

MAINE'S STANDARD OFFER EXPERIENCE



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Rome
13 February, 2003



Outline of Discussion

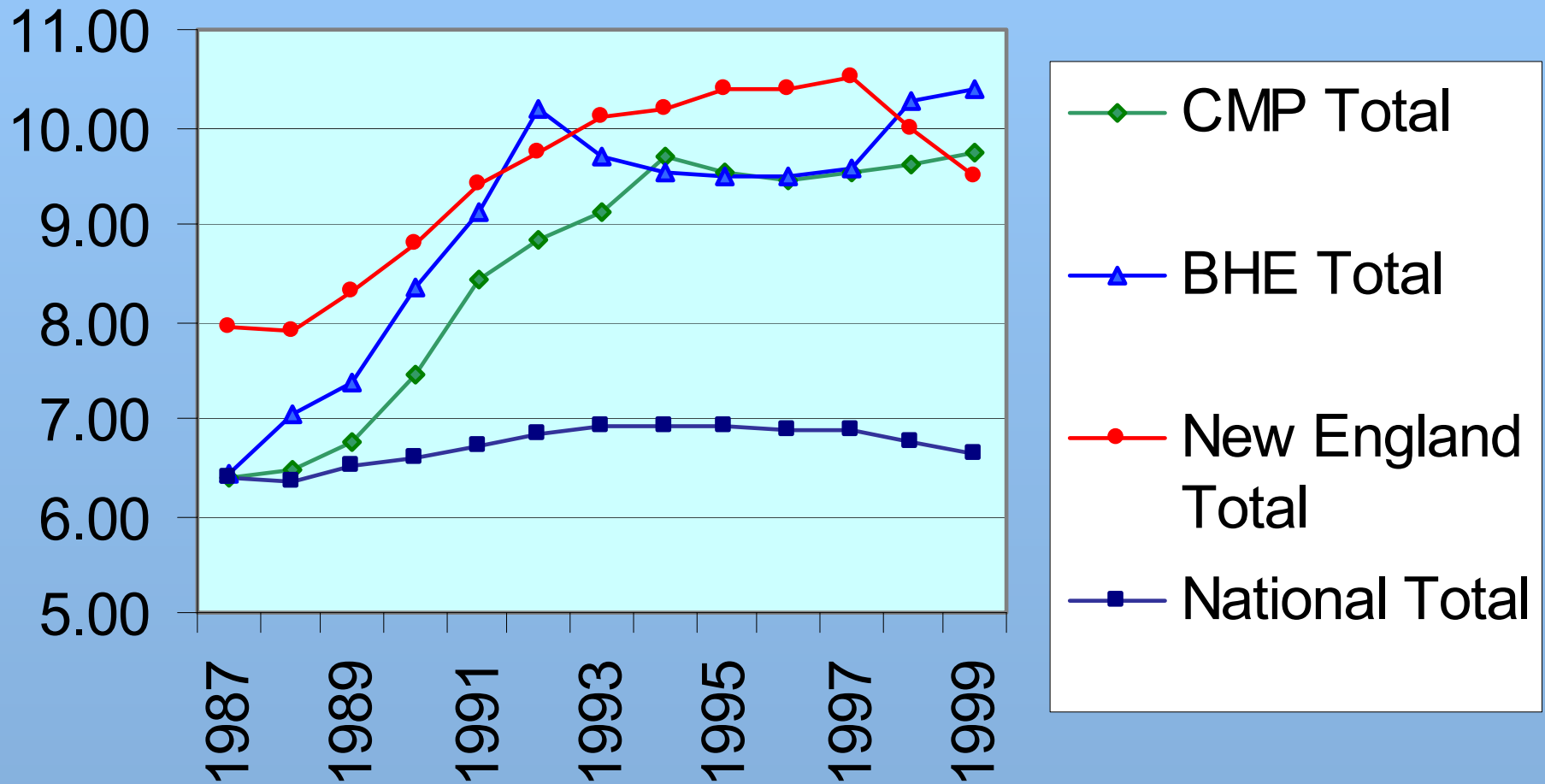
- Review of Maine's Market Structure
- Standard Offer Rules
- History of Standard Offer Bids
- Relationship of Competition and Standard Offer Prices
- Issues and case histories



Why did Maine Restructure?

- Poor experience with long term planning (Purchase Power Contracts and Nuclear Costs) created significant “stranded costs”
- Relatively high prices compared to other regions of the US
- Consistent with “trend” in US to “deregulate” (“liberalize”)

Average Electrical Rates





Maine's Market Structure

- Full divestiture of generation
- All customers immediately eligible to buy energy supply from competitive suppliers
- Very limited sales of energy supply by T&D utilities
- Standard Offer supplier (provider of last resort) selected by competitive bid



Maine's Portfolio Requirement

- Requires 30% “eligible”
 - Maine's existing supply is about 40-50% “eligible”
 - Compare to “energy source diversification” and “priority utilization of renewable/co-generation”



Why Full Divestiture?

- Discrimination against competitors
 - Superior information
 - Access to facilities
 - Contract favoritism
- Cross-subsidies
 - Shifting costs to regulated business



Asset Divestiture

- Required by law
- Sold to highest bidder
- All units sold together
 - Price advantage
 - Maine assets represented small % of New England market
 - Market power is persistent issue, especially if any participant can predict when it will be “on the margin.” Any concentration over 20% very troublesome.
- Favorable result of sale



Sale of Purchase Power Rights

- Rights to power from continuing long-term contracts auctioned to the market
- Proceeds netted against stranded cost obligation



Limitations on Marketing by T&D Utilities

- Limits apply to “in-region” sales
- No use of T&D name or logo
- Little activity by T&D companies
- T&D has no “incumbent” supply role; continues to be franchise monopoly for T&D services
- Note differences from Enel structure



Code of Conduct

- Applies to non-regulated activities of all regulated utilities
- Elements include
 - Separate subsidiary
 - Cost manual to govern transactions
 - Limitations on investment
 - Limits on use of utility information
 - Prohibitions against discrimination



Standard Offer Design

- Available to all customers
- Prices differentiated by customer size (small, medium, large)
- Billed through T&D company
- Use of “load profiling” to determine residual load
- Bids by percentage of load (to permit selection of multiple bidders)
- Objective is to obtain good price but avoid distorting retail market



Key Design Elements

- Relatively short term fixed price
- Supplier takes all risk
 - Load risk
 - Price risk
- Relatively free customer entry/exit
 - Anti-gaming rules
- No new deferred costs
- “Market” priced
- Retail price: price is not raised or lowered by regulator (avoids new stranded costs)



Relationship to Wholesale Market

- Maine alone is about 2000 MW; is full participant in NE market (about 25,000 MW)
- NE Market is reasonably competitive
 - Market shares range up to about 20%
 - Studies of market power suggest that it is a problem in constrained areas at peak load periods (addressed in part through mitigation rules)
- Rules in Italy for Enel ownership may permit exercise of market power (I.e. allowing 50% market share)



Bid Process

- Issue RFPs
 - Describe product clearly
 - Documents available in hard copy and on website
 - Provide load data
- Pre-bid conferences
 - Answer questions and post on website
- Seek “indicative” prices
 - Periodic update of bids (can add or drop from “preferred” list)
 - Most bidders are consistent, but some bid low initially to “get into the game”



Bid Process 2

- Negotiate non-price terms
 - Rank suppliers; negotiate with “best” (rank can change)
 - Keep enough bidders to avoid being “boxed in” and to keep bidders nervous
 - Negotiations are confidential
 - Complete negotiations with preferred list before asking for “final” bids



Bid Process 3

- Non-price terms (cont.)
 - This phase is most time-consuming and difficult (our attempts to “standardize” terms resulted in very few bidders)
 - Focus on bidders with best prices, but do not eliminate anyone until final bids are accepted
 - Key non-price issues: security, breach/termination, change of law



Bid Process 3

- Final bids
 - Very rapid (one day) process; receive bids at 11:00, decide by 13:00; execute contracts the same day.
 - All evaluation must be done in advance
 - Requires thorough and accurate staff work and frequent meetings with Commissioners



Bid Process 4

- After bids are accepted and contracts signed
 - “Supplier care” of winners
 - Tracking financial status of winners; obtain additional security if warranted
 - Discuss process with all bidders (and potential bidders)
 - Prepare for next round



History of Bids

- First year
 - 5 to 10 Bidders (depending on class)
 - Bids unexpectedly high; rejected most
 - Required T&D companies to buy at wholesale (for medium and large)
 - Accepted “linked bid” (bid linked to acquisition of purchase power supply), for two year term, for residential customers



History of Bids

- Second Year
 - 0 to 3 Bidders
 - Very high prices
 - Rejected some bids (requiring T&D utilities to purchase at wholesale)
 - Engaged in some “mitigation” by “going long” on some supply and taking funds from “asset sale gain account”



Experience: CMP Residential

- Rejected bids
- Accepted two-year “linked” bid
- Efforts to preserve the deal
 - Threat due to changes in market price and ICAP issues
 - Litigation avoided by settlement



BHE Residential

- 2000
 - Rejected bids
 - BHE developed portfolio
 - PUC set price to cover expected cost
 - Mid-course adjustment (increases only)
- 2001
 - Rejected bids
 - BHE developed portfolio (multi-year aspects)



CMP Medium Class

- 2000
 - Rejected bids
 - CMP secured all requirements contract
 - Mid-course correction
- 2001
 - Rejected bids (\$9 natural gas, high capacity costs)
 - CMP secured all requirements contract



BHE Medium Class

- 2000
 - Rejected bids (only 1 compliant)
 - BHE secured supply portfolio
 - Mid-course increase (ICAP)
- 2001
 - Rejected bids
 - BHE secured supply portfolio (multi-year aspects)



CMP Large Class

- 2000
 - Rejected bids
 - CMP obtained all requirements contract
 - Gaming issue mid-course
 - Mid-course price change
- 2001
 - Rejected bids
 - CMP obtained all requirements contract



BHE Large Class

- 2000
 - Rejected Bids
 - Portfolio approach
- 2001
 - Rejected Bids
 - Almost Full Requirements Contract
 - Mitigation of T&D rate



History of Bids

- Third Year
 - 8 bidders
 - Prices lower
 - Wholesale market more stable; bids consistent with wholesale prices
 - Accepted three year contract for residential, one year for medium and large classes
 - All contracts at retail (I.e., bids accepted for all classes)



History of Bids

- Fourth Year (2003)
 - Only for large and medium class (residential has contract to 2005)
 - 7 bidders
 - Accepted bids for six month terms for medium and large
 - Prices significantly higher than 2002

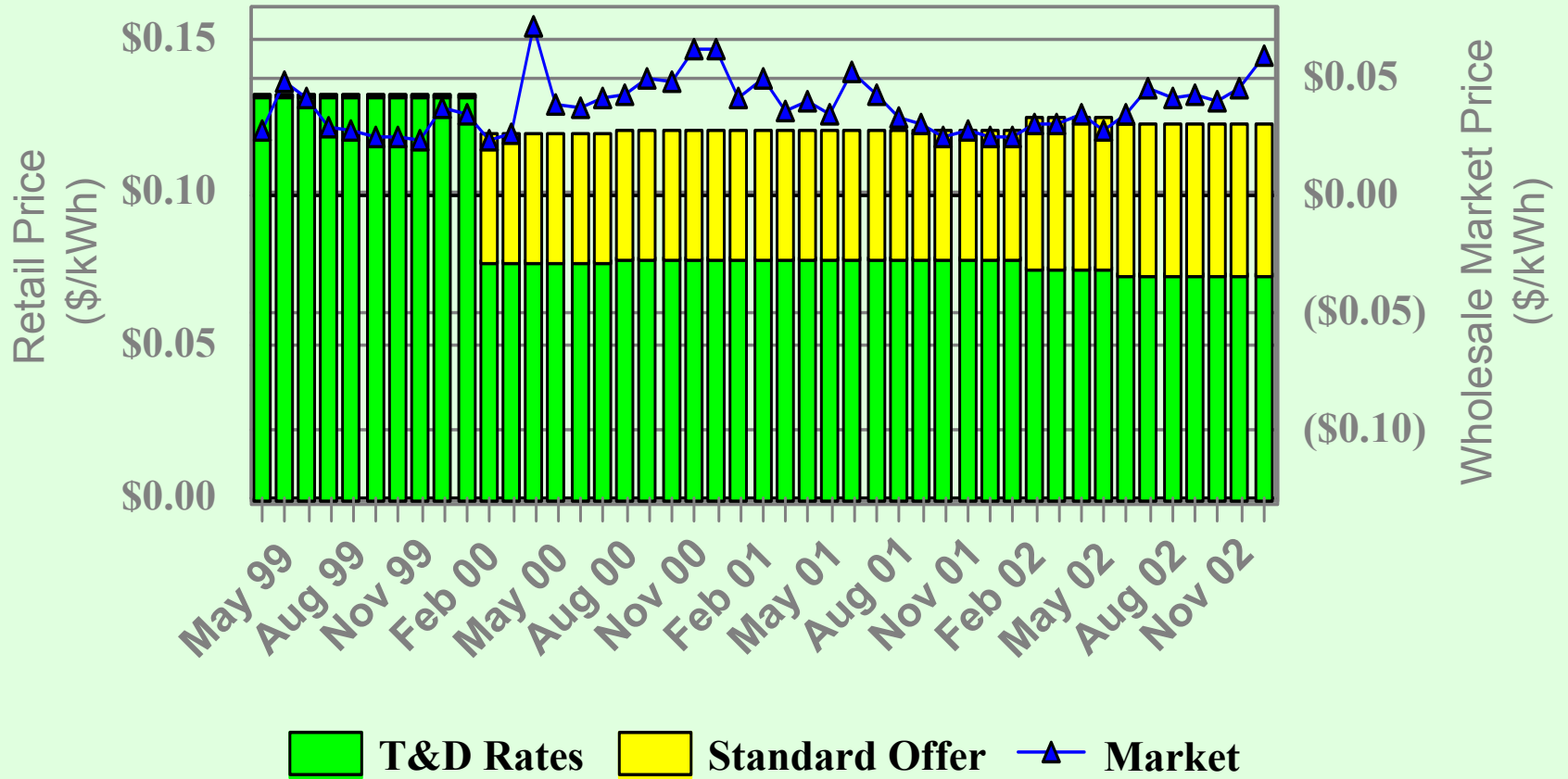


Relationship of Bids to Market

- Bids track market closely, but market is much more variable than prices

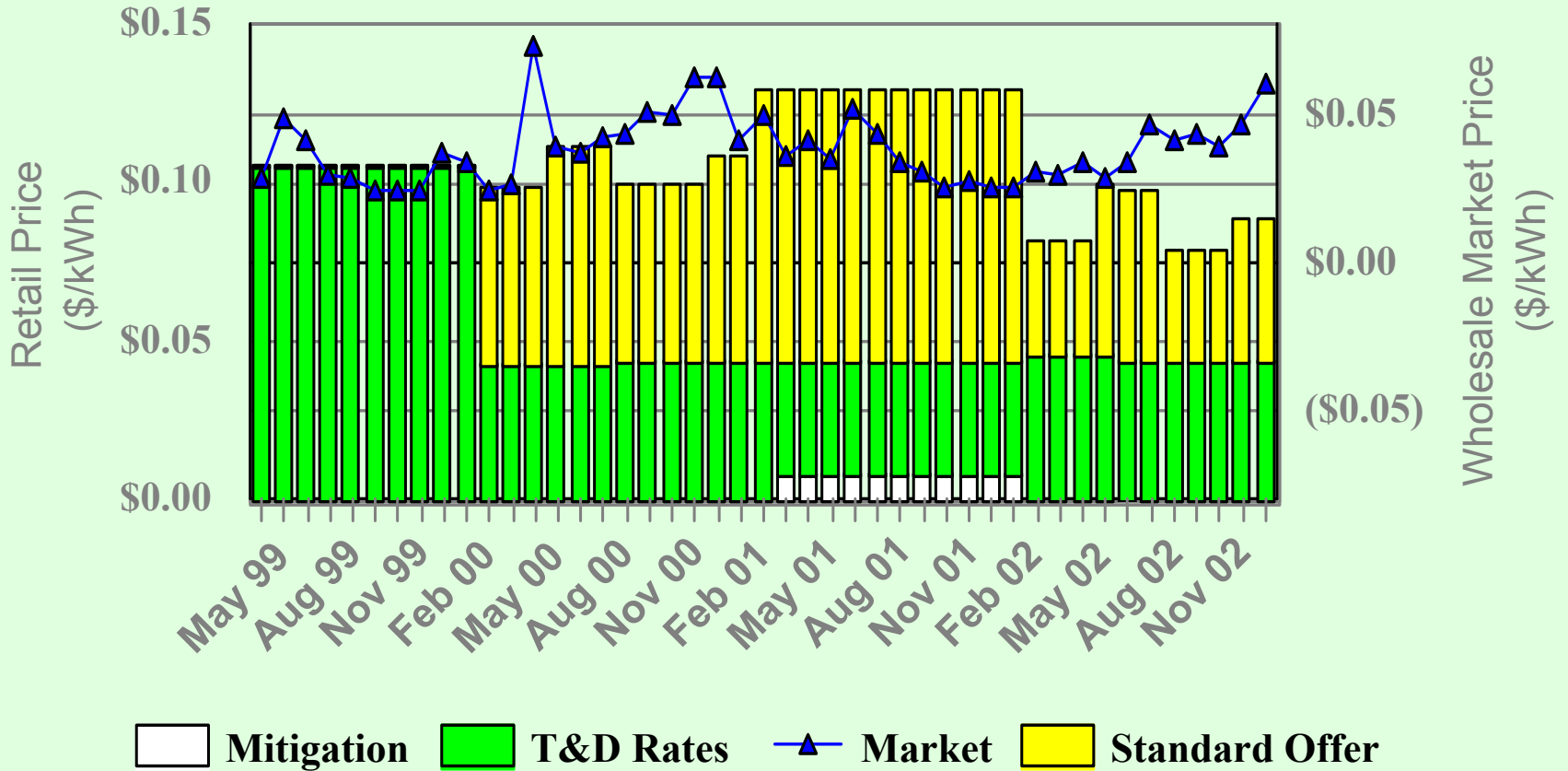
CMP RESIDENTIAL CLASS

Electric Rates



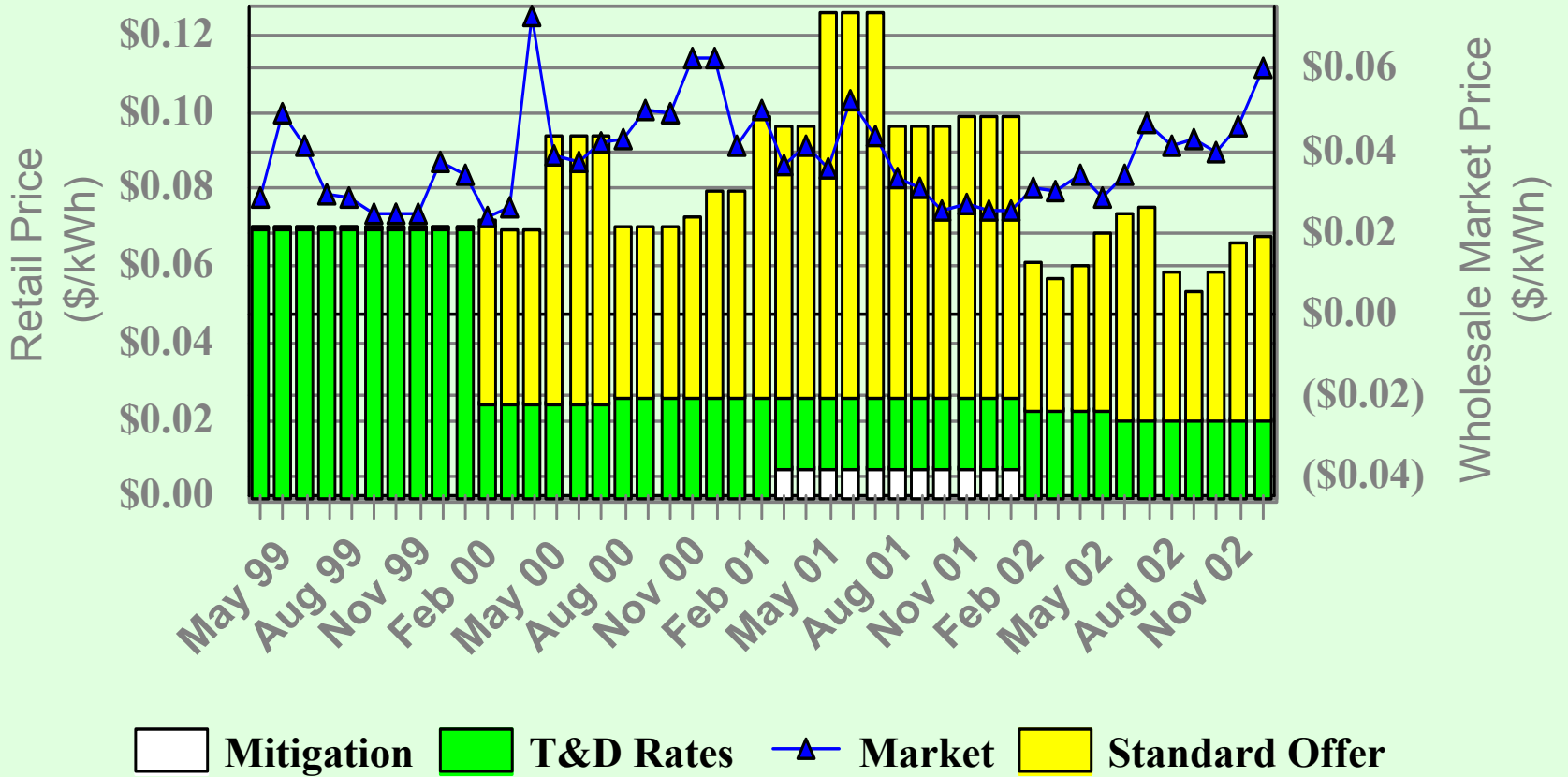
CMP MEDIUM CLASS

Electric Rates

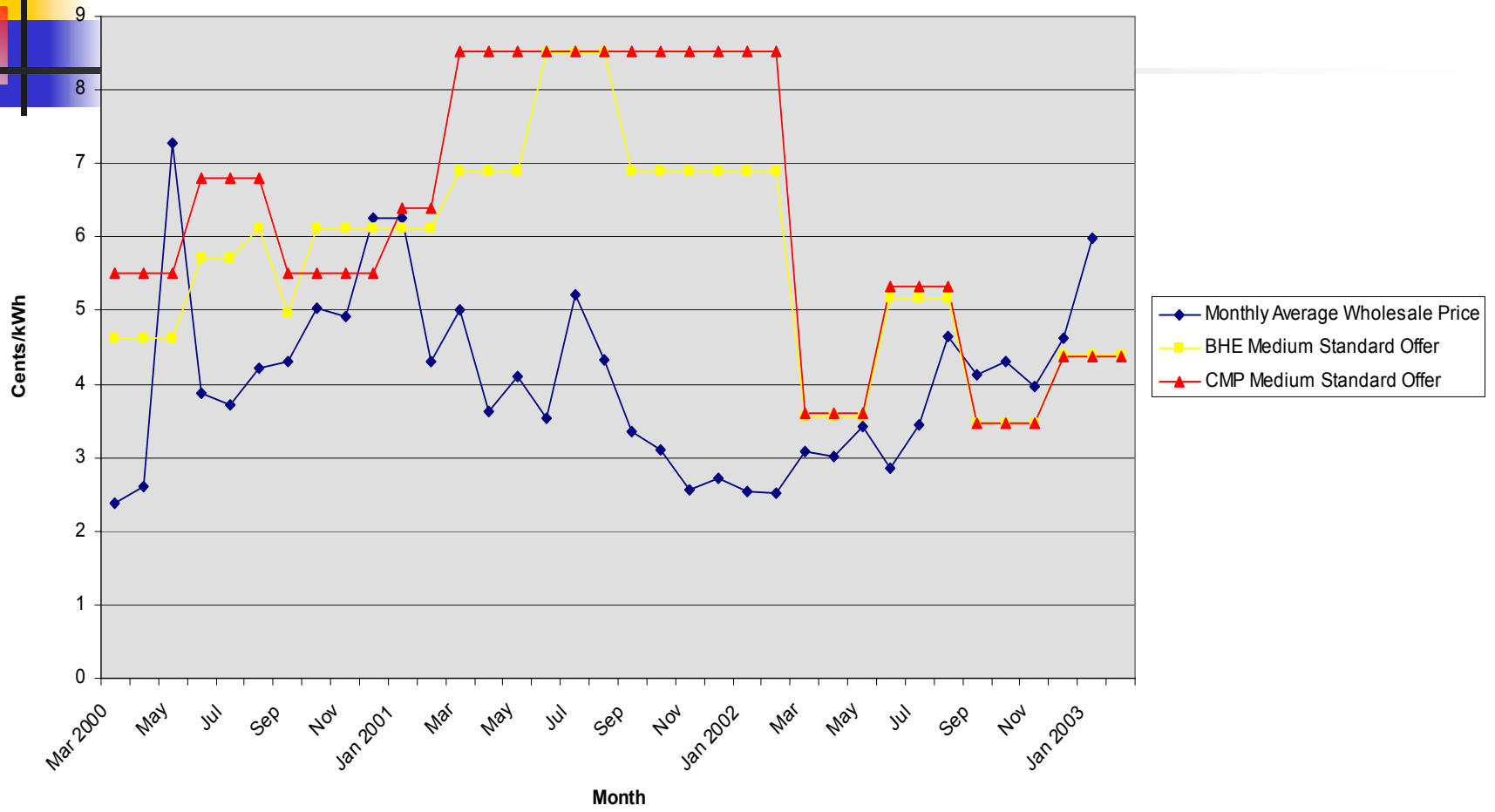


CMP LARGE CLASS

Electric Rates



Wholesale Market & Standard Offer Prices for Medium Customers





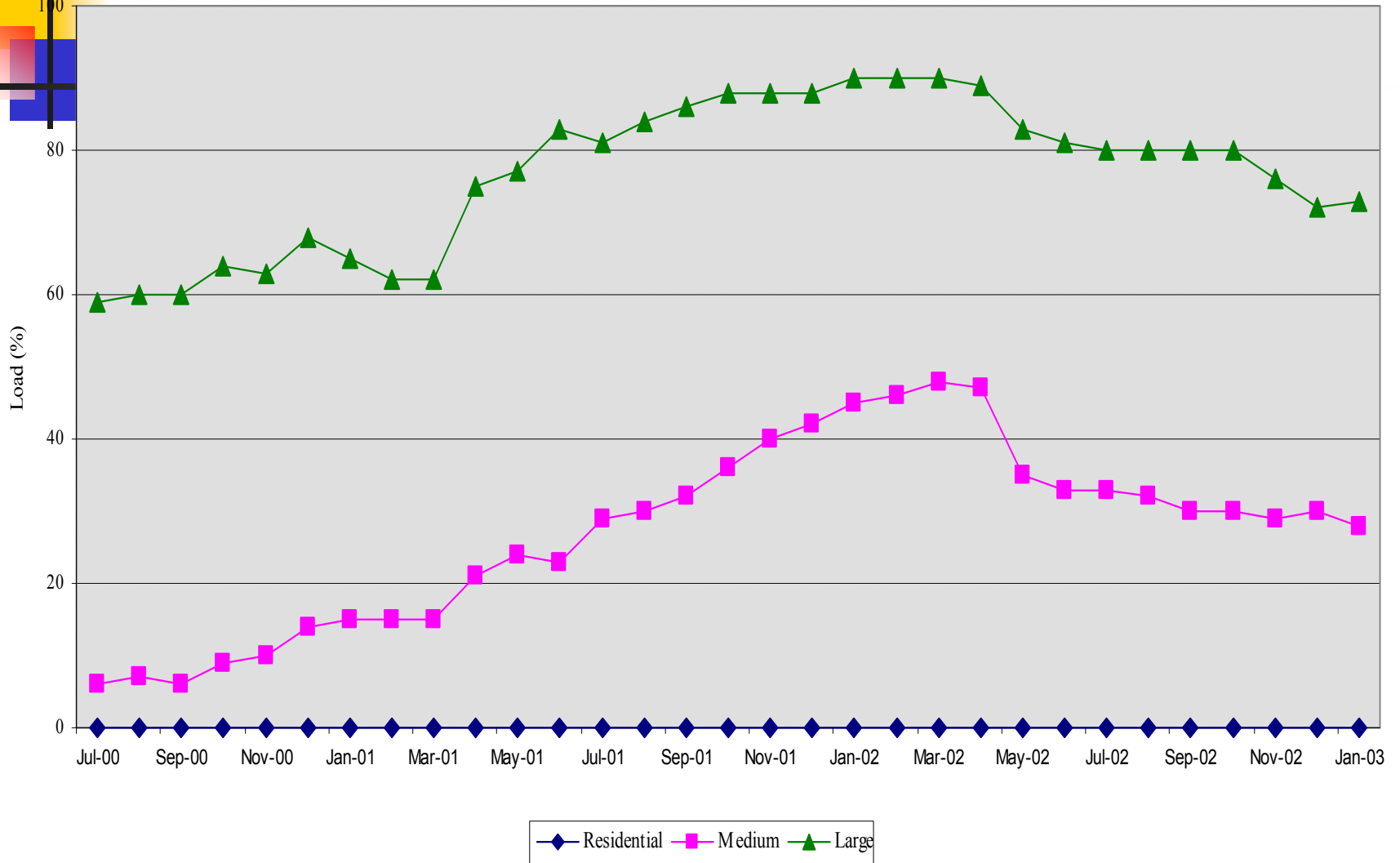
Relationship of Standard Offer to Competitive Activity

- High percentage of Customers in larger classes have entered competitive market
- Strong correlation among standard offer price, wholesale market price, and competitive activity

Load Served by Competitive Providers - CMP

July 2000 - January 2003

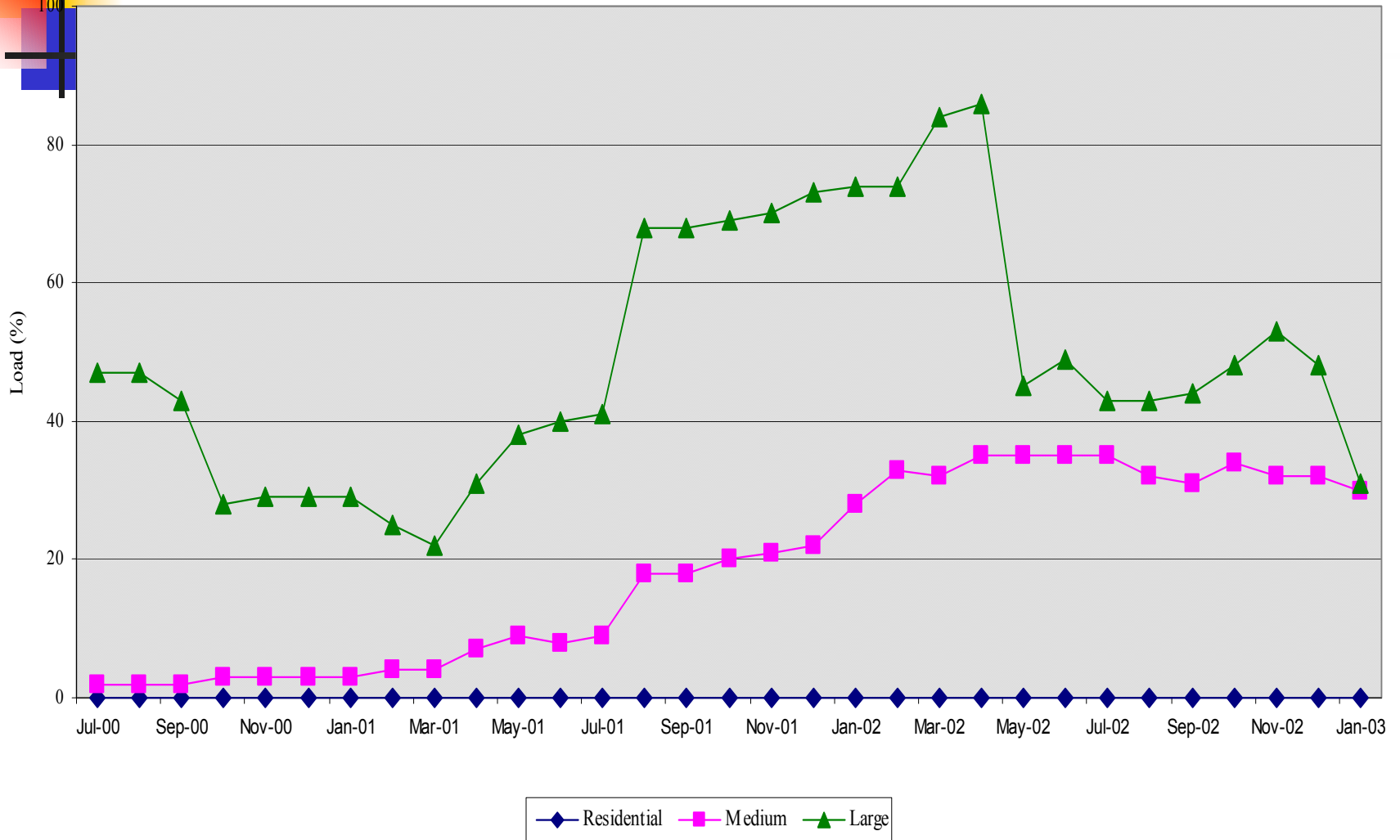
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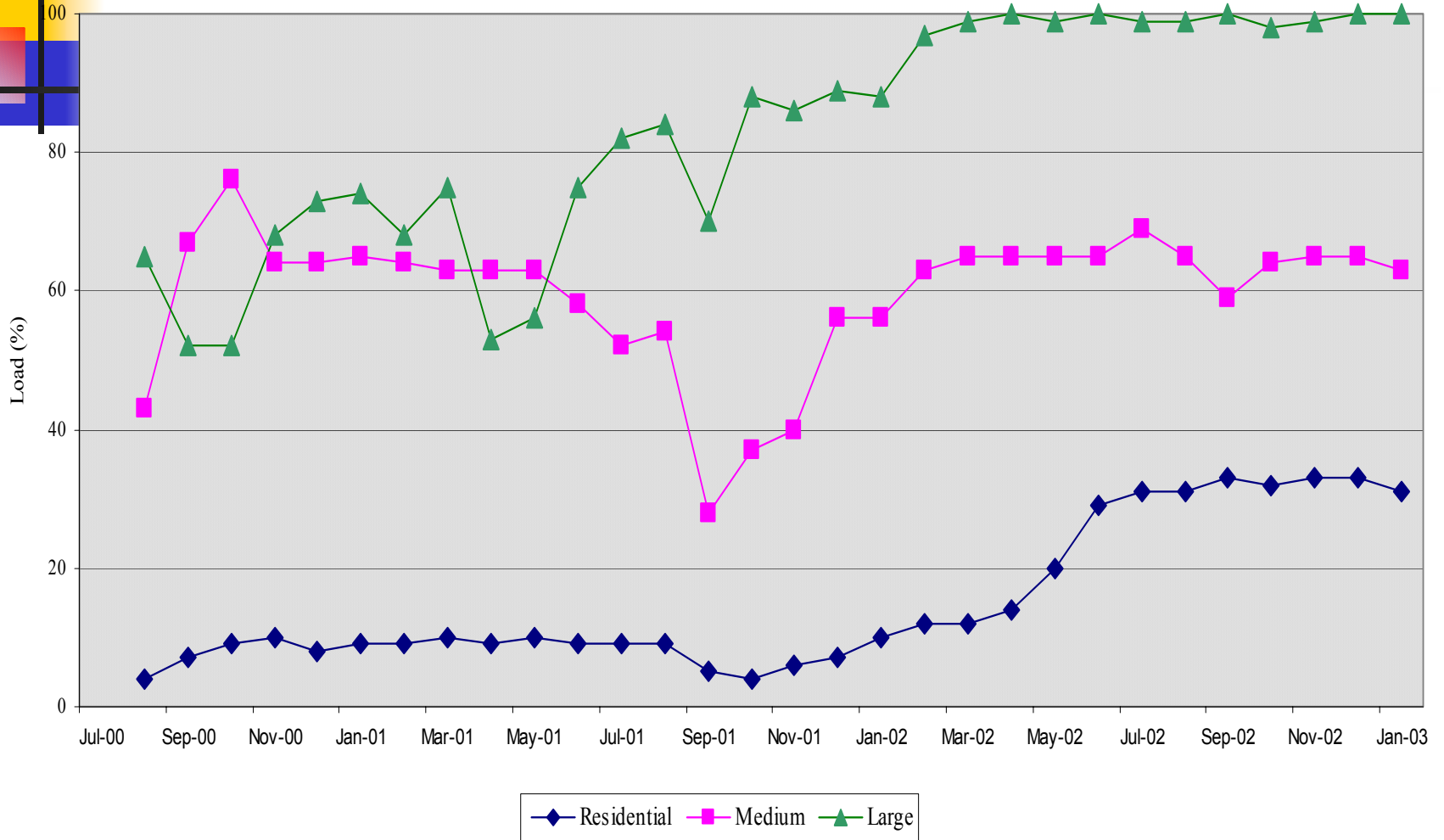
Load Served by Competitive Providers - BHE

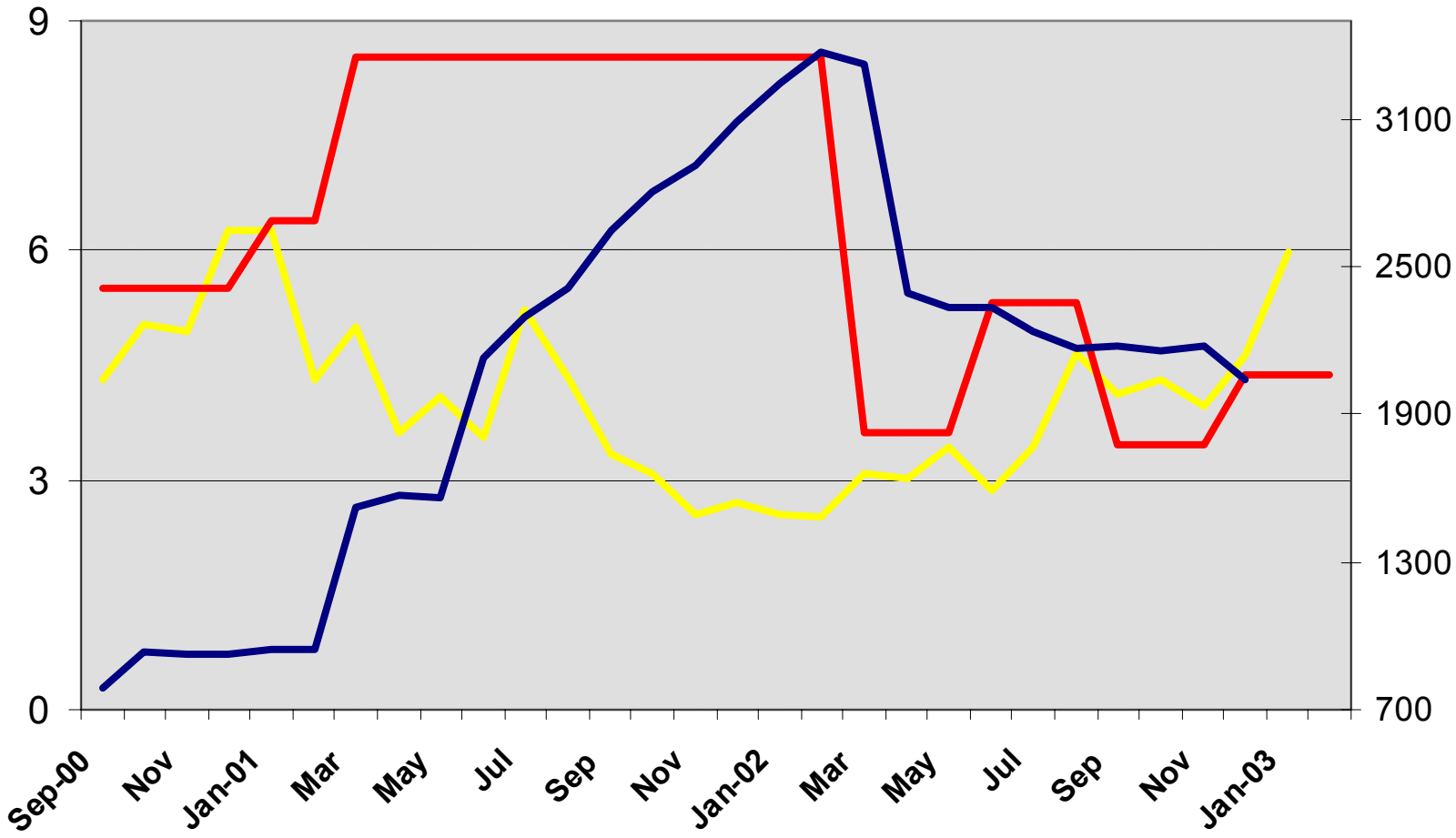
July 2000 - January 2003

Presented by the MPUC



Load Served by Competitive Suppliers - MPS
July 2000 - January 2003
Presented by the MPUC







Dependence on Wholesale Market

- ICAP
- Dependence on Natural Gas



Process and Practice

- Listen to suppliers, and accommodate when possible
 - Indicative bids
 - Bids open for short period (First year, many weeks; Fourth year, 5 hours)
 - Negotiate non-price issues (e.g. change of law)



Process and Practice 2

- Adapt as experience dictates
 - Moved from firm to indicative bids
- Find independent basis to evaluate bids
 - E.g. relationship to wholesale forward markets
- Develop contingency plan if bids fail
 - Rejection of bids in first year was controversial, but led to better bids



Process and Practice 3

- Seek financial security, but do not assume that complete protection is possible
 - Experience with Supplier in second year of two year contract
 - Wholesale prices were much higher than when bid was accepted
 - Supplier found pretext to attempt to terminate contract
 - Settlement involved substantial payment (but only about \$5 million, when exposure was \$100 million)



Process and Practice 4

- Be “transparent” and consistent
 - Change rules only when clearly necessary, and only after extensive consultation
- Prices are primary consideration, but security and other non-price terms (e.g. “exit” clauses) are also important



Inherent Tension: Politics

- Don't repeat mistake of government-driven long positions
 - Retail Model is essential
- Don't make promises
- Price shock is destabilizing
- Assignment model not attractive



Inherent Tension: Market

- Product is a hybrid
 - Free aggregation
 - Price and volume risk
 - Increasing credit risk
- Encourage competition without creating price umbrella
- Provide good price without killing competition



Standard Offer Lessons

- Bids are best if you can get them
- Security is essential
- T&D should have neither risk nor reward for supply
 - Pervasive participation by PUC may be unavoidable
- Limit distortion of energy prices paid by consumers
- Minimize new deferrals