In the Matter of the Commission's Inquiry into the Competitive Selection of Electricity Supplier/Standard Offer Service.	* * * * *	Case No. 8908, Phase II

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ORDER NO. 78710

Before: Kenneth D. Schisler, Chairman
J. Joseph Curran, III, Commissioner
Gail C. McDonald, Commissioner
Ronald A. Guns, Commissioner
Harold D. Williams, Commissioner

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I. Introduction

The Public Service Commission of Maryland ("Commission" or "PSC") in this Order approves the Phase II Settlement filed in these proceedings on July 2, 2003.[1] Previously, in Order No. 78400, the Commission approved a Phase I Settlement, which established the policy framework for the continued provision of Standard Offer Service ("SOS")[2] by Maryland's investor-owned electric utilities. This Phase II Settlement sets forth the specific requirements and processes necessary to implement those policies.

This Order is another in series of Commission Orders that implements the Electric Customer Choice And Competition Act of 1999 ("Electric Act")[3], which restructures the electric industry in this State, and fosters the orderly development of competition in the retail electric supply market for Maryland's citizens. In Phase I the Commission concluded that Maryland's retail electricity market is not yet competitive

[1] The "Settling Parties" are: The Potomac Edison Company d/b/a Allegheny Power ("AP"), Baltimore Gas and Electric Company ("BGE"), Delmarva Power & Light Company ("Delmarva"), Potomac Electric Power Company ("Pepco"), the Staff of the Public Service Commission of Maryland ("Staff"), Maryland Office of People's Counsel ("OPC"), Conectiv Energy Supply, Inc., ("CESI"), Mid-Atlantic Power Supply Association ("MAPSA"), Constellation NewEnergy, Inc., Pepco Energy Services, Inc., ("PES"), Maryland Energy Users Group ("MEUG"), the Maryland Energy Administration and the Power Plant Research Program of the Department of Natural Resources (jointly "MEA"), Strategic Energy, LLC, Reliant Resources, Inc., and Constellation Power Source, Inc., ("CPS").

[2] For discussion purposes, references in this Order to SOS include Type III Large Customer Service, unless otherwise stated. As noted in Section V.F. in the Phase I Order, the Commission is deferring consideration of whether the Electric Act requires the provision of SOS to other than mass market customers because the Settlements in this case address this issue appropriately at this time. Order No. 78400 at 95.

[3] Public Utility Companies Article of the Maryland Code of Maryland. The Electric Act is §§ 7-501 through 7-518. All statutory references herein are to the "PUC Article" unless otherwise stated.

and that as a result Maryland's investor-owned electric utilities are required to extend the provision of SOS pursuant to § 7-510(c), after their restructuring settlements expire. In so concluding, the Commission approved the Phase I Settlement's competitive wholesale procurement process framework for electric supply. The Phase II Settlement implements that framework in a manner that assures that SOS rates will be based upon market prices.

Testimony was filed in Phase II in July 2003 and hearings were held in August and September 2003. The record demonstrates that the Phase II Settlement establishes the details and procedures necessary to implement the approved policy framework. Among other things, the Phase II Settlement sets forth: the qualifications for those suppliers wishing to bid for a utility's SOS load obligations; the details of the bid request process; an objective and fair bid evaluation methodology; and a complete and thorough Full Requirements Service Agreement, which will control the terms of service between the utility and a winning supplier. Importantly, individual Utility Bid Plans are approved herein that will be separately applicable in each of the four utility service territories, thereby tailoring this process to the unique characteristics and requirements for each utility and its customers.

The Commission finds that the Phase II Settlement, as a whole, comports with the requirements and goals set forth in our Phase I Order, as well as the requirements of the PUC Article, including the Electric Act. It fairly balances the need to attract a diverse group of suppliers into this bidding process with the need to ensure reliable supply from financially capable suppliers. In our opinion, the process developed by the parties is fair, and comprehensive. It should not only produce stable market-based retail electric service rates for Maryland's citizens, but also ensure the reliability and integrity of this service.

The Phase II Settlement reflects the outcome of extensive and exhaustive negotiations between informed parties of diverse and traditionally adverse interests. These negotiations produced a reasonable and workable process to implement this vital public service. Furthermore, the Commission is persuaded that the process is designed in a manner that will allow the Commission to oversee the process and assure that it is implemented consistent with the public interest. Accordingly, the Commission approves this Phase II Settlement without modification.

II. Summary of Phase II Settlement

The Phase II Settlement consists of the Phase II Settlement Agreement and eight attachments. The attachments include: a Request for Proposals For Full-Requirements Wholesale Electric Power Supply or "Model RFP" (Attachment A); a Full Requirements Service Agreement or "FSA" (Attachment B); utility specific bid plans for AP, BGE Delmarva and Pepco (Attachments C-1 through C-4 respectively); Consultant Documents (Attachment D); and Confidentiality Agreements (Attachment E).[4] The Phase II Settlement describes the terms for wholesale electric power supply procurement for SOS, reporting and monitoring procedures, pricing and true-up procedures, other services, miscellaneous provisions and reservations.

Wholesale electric supply will be procured based upon the Model RFP and Model FSA (collectively the "Model Bid Plan" or "MBP"). The Model RFP includes the bid request process, the bid evaluation methodology, a timeline, and appropriate sample forms and agreements.[5] The Model FSA is the agreement that will exist between utilities

[4] There are eight "tabs" or attachments to the Settlement Agreement. However, paragraph 9 of the Settlement Agreement labels the OPC Confidentiality Agreement as Attachment E and the MEA Confidentiality Agreement as Attachment F, both of which are in tab 8.
[5] Phase II Settlement Agreement, Paragraph 2.

and wholesale suppliers who win a bid or bids. Each Utility Bid Plan ("UBP") will consist of the Model RFP, included the utility's respective attachment, plus the Model FSA.

The procurement process in the Phase II Settlement is for full-requirements wholesale electric supply service to meet the SOS retail load obligations of each utility.[6] Suppliers will have a service obligation stated as a specific percentage of retail load for specific service types, which thereby encompasses changes in customer demand for any reason.[7] Full Requirements Service is defined as "all necessary Energy, Capacity, Transmission other than Network Integration Transmission Service, Ancillary Services, Renewable Energy Resource requirement, transmission and distribution losses, congestion management costs, and such other services or products that are required to supply the specified percentage except for Network Integration Transmission Service and distribution service."[8] Suppliers will bid for, and if successful be responsible for, a specified percentage of full requirements service load during a particular delivery period.[9]

Prior to submitting bids, suppliers and utilities will exchange various information and the suppliers will undergo an eligibility review process set out in the Model RFP. The purpose of the pre-bid eligibility review is to pre-qualify suppliers to bid in advance of the first tranche (i.e. round of bidding) of the bidding process. If a supplier fails to meet the qualification requirements prior to the first tranche, it can cure such defects and

[6] Model RFP at 3.
[7] *Id*.
[8] FSA at 4
[9] FSA, Article 2.1.

participate in the next tranche provided any deficiencies are cured two weeks prior to the due date of proposals for the next tranche.[10]

The utilities will use a multi-tranche bid process to procure wholesale electric supply. The load associated with each tranche will be further divided among the contract terms where multi-year contracts are applicable. Furthermore, load will be divided into bid blocks of approximately 50 megawatts ("MW") each, which represents a certain and specific percentage of the associated SOS load of the utility.

Section 4 of the Model RFP outlines the bidding process. Bidders shall submit proposals using the bid forms attached as Appendix 4.[11] There is a separate Bid Form Spreadsheet for each tranche, each service type, and each contract term.[12] Conforming proposals must be: accompanied by an executed Binding Bid Agreement;[13] accompanied by the appropriate amount of bid assurance collateral; submitted using the Bid Form Spreadsheet(s), completed in full and without modification; submitted by the due date(s) and due time; and submitted by an eligible applicant.[14] There is no limitation on the number of proposals that a bidder may offer, however, no proposal(s) may be conditioned in any manner.[15] The utilities reserve the right to accept or reject bidders' proposals in accordance with the proposal evaluation criteria in Section 4.6 of the Model RFP.[16]

In submitting a bid, the supplier will indicate the number of bid blocks in the bid, and provide individual price values to serve, for example, the summer, non-summer, peak, and non-peak load for each term period covered by the bid. In order to evaluate the

[10] Model RFP, Section 3.6.
[11] Model RFP, Section 4.2.
[12] Model RFP, Section 4.1.
[13] *See* Model RFP, Appendix 5 for the Binding Bid Agreement.
[14] Model RFP, Section 4.4.
[15] Model RFP, Section 4.1.
[16] Model RFP, Section 4.1. *See* also Section 4.6.

bids, the individual prices are reduced to a single number. This is done by discounting each price to present value and applying volume weighting factors to arrive a single Discounted Average Term Price for Evaluation Purposes (DATP). This single value is the one and only determinant used to rank bids submitted.

The bid block offers with the lowest DATP will be selected within each contract term until the specified tranche targets have been met. The DATP is for bid evaluation purposes only; bidders that are awarded bid blocks shall receive their actual bid prices.[17] In evaluating Residential SOS bids, a residential price anomaly mechanism will be used to further evaluate bids.[18]

The multi-tranche bid process is designed to award supply contracts for the utilities' entire SOS load. However, the settlement includes contingency plans in the event that the entire load is not subscribed. If a utility still has load that has not been awarded to a supplier at the conclusion of the bid process, then the utility will initially procure power to supply the unsubscribed load by purchasing energy and all other necessary services through the PJM-administered markets, and prompt discussions will be initiated to discuss alternative methods to fill the unsubscribed load.[19] If a supplier defaults and any load is left unreserved after the load has been offered to other suppliers (in accordance with the FSA and the UBP), then the utility will initially supply the load in the manner described above. As soon a practicable thereafter, the utility will auction (i.e., a single RFP process will be conducted) the remaining term of the defaulted FSA,

[17] Model RFP, Section 4.6.
[18] *See* Appendix 6 of the Model RFP for a description of the procedure.
[19] Phase I Settlement Agreement, Paragraph 6.

on the same terms and conditions as in the FSA. The auction is subject to Commission approval.[20]

At the conclusion of each tranche, successful suppliers will be required to execute the FSA, which describes the responsibilities and obligations for electric supply between utilities and wholesale suppliers for SOS.[21] All service provided by suppliers to utilities shall be sales for resale by the utility to SOS customers. The master FSA that is executed with each supplier will include separate transactions for the specific service types and contract terms.[22]

The FSA includes provisions to address volumetric risk, the risk suppliers face from non-residential customer migration to and from SOS. The Volumetric Risk Mechanism ("VRM") mitigates this risk by allowing for incremental load pricing for the portion of the load above the increment band to be supplied under the agreement. If customers migrate away from SOS below the decrement band, suppliers are no longer obligated to serve the load at the contract price if customers later migrate back to SOS. Any additional load from return migration above the increment band will be subject to incremental load pricing.

The FSA also contains provisions to minimize a utility's or supplier's financial exposure in the event of a default. Suppliers are required to post performance assurance collateral to cover the utility's exposure over the course of the contract. If the utility's credit rating is downgraded then a supplier can require the utility to settle accounts on a weekly basis to protect the supplier.[23]

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[20] *Id.* at Paragraph 7.
[21] No provision within the FSA is negotiable. *See* Model RFP, Section 5.
[22] Model RFP, Section 5.
[23] FSA, Article 14.7.

In the Phase II Settlement AP, BGE, Delmarva and Pepco have each filed utility specific bid plans (UBPs), rather than wait for Commission approval of the Model RFP as originally contemplated in the Phase I Settlement. The UBPs:

- List the customer classes, the total load, the number of load blocks and approximate size of each load block for each solicitation;
- Provide the bidding timeline and deadlines for key activities in each bidding tranche;
- Provide a general description of customer class and pricing characteristics . . . for each service; . . . and
- Include the bid form spreadsheets to be used for an applicant's offer for load blocks for each service and each tranche.[24]

Each spreadsheet in the UBPs represents a specific solicitation. Bidders may submit multiple spreadsheets with different prices and different numbers of blocks offered, but a bid cannot be contingent on another bid.[25] For the BGE, Delmarva, and Pepco UBPs, the summer and non-summer and, as applicable, time of use and demand, rate elements that appear in the bid form spreadsheets of all contracted bidders for each customer class and service type will be weighted by the load served on each winning bid form spreadsheet. The resulting weighted averages of all of the winning bids for each rate element will be the electric supply component retail rates for each service."[26] AP's utility bid plan uses a simpler pricing structure based upon a single summer and non-summer price per

[24] Staff Ex. 1 at 9. Docket No. 205. Staff presented the testimony of Calvin L. Timmerman, Director of the Rate Research & Economics Division.
[25] Staff Ex. 1 at 10.
[26] *Id*. at 11.

megawatthour ("MWh"), and a single summer and non-summer demand price for services that have demand rates, for each service and contract year.[27]

In addition to the Phase II Settlement providing for wholesale power supply procurement based upon the above-described process, it also specifies numerous reporting and monitoring procedures, detailed confidentiality protocols, pricing and true-up procedures, as well as miscellaneous other provisions for implementation of the wholesale SOS procurement.

III. Standard of Review

In Commission Order No. 78400, approving the Phase I Settlement, the Commission discussed the standard of review for contested settlements.[28] Under that standard the Commission considers whether the proposed settlement is the product of careful negotiations between informed parties normally holding adverse positions, is supported by substantial evidence in the record[29], and is in the public interest.

IV. Issues

A. The Bidding Process Proposed In The Phase II Settlement Meets The Statutory And Phase I Requirements.

The Commission found, in Order No. 78400, pursuant to §7-510(c), that the retail electricity supply market in Maryland is not competitive.[30] As a result of that finding, the Commission is required, pursuant to §7-510(c)(3)(ii), to extend the obligation of electric companies to provide SOS to small commercial and residential customers. The statute

[27] *Id*. at 11-12. *See* also AP's utility bid plan – Attachment C-1.
[28] Order No. 78400 at 77-79.
[29] Re Potomac Electric Power Company 80 MD PSC 61, 64 (1989). Potomac Electric Power Company, 83 MD PSC 330, 332-3 (1992); Washington Gas Light Company, 91 MD PSC 464, 466-8 (2000); Association of Maryland Docking Pilots, 92 MD PSC 438, 443 (2001); Washington Gas Light Company, 93 MD PSC 265, 270 (2002).

requires such service to be provided "at a market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return."[31]

1. Pre Bid Qualifications

The proposed Phase II Settlement relies on a RFP bidding process as the means for selecting the wholesale suppliers of electricity necessary for the provision of the retail SOS. Eligibility to bid is governed by Section 3 of the Model RFP. The criteria for bidding eligibility includes submission of certain basic information: a signed confidentiality agreement; documentation that the potential supplier is a member of PJM and qualified as a market buyer and market seller in good standing; documentation that it is authorized by FERC to make sales of energy, capacity and ancillary services at market-based rates; submission of the credit application and associated financial information to the relevant utility; and provision of liquid Bid Assurance Collateral equivalent to $300,000 per each bid block included in a supplier's bid.

The above criteria are, in the Commission's view, objective and reasonably tailored to encourage the submission of bids from many wholesale suppliers, while also supporting the reliability and performance requirements that the utilities have pursuant to their public service company obligations. Specifically, the PJM and FERC authorizations, in addition to being threshold legal requirements to engage in the wholesale transactions envisioned at the conclusion of the bidding process, help ensure that the bidders have the wherewithal to perform under the contracts that will ultimately be awarded. The credit requirements and associated financial information also help

[30] Order No. 78400 at 80.
[31] Section 7-510(c)(3)(ii).

ensure that the bidders have both the financial resources necessary to ensure reliability of contract performance and the financial stability to deliver wholesale power for the duration of the long-term contracts awarded at the conclusion of the bidding process. Finally, the Bid Assurance Collateral of $300,000 per bid block should provide assurance that the entity bidding is a serious bidder and serve as an incentive for an entity bidding to carry through on the execution of a contract if it is the winning bidder. In light of the fact that a single contract may be valued in the tens of millions of dollars, and after weighing the barrier to market entry against the potential harm to ratepayers that conducting a re-bidding process may cause, the Commission finds that a requirement that suppliers post $300,000 per bid block in refundable collateral is reasonable.

2. Bid Process

The fundamental decision to rely on a wholesale bidding structure and the principles of how that would be structured were resolved in Phase I. Phase II determined that the specific type of wholesale bidding structure will be an RFP process. The bidding process itself is conducted individually by each electric company for its own system's requirements. There are actually four separate bid processes. While there is a UBP containing specific data requirements applicable to each electric company included in the proposed Phase II Settlement, the common elements of the four bidding processes are described in the Model RFP.

It is sufficient for purposes of considering the proposed Phase II Settlement for the Commission to determine whether the UBPs and overall process described in the Model RFP conforms to the structure approved in Phase I and meet the statutory requirements contained in the PUC Article. We so find. Furthermore, the Commission

finds that the Phase II Settlement meets the requirements of Title 4 of the PUC Article regarding just and reasonable rates and §§7-505(b)(8), 7-510(c)(3)(ii) and 7-505(b)(10) requiring that SOS rates reflect a market price and charging the Commission with ensuring the creation of competitive retail electric supply and electric services markets.

The Settlement approved in Phase I contained certain principles or requirements by which to judge the proposed Phase II Settlement. These principals are also useful in determining compliance with the statutory requirements described above.

The Commission finds that the Phase I requirement for a competitive wholesale procurement process has been satisfied. In addition, the proposed procurement process will lead to a market price for SOS. Conducted over approximately six months, the bidding process is sophisticated and structured to produce bids from reliable entities and to produce contract wholesale prices that will, in turn, produce a market-based retail SOS price for customers of each of the utilities.

Another Phase I principle required that SOS include supply portfolios of varying duration for certain service types.[32] By meeting that principle, the resulting retail SOS price will reflect a blend of the market prices and ensure price stability.

A final consideration regarding the market price requirement is the requirement that Phase II include provisions for dealing with bid price anomalies for the residential class. The residential price anomaly mechanism contained in the proposed Phase II Settlement will operate, if necessary, to protect against systemic problems that could produce above-market results in the aggregate, thus keeping the SOS retail price within

[32] The individual UBPs may vary from precise annual term contracts in the initial bid process because the utilities have different ending dates in their restructuring settlements. The utilities will conform the start date for all contracts to run from June 1st of every year after the initial term.

the bounds of reasonableness and satisfying the requirements of Title 4 of the PUC Article.

Other principles arising from Phase I require that the bid processes produce contracts to meet the full requirements of the electric companies by offering universal eligibility to virtually all customers. In meeting these requirements, the proposed Phase II Settlement also satisfies that portion of §7-510(c)(3)(ii) requiring electric companies to provide SOS to the residential and small commercial customer classes.

Each utility will conduct up to three rounds of bidding, with a fourth round of bidding (a fourth tranche) held in reserve to be used if wholesale contract requirements are still unfilled after the third round of bidding. One hundred percent of these requirements will be solicited in the first three tranches in bid blocks of approximately 50 MW. The fourth round of bidding or tranche will be used only in the event that all contract requirements are not awarded in the first three rounds of bidding. This additional tranche should ensure that the full requirements are in fact met and should avoid any "orphan" or uncommitted SOS load. The Settlement has provisions that ensure that there will never be a situation where wholesale power is not available.

Each utility's requirements for its blended portfolio will be split among the three tranches in accordance with each utility's specific bid plan as presented in the Phase II Settlement. There will be cases where all three rounds of bidding are not necessary to solicit bids for certain service types. This is due to the limited total MW of load to be filled in any particular service type. Bids will be solicited by service type (*i.e.*, Residential, Type I Non-Residential SOS, Type II Non-Residential SOS, and Type III Large Customer Service). According to the Phase II Settlement, bidding in each

tranche will be conducted at the same time for all four utilities. This will ensure the most equitable opportunities are afforded to each utility in terms of getting its load served at a reasonable and market-based price.

Suppliers may bid on as many of the approximately 50 MW blocks for as many different service types as any one supplier may choose. It is clear in the Model RFP and Model FSA that a winning bidder is required to serve a specific percentage of a utility's actual load for a service type, as that load may vary from hour to hour due to, for example, changes in a customer's usage due to weather conditions. In other words, the bid is for full requirements service.

As noted above, §7-505(b)(10) charges the Commission with ensuring the creation of competitive retail electric supply and electric services markets. Because it incorporates unlimited residential switching and a volumetric risk mechanism related to non-residential switching, principles contained in the Phase I Settlement, the Settlement in Phase II lays the foundation for a competitive residential retail market and removes a potential disincentive for non-residential customers to shop. Breaking the bid blocks into commercially reasonable sizes of 50 MW should also attract wholesale bidders to Maryland, a necessary pre-condition for viable retail markets. Finally, seasonally differentiated and, if applicable, time-of-use pricing approved as principles in Phase I and provided for in the various UBPs in Phase II, will better reflect actual costs and provide points of differentiation that will send market signals and should provide market opportunities for retail electricity suppliers whose prices are not regulated.

The Commission, in addition to its new responsibilities under the Electric Act, has the traditional regulatory responsibilities regarding the utility services provided by public

service companies in Maryland. Among these are the responsibilities imposed under §2-113 charging the Commission with regulating the electric distribution companies to ensure their operation in the interest of the public and to promote adequate, economical and efficient delivery of utility services.

Three of the principles approved in the Phase I Settlement and, the Commission finds, implemented in the proposed Phase II Settlement, assist the Commission in meeting the statutory charge. The Commission, as part of its review and consideration of the proposed Phase II Settlement, has reviewed the forms, model contracts and bid processes. Use of these forms and contracts and proper implementation of the bid processes should, in the Commission's judgment, allow for the adequate and reliable provision of SOS services by the regulated distribution companies. Further, the provisions for PSC review of the final bid results, bid awards and proposed contracts as well as the provision for a major policy review in the second year will ensure active, continuing Commission oversight.

B. The Volumetric Risk Mechanism will mitigate the impact of customer migration on wholesale suppliers and avoid the need to impute volumetric risk in bid prices.

The Phase I Settlement required that provisions be developed in Phase II to mitigate wholesale supplier exposure to changes in the amount of contracted load, known as volumetric risk, associated with customer migration between SOS and competitive retail suppliers for the non-residential Type I, II, and III services. Allowing customers to freely switch promotes retail competition, one of the fundamental objectives of the Electric Act. However, unfettered customer movement to and from SOS can create substantial risk for wholesale suppliers who must make arrangements for generation to

serve the load. If there were no provisions for mitigating this risk, suppliers would need to impute a substantial risk premium in their bids. Mitigating the risk of substantial customer movement through the Volumetric Risk Mechanism ("VRM") enables wholesale suppliers to submit bid prices for utility provided SOS that do not include a mark-up for such risk. Thus, the bid prices will be lower than they would be without this mechanism. The Commission finds that a VRM is appropriate for non-residential customers. However, a similar mitigation mechanism for residential customers is not necessary at this time due to the expectation that the residential market will develop at a rate slower than the non-residential market. All customers are free to switch to and from any electricity supplier and service.[33]

The VRM developed in Phase II defines the levels of volumetric and pricing risks to which the wholesale suppliers will be exposed and how such risks will be addressed. Through this mechanism wholesale suppliers will be required to fully meet the service load contracted for at all times. However, suppliers will not be required to assume incremental load obligations that are not specifically identified and priced as incremental load. In the event of a decrement situation due to customer migration, wholesale suppliers are released from their obligation to supply the decrement load at the original contract fixed price. Load served will be tracked by the utilities on a daily basis.

The increment is triggered when the incremental load increases more than 5 MW above the base load that was contracted. The decrement is triggered at less than or equal to 3 MW below the base load percentage that was contracted. Since SOS load served

[33] Certain customer migration restrictions exist in the utilities' customer enrollment rules and tariffs. They will remain fully effective. These restrictions exist to enable choice to function from a purely administrative perspective and are essential for such fundamental tasks as enrolling and re-enrolling

will be tracked on a daily basis, increments and decrements will be adjusted on a daily basis as applicable.

For the load increment exceeding the base load plus 5 MW per awarded bid block, the supplier will be paid the PJM spot market price for energy, capacity, and ancillary services plus $3 per MWh. As discussed in the preceding paragraph, if load declines below the base load in an amount that equals 3 MW per awarded bid block, a new base load is established at the previous base load less 3 MW per awarded bid block. The Commission concludes that a reasonable decrement trigger (3 MW) is lower than the increment trigger (5 MW) because it enables capacity to be freed up and made available for retail suppliers to secure for their load, and thus facilitates competition at the retail level.

In the event an increment is triggered, new pricing is established for the portion of load that represents the increment. That incremental pricing is tracked for the duration that the increment is active and included as part of the retail rate true up.

C. The Performance Assurance Requirements in the Phase II Settlement are Appropriate.

After the execution of a FSA between a utility and a wholesale supplier, the Phase II Settlement imposes a continuing potential obligation on the part of the supplier to provide performance assurance under certain conditions to ensure the supplier's performance under its contract.[34] A supplier's undertaking to provide Full Requirements Service incorporates certain physical and financial components. Both are within this

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customers in computer systems as they move from one supplier service to another. Type III LCS has certain additional limitations. *See* Phase I Settlement, Paragraph 60.

[34] FSA, Article 14.

Commission's delegated responsibility. The following discussion primarily concerns the financial components.

The performance assurance includes both unsecured credit and collateral. Unsecured credit is available in graduated amounts depending upon the supplier's credit ratings with nationally recognized credit rating agencies.[35] The higher the credit rating or net worth of the supplier, the more unsecured credit that will be available. The FSA requires the supplier to post collateral, which may take the form of cash or a letter of credit, to the extent that the utility's exposure for the remainder of the term of the contract exceeds the level of unsecured credit available to the supplier, if any. Since the utility's exposure will change over time as the electricity market fluctuates and as the supplier performs during the course of the contract, the Phase II Settlement includes a mechanism for adjustments to the supplier collateral requirement. For the reasons set forth below, the Commission finds that the performance assurance requirements contained in the Phase II Settlement are in the public interest.

1. Unsecured Credit

The unsecured credit provisions should achieve the desirable objectives of promoting supplier diversity and interest in Maryland's wholesale bidding process. The Commission balances these objective against the needs of both utilities and ratepayers, for the reliable and economic provision of wholesale power and the resulting SOS.

Under the Phase II Settlement, depending upon the credit rating and net worth of the supplier, the suppliers may be eligible for up to $125 million in unsecured credit. The unsecured credit provisions of the FSA are regarded as generous to suppliers by the Settling Parties and by the Commission, and should serve to entice potential suppliers to

bid for SOS. [36] Even suppliers whose credit rating falls below investment grade,[37] within certain credit rating parameters, may still have a relatively small amount of unsecured credit extended to the supplier by the utility. Extending modest amounts of unsecured credit to companies whose credit rating is below investment grade is common industry practice in today's wholesale power market.[38]

While attracting as many bidders as possible is a desirable objective, limiting the exposure of a utility and ratepayers in the event of default by a wholesale supplier remains an important competing objective. The Phase II Settlement achieves both objectives in a balanced manner. The settlement scheme of extending unsecured credit on a sliding scale based upon a supplier's net worth and creditworthiness, coupled with collateralization requirements for any exposure beyond any unsecured credit amount, is a reasonable approach for encouraging bidder participation and mitigating risk associated with a potential supplier default.

In addition to serving as a barrier to participation, if no unsecured credit was available to suppliers under the FSA, suppliers would have to submit higher bids to cover the costs of securing collateral for the full amount of their contractual obligations. The wholesale power industry has recognized that extending reasonable amounts of unsecured credit to suppliers, as is proposed in the Phase II Settlement, is a modest risk that is commercially reasonable.

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[35] FSA Art. 14.3.
[36] Tr. at 1829.
[37] "Investment grade" is generally regarded as credit receiving a rating of "BBB" in S&P and Fitch's rating systems or "Baa2" in Moody's rating system, or higher.
[38] CPS Ex. 1 at 8. Docket No. 213. CPS presented the testimony of Mary M. Lynch, Vice President, Regulatory Affairs.

The Commission concludes that the entire Phase II Settlement, when viewed as a whole, contains adequate assurances for supplier reliability, and that full collateralization of the exposure from the suppliers is not necessary. The important values of encouraging bidder participation and lower costs outweigh the risks associated with the modest amounts of unsecured credit proposed to be extended in the FSA. The Commission therefore finds that allowing firms supplying power for SOS to have modest amounts of unsecured credit available is both consistent with industry practice and in the interest of both the utilities and ratepayers of Maryland**.**

2. Mark to Market Calculation

A utility's financial exposure under a contract with a supplier will change over the course of time as wholesale market prices vary from the prices that existed on the date the FSA was executed. This is true because in the event of default by a supplier, the utility will procure replacement power at market prices that may be higher than the prices at the time of contract execution. In order to account for changes in the utility's financial exposure in the determination of the appropriate collateral requirement of a supplier, the Phase II Settlement incorporates the use of a "mark to market" calculation to adjust the collateral requirement as the wholesale market changes over time.[39] The mark to market mechanism provides that both the utility and the supplier may request that the counter party act in a timely fashion either to provide additional collateral or release excess collateral, depending upon the status of the market at the time.[40] The Commission approves of the mark to market mechanism as a fair and commercially reasonable device

[39] CPS Ex. 1 at 9.
[40] FSA, Article 14.2.

to ensure that the collateral required of suppliers matches the financial exposure to the utilities over the course of the contract.

3. Reciprocal Collateral Requirements

Mirant, in its Initial Brief, asserts that utilities should be required to post reciprocal collateral in the event of a utility bankruptcy or other default. The Commission finds this argument without merit and unsupported. First, Mirant's implicit assumption that the risk to the wholesale supplier is the same type and magnitude as the risk to the utility, does not withstand scrutiny. The risk to the utility of a failure by a wholesale supplier has both physical and financial elements. If the supplier fails to deliver power then the utilities must find and pay for replacement power. A wholesale supplier most likely would chose not to deliver power during a rising market, (i.e. where the market price is higher than the contract price). Whereas the risk to the wholesale supplier is the failure of the utility to pay for the power sold to it by the supplier. This is largely a cash flow risk to the wholesale supplier since the power delivered will be consumed immediately and generate account receivables in favor of the utility, which can be used to pay the wholesale supplier. Second, as regulated utilities, the utilities carry less risk than unregulated entities. Therefore they are less likely to be in a position of being unable to pay the costs of purchased power as they become due, and there is less reason for reciprocal collateral. Finally, it is significant to note that, of the several wholesale suppliers participating as parties in this proceeding, only Mirant raises this issue. Moreover, when Mirant raised the issue, it did so on brief only, and failed to sponsor any witness or offer any evidentiary support for its assertion.

There may be some risk to suppliers associated with a potential utility default,[41] however, the Settling Parties to the Phase II Settlement could have, but did not, address this risk by including a reciprocal credit requirement. In lieu of such a requirement, the Settling Parties adopted a mechanism for accelerated weekly payments to suppliers following a "Buyer Downgrade Event," when a utility's credit rating falls below a defined level.[42] Mirant is undoubtedly correct that the weekly payment mechanism would not protect the forward market value of the contract, although the scope or significance of that exposure was not developed in the record. The Phase II Settlement, however, is intended to be a reasonable balance between the interests of wholesale suppliers, utilities, and SOS ratepayers. The Commission finds that the supplier collateral requirements, coupled with the utility accelerated payment provisions achieve the proper balance.

D. Adoption of a Price Anomaly Threshold Mechanism is consistent with the Phase I Settlement and is supported by the evidence.

The proposed Phase II Settlement provides for a price anomaly threshold ("PAT") mechanism for Residential SOS.[43] The purpose of pricing anomaly procedures is to protect against systemic problems that produce above-market results in the aggregate in order to prevent residential ratepayers from being charged more than a competitive market price for electricity supply. According to OPC Witness Wallach:

> The pricing anomaly procedures provide critical protections for residential consumers in the unlikely event that prices resulting from the RFP process do not reflect truly competitive market conditions and are therefore unreasonable. . . . [T]hese procedures do not necessarily preclude individual competitive offers that exceed expected market prices (represented by the

[41] Tr. at 1681.
[42] FSA, Article 14.7.
[43] See Appendix 6 of the Model RFP in the Phase II Settlement.

> PAT). Instead, these procedures protect against systemic problems, such as unanticipated flaws in the design of the procurement process or anti-competitive gaming of the procurement procedures by individual bidders, that produce above-market results in the aggregate. Thus, the pricing anomaly procedures play a critical role in ensuring that Residential SOS customers are charged no more than a competitive market rate for such supply, as required under PUC Section 7-510(c)(3)(ii)(1).[44]

The PAT is actually a number, or price point, determined by the Commission Staff, the utilities and the Commission's SOS consultant. The objective in the PAT determination is to define the highest reasonable wholesale market prices for full service SOS according to current market conditions.[45] The PAT is calculated just prior to the bidding in each tranche, and then compared against the actual bids received.[46] As described by Mr. Wallach above, bids that are above the PAT are not necessarily rejected. Instead, the aggregated average of the actual bids are compared against the PAT. If the aggregated average exceeds the PAT, then and only then, will the mechanism operate to exclude high bids.[47] In this way, the mechanism is intended to work as a gross target designed to prevent irregular or out of market bids from being included in a utility's SOS supply portfolio.[48]

There are four tasks that must be completed as part of the residential price anomaly mechanism, the details of which are outlined in Appendix 6 of the Model RFP. First, all supply offers for each of the three bid terms are ranked according to price. The offers are discounted to present value to a single Discounted Average Term Price for

[44] OPC Ex. 1 at 14. Docket No. 235. Mr. Wallach is a consultant for OPC. Mr. Wallach's Corrected Phase II Direct Testimony did not contain the exhibits from his original Direct Testimony; Exhibits JFW 1 and 2 were admitted as OPC Ex. 3. See Docket No. 207.
[45] OPC Ex. 1 at 13.
[46] *Id*. at 13.
[47] *Id.* at 12.
[48] Tr. at 1319-1320.

Evaluation Purposes ("DATP"). Second, an initial portfolio is assembled that achieves both the total load requirement and the bid portfolio targets for one, two and three-year term supply offers. The third step of the process introduces the PAT. In this step, the initial portfolio is assessed for pricing anomalies. The average of all of the DATPs is calculated for each bid term in the initial portfolio. The average of the DATPs is then compared to a PAT to determine whether the average for any bid term exceeds the related PAT for that term. If so, the initial portfolio for that particular bid term is considered anomalous. The fourth step in the procedure involves revising the initial portfolio, if necessary, to address and eliminate any individual pricing anomalies that may exist among the supply offers. If the average price for a term exceeds its related PAT, supply offers for that term are removed beginning with the highest priced offer until the average price of the remaining supply offers is less than or equal to the related PAT.

If supply offers are eliminated in the one year bid term, the unfilled load is to be included in the next tranche with offers of the same term. If supply offers are eliminated in the two or three year bid terms, the PAT mechanism first considers whether any bids remaining from shorter term (one or two year) supply offers are available to serve the load. Shorter-term bids will be accepted so long as the average for that particular bid term, with the shorter-term bid(s) included, is equal to or below the PAT for that bid term. If not, the bid blocks will remain unfilled to be bid upon in the next tranche.[49]

There are eight cost elements used to determine the residential price anomaly threshold. These eight elements are as follows: (1) the PJM Western Hub On-Peak Energy Price; (2) the PJM Western Hub Off-Peak Energy Price; (3) EDC-Specific

[49] OPC Ex. 1 at 10-12.

Unhedged Congestion Adder;[50] (4) EDC Rate Class-Specific Load Shape Adder; (5) Capacity Price; (6) Loss Adder; (7) Ancillary Service Adder; and, (8) Transaction Cost and Risk Adder.[51] Thus, the first seven cost elements of the PAT will be based on historic or forward wholesale electricity price figures and quotes, and are available or may be computed from public sources.[52] The Commission consultant and the utilities will compute these seven components.[53] The eighth element of the PAT will be determined by Staff and will be kept confidential.[54] These eight elements will then be compiled into one composite PAT by the Consultant, which is intended to reflect the highest reasonable wholesale market price for residential SOS. According to OPC, the PAT will mirror prevailing market conditions for each tranche because the PATs will be calculated just prior to the offer submission date for the first tranche.[55] Further, the PATs will be updated immediately before the submission date for each successive tranche.[56]

WGES objects to the price anomaly mechanism, arguing that it is a "potentially abusive element" and suggests that the Commission "remove the PAT mechanism from the final rules it adopts in this proceeding."[57] The Commission notes that WGES offered no evidence or sponsored any witness in support of its position. WGES's policy positions, presented as legal argument, remain wholly unsupported on the record. Consequently, the Commission rejects WGES's arguments in their entirety.

[50] An "EDC" is an electric distribution company.
[51] See Appendix 6 of the Model RFP in the Phase II Settlement.
[52] Brief of Staff at 24. Docket No. 252.
[53] Tr. at 1338.
[54] Brief of Staff at 24.
[55] OPC Ex. 1 at 13.
[56] *Id.*
[57] Brief of WGES at 1-3. Docket No. 253.

WGES asserts that the PAT mechanism is an "administrative price ceiling that does not otherwise represent a high end of a range of reasonable prices as Staff asserts."[58] WGES states that "the fact is that if the average price of the awarded bids cannot exceed the PAT set for each tranche for each bid term, the PAT acts as a price ceiling."[59]

OPC counters WGES by stating that the PAT is necessary to reduce the possibility of above market prices.[60] OPC further suggests that the PAT is intended to protect against the award of contracts for unreasonable bids rather than act as a mechanism to serve as a price ceiling.[61] Mr. Timmerman argues that "a particular price anomaly threshold is not setting a single ceiling for the resulting generation component, because there is going to be a different price anomaly threshold for each tranche and multiple tranches make up the final composite average generation component."[62]

The Commission finds that the PAT mechanism is not a price ceiling, and finds WGES's argument in this regard unavailing. The PAT mechanism allows bids above the PAT to be accepted provided that the ***average*** of all the bids is not anomalous, or above the PAT. There is no ceiling on any individual bid. Any bid will be accepted provided that the average of all bids achieves a wholesale price that is at or below the highest reasonable price according to current market conditions. The PAT mechanism is not a price ceiling, but instead a method to prevent passing on the costs of unreasonably high bids to residential ratepayers.

[58] Brief of WGES at 3.
[59] *Id*. at 4.
[60] Brief of OPC at 15. Docket No. 249.
[61] Brief of OPC at 15 quoting Tr. at 1219-1220.
[62] Tr. at 1333.

WGES also claims that the PAT is an unspecified, non-transparent confidential formula.[63] The Commission dismisses this concern, and finds that the confidentiality of the PAT is a necessary feature of the PAT mechanism.

According to Staff, the first seven components of the PAT will be based upon publicly available market information.[64] OPC notes that "the pricing anomaly thresholds will incorporate estimates of market prices for all products and services bundled in full requirements wholesale supply."[65] The eighth and final component of the PAT, the Transaction Cost and Risk Adder, incorporates the inherent risks and costs associated with participating in Maryland's SOS bid process and will be determined by Staff.

Staff argues that, "the PAT strikes a sound balance between a transparent and open process and giving the bidders information that prejudices the results for utilities."[66] Further, Staff states that, "[t]he confidential element of the PAT is designed to prevent bidders from having complete knowledge of what the threshold will be, and thereby prevent them from altering their bids to defeat the overall purpose of the mechanism."[67] Staff asserts that the PAT incorporates the minimum degree of confidentiality necessary to satisfy its purpose.[68] OPC states that the confidentiality of the PAT is appropriate and the bid evaluation is sufficiently transparent.[69]

The Commission notes that the eighth element of the PAT includes an intentional element of subjectivity and that the composite number determined from the eight attributes will be kept confidential. The primary reason for this subjectivity and

[63] Brief of WGES at 4-5.
[64] Brief of Staff at 24.
[65] OPC Ex. 1 at 13.
[66] Brief of Staff at 25.
[67] Brief of Staff at 24 quoting Tr. at 1250.
[68] Brief of Staff at 24.

confidentiality is to protect the bid process from gaming and market manipulation by bidders. If the PAT were known to all, bidders could undermine the safety net by structuring bids around the PAT. [70] The PAT itself is commercially sensitive information, and must remain so, or else residential consumers will not have the protections against anomalous prices that is required in the Phase I Settlement.

WGES in essence argues that the PAT will somehow retard the development of the competitive electricity market place. However, the record in Phase II demonstrates to the Commission that in fact the PAT is unlikely to pose a problem for either retail or wholesale suppliers. Strategic Energy LLC Witness Swider testified that the PAT would probably not be a barrier to a licensed retail electricity supplier such as his company entering the residential market.[71] CPS witness Lynch concurred stating that "I don't think that the residential price anomaly [mechanism] that's incorporated here introduces any additional level or barrier to entry that a wholesale supplier would look at in making a decision as to whether or not to participate."[72] The Commission concurs in these sentiments.

In our view, maintaining the integrity and confidentiality of the PAT mechanism is critically important and in the public interest. The bid process that will be held as a result of the Commission's approval of the Phase II Settlement will be Maryland's first endeavor since the passage of the Electric Act to procure electricity on behalf of SOS customers at market prices. While the Settling Parties believe that it is unlikely that the

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[69] OPC Brief at 11. Pepco/Delmarva Witness Schaub also noted the high level of transparency in the Phase II Settlement. PHI Ex. 1 at 8-9. Docket No. 212.
[70] See Tr. at 1250.
[71] Tr. at 1472-1473. *See* also Strategic Energy, LLC Ex. 1 at 1. Docket No. 211.
[72] Tr. at 1706. CPS is a wholesale supplier and potential SOS bidder.

PAT mechanism will cause bids to be discarded as anomalous, having the PAT mechanism in place however, will provide important protections should something in the bid process go awry.

The Commission concludes that the PAT procedure developed and included in the Phase II Settlement is appropriate for all of the foregoing reasons. In addition, the record reflects that the PAT is consistent with the statutory requirement that residential SOS be extended at a "market price."[73] Finally, the Commission finds that the PAT mechanism proposed in Phase II is consistent with the Phase I Settlement requirement that the Model Bid Plan include procedures for addressing potential residential SOS pricing anomalies.[74]

E. The Phase II Settlement addresses affiliate relationships in an appropriate manner

The Commission is mindful of concerns regarding potential inappropriate communications or dealings between a utility and an affiliate of that utility that may submit one or more bids to provide wholesale power. Such communications or dealings would be harmful to the development of a competitive retail market and may raise costs to SOS ratepayers. The Commission expects that the bidding structure itself will operate to preclude opportunities for favoritism by a utility toward its affiliate. The relatively lengthy pre-bid process, in addition to being monitored by the Commission through its independent consultant and its Staff, provides sufficient time for allegations of undue discrimination by utilities or other improper actions to be dealt with by the Commission. The bids will be submitted within a very tight time frame and access to the bids by utility

[73] *See* § 7-510(c)(3)(ii).
[74] *See* Phase I Settlement paragraph 7(h) at p. 6-7.

personnel will be closely held. This step will also be closely monitored by the Commission.

Finally, the award of the winning bids for a particular service type and contract term has been reduced to a comparison of a single parameter, the Discounted Average Term Price for Evaluation Purposes ("DATP"). Bids will be compared and selected based upon price alone. This very limited decisional process provides an inherent assurance that bids selected will be based upon price rather than any supplier's affiliation with a utility.

Upon review of the Phase II Settlement, the Commission concludes that adequate safeguards are built into the process to ensure that a utility's affiliate will not receive an unfair advantage based on the affiliate relationship. Nevertheless, in order to better protect against inappropriate communications, the Commission has proposed the promulgation of certain emergency regulations to prohibit communications between a utility and an affiliate that would improperly advantage an affiliate over competitors in the market.

F. Consultants will be employed to assist the Commission in any manner necessary to monitor and evaluate all aspects of SOS pursuant to the Phase I and II Settlements.

During the Phase II proceedings some confusion arose as to the role of the consultants. The Phase I Settlement approved by the Commission envisioned a very broad role for the Commission's consultants in the SOS process. Paragraph 84 thereof states that the utilities "will procure and pay for independent consultant's who will be responsible for monitoring *all aspects* of the procurement of the Utility SOS services and

the Type III Large-Customer Service described in the [Phase I] Settlement."[75] (emphasis added). However, paragraph 8 of the Phase II Settlement provides that "[e]ach Utility will only be required to pay for work that the Consultant does in reviewing the Utility's compliance with Paragraphs 9, 28, 47, and 65 of the Phase I Settlement; any other work that the Staff or the Commission asks the Consultant to perform shall not be the responsibility of any of the Utilities." Pursuant to questions posed by the Commission, the Settling Parties, particularly the utility panel, confirmed the broad scope of consultant responsibilities.

The Consultant Documents in Appendix D of the Phase II Settlement provide an extensive list of duties that the consultant will perform. The consultant will be selected and supervised by the Commission and will provide his consultation and work product directly to the Commission.[76] BGE witness Pino stated that the parties have no intent in Phase II to limit the Commission in any way from ordering the consultant to do whatever the Commission deems appropriate for the consultant to do.[77] Mr. Pino emphasized that

> "from the very start of communication . . . all the way through Commission approval . . . the entire process I think is under the purview and work scope of the consultant to give the Commission assurance that the entire process, not just the final bid results . . . including those communications that occur between the utility and the suppliers, were done fairly and appropriately."[78]

Pepco, Delmarva and AP all concurred with this interpretation of the Phase II Settlement.[79] Furthermore, Pepco/Delmarva Witness Schaub and Mr. Pino stated that the

[75] Paragraph 84(b) provides that the utilities will recover these costs through the Administrative Charge.
[76] Phase I Settlement, Paragraph 84(a).
[77] Tr. at 1666. There is also no intent to change the scope of the consultant's duties in Phase II from Phase I. Tr. at 1660-61.
[78] Tr. at 1653-64. *See* also Tr. at 1612-13.
[79] Tr. at 1564.

consultant will have full access to the internal activities and process used to obtain and evaluate the SOS bids.[80] AP witness Valdes concurred.[81] Mr. Wallach noted that the consultant will report to the Commission on whatever the Commission wants to see from the consultant.[82] Mr. Timmerman asserted that the consultant's scope of work activities includes "monitoring the bid process from the very beginning, namely the website going active, the materials going out, all the way through the award, bids and the putting together of the report on the results of the bids."[83]

Mr. Pino noted that the ultimate role of the consultant is to render a report on the entire bid process and compliance with the UBPs and consequently the consultant needs to be able to address all of the issues raised by the Commission during the hearing.[84] Mr. Pino concluded that "the final report will provide the information that Staff deems appropriate for it to include."[85] Furthermore, Mr. Pino emphasized that there would not be a billing dispute with the Commission if the Commission directed the consultant to examine a matter related to the provision of SOS.[86] Pepco, Delmarva and AP supported Mr. Pino's position.[87] Finally, BGE notes in its Brief that the Settling Parties in the Phase II Settlement "merely have tried to articulate the relevancy parameter" of the consultant's work that will be paid for through the Administrative Charge and that, ultimately, "the Commission must determine for itself what consultant work is relevant to

[80] Tr. at 1559 and 1575.
[81] Tr. at 1576-77. He also stated that it would be within the consultant's scope of activities to review corporate policies regarding confidentiality standards. Tr. at 1595-98.
[82] Tr. at 1768-1769.
[83] Tr. at 1345.
[84] Tr. at 1605-1606.
[85] Tr. at 1530.
[86] Tr. at 1612-1613, 1617-1618, 1662-63 and 1666-1667. This could also include consultant recommendations for prospective improvement in the bid process. Tr. at 1627-28.
[87] Tr. at 1613 and 1618.

a review of the procurement" and work will be paid for that is "deemed appropriate by the Commission."[88]

The Commission accepts the representation of the parties' witnesses that the language in the Phase II settlement in no way limits what the Commission consultant will do or the utilities will pay for, and so finds in this proceeding.

G. Article 15.1(e) of the Full Requirements Service Agreement properly operates to exclude bankrupt suppliers from participation in the SOS bidding process.

During the second day of hearings on August 26, 2003, questions arose for the first time in this proceeding concerning whether Article 15.1(e) of the Full Requirements Service Agreement ("FSA") operates to exclude suppliers in bankruptcy from participation in the SOS bidding process. Article 15.1(e) requires a prevailing bidder to represent that it is not in or contemplating bankruptcy. BGE Witness Pino testified that, in his opinion, a bankrupt bidder could bid, although if successful, the supplier would be in default under the FSA immediately upon execution. Mr. Pino further suggested that the default could be addressed as a Special Remedy under paragraph 38 of the Phase II Settlement.[89] When presented with the same issue in cross-examination, CPS Witness Lynch stated that the matter was a legal question but believed that a bankrupt supplier could not make the necessary warranty to enter into the FSA.[90] As a result of these discussions, the Commission requested the parties address the issue directly in their post-hearing briefs.[91]

[88] Brief of BGE at 14-15. Docket No. 251.
[89] Tr. 1631-1634.
[90] Tr. 1675-1676.
[91] Tr. 1721-1722.

Upon consideration of the legal arguments of the parties, the Commission finds that Article 15.1(e) of the FSA operates to exclude bankrupt suppliers and those contemplating bankruptcy from bidding for SOS supply. The Commission further finds that such an exclusion is appropriate and in the public interest.

1. Bankrupt Supplier Participation in SOS Bidding Process

Pursuant to the Phase II Settlement, each successful wholesale bidder must execute a FSA with each utility purchasing that supply. Article 15.1 – Representations and Warranties – of the FSA requires that:

> each Party represents and warrants to the other Party that:
>
> * * *
>
> (e) it is not Bankrupt and there are no proceedings pending or being contemplated by it or, to its knowledge, threatened against it which would result in it being or becoming Bankrupt.
>
> * * *

In its Initial Brief filed on September 8, 2003, Mirant, a company currently the subject of a bankruptcy proceeding in the United States Bankruptcy Court for the Northern District of Texas, Forth Worth Division, states that the plain meaning of Article 15.1(e) unfairly prohibits it and any other supplier that is in or contemplating bankruptcy from executing a FSA.[92] Since Mirant cannot represent that it is not in bankruptcy, it argues that as a practical matter, it is precluded from direct participation in the SOS bidding process.[93] While providing the Commission with no legal or policy justification as to why such a prohibition is unwarranted, Mirant recommends that the Commission make a number of alterations to the settlement package. The company proposes a

[92] Initial Brief of Mirant, at 1-3.

lengthy set of specific modifications to Article 15.1(e) of the FSA and suggests that other general alterations may be required to the Phase II Settlement in order to ensure its participation in the process.[94]

Of the other parties that commented on the issue in their initial briefs, all agree with Mirant that Article 15.1(e) of FSA effectively operates to prohibit bankrupt suppliers from direct participation in the SOS bidding process.[95] Nevertheless, with the exception of Mirant, the parties contend that such a prohibition is both appropriate and in the public interest. The basic argument of those opposing bankrupt supplier participation is that it would be harmful to the financial protections the FSA seeks to provide to utilities and SOS customers.[96] In reply briefs filed on September 12, 2003, these parties also argue that bankrupt supplier participation would add an unwarranted level of uncertainty and unpredictability to the bidding process, and could wreak havoc upon the tight time periods for filling the utilities' SOS load obligation in each bid tranche.[97] These parties contend that Mirant's proposed modifications would result in the potential surrender of control over Maryland's SOS RFP bidding process to the jurisdiction of any bankruptcy court presiding over any bankrupt supplier that might wish to bid.[98]

Even Mirant acknowledges that depending on the magnitude and term of the bid award, a bankruptcy court may be required to review and approve a bankrupt supplier's FSA prior to the bid becoming final.[99] This determination may depend upon whether the bankruptcy court considers the supplier's bid to be in the "ordinary course" of its

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[93] *Id*.
[94] *Id*. at 4-5.
[95] Brief of People's Counsel, at 21-23; Brief of BGE, at 8; Brief of Staff, at 21-23; Brief of Pepco, at 13; Brief of AP at 4, fn. 2.
[96] *See* e.g., Brief of Staff at 22.
[97] *See* e.g., Reply Brief of BGE at 4.
[98] See Reply Brief of BGE at 4.

business as defined by the Bankruptcy Code.[100] Due to the potential role a bankruptcy court could play in this process, Mirant seeks a further clarification from the Commission that should a bankruptcy court not approve the FSA, through no fault of the supplier, the bid assurance collateral would be returned to the supplier.[101]

Several parties further argue that because of the complete lack of support in the record, the Commission is precluded, by Mirant's own actions, from being able to conclude that Mirant's proposals are either necessary or in the public interest.[102] Mirant elected not to present any testimony at the hearing to address any of its concerns, or to lend support for its suggested modifications, thereby depriving the Commission of any evidentiary basis to support Mirant's positions.[103] Mirant offered no witness who could be cross-examined as to the merits of its proposals.[104] Furthermore, Mirant failed to provide the Commission with any policy or legal justification as to why either the FSA or any other provision of the Phase II Settlement is illegal, unreasonable, or contrary to the public interest.[105]

Several witnesses noted during their testimony that while a bankrupt supplier may be prohibited from directly bidding into the SOS bid process, the nature of bulk power markets virtually guarantee that bankrupt suppliers will participate, albeit

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[99] Initial Brief of Mirant at 5.
[100] *See* 11 U.S.C. 363(c). Mirant initially raised the issue that Bankruptcy Court approval might be necessary following a bid award. (Mirant Initial Brief p. 5.). BGE also argued in its brief that Bankruptcy Court approval might be necessary following a successful bid by a bankrupt supplier. (BGE Initial Brief, p. 9). Mirant argued in its reply brief that Bankruptcy Court approval would only be necessary if the bid award was of a size or term that would enable a third party to argue that the contract was outside the 'ordinary course of business.' Mirant proffers that the company would only submit bids for which approval would be granted. (Mirant Reply Brief, p. 5, footnote 3). The Commission does not have jurisdiction to determine whether Bankruptcy Court approval would be necessary, and makes no finding in this regard.
[101] Brief of Mirant at 5.

[102] *See* Reply Brief of BGE at 3; Reply Brief of Pepco/Delmarva at 4.
[103] *Id*.
[104] *Id*.

indirectly, in the provision of SOS. Peter E. Schaub, a witness for Pepco and Delmarva, testified there are mechanisms by which Mirant could indirectly participate in Maryland's SOS bid process:

> It is a common practice in the wholesale market place to make arrangement through a third party who has better credit or more liquidity in a transaction, so it is possible, for instance a generation [generator] that could not meet this representation
> [Article 15.1 (e)], to contract through a third party who is creditworthy, . . . who can make these representations, to provide power.[106]

Commission Staff Witness Timmerman further explained why it is highly likely that electricity produced by bankrupt generation companies within the PJM service territory would be available in the wholesale market:

> [T]he market is designed, no matter what, to entice load from the generator to serve demand. . . . [T]he whole fundamental of the PJM world is this system of sticks and carrots, that try to ensure that power plants will produce electricity if they are able to do so to serve the demand that requires electricity. So all these things we talked about, bankruptcies and whatever, those are financial discussions, they are not physical discussions. The plants don't stop running, demand doesn't go away. . . . [G]enerally speaking, in all these bankruptcies . . . for all of our energy resources, gas wells don't stop producing, electric power plants don't stop running.[107]

Therefore, Mr. Timmerman later explained,

> [G]iven the fact you have a rough equilibrium between generation and demand . . . it is hard to conceive of an owner of substantial generation, no matter how bad their credit rating might be, being locked out of the market, because their generation needs to be used and the other

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[105] *Id*.
[106] Tr. at 1634-35.
[107] Tr. at 1404-05.

> participants in the market don't have enough generation to fill that void.[108]

MEA witness Kahal concurred explaining that if a bankrupt supplier is precluded from formally bidding,

> the power is going to go somewhere, it is going to go into the market, whether it goes into the spot market or other wholesale bilateral transactions, it is going to be power that is out there in the market to be procured by others who would prevail in the competitive bidding process, even if this company doesn't happen to participate.[109]

The Commission is persuaded by the testimony and briefs of the parties on this issue that the Settling Parties' decision to exclude bankrupt suppliers from *directly* bidding into the SOS process is reasonable and addresses their legitimate concerns about the financial integrity of SOS suppliers. The Commission finds that Article 15.1(e) of the FSA operates to bar bankrupt supplier participation in this process, and as described below, the Commission finds that Article 15.1(e) is in the public interest. In so finding, we reject Mirant's belated requests to modify the FSA or any other provision of the Phase II Settlement.

The Commission recognizes that allowing bankrupt supplier participation in the SOS bid process could subject the process to the jurisdiction of the United States bankruptcy courts and attendant uncertainties therein. The bidding process embodied in this Phase II Settlement is, by design, intended to operate with rigid rules and tight bidding schedules. The Commission believes that given the amount of money and financial risk involved, utilities and suppliers participating in the bidding process need a

[108] Tr. at 1411-12.
[109] Tr. at 1454.

concrete and certain process. Without such certainty, suppliers may not be interested in bidding into Maryland's SOS procurement.

In addition to the concern above, the Commission is of the view that altering the Phase II Settlement, as suggested by Mirant, would give bankrupt suppliers privileges that are not afforded to other suppliers. For example, Mirant believes a bankrupt supplier should be entitled to the return of its bid assurance collateral, should the bankruptcy court not approve its bid. If the Commission were to agree with this request, it would not only bestow upon a bankrupt supplier a special advantage not granted to solvent suppliers, but would deny customers the benefits that such collateral could provide to mitigate any damages to customers resulting from the supplier's failure to make good on its bid. Furthermore, our acceptance of Mirant's proposals at this late date could, without justification, disrupt the complex bidding structure developed by the parties through a series of extensive negotiations and delicate compromises.

The Commission also believes that the supplier financial integrity provisions are necessary and appropriate reliability safeguards for SOS customers. Electricity is a vitally important commodity in today's society. All classes of SOS customers, but particularly the residential SOS customers, need assurances that suppliers will be able to adequately meet demand for electricity through the term of the contract. SOS customers should not be subjected to any substantial or unwarranted risks that a supplier might fail or abandon its contract**.** The Commission finds that the financial integrity provisions of the Phase II Settlement generally, and § 15.1(e) of the FSA in particular, are in the public interest.

2. 11 U.S.C. §525(a)

The Commission rejects as untimely and procedurally defective Mirant's latest argument that the approval and enforcement of Article 15.1(e) of the FSA violates §525 (a) of the Bankruptcy Code. It was wholly inappropriate for Mirant to use its reply brief as a means to assert a completely new argument for the first time at the end of this lengthy and exhaustive process. This new argument is in no way responsive to any position asserted by the parties in their initial briefs. Furthermore, Mirant's actions at such a late juncture, deprives the Commission and the parties of a fair opportunity to fully and reasonably explore the merits of the argument.

On September 15, 2003, the Commission received Mirant's reply brief dated September 12, 2003.[110] In its reply brief, Mirant raises a new argument, that the "Commission's adoption and enforcement of the FSA may be considered a violation of §525(a) of the Bankruptcy Code-Protection Against Discriminatory Treatment. . . ."[111] Mirant claims that §525(a) may prevent the Commission, as a governmental unit, from enforcing Article 15.1(e) of the FSA because it inappropriately prohibits a bankrupt supplier from entering into the FSA "based solely on the entity's status as a debtor."[112] Mirant asserts that Article 15.1(e) of the FSA is "tantamount to an automatic disqualification which is impermissible under the Bankruptcy Code" and therefore, unenforceable as a matter of law.[113]

[110] The Commission notes its Order of August 26, 2003, directing parties wishing to file reply briefs to do so by September 12, 2003. Tr. at 1721. Furthermore, the Commission specifically denied Mirant's request to file reply briefs on September 15, 2003. Tr. at 1723-1724.
[111] Reply Brief of Mirant at 2-4.
[112] *Id.* at 3.
[113] Reply Brief of Mirant at 3-4.

On September 17, 2003, the Commission received a Motion to Strike Mirant's Reply Brief filed by Pepco and Delmarva and a similar Motion to Strike presented as a joint filing on behalf of Staff, OPC and BGE. Both motions request that Mirant's latest argument be stricken as procedurally defective because it is a new argument that is "unresponsive" to any position asserted by parties in their initial briefs. Both motions also go on to rebuke Mirant's contention that the Commission's approval of the FSA would constitute a violation of §525(a) of the Bankruptcy Code. Essentially, these parties contend that §525(a) does not apply to the FSA because by its nature, the FSA is a private contract between the utility and the winning supplier, neither of which are governmental units.[114] Section 525(a) only involves a prohibition against certain specific governmental discriminatory actions which are simply not at issue in this private transaction.[115]

Reply briefs serve a limited purpose. A party is supposed to use its reply brief to respond to the points and issues asserted in an opposing party's initial brief. If a party is permitted to inject new claims or issues in a reply brief, this may well result in a fundamental injustice upon opposing parties, who would then have no opportunity to respond in writing to the new questions raised. Accordingly, the Commission finds that the argument asserted by Mirant in its Reply Brief relative to the alleged violation of §525(a) of the Bankruptcy Code was untimely presented, was unresponsive to the positions asserted by parties in the initial briefs, and is therefore stricken.

The Commission takes this opportunity to note that Mirant's argument would also fail on substantive grounds. First, § 525(a) only applies to a governmental unit taking

[114] *See* e.g., Pepco/Delmarva Motion to Strike at 5.
[115] *Id*.

adverse action against a bankrupt entity relative to a license, permit or similar grant. The terms of the FSA simply do not involve such conduct on the part of the Commission. Second, the FSA is a contract between the utility and a winning supplier and does not involve any improper discriminatory action by a governmental unit.

H. The Commission will adopt new regulations in a timely manner to implement the continued provision of a SOS option.

WGES asserts that the Phase I Settlement and §7-510(e) require the Commission to institute a rulemaking and propose regulations that implement the Electric Customer Choice and Competition Act of 1999 ("Electric Act") and the policies underlying the Phase I and Phase II Settlements based on the procedures of the Administrative Procedure Act ("APA").[116] Paragraphs 6, 25, 44 and 62 of the Phase I Settlement provide that the Settling Parties will propose regulations that implement the Settlements and will submit them to the Commission for approval after Phase II.[117] In Order No. 78400 the Commission stated that it will implement appropriate regulations following the Phase II proceedings.[118] The Commission affirms that decision in this Order.

WGES's argument on Brief is premature and not ripe for review. Since the Phase I Settlement, it has been clear that regulations would come *after* Phase II is concluded. The Commission is mindful of the Court's holding in *Delmarva Power & Light Company v. Public Service Commission of Maryland* 370 Md. 1 (2002) ("*Delmarva Decsion*"). The Commission intends to promulgate regulations implementing those elements of the Phase II Settlement to the extent they require codification in the Code of Maryland Regulations (COMAR). Nevertheless, notwithstanding the *Delmarva Decision*, §7-

[116] Brief of WGES at 12.
[117] *See* also Appendix I of the Phase I Settlement. Docket No. 119.

510(e) specifically provides that procedures adopted to implement § 7-510 shall be by regulation ***or order***. (emphasis added). The Phase II Settlement includes specific provisions relative to individual utilities (i.e. the UBPs) as well as provisions generic to all stakeholder groups. The Commission intends that the generic provisions will be addressed in regulations to the extent it is necessary to do so, but that individual utility provisions will be implemented according to this Order.

I. WGES raised issues that were resolved in Phase I.

WGES has raised two issues in its Brief that were previously decided by the Commission in Phase I.[119] WGES says the Phase I and II Settlements will restrain the Commission from implementing retail bidding. Furthermore, according to WGES the final rules adopted should include retail instead of wholesale bid procedures, [120] WGES also argues that multi-year contract awards undercut the creation of competitive markets and that the Commission should not be constrained to replace the settlements with an annual wholesale bid procedure.[121] The Commission notes that these issues were resolved in Order No. 77806 and Order 78400, respectively.[122] The Commission declines to revisit those issues in Phase II.

J. The Commission will use the Procurement Improvement process to make any necessary improvements.

Paragraph 12 of the Phase II Settlement Agreement provides that any party may propose an improvement in the Procurement Procedures with respect to the conduct of

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[118] Order No. 78400 at 94-95. Docket No. 184. *See* also Order No. 78535 at 6. Docket No. 192.
[119] Brief of WGES at 10-11.
[120] *Id.*
[121] Brief of WGES at 11.
[122] Order No. 78400 was later reaffirmed by the Commission in Order No. 78535.

future bidding. Staff is to convene annual meetings to consider improvements. Proposed improvements will be submitted to the Commission for approval, subject to certain limitations.[123]

Staff noted that the procurement improvement process "embodies the expectation that the participants will learn from experience, and may wish to alter aspects of the procurement process."[124] For example, if operation of the PAT mechanism or the volumetric risk mechanism requires, a modification, a party could make such a proposal through the procurement improvement process.[125]

We believe the procurement improvement process in Phase II will facilitate appropriate opportunities to consider and implement necessary improvements over time. Furthermore, the Commission will closely monitor the entire SOS process and reserves jurisdiction if and when a procurement improvement merits review.

IT IS, THEREFORE, this 30th day of September, in the year Two-Thousand and Three, by the Public Service Commission of Maryland,

ORDERED THAT: (1) The Phase II Settlement be, and hereby is, approved without modification.

(2) The objections raised by Washington Gas Energy Services and Mirant be, and hereby are, rejected.

(3) The new arguments raised by Mirant for the first time in its Reply Brief be, and hereby are, stricken from the record in this matter.

[123] Phase II Settlement Agreement, Paragraph 12. *See* also Paragraph 13.
[124] Brief of Staff at 5.
[125] Brief of PHI at 17. Docket No. 254.

(4) The Potomac Edison Company d/b/a Allegheny Power Utility Bid Plan for customers in AP's service territory be, and hereby is, approved.

(5) The Baltimore Gas and Electric Utility Bid Plan for customers in BGE's service territory be, and hereby is, approved.

(6) The Delmarva Power & Light Company's Utility Bid Plan for customers in Delmarva's service territory be, and hereby is, approved.

(7) The Potomac Electric Power Company's Utility Bid Plan for customers in Pepco's service territory be, and hereby is, approved.

/s/ Kenneth D. Schisler

/s/ J. Joseph Curran, III

/s/ Gail C. McDonald

/s/ Ronald A. Guns

/s/ Harold D. Williams
Commissioners