

Power Markets Week

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Plenty of unknowns in Texas retail change, but few fear immediate impact January 1

In just over four months, the Electric Reliability Council of Texas region will become the first in the nation to implement full retail competition for residential and small commercial customers without any regulated cap on utility rates, and predictions for what will happen vary along expected lines.

Market participants, consumer advocates and others interviewed last week agree that the elimination of the "price-to-beat" or default rates on January 1, 2007, is unlikely to have any significant immediate impact on ERCOT's retail market because it has had a relatively smooth transition to full competition at the small-customer level.

However, some retail-competition critics said that while there may be no sudden spike in power prices at the start of the new era, there is the potential for future price gouging as retail electric providers test, in the words of one critic, "what they can get away with."

There even is a possibility, some said, that retail competition may eventually be undone by the Texas Legislature if electricity prices continue to soar, although they admit that "putting the genie back in the bottle" would not happen until the Legislature's 2011 biennial session — at the earliest.

Texas on January 1, 2002, gave all retail customers in the five investor-owned utilities in the ERCOT region the right to select their retail electricity provider. The state required all REPs affiliated with the investor-owned utilities to provide default service at price-to-beat rates approved by the Public Utility Commission and based in large part on the price of natural gas, which is the dominant power-plant fuel in ERCOT. The affiliated REPs, or AREPs, could ask the PUC to increase the price to beat up to two times each calendar year to reflect higher gas prices.

As a result of the rules and sharply higher gas prices since the start of customer choice, the five AREPs — TXU Energy, Reliant Energy, First Choice Power and affiliates of Direct Energy in the AEP Texas Central and AEP Texas North areas — have nearly doubled the price to beat in the five IOU areas over the past four years and eight months.

TXU Energy's price to beat, for example, has soared to 15 cents/kWh from 8.25 cents, and Reliant's has risen to 16.3 cents from 8.61 cents in January 2002, leading consumer advocates such as Tom Smith, executive director of the Texas office of Public Citizen, to question whether customer choice has really benefited small customers.

The most recent data from the PUC suggest that as of March 30 only about one-third of all residential customers in the five

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MISO review of strains from high demand indicates grid constraints and load pockets

A report released Friday by the Midwest Independent Transmission System Operator shows that the transmission system worked well during the recent record-breaking loads but revealed some issues that need to be dealt with, said John Bear, the Midwest ISO's senior vice president and chief operating officer.

As a heat wave slowly moved east during July 31-August 2, power flows in the region switched from east to west to west to east. As the western part of the footprint cooled and the eastern part heated up, constraints made moving power from west to east difficult, Bear said.

"Power was trapped in the west," Bear said. Those constraints, he said, were not a problem when power needed to be moved west.

The solution is "more long-term," Bear said. The Midwest ISO also is looking at short-term measures to ease the flows, including replacing transformers or other engineering changes.

The heat wave also revealed load pockets in the region that caused real-time locational marginal prices to climb in some areas.

"That's a component of congestion," Bear said. But another cause could have been the generation mix, he added. More

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IOU areas have switched to REPs other than their incumbent or default provider.

The PUC required AREPs to offer price-to-beat rates in their native areas until January 1, 2007, but it permitted them to compete with competitive REPs in other IOU areas opened to customer choice.

The rules also permitted AREPs to start offering lower-cost, competitively priced alternatives to their price to beat in their native areas on January 1, 2005, but initially such offers were scant.

Starting in early 2006, TXU Energy, Reliant, First Choice and Direct rolled out an increasing number of price-to-beat alternatives — all with the aim of keeping customers from switching to a competing REP.

"In the past few months we've been seeing an increasing number of [retail-electricity] products being offered by AREPs," said Steve Davis, president of the Austin-based Alliance for Retail Markets, which includes seven competitive suppliers. "I anticipate that on January 1, 2007, when full-fledged competition begins, that we will see even more competitive products coming into the market from both AREPs and competitive REPs.

Dallas-based TXU has been the most aggressive in developing new rate offers. "We have 10 new plans," said David Hennekes, TXU's vice president for consumer markets, adding that customers have different needs and that each TXU offer is designed to appeal to different customers.

For example, customers who seek to avoid rate volatility can sign up for TXU's "PriceGuarantee 24," which offers a fixed two-year rate. Customers expecting power prices to drop may be attracted to TXU's "Market Tracker +" variable-rate plan, while those interested in helping the environment can sign up for one of the company's two "EarthWise" green-power offers.

Hennekes said that TXU has been actively promoting its various offers in recent weeks, and that a "significant portion" of TXU's long-time default customers already have switched from price-to-beat rates to one of the company's new offers.

He declined to reveal TXU's strategy for retaining default customers who still have not switched from price-to-beat rates by mid-November. Then — 45 days before the January 1 end of price-to-beat rates — default providers must notify such customers what their new rate plan will be called and how much they will be paying for their electricity if they do not choose a plan on their own.

Glen Stancil, vice president for Houston residential marketing at Houston-based Reliant, said his company, too, has been rolling out a series of alternatives to the price to beat in the CenterPoint utility area. The alternatives include Reliant's "2007 Secure" plan, which gives customers a 3% discount on the company's current price to beat through the end of this year, a 5% discount next year, and a \$25 sign-up bonus; and the "Simple Solutions Renewable" plan, which offers 100% wind power at a slight discount to the price to beat.

Already, Reliant has lured 350,000 of its one-million-plus residential customers in the CenterPoint area to alternative offers, Stancil said, and by the end of this year it plans to increase that number to 500,000.

As for Reliant's price-to-beat customers who have not switched to another plan by January 1, Stancil is similarly reticent

to discuss details of Reliant's strategy. "We are still working on the specifics, and I'm not prepared to share the product structure or price," he said. "But I would say that our objective is to provide a seamless transition to a new month-to-month product."

Partly in response to the new plans being offered by AREP giants, smaller suppliers are expanding their own offerings. For example, StarTex Power — a recent entrant to the market, started up by the founders of Gexa Energy, which was acquired by FPL Energy in June 2005 for \$81 million — currently offers eight plans, said Marcie Zlotnick, StarTex's president and COO.

"All retailers need to be innovative" now that AREPs are able to offer a wide range of plans, said Zlotnick, adding that her company continues to explore additional offers it might make.

StarTex also is seeking to differentiate itself from other REPs in the quality of its customer service. Customers and potential customers who call Zlotnick's company "love the fact that real people pick up the phone and are eager to help them," she said.

At Constellation NewEnergy, one of the largest competitive suppliers in the state, "I don't expect the market to change a whole lot" because customers are accustomed to the competitive market and have become more savvy over the years, said Rob Task, vice president at NewEnergy's Texas office.

There have been periods when the price to beat was close to what competitive suppliers could offer and periods when it was not competitive, Task said. The amount of switching that will take place near January 1 "really depends on if companies are targeting those customers," he said.

At NewEnergy, "we'll function the same way we have," which includes selling to smaller customers, with some at the 50-kV level of small commercial users. The company does not currently offer a 100% green power product but "we're constantly evaluating our suite of products" and if there is sufficient customer interest, that could change, Task said.

But what will happen to retail electricity prices come January 1 and the end of price-to-beat rates? And how much switching will there be? And will ERCOT, which is responsible for handling customer switching, be able to handle a potentially large number of switches in a short period of time?

Most market participants said they are not expecting much change in retail prices unless there is a major move in gas and wholesale power prices. They also agree there probably will not be much switching from AREPs to competitive suppliers.

Some market participants said that to date, prices in the market have been based largely on the price to beat itself, with each competitive supplier determining how much it needs to undercut that benchmark price to draw customers away from the default provider.

But StarTex's Zlotnick disagreed, stating that her company determines what its prices will be "from the bottom up" by adding a small margin to what StarTex pays for wholesale power.

Stancil, the Reliant executive, said he believes that once the price to beat has been eliminated, the level of retail electricity prices "will be much more dynamic, and responsive to the gas market and the natural competitive margin" that the market determines is sufficient to support the financial viability and vitality of REPs. "We don't know yet what that healthy margin will be," Stancil added.

Public Citizen's Smith has another theory: that prices will cluster around what all REPs determine "the market will bear," similar to how gas stations change prices based on what other stations in their area are charging.

Whatever level of switching there may be in November, December and January, ERCOT is prepared to handle it, said ERCOT spokeswoman Dottie Roark. She noted that ERCOT's retail transaction processing systems were built to handle approximately 100,000 registration transactions daily. That includes "any combination of switches, move-ins, move-outs, drops" and other service changes.

Stancil noted that if a price-to-beat customer switches to another rate offer by the same AREP, or if a customer of a competitive supplier switches to another offer by the same supplier, ERCOT does not even need to be involved.

The transition to a fully competitive retail market in ERCOT also has been characterized by some attrition and consolidation among REPs — as well as the addition of some new entrants such as StarTex — and by a growing number of Internet-based "brokers" that seek to simplify the process of selecting a power supplier.

Consolidation has been a bit below market expectations given that Texas has about 50 retailers competing for a limited number of customers, and the January 1 change is unlikely to facilitate additional mergers or acquisitions, according to Task.

Among the M&A deals to date, Direct Energy in April acquired the customer base of Entergy Solutions, the Entergy subsidiary and competitive supplier that served more than 100,000 residential and small commercial customers. Direct, a unit of UK-based Centrica, said the acquisition made it the largest competitive supplier in the CenterPoint area.

Direct also is the AREP in the AEP Texas Central and AEP Texas North areas, thanks to its December 2002 acquisition of American Electric Power AREP subsidiaries.

Regarding Internet-based brokers, initially only the PUC's own powertochoose.org website offered residential and small commercial customers an opportunity to do side-by-side comparisons of retail electricity offers.

Now, several private companies do. They include saveonenergy.com, a three-year-old entity that in its newly updated website seeks to simplify the REP selection process by focusing on retailers that it has determined offer financial strength, good customer service and low prices, then making recommendations. Others are electricitytexas.com and movetx.com.

As noted, many consumer advocates have questioned the benefit of retail competition to smaller customers and believe that the elimination of the price to beat will help prove their case. Public Citizen's Smith said, "My sense is that nothing much will happen [regarding price levels] immediately after January 1, and that there will be six-month hiatus [during which] everyone will be particularly cautious because they are very worried about what the reaction to higher prices would be among legislators," who begin their 2007 session within days after the price to beat disappears.

After the Legislature adjourns in June, he said, "I think what we will see is a significant amount of profit-taking as various [REPs] start to ratchet up their prices." That profit-taking, in turn, will be followed by a period when something approaching

true competition "kicks in" for a year or so, followed by another round of profit-taking, he said.

Smith predicted that in the short- and medium-term, or legislative sessions in 2007 and 2009, the Legislature is unlikely to make any big changes in retail competition, although it may approve "some sort of 'safe-harbor' package for low-income customers" who cannot contract with an REP because of bad credit ratings or other financial problems. "Low-income customers don't have the choices that other customers have," added Randy Chapman, executive director of the non-profit Texas Legal Services Center.

Smith added that he believes it is possible that still-high electricity prices and a strong sense that retail competition is not working may lead the 2011 session of the Legislature to take more dramatic action.

State legislators "certainly will be watching" how the retail market works once the price to beat is eliminated on January 1, said an aide to State Representative Sylvester Turner (Democrat-Houston) who declined to be identified by name. "But as far as the Legislature 'putting the genie back in the bottle,' I haven't heard of anyone talking about that."

Re-regulating retail prices would be a mistake, said Reliant's Stancil, because it would eliminate competition, take away customer choice, and "probably would not change the ultimate price the consumer sees."

Davis of the Alliance for Retail Markets agreed, asserting that implementing retail competition has given residential and small commercial customers in ERCOT an increasing array of choices at competitive prices that reflect the realities of wholesale electricity. Texas, he said, is "the most successful retail electricity market in the country."

The Texas retail market "has had some time to mature" and should weather any change, Task added. Even with additional coal-fired generation being planned in Texas, power prices largely will track the cost of natural gas and "at the end of the day, electricity is traded as a commodity" with market forces playing a larger role, he said. —*Housley Carr, Tom Tiernan*

Cal-ISO cautions... from page 1

have to be part of the utilities' capacity. Instead, a utility has to demonstrate through ownership of renewable energy credits that it has supported an amount of renewable generation equal to 20% of their total annual kWh sales.

"You really don't count on wind energy as capacity. It is different from other technologies because it can't be dispatched," said Christine Real de Azua, assistant director of communications for the American Wind Energy Association.

The ISO believes wind is a great resource for replacing power purchased from gas and coal power plants, "but it is not a panacea," an ISO spokesman said. "We advocate a balanced portfolio." Generators will still need to supplement the intermittent nature of wind by shaping hydroelectric output or with new coal- and gas-fired generation.

There is about 2,500 MW of installed nameplate wind generation currently operational in California, according to ISO documents. Wind turbines typically can produce at 25% to 30%