Testimony of

The United Illuminating Company

Re:

Raised House Bill No. 6512
AAC THE ELECTRIC CONTRACT PROCUREMENT PROCESS

Before the Energy & Technology Committee
Legislative Office Building
February 24, 2009

Good afternoon, Senator Fonfara, Representative Nardello and members of the Energy and Technology Committee. My name is Alan Trotta, and I am the Manager of Wholesale Power Contracts for The United Illuminating Company (UI). In that capacity I manage all aspects of the power procurement process for UI's Standard Service and Last Resort Service customers.

Raised House Bill No. 6512 (the Bill) introduces changes designed to reduce energy prices and price volatility for the State's energy consumers. UI strongly supports the changes proposed in the Bill, because the changes would be likely to result in a reduction over time in both energy prices and the volatility of energy prices for the benefit of Connecticut's electric customers.

1. A portfolio management approach to power procurement is superior to the current approach of buying full requirements service, and will allow the electric distribution companies to achieve lower and less volatile pricing over the long run.

The new subdivison 4 of the Bill expands the role of the electric distribution companies (EDCs) in procuring power on behalf of customers by establishing a portfolio management approach to power procurement. Currently, the EDCs procure full requirements service via formal requests for proposals (RFPs).

Here are some of the issues associated with full requirements service:

A. There are about ten wholesale suppliers of full requirements electric generation service in New England vs. a hundred or more suppliers of individual power products, and has seen indications that the number of full requirements suppliers may be dwindling.

B. Under full requirements contracts EDCs do not necessarily have access to the lowest priced sellers of individual products, and do not have the flexibility to react quickly to optimal buying opportunities.

C. Having fewer suppliers creates more exposure to the credit of individual suppliers. This has become a more crucial factor recently with the near failure of a major supplier in New England, and the failures and near failures of several banks that provide credit support to suppliers. It is unknown whether the current financial crisis will further reduce the number of full requirements service suppliers, but such a reduction would be a negative for customers.

D. Full requirements service is a risky product for suppliers to provide. They take on load and pricing risk, and there is an embedded risk premium in their pricing.

E. Full requirements service is necessarily a short to mid term product only. It is risky for suppliers to provide full requirements service beyond 3 years in the future because it would be very difficult to hedge their obligations beyond that time horizon.

F. Full requirements service does not fit well with the long term contracts allowed in Public Act No. 07-242, because full requirements service must be procured as a percentage of load, while long term contracts are based on fixed quantities or percentage of unit output. Absent a portfolio management approach to power procurement, the balancing of full requirements service and long term contracts could prove difficult and may increase costs for customers.

The transition from reliance on full requirements service to the development and management of a portfolio of power contracts will help the EDCs to provide lower overall generation costs to customers over the long run, and can provide improved price stability if longer term commitments are made. A preferred balance between stability and market responsiveness can be determined and achieved through the selection of an appropriate blend of contract durations (i.e. longer term contracts for stability; shorter term contracts for market responsiveness, and for taking advantage of opportunities to buy at low prices). Here are some other benefits of adopting a portfolio management approach:

A. Diversification of products purchased, pricing methodologies and procurement timing. This will reduce risk, and allow for the procurement of individual products from the lowest cost providers.

B. Diversification of credit exposure (the failure of a single supplier has much less of an impact).

C. Allows for better access to short term purchasing opportunities because the EDCs could be active as purchasers in the short and mid term markets on a day to day basis, and not only purchasing under lengthy RFPs.

D. Removes the risk premium embedded in full requirements service prices.

E. The EDCs can blend cost-based longer term supply arrangements into their portfolios.

It should be noted that all of these benefits accrue directly and completely to customers, and that the benefits are cumulative (eg. savings achieved by the utilities being active purchasers in the market are additive with the reduction in risk premium).

Portfolio management is a long term strategy, and is not likely to result in immediate substantial savings. However, over time the strategy will provide more and more substantial benefits for customers through the diversification of purchases and suppliers, and from the inclusion of long term commitments at cost-based pricing.

2. A portfolio management approach will be most successful if the EDCs are able to react quickly to market opportunities.

While UI strongly supports the adoption of a portfolio management approach to power procurement, UI believes that the language in the Bill can be improved to allow the EDCs to react to market opportunities on a timely basis.

Attached to this testimony is a redlined version of the Bill with UI's proposed changes.

3. For future procurement activities to be successful, it is essential that the sanctity of existing contracts be upheld.

New Section 3 appears to require that the DPUC establish a proceeding to seek buyout proposals from suppliers under existing contracts for standard service supply. UI is supportive of such a proceeding, provided that participation be optional on the part of existing suppliers.

It is essential for the success of future procurement activities that the sanctity of existing contracts be upheld, and that existing suppliers not be forced to renegotiate contracts that were entered into in good faith, and fully in accordance with existing law and energy policy. Any requirement that suppliers renegotiate, or buyout, existing contracts would have a devastating effect on the ability of the EDCs, or any state authority, to negotiate procurement contracts for customers in the future. Suppliers would view Connecticut as a State that will gladly reap the benefit of contracts that end up being favorable, but would walk away from contracts that end up not being favorable at the first opportunity.

The laddering of purchases currently performed by the EDCs was required by law. This laddering of purchase contracts will, by its very nature, result in prices that can be either higher or lower than the spot market prices at various points in time. While it's true that the spot price is currently lower than the laddered price, it's also true that during the summer of 2008 the spot price was much higher than the laddered price, and customers benefitted by not seeing the same dramatic increase in electric rates that they saw in gasoline prices.

The redline version of the Bill attached by UI includes proposed clarifying language.

Thank you for this opportunity to testify. I would be happy to answer any questions that you may have.

General Assembly

January Session, 2009

Raised Bill No. 6512

LCO No. **3718**

*03718_______ET_*

Referred to Committee on Energy and Technology

Introduced by:

(ET)

AN ACT CONCERNING THE ELECTRIC CONTRACT PROCUREMENT PROCESS.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

Section 1. Subsection (c) of section 16-244c of the general statutes is repealed and the following is substituted in lieu thereof (*Effective from passage*):

(c) (1) On and after January 1, 2007, each electric distribution company shall provide electric generation services through standard service to any customer who (A) does not arrange for or is not receiving electric generation services from an electric supplier, and (B) does not use a demand meter or has a maximum demand of less than five hundred kilowatts.

(2) Not later than October 1, 2006, and periodically as required by subdivision (3) of this subsection, but not more often than every calendar quarter, the Department of Public Utility Control shall establish the standard service price for such customers pursuant to subdivision (3) of this subsection. Each electric distribution company shall recover the actual net costs of procuring and providing electric generation services pursuant to this subsection, provided such company mitigates the costs it incurs for the procurement of electric generation services for customers who are no longer receiving service pursuant to this subsection.

(3) An electric distribution company providing electric generation services pursuant to this subsection shall mitigate the variation of the price of the service offered to its customers by procuring electric generation services contracts in the manner prescribed in a plan approved by the department. Such plan shall require the procurement of a portfolio of service contracts sufficient to meet the projected load of the electric distribution company. Such plan shall require that the portfolio of service contracts be procured in an overlapping pattern of fixed periods 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. The portfolio of contracts shall 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. The 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. An electric distribution company may receive a bid for an electric generation services contract from any of its generation entities or affiliates, provided such generation entity or affiliate submits its bid the business day preceding the first day on which an unaffiliated electric supplier may submit its bid and further provided the electric distribution company and the generation entity or affiliate are in compliance with the code of conduct established in section 16-244h.

<u>(4) On or before July 1, 2010, each electric distribution company providing electric generation services pursuant to this subsection shall file with the department a procurement plan that provides for a transition from sole reliance on full requirements generation service contracts for standard service supply to a procurement process in which the distribution company manages a portfolio of electric generation supply resources by January 1, 2012. Each electric distribution company shall develop such portfolio in a manner that mitigates the variation of the price of the service offered to the electric distribution company's customers by blending short and mid-term market purchases at prevailing market prices with long-term purchases at prices aligned with the cost of electricity production. Such plan shall specify the method for purchasing power for standard service and the electric distribution companies may (A) procure load following full requirements service contracts in a manner similar to that pursuant to subdivision (3) of this subsection; (B) procure individual electric supply components, including, but not limited to, base load, intermediate and peaking energy resources, capacity, renewable energy certificates and other power supply services, using requests for proposals, bilateral contracts outside the request for proposals process and the regional power market; [and] (C) procure physical and financial hedges to manage prices, including, but not limited to, tolling arrangements and financial transmission rights; and (D) manage the power supply portfolio with purchases and sales of energy and other products in the spot market and on a real-time basis, to balance purchases with load, and to optimize supply for the benefit of customers. Such plan shall describe how an electric distribution company shall, over time, transition to its new supply aggregation role and manage the power supply portfolio on a real-time basis to optimize supply for the benefit of customers. The department shall set standard service rates in accordance with subdivision (2) of this subsection, provided such rates will be trued up to actual revenues and expenses twice per year, with any over or under recovery being included in either the current period or subsequent standard service rate, as determined by the department. An electric distribution company shall recover the reasonable costs it incurs to provide such service.</u>

[(4) The] (5) In approving a plan pursuant to subdivision (3) or (4) of this subsection, the department, in consultation with the Office of Consumer Counsel, shall retain the services of a third-party entity with expertise in the area of energy procurement to oversee the initial development of the request for proposals and the procurement of contracts by an electric distribution company for the provision of electric generation services offered pursuant to subdivision (3) of this subsection, and for the provision of electric generation services of greater than 1 year in duration offered pursuant to subdivision (4) of this subsection. Costs associated with the retention of such third-party entity shall be included in the cost of electric generation services that is included in such price.

[(5) Each] (6) For resources acquired pursuant to subdivisions (3) and (4) of this subsection, each bidder for a standard service contract shall submit its bid to the electric distribution company and the third-party entity who shall jointly review the bids and submit an overview of all bids together with a joint recommendation to the department as to the preferred bidders, provided that short term power transactions of 1 year of shorter in duration made pursuant to subsection (4) shall be managed by an electric distribution company without preapproval and shall be subject to periodic reviews by the department, in consultation with the Office of Consumer Counsel, to monitor consistency with an approved plan. The department may, within ten business days of submission of the overview, reject the recommendation regarding preferred bidders. In the event that the department rejects the preferred bids, the electric distribution company and the third-party entity shall rebid the service pursuant to this subdivision.

Sec. 2. (NEW) (*Effective from passage*) (a) Each electric distribution company shall apply for any federal economic recovery funds received by the state pursuant to any federal economic stimulus recovery legislation passed in 2008 or 2009 for energy purposes for any qualified project. Any money received by such electric distribution companies shall be used to offset costs to customers.

(b) On or before February 1, 2010, each electric distribution company shall report, in accordance with the provisions of section 11-4a of the general statutes, to the joint standing committee of the General Assembly having cognizance of matters relating to energy regarding federal economic recovery funds applied for and received, if applicable.

Sec. 3. (NEW) (*Effective from passage*) The Department of Public Utility Control shall conduct a uncontested case proceeding to seek immediate proposals for any outstanding contracts pursuant to section 16-244c of the general statutes if doing so would result in lower prices for consumers. The suppliers under such existing contracts shall not be required to submit proposals, and nothing contained herein shall be construed as requiring the abrogation of existing contracts.

This act shall take effect as follows and shall amend the following sections:		
Section 1	*from passage*	16-244c(c)
Sec. 2	*from passage*	New section
Sec. 3	*from passage*	New section

Statement of Purpose:

To make certain changes to the state's electric contract procurement process to result in lower prices for consumers.

[Proposed deletions are enclosed in brackets. Proposed additions are indicated by underline, except that when the entire text of a bill or resolution or a section of a bill or resolution is new, it is not underlined.]