

ORDER NO. 87347

IN THE MATTER OF THE * BEFORE THE
COMMISSION’S INVESTIGATION INTO * PUBLIC SERVICE COMMISSION
DEFAULT SERVICE FOR TYPE II * OF MARYLAND
STANDARD OFFER SERVICE *
CUSTOMERS *

CASE NO. 9056

IN THE MATTER OF THE COMPETITIVE *
SELECTION OF ELECTRICITY *
SUPPLIER/STANDARD OFFER OR *
DEFAULT SERVICE FOR INVESTOR- *
OWNED UTILITY SMALL COMMERCIAL *
CUSTOMERS AND FOR THE POTOMAC *
EDISON COMPANY D/B/A ALLEGHENY *
POWER’S, BALTIMORE GAS AND *
ELECTIC COMPANY’S, DELMARVA *
POWER AND LIGHT COMPANY’S AND *
POTOMAC ELECTRIC POWER *
COMPANY’S RESIDENTIAL *
CUSTOMERS *

CASE NO. 9064

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Issue Date: January 6, 2016

To: All Parties of Record

On July 15 and 30, 2015, the Technical Staff of the Public Service Commission (“Staff”) convened the meeting of the Procurement Improvement Process Working Group.¹

The Working Group consists of interested parties who meet annually to consider

¹ The following interested parties participated in the meetings: Baltimore Gas and Electric Company; Constellation Energy; Maryland Office of People’s Counsel; Pepco Holdings, Inc., including Delmarva Power and Light Company and the Potomac Electric Power Company; The Potomac Edison Company; First Energy Corp.; Exelon Generation; Talen Energy; TransCanada Power Marketing, Ltd.; Energy America; and Commission Staff.

improvements to the Maryland standard offer service (“SOS”) procurement process, pursuant to Paragraph 12 of the SOS Phase II Settlement Agreement approved by the Commission in Case No. 8908.² During this year’s meeting, two non-consensus proposals were introduced. First, TransCanada Power Marketing Ltd. (“TransCanada”) proposed that the deadlines for SOS bid submissions and awards be shifted to earlier times in the day. Second, BTG Pactual Commodities US (“BTG”) proposed that the qualification requirements for bidders in the SOS process be amended to allow bidders without a credit rating to participate subject to the posting of additional pre-bid collateral.

On September 9, 2015, the Maryland Public Service Commission (“Commission”) directed its Staff to file a report addressing the non-consensus proposals by October 26, 2015. The Commission also requested that its technical consultant, Boston Pacific Company (“Boston Pacific”) file a separate report by the same deadline. The Commission required that other interested parties file reply comments to the Staff or Boston Pacific reports by November 2, 2015.³ On November 24, 2015, the Commission heard argument from parties regarding the two non-consensus proposals during its Administrative

² *In the Matter of the Commission's Inquiry into the Competitive Selection of Electricity Supplier/Standard Offer Service*, 94 Md. P.S.C. 286 (2003) (Phase II Order) at 307.

³ The Commission received the following comments addressing these two issues: September 3, 2015 Comments of TransCanada; September 8, 2015 Comments of Exelon Generation, LLC; October 19, 2015 Comments of TransCanada; October 26, 2015 memorandum of Boston Pacific; October 26, 2015 Supplemental Report of Staff; November 2, 2015 Comments of Maryland Office of People’s Counsel; November 2, 2015 Comments of BTG; November 2, 2015 Comments of the Joint Utilities (including Baltimore Gas & Electric Company, Delmarva Power & Light Company, Potomac Electric Power Company, and The Potomac Edison Company) (“Joint Utilities”); and the November 2, 2015 Comments of Exelon Generation, LLC.

Meeting.⁴ For the reasons discussed below, we reject TransCanada's proposal to change the timing of SOS bids and awards and accept the proposal of BTG to amend the qualification requirements of unrated bidders, subject to the discussion below.

1. Timing of SOS Bid Submissions and Awards

Pursuant to the SOS bidding schedule currently approved in Maryland, SOS bids are due on Monday by 4:30 p.m. and bidders are notified whether their bids have won by 8:30 p.m. the same day.⁵ TransCanada criticizes that schedule, arguing that because the markets close at 4:30 p.m., winning bidders are left unable to procure the needed power or hedge their obligations until the markets open the next day at 9:30 a.m.⁶ As an alternative to the status quo, TransCanada proposes that the bid deadline be set at 10:00 a.m. with notification of winning bids by 1:00 p.m. Although TransCanada concedes that some intraday risk will continue to exist under its proposal, the company claims that the risk would be limited to 3 hours versus the 17 hours faced by suppliers under the current rules. TransCanada further claims that decreasing the amount of time suppliers are required to bear risk will reduce the risk premiums suppliers are otherwise required to include in their

⁴ The following persons commented on these issues during the November 24, 2015 Administrative Meeting: Lloyd Spivak, Esq. on behalf of Technical Staff; Frank Mossburg and Katherine Gottshall, for Boston Pacific; Todd R. Chason, Esq., representing BTG; Jeffrey Trout, Esq., on behalf of the Joint Utilities; Kimberly A. Curry, Esq., for Baltimore Gas and Electric Company; and Matthew K. Segers, Esq., on behalf of Pepco Holdings, Inc. TransCanada did not provide a representative to speak for the company during the Administrative Meeting.

⁵ As Boston Pacific observes, the timing of the award notification varies depending upon the product being solicited. For Type II products, for example, the utilities may notify the bidders very quickly after bid submission. However, Type I winning bids must pass the Price Anomaly Threshold Screen, which requires a more time-consuming technical analysis that will delay notification. Boston Pacific October 26, 2015 Memorandum at 1.

⁶ TransCanada September 3, 2015 comments at 2.

bids, which will ultimately benefit ratepayers.⁷

Boston Pacific provided an evaluation of TransCanada's proposal that was informed by the consultant's experience monitoring standard offer service and other energy auctions in multiple states.⁸ It found that TransCanada's proposal did not pass a cost benefit analysis, advising that the putative benefit ("a tiny, but essentially unobservable decrease in bid prices") did not outweigh the considerable costs, which stemmed from damaging the effectiveness of the Price Anomaly Threshold ("PAT") Screen. Referencing other markets where bidders are notified of their selection prior to the market closing time, Boston Pacific stated: "We have not observed any discounts in the bids" when compared to markets like Maryland's where winning bidders are notified after the market closes.⁹ Boston Pacific therefore concluded that if there were any benefits to the proposal, they were "very small."¹⁰ On the other hand, Boston Pacific found that the costs of implementing the proposal would be significant. For example, the consultant advised that the PAT Screen would have to be calculated using "stale" data.¹¹ That is because a Monday bid submission would require the PAT Screen to use data from the preceding Friday, creating a risk that the market would materially change in the time between the price posting and the bid offer. Boston Pacific concluded that implementing TransCanada's proposal could result in the PAT rejecting otherwise reasonable bids (if

⁷ *Id.* at 3. See also TransCanada October 19, 2015 Comments at 3, stating that moving the schedule forward "would allow [suppliers] to offer lower prices."

⁸ Boston Pacific has monitored standard offer service auctions in Maryland, the District of Columbia, Ohio, New Jersey, Illinois, and Delaware. Boston Pacific Memorandum at 2.

⁹ Boston Pacific Memorandum at 3.

¹⁰ *Id.*

¹¹ *Id.*

market prices rise over the weekend), or accepting bids that are not reasonable (if prices decline over the weekend). Boston Pacific therefore concluded that “the risks of this proposal outweigh the benefits.”¹²

In its October 26, 2015 Supplemental Report, Staff concurred with Boston Pacific’s conclusion. Based on its research and data requests to supplier participants, Staff found no compelling evidence that the intra-day risk preferred by TransCanada is significantly different than the overnight risk that exists under Maryland’s current SOS auctions.¹³ Similarly, Staff found little evidence that bid submissions would be lower under TransCanada’s proposal, stating that the data responses “did not result in any conclusive evidence that moving the bids and bid awards to an earlier time in the day would result in substantial savings for SOS customers.”¹⁴ Staff also reviewed the New Jersey energy auction relied upon by TransCanada in its request, and found that the changes in the New Jersey auction, which reduced the time bids were open, did “not appear to have driven substantial increases or decreases in procurement participation in New Jersey to date, nor to the prices received there.”¹⁵ Regarding the PAT Screen, Staff commented that using market data from the close of markets on Friday could produce false positive and false negative test results, thereby negatively “affecting the integrity of the whole SOS

¹² *Id.* Boston Pacific identified other problems with TransCanada’s proposal, finding, for example, that the company had not addressed the timing of bid approvals by relevant state utility commissions. The consultant observed: “In every case [a state commission] has a review window (typically two to three business days) to review the winning offers and the bidding process and make a determination to accept or reject the offers.” Boston Pacific Memorandum at 2. Even under TransCanada’s proposal, therefore, the bidder would not know whether its bid was accepted by the Commission within a three-hour window.

¹³ Staff Supplemental Report at 10. Staff also observed that in its discussions with the Independent Market Monitor for PJM (“IMM”), the IMM opined that the risks related to overnight hedging were not meaningfully different than the risks associated with intra-day hedging. *Id.* at 13.

¹⁴ *Id.* at 11.

¹⁵ *Id.* at 12.

procurement...”¹⁶ Although Staff conceded it would be theoretically possible to move the auction bids to Tuesday and use market data from Monday for the PAT Screen, as a practical matter, Staff concluded it would be “virtually impossible” to complete the required hearing and approval process within the remaining single week timeframe. Staff therefore advised that TransCanada’s proposal imposed “unacceptable risks.”¹⁷

OPC also argued against TransCanada’s proposal, stating that it “leaves too much opportunity for the PAT to be disconnected to market conditions at the time bids are submitted.”¹⁸ The Joint Utilities similarly commented that the auction times should not be changed.¹⁹ Finally, Exelon Generation, LLC commented against changing the timing of SOS bidding, pointing to the “complexity involved and the lack of demonstrable benefit associated with moving the times forward.”²⁰

Commission Decision

We decline to modify the deadlines for SOS bid submissions and awards as advocated by TransCanada. We agree with Boston Pacific that the proposed modifications do not pass a cost benefit analysis. First, there is little evidence that bid prices will be lower as a result of moving the schedule for bid submissions and awards to an earlier time. Boston Pacific, which possesses considerable experience in administering standard offer service auctions throughout multiple states, reported that it had not observed any measurable discounts in supplier bids in auctions with the schedule advocated by

¹⁶ *Id.* at 14.

¹⁷ *Id.*

¹⁸ OPC Comments at 3.

¹⁹ Joint Utility Comments at 2.

²⁰ Exelon Generation, LLC Reply Comments at 3.

TransCanada. Similarly, Staff found no evidence to support the premise that intra-day risk is significantly different in quantity from the overnight risk that exists now under Maryland's SOS auctions.²¹ Moreover, Staff found that the modifications in the New Jersey auction, which reduced the time bids remained open, did not increase procurement participation or reduce prices.²²

Second, the costs of implementing TransCanada's request could be significant in terms of impairing the efficacy of the PAT Screen. We agree that utilizing "stale" data from Friday to administer the PAT Screen for Monday's bids could lead to false positives that reject reasonable bids as well as false negatives that accept unreasonable bids.²³ Either result is deleterious to ratepayers. Finally, regarding TransCanada's suggestion to move the auction to Tuesday and utilize Monday's data for the PAT Screen, we agree with Staff that the suggestion is impractical given the numerous milestones required in the hearing and approval process in the remaining week of the SOS procurement.

2. Pre-bid Qualification Requirements

In order to bid into Maryland's SOS procurement, a prospective supplier must comply with three existing credit requirements. First, the supplier must present pre-bid eligibility documentation at least two weeks prior to the procurement demonstrating that the supplier or its guarantor is rated by a major rating agency.²⁴ Second, the supplier must submit bid assurance collateral of \$300,000 for each 50 megawatt block it is bidding to

²¹ Staff Supplemental Report at 10.

²² *Id.* at 12.

²³ Boston Pacific Memorandum at 3.

²⁴ Model RFP 2016 § 3.1. An unrated supplier will frequently present the guaranty of its rated parent company to comply with the pre-bid eligibility requirement.

provide.²⁵ Third, winning bidders must present performance assurance collateral once they have executed the Full Requirements Service Agreement (FSA).²⁶ The amount of performance assurance collateral the winning bidder is required to post depends upon the bidder's credit rating as well as the seller's daily exposure.²⁷

During the Maryland SOS procurement improvement process, BTG proposed that the qualification requirements for SOS bidders be amended to allow prospective suppliers not rated by a major credit rating agency to make bids.²⁸ BTG offered several alternatives to allow unrated entities to participate, including by posting additional pre-bid collateral or by creating an exemption applicable solely to BTG.²⁹

Boston Pacific advised that unrated bidders should be allowed to participate in the SOS auctions, emphasizing the positive competitive benefits of allowing additional bidders in Maryland's SOS procurements.³⁰ Boston Pacific downplayed the incremental risk posed by allowing unrated bidders to participate. The consultant observed that under the existing SOS rules, a bidder is required merely to be rated by a major rating agency, not to have any particular score.³¹ That is because the purpose of the pre-bid eligibility criteria is to ensure that the bidder is serious, not to protect against default. Protection against default

²⁵ Model RFP 2016 § 3.9.

²⁶ Model RFP 2016 § 3.10.

²⁷ As Staff observes, the seller's exposure is determined based upon a formula that relates the daily and forward market price of electricity to the initial market price of electricity at the time the FSA is executed. Supplemental Staff Report at 5.

²⁸ BTG has only recently entered the wholesale supply market and does not yet have a rating from a major credit agency. Although BTG is the subsidiary of a large Brazilian company that is rated, BTG's parent company is prohibited by Brazilian law from acting as a guarantor. Boston Pacific Memorandum at 4.

²⁹ See BTG Revised Proposal, appended as Attachment B to Staff's Supplemental Report.

³⁰ Boston Pacific Memorandum at 5.

³¹ *Id.* at 6.

is an element addressed by the Commission’s rules on bid assurance collateral and performance assurance collateral, neither one of which will be diminished by approving BTG’s proposal.

Boston Pacific commented that a requirement to post additional bid assurance collateral will mitigate any marginal risk imposed by allowing unrated bidders to participate. Specifically, Boston Pacific proposed that unrated bidders offer an additional \$300,000 in pre-bid collateral per bid block, an amount that doubles the pre-bid credit requirement for an unrated bidder and will ensure that bidders who participate in Maryland auctions are “serious.”³² Boston Pacific prefers this approach to other proposals discussed below because it is a per-block requirement that will not serve as a deterrent for a bidder offering to the smaller utilities. Regarding default risk, Boston Pacific observes that under Maryland’s existing rules, a winning, unrated bidder will not receive any unsecured credit pursuant to the FSA and will therefore be required to post the full mark to market exposure for the contract.³³ Finally, Boston Pacific states that other jurisdictions such as New Jersey and Ohio allow unrated entities to bid and have not experienced adverse effects, such as unrated and winning SOS bidders later defaulting on their contracts.³⁴

Staff encourages the Commission to accept a modified version of BTG’s proposal.³⁵ Specifically, Staff proposes that unrated bidders without a guarantor be

³² *Id.*

³³ *Id.* at 7.

³⁴ *Id.*

³⁵ Staff recommends against BTG’s alternate proposal that the Commission simply waive the pre-bid eligibility requirements for its participation in the SOS procurements, stating: “One of the greatest strengths of the Maryland SOS procurement process is that it is highly transparent in applying the same rules to all participants.” Staff concludes that the granting of an exemption for one entity would violate that principle and be discriminatory. Staff Supplemental Report at 9.

required to post a minimum of \$2.4 million in pre-bid eligibility / bid assurance collateral for each utility procurement in which the bidder seeks to participate, up to a maximum of four bid blocks. If the bidder desires to exceed four bid blocks from a particular utility, Staff recommends that it be required to post an additional \$600,000 per bid block (comprised of the existing \$300,000 pre-bid collateral plus an additional \$300,000 of collateral).³⁶ Although Staff concedes that there is some risk in allowing unrated bidders to participate in the SOS process, it argues that “the additional risk is minimal” because the purpose of the pre-bid eligibility requirement is merely to ensure that the bidder is a “serious creditworthy entity that is capable of meeting its commitments.”³⁷ Staff believes that the modified proposal accomplishes that objective and “strikes an appropriate balance between protecting ratepayers from supplier defaults, and encouraging more competitive SOS bids.”³⁸

OPC agrees with Staff and Boston Pacific that unrated bidders should be allowed to participate in Maryland’s SOS procurements, but advocates for a higher level of additional collateral. In particular, OPC recommends that \$300,000 per bid block be added on top of Staff’s proposal.³⁹ OPC contends that this augmented level of required collateral will better protect ratepayers in the event of a default.

The Joint Utilities oppose BTG’s proposal. They argue that the current Maryland SOS pre-bid eligibility provisions are the result of a Settlement Agreement reached by numerous stakeholders 12 years ago. The Joint Utilities contend that those Settlement

³⁶ Staff Supplemental Report at 7-8.

³⁷ *Id.* at 8.

³⁸ *Id.* at 9.

³⁹ OPC November 2, 2015 Comments at 5.

provisions should not be changed absent a comprehensive review of other RFP and FSA provisions, in order to ensure that “the balance is maintained between proper protections for customers and competitive equity for suppliers.”⁴⁰ The Joint Utilities criticized the proposal to allow unrated bidders to participate through the posting of additional collateral, stating: “The posting of cash does not test an entity’s creditworthiness.”⁴¹ Nevertheless, in the event the Commission were to allow unrated bidders to participate, the Joint Utilities recommend that unrated bidders be required to post performance assurance in a minimum amount of \$5 million.⁴²

In its Reply Comments, BTG states that it prefers Staff’s proposal to Boston Pacific’s. However, BTG notes that Boston Pacific’s proposal is also “feasible” and is in fact one of the alternative proposals presented by BTG during the procurement improvement process.⁴³ BTG asks for Commission clarification that for multi-procurement RFPs, an unrated bidder is required only to post pre-bid eligibility collateral between the RFP eligibility deadline and the first auction. In other words, the unrated bidder would remain qualified for subsequent auctions within the same multi-procurement RFP without reposting.⁴⁴ Alternatively, BTG recommends that the Commission allow unrated bidders to repost the pre-bid eligibility before each auction of a multi-procurement RFP.

⁴⁰ Joint Utility Comments at 1.

⁴¹ *Id.* at 2.

⁴² Initial Utility Response to BTG Proposal, appended as Attachment A to Staff’s Supplemental Report.

⁴³ BTG Reply Comments at 2.

⁴⁴ *Id.* at 8.

Commission Decision

We grant BTG's request to modify the qualification requirements for bidders in Maryland's SOS auctions to allow unrated bidders to participate subject to the posting of additional pre-bid collateral. At the outset, we reject BTG's proposal for an entity-specific exemption. Staff correctly observes that a hallmark of Maryland's SOS procurement process is that it is transparent and non-discriminatory. The granting of an exemption that would be applicable to only one entity would violate that principle.

Nevertheless, we see value in amending the qualification rules to allow prospective suppliers not rated by a major credit rating agency to make bids. Boston Pacific correctly notes that making this change will expand the field of potential bidders and produce competitive benefits within Maryland's SOS procurements.⁴⁵ Indeed, the additional competition BTG and other similarly situated entities could bring to Maryland is not merely hypothetical – BTG won supplier bids in the New Jersey and Duke Ohio standard offer service auctions this year.⁴⁶

We agree with Boston Pacific, Staff and OPC that unrated bidders should be required to post additional collateral to demonstrate “seriousness.” This augmented collateral requirement acts as a more nuanced test than the absolute bar to unrated bidders that exists under our current rules. Of the competing plans, we find Boston Pacific's collateral proposal most appropriate.⁴⁷ Namely, unrated bidders will be required to offer

⁴⁵ Staff also contends that ratepayers “are served by having more competitive SOS procurements.” Supplemental Staff Report at 8.

⁴⁶ Boston Pacific Memorandum at 7.

⁴⁷ During the November 24, 2015 Administrative Meeting, BTG stated that it finds both the Staff and Boston Pacific proposals acceptable and that it would participate in future Maryland SOS auctions if either proposal is adopted.

an additional \$300,000 in pre-bid collateral per bid block.⁴⁸ We find that this per-block requirement is preferable because it does not act as a deterrent to bidders who may offer in the auctions of smaller utilities. In contrast, Staff’s proposal could have the unintended consequence of chilling bids by unrated bidders who desire to offer in a smaller number of bid blocks. We also find the Joint Utilities’ \$5 million collateral requirement proposal to be higher than necessary to demonstrate seriousness. We agree with Boston Pacific that “there is nothing to suggest that the incremental risk posed by an unrated bidder is this high.”⁴⁹

The Joint Utilities oppose allowing unrated bidders to participate in SOS auctions regardless of the amount of collateral posted. First, they argue that the pre-bid eligibility provisions are the result of a carefully negotiated Settlement Agreement and that no changes should be made absent a comprehensive review of other RFP and FSA provisions. Nevertheless, nothing in the Settlement Agreement prohibits changes to the Agreement, much less after the passage of twelve years. To the contrary, the Settlement Agreement provides for an annual meeting to consider improvements to the SOS procurement process, which has been led by Staff through the Procurement Improvement Process Working Group. Furthermore, our Order approving the Settlement Agreement clearly contemplated that changes would be made periodically as improvements were identified. That Order provides: “We believe the procurement improvement process in Phase II will facilitate appropriate opportunities to consider and implement necessary improvements over time.

⁴⁸ Accordingly, unrated bidders will be required to post a total of \$600,000 of bid assurance collateral for each 50 megawatt block.

⁴⁹ Boston Pacific Memorandum at 6. Similarly, we find that OPC’s proposal to add \$300,000 per bid block to Staff’s proposal is excessive.

Furthermore, the Commission will closely monitor the entire SOS process and reserves jurisdiction if and when a procurement improvement merits review.”⁵⁰

Second, the Joint Utilities oppose allowing unrated bidders to participate, even with expanded collateral requirements, because in their opinion “[t]he posting of cash does not test an entity’s creditworthiness.”⁵¹ Nevertheless, Boston Pacific correctly observes that the Commission’s existing credit rating requirement does not gauge a supplier’s creditworthiness.⁵² Under the existing rules, a supplier is simply required to have a credit rating; it is not required to have a rating above a particular threshold. Moreover, under the current rules, the amount of collateral required does not increase merely because a supplier has a poor rating. Given these circumstances, we find that the requirement to post an additional \$300,000 in pre-bid collateral per bid block by an unrated supplier will demonstrate the seriousness required to qualify a supplier to bid. To the extent the Joint Utilities are arguing that unrated bidders present an incremental risk of default, we note that our existing rules provide that a winning, unrated bidder will not receive any unsecured credit pursuant to the FSA and it will therefore have to post the full mark to market exposure for the contract.⁵³ We find that result appropriate because it will mitigate the risk of default.

Finally, in its Reply Comments, BTG asks for clarification regarding the collateral requirements for multi-procurement RFPs. BTG requests that unrated bidders be required only to post pre-bid collateral between the RFP eligibility deadline and the *first* auction,

⁵⁰ Phase II Order at 307.

⁵¹ Joint Utility Comments at 2.

⁵² Boston Pacific Memorandum at 6.

⁵³ *Id.* at 7.

and that unrated bidders remain qualified for *subsequent* auctions within the same multi-procurement RFP without reposting. We reject that request. We find that unrated bidders should be required to repost the pre-bid eligibility collateral before each auction of a multi-procurement RFP.

IT IS THEREFORE, this 6th day of January, in the year Two Thousand Sixteen, by the Public Service Commission of Maryland,

ORDERED: (1) That the request of TransCanada Power Marketing Ltd. to shift the deadlines for SOS bid submissions and awards to earlier times in the day is denied;

(2) That the proposal of BTG Pactual Commodities US that unrated bidders in Maryland's Standard Offer Service procurements be allowed to participate through the posting of additional pre-bid collateral is granted, subject to the limitations discussed above; and

(3) That the changes required by Paragraph 2 above be implemented in time for the April 18, 2016 Standard Offer Service auctions.

By Direction of the Commission,

/s/ David J Collins

David J. Collins
Executive Secretary