Restructuring Today

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Thursday April 22 2004

NECC leaders deny need for clearinghouse to be a monopoly

A friend at FERC called yesterday to alert us that the North American Energy Credit & Clearing (NECC) we wrote about yesterday would require a monopoly and that FERC will get asked to give them a monopoly for the system to work.

Crestfallen — given our view of monopoly — we checked back with the team of Jeannine Hull, formerly of Cantor Fitzgerald; Becky Kilbourne, marketing and regulatory affairs head, and John Flory, NECC's CEO.

We explained that our friend at FERC has sat in on a two-hour briefing NECC had done at FERC and gained the impression that NECC would want a monopoly to make the risk clearing work.

He agreed that NECC leaders hadn't asked FERC in the briefing for anything specifically.

It was understood that NECC would be regulated by the CFTC that wouldn't have the authority to grant a monopoly but that FERC could put that into the RTO's tariff.

Kilbourne was quick to point out that NECC had not asked FERC for any regulatory treatment though some in the audience "in their minds leaped to this approach but we don't believe it needs to be that way or should be that way," Kilbourne explained.

"In fact we see ourselves more as a service provider to the RTO," she explained in the sense of an unregulated software provider "further down the food chain."

"The entities that want to use us for over-the-counter markets to net their positions, there we would be regulated by FERC," said Kilbourne, but that's a "totally voluntary thing."

"We don't have to be a monopoly. We would be regulated similar to power marketers with a flat position," she added.

The plan now is to seek derivative clearing organization (DCO) status with the CFTC, said Flory.

Since the meeting with FERC the leaders have been kicking around ways that they can be involved with FERC, he said.

Hull suggested that NECC may not need FERC regulation at all, Flory added. "We're still exploring it," he noted.

"There is one thing we can state categorically," Hull assured. "We are not going to ask FERC for monopoly status for anything.

"Absolutely," chimed in Kilbourne.

Our fiend at FERC made clear that having the exchange is a great idea although he was chilly to the monopoly idea.

"Without the monopoly, I'll be out in front of the parade," he clarified.

NECC: A central counterparty for all to trade with

The firm finds very little forward market activity today because so few organizations are there to trade with who have decent credit.

Novation comes to mind.

It's the substitution of a new obligation for an older one, a legal term meaning the contract is made anew with us, said Hull, without changing the contract's terms.

Buyers and sellers dealing with each other "can novate to the clearinghouse," said Kilbourne, and the clearinghouse becomes the buyer and the seller.

"If everyone in the marketplace turns over all their bilateral arrangements to a central clearinghouse then the central clearinghouse has all buys and all the sells and can net those positions against each other lowering the need for collateral, Kilbourne explained.

At the heart of the problem NECC would fix is, in Kilbourne's words, "that if I'm a utility today buying over here from this guy and I'm buying over here from that guy and I'm selling to this guy I may have to have collateral against all those positions.

In her view a better way is to have a central counterparty thus cutting dramatically the capital needed to post.

Hull cited buying in the PJM day-ahead market where PJM is the central counterparty.

But where someone defaults, said Kilbourne, "they spread the risk across all the participants in the PJM pool."

We had a friend who got a bill for one of those defaults and decided to drop out of PJM.

NECC people report the liquidity problem is getting worse because of the "large, unquantifiable risk" from trading in "mutualized pools."

NECC's way instead as the novator is to take "all that risk out of the pool . . . In essence what we do with the risk is that we take it and we send it to Wall Street.

"We use insurance and derivatives markets to absorb the risk," Kilbourne added.

TOMORROW: *Timing plays key role in what NECC does.*

CORRECTION: In the NECC story on page one yesterday at the bottom of page one talking about ICE Jeanine Hull said it captures the bids and the "acts" and that should have been asks — the buys and the sells. A feature of the high-tech transcribing equipment RT uses doesn't hear as well as a human being. The editors should have caught it.

Mona Tierney looking for important signal

It's a signal that will alert utilities not to sign new contracts that would foreclose the economic development of non-core markets, Constellation NewEnergy's Mona Tierney told the California PUC and other state energy officials weighing core/non-core market design Tuesday.

Regulators should create a stable, durable framework to encourage investment in the state, she said, acting in a way that avoids "perpetual discussions."

Under a core/non-core regime, 65-70% of California's load would remain under bundled service with utilities, she estimates, with the rest able to shop.

Full retail choice should be available for everyone, even though not everyone would take advantage, said Gary Ackerman of the Western Power Trading Forum.

The core/non-core model is a good first practical step toward full retail choice, and has the Forum's support.

Ackerman backed customer aggregation and a core commitment of one year, not five.

He favors a core/non-core market beginning a year after legislative approval and after the summer peak season.

Whatever rules are established, Calpine's Steve Schleimer advised that the

7 stories in 2 minutes

PUC gets third member: Gov Rick Perry chose Barry Smitherman, a Harris County assistant district attorney who had earlier worked as an investment banker including stints as head of JP Morgan's Houston office and as managing director and head of tax-exempt origination at BancOne Capital Markets in Chicago. Senate confirmation is needed. He was an adjunct professor of public administration at the city's University of St Thomas. A Texas A&M grad, he has a law degree from the University of Texas and a master's in public administration at Harvard's JFK School of Government.

North Slope gas a step closer: TransCanada stepped in with a plan to move much-needed gas from Alaska's North Slope to the lower 48 and signed a deal with the state to get the job done. The Canadian pipeline firm is to file an application under Alaska's Stranded Gas Development Act while the state processes TCPL's "long-pending" application for a right-of-way lease that would go to the corporation or partnership that works with TCPL to build the 745-mile Alaska portion of the line, the firm said. The deal includes an exclusive hook-up agreement with TransCanada at the Canadian border. MidAmerican Energy pulled out of a similar deal after it was denied exclusivity (RT, 3/29).

Panhandle capacity opening up: Panhandle Eastern (Southern Union) is accepting requests for firm capacity on its beefed-up Muncie (Ohio) lateral pipeline due to open by November 2006. The line is to carry another 500 million cfd to Dayton, Cincinnati and East Coast markets from the Midcontinent, Rockies and Gulf Coast and move imported LNG, too. Non-binding requests are due May 14. Call Jim Van Matre at 713-989-7625 for more.

AEP closer to PJM: A deal agreed to by AEP's Kentucky Power (KP), PJM, a large customer group and the state attorney general that could grease American Electric Power's entry into PJM awaits PSC approval. Under the pact, KP could transfer control of its Kentucky lines to PJM without paying for the ISO capacity reserves as long as it keeps its own reserves. FERC's approval is needed plus the PSC's. A Virginia law's postponing PJM membership expires this summer.

WPS marketer does better: WPS Energy Services boosted revenues 8% in the first quarter. Retail electric margins grew by $3.1 million the firm credits to improvements in management and supply buying in its Ohio and Michigan territories. That and higher customer load. Retail gas margins rose 1.7% in the first quarter as customer numbers and load rose in Ohio where it sells to residential and small business customers. The non-regulated affiliate of Wisconsin Public Service cites too expanding its customer base in Canada's retail gas market and winning contracts in the New Jersey basic generation auction.

SBC under pressure makes an offer: SBC made a UNE-P offer to competitive carriers that would lock in a wholesale rate of $22 throughout the firm's 13-state service territory for the rest of 2004, CompTel/ASCENT, the competitive association reported, intending to share the offer with member companies. "We hope that this proposal will serve as a starting point for true negotiations," said CEO Russell Frisby.

Schwarzenegger starts hydrogen highway: Gov Arnold Schwarzenegger Tuesday signed an executive order creating a public and private partnership to build a hydrogen highway in California by 2010 — called the California Hydrogen Highways Network. At a ceremony at UC Davis, he christened the highway's Station #1 by fueling a hydrogen fuel cell vehicle at the pump. A starter-network of 150 to 200 hydrogen-fueling stations — around one every 20 miles on California's major highways — would make hydrogen fuel available to the vast majority of Californians, he added. Fuel cell maker Proton Energy Systems (Distributed Energy Systems) plans to take part in building the infrastructure, the firm said at the ceremony, and is working with the California Fuel Cell Partnership and others to supply hydrogen generator 'gas pumps' for local service stations.

market be implemented sooner — not later.

The ISO is worried about power availability for this summer and beyond, he noted, favoring rules as simple as possible so people can make informed choices.

Competition, not regulation, brings out innovation and does so at a low price, he assured.

"We can deal with uncertainty," said Schleimer.

"What we can't deal with are complete changes in how the market and regulatory world work."

The IPP community isn't a financial basket case, and is "perfectly capable" of financing needed power plants, Jan Smutny-Jones told regulators. He runs the Independent Energy Producers.

Several members of his group are active in direct access markets and would compete in a core/non-core regime on price and service alike, he committed.

Multiple buyers are needed, Smutny-Jones noted, to protect wholesale generators against monopoly buyer power.

Financial stability is a contract-must, as the bankers "are very interested in whom we do business with." Thus core/non-core market design needs longer-term decision making, he added.

Nobody should be left holding the bag for costs incurred, he urged, but some proposals he's seen are almost punitive.

Merchant power plant can come to California, he reported, if core/non-core markets are stable and capacity is needed, he assured, envisioning a financial community positive about a place "to sell your power."

Aggregation was urged by Dan Douglass of the Alliance for Retail Energy Markets, who favors grandfathering

Regulators see lopsided competition in Illinois

Competitive power sales grew by almost a third last year and established a toehold in two added IOUs' footprints, the Illinois Commerce Commission told state lawmakers.

Marketers sold 11.6% of all retail power in the state and three IOUs — AmerenCILCO, Illinois Power and MidAmerican — who sell power outside their territories — accounted for 4.8% of power sales.

Another 10% of power was sold by utilities on power purchase options (PPO) — unbundled energy priced to the market that competes with marketer offers though some marketers resell PPO power directly to customers.

Much of the gain in shopping, the ICC explained, came from customers leaving PPO service at AmerenCIPS and

ComEd and those whose pre-1997 special contracts expired.

Commonwealth Edison's (Exelon) market is the most robust with 17,400 customers shopping — about 46% of ComEd's C&I load — with marketers or taking the IOU's PPO (see table).

Shopping customers actually fell by a third — to 500 — in AmerenCIPS territory after it dropped its PPO service when it suspended collecting transition charges for at least two years.

Some customers returned to bundled service, the ICC said.

About 1,100 Illinois Power customers were shopping by the end of the year — 31% of the IOU's load — but only 35 bought from marketers. The rest chose IP's PPO.

Is the PPO a problem?

ComEd customers taking PPO service dropped from 40% to 30% last year after ComEd gave large customers a chance to lock-in a multi-year transition charge.

It gave customers confidence to sign longer deals with marketers, the ICC said, without fearing that next year's transition charges would make their deals uneconomic.

Illinois Power's PPO attracted 99% of the under 1 mw unbundled customers and 80% of larger shoppers, an ominous sign for long-term development of the competitive market, the ICC noted.

PPOs were designed to give customers a chance to get cheaper power even if marketers were not making offers and thus giving marketers a chance to gain a foothold in the market by acting as a billing agent or through PPO assignment.

The PPO goes away after 2006 and might disappear earlier as it did when AmerenCIPS dropped it.

Unless marketers fill the gap, shoppers won't have an alternative to bundled service — if it's still offered.

Utilities can petition the ICC to declare power and energy competitive as ComEd did with its largest customers last year, thus eliminating their obligation to offer bundled service.

Only 12 of 15 licensed marketers served clients last year in Illinois, the same number as in 2002, the ICC noted, and most concentrate on ComEd territory where eight were active.

Only three were selling in IP territory and five to AmerenCIPS customers last year while AmerenUE and AmerenCILCO shoppers had only one active marketer.

Marketers weren't selling in MidAmerican or smaller utilities' footprints last year, the ICC reported.

The 4.4 million-customer residential market is dead, without any marketers licensed to serve them, regulators reported.

Marketers cite high transactions costs relative to the small profits they expect to earn though the ICC changed its rules to let marketers sign up customers on their websites to keep costs low.

The failure of the residential market and the popularity of PPOs are worrisome

Illinois Electric Shopping in 2003

	Customers Eligible to Shop		Customers Switching off Bundled Service**		% Switching*	
	< 1 mw	> 1 mw	< 1 mw	> 1 mw	< 1 mw	> 1 mw
AmerenCILCO	23,240	89	0	-	0.0%	-
AmerenCIPS	47,921	152	469	43	0.0%	0.0%
AmerenUE	7,525	37	2	-	1.0%	0.0%
ComEd	321,341	1,394	16,422	996	5.1%	71.4%
Illinois Power	66,259	215	1,032	77	1.6%	35.8%
MidAmerican	1,298	16	-	-	0.0%	0.0%
Total	467,584	1,903	17,926	1,116	3.8%	58.6%

	Megawatts Eligible to Shop (in 1,000 mwh)		Megawatts Switched off Bundled Service**		% Switching*	
	< 1 mw	> 1 mw	< 1 mw	> 1 mw	< 1 mw	> 1 mw
AmerenCILCO	1,495	1,852	0	-	0.0%	-
AmerenCIPS	2,574	3,125	174	1,612	6.8%	51.6%
AmerenUE	663	1,855	2	7	0.3%	0.4%
ComEd	28,515	26,328	10,248	15,217	35.9%	57.8%
Illinois Power	4,691	8,079	736	4,843	15.7%	59.9%
MidAmerican	485	371	0	0	0.0%	0.0%
Total	38,423	41,610	11,160	21,678	30.2%	54.5%

* AmerenCILCO figures not included in state totals

**Includes customers buying power under PPOs, from marketers and from utilities outside their territories

Source: Illinois Commerce Commission

as the ICC gears up for the next phase of market development in 2007 when frozen rates thaw, but another fear looms.

It's lack of competition in the wholesale market fueled by affiliate ownership of generation, limited grid capacity and market power, the ICC noted.

Grid constraints within and between utilities created load pockets where generation ownership is highly concentrated, the ICC reported two years ago.

Lacking liquid transmission, the market's self-healing mechanism — new entrants — is constrained, the ICC explained.

"As the national market for wholesale power has grown, so has the number of [TLRs]," the ICC pointed out in its July 2001 report, and swelling numbers of TLRs are evidence of a grid "that may not be prepared to support competition.

Power supply contracts IOUs signed when they divested their generation — often to affiliates — expire in 2007.

Abbreviations: To see a glossary of RT's abbreviations, go to www.restructuringtoday.com/glossary.html.

Restructuring Today (ISSN 1522-7324) is published 247 times a year on business days by **ghi** llc at 4418 MacArthur Boulevard, Washington DC 20007. Phone 800-486-8201 or 202-298-8201 and fax to 202-298-8210. One year's subscription is $487 in US funds (plus 8% sales tax in the District of Columbia). Significant discounts for site licenses that allow you to put our copyright-protected issues on your internal intranet site for others to see. George Spencer, editor& publisher; Joan Henderson, managing editor; Todd Cunningham, Washington editor; Season Hawksley, marketing director.

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After SMD, what?

Live Interactive Audio Conference

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FERC invested a lot 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.

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- **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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