noted above, the MMU could not conclude that the Regulation Market produced competitive results or noncompetitive results, based on the MMU analysis of the relationship between the offer prices and marginal costs of the marginal units, where the MMU found that prices were set by offers above the competitive level in 18% of the hours. The absence of a definitive conclusion results from the fact that the cost data is based on MMU estimates rather than data submitted by market participants, the MMU said. The MMU expects that the application of the three pivotal supplier test to the Regulation Market, which started in December, will mean that the results of the Regulation Market will be competitive in 2009.

Among other recommendations from the MMU is that the current single scarcity price signal should be replaced by locational signals. Locational scarcity signals could be implemented via reserve requirements modeled as constraints for scarcity regions, with administrative scarcity penalty factors, in the security constrained dispatch. Market rules must be designed to ensure that scarcity revenues directly offset RPM revenues to prevent double collection of scarcity revenues, the MMU said. The \$1,000 energy market offer caps should remain.

The MMU recommended continued efforts to ensure that market power is not exercised on the demand side of the market, particularly via gaming of the measurement and verification process. There are "significant issues" with the current approach to measuring demand-side response megawatts, the MMU said, even with recent improvements. The principal barrier to the further development of demand-side response is in the interface between wholesale and retail markets, the MMU said.

PJM and the New York ISO should develop market-based congestion management protocols, modeled on the PJM and Midwest ISO joint operating agreement,

"as soon as practicable," the MMU said, which also recommended better coordination with other external areas as well.

Offer-capping levels remained lower in 2008. Day-Ahead Energy Market offer-capped unit hours were 0.2% in 2008, the same level as 2007. In the Real-Time Energy Market, offer-capped unit hours fell from 1.1% in 2007 to 1.0% in 2008.

The level of energy markup in 2008 indicates that prices in PJM are set, on average, by marginal units operating at or close to their marginal costs, the MMU concluded. The markup component of the overall system load-weighted, average LMP was \$2.04 per MWh, or 3%. The markup was \$3.27 per MWh during peak hours and \$0.74 per MWh during off-peak hours. "This is strong evidence of competitive behavior and competitive market performance," the MMU said.

PJM Real-Time Energy Market prices rose in 2008 over 2007. The load-weighted LMP was 15.4% higher in 2008 than in 2007, at \$71.13 per MWh versus \$61.66 per MWh. The fuel-cost-adjusted, load-weighted, average LMP was 16.0% lower in 2008 than in 2007, at \$51.79 per MWh compared to \$61.66 per MWh.

Bilateral contracting fell marginally in 2008. In 2008, 14.6% of real-time load was supplied by bilateral contracts, 20.1% by spot market purchases and 65.2% by self-supply. Compared with 2007, reliance on bilateral contracts decreased by 2.0 percentage points; reliance on spot supply increased by 4.2 percentage points; and reliance on self-supply decreased by 2.3 percentage points in 2008.