

# Restructuring Today



1-800-486-8201

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## How to end the power markets liquidity/credit crisis?

### New firm has way to clear trading that may save America a bundle

What's the worst part of today's wholesale power crisis?

Craig Pirrong at the University of Houston estimates that a third of the cost of electric power today is the premium added to cover the risks in trading — the cost of money taken out of use to support trades with those who have less than ideal credit.

After Enron crashed and couldn't make good on contracts, buying and selling power became exceedingly costly because of the money needed to persuade trading partners that your credit is acceptable.

We met yesterday with a team that's putting together a credit and clearing firm

prepared to take the risks by operating an exchange that sells the risk for a price to Wall Street investors.

What's the cost of this fine service?

They expect 0.7% of amount at risk.

Commissioner Sharon Brown-Hruska of the Commodity Futures Trading Commission thinks the venture is a "very good concept."

She's been strongly advocating clearing solutions to the credit quality and credit risk problems that exist in the energy market.

"There are deals that don't get done and trading that doesn't take place because of concerns that your trading partner doesn't have adequate credit quality."

CFTC and FERC, she said, have been eager to find "better ways to manage credit risk and this seems to be a very good solution. It's cognizant of the specialized issues associated with trading power — lack of storability."

What is the firm and how will it

work?

It's the North American Energy Credit & Clearing (NECC).

We met with Jeannine Hull, whom we knew for many years at Cantor Fitzgerald where she hatched the idea.

Becky Kilbourne, marketing and regulatory affairs lead, and John Flory, CEO.

George Sladoje, an officer of the Chicago Board of Trade, ran the California Power Exchange when Flory was there.

David Haley of Cross Commodity Trading had been with Aquila.

Mike Kane is a director of the Chicago Mercantile Exchange and Seth Wilson had served Cinergy Power & Gas Trading.

**QUOTE OF THE DAY:** In essence what we're proposing is a clearing house for the energy markets.

*Becky Kilbourne in an interview yesterday.*

## Developing markets in the West

### Schwarzenegger takes a big step for California

#### But is it a big step for America too?

Emphasizing his intent to create an efficient market structure, California Gov Arnold Schwarzenegger appointed several key members to his energy team yesterday.

The governor knows that if his energy team doesn't attract capital investment to the Golden State, he's going to be in the soup fairly soon — especially if the economy picks up, power demand jumps and the power isn't ready.

He believes in markets.

His new team believes in markets and the government-can-fix-everything team in the legislature has been severely chastened by the big Schwarzenegger victory last year.

The Democrats have been amazingly cooperative with the governor.

We think he'll get markets.

The governor tapped Joseph

Desmond as deputy secretary of energy at the Resources Agency, not much of a title but he's the key energy adviser.

Schwarzenegger had picked a cabinet affairs team that includes deputy Dan Skopec (RT, 1/20) who was initially picked as an energy and environment adviser (RT, 12/5).

Desmond is CEO of Infotility, an energy consulting and software development company that helps clients capture value by collecting high-quality, time-sensitive information on supply, demand and price.

As co-chairman of the energy branch of the Silicon Valley Manufacturers Group, Desmond provides Schwarzenegger with a special knowledge of what the Valley worries about and needs.

The governor named Jackalyn Pfannenstiel as a member of the State Energy Resources Conservation & Development Commission.

Pfannenstiel has been an energy policy and strategy advisor for energy developers and was a vice president for strategic initiatives, vice president for planning and manager of rates and regulation at ...

*(Continued on page 2)*

"All exchanges are associated with clearinghouses because all futures exchanges have been built on the foundation of a clearinghouse," chimed in Hull.

"They clear futures contracts. They don't now clear anything in the physical market and that's the big difference that we bring to the energy markets," Hull added.

"We emboldened the physical markets with the financial markets and we clear across all physical commodities and can clear across multiple markets and clear — it's called multi-party netting — multiple parties, multiple markets and multiple products," Hull explained.

Flory defined clearing as managing what the cash obligations are in the movement of cash.

What about the Intercontinental Exchange (ICE), one of NECC's partners?

"They have a trading platform. They are the front end. They capture the bids, the acts, the buys, the sells, that's called the front end, the front office, the trade capture," Hull noted.

"That clearinghouse clears up their trades ... the entity that holds the payables, the accounts receivable and ensures the party in the marketplace gets the benefit of the bargain they've struck," said Hull.

Brown-Hruska has seen similar issues

## 5 stories in 1.5 minutes

**CORRECTION:** Got a call yesterday from Marnie Funk, communications director for the Senate Energy & Natural Resources Committee about what we wrote about Sen Pete Domenici yesterday. “Thank you for taking the time to talk to me on a hectic news day. I hope the news story you are working on goes well,” she said. What had upset Funk and Domenici was our analysis that:

Domenici fears that if those who can’t see the forest look a bit harder they’ll see all the pork barrel handiwork.

“I followed up with Chairman Domenici and advised him that a correction will be running in tomorrow’s publication. Domenici has no such views. He has never expressed a sentiment even close to that. Chairman Domenici and his staff find the attribution of that sentiment to Chairman Domenici both baffling and offensive...”

RT’s editor regrets the error.

Funk added pleasant views about former RT staffer, Art Kingdom.

### Sprint, AT&T sign

**WiFi roaming deal:** They signed their first-ever reciprocal WiFi roaming deal for five major US airports, the two said yesterday. The deal gives Sprint PCS WiFi customers broadband access in Denver International, Philadelphia International and Raleigh-Durham International airports. AT&T WiFi subscribers can do the same in Kansas City International and Salt Lake City. Customers’ existing user IDs and passwords are to work in the new locations. Sprint’s moving its WiFi into other airports and a variety of places that cater to business and consumer audiences, said the firm. AT&T Wireless offers WiFi access in hundreds of locations around the country, it said.

### Getting LNG from

**Bahamas:** That’s what an El Paso Corp subsidiary is doing in a deal with an FPL Group affiliate. The proposed Seafarer Pipeline System is to bring gas from the

in derivatives where triple A credit-rated firms don’t want to trade with double Bs, she noted.

The As don’t feel that they have to but after the issues that have plagued the energy market lower credit quality firms are still operating and trying to serve their customers, she said.

“We have to find a way to bridge that gap,” said Brown-Hruska. “This,” citing NECC, “is one of those ways.”

Often the better credit firms get favorable rates and the lesser quality futures traders pay a lot more but the NECC-type approach was used in futures to lower cost of financing trades “than if they had simply used direct borrowing.”

The NECC way “is unique, financially well-vetted approach to solving that

problem.”

We asked NEMA’s President Craig Goodman his view of the NECC exchange.

He finds the NECC business model does things “that cannot be accomplished any other way.”

“She’s [Hull] gotten enough credit behind her to implement the lowest cost liquidity solution to the market,” he added.

Hull “is marrying the physical with the financial so that all the risks are offset in a way that you cannot do in private contracts because private contract law does not permit you to do it and bankruptcy law does not permit you to do it.”

**TOMORROW:** *More detail on how the clearing works.*

## Developing markets in the West

*From page 1*

... PG&E Corp from 1980 to 2000 and as a staff member at the California and Connecticut PUCs.

Shannon Eddy was picked as adviser on energy efficiency and renewables at the PUC and Robert Lane as an advisor on policy and planning at the PUC.

Todd Slosek was named PUC communications director.

Desmond has headed Infotility since 2000 and formerly served on the board of the National Assn of Energy Service Companies.

Before Infotility, Desmond was CEO of Electronic Lighting, a manufacturer of controllable lighting systems, from 1997 to 2000, following stints with Parke Industries and Taunton Municipal Lighting Plant, a publicly owned utility where he was marketing and demand planning administrator from 1987 to 1991.

Desmond wrote *Seizing the Opportunity: Breakthrough Strategies for Achieving a Competitive Advantage in the Deregulated Age*.

Desmond, 40, lives in Pleasanton and is a Republican. The appointment doesn’t

need Senate confirmation and pays \$123,255. Eddy was a senior policy consultant at the Center for Energy Efficiency and Renewable Technologies and a senior legislative advocate at John White Associates, an environmental consulting firm, since 2001.

Slosek has served as chief of staff and political director to Assemblyman Guy Houston since 2003, following stints in the Texas General Land Office and InterTrust Technologies. He previously worked on Capitol Hill for retired Sen Malcolm Wallop (R-Wyo).

Skopec had served as staff director of the federal House Government Reform Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs.

Skopec, 32, holds a bachelors from the University of California, San Diego, and a masters degree from George Washington University.

He is a Republican from San Diego.

**BOTTOMLINE:** *If Schwarzenegger with markets and this team can turn around the mess in California, can spring be far behind across America?*

## Peevey shares vision for California energy markets

The PUC and other state energy officials met yesterday on the 10th anniversary of the unveiling of the PUC’s Blue Book initiative — a key event then in the state’s ultimately disastrous foray into badly rigged markets.

PUC President Michael Peevey focused on the customer and the need for lower power and gas prices.

The public wants high-quality service and options in who they buy power from

and what kind they buy.

“It’s fair to conclude that in many instances the current market structure isn’t serving customers’ needs and wants,” Peevey’s paper noted.

Past errors need to be avoided, noted session attendees.

The importance of resource adequacy and long-term contracts were stressed throughout the discussion.

San Diego Gas & Electric was a

consistent supporter of direct access (California slang for competitive markets), noted parent Sempra Energy's Bill Reed.

He doesn't see a conflict between supporting such access and giving a bundled product to those that want it, he emphasized.

Reed sees competitive markets as the means for some customers to control costs.

When looking back at the crisis of 2000-01, it's clear that resource adequacy was one of the major contributing causes in his view.

To avoid a repeat, the PUC needs to set reserve margins, he said. The firm had some problems getting costs right, Reed said. Efforts were made during the

'90s to get rid of subsidies between classes, he reported, but C&I customers are again subsidizing residential.

One reason is that 70% of a firm's load is free of rate hikes — leaving only 30% of sales to absorb the increase.

"We can't afford to get it wrong," said Robert Foster of Southern California Edison.

"We need to be guided by standards, not ideology."

Foster sees a big need for investment in new generation but how should California do that?

Ten years ago merchant generation was the model of choice, but today long-term contracts (10-15 years) with credible generators are essential, Foster said.

Is retail competition doing well, Foster asked, then answered "don't believe the hype."

The jury is still out, he added, suggesting that in choice states such as Texas and New Jersey, when today's big reserve margins drop, new investment may falter.

Foster cautioned of a looming 2006-2008 shortfall.

To undermine competition on its way back to monopoly, Foster asks who today has the political will to let retail reliability risk fall only on advocates of retail competition.

Policymakers have to decide whether the goal is competition for competition's sake or to benefit customers, he added.

If you ask the customer what they really want, Foster urged, they will answer reliability over stable or low prices.

Pacific Gas & Electric has a history of supporting customer choice, even in the darkest hours of the energy crisis, said the utility's Dan Richard.

The utility plans significant resource buying in the next 12 months, Richard said.

It'll take a broad and integrated approach, encompassing customer energy efficiency, added renewables, more non-utility generation on long-term contracts and proposals for utility ownership of some turnkey facilities.

PacifiCorp's Don Furman asked regulators to see the significant differences between the firm and its customers and the state's three major utilities.

The firm operates in northern California and has only 15,000 customers in the state, he reported — only 15 with a load of over 500 kw.

PacifiCorp is looking at a growing gap between demand and the resources in its portfolio, Furman noted. The Scottish-owned firm is amenable to expanding customer choice.

### Continued

## 5 stories in 1.5 minutes

proposed High Rock LNG regasification plant in the Bahamas to Southern Florida. The deal is for 800,000 dkt/day when the plant and pipeline are built — probably in 2008. El Paso is testing FERC's pre-filing process where the commission is to help with other permitting agencies — and get a look at the firm's formal application in advance to speed its own approval. Seafarer is to be an 87-mile international pipeline from High Rock to the US-Bahamas Exclusive Economic Zone (EEZ) boundary, then a 41-mile US segment from the EEZ to an onshore hookup with the Florida Gas Transmission pipeline in Palm Beach County.

### LNG pays big in Nigeria:

Nigeria and other shareholders of Nigeria LNG are starting to see returns on their investment. The firm Monday declared a \$569 million dividend, reported All Africa Global Media.

### Bush hydrogen dream

**one step closer:** The US Department of Transportation approved moving hydrogen in metal hydride storage systems for small applications — developed by Texaco Ovonic Hydrogen Systems (TOHS), the firm announced yesterday. Approval lets customers across the US get hydrogen fuel ready to be plugged into a growing array of hydrogen-fueled devices, the firm explained. TOHS sees the authorization as "a major regulatory achievement."

## Maine PUC seeks political solution to default provider mess

Do huge, single contracts for SOS put small customers at risk?

The Maine PUC asked stakeholders last month for their views on fine tuning SOS supply solicitations, acting on the urging of the Public Advocate and AARP fears of buying power for small customers in one huge gulp (RT, 3/26) in a volatile commodity.

How to ease that risk (assuming it exists)?

A portfolio approach that combines contracts expiring at different times or mixing in full-requirements with indexed contracts and some renewables, for example?

Should the PUC buy options, derivatives or take other positions in the market to protect small customers?

Dominion Retail worries that Maine's existing SOS supply contract — a 34-month accord for Bangor Hydro-Electric and Central Maine Power small customers ending in February — is too long thus blunting price signals to residential and small commercial customers.

The firm wants to see Maine take the Massachusetts route and bid out load for six months.

All types of consumers, noted Dominion, need market price signals to

learn when marketers are in short or long supply so they can respond accordingly.

If prices seem high, consumers who want to lock in prices can go to marketers, Dominion added.

Segmenting SOS contracts and prices "is very likely to confuse consumers since their prices would be blended with other supply auction purchases," Dominion warned, and that's hurt the development of "vibrant" retail markets elsewhere.

Maine's small customer market still is "in its infancy," the marketer commented.

SOS suppliers should bid on all or full-requirements retail service, Dominion urged, so rates include the costs of load shaping, customer service, administration, billing, customer attrition, regulatory compliance and even bad debt so true costs "aren't hidden by the utilities on the distribution side of their bills."

A clearly defined fixed rate with a "transparent target price to beat," Dominion advised, would make the Maine mass market more appealing to retail competitors.

More volatile SOS rates are best only for C&Is who are sophisticated enough to deal with them, Dominion added.

Maine Public Service doesn't see a problem in bidding out SOS supply at

various contract lengths.

It's the kind of "dollar-cost-averaging" approach smart investors take to dampen volatility.

The drawback, the IOU pointed out, is that contracts might be too small to attract competitive bids, especially in MPS's northern service territory, and is likely to have "some marginal effects on retail competition."

A blended average rate based on a portfolio of contracts would mix in some power at current market prices — a good thing for marketers, MPS noted.

Or at least better than the existing system where SOS pricing "may be significantly out of line with current market conditions" thus driving some competitors out of the market, MPS added.

Mixing in some supply at monthly or seasonal market prices via indexing could help competition develop, MPS explained, but would introduce added volatility that AARP and the advocate don't want.

If the PUC wants a portfolio manager, that's a role utilities could play, MPS noted.

The PUC and utilities now put out

## Chair fires five Maryland staffers

Five Maryland PSC staff members were shown the door last week, some escorted by plainclothes police officers, the *Washington Post* reported.

Fired were Andrew Mosier, chief hearing examiner; Blaine Keener, chief engineer; Randy Allen, director of accounting; Chrys Wilson, PSC spokesperson and Robert Higginbotham, a public information officer.

Their existence had been purged by yesterday morning from the PSC website's employee directory.

The firings weren't political, PSC Chairman Kenneth Schisler told the Post, but other sources disagreed.

Maryland's state government was a Democratic stronghold for decades until Republican Gov Robert Ehrlich won two years ago and Schisler, a former state delegate was an Ehrlich appointment.

"The Maryland PSC staff has been particularly competent and thorough in restructuring efforts," Ron Sutherland, economist with the Center for the Advancement of Energy Markets (CAEM), told RT. Sutherland worked with many on the PSC staff in the early days of restructuring and hopes staff changes won't disrupt a program that he finds has saved millions for Maryland tax and ratepayers.

Our call to the commission for details on when the five are to be replaced wasn't returned.

dueling solicitations — the PUC's for full-requirements (retail) supply and the utilities for wholesale supply, then add in retail costs.

Usually the PUC RFP produces the winning bid.

Would separate bidding for the needed 30% renewables help?

It might, said MPS, because other supply segments needs could be bid with any portfolio mix.

Select Energy agrees with Dominion Retail that shorter-term contracts carry less risk and recommends soliciting staggering SOS RFPs so half the load is hired in the summer and half in the winter.

That's how Massachusetts handles the bidding for its default service, Select noted.

The overlapping terms tend to cut the risk of all the power being bought during a market high, Select pointed out, and "help to stabilize consumer prices."

Select sees an advantage in bidding out separately for small commercial customers and residential and doesn't see a price disadvantage in splitting load into smaller pieces.

"Just the opposite," Select said, since

the market for smaller chunks is more liquid.

The trend around the Northeast is to chop up SOS and default service supply into several contracts, Select explained.

Massachusetts, Connecticut, New Jersey and Maryland do it and New Jersey even sets a limit of one-third of the load for any single supplier, Select added.

Select prefers letting customers choose marketers offering green energy or other special supply options — including fixed prices.

If customers find too much volatility in SOS rates, "the market could fulfill their needs," Select urged.

The idea that the PUC should get into the risk-management business?

"To our knowledge, no other state utility commission has, for its own account, participated in hedging commodity prices through the use of financial derivatives," Dominion noted, adding that Maine should not be the first to do it since that's best left to the private sector.

Not appropriate, MPS agreed, but utilities should be allowed to hedge under commission oversight and recover a supply management fee for doing it.

## Unlimited 'free' calling around the globe?

Peer-to-peer file-sharing software, bane of the music industry thanks to the effects of MP3-downloading on CD sales, has been retooled for VOIP (RT wrote about the inventors of Kazaa releasing a VOIP package (RT, 4/7).

Creators of Morpheus, well known to file traders but less famous than Napster and Kazaa, created a VOIP hardware and software firm called StreamCast Networks and have just released a VOIP interface called the Morpheus Voicebox.

The firm teamed up with VOIP provider i2Telecom to offer consumer VOIP calling plans to regular phones. The Morpheus Voicebox lets anyone with broadband use standard phones to make unlimited free calls over the internet to other users anywhere in the world.

i2Telecom's "high-quality and low

cost" VOIP services and StreamCast's following of loyal Morpheus users has the potential to boost VOIP adoption, said i2Telecom.

Until May 15, email coupons for free voiceboxes sweeten the deal.

Customers can send them to family and friends anywhere in the world to start taking advantage global unlimited free calling. After May 15 the box is \$50 plus \$25 for activation.

i2Telecom's global community calling plan is \$7/month plus 3.9¢/minute for calls to the US and Canada and various "rock-bottom" rates for international calls.

The North America 1,000 plan is \$8.95/month for 1,000 minutes from anywhere in the world to US and Canadian telephones for under 1¢/minute, then 3.9¢/minute after that.

Other plans are available.

**Abbreviations:** To see a glossary of RT's abbreviations, go to [www.restructuringtoday.com/glossary.html](http://www.restructuringtoday.com/glossary.html).

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Early Bird Discount Ends Friday!

# After SMD, what?

Live Interactive Audio Conference

May 28 from noon - 1:30 PM ET

FERC invested a lot of time and effort in developing a robust wholesale market via standard market design — meeting with stakeholder groups around the nation — but the measure upset those in Congress who felt threatened by that design.

Congressional leaders blocked the SMD in legislation that has yet to pass but FERC has been warned by Senate leaders not to implement SMD while legislation is pending.

Meanwhile **Harvard utility expert, William Hogan**, tells groups that SMD will come back because it's the only method that works.

He cites the examples of failures without it and successes with it.

Not everyone agrees.

**Bruce Edelston**, director of policy & planning at **Southern Co Services**, is good at explaining Southern's strong views on the subject.

**North Carolina Commissioner James Kerr** is a widely known opponent of SMD who has agreed to join Hogan and Edelston in a 90-minute conference call sponsored by *Restructuring Today*.

FERC's view and what's next at FERC will be presented by **Richard O'Neill**, top FERC economist.

The call begins with introduction of each panelist who speaks for just six minutes.

Facilitator George Spencer, editor of *Restructuring Today* then asks the panel a few questions and then the call is opened for questions from those — such as you — on the call and by email.

**The goal of this call is to let you know — now that SMD has been blocked — what to expect next from FERC.**

How can FERC open up competitive wholesale markets as instructed by the Energy Policy Act of 1992?

Will it be SMD by another name?

Can the supply margin assessment (SMA) accomplish the same goal? It's intended to attach generation market power when it should go after transmission access.

Can locational pricing do the job?

*Get your questions answered for very little money* — no hotels or airplanes — and registration is only \$150 for early-birds.

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## Speakers

- **Harvard** utility expert, **William Hogan**
- **Bruce Edelston**, director of policy & planning at **Southern Co Services**
- **North Carolina** Commissioner **James Kerr**
- **Richard O'Neill**, top FERC economist

## Topics

- Now that SMD has been blocked — what can we expect next from FERC?
- How can FERC open up competitive wholesale markets as instructed by the Energy Policy Act of 1992?
- Will it be SMD by another name?
- Can the supply margin assessment (SMA) accomplish the same goal?
- Can locational pricing do the job?
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