Energy Choice Matters

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Reliant Reports Slowing Customer Attrition, Strong Unit Margins

Reliant Energy posted net income of $966 million from May 1, 2009 through December 31, 2009, on $1.0 billion in operating income, parent NRG Energy said in its annual 10-K filing. For the fourth quarter, Reliant's net income was $159 million.

Reliant posted adjusted EBITDA of $104 million for the fourth quarter, and $642 million from May 1, 2009 through December 31, 2009. The metric excludes an $89 million loss associated with the termination of forward positions related to the Merrill Lynch credit sleeve unwind.

Operating revenues at Reliant for the eight-month period were $4.2 billion, comprised of $2.6 billion in mass market revenues and $1.6 billion in commercial and industrial (C&I) revenues, with supply management revenues (sales of excess power into the wholesale market) of $251 million essentially negating a reduction in revenue of $258 million due contract amortization.

Reliant's gross margin was $909 million for the period May 1, 2009 through December 31, 2009. NRG said that the gross margin was driven by "strong" margins in the mass market customer class and expanding margins in the C&I customer class. Gross margin was also lifted by higher volumes, as favorable weather offset customer attrition. "Competition, price reductions, and supply costs based on forward market prices, will likely drive lower margins in the future," NRG said in its 10-K. "If supply costs continue to remain low, the Company expects competitive retail prices to continue their decline and to place pressure on unit margins," NRG added.

Reliant's 1.6 million customer count as of December 31, 2009, represents about a 6% decline since May 1, 2009. Although Reliant lowered prices for mass market customers during the summer, "competitors took more aggressive pricing actions," said John Ragan, NRG Chief Operating Officer. Attrition in the C&I segment resulted from lower success in re-signing legacy contracts that were due

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First Choice Power Produces Record Earnings on High Margins

First Choice Power reported net income for the fourth quarter of 2009 of $4.4 million, reversing the year-ago net loss of $76.6 million, on lower purchased power expenses, lower bad debt, and on the absence of impairment and goodwill charges taken in the fourth quarter of 2008.

Ongoing EBITDA for First Choice was $5.8 million for the fourth quarter of 2009, reversing the year-ago negative EBITDA of $12.1 million.

For the full year of fiscal 2009, net income was $44.4 million, reversing the year-ago loss of $177.6 million. Ongoing EBITDA for fiscal 2009 was $68.5 million, reversing negative EBITDA of $29.5 million for fiscal 2008. High margins throughout 2009 drove the record performance.

For the fourth quarter, the main driver in improved EBITDA was a $21.3 million decrease in bad debt expense, as First Choice Power has spent the past year restructuring its customer base to include customers with higher credit. Also contributing to the positive EBITDA was $2.9 million in lower purchased power expenses, which lifted gross margins, partially offset by a $5.8 million increase in operations and maintenance expenses.

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Revised Conn. Draft Maintains Supplier Accident Reporting Requirements

A revised draft Connecticut DPUC decision regarding the reporting of accidents by utilities and electric suppliers maintains the requirement for the filing of monthly reports (08-09-02, Only in Matters, 11/30/09).

As only reported in *Matters*, the proposed rules (16-16 of the Regulations of Connecticut State Agencies) defines "utility" as a public service company or electric supplier. The definition of electric supplier includes licensed aggregators as well as load serving entities.

Among the draft requirements is that, "[n]o later than the tenth day of each month, each utility shall file with the Department a monthly accident report." The report shall list, in summary form, all minor and major accidents that occurred in Connecticut or affected Connecticut residents in the previous calendar month.

Suppliers have objected to the burden of filing reports for months in which there are no accidents.

Most of the major accidents defined under the draft rules would rarely come into play for electric suppliers; however, a minor accident includes certain traffic accidents involving the supplier's, "operation, property or facility."

While the draft rule regarding the definition of minor accident has been tweaked (adding a nominal dollar value threshold to the reporting requirement trigger), the draft rule still provides that a minor accident includes, "Any accidents to employees or to members of the public which were or may have been connected with or due to a utility's operation, property or facility, including traffic accidents, resulting in property damage of $50,000 or more, or in personal injury, whether or not hospitalization is required, that are not considered a major accident pursuant to subsection (a) of this section."

The revised draft does not grant an exemption from the reporting requirements to non-fatal vehicular accidents, as requested by suppliers (Only in Matters, 1/18/10).

Briefly:

Bishop Energy Services Seeks Mich. Gas Supply License

Bishop Energy Services, LLC applied for a Michigan alternative natural gas supplier license. Bishop is a large volume marketer active in the transportation segment of the market, but has not been active in the Michigan retail customer choice space since 2002. Bishop applied to serve all customer classes, but said that it will not target residential customers.

America Approved Energy Services Direct Seeks Md. Broker License

America Approved Energy Services Direct, LLC applied for a Maryland electric broker license to serve all customer classes at all of the investor-owned utilities, though it will focus on residential and small commercial customers. Affiliate America Approved.com, which was recently licensed in Maryland, handles medium and large commercial and industrial sales.

D.C. PSC Approves Extension of WGL Pilot Hedging Program

The District of Columbia PSC approved Washington Gas Light's request to extend its pilot natural gas hedging program through the 2010-11 winter heating season (GT01-1). While the Office of People's Counsel has raised objections to continuing the program by citing the lack of success in reducing volatility (Matters, 7/20/09), the Commission said that it, "continues to believe that the Pilot Hedging Program is in the public interest and that a further extension of the program will allow natural gas customers the opportunity to benefit from hedged transactions. As the Commission has not yet reached a determination regarding the Application for Approval of a Permanent Hedging Program, which may impact the authority granted herein, authorization to conduct physical hedging transactions for the 2010-2011 winter heating season will avoid a lapse in the Company's hedging authority for this winter."

AOBA Alliance Selects Constellation NewEnergy for Supply

The AOBA Alliance, Inc., announced that it has chosen Constellation NewEnergy as its new

energy services supplier. Through this new relationship, the AOBA Alliance said that it has the potential to become Constellation NewEnergy's largest retail customer given its commercial property relationship in the markets of Maryland, Washington D.C., and Virginia. Over the past decade AOBA Alliance participation has grown to roughly 650 megawatts of peak load and nearly 3.0 billion kilowatt-hours of annual electricity sales. Aside from commodity supply, the arrangement provides for renewable and energy efficiency programs. The AOBA Alliance has been supplied for several years by Pepco Energy Services, which is exiting the retail supply business.

GDF Suez Increases Astoria I Stake

GDF Suez Energy North America, Inc. said that it has increased its ownership interest from 30.45% to 58.54% in the 575 MW Astoria Energy I natural gas-fired power plant located in the Queens Borough of New York City, making the company the largest shareholder in the facility. The majority of Astoria Energy I's capacity, 500 MW, is being purchased by Consolidated Edison under a 10-year Power Purchase Agreement. With Suez's previously reported interest in the new Astoria Energy II project, Suez will own an interest in 1,150 MW in the New York ISO Zone J market, and 1,267 MW in the entire New York ISO.

DTE Energy Trading Net Income Rises

Net income at DTE Energy Trading increased to $75 million in fiscal 2009, from $42 million in 2008, parent DTE Energy reported in a 10-K. "Economic" net income, which excludes the impact of changes in the fair market value of certain non-derivative contracts, was lower at $62 million versus $82 million a year ago. Gross margin for the year increased to $201 million from $153 million a year ago. The $48 million increase in gross margin in 2009 was due to increases in realized margins of $69 million, offset by decreases in unrealized margins of $21 million. The $69 million increase in realized margins was primarily the result of increases in Energy Trading's gas trading strategy and timing-related increases in gas storage and transportation optimization strategies. The $21 million decrease in unrealized margins consisted of unfavorable results of $58 million from gas trading and gas marketing and origination strategies, partially offset by increases of $29 million in power trading and timing-related improvements of $8 million in oil strategies. DTE did not address in its 10-K or on its earnings call the net impact of increased customer migration on Detroit Edison's results.

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to expire, Ragan said. Ragan said that the C&I attrition was partially offset by improved performance in winning new large customer accounts, as Reliant ended the fourth quarter ahead of its internal new customer plan.

Mass market customers as of December 31, 2009 were 1.531 million, with more than half of Reliant's mass market customers located in its former affiliated region of Houston. Reliant recorded 66,000 C&I customers as of December 31, 2009. NRG said that Reliant remains the largest C&I provider in ERCOT.

NRG CEO David Crane said that the rate of net attrition reduced substantially over the course of the year from 2.4% in quarter three to 1.6% in quarter four, a 30% improvement. Crane said that the net attrition metric continues to trend positive.

Crane added that in 2010, Reliant aims to stabilize and grow the mass market business through a variety of targeted marketing campaigns, plus a more extensive rollout of smart energy programs which are being financially supported by the previously reported $20 million stimulus funding which Reliant received from the U.S. Department of Energy.

"It is our view that the introduction and greater public acceptance of smart metering equipment will benefit premium service-oriented retail providers like Reliant more than their price-only based competitors," Crane said. Reliant has targeted enrolling 75,000 mass market customers onto such smart energy products in the near-term.

NRG also cited home service bundling products as increasing customer stickiness.

To grow the C&I business, and associated margins, Reliant is focusing on targeting new segments, including Combined Heat and Power

opportunities, and rooftop solar. Reliant will also expand its C&I service offerings to include maintenance services and energy efficiency audits.

"The C&I business also is the bridge into some potential brand extension for Reliant through electric vehicle services or other services that are logically related to retail electricity," Crane said. In its 10-K, Reliant said that it plans to begin selling new products and services that enable both public and home charging of electric vehicles this year.

Mass market volumes from May through December were 17,152 GWh, while C&I volumes were 20,915 GWh. Fourth-quarter volumes were 4,525 GWh for mass market customers, and 7,135 GWh for C&I customers. Variable rate contracts tied to the market price of natural gas accounted for approximately 73% of the C&I contracted volumes as of December 31, 2009.

Bad debt expense for the May through December period totaled $61 million, or 1.5% of revenues, which was driven by higher summer bills due to warmer weather and economic factors including unemployment in Dallas and Houston which is approaching national averages.

Selling, general and administrative expenses (excluding bad debt) for Reliant were $142 million for the period May 1, 2009 through December 31, 2009.

Regarding its retail load supply strategy, NRG said that it plans to continue to hedge the retail portfolio in the market when prices are low, and hedge the retail portfolio from internal generation when market prices are high,

Generation

During an earnings call, Crane said that, given looming environmental regulations, he expects a wave of retirements of older and smaller coal units from the industrial Midwest through the mid-Atlantic states and up into New England, which will rebalance the supply/demand dynamic from the supply side much more quickly than is currently anticipated.

Expanding on Crane's comments, Mauricio Gutierrez, NRG Executive Vice President for Commercial Operations, said that NRG's modeling shows about 40-45 GW of coal retirements in SERC and the Midwest ISO, with about 10-11 GW split between PJM, New York and New England, though the majority of that total will be in PJM. The modeling is based on merchant economics, and Gutierrez noted that reliability concerns could prevent the plants from retiring.

Gutierrez said that with the retirements, the market will probably see some increasing capacity prices in New York, and possibly New England. The indirect effect of the SERC and MISO retirements will depend on power flows. Gutierrez said that coal retirements are not expected in ERCOT.

Asked about potential acquisitions of other large independent power producers, Crane dismissed NRG's interest in such transactions. While NRG has sufficient cash on hand to engage in extensive asset acquisitions in a more targeted or incremental approach, no merchant player will be able to acquire a large competitor in an all-cash transaction, Crane said, and thus stock would be required. Since Crane believes that NRG's stock is "grossly undervalued," it is not a particularly attractive acquisition currency, and thus NRG is not pursing any large scale acquisitions, choosing instead to focus on smaller deals such as its acquisition of Bluewater Wind and the Blythe solar facility.

NRG's Texas generation assets saw adjusted EBITDA for the fourth quarter decrease by $6 million to $264 million versus the year-ago period, on $2 million in lower gross margin, plus higher property tax and operation and maintenance expenses.

NRG's Northeast assets posted lower adjusted EBITDA of $77 million, a $15 million decrease versus the fourth quarter of 2008, on an $8 million decline in margins due to lower pricing and decreased volume. Emission expenses were also higher.

On a consolidated basis, fourth quarter net income at NRG was $33 million, down from $271 million a year ago, on higher operating costs and the absence of prior-year hedging gains. For the year 2009, net income was down at $942 million versus $1.2 billion a year ago.

First Choice ... *from 1*

For the full year results, the largest driver in the turnaround was a $105.1 million decrease in purchased power expenses, followed by a $10.7 million reduction in bad debt.

Bad-debt expense decreased from $51.8 million in 2008 to $41.2 million in 2009. As a percent of sales revenue, bad-debt expense decreased from 8.2% in 2008 to 7.8% in 2009.

First Choice reported that margins in the fourth quarter decreased to the mid-$40/MWh range, from the high-$40/MWh range in the third quarter. PNM Resources CFO Chuck Eldred said that First Choice saw margins decline by 20% from the first quarter of 2009 to the fourth quarter. However, margin compression during 2009 was still slower than anticipated at the start of the year, contributing to the turnaround.

Incoming PNM Resources CEO Pat Vincent-Collawn said that PNM does not expect First Choice to see record earnings again in 2010 as the margin compression continues. First Choice expects margins to eventually reach the historic range of $25-30/MWh.

Attrition continued during the fourth quarter, as First Choice reported 225,000 customers as of December 31, 2009, versus 232,100 customers as of September 30, 2009, and 237,400 as of December 31, 2008. Aside from competitive pressure, the attrition continues to reflect First Choice's strategy of reconstituting its book to include customers with higher levels of credit quality. First Choice expects to record net customer growth in the second half of 2010, and projected 5% residential customer growth during the year.

First Choice also said that it will continue to focus on developing differentiated products and services to build its customer base, citing its advanced-meter-based prepaid product as one of its recent endeavors.

PNM Resources' share of Optim Energy's net ongoing losses for the year 2009 was $0.6 million, compared with 2008 losses of $2.5 million. GAAP losses were $18.2 million, compared with 2008 losses of $17.9 million,. GAAP losses were driven primarily by write-downs associated with emission allowances in both years and impairment charges in 2008.

PNM Resources' share of Optim Energy's ongoing EBITDA was $31.9 million for the year 2009, compared with $24.5 million in 2008. Improvement resulted from the addition of Cedar Bayou 4, favorable hedged positions, Twin Oaks Power fuel savings, and operational cost reductions.

PNM Resources has not yet filed a 10-K.

First Choice Operating Revenues

(millions)

	Year Ended December 31,	
	2009	**2008**
Residential	$ 349.6	$ 407.3
Mass-Market	25.7	52.7
Mid-Market	133.1	149.3
Trading gains (losses)	0	(49.9)
Other	20.4	22.8
Total	$ 528.8	$ 582.2

First Choice Sales

(GWh)

	Year Ended December 31,	
	2009	**2008**
Residential	2,441.6	2,547.5
Mass-Market	145.6	278.3
Mid-Market	1,063.6	1,176.8
Other	9.7	16.3
Total	3,660.5	4,018.9