

Facilitating Infrastructure Development: A Critical Role for Electric Restructuring

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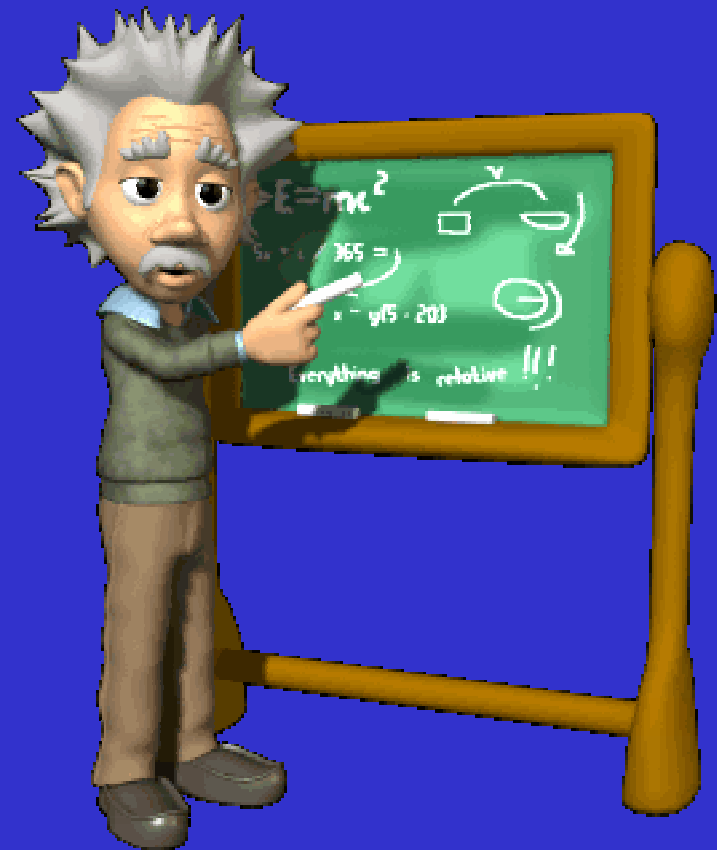
National Energy Modeling System/Annual Energy
Outlook Conference

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The Real Questions?

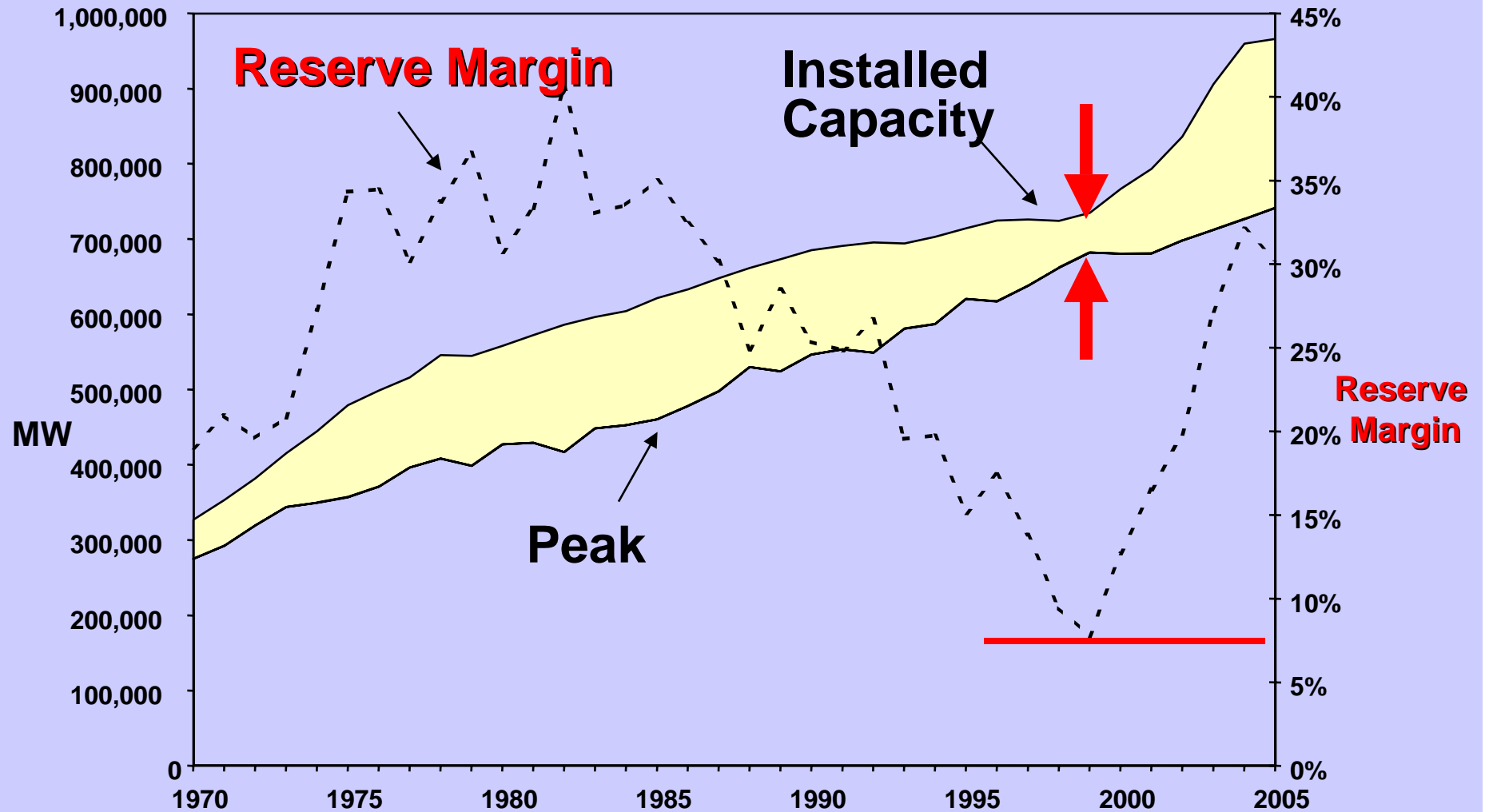
- What does it take to provide low cost, reliable electricity?
- Can we finance the next round of generation and transmission.
- Can we harmonize the goals of the Federal Energy Regulatory Commission (FERC) with State Commissions in support of new infrastructure investment?



Low Cost, Reliable Electricity Requires:

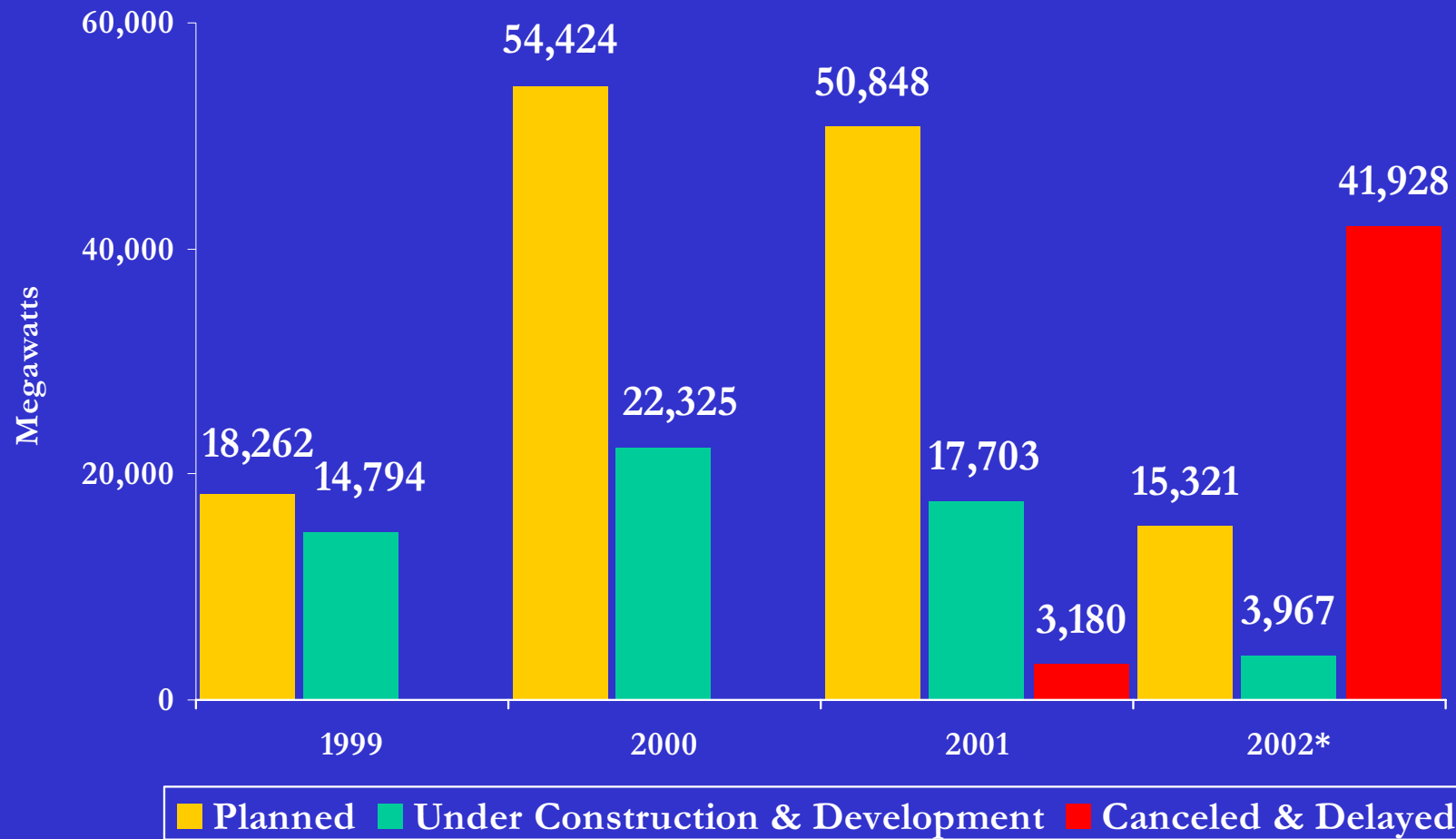
- Adequate generating and demand side resources.
 - Viable spot market.
 - Long-term contracting.
 - Trading to manage risk.
- Market rules and regulations that allow markets to function efficiently.
- A strong energy delivery system.

Stable Demand, Cyclical Supply



Source: NERC, RDI NewGen, NEG analysis

New Generating Capacity *Increased Cancellations*



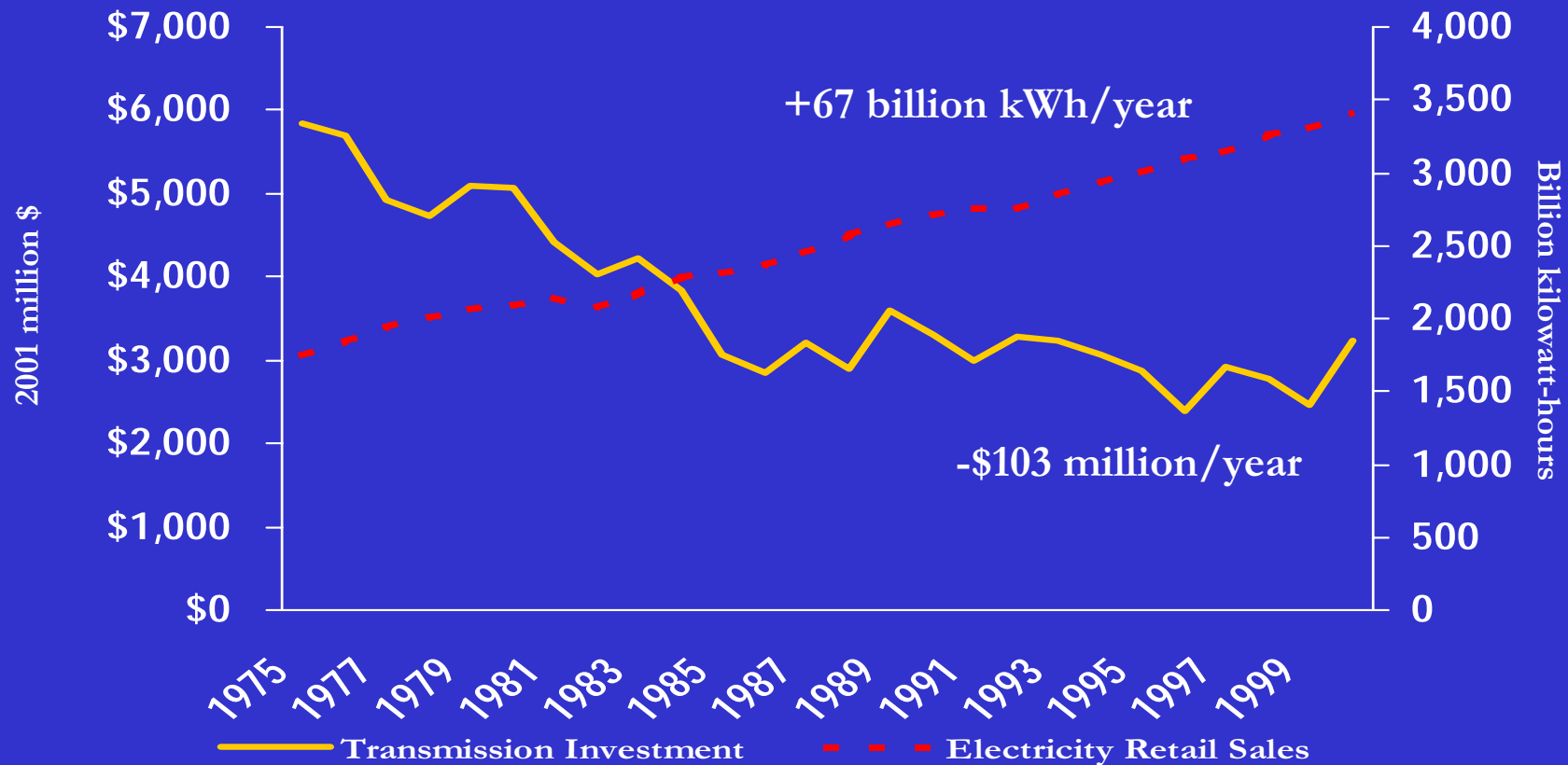
*Through November 2002.

Source: Energy Info Source *New Plant Construction Report* . November 15, 2002.

The Viability of Trading Business

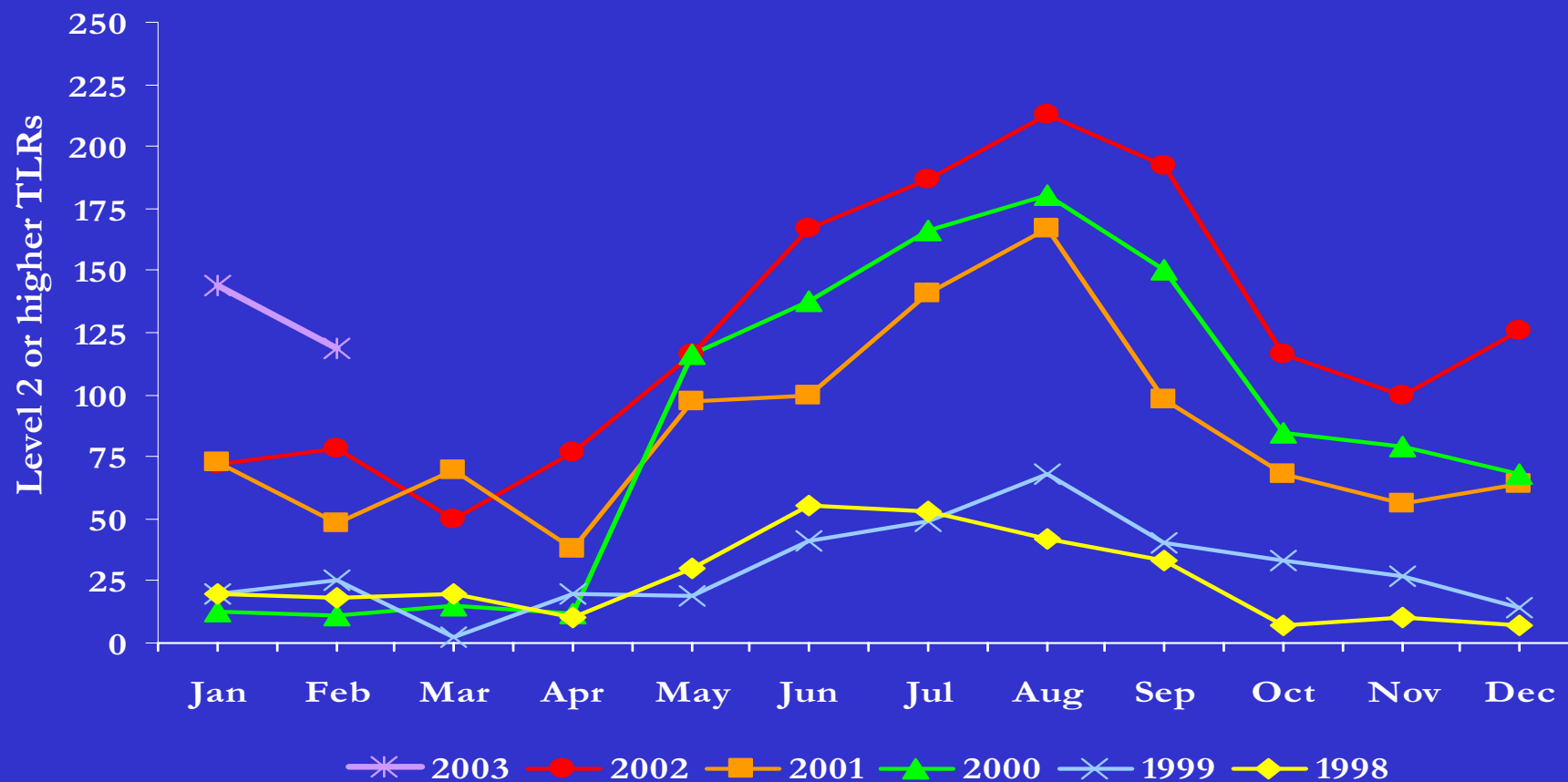
- Severe reduction in energy trading activity (down 70+%).
- Major parties exiting the trading business.
- Enron model – investigations.
- Market credibility.
- Counter-party credit risk.
- Role of financial institutions.

Transmission Investment Has Not Kept Pace With Electricity Demand



Sources: 2001 EEI Construction Survey (Note: Data represents Shareholder-owned electric utilities.)
Table 8.5 *Electricity End Use*, (1949-2001). EIA *Annual Energy Review*.

Congestion on Transmission Lines Has Increased



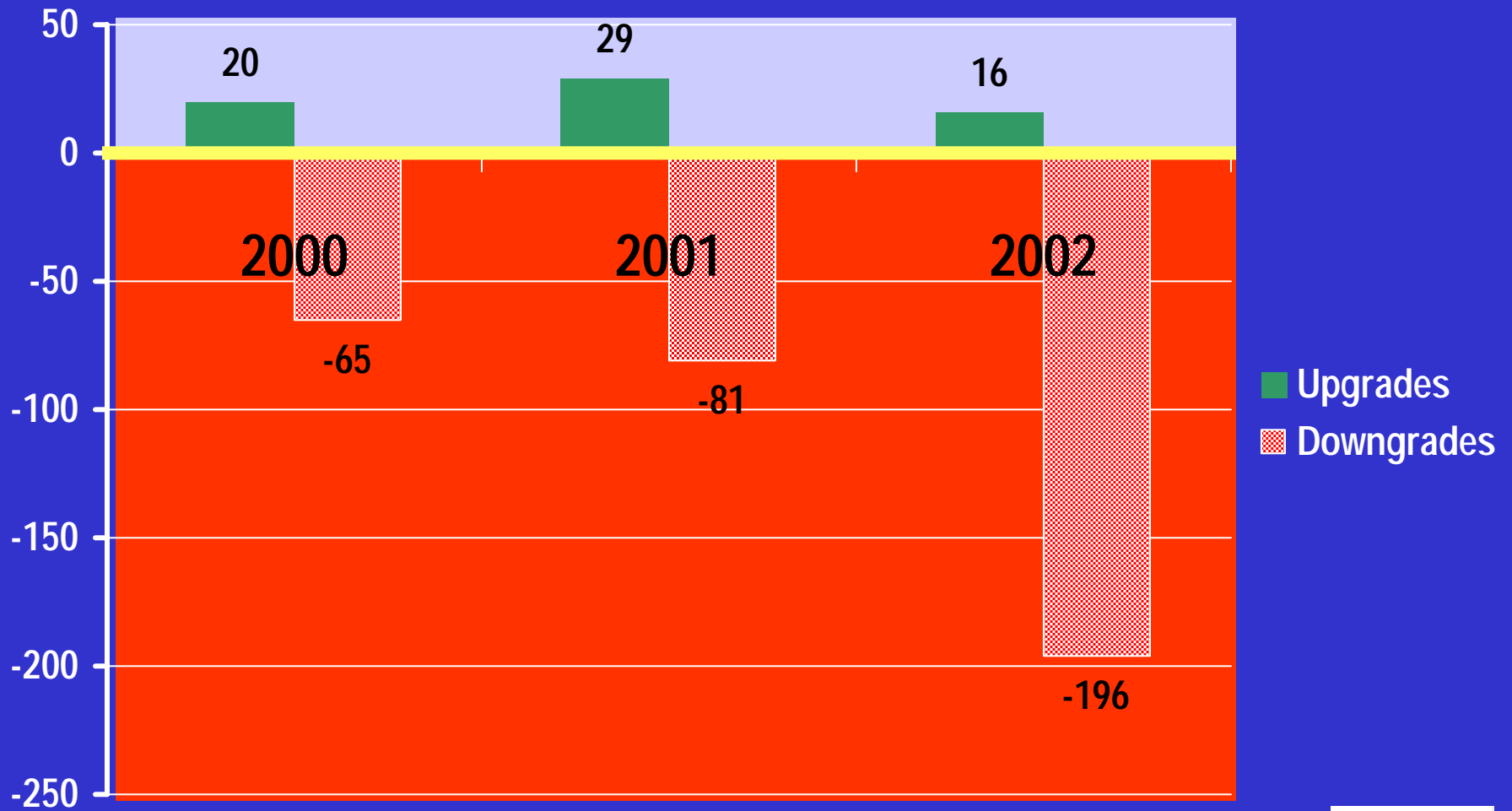
Source: NERC Transmission Loading Relief Procedure Logs

*Can We Finance the
Next Round of
Generation and
Transmission?*



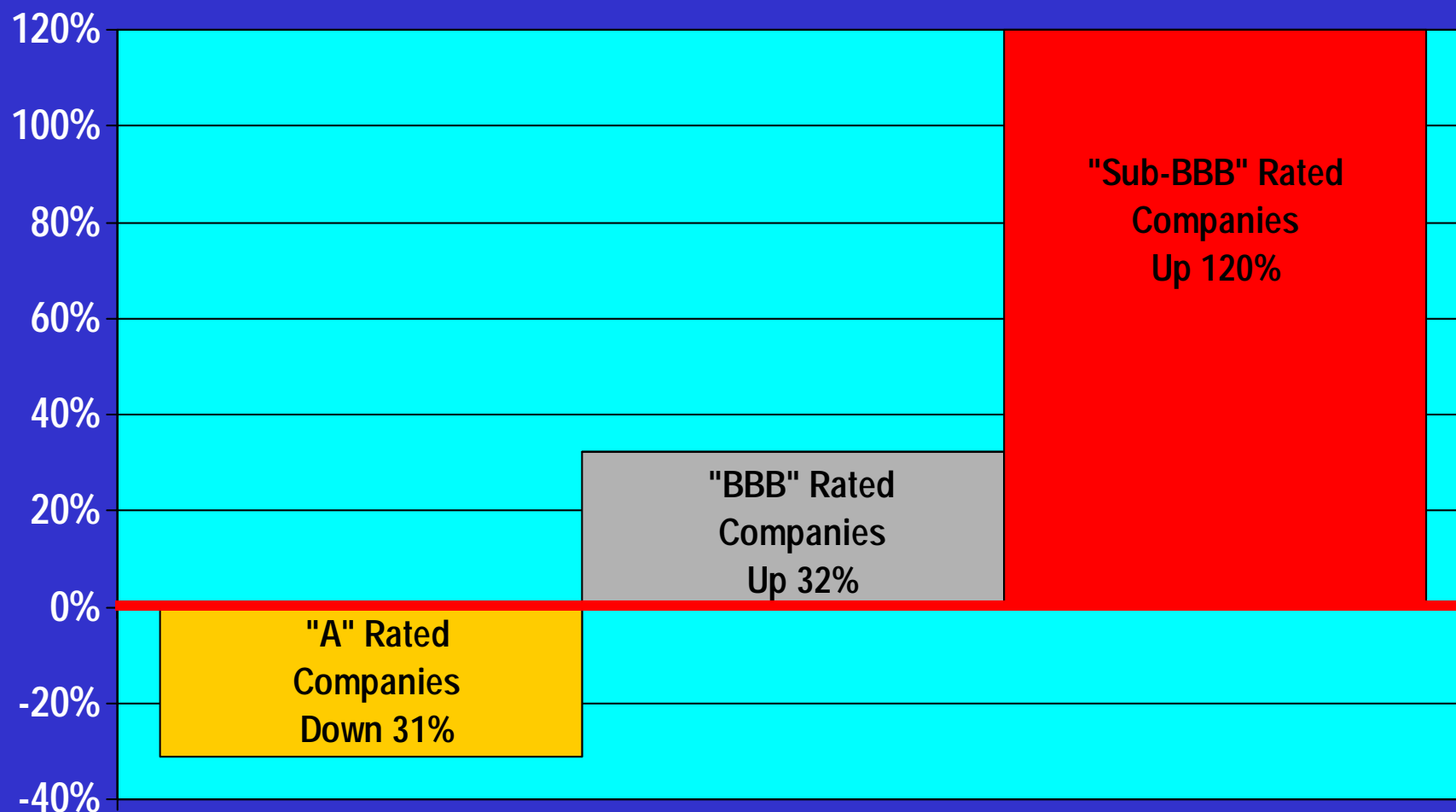
The Industry – Doing the “Electric Slide”

Credit Rating Actions 2000-2002



2002 Downgrade to Upgrade Ratio of 12+:1

Credit Rating Changes 2000-2002



Companies are Responding

- Making more comprehensive financial disclosures.

A Guide To Improving Financial Information and Energy Trading Disclosure for the Electric Industry

- Restating financial statements.
- Raising equity capital / announcing assets for sale.
- Negotiating terms with banks.
- Canceling acquisitions and new construction.
- Curtailing or exiting energy trading and marketing.
- Changing senior management and evaluating the Board.

Will SMD Improve Infrastructure Investment?

- SMD proposal seeks to “regionalize” transmission planning and resource adequacy.
- Enormous Independent Transmission Provider (ITP) role: transmission planning + resource planning on a regional basis.
- Regional State Advisory Committee (RSAC) provides formal advisory role for state representatives.

Resource Adequacy Requirement

■ The SMD Proposal

- Spot market prices that are subject to mitigation measures may not produce an adequate level of infrastructure investment.
- ITP forecasts regional demand, helps determine adequate level of resources with RSAC and assigns each LSE a share of resource requirement.
- ITP assesses monetary penalties and curtailment penalties if LSEs don't meet resource requirements.

■ Issues

- Curtailment not technically feasible.
- Not clear that proposed financial penalties sufficient to eliminate incentives to "free-ride".
- No basis to translate LSE's obligation into transparent economic signals.
- Need to address retail load migration.
- Provide regions with broad latitude to develop workable resource adequacy programs.

Transmission Planning

■ The SMD Proposal

- SMD proposes RFP driven regional planning process for competition among generation, transmission and demand response.
- Integrated transmission utilities are builders of last resort.
- FERC recently indicated this proposal would not be in final rule.
- States provide non-binding input into ITP planning process through Regional State Advisory Committee (RSAC).

■ Issues

- Top down, ITP-driven, all-source bidding approach risks continued under-investment in transmission.
- Transmission owners should not be last resort option. Use all options to get transmission built: Integrated utilities, ITCs, and Merchant Transmission.
- FERC needs to recognize states' decisional role and states need to recognize evolution to regional markets.

Transmission Pricing Policy Proposal

- Relies on “carrot” mechanisms rather than prescriptive “stick” mechanisms to achieve transmission independence.
 - FERC Transmission Pricing Initiative (issued January 15th)
 - Additional equity percentage points for –
 - Transfer operational control to RTO – 50 basis points.
 - ITCs that are part of an RTO – 150 basis points.
 - Efficient grid expansion and operation – 100 basis points.
- EEI's concern --
 - Policy narrowly focuses on complete divestiture as the primary vehicle for getting higher returns and has not adequately recognized utilities that are turning operational control but not ownership over to regional transmission organizations.

Common Regional Views on SMD

- Everyone likes some elements - no one supports SMD as released.
- No support favoring opening state retail markets that are not already opened.
- Regional differences require regional approaches.
- Erosion of state role in resource adequacy, transmission planning, pricing.
- Regions should accept responsibility for regional market design, using their own processes or regional institutions.
- FERC should set flexible, regional implementation schedule.

Unique Regional SMD Concerns

■ Mid-Atlantic

- Don't use PJM as a "living laboratory" for untested market design.

■ Western

- Majority transmission system owned by non-jurisdictional entities.
- Primarily hydro based system.
- Conflict with existing regional entities.

■ Southeastern

- Lack of confidence in cost effectiveness of FERC NOPR.
- Funding - "Rolled in" versus "Participant" funding , Regional cost shifting.
- Native load priority.

Unique Regional SMD Concerns

■ Mid-America

- Regional mechanism desirable, but not additional layer of regulation.
- Favor regional certificate of need for use in state action.

■ New England

- Flexibility needed – don't disrupt current progress.

Summary

- We must **restore investor confidence** among investors and the investment community – so they will want to invest again.
- We must ensure that the **rules of competition** still being written are done so and applied in ways that provide the **flexibility and incentives** needed to ensure a strong, reliable system.
- We must **move FERC and the states to a regional process** for transmission planning and resource adequacy that both recognizes a decisional role for states and supports FERC's efforts to improve wholesale markets.