

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL

DPUC DEVELOPMENT AND REVIEW OF : DOCKET NO. 06-01-08RE03
STANDARD SERVICE AND LAST RESORT :
SERVICE – LONG-TERM CONTRACT :
REVIEW : JULY 13, 2009

COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

The Retail Energy Supply Association (“RESA”)¹ hereby submits its comments in response to the Department of Public Utility Control’s (“Department”) June 17, 2009 Notice of Request for Written Comments (“Notice”) in connection with the above-referenced proceeding.

INTRODUCTION

On April 2, 2008, the Department authorized the electric distribution companies (“EDCs”) to investigate the use of long-term bilateral contracts. Final Decision, dated April 2, 2008, consolidated Docket No. 07-06-58, *DPUC Report to Connecticut General Assembly on Standard Service Procurement*, and Docket No. 06-01-08RE01, *DPUC Development and Review of Standard Service and Last Resort Service – Plan Approval – Bilateral Contracts Outside of Auction* (“Decision”). As part of the Decision, the Department limited the total quantity of such bilateral contracts to no more than 20% of Standard Service load. Decision at 12.

On April 8, 2009, the Department reopened the current proceeding to further define and establish the parameters of the approval process for any such bilateral contracts. Final Decision, dated April 8, 2009, Docket No. 06-01-08RE03, *DPUC Development and Review of Standard*

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

Service and Last Resort Service – Long-Term Contract Review. To aid the Department in those efforts, the Department held a technical meeting on April 24, 2009 and issued the Notice inviting interested parties to submit comments concerning the Department’s Draft Procedural Order (“Draft Order”) establishing the parameters for the review of long-term contracts submitted for Department approval. Notice at 3. RESA hereby submits its comments in response to the Notice.

COMMENTS

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 the issues in this proceeding, 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 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). 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 the Decision, the Department concluded that long-term bilateral contracts may be used to supply Standard Service power. Decision at 1. Although RESA disagreed with the Department's initial decision to permit the EDCs to enter into long-term bilateral agreements directly with generators because such agreements will negatively impact the competitive retail market for electricity, RESA believes that the Department has attempted to mitigate this risk by limiting the total size of these long-term contracts to no more than 20% of Standard Service load. RESA encourages the Department to continue to limit the use of long-term bilateral agreements and to consider the following measures to further mitigate the potential negative impacts of such long-term agreements.

Cost Recovery

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. For instance, in its most recent monthly compliance filing with the Department, the United Illuminating Company ("UI") reported that more than 40 percent of its Standard Service load was being served by competitive suppliers. *See Docket 06-10-22, DPUC Monitoring of the State of Competition in the Electric Industry, UI Compliance Filing, dated July 8, 2009 (Connecticut Update – Switches to Alternate Suppliers, June 2009 Report).* For The Connecticut Light & Power Company ("CL&P), the figure is more than 32 percent as of May 2009². With the level of Standard Service migration statewide at more than 35 percent and growing, layering a significant percentage of medium and long-term bilateral contracts with generators into Standard Service supply would have two effects. The first would

² Because of the current level of standard service rates versus the competitive market, RESA expects that the percentage of standard service load migrating to competitive supply will continue to increase appreciably for at least the next several months.

be to expose Connecticut consumers to a high risk of potential stranded costs. When CL&P filed its motion (in August 2007) seeking amendment of its standard service procurement plan to pursue bilateral contracts for wholesale power products, and when the department consolidated (in November 2007) its consideration of that motion with the proceeding (Docket 07-06-58) in which it would fulfill its obligations under Section 104 of Public Act 07-242. An Act Concerning Electricity and Energy Efficiency, migration levels were much lower than they are now. The possibility that migration from Standard Service would reach the levels it has may have seemed remote at the time, but the events of the past year have demonstrated that commodity prices (even, or perhaps especially, those that have seen a long period of sustained increase) can go down as well as up.

As a result, it appears much more likely that predicting the level of Standard Service penetration over a period as long as 15 or 20 years is an exercise fraught with uncertainty. This is especially true where the relevant measure of migration from standard service is the percentage of load rather than the percentage of customers. While residential migration is also robust, migration of the commercial and industrial sector of Standard Service customers is over 60 percent statewide. In RESA's view it would be imprudent to allow utilities to take on such long-term obligations within the Standard Service portfolio on the assumption that there will be any particular level of sustained load taking utility service over the life of the contract.

Second, allowing utilities to take on such long-term contracts within Standard Service will destroy the effectiveness of the price signals that have helped to create the improvements now seen in the Connecticut market. 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 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 customers.

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.

To mitigate these negative impacts, to the extent the EDCs are allowed to enter into medium and long-term contracts with generators, the resulting energy and capacity should be periodically sold into the wholesale market (rather than be used directly to serve the Standard Service load) with the costs associated with those long-term commitments recovered through the

non-bypassable charges on the EDCs' bills, similar to how the EDCs' historically recover the costs associated with their long-term contracts with independent power producers. *See* Final Decision, dated October 1, 1999, *DPUC Determination of The Connecticut Light and Power Company's Standard Offer*; Final Decision, dated October 1, 1999, *DPUC Determination of the United Illuminating Company's Standard Offer*. Otherwise, the electric suppliers that have begun to actively serve customers in Connecticut will be discouraged from continuing or expanding their presence in Connecticut; thus reducing the options available to customers for managing their energy needs.

Approval Criteria

The Department can further mitigate the impact to the retail competitive electric market by carefully scrutinizing the long-term contracts that are presented by the EDCs for approval. In the Draft Order, “[t]he Department encourages the submittal of renewable projects/contracts” Notice at 2. In the Decision, the Department specifically found that “[f]or bilateral contracts to provide meaningful benefits they must break the link between natural gas prices and electric rates.” Decision at 8. RESA agrees. 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. Indeed, to the extent the EDCs present any contracts with natural gas fired plants for review and approval, it is likely that those agreements would include a fuel escalation clause or a large risk premium to ensure against significant price increases in the natural gas market during the term of the agreement. Accordingly, the Department would not satisfy its goal of breaking the link between natural gas prices and retail electric rates. Thus, RESA encourages the

Department not to accept any bilateral long-term contracts with electric generators whose primary fuel source is natural gas.

During the technical meeting in this proceeding, the EDCs suggested that medium term bilateral agreement (i.e., agreements of three to five years) be benchmarked against forward prices and that the Department approve any medium term contract that agreed to prices lower than those forward prices. RESA disagrees. First and foremost, these forward prices are simply a snap shot of what *may* happen in the market based on the information available at a given point in time and do not provide an accurate indication of what prices will *actually* be in the future. Accordingly, approval of contracts based on this benchmark could lead to significant stranded costs in the future.

Moreover, any generator submitting a bilateral agreement to the EDCs for consideration will have access to the same forward pricing benchmarks and will need only to “beat” these forward prices, even by only a fraction of a cent, to be guaranteed approval of an agreement. 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. Accordingly, 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.

Alternatively, since the EDCs will not be conducting a request for proposal (“RFP”) process at any set time to acquire bilateral agreements, generators could simply wait until the forward prices are at a sufficient level to account for risks associated with entering into long-

term agreements, such as when the forward prices spike due to natural catastrophes like Hurricane Katrina, before submitting a bilateral agreement to the EDCs; thereby, exposing customers to higher than market prices over the long-term and significant risks of stranded costs. Accordingly, RESA encourages the Department to conduct a thorough review of all bilateral agreements, no matter the length, that takes into account the current factors impacting the wholesale prices of electricity, rather than agreeing to specific review criteria in advance that can be used by generators to “game” the system.

Approval Process

The Department should consider the **full** impact on customer rates before approving any long-term agreements. For instance, to the extent the Department approves agreements to be used to satisfy the EDCs’ Standard Service load obligations, the Department must consider the impact those agreements will have on the price the EDCs are able to achieve in procuring the remaining percentage of their Standard Service load through the current RFP process as this will ultimately impact the total cost to ratepayers.

The Department has already found that long-term contracts create risks of stranded costs to customers. *See* Decision at 8 (“If the bilateral contracts are above market rate, ratepayers could be faced with stranded costs.”) Indeed, prior to restructuring, the EDCs’ customers bore the risk of uneconomic decisions, which resulted in billions of dollars in stranded costs that are still being recovered from ratepayers today and will be for years to come. *See* Final Decision, dated July 7, 1999, Docket No. 99-02-05, *Application of The Connecticut Light and Power Company for Calculation of Stranded Costs*, at 83 (finding that CL&P’s stranded costs were \$3,582,126,000); Final Decision, dated August 4, 1999, Docket No. 99-03-04, *Application of the United Illuminating Company for Calculation of Stranded Costs*, at 75 (finding that UI’s

stranded costs were \$801,300,000); Final Decision, dated August 29, 2007, Docket No. 99-03-35RE13, *DPUC Determination of the United Illuminating Company's Standard Offer – 2006 Reconciliation of CTA and SBC*, at 3 (finding that UI will not collect all of its stranded costs until 2015). As a consequence, one of the primary rationales for the restructuring of the electric industry in the State of Connecticut was to remove the risk of uneconomic investment from ratepayers and place it on the shareholders of market players. Supplier Comments at 6-7. The use of long-term contracts, however, places these risks back on Connecticut's ratepayers and potentially lead to higher costs in direct contradiction to the requirements of Section 51 of the Act. *See* 07-242 § 51(a).

Moreover, long-term contracts with unregulated generators would likely entail significant counterparty credit risks and collateral costs. For instance, depending on the agreement and counterparty, the EDCs may be required to consolidate the financials of the counterparty into the EDCs' financial reporting. This consolidation can lead to increased ratepayer costs. *See, generally*, Final Decision, dated December 28, 2005, *DPUC Investigation into the Financial Impact of Long-Term Contracts on Electric Distribution Companies*. These potential costs must be considered as part of the Department's review of any bilateral agreements as these costs can be more than the potential savings expected from the bilateral agreements.

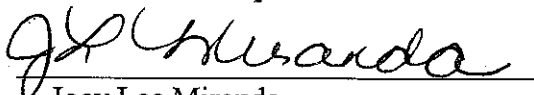
Furthermore, the Department's review of any long-term agreements should also account for the total costs associated with any ratepayer funded infrastructure improvements that may be required to allow for the generator to satisfy the agreement. For instance, should the EDCs be required to build ratepayer funded transmission lines to allow the project to interconnect to the grid, those costs should be considered in the total cost of the agreement to ensure that ratepayers will truly achieve a lower cost alternative to the current Standard Service procurement methods.

In the Draft Order, “[t]he Department anticipates conducting an expedited, yet full review of the evidentiary record, which includes hearings, late filed hearings, briefs, reply briefs and written exceptions.” Notice at 2. As part of this process, the Department should ensure that there is an open and full exchange of information by permitting participation by all potentially affected electric market participants, including wholesale suppliers and retail electric suppliers of electricity, to ensure that the full impact of the agreement on the electric market and future prices for Connecticut consumers is understood.

CONCLUSION

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 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 Connecticut’s policy goals. RESA appreciates the opportunity to participate in this proceeding.


Respectfully submitted,
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CERTIFICATION

I hereby certify that, a copy of the foregoing was mailed via first-class mail, postage pre-paid, to all participants of record, on this 13th day of July 2009.


Joey Lee Miranda