

STATE OF CONNECTICUT
DEPARTMENT OF PUBLIC UTILITY CONTROL

**DPUC DEVELOPMENT AND REVIEW OF STANDARD SERVICE AND SUPPLIER
OF LAST RESORT SERVICE - PLAN APPROVAL - BILATERAL CONTRACTS
OUTSIDE OF AUCTION**

Docket No. 06-01-08RE01

**DPUC REPORT TO CONNECTICUT GENERAL ASSEMBLY ON STANDARD
SERVICE PROCUREMENT**

Docket No. 07-06-58

COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

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Introduction and Summary of Comments

The Retail Energy Supply Association (“RESA”)¹ provides these comments in response to a Notice of Request for Written Comments (“Notice”) issued by the Department of Public Utility Control (“Department”) on November 23, 2007 in the above-referenced dockets. In the Notice, the Department sought comments concerning the desirability of using a Standard Service portfolio manager, which may include the electric distribution companies (“EDCs”); whether a non-profit entity should be created for the procurement of Standard Service power; whether physical and financial hedges should be utilized to manage prices; and comments on initiatives in other states, including whether spot market purchases should be used as a Standard Service procurement strategy in Connecticut. Moreover, the Department sought comments concerning Connecticut Light and Power Company’s (“CL&P”) motion to amend its Standard Service procurement plan to facilitate its pursuit of bilateral contracts for wholesale power products.

RESA is a non-profit corporation and trade association that represents the interests of its members in regulatory proceedings in the New England, New York and Mid-Atlantic regions. Its members include providers of competitive supply products to electricity and natural gas consumers in the New England states that have restructured their energy markets.

In considering these issues, RESA urges the Department to keep in mind several broad policy goals. The first is the goal of sending accurate pricing signals in order to continue to develop the competitive market and provide additional supply options for Connecticut’s customers. Accurate price signals, in turn, further the important goals of promoting greater reliance on energy efficiency, demand response, conservation and distributed generation. These

¹ RESA member companies include Commerce Energy, Consolidated Edison Solutions, Inc., Direct Energy Services, LLC, Gexa Energy, Hess Corporation, Integrys Energy Services, Inc., Liberty Power, Reliant Energy Retail Services, LLC, Sempra Energy Solutions, Strategic Energy LLC, SUEZ Energy Resources NA, Inc., and U.S. Energy Savings Corp. The opinions expressed in this filing may not represent the views of all members of RESA.

goals are embodied not only in the Department's own priorities, but also in those of the Legislature, as expressed in both an Act Concerning Energy Independence (Public Act 05-1) and an Act Concerning Electricity and Energy Efficiency (Public Act 07-242) ("Energy Efficiency Act"). Finally, RESA urges the Department, wherever possible, to continue to promote the goal of minimizing the risks inherent in the procurement of electric supply for Standard Service and, wherever possible, avoid forcing Connecticut ratepayers to shoulder risks that are better managed by the competitive market.

In order to accomplish these goals, RESA believes the Department should not allow EDCs to procure their Standard Service supplies through direct bilateral long-term contracts with wholesale suppliers or owners of merchant power plants, or to re-enter the business of providing "managed portfolio" services for Standard Service customers (which is essentially what they were doing before restructuring). Following restructuring and the divestiture of generation assets, the EDCs, as true wires and poles distribution utilities, no longer have the in-house expertise to analyze future market prices and enter into risky long-term procurement contracts, and certainly have not shown that they are in a better position to serve this function than the wholesale suppliers now providing supply for Standard Service. Allowing EDCs to enter into such arrangements would, therefore, add potential stranded costs, send distorted pricing signals to customers, and could result in greater rate shock when long-term contracts acquired in pursuing this strategy expire. Furthermore, if the contracts were not structured to procure the full requirements of Standard Service customers, inclusive of balancing energy and ancillary services, customers would not know the full cost of such supply until after the fact and would not be able to adequately compare estimates of the Standard Service rate to competitive alternatives.

There is also no evidence that allowing a non-utility entity to perform such a “portfolio manager” role – beyond that currently being provided by wholesale suppliers – would have any benefits for customers that would offset the risks involved, which are little different from the risk posed by having utilities serve this function. Finally, RESA can discern no advantages whatsoever, and potentially catastrophic risks, from having a non-profit entity take on the role of procuring supply for Standard Service.

RESA notes also that this investigation takes place as Connecticut has begun to be considered one of the success stories in gaining the benefits of competition for its citizens while also managing many of the challenges presented by the energy markets, which are shared by nearly all states, regardless of whether their electricity markets have been restructured or remain vertically integrated. During the past year in Connecticut, more customers have migrated to competitive suppliers than ever before since the enactment of electric restructuring with Public Act 98-28 and the Legislature’s and Department’s policy goals have been working – more suppliers have entered the market and competitive choices are attracting customers. The Department should therefore be more reluctant than ever before pursuing medium and longer term supply contracts, which would expose customers to additional risks and would likely thwart the growing migration away from Standard Service.

RESA also fully supports the use of spot marketing pricing, as recently adopted in Pennsylvania. The underlying policy goals mentioned above of encouraging energy efficiency and demand side management, as demonstrated decisively in the Energy Efficiency Act, would further be enhanced with the use of a mix of procurement contracts that includes spot market pricing because it would send the right price signals to residential and small commercial customers and encourage cost effective energy efficiency and demand response, saving money

both for the consumers who implement such measures and, by reducing the need for more expensive generation, reduce the cost of electricity for all of Connecticut.

The Department should consider integrating regular adjustments to the Standard Service price with the use of spot market energy supply products to ensure that rates more closely track prevailing wholesale energy prices, and that customers do not experience large changes in rates as program terms expire. When wholesale energy prices rise over a period of several years, experience in other states suggest that a series of small rate increases is preferable to one large increase at the end of a plan's term of service.

Comments

I. ENSURING THAT STANDARD SERVICE RATES SEND ACCURATE PRICE SIGNALS TO CUSTOMERS AND PROTECTING CUSTOMERS FROM THE RISKS OF ADDITIONAL STRANDED COSTS ARE OVER-ARCHING GOALS THAT WILL NOT BE SERVED BY ALLOWING UTILITIES OR OTHER ENTITIES TO ENTER INTO MEDIUM AND LONGER TERM COMMITMENTS FOR STANDARD SERVICE SUPPLY.

If retail competition is to succeed and energy efficiency and other demand resources are to be encouraged, customers must receive accurate and timely price signals. Conversely, proposals that distort price signals will undermine competition, discourage customers from engaging in demand side management of scarce energy resources, and will ultimately harm the environment as customers use the energy resources without due regard for the full impacts of their decisions. Particularly in transmission-constrained southwest Connecticut, the importance of sending accurate price signals cannot be overemphasized. The same policies that result in accurate price signals also tend to protect customers from the risk of further stranded costs.

A. Medium and Long-Term Procurement Contracts Such as Those that Would Be Used in a "Managed Portfolio" Would Send Distorted Price Signals to Standard Service Customers and Increase the Risk of Stranded Costs.

The past year has seen an influx of competitive suppliers into Connecticut as a result of the progressive market improvements made by the Department and the Legislature. This has, in turn, resulted in a tremendous increase in migration away from utility default service to competitive suppliers.² RESA recognizes and appreciates the efforts made by the Legislature and the Department to provide incentives that spur competition. In response, conditions in the Connecticut market have changed and suppliers are offering customers of all sizes more choices and value than ever. These positive developments would be at risk if the Department takes steps that would re-incorporate elements of the pre-restructuring, vertically-integrated system into Standard Service. Because customers now have many more supply options in the market, and are responding as expected by exercising their right to choose the option(s), that best meet their needs, Standard Service has reached the point where it can be viewed more as the transitional or “last resort” service it was meant to be. Layering medium and long-term contracts, especially bilateral contracts directly with generators, into Standard Service supply will destroy the effectiveness of the price signals that have helped to create the improvements now seen in the Connecticut market, and will also expose Connecticut ratepayers to the risk of a new round of stranded costs.

In this respect, to the extent the EDCs are allowed to enter into medium and long-term commitments, including physical or financial hedges and bilateral contracts with generators,

² According to the latest monthly data reported by the EDCs to the Department, as of October 31, 2007, CL&P reported 60,806 accounts as competitively supplied as compared to 39,631 accounts competitively supplied as of November 30, 2006. As of November 30, 2007, the United Illuminated Company (“UI”) reported 27,064 accounts as competitively supplied as compared to 0 accounts competitively supplied as of November 30, 2006. (Note, due to the different dates on which CL&P and UI report, we do not yet have information as to CL&P’s November data.) November is a significant month for customer migrations because it is also the month in which two RESA members, Consolidated Edison Solutions, Inc. and Direct Energy Services, LLC, announced their market entry into the residential electric market in Connecticut so RESA has reason to believe that the migration trend will continue even more. Nonetheless, the released numbers show that customer choice is becoming a reality in Connecticut: *approximately 20,000 customers have switched from CL&P during the past year and approximately 30,000 customers have switched from UI during the past year.* See information under Docket 06-10-22 at www.state.ct.us/dpuc.

consumers will lose. The electric suppliers which have recently begun to actively serve customers in Connecticut will be discouraged from continuing or expanding their presence in the Connecticut market if accurate pricing signals are not sent, thus reducing the options available to customers for managing their energy needs. Furthermore, any contracts that do not provide balancing energy and ancillary services would not provide price certainty, thereby making it more difficult to evaluate competitive alternatives. Creating a disconnect between retail prices and the wholesale market will also send inaccurate pricing signals with regard to the cost-effectiveness of demand resources and the need for new power plants, which would tend to offset the substantial improvements that have resulted from the Department's implementation of measures encouraging the development of demand side resources, distributed generation, and new larger-scale power projects. This would ultimately result in higher prices for Connecticut's residential as well as commercial and industrial customers.

Longer term arrangements of any kind also carry substantial risks that are not mitigated simply because such arrangements take the form of something other than full requirements load following service. For example, there is no evidence that any supplier is willing to take the long-term risk associated with fuel prices or for compliance with greenhouse gas regulations, especially for the natural gas-fired plants that set the clearing price in most hours in New England. Moreover, none of these alternative arrangements will come with a guarantee that the basic premises underlying their acquisition – namely that prices can only go up and that volatility of any kind for mass market customers is undesirable – will prove to be true. The impulse to “go long” in power was the same impulse that led to the execution of power contracts that were rendered uneconomic by market developments and which led to the desire to pursue restructuring. As discussed further below, there are far more effective ways to deal with the risk

of rising prices and to harness the benefits of accurate pricing, which the Department is fully empowered to pursue.³ Rather than pursue bilateral contracts with generators or more exotic hedging strategies, RESA encourages the Department to direct the EDCs to engage in systematic, shorter-term procurements of Standard Service supply, reflecting market prices and fostering the continued growth of retail choice and competitive market prices in Connecticut.

In short, entering into medium and long-term commitments for the acquisition of power supplies would distort the accurate market price signals that customers should see, promote inefficient use of electricity with an attendant negative impact on the environment, and retard the further development of the competitive options that have just recently begun to emerge for customers in Connecticut.

B. The Connecticut Energy Independence Act Authorizes the Implementation of More Efficacious Approaches to Procuring Standard Service Supply.

In designing the Standard Service model, the Legislature required that the Department establish a price for Standard Service “not more often than every calendar quarter.” See C.G.S. §16-244c(c)(2). Moreover, the applicable statutes allow for contracts of shorter terms: “[t]he portfolio of contracts procured under such plan shall be for terms of not less than six months, provided *contracts for shorter periods may be procured* under such conditions as the department shall prescribe to (A) ensure the lowest rates possible for end-use customers; (B) ensure reliable service under extraordinary circumstances; and (C) ensure the prudent management of the contract portfolio.” C.G.S. §16-244c(c)(3) (emphasis added).

³ The risks of longer-term contracts perhaps can best be illustrated with reference to those approved earlier this decade by the California Public Utility Commission, which made such a mistake in the midst of its electricity crisis by locking into long-term contracts at what turned out to be the top of the market. These contracts were seen as a bad deal shortly after they were signed. See James L. Sweeney, Stanford University, [The California Electricity Crisis: Lessons for the Future](http://www.nae.edu/nae/bridgecom.nsf/Multi+Database+Search/8DB85E5C8472266285257111006F3DDA?OpenDocument) (Summer 2002), p. 11 (stating that California adopted long-term electricity purchase contracts to address short-term problems at roughly twice as high as expected market prices), available at <http://www.nae.edu/nae/bridgecom.nsf/Multi+Database+Search/8DB85E5C8472266285257111006F3DDA?OpenDocument>.

When the Department first analyzed the *Development and Review of Standard Service and Supplier of Last Resort Service* in Docket No. 06-01-08PH01, even the EDCs recognized that less risk is assigned to bids in shorter period contracts than in longer-period contracts. (See CL&P plan, p.5). The plain language of the statute allows the Department to adopt this view, and reject more complex and risky approaches to Standard Service supply in favor of an approach that will encourage competition and promote the further development of demand resources by sending accurate signals and shielding customers from the risks of long-term commitments.

As discussed further below, establishing at least a portion of the Standard Service price on as close to a real-time basis as possible would send more accurate pricing signals to those customers, further ensuring that the goals of the Energy Efficiency Act will be met and that competitive options will continue to develop in the Connecticut market as has begun to occur recently. RESA thus urges the Department to move toward an approach to Standard Service procurement that incorporates spot market and other short term resources to replace contracts greater than one year in length as they expire.

II. PROCURING STANDARD SERVICE POWER

With regard to the procurement parameters raised by the Notice, including whether to use a Standard Service portfolio manager, whether a non-profit entity should be created to procure Standard Service power, whether physical and financial hedges should be utilized to manage prices, and whether spot market pricing should be considered in such procurement, RESA suggests that the goals of the statute should guide the analysis. These goals would not be served by these alternative approaches.

A. A Managed Portfolio Would Not Meet the Goals of the Statute.

The statute requires that the EDCs' portfolio of contracts "be assembled in such manner as to invite competition; guard against favoritism, improvidence, extravagance, fraud and corruption; and secure a reliable electricity supply while avoiding unusual, anomalous or excessive pricing." C.G.S. §16-244c(c)(3). Furthermore, the statute directs that the contracts be entered at "such times and in such manner and duration as the department determines to be most likely to produce just, reasonable and reasonably stable retail rates *while reflecting underlying wholesale market prices* over time." C.G.S. §16-244c(c)(3) (emphasis added).

Thus, the Legislature wisely recognized that in order to promote retail competition, the Standard Service prices must provide reasonably timely pricing signals in order to foster competition for small and medium customers. As experience has shown, when proper pricing signals are sent, competition is encouraged and customers are able to choose their electric supplier and make decisions that are attuned to the available market signals and energy efficiency opportunities.

The goal is *not* to render Standard Service a *de facto* monopoly similar to that which existed before restructuring through a managed portfolio of power contracts, particularly where customers bear the full risk of the complex and exotic arrangements a portfolio manager might enter into, but rather to encourage low-cost competitive alternatives for the purchase of electricity and energy efficiency services. The "managed" component of the term "managed portfolio" clearly implies that some person or entity is going to have to make purchasing decisions. That person cannot and will not always make perfect purchasing decisions⁴ so,

⁴ As discussed further below, the Pennsylvania Commission is "discouraging the use of bilateral contract in the acquisition of default service supply" and is "skeptical of the DSP's ability to beat the market over periods of time...." A regulatory proceeding that lasted three years with over 200 pieces of evidence showed no record evidence to support the notion that a portfolio manager could obtain consistently lower prices than the market. *Final Default Service Rulemaking* at page 25 ("Pennsylvania Rulemaking").

inevitably, that person will cause costs to be incurred in excess of the cost that would have been incurred by simply purchasing at the true market price over the same period of time. The criteria established by the Legislature for Standard Service cannot be met by an actively managed portfolio. A managed portfolio might produce a “reasonably stable” price – however high that price might be – but there is no evidence that such a price would also be just and reasonable while also reflecting underlying wholesale market prices over time.

Rather than having an actively managed longer term portfolio and the inherent additional costs associated with such portfolio management services, RESA recommends that the Department remain focused on the State’s public policy goals of achieving just and reasonable rates that reflect wholesale market prices by moving to shorter term procurement increments. It is worth noting, furthermore, that while Section 104 of the Energy Efficiency Act required the Department to examine the feasibility and potential risks and benefits associated with selecting a Standard Service portfolio manager, the Legislature clearly stopped short of requiring that a Standard Service portfolio manager be put in place at this time, preferring to receive a report on findings and recommendations by February 1, 2008.

Moreover, if the Department decides to use a managed Standard Service portfolio manager to implement the strategies it proposes, the EDCs should not be the managers of such portfolios. To allow the incumbent utilities, especially those that have (or previously had) an unregulated wholesale affiliate, the opportunity to actively manage the Standard Service portfolio runs contrary to the policy goals of restructuring the electric industry and creating a level playing field to spur competition. The EDCs were allowed to operate a “managed portfolio” of resources for many decades, and the result was four billion dollars of stranded costs that Connecticut citizens continue to pay down. If a Standard Service portfolio manager is

chosen, RESA recommends outsourcing this responsibility to a competitively neutral manager, which has no connection to the EDCs or their affiliates, would report directly to the Department, and could demonstrate sufficient experience and financial strength to carry out these functions. Even then, the managed portfolio approach should be undertaken only if such an entity provides some enforceable guarantee of results that would be superior to those being achieved under the current system or which could be easily achieved using the shorter term procurements strategy RESA recommends.

Regardless of the specific approach taken, RESA does not recommend that the Standard Service procurement function be undertaken by a non-profit entity. This approach would entail all of the risks discussed above with respect to a managed portfolio and, in addition, would require the citizens of Connecticut to capitalize such an entity to a degree that would allow it to conduct billions of dollars of transactions both directly with counter-parties and through ISO New England. Further, a non-profit entity would, literally, have no financial interest in doing as good a job as possible in procuring power for Standard Service. While there appears to be some allure in the idea that attempting to wring profit out of the system will lower costs for customers, there is no evidence that this can actually be done. It is the profit motive inherent in competitive markets that drives both wholesale and retail suppliers to drive prices as low as possible in order to successfully win customers.

While some have pointed to the experience of Connecticut Municipal Electrical Energy Cooperative (“CMEEC”) as an example of what can be done by a non-profit entity, this is not a useful analogy for two key reasons. First, CMEEC’s behavior and role in the market is more analogous to a large customer than to an entity that procures supply for a customer base with as

much as several thousand megawatts of peak load.⁵ Second, and perhaps more importantly, the territories of municipal light plants are not open to competition. The municipals' customers cannot leave and therefore CMEEC is not exposed to the same migration risk inherent in utility Standard Service or the risk of stranded costs that would be imposed on Standard Service customers should a "portfolio manager" for Standard Service act in the same manner as CMEEC.

B. Long-term Bilateral Contracts Will Not Serve the Statutory Goals.

Since restructuring, the power supply for the EDCs' default customers has traditionally been procured through the wholesale power markets overseen by ISO-NE. Through this proceeding, at least one utility, CL&P, expresses its desire to re-invent the market dynamic by entering into long-term bilateral energy contracts between EDCs and merchant generators as part of the Standard Service procurement process. Utility participation in the supply business would raise significant questions about unfair cost allocations and/or customer subsidies and would likely detract from efforts to improve the EDCs' transmission and distribution networks. Even if costs could be properly allocated, the perception emerges of a competitive advantage to the EDCs, which could damage the competitive market that the Legislature and Department have worked so hard to develop. Traditional utility ownership of generation assets on a regulated basis provided a guaranteed recovery of cost and rate of return from the State's ratepayers – an advantage that no other market participant has and an option that the Legislature specifically rejected in enacting the Energy Efficiency Act. Long-term contracts with unregulated generators may seemingly provide a ratepayer hedge against market prices and fluctuation, but they also carry the risk of new stranded costs and would likely entail significant counterparty credit risks

⁵ See *Review of the Ten Year Forecast of Connecticut Electric Loads and Resources 2007-2016*, available at the Connecticut Siting Council's website, www.ct.gov/csc/site/default.asp. According to the 2007 Report, peak load for CMEEC in 2006 was 398 MW compared to 5512 MW for CL&P and 1456 MW for UI. (see p. 5 of 2007 Report).

and collateral costs. In particular, such long-term bilateral contracts are generally based on expectations of future market prices, which in turn reflect future projections of natural gas prices.

Long-term bilateral contracts that would lock Standard Service customers into a fixed energy price for years should not be part of the Standard Service structure because such long-term contracts: (1) are based on forecasts and may lock customers into paying higher rates if the market prices fall; (2) send distorted pricing signals, crushing the development of a competitive market; (3) may result in rate shock at the expiration of the long-term contracts; (4) provide disincentives for energy efficiency to which customers are otherwise attuned when accurate seasonal prices are sent out; and (5) divert utility resources that would otherwise be available for transmission and distribution infrastructure projects.

Moreover, merchant generators may be reluctant to enter into long-term contracts with EDCs at or near their marginal cost of production (which apparently is what proponents of this approach believe will occur). Generators are privy to the same information that has led some to promote the use of long-term bilateral contracts. If they believe that there will continue to be upward movement in energy prices, especially natural gas prices, to which New England electricity prices are intimately linked, over the long term, there is no reason to expect such generators to accept a substantial discount from what they could reasonably achieve by relying on shorter term and spot market sales. What proponents of these various alternative methods of Standard Service ignore is that at some point, some entity must take on the risk that the assumptions underpinning the resulting transaction will prove to be wrong, to that party's detriment. Generators are no more anxious than any other entity to be the party left holding that risk by accepting contract terms less favorable than they would receive from selling on a shorter term basis in what they believe would be a rising fuel price, capacity-constraint market.

1. The Unpredictability of the Market and Rate Shock That May Result from the Expiration of a Long-Term Contract

There are other risks associated with longer-term and bilateral contracts. Neither the EDCs nor any other market participant can accurately predict future price trends.⁶ Implementing a portfolio structure that entails long-term contracts might be characterized as a “hedge,” but any fixed position is a hedge that carries with it inherent risks. Even if prices remain low for the duration of the contract periods, after the terms expire, customers may experience jarring rate shocks. If the EDCs predict long-term prices and the market brings lower prices, then ratepayers will be locked in to higher prices for several years.

Either scenario (locked in prices that are too high or too low as compared to the future market) carries inaccurate pricing signals, undermining the efforts made toward encouraging competition in Connecticut. The problem raised by entering into long-term contracts that provide artificially low prices, followed by extraordinary generation rate spikes after the expiration of such contracts is illustrated by the recent experience of UI resulting from its entry into a three-year fixed price contract for its Standard Offer and Transitional Standard Offer (“TSO”) customers in contracts that expired on December 31, 2006. While there were benefits to those customers who paid a price that resulted in rates well below current market prices, after that long-term contract expired, a political and media crisis ensued when those customers were faced with the jarring rate shock linked to having to pay current market prices. Had shorter-term TSO contracts been implemented instead of one such long-term contract, the gradual rate

⁶ Moreover, with regard to CL&P’s motion to amend its Standard Service plan to facilitate its negotiation of bilateral contracts for wholesale power products rather than using the auction process, RESA notes that CL&P’s parent company, Northeast Utilities, sold its apparently unprofitable unregulated marketing, generation and services assets (see <http://www.allbusiness.com/services/business-services/4342689-1.html>), so it no longer has particular in-house expertise with regard to generation or long-term contracting. There is no reason to expect or believe that the EDCs are in a better position to develop and enter into long-term contracts than those market participants who are currently in the generation and energy procurement business and, in any event, query why the CL&P ratepayers should take the risk that the NU shareholders could no longer bear.

impacts, more reflective of the movement of the market, may have prevented the crisis that resulted.

2. Long-Term Contracts Impede Retail Competition and Discourage Energy Efficiency

RESA recognizes the efforts made by the Legislature and Department to plant and nurture the seeds of a competitive market in Connecticut. For retail competition, including competitive demand response and energy efficiency offerings to continue to develop, Standard Service rates must reflect wholesale price signals. Only then can the State's goals of sending accurate pricing signals and encouraging energy efficiency be met. Because long-term contracts obscure market signals and remove market transparency, customers do not receive the information and incentives that they need in order to make reasoned decisions as to energy efficiency and alternative energy offerings. If customers receive distorted, artificially low, locked-in prices for a long period, they will receive the wrong price signal – namely, that power is cheaper than it really is – and will not explore demand-side conservation measures and improvements that they otherwise would. Greater use of demand-side management needs to be encouraged not only because it allows customers to control their electricity bills, but also because it relieves pressure on the already strained electric grid. Moreover, electric suppliers are justifiably very hesitant to enter a market and make the necessary long term investment where there is regulatory uncertainty in the form of an ever lingering possibility that an EDC may be permitted to enter into ratepayer-subsidized long-term contracts that could substantially erode or eliminate market incentives for customers to choose competitive supply. The key, again, is for the regulated EDCs' service to be provided through predictable, regular procurements of a short duration so that accurate prices, reflective of the market, are sent to customers. Only in such an

environment can Connecticut's long-term goals (including energy efficiency and conservation) be met.⁷

III. THE EXPERIENCE OF OTHER STATES FAVORS SHORTER TERM PROCUREMENTS AND KEEPING THE UTILITY OUT OF THE POWER SUPPLY BUSINESS.

RESA took great interest in the Department's invitation to comment on initiatives in other states that would be useful in the Department's report and, specifically, on "whether spot market purchases should also be utilized as a standard service procurement strategy in Connecticut." Notice at 2. As the Department noted, Pennsylvania has recently undertaken an inquiry similar to the Department's investigation here, and RESA believes the findings in the Pennsylvania Rulemaking are especially instructive.

Pennsylvania undertook an investigation of how to design and procure utility default service in anticipation of the expiration of statutorily mandated rate caps at the end of 2008. In this respect, Connecticut is farther along in its restructuring efforts than Pennsylvania, having already addressed the expiration of both standard offer and transitional standard offer through the creation of Standard Service and supplier of last resort service. The questions the Pennsylvania Commission addressed, however, are essentially the same as those presented in the Notice, focusing as they do on default service design, the possible use of longer-term, bilateral contracts or a "managed portfolio," and the use of shorter-term and spot market pricing for all customers, including residential customers. Having conducted an extraordinarily thorough investigation of these issues, the Pennsylvania Commission reached several conclusions that are relevant here. The Pennsylvania Commission rejected the notion that an EDC managing a portfolio that

⁷ If the Department decides to allow EDCs to enter into long-term arrangements (which is contrary to RESA's recommendation), the resulting energy and capacity should be periodically sold into the wholesale market (rather than be used directly to serve the Standard Service load). In this manner, a hedge may be provided without sending such distorted pricing signals that disrupt Connecticut's developing retail market.

includes long-term and bilateral contracts will achieve better pricing than a system that relies on shorter-term procurements:

In conclusion, we are generally skeptical of the DSP's [default service provider's] ability to beat the market over periods of time greater than one year. Incumbent EDCs have simply not provided any real record in this or other default service proceedings to show that they can anticipate changes in market prices, and take advantage of this information to obtain consistently lower prices through long-term contracts compared to short-term and spot market purchases. Wholesale market prices are very sensitive to factors completely beyond the control of DSPs, suppliers and regulators, including weather, global energy demand, and war. This is one of the key reasons we are discouraging the use of bilateral contracts in the acquisition of default service supply. We believe customers will save more money as DSPs gradually increase their utilization of short-term fixed price contracts and spot market products, and what data we do have supports this premise. For example, Direct Energy cited to a report in its reply comments that Duquesne's residential customers would have saved \$75 million during the first two years of its "POLR III" plan if they had been on monthly priced service. Small commercial customers would have realized savings of \$28 million over the first 23 months of the POLR III plan. *Id.*⁸

While the Pennsylvania Commission did recommend the use of longer-term, fixed price all requirements contracts "immediately following the expiration of rate caps," it also recommended that "the portion of the portfolio that relies on shorter term contracts (e.g., 1 year or less) and the spot market be gradually increased with time."⁹ The Pennsylvania Commission found:

This practice of regular adjustment with the use of spot market energy supply products will ensure that rates more closely track prevailing wholesale energy prices, and that customers do not experience large changes in rates as program terms expire. When wholesale energy prices rise over a period of several years, we find

⁸ Pennsylvania Rulemaking at 25.

⁹ *Id.* at 24.

that a series of small rate increases is to be preferred to one large increase at the end of a plan's term of service.¹⁰

Connecticut has reached the point that the Pennsylvania Commission envisions Pennsylvania will reach in several years. Post-restructuring rate caps have expired. A laddered portfolio on all requirements contracts with terms of up to three years has been put into place in an attempt to reduce volatility for Standard Service customers (many of whom, it should be noted, are of a sufficient size that they cannot be accurately characterized as "small"). Pro-competitive measures passed by the Legislature and implemented by the Department have resulted in increased competitive options for customers, who have responded by leaving utility service in ever-larger numbers. Connecticut is moving aggressively toward increased levels of demand resources. This is the ideal time to move from a procurement approach that emphasizes reducing rate volatility to one that not only manages volatility appropriately but also will bring further efficiency to the market and promote customer acquisition of additional demand resources.

For these reasons, RESA favors adding spot market (and, perhaps, other short-term procurements) as an expanding component of Standard Service procurement, taking the place of two- and three-year all requirements contracts as they expire. This use of spot market and other short-term pricing, in combination with some continued level of one-year contracts, will promote beneficial customer behavior with regard to energy efficiency and demand response, thereby supporting the goals set forth most recently by the Legislature during the 2007 session in the Energy Efficiency Act, while also reducing the risk and migration premiums that would arise should EDCs continue to add longer term contracts to the default service portfolio.

¹⁰ *Id.* at 5.

This approach would also serve the critical goal of ensuring that customers continue to have a real choice among many supply options. While the Department (just as any other Commission, EDC, or portfolio manager) cannot control electricity prices (which are functions of various state, regional, and global factors, including the price of natural gas and other fuels used in generation, the availability of transmission, the availability of generation capacity, environmental requirements, renewable portfolio requirements, and the like), the Department can control the structure of the market to ensure that if and when customers are faced with higher energy prices, customers have a choice among options for managing higher prices, both on the supply and demand side. An improperly structured managed portfolio could eliminate competition from the market, essentially reverting to an unregulated monopoly of the EDCs over Connecticut's Standard Service customers. Adopting the approach set forth above would, on the other hand, promote the continued development of the Connecticut market that has occurred in earnest in the past year.

Conclusion

The Department faces an important inflection point in these combined dockets. The recent measures put into place by the Legislature and deftly implemented by the Department have made Connecticut one of the success stories in managing the challenge of retail electric market design in a complex and ever-changing landscape of factors that affect those markets. RESA encourages the Department to adopt steps that will continue to foster the growth of a competitive market in Connecticut, promoting the public policy goals of the Legislature that, with the Energy Efficiency Act, endorse expansion of competition and energy efficiency by sending accurate price signals and incentives to customers, and allowing competitive suppliers to enter the market and provide alternatives to Connecticut customers.

The key to this further development is to eschew policies that will tend to reduce choice over time by insulating customers from the true impacts of their energy purchasing decisions and, instead, adopt an approach that will effectively promote all of the policy goals set forth in the Connecticut Energy Independence Act and the Energy Efficiency Act. The approach that most effectively balances these goals is the one described above: introducing spot market and other shorter-term procurements into Standard Service, and increasing the amount of supply procured in that manner as the longer-term (greater than one year) contracts in the existing portfolio expire. RESA appreciates the opportunity to participate in this seminal proceeding.

Respectfully submitted,

THE RETAIL ENERGY SUPPLY
ASSOCIATION

By: _____

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CERTIFICATION OF SERVICE

This is to certify that on December 18, 2007, a copy of the foregoing has been sent via first class mail to those on the service list that have selected receipt of service by mail and electronically to those on the service list that have selected receipt of service electronically.

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* Not admitted in Connecticut.