

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 : SEPTEMBER 15, 2009

WRITTEN EXCEPTIONS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

The Retail Energy Supply Association (“RESA”)¹ hereby respectfully submits its Written Exceptions to the Department of Public Utility Control’s (“Department”) September 1, 2009 Draft Decision (“Draft”) in connection with the above-referenced proceeding. RESA does not request oral argument but reserves the right to participate in oral argument should such be requested by any other participant.

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”). 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

¹ RESA’s members include ConEd Solutions; Direct Energy Services, LLC; Exelon Energy Company; GDF SUEZ Energy Resources NA, Inc.; Gexa Energy; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Just Energy; Liberty Power; RRI Energy; Sempra Energy Solutions LLC. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

contracts. Final Decision, dated April 8, 2009, Docket No. 06-01-08RE03, *DPUC Development and Review of Standard Service and Last Resort Service – Long-Term Contract Review*.

To assist in those efforts, the Department held a technical meeting and subsequently invited interested parties to submit comments regarding a Draft Procedural Order. Notice of Request for Written Comments, dated June 17, 2009. On September 1, 2009, the Department issued the Draft. RESA hereby submits its written exceptions to the Draft.

WRITTEN EXCEPTIONS

RESA appreciates the Department's efforts in this proceeding. Nevertheless, RESA respectfully suggests that, as discussed more fully below, the Department reconsider certain aspects of the Draft before issuing a final decision. In particular, RESA urges the Department to recognize the distinct risks that long-term bilateral contracts present vis-à-vis the current method used to procure Standard Service (i.e., full requirements contracts) and the potential impact of those risks on ratepayers.

As discussed more fully below, the procurement of a portion of the Standard Service load through bilateral agreements will increase the market risk assumed by ratepayers and shift stranded cost risk, migration risk and performance risk from the EDCs' wholesale suppliers to ratepayers. Accordingly, RESA urges the Department, wherever possible, to avoid forcing Connecticut ratepayers to shoulder risks that are better managed by the competitive market.

Market Risk

First and foremost, the procurement of a portion of Standard Service through bilateral agreements will increase the amount of market risk that ratepayers assume. According to the Draft, the Department's goal in approving the use of bilateral contracts is "to lower the cost of Standard Service power." Draft at 3. However, there is simply *no* basis upon which to believe

that the EDCs will actually procure Standard Service power through bilateral agreements at a cost that is less than that currently derived from the procurement of full requirements contracts. As a consequence, ratepayers could be faced with the EDCs' uneconomic decisions for years to come. *Cf.* 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).

Under current Standard Service procurement practices, the EDCs enter into a series of laddered, full requirements contracts with wholesale suppliers for a period of three (3) years. Decision at 6. The costs associated with the full requirements contracts are then passed onto ratepayers through the EDCs' Standard Service rates. *See, e.g.*, Final Decision, dated September 14, 2006, *DPUC Development and Review of Standard Service and Last Resort Service - Review of Standard Service Auction Results Solicited by CL&P*, at 4 (ordering that the approved auction results be included in the establishment of the overall Standard Service rate). Once the costs associated with the full requirements contracts are included in Standard Service rates, the ratepayers assume the risk that the current market price of power at any given point in time will be less than the full requirements contract rate. Because the EDCs' full requirements contracts are limited in duration, however, the risk is also limited - to a three (3) year period.

Conversely, under the bilateral agreement procurement practices being evaluated in this proceeding, the EDCs will be permitted to enter into bilateral agreements that may extend for decades into the future. Draft at 8 (finding that bilateral agreements may need to be "significantly longer" than full requirements contracts, perhaps fifteen years or longer). As a consequence, ratepayers will assume the risk that the price at which the EDCs procure power will be higher than the current market price of power at a given time for a significantly longer

period of time as well – possibly *for decades*. The more power that is procured through bilateral agreements, the greater the risk to ratepayers.

To minimize this risk, RESA urges the Department, consistent with the Draft, to continue to prohibit the EDCs from procuring more than twenty percent (20%) of their Standard Service load through bilateral agreements. Draft at 9. Moreover, RESA requests that the Department clarify that the twenty percent (20%) cap applies to the EDCs' *existing* Standard Service load at the time of the procurement, not their eligible Standard Service load as more and more of that load is being served by competitive suppliers. *See* Docket 06-10-22, *DPUC Monitoring of the State of Competition in the Electric Industry*, United Illuminating Company (“UI”) Compliance Filing, dated September 8, 2009 (Connecticut Update – Switches to Alternate Suppliers, August 2009 Report) (“UI Compliance Report”) (reporting that nearly 40% of UI’s Standard Service load is being served by competitive suppliers); Docket 06-10-22, *DPUC Monitoring of the State of Competition in the Electric Industry*, The Connecticut Light & Power Company (“CL&P”) Compliance Filing, dated August 14, 2009 (Connecticut Update – Switches to Alternate Suppliers, July 2009 Report) (“CL&P Compliance Report”) (reporting that more than 32% of CL&P’s Standard Service load is being served by competitive suppliers).

Stranded Cost Risk

Currently, the Draft states that “[w]ith respect to bilateral energy-only contracts, two to five years in length, the Department can commit to approval the same day the application is filed, provided the solicitation is for energy only, is benchmarked against forward prices, and is received before 9:00 a.m.” Draft at 10. RESA presumes that the Department intends to approve such agreements so long as the contract price is less than the forward prices. However, because of the significant ratepayer risks involved, the bilateral agreements that will be submitted for

Department review and approval will require a more thorough analysis than simply comparing the contract price to the forward prices on a given day.

As RESA explained previously, 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. Comments of the Retail Energy Supply Association, dated July 13, 2009 (“RESA Comments”), at 7. Accordingly, approval of contracts based on this benchmark could lead to significant stranded costs in the future. In fact, 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.”)

A one day approval process based solely on a snap shot of forward prices on that day will exacerbate that risk. For example, if the EDCs had procured power right after Hurricane Katrina for a five year period based solely on the criteria that they were guaranteed a price that was one percent (1%) below the then existing forward prices, ratepayers would still be paying too much for energy today. Indeed, if the Department were to compare the historical forward prices over a given period of time to the actual prices for energy for that period, it would find that the actual price rarely, if ever, matched the forward prices.

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. As a result, 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. RESA Comments at 7.

As the Department's consultant, Levitan and Associates, Inc. ("Levitan") pointed out in its comments, "the bid solicitation and selection process envisioned under the long-term bilateral contract initiative is distinct from the conventional Standard Service bid selection process." Written Comments of Levitan & Associates, Inc. on Draft Procedural Order, dated July 7, 2009 ("Levitan Comments"), at 2. Accordingly, Levitan recommended that requests for approval of bilateral agreements "be supported by sufficient market analysis and due diligence to demonstrate net benefits to ratepayers and to assess the risks associated with such contracts." Levitan Comments at 2. RESA agrees. 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.

Migration Risk

The Draft states that the Department will not conduct a migration study because the potential *ingress* to Standard Service as a result of the bilateral agreements contemplated in this proceeding presents a policy issue already decided by the General Assembly. Draft at 2-3. Although the ingress to Standard Service may impact the competitive market, the *egress* from Standard Service presents an increased risk to ratepayers. *See* Decision at 6-7 (recognizing risk that if prices decline, customers will switch from Standard Service to competitive suppliers).

Under the current full requirements contract procurements, the EDCs do not contract for a set amount of output. As a consequence, the EDCs' wholesale suppliers bear the migration risk. Decision at 6 (finding that the wholesale suppliers bear the costs if they procure too much power and customers switch suppliers). Under the bilateral contract procurement process being evaluated in this proceeding, RESA anticipates that the EDCs will be contracting for a set amount of output. As a consequence, the ratepayers will bear the migration risk.

For instance, if the EDCs procure twenty percent (20%) of their Standard Service load through bilateral agreements, the EDCs will basically guarantee the generator(s) with whom they bilaterally contract that the EDCs will retain twenty percent (20%) of the Standard Service load for the *life* of the agreement, which can span for decades. As a result, the wholesale suppliers serving the remaining eighty percent (80%) of the Standard Service load through full requirements contracts are taking on *one hundred percent (100%)* of the risk that ratepayers will migrate *away from* Standard Service to competitive supply. As a consequence, the wholesale suppliers serving Standard Service load through the full requirements contracts will raise their risk premium to account for this increased migration risk.

Given the recent growth in customers switching from Standard Service *to competitive supply*, this risk premium could be quite substantial. Indeed, 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. RESA Comments at 3. For instance, in its most recent monthly compliance filing with the Department, UI reported that nearly forty percent (40%) of its Standard Service load is being served by

competitive suppliers. *See* UI Compliance Report. For CL&P, the figure is more than 32 percent as of July 2009. *See* CL&P Compliance Report.

With the overall level of Standard Service migration statewide at nearly thirty five percent (35%) and growing, layering a significant percentage of bilateral contracts with generators into Standard Service supply would expose Connecticut consumers to an elevated risk of increased costs due to the higher risk premiums necessary to compensate the full requirements wholesale suppliers for the increased migration risk being undertaken. While residential migration is also robust, migration of the commercial and industrial sector of Standard Service customers (i.e., generally customers with larger loads) is over sixty percent (60%) statewide. *See* UI Compliance Report; CL&P Compliance Report. Indeed, predicting the level of Standard Service load 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. RESA Comments at 4.

Because the bilateral agreements are not likely to be reviewed at the same time as the full requirements contracts, the actual impact of this migration risk will not be known when the Department evaluates the bilateral agreements. As a consequence, the Department will be reviewing the bilateral agreements without a full appreciation of the entire potential impact on customer rates. Accordingly, RESA recommends that, as part of its due diligence in evaluating bilateral agreements, the Department, consistent with its decision approving the exploration of bilateral arrangements, consider undertaking a migration study to more fully understand what percentage of Standard Service eligible load will actually continue to pay for Standard Service during the term of any bilateral agreements that the Department is considering approving. *See*

Decision at 12 (requiring that the EDCs provide information as to how bilateral contracts will impact Standard Service procurements).

Performance Risk

In its supplemental comments, UI recommended that the Department clarify that the EDCs would be assured recovery of all costs associated with any bilateral contracts approved by the Department in order to ease potential bidder concerns regarding *unsecured credit support*. Supplemental Written Comments of the United Illuminating Company, dated August 27, 2009 (“UI Supplemental Comments”), at 7. Although it is unclear from UI’s Supplemental Comments, RESA presumes that potential counterparties expressed concern about the credit support they may be required to provide and wanted assurances that *no* credit support would be necessary.

If generator(s) are not required to provide credit support, ratepayers are not really getting a "fixed price" contract since there would be no consequences from default. Thus, if the generator can obtain a better price in the market for the power it is supplying (i.e., the contract with the EDCs is below market), the generator(s) has no incentive to honor the contract. In fact, it has every incentive to pursue the higher price in the market and leave the ratepayers holding the bag for the cost of procuring replacement power at the then existing higher price in the spot market. The only way to assure that ratepayers receive the benefit of the bargain from any bilateral agreement is to ensure that there is sufficient credit support provided by the generator to cover the costs of default. Accordingly, RESA requests that the Department clarify that all counterparties will be required to provide performance assurances and adequate credit support to back those assurances that at a minimum satisfies the requirements set forth in ISO New

England's Financial Assurance Policy for Market Participants. Otherwise, the risk of default (i.e., performance risk) passes from the generator(s) to the ratepayers.

Cost Recovery Risk

The Draft seems to contemplate that the bilateral agreements will be used to ***directly serve*** Standard Service load. Draft at 3-4. If that is the case, the costs associated with these bilateral agreements should be collected through bypassable charges in order to accurately reflect the cost of Standard Service consistent with how the costs of full requirements contracts are currently collected. *See, e.g.,* Final Decision, dated December 8, 2006, Docket No. 03-07-02RE09, *Application of The Connecticut Light and Power Company To Amend Its Rate Schedules – 2007 Rates*; Final Decision, dated December 19, 2006, *Application of the United Illuminating Company to Increase its Rates and Charges – 2007 Rates and Terms and Conditions*.

Because of the differences between full requirements contracts and bilateral agreements, however, this cost recovery mechanism presents further risks of increased costs to ratepayers. Under the full requirements contract, the EDCs do not pay for more load than they actually need to serve their customers (i.e., the migration risk rests with the wholesale supplier). Under the bilateral agreements, RESA anticipates the EDCs will be contracting for a set amount of output (i.e., ratepayers will incur the migration risk). As more and more customers migrate to competitive supply, the costs associated with the bilateral agreements will be spread over fewer and fewer customers; thereby, significantly increasing the cost to customers that continue to take Standard Service, rather than choose a competitive supply option.

To mitigate these negative impacts, to the extent the EDCs are allowed to enter into medium and long-term bilateral contracts with generators, these contracts should ***not*** be used to

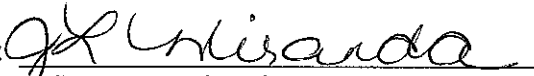
directly serve Standard Service load. Instead, the resulting energy and capacity² should be periodically sold into the wholesale market with the costs associated with those long-term commitments recovered through the non-bypassable charges on the EDCs' bills, similar to how the EDCs' historically recover the costs associated with their long-term contracts with independent power producers. RESA Comments at 5-6 (*citing* 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, customers that remain on Standard Service could face substantial per kWh cost increases as more and more customers move to competitive supply.

CONCLUSION

RESA encourages the Department to recognize the increased risks that ratepayers will face as a result of bilateral agreements and, wherever possible, to avoid forcing Connecticut ratepayers to shoulder risks that are better managed by the competitive market. RESA appreciates the opportunity to participate in this proceeding and respectfully requests that the Department consider these written exceptions before issuing a final decision.

² The Draft states that "[t]he Department is primarily concerned with energy, capacity and REC costs in the long-term Standard Service contract procurements." Draft at 3. In another proceeding, UI requested the opportunity to contract for bundled energy, capacity and RECs. Based on the plain language of the relevant statutory provisions, the Department found that this was inappropriate. Final Decision, dated July 30, 2008, Docket No. 07-06-61, *DPUC Examination of Electric Distribution Company Contracts for Renewable Energy Certificates* ("REC Decision"), at 3. RESA requests that the Department clarify that nothing in its decision in this proceeding modifies its earlier rulings in the REC Decision.

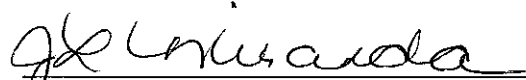
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CERTIFICATION

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 15th day of September 2009.


Joey Lee Miranda