

Energy Choice Matters

May 12, 2009

RRI Energy Earnings Fall from Open Position, Lower Market Prices

RRI Energy reported a quarterly net loss of \$151 million versus earnings of \$377 million in the year-ago quarter on lower generation margins as well as unrealized hedging losses. Adjusted EBITDA was down at \$19 million from \$157 million a year ago, as RRI's largely open position left it especially vulnerable to the decline in market pricing.

Total wholesale energy contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives, was negative \$15 million, versus positive \$217 million a year ago, on lower volumes and lower market pricing.

Average open energy unit margin was \$17.50/MWh versus \$33.02/MWh in the year-ago quarter. Open energy unit margin by plant type was as follows

<u>Open Energy Unit Margin (\$/MWh)</u>	<u>Q109</u>	<u>Q108</u>
PJM Coal	\$19.65	\$35.55
MISO Coal	\$11.43	\$29.83
PJM/MISO Gas	\$6.39	\$87.57

CEO Mark Jacobs said a top priority for RRI is to selectively deploy capital for value-creating opportunities, but added that RRI will be "pragmatic." In the near term, that rules out any major asset purchases or consolidation, with any actions likely confined to investment in current assets.

However, size and scale represent a longer-term priority for RRI, Jacobs said, who believes that, "size, scale and diversity matter in delivering shareholder value through the cycles." RRI is committed to exploring all avenues to achieve that objective.

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South Jersey Energy Seeing Customer Churn in "Difficult" Market Conditions

South Jersey Energy said that market conditions continue to make it difficult to be competitive in retail natural gas sales, as South Jersey Energy reported continued churn year-over-year.

As of March 31, 2009, South Jersey Energy was serving 9,900 residential gas customers compared with 12,800 a year ago. South Jersey Energy also saw its commercial and industrial gas customer base decline to 1,000 at the end of the first quarter, from 1,300 a year ago, mainly due to the expiration of a large municipal bid early in the fourth quarter of 2008. South Jersey Energy said it will continue to focus marketing efforts on the pursuit of non-heat-sensitive commercial customers in an effort to mitigate price volatility and weather risk.

Gross margin from South Jersey Energy's retail gas sales decreased \$1.0 million in the three months ended March 31, 2009, compared with the same period in 2008. The majority of the retailer's natural gas customer contracts are market-priced. Operating income from South Jersey Energy's Retail Gas and Other Operations was down at \$661,000 from \$1.9 million a year ago.

Gross margin from South Jersey Energy's retail electricity sales decreased \$2.1 million in the first quarter compared with year-ago period. However, \$2.0 million of the decline was due to an increase in unrealized hedging losses. Excluding the unrealized hedging impact, gross electric margin was only down \$100,000 year-over-year. Operating income, which includes the unrealized hedging

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CMP Says Current Payment Order Complies with PUC Rules

Central Maine Power argued that its current payment application methodology is consistent with all applicable Maine PUC rules and should not be changed as recommended under a hearing examiner's report (2008-351, Matters, 4/15/09).

Commission rules require that partial payments first be allocated to past due transmission and distribution (T&D) charges and Standard Offer charges, with the oldest charges paid first. In the event that T&D and Standard Offer charges are of the same vintage, then the T&D charges are paid first.

CMP currently uses a vintaging system with four buckets (current; 30-day; 60-day; and 90 or more days), which treats all past due amounts beyond 90 days as the same age. For arrearages beyond 90 days, the system allows newer T&D arrearages to "leapfrog" older Standard Offer charges, since the system treats them as the same age, in which case T&D charges must be paid first.

The hearing examiner's report found such a result to be plainly inconsistent with Commission rules.

However, CMP countered that Section 6(C) of Chapter 322, which governs the application of partial payments, neither specifically authorizes nor prohibits the use of vintaging buckets.

CMP argued that the timing and context of the adoption Section 6(C) of Chapter 322 suggests that the Commission was "keenly aware" of the fact that CMP and Maine Public Service had billing systems that used a vintage buckets methodology, and that the Commission did not intend to require utilities to modify their billing systems to remove the vintage bucket and payment application methodology.

CMP pointed to the PUC's order adopting the payment rules in Docket No. 98-810, which recognized the impact of the vintaging system, even providing an example under the approved methodology where older Complete Electricity Provider charges would be paid after newer T&D charges, because both charges fell into the oldest vintage bucket.

While CMP noted there have been subsequent amendments to Chapter 322, "none

of these amendments or the orders approving them in any way specifically overturned the Commission's endorsement of the utilities' retention of their existing vintage buckets."

CMP conceded that express language concerning the use of vintage buckets was not included in a 1999 amendment to Chapter 322, but chalked up the omission to either an oversight, or the elimination of unnecessary language. Despite the omission, "there is no evidence that anyone associated with the various rulemakings ever intended the elimination of the use of vintage buckets for partial payment allocation," CMP argued. Rather, the PUC's 1999 order said it was adopting the various utility proposals, and CMP's proposal retained the use of vintaging buckets, CMP said.

If the Commission requires a change so that the older of T&D and Standard Offer arrearages is paid first regardless of age, CMP asked that the PUC make utilities whole both for system upgrade costs as well as increased uncollectibles.

CMP estimated that upgrading its system to create an unlimited number of "virtual" vintage aging buckets to accomplish such a change would take nine months at a cost of \$540,000.

WGES Opposes Change to Limit Credit for Excess Generation from Larger Distributed Systems

Washington Gas Energy Services opposed a proposed revision to the District of Columbia's net metering rules that would limit compensation for excess generation at the full retail rate to only those distributed systems 100 kW or smaller, arguing in comments to the D.C. PSC that the limit would discourage larger solar systems and raise solar REC prices (FC 945).

Currently, all excess generation is credited on the customer's next bill at the full retail rate, which includes transmission and distribution charges. The proposed rule would maintain that framework for customers with distributed systems of 100 kW or less (Matters, 4/2/09).

However, for customers with systems in excess of 100 kW, any excess generation carried to the next billing period would only be credited at the "generation rate" applicable

during the billing period in which the excess generation occurred, rather than the full retail rate.

"Generation rate" is defined as, "the kilowatt-hour usage charge associated with the SOS generation service that is applicable to the customer generator."

WGES said that the change would discourage larger installations of distributed generation, including solar. Reducing the economic attractiveness of solar installations will stymie the supply of solar RECs for D.C.'s solar RPS carve-out, raising the cost of compliance and thus electric rates.

Furthermore, WGES argued that paying larger systems only the generation rate is inconsistent with other provisions in the rule which hold that net metering customers shall not pay transmission and distribution charges for the generation from their distributed system. However, by crediting excess generation at a rate less than the full retail rate, customers are essentially charged for transmission and distribution of their excess power, WGES argued. Since excess generation is credited to the next bill, crediting a customer's excess generation only at the generation rate means the customer will be paying transmission and distribution charges related to "flowing" such excess generation back to the customer in the next month, WGES reasoned.

WGES said its modification would preclude the need to define the term "generation rate." However, should the PSC retain its proposal, WGES said that the term generation rate must be clarified, as it is confusing and ostensibly does not contemplate that a customer may be receiving competitive supply and not Standard Offer Service.

Commenting on a separate proposal issued by the PSC coincident to the net metering NOPR, Constellation NewEnergy and affiliates asked for greater clarity regarding solar RPS compliance.

Among other things, the NOPR would require that an electricity supplier must exhaust all opportunities to meet the solar RPS mandate through District-interconnected solar facilities before using RECs from outside the District.

Constellation noted it's unclear how a supplier is to determine whether District-

interconnected solar supplies have been exhausted. Absent clarification, suppliers may simply pay the alternative compliance payment for solar resources, rather than investing the time and energy into attempting to figure out whether D.C. solar resources have been exhausted, and then accepting any risks associated with whether that assumption is correct.

Constellation suggested that the PSC annually survey the amount of D.C. solar RECs available. If the available D.C. solar RECs are less than 75% of expected electric sales in the next year, the PSC should declare that the supply has been exhausted, and RECs from other jurisdictions will be allowed for compliance.

Calif. IOUs Report on Novation Efforts

Southern California Edison is in active novation discussions with Sempra Generation and Mountain View Power Partners, it said in a report on the status of novating Department of Water Resources supply contracts to remove DWR from its supply role. SCE said it is currently unknown whether the Sempra contract can be novated as-is, or will instead require renegotiation. SCE currently expects that the Mountain View novation will require a restructured replacement agreement.

Pacific Gas & Electric said its current view is that the Coral contract, deemed a priority since it lacks a novation clause, will need to be renegotiated, and said negotiations have commenced. PG&E said it is currently unknown whether two other priority contracts without novation clauses, the PacifiCorp Power Marketing contract and the SFO Peakers contract, will need to be renegotiated, or can be novated as-is.

San Diego Gas & Electric, responsible for seven contracts which were not deemed the highest priority, said preliminary discussions with counterparties have resulted in all parties agreeing novation of contracts would be performed as-is.

AReM Says Accelerated Resource Adequacy Deadline Would Put ESPs at Risk

The California PUC should not change the long-standing Resource Adequacy compliance schedule, because an accelerated deadline would create undue risks for electric service providers, the Alliance for Retail Energy Markets said in comments (R. 08-01-025).

The California ISO has proposed moving up the current October 31 annual deadline due to new milestone dates under the Market Redesign and Technology Upgrade. Specifically, under MRTU, CAISO must identify Resource Adequacy deficiencies by November 2. LSEs may then make optional Resource Adequacy procurements to reduce or eliminate deficiencies by December 2. To allow for processing of Resource Adequacy data ahead of the November 2 deadline, CAISO Staff suggested that the final LSE Resource Adequacy showings for 2010 should be submitted no later than the first week of October 2009.

However, AReM said that significantly shortening the procurement time period would create "significant risk" that electric service providers may be unable to meet their Local Resource Adequacy Requirements.

Electric service providers, AReM noted, must procure Local Resource Adequacy capacity from the utilities, who own or control all the Local Resource Adequacy capacity in some Local Capacity Areas, such as San Diego. Typically, the utilities have been reluctant to sell excess Local Resource Adequacy capacity until the CAISO releases its decision on retaining Reliability Must-Run units on October 1. Moving the deadline for final Resource Adequacy showings by LSEs to the first week of October would leave insufficient time for electric service providers to procure from the utilities, leaving them with significant risk for non-compliance, AReM said.

AReM proposed two alternatives that would retain the existing Resource Adequacy compliance date, but provide flexibility for the CAISO to meet its needs. AReM's proposed solution is for CAISO to apply for a waiver of its MRTU tariff deadlines at FERC, and work on a

subsequent filing to permanently alter the MRTU dates. Alternatively, CAISO could issue a revised report on Resource Adequacy deficiencies for 2010 after the November 2 report is issued, but before December 2.

AReM also strongly urged the PUC to continue the existing Resource Adequacy market power mitigation measures for the 2010 compliance year. Specifically, AReM said that the Commission should approve the: (a) the blanket waiver for generation deficiencies in the North Bay/North Coast, Sierra, Stockton, Kern and San Diego Local Capacity Areas; and (b) the aggregation of six of PG&E's Local Capacity Areas into one "Other PG&E" LCA.

State Regulators Assert Smart Grid Authority at FERC

State regulators asserted jurisdiction over retail-related smart grid applications while consumer advocates opposed blanket incentives for smart grid deployment in comments on FERC's draft smart grid policy statement (PL09-4, Matters, 3/20/09).

The Maryland Office of People's Counsel said that the FERC statement, "lacks clarity in its discussion of Smart Grid technologies, and may leave the impression that certain Smart Grid devices and systems related to the distribution system are eligible for cost recovery in wholesale rates under FERC's proposed rate policy because of some tangential impact of these devices or related pricing schemes (e.g. smart meters and real-time pricing) on bulk power operation due to interoperability issues."

The Public Utility Commission of Ohio also pushed back against federal encroachment, stating that the Energy Independence and Security Act of 2007, "does not give FERC authority to adopt standards and protocols to ensure smart-grid functionality and interoperability in areas that are not subject to substantive Federal jurisdiction."

PUCO listed the following areas as subject to state jurisdiction: the adequacy of electric facilities and services, generator operating procedures, electric distribution, LDC information and communications systems, distribution utility demand response programs, retail rate designs and related demand response,

meters and customer premises equipment, net metering, integration of distributed energy resources, retail rate offerings for electric vehicle charging, LDC cost recovery, and retail transactions between consumers and a distribution utility or curtailment service provider.

NARUC highlighted state jurisdiction over demand response as well, since retail customer involvement is, "an area which falls squarely within State-Commission jurisdiction."

"A rulemaking targeting standards connected to customer premises will exceed the authority granted to the Commission to 'institute a rulemaking proceeding to adopt such standards and protocols as may be necessary to insure Smart Grid functionality and interoperability in interstate transmission of electric power, and regional wholesale electricity markets,'" NARUC said.

Reliant Energy and the NRG Companies cautioned FERC that no federal entity should attempt to develop interoperability standards. The Texas experience, Reliant said, has demonstrated that the most effective role of a state or federal regulator is to establish broad guidelines and then allow industry groups and standards development organizations to develop the actual standards. "In this sense, the Commission should refrain from determining smart grid technology 'winners and losers,' and instead work to: (1) create appropriate market mechanisms for monetizing wholesale products related to the provision of Smart Grid Applications, and (2) establish broad guidelines within which industry standards groups can operate," Reliant said.

Maryland's OPC as well as AARP challenged FERC's unequivocal statement that smart grid applications will translate into savings in the provision of electric service, with OPC arguing, from the consumer perspective, "data and scrutiny have been lacking at both the federal and state levels regarding this notion of savings."

OPC, ELCON, and the National Rural Electric Cooperative Association also opposed the draft statement's use of single-issue rate filings for smart grid applications, calling such single-issue ratemaking contrary to long-standing court and Commission policy.

Briefly:

On-Demand Energy Seeks Ohio Electric License

On-Demand Energy applied for an Ohio electric aggregator/broker license for commercial, industrial, and mercantile customers at all of the investor owned utilities. On-Demand, which has been licensed in Pennsylvania for a decade, said over the last three years it has assembled two large pools of primarily mid-sized commercial and industrial accounts at Duquesne Light and Penn Power. On-Demand is currently in the process of assembling a pool of chamber of commerce accounts in the PPL territory. The Duquesne Light pool has over 800 accounts representing approximately 140 million kWh in annual usage, and the Penn Power pool has about 160 accounts representing approximately 50 million kWh in annual usage. The PPL pool is anticipated to include over 1,000 accounts in excess of 150 million kWh in annual usage. On-Demand is also licensed in Delaware and has a pending Maryland application (Matters, 10/22/09).

Texas Senate Passes Non-Wind RPS Carve-Out

The Texas Senate passed SB 541 which would create a separate RPS carve-out for non-wind resources, and institute a REC trading program devoted to such tier 2 resources. Specifically, tier 1 resources would include all currently eligible renewable resources, while tier 2 resources would be any tier 1 renewable energy technology excluding energy derived from wind with a capacity of more than 150 kilowatts. Up to 500 megawatts of renewable energy storage may qualify to meet the tier 2 mandate. Under the bill, the tier 2 requirement would gradually increase from 50 MW by January 1, 2011, to 100 MW by January 1, 2012, to 1,500 MW by January 1, 2020. As under the current system, the compliance obligation would fall on REPs. The bill moves to the House.

O&R Firm on Assignment of Account Look-up Costs to ESCOs

Orange and Rockland told the New York PSC that the costs of mechanisms to allow customers to look up their utility account numbers remotely

should be borne by ESCOs, since the function does not fall under general outreach and education, nor does it fall under the ambit of platform programs like EDI or billing systems (Matters, 4/28/09). In reply comments, O&R said its proposal would cost \$5,000 for implementation and \$500 per year for maintenance, though changes made by the Commission could increase costs.

FERC Approves NYISO Wind Changes

FERC approved the New York ISO's tariff changes to put wind resources on dispatch and include them among those flexible resources for which a dispatch-down instruction could be used in resolving a constraint on the transmission system (ER09-802). Under the new tariff, wind resources will submit economic offers indicating the price at which they desire to reduce their generation, which will identify units that are economically appropriate for output reduction in order to maintain reliability in the face of a constrained system. The dispatch system will identify only as much output reduction and duration as is necessary to resolve the constraint, and allows wind resources to continue to generate as much energy as the system can handle, as opposed to current practice where wind resources may go completely off-line.

Boralex Files Complaint Against ISO-NE Over Grandfathered Transmission

Boralex Ashland filed a complaint at FERC against ISO New England, claiming that a grandfathered transmission service agreement with Maine Electric Power Company gives Boralex highest priority for both energy and capacity imports from the Northern Maine Independent System Administrator in the amount of 26 MW. ISO New England has held that Boralex only retains priority rights for energy, not capacity.

RRI ... from 1

In response to an analyst questioning the use of RRI's "whopping" \$1.5 billion cash balance, Jacobs said in the near-term RRI views its cash as a tool to persevere through a sustained and difficult market, and to mitigate a potentially

sustained commodity price decline. RRI has also set aside \$400 million for a maturity next year.

Still, Jacobs added that RRI is open to using a "modest" portion of cash for the "right opportunity," though again stressed in the near-term such opportunities are likely to be investments in existing plants. As market conditions improve and capital markets open up under more favorable terms, Jacobs expects to deploy more of RRI's cash in a manner to create value. Purchasing distressed assets remains an intermediate or longer-term opportunity.

RRI is not going to hedge the majority of its output at what it believes is the trough of the cycle, but may implement selective hedging to mitigate risk. RRI also noted there continues to be no meaningful increase in supply.

RRI's Illinois retail commercial and industrial book remains held for sale, the only vestige of the Reliant retail unit. The Illinois book reported \$25 million in revenue during the quarter, versus \$6 million a year ago.

SJE ... from 1

impacts, from retail electric operations was down at negative \$1.6 million from positive \$461,000 a year ago. Essentially all of South Jersey Energy's retail electric customer contracts are market-priced.

South Jersey Energy said its recent agreement to supply electricity to 400 New Jersey school districts through the Alliance for Competitive Energy Services will generate \$4.5 million in pre-tax income over the contract's two-year period (Matters, 3/12/09).