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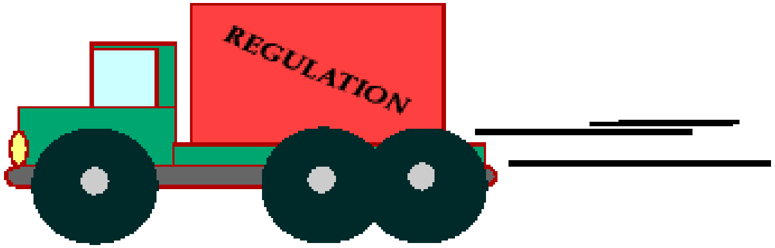
What's Required and What's Allowed?

December 5, 2002



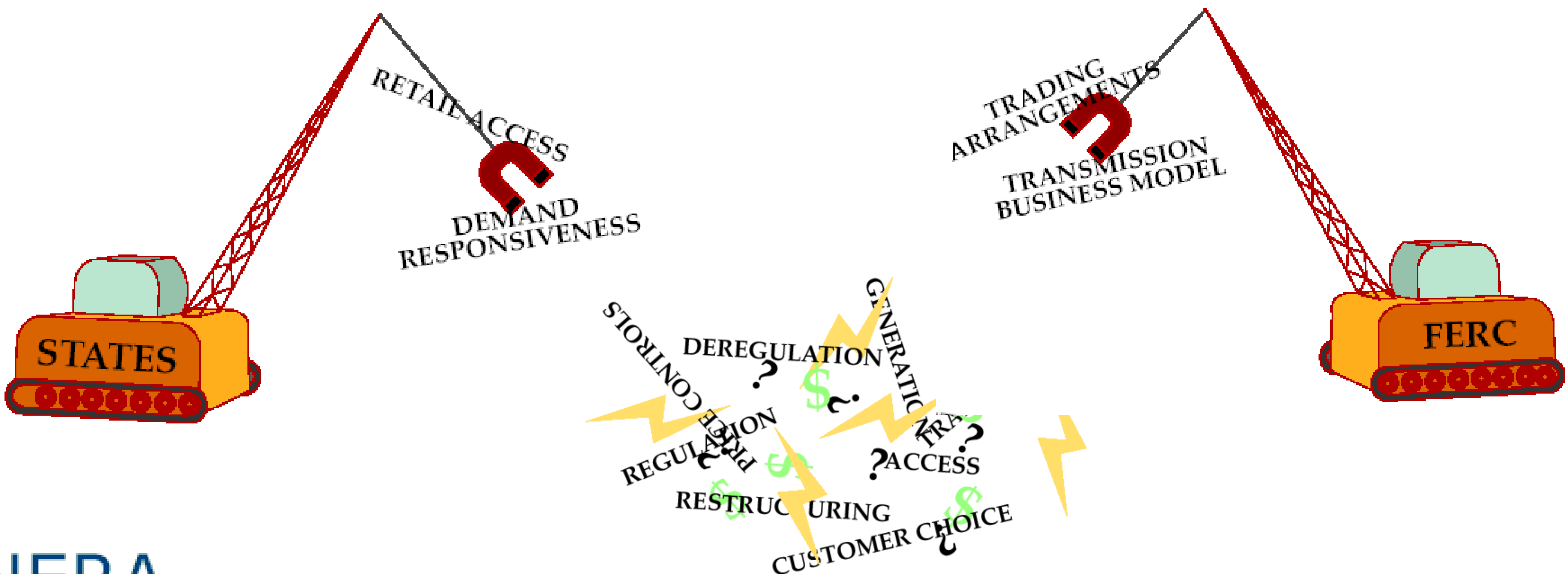
How Markets Work℠

Restructuring is a Complicated Mess in the United States

- Legislation is 10 Years old
- Progress is piecemeal, on a state-by state basis

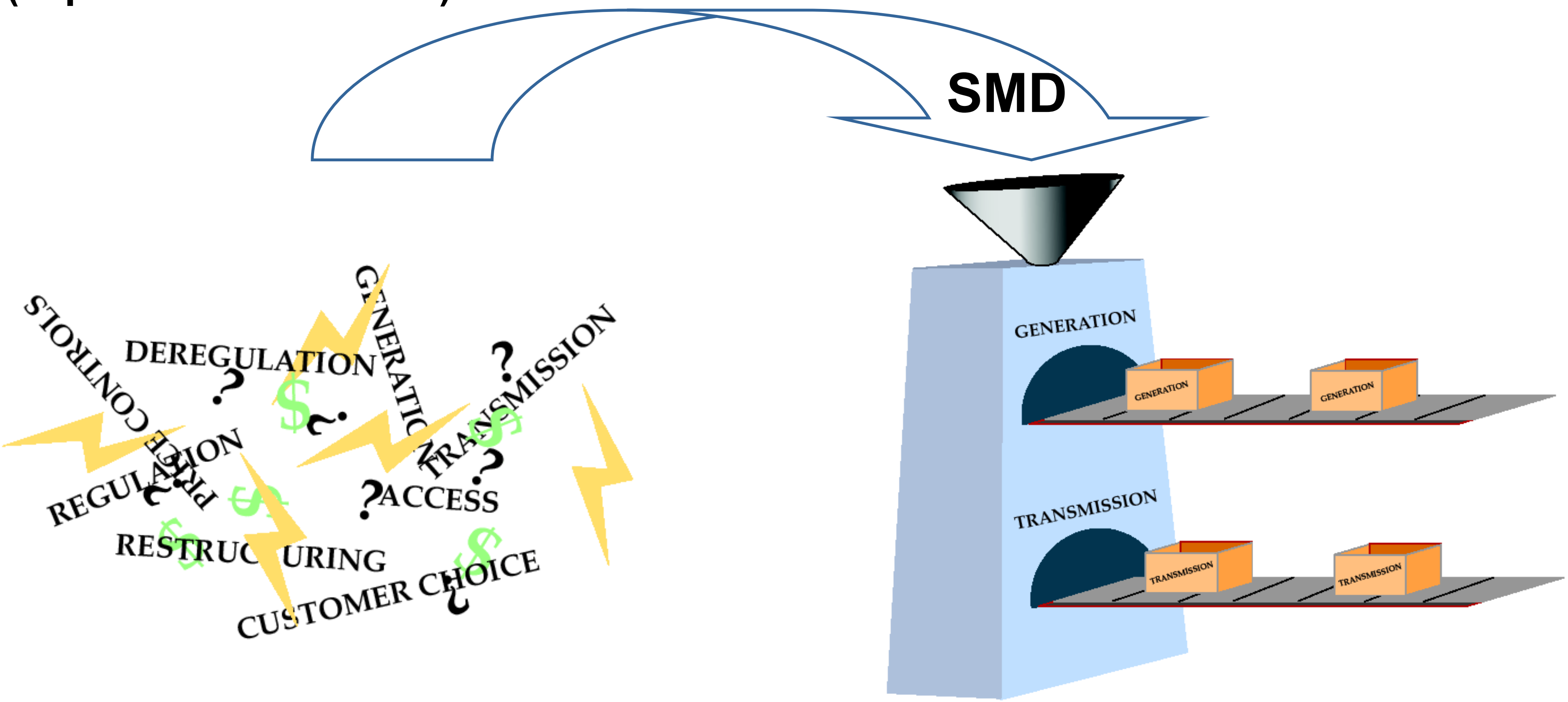
What is required and what is allowed?

- **Access** is required by the 1992 law – SMD is the best way to do it.
- **Access** is necessary but not sufficient for successful **deregulation.** (removal of price controls)
- Competition at the production level should control prices, but requires **restructuring.**
- **Customer choice** for small customers is a red herring.



Access is required – SMD is how to do it – wheeling was not.

- SMD will permit access (as envisaged in 1992 by EPAct)
- SMD will deal with short term issues
- SMD will offer the minimal amount of restructuring to make access work (separation of T and G)



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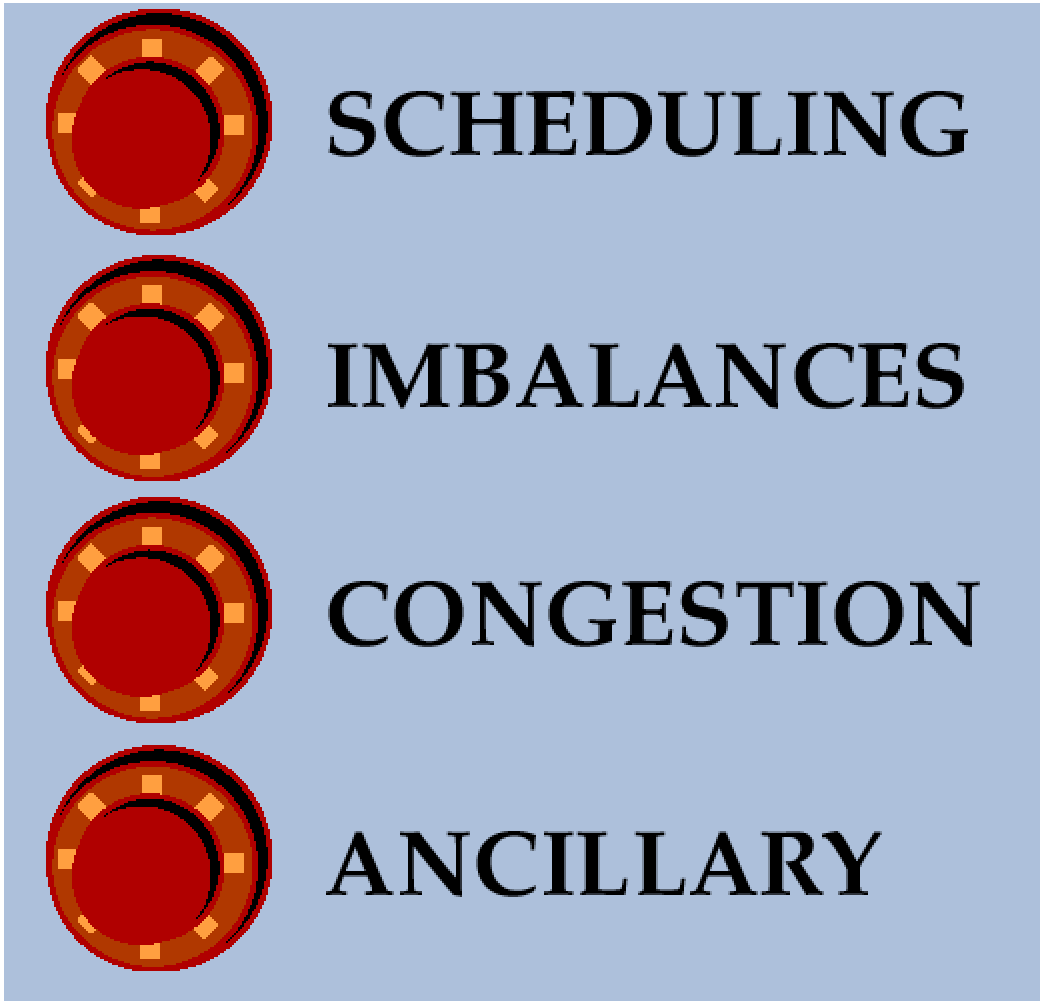
The Four “Controls” of Trading Arrangements



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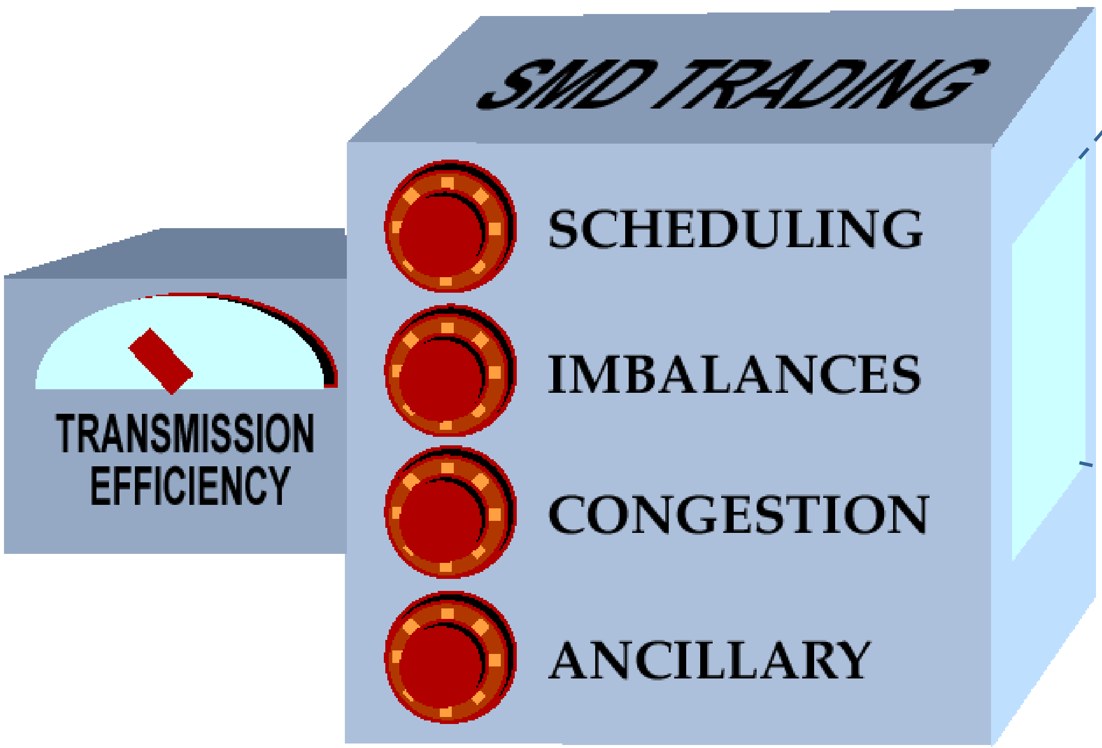
These changes will increase efficiency even without deregulation



- They are equivalent to the old tight pools
- They do not presuppose deregulated generation
- They do not require customer choice
- They will use the transmission more efficiently

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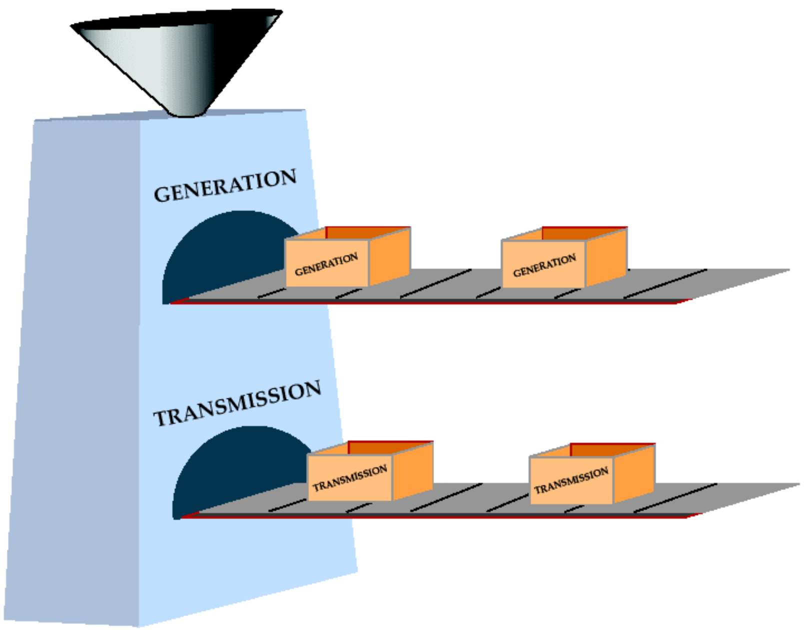
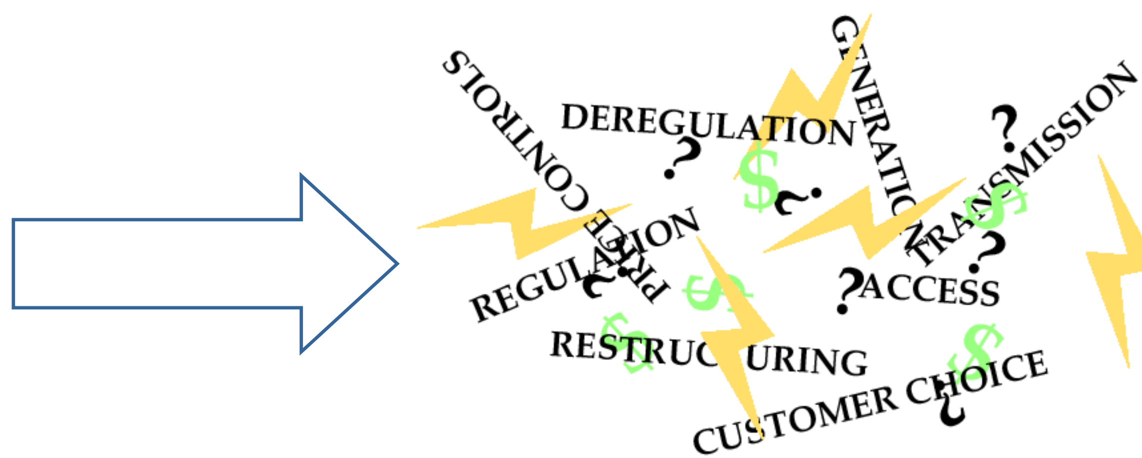
Restructuring is still a problem

- **SMD requires separation of T and G**

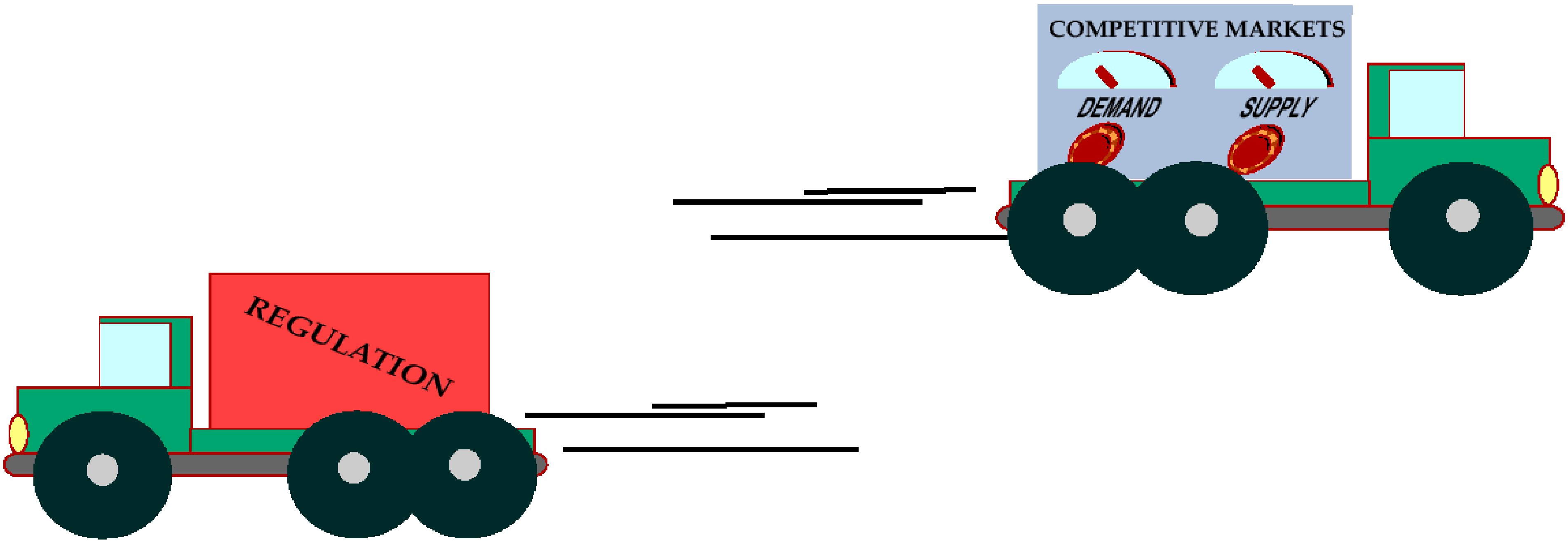
- **Does not address other restructuring problems**
  - Consolidation of RTOs
  - Who is responsible for T-expansion
  - Who can restructure generation





SMD is necessary but not sufficient for successful deregulation

- Deregulation means the regulators stop setting prices **because something else is making prices just and reasonable.**
- That something has to be competitive generating markets.



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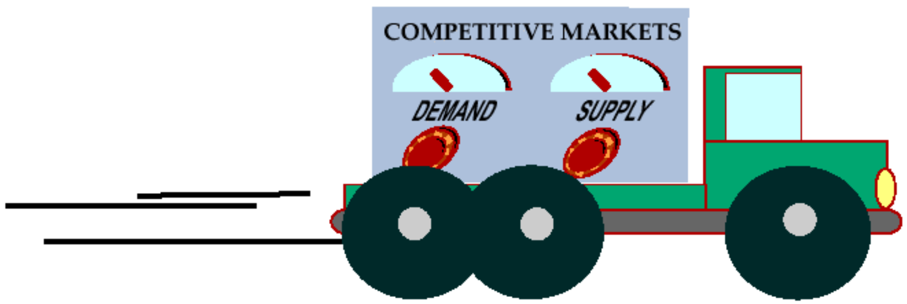
Competitive markets need:

- Liquid, efficient market places (SMD)
- Many Buyers
- Many Sellers
- Demand response
- Supply response



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Deregulation without competitive wholesale markets fleeces customers

- Ownership in the US is concentrated by area – may need divestiture
- Federal government dominates some areas
- Too little transmission – small markets (??)
- Too much regulation of entry
- Need demand response

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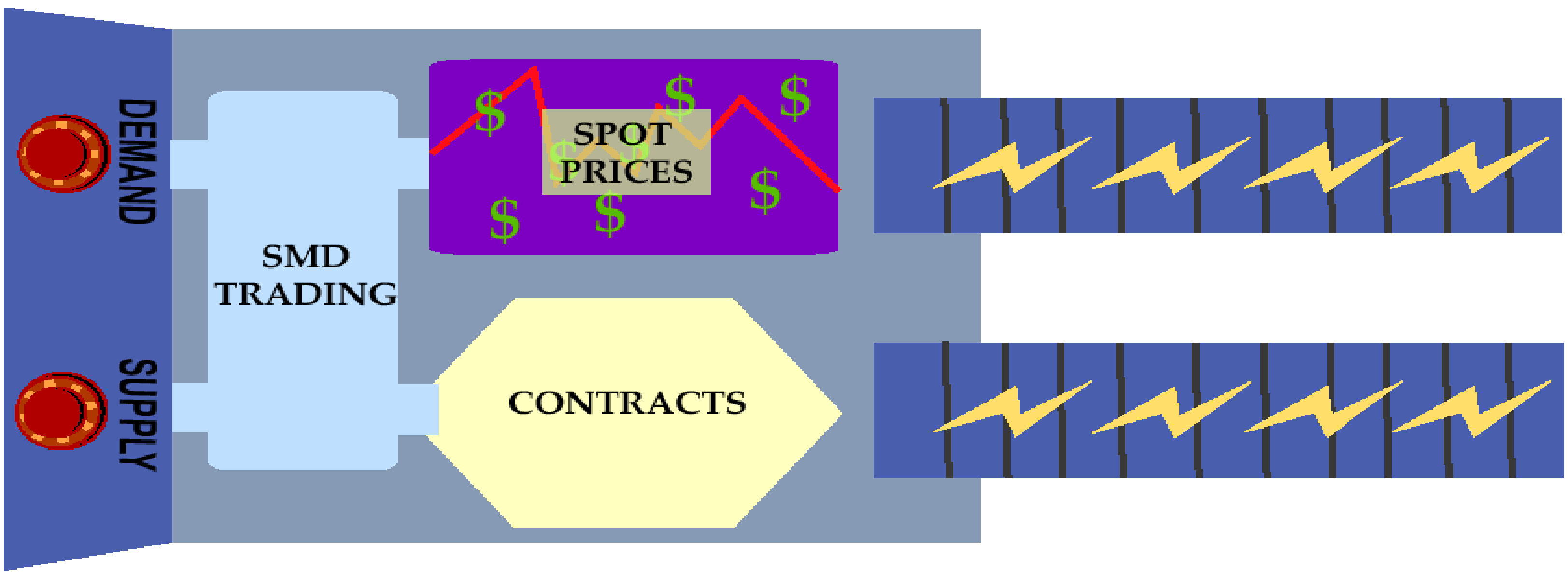
SMD gives Transparent Spot Prices

- **Spot prices are needed for settlement of contracts**
- **Prices should be set by demand as well as supply**
- **Most of the wholesale transactions should be at contract prices**
- **If small customers do not have choice, regulators should require contracts, to limit market power**



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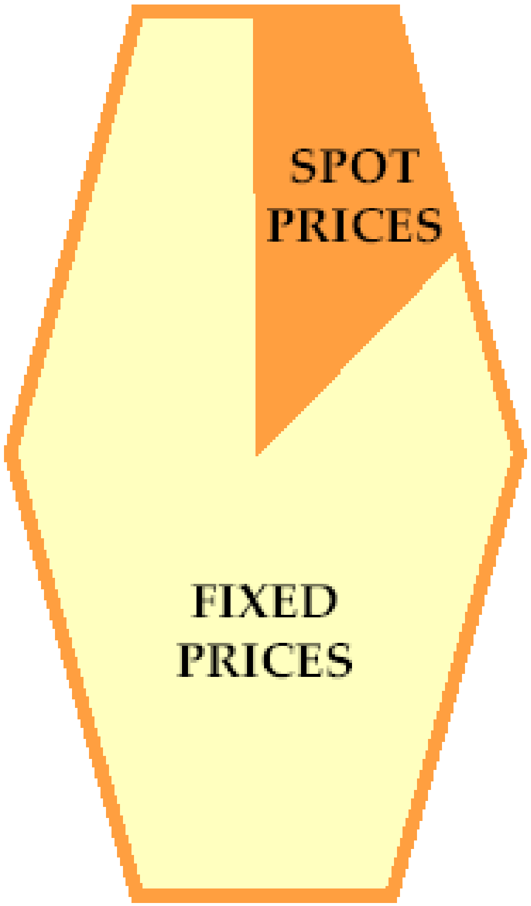
Demand responsiveness

- Customers should be metered and priced by the hour
- Most of the purchases should be fixed price – marginal purchases at spot prices.
- This limits market prices – allows spot markets to clear

- If this had been done CALIFORNIA WOULD NOT HAVE HAPPENED.



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Then markets can be competitive

- Distribution companies (Distcos) buy most (but not all) on contract
- Contract could be market price (auction) or historic cost (regulated)
- Large customers have choice, to provide enough buyers

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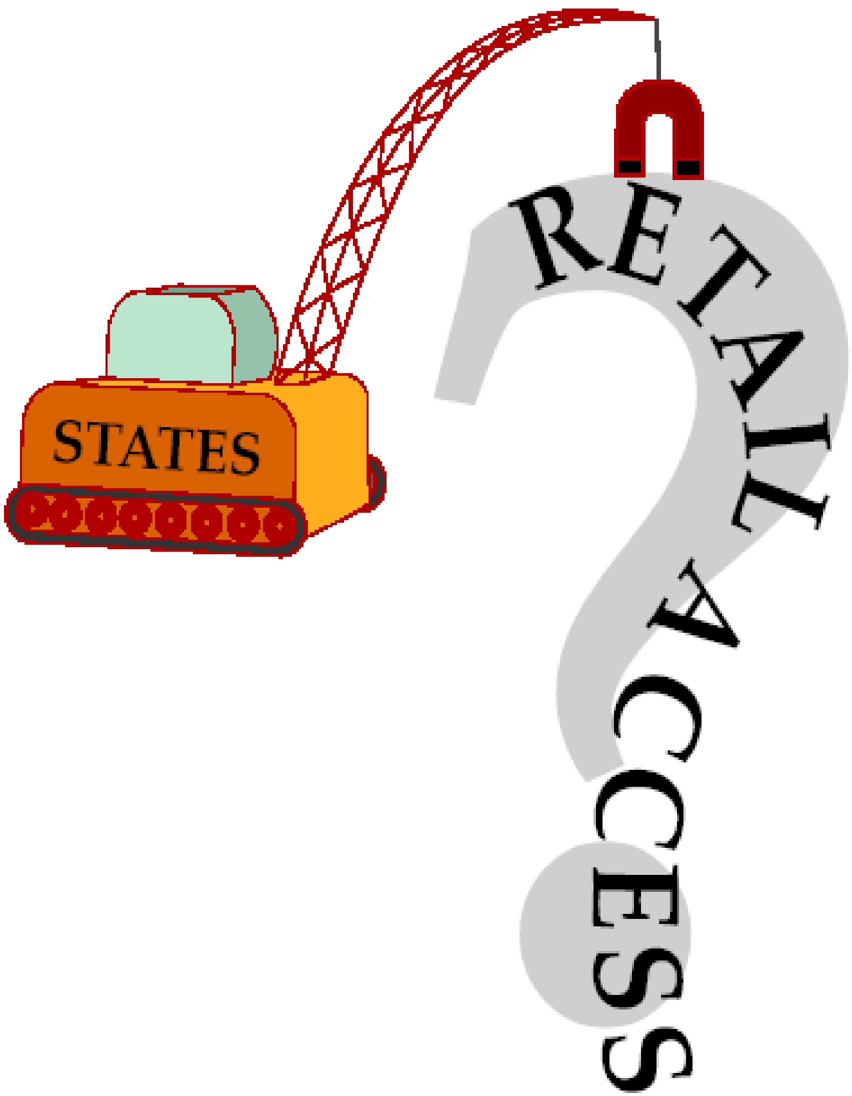
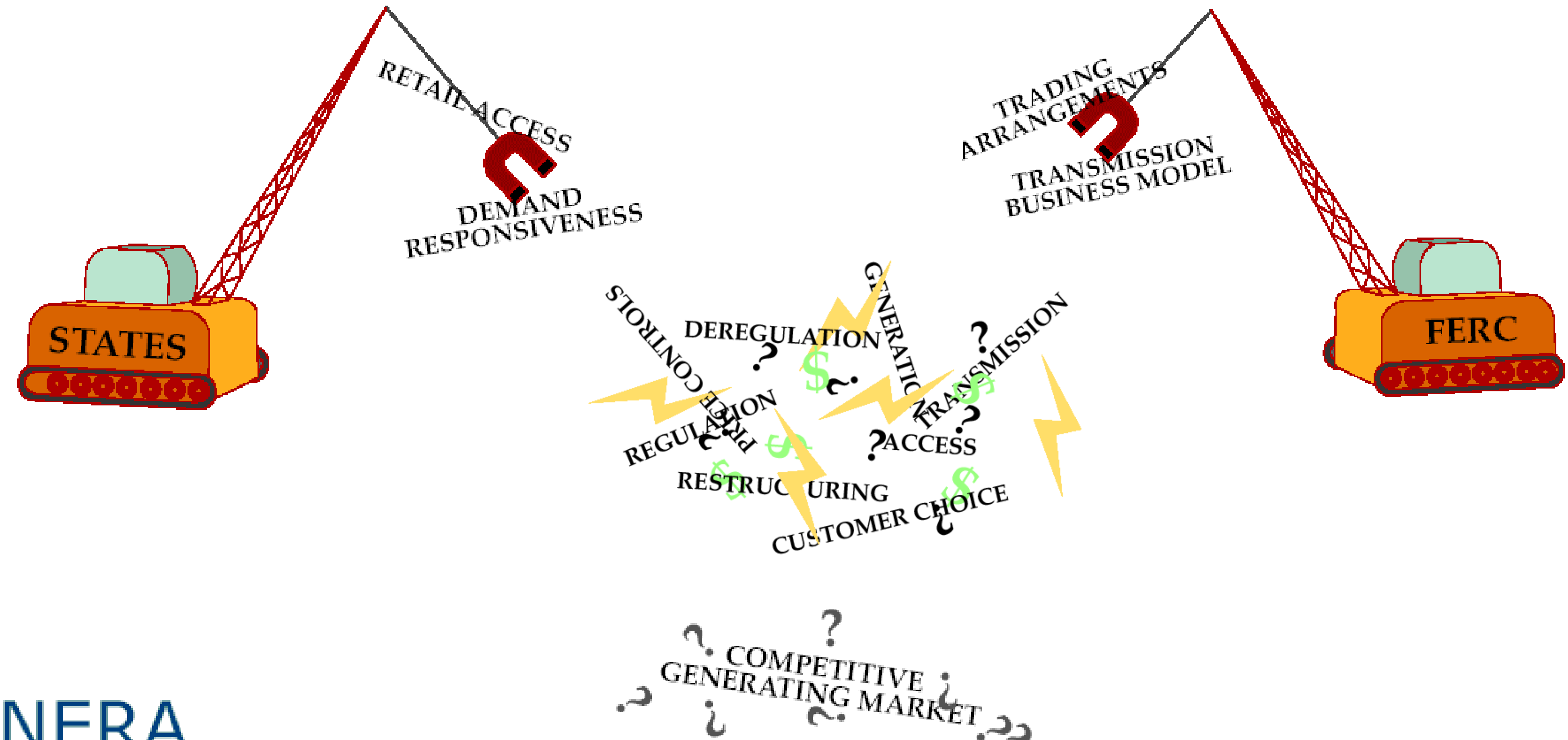
Finally – complete retail access?

- New settlement software
- Much customer information
- Issues of the couch potatoes
- Default service problems

- This is not where most of the benefit is…Customer choice for small customers is a red herring



Five problems and 51 jurisdictions



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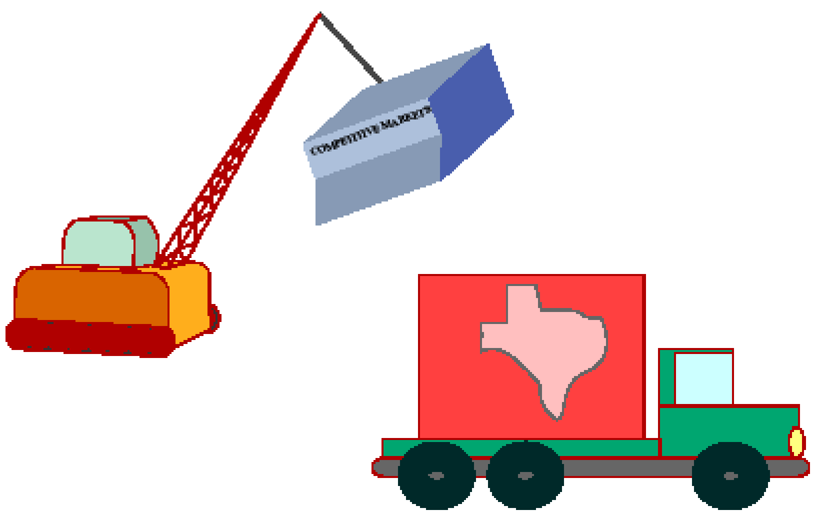
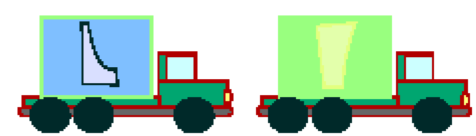
Competition falls through the cracks

- **Big states and preexisting arrangements are competitive (5 areas)**
- **In the rest of the country no single state can make a competitive market alone**
- **FERC does not have the authority**
  - To require divestiture of generation
  - To expand transmission
  - To require metering
  - To remove barriers to entry





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What has gone wrong?

QUALITY CONTROL

Too many actors, no common script

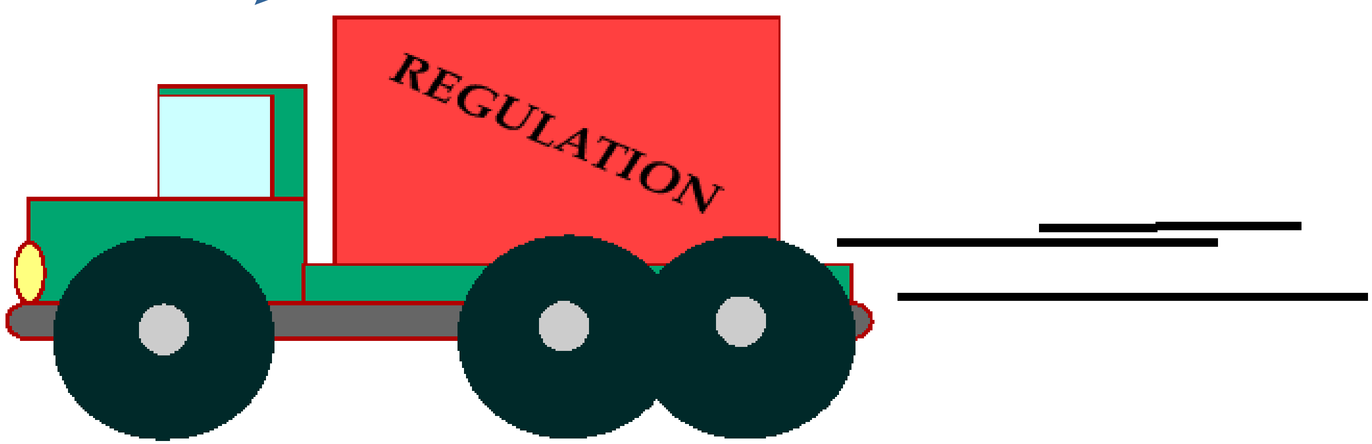
Need a national vision and roadmap

FERC has a vision but still no power; no staff.

May not be solvable without shift of jurisdiction from states to feds to create competition.

In theory, there is no difference between theory and practice

In practice, there is



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