Energy Choice Matters

March 26, 2009

PUCT Staff Files Proposal for $500K Letter of Credit for Ongoing REP Certification

Non-investment grade REPs would be required to demonstrate shareholder's equity of not less than $1 million to obtain a REP certificate, while maintaining an irrevocable stand-by letter of credit of $500,000 to maintain certification, under the latest draft certification rules developed by PUCT Staff (35767, Matters, 3/12/09).

A REP that began serving load on or before January 1, 2009, would not be required to demonstrate the required shareholder's equity. The $500,000 letter of credit could be provided by the REP's guarantor as well.

From the time of certification until two years after the REP commences serving load, a REP would not be permitted to make any distribution or other payment to any shareholders or affiliates if such payment would decrease the REP's shareholder's equity to less than $1 million, net of collateral pledges to secure the irrevocable stand-by letter of credit of $500,000. The restriction on distributions or other payments would include dividend distributions, redemptions and repurchases of equity securities, or loans to shareholders or affiliates.

REPs could also meet certification financial requirements via an investment grade credit rating; or tangible net worth of at least $100 million, a minimum current ratio (current assets divided by current liabilities) of 1.0, and a debt to total capitalization ratio not greater than 0.60. Calculations would exclude unrealized gains and losses resulting from valuing to market the power contracts and financial instruments used as supply hedges to serve load, where such calculations are supported by an affidavit from an officer of the REP attesting to the accuracy of

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PUCO Approves FirstEnergy ESP Settlement, Lack of Load Cap Engenders Debate

PUCO approved a settlement implementing a revised electric security plan at the FirstEnergy Ohio utilities, without any changes affecting retail generation pricing or surcharges from what was in the stipulation. The settlement establishes a descending clock auction to set retail prices starting June 1, 2009, through May 31, 2011, subject to PUCO approval. A previous Commission order approved interim pricing for the period until June 1 (Matters, 3/5/09).

Although the Commission did not alter the stipulation's provisions regarding the descending clock auction, the absence of a load cap in the procurement was at the front of Commissioners' minds. In a concurring opinion, Chairman Alan Schriber and Commissioner Ronda Hartman Fergus noted that Ohio's limited experience with auctions means the Commissioners, "really have no idea," of whether a load cap would make sense, or would skew auction results. But settling parties negotiated the stipulation, and what they received, "was more valuable to them than what they perceived to be the outcome of an auction with or without a load cap," Schriber and Fergus said. Accordingly, "there is virtually no one left to 'protect' by modifying the Stipulation," regarding a load cap, as parties implicitly agreed to the auction terms as presented, the duo added.

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Pepco Energy Services Signs Credit Agreement with Morgan Stanley

Pepco Energy Services has entered into a credit intermediation arrangement with Morgan Stanley Capital Group to reduce its collateral requirements. Under the arrangement, Morgan Stanley has agreed to assume the obligations of Pepco Energy Services with respect to certain wholesale purchase contracts in 2009, 2010 and 2011, through novation agreements with the wholesale counterparties.

Pepco Energy Services has been evaluating different options to reduce collateral requirements, including a potential sale of the commodity supply unit (Matters, 3/4/09).

Simultaneously with each novation, Pepco Energy Services and Morgan Stanley will enter into a wholesale supply agreement under which Morgan Stanley will supply Pepco Energy Services at terms identical to the novated contracts, except that Pepco Energy Services will not have any obligation to post collateral with Morgan Stanley based on changes in electricity prices.

To date, approximately 32% of Pepco Energy Services' wholesale electric purchase obligations (measured in megawatt-hours) have been replaced by contracts with Morgan Stanley, resulting in the return to Pepco Energy Services of approximately $198 million of collateral. Pepco Energy Services will also avoid ongoing collateral obligations of up to $55 million each month depending on volume, the retailer estimated.

Pepco Energy Services will be required to post collateral with Morgan Stanley only if (i) Pepco Energy Services is no longer a wholly owned subsidiary of Pepco Holdings or (ii) Pepco Holdings undergoes a merger or similar change in control, if the creditworthiness of the surviving or acquiring entity is materially weaker than Pepco Holdings' creditworthiness immediately prior to the transaction.

The credit intermediation arrangement with Morgan Stanley does not apply to any future electricity wholesale purchase obligations incurred by Pepco Energy Services.

The payment obligations of Pepco Energy Services to Morgan Stanley under the new wholesale supply agreement are guaranteed by Pepco Holdings in an amount up to $340 million during the first year following the effective date of the first novation transaction, which decreases to $204 million during the second year and to $68 million during the third year.

New York Committee Chairs Introduce Energy Planning Bill

New York State Senate Energy and Telecommunications Committee Chair Kevin Parker, D-Brooklyn, and Assembly Energy Committee Chair Kevin Cahill, D-Kingston, yesterday announced legislation requiring a state energy board and planning process, which could seek to limit the volatility of market prices and ensure affordability for New York consumers.

Cahill earlier this month said that, "We can no longer afford to take a hands off approach to the buying and selling of electricity in New York," in opening a hearing on the New York ISO's single clearing price market.

The legislation, to be filed today, would require the development of a statewide energy plan by 2013. Although Gov. David Paterson has instituted a planning process, Cahill said legislation is required to ensure that the process continues in future years, during administration changes. Cahill added that there is no area of state energy policy that would not be touched by the board.

The plan would include assessments of regional and statewide analyses of power generation; transmission and distribution; reliability and affordability; short- and long-term fuel forecasts; renewable energy technologies and distributed generation; environmental justice and public health; efficiency and conservation; transportation; residential, commercial and industrial construction; emergency management; and economic development.

Cahill said that he and Parker are working on an Article X compromise, which had streamlined the siting process for power plants prior to its expiration in 2003.

ICC Rejects Several Nicor Changes Relating to Transportation Service

Agreeing with an earlier draft decision (Matters, 2/12/09), the Illinois Commerce Commission rejected Nicor's proposal to reduce the Maximum Daily Nominations (MDN) of transportation customers in the months of July through October, and in the months of March and April, in a final order in Nicor's rate case (08-0363).

The Commission found that Nicor did not prove such a reduction is needed to protect sales service customers. The Commission also rejected alternate proposals from parties, finding no change in MDN limits is needed. Nicor had contended that the reductions to the MDN limitations were necessary to reduce the likelihood of pipeline caps, but the ICC noted Nicor has not imposed such caps in the last 16 months. There is no evidence that Nicor's ability to serve its sales customers is harmed or compromised by the activity of its transportation customers, the Commission held.

The ICC declined to accept any of the proposed changes to the amount of Storage Banking Service capacity that was determined in Nicor's last rate case, which is 149.74 Bcf of storage. Nicor had petitioned to lower the amount used in storage calculations to 134.6 Bcf, based on the operational capacity of the fields, but the Commission found no support to change the calculation from the maximum capacity of the fields to the lower amount of Nicor's expected cycling.

Nicor and Constellation NewEnergy's compromise proposal on intraday nominations was accepted on a pilot basis for four years. Under the pilot, Nicor will add an additional late nomination cycle (a modified evening cycle) with a deadline of 3:00 p.m. on the business day before the start that would be capped, according to Nicor's capacity availability. The modified evening cycle nomination will: (1) be offered on a firm basis to the extent the volume is within the 1:00 p.m. posted availability for that date; (2) be available to all of Nicor's transportation customers; and (3) include, at a minimum, an additional 20,000 MMBtu on a daily basis over and above the volume of timely cycle nominations.

Under the Commission's order, all sizes of transportation customers will be allowed to trade, once per year, storage balances even if none of the parties involved is overfilled. Trading has previously been limited to instances in which one of the parties in the transaction has an excess storage position. Nicor's proposal to increase the Excess Storage Balance Transfer fee from $15 to $24 was rejected.

The ICC also approved an uncontested Memorandum of Understanding among Nicor, Interstate Gas Supply and Dominion Retail regarding issues for the Customer Select small volume choice program. The MOU provides that:

1) Customer Select customers shall receive a credit for gas in storage as part of the Transportation Service Credit;

2) Nicor will calculate a supplier's end-of-month Storage Inventory Target Levels during the winter as a percentage of month-end storage capacity, as opposed to a percentage of the preceding November 1 inventory;

3) Customer Select suppliers shall be allowed to cycle annually the additional operational balancing storage capacity of 6 times the Group's Maximum Daily Contract Quantity (MDCQ) effective as of the first May following the effective date of the tariff, and, also, permit the combined storage capacity of 34 times the Group's MDCQ as the basis for calculating monthly storage inventory target levels and the daily storage injection capacity;

4) The Account Charge will be included in the base rates of all eligible customers;

5) The $10.00 Group Addition fee as it relates to switching from one supplier to another will be eliminated, with such costs recovered through base rates;

6) The number of days that a customer has to select a new Customer Select supplier after returning to Nicor from another Customer Select supplier is extended from 45

to 120 days, and

7) A residential customer mailing list will be made available to Customer Select suppliers.

The Commission rejected Staff's argument to impute a $0.25 per bill charge for billing services that Nicor provides to Nicor Energy Services, instead of the current $0.112 per bill charge. Staff had noted that another Nicor affiliate, Nicor Solutions, pays $0.25 per bill, but the Commission held that Nicor Energy Services (a service/ maintenance vendor) receives different services than Nicor Solutions (a commodity supplier). The $0.112 per bill charge is appropriate since it is the fully distributed cost of the billing service, the ICC said.

The ICC ordered that a proceeding be initiated to investigate whether Nicor's affiliate Operating Agreement is in the public interest, after Staff raised concerns about the current agreement during discovery (Matters, 10/24/08). The investigation will consider Nicor employees that are dedicated full-time to Nicor Gas affiliates, facilitation of affiliate endeavors through utility activities, and annual reporting and auditing requirements.

DPUC Draft Finds Current Laddering Meeting Goals of Volatility Mitigation

The current three-year laddering approach for Standard Service supplies is meeting statutory goals of limiting price volatility, the Connecticut DPUC said in a draft order on its review of the efficacy of Standard Service and Last Resort Service (09-02-03).

Standard Service rates, the DPUC noted, remained relatively stable last year despite a significant increase in wholesale prices during the second and third quarters of 2008 as gas and oil prices increased to historic highs. On the other hand, the DPUC has noted there have been some complaints by customers that prices have not declined as oil and gas prices dropped during the later months of 2008. Although prices will not decline as fast with laddering, customers may benefit by switching to a competitive supplier, the DPUC said. The DPUC added that it has seen increased activity by competitive suppliers in 2009, reflected in the migration statistics.

The current laddering process provides Standard Service customers with a stable and predictable pricing structure and should prevent a repeat of the dramatic price increases seen at the end of the Transitional Standard Offer on December 31, 2006. "With a stable and predictable price fall-back position ratepayers are able to make reasoned decisions on 3rd party supplier offers facilitating choice in the market," the draft says.

In contrast, the quarterly-procured Last Resort Service saw prices decline from 14¢/ kWh in the third quarter of 2008 to 8¢ in the second quarter of 2009, because the supplies and rates are more market reflective.

FERC Denies Hess Request on Pipeline Refunds

FERC accepted a compliance filing from Empire Pipeline relating to new capacity release rules under Order No. 712-A, denying a request from Hess Corporation that Empire include explicit language in its tariff regarding refunds available to retail marketer replacement shippers (RP09-267).

Hess argued that Empire's proposed tariff revisions would deny refunds to any short-term replacement shippers, including short-term state retail marketer replacement shippers. Hess recommended that Empire should be required to provide refunds to state retail marketer replacement shippers obtaining capacity on a short-term basis as part of a state-mandated retail unbundling program. To the extent Empire does not deem replacement shippers eligible for refunds, Hess asked FERC to clarify that releasing shippers are eligible for refunds on Empire's system.

FERC said its prior order in *Texas Eastern Transmission, LP* already addressed the question. Rates paid by replacement shippers for terms of one year or less are final and not subject to refund, as the pipeline's maximum rates no longer apply to such short-term releases. However, in *Texas Eastern* the Commission also stated that a releasing shipper paying a recourse rate higher than the maximum just and reasonable rate determined in a rate case is eligible for refunds because Order No. 712 did not remove any maximum rates for the pipeline's sale of its own capacity. FERC said its discussion in *Texas Eastern* provides sufficient guidance on the issue, ruling that Hess' suggested tariff revisions to expressly require Empire to make such refunds to the releasing shipper are unnecessary.

Furthermore, the Commission stressed that its holding in *Texas Eastern* that the pipeline need not make refunds to replacement shippers in short-term releases applies to marketers in retail access programs in the same manner as it applies to any other short-term replacement shipper. However, section 284.8(b) of the Commission's regulations permits the releasing shipper to include terms and conditions in its releases. Such conditions may address the issue of the releasing shipper's disposition of any refunds it receives from the pipeline, FERC said.

Thus, if a state commission and the participants in a state retail access program wish to provide for a local distribution company to pass through refunds it receives from a pipeline to the marketers in the program, they can do so through conditions in the LDC's releases to the marketers, FERC noted.

Briefly:

Direct to Unveil New Energy Management Solution

Direct Energy said it and software developer Exceptional Innovation will unveil a new energy management solution for reducing residential energy consumption and lowering energy costs at the Broadband Nation Exhibit at The Cable Show in Washington, D.C., starting April 1. Direct said its home energy-management solution, "leverages electronic devices and existing infrastructure within the home," and, "provides a platform to integrate future smartgrid technologies into the home in a manner that is both cost effective and simple to use." Exceptional Innovation's current "Life|ware" product uses a computer's Windows Media Center to give users one-touch control of a home's climate, lighting, security, audio and entertainment systems, as well as energy monitoring and metering devices. Direct said Exceptional Innovation's web services technology provides a, "holistic way to connect the smart meter and energy devices such as thermostats, and handle data exchanges from both the home and the utility company."

OCC Moves to Stay Retroactive Rates at AEP Ohio

The Ohio Consumers' Counsel petitioned PUCO to stay the retroactive application of new rates at Columbus Southern Power and Ohio Power, which PUCO allowed in its recent order approving the AEP utilities' electric security plan (Matters, 3/19/09). OCC argued retroactive collection of the ESP rates back to January 1, 2009, is not permitted by statute.

PUCO Approves Columbia PIPP Suppliers

PUCO approved Columbia Gas of Ohio's application to select Citigroup Energy and Shell Energy North America as the alternative natural gas suppliers for the Percentage of Income Payment Plan (PIPP) customer class (Matters, 2/24/09). The marketers were selected via auction, with a weighted average supplier bid credit of $0.01275/MMBtu

Delaware PSC Sets More Public Meetings on Horizon

The Delaware PSC has set two additional days of public comment meetings for Horizon Power and Light customer complaints, on April 1-2 (Matters, 3/16/09).

Messer Resigns as CEO of RBS Sempra Commodities

David Messer, CEO of RBS Sempra Commodities, has resigned, though the firm said the resignation does not indicate any strategic shift. Sempra Energy CFO Mark Snell and Jeremy Wright, chief administrative officer of RBS' markets business, will manage the business jointly until a successor is named.

FERC Staff Says Commission May not Approve ConEd-PSE&G Rollover Settlement

FERC cannot approve a contested settlement that would allow Consolidated Edison to roll-over its current service under two grandfathered transmission contracts between ConEd and PSE&G, FERC Staff said in reply comments, because the record lacks substantial evidence, and because genuine issues of material fact exist. Staff initially raised concerns that the settlement may be inconsistent with the Commission's open access transmission policy (Matters, 3/17/09). Staff now notes that the NRG Companies have raised issues of material fact in their initial comments, with NRG arguing that the rollover would adversely affect pricing in the real-time market and result in economic harm to NRG.

***REP Certification** ... from 1:*

the calculation.

A REP could meet the investment grade credit rating or tangible net worth test by relying upon a guarantor provided that:

(i) The guarantor is one or more entities that are affiliates of the REP and each affiliate has executed and maintains the standard form guaranty agreement approved by the Commission, or

(ii) The guarantor is one or more entities that are affiliates of the REP and each affiliate has executed and maintains guaranty agreements, business financial commitments, or credit support agreements that demonstrate financial support for credit or collateral requirements associated with a power purchase agreement and for security associated with participation at ERCOT;

(iii) The guarantor is a financial institution that maintains an investment grade credit rating and has executed and maintains guaranty agreements, business financial commitments, or credit support agreements that demonstrate financial support for credit or collateral requirements associated with a power purchase agreement and for security associated with participation at ERCOT.

(iv) The guarantor is a provider of wholesale supply to the REP that maintains an investment grade credit rating and has executed and maintains guaranty agreements, business financial commitments, or credit support agreements that demonstrate financial support for credit or collateral requirements associated with a power purchase agreement and for security associated with participation at ERCOT.

A REP that obtained certification before the effective date of the new certification rules which does not meet all of the requirements of the new rules may continue to operate as a REP until 12 months after the effective date of the new rules.

In addition to an annual report, REPs would be required to file semi-annual reports due on January 15 and July 15 of each year. The reports would include documentation demonstrating compliance with the financial certification requirements, as well as the amount of customer deposits and compliance with customer deposit financial requirements. The July report would also require, for non-investment grade REPs and guarantors, audited financial statements of the REP or its guarantor for the most recent completed calendar or fiscal year, and unaudited financial statements for the most recent six-month financial period that immediately follows the end of its most recent fiscal year (or six consecutive monthly statements).

Staff's latest draft also makes changes to the technical and managerial requirements for REPs. In addition to prohibiting an individual that was a principal of a REP which defaulted from satisfying any managerial or technical requirements, the updated draft would prohibit such individuals from owning more than 10% of a REP, and from directly or indirectly controlling a REP.

The revised draft removes a provision that would have required REPs to provide customer service at fully staffed levels at least five days a week from 8 a.m. to 9 p.m.

***FirstEnergy** ... from 1:*

However, Commissioner Cheryl Roberto, in a partial dissent, argued that because the distribution utility may statutorily withdraw an

ESP after modification by PUCO, other parties, "certainly do not possess equal bargaining power," regarding the ESP. Accordingly, the Commission, "must consider whether an agreed-upon stipulation arising under an ESP represents what the parties truly view to be in their best interest - or simply the best that they can hope to achieve when one party has the singular authority to reject not only any and all modifications proffered by the other parties but the Commission's independent judgment as to what is just and reasonable."

Roberto said a load cap is "essential" to meet statutory policies including reasonably priced electric service, diversity of suppliers, and effective competition. Roberto argued a load cap would support competition, facilitate supplier participation, mitigate the risk from a supplier's failure to perform, and protect consumers from the exercise of market power, noting that the only two previous descending clock auctions approved by PUCO each contained a load cap. Roberto favored a 50% load cap.

Commissioners Paul Centolella and Valerie Lemmie also supported a load cap in a concurring opinion, noting that new suppliers may be less likely to participate in bidding if they perceive that an incumbent's structural advantages could prevent them from winning load. Centolella and Lemmie noted that while 11 suppliers expressed interest in FirstEnergy's interim RFP in December 2008, only four submitted qualifying offers. Centolella and Lemmie would have applied a load cap of 65%, as used in previous Ohio auctions.

Reflecting this divergence, the final order emphasized the Commission's desire that the auction be a success, and PUCO encouraged a large number of bidders to participate to make that possible. PUCO believes the auction will attract a large numbers of bidders since it features a transparent and common product definition (full requirements service) and a fair and transparent process for submitting and evaluating bids. Furthermore, robust participation should be encouraged since bids will be judged solely on the basis of price, with no subjective "non-price" evaluation.

However, PUCO noted it will review the results of the auction, and said it may reject the results if the Commission finds that the auction violated the competitive bidding process rules, "or that the results are inconsistent with the Commission's statutory obligations." In addition to auction manager CRA International, PUCO selected Boston Pacific Company as the Commission's independent monitor.

The Stipulation

The stipulation was mostly unaltered in PUCO's order, and portions dealing with retail generation rates and service were unchanged from the settlement filed (see Matters, 2/20/09 and 3/2/09 for extensive discussion).

Briefly, the approved settlement will use a descending clock, full requirements auction to set generation rates starting June 1. The stipulation provides that PUCO may phase-in the new generation rates at its discretion in an amount not to exceed, in the aggregate for all three utilities, $300 million in 2009, $500 million in 2010, and $200 million in 2011. Deferrals would be collected through a nonbypassable rider.

Governmental aggregators may choose to match any generation deferrals approved by PUCO, and aggregation suppliers providing the phase-in credit would be entitled to receive such credits on a deferred basis from the FirstEnergy utilities. Suppliers of governmental aggregations providing deferrals will be allowed to collect unpaid receivables from the FirstEnergy utilities as well. As part of the stipulation, the uncollectible aggregation receivables will be included in the utilities' Generation Service Uncollectible Rider, which will become nonbypassable for customers in an aggregation territory with phase-ins, except for Rate GT and Rate GSU customers on competitive supply with a provider other than a governmental aggregator (Matters, 3/2/09).

The settlement does not include any nonbypassable standby or POLR charges, but does provide that deferred fuel expenses from 2006 and 2007 will be recovered via a nonbypassable surcharge over 25 years.

Rate Stabilization Charges will cease starting June 1, 2009, and there will be no shopping credit caps. FirstEnergy will write-off 50% of the extended Regulatory Transition Credit balance at Cleveland Electric Illuminating, or about $215 million.

The ESP does not impose a minimum stay for residential and small commercial non-aggregation customers.

Qualifying schools and certain large customers will receive mitigated or discounted rates, with such mitigation recovered via nonbypassable surcharge.