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# the DESK

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## We Got 'Yer Digital Confirm

**Confirming OTC Transactions; Now There's One Topic** that consistently appears in the "perennial complaint category," among trading managers and directors. For all the new ground we've covered in the past few years, thanks to fancy new trading platforms, information systems and Web-based trading hubs, the confirmation process is still comfortably archaic, stuck in the Paleozoic period of the '80s. And for that reason, traditional fax/phone/smoke signal aspects of this fast-liquefying market rates an increasingly high ops risk score.

But thanks to the recent efforts of a former risk control manager at TXU, some of these issues may soon evaporate. Meet Chris Papousek, the founder of newly formed Confirmation Clearing Corp., a centralized, secure electronic confirmation process that, get this, won't cost you a nickel up front. And even on the back-end transaction, Papousek's modest fees are a better deal than Ameritrade, regardless of the size of the transaction. That's cheap.

Development of the software and the hub-based digital confirm idea (yes it's Web-based) began in June. The company incorporated last month in Houston.

Subscribing counterparties transmit data files to a central ConfirmCorp database, matching trade attributes instantly.

"Unlike market risk and credit risk, which a company may be rewarded in taking certain positions, no company is rewarded in taking added operational risks. If they can hedge it away, then they should. This is one way to do just that," Papousek says.

We've run various stories in the past on encrypted file transfers, digital certificates and other procedures aimed at making various forms of contract confirmations and online transactions

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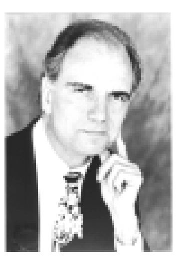
## Power Moves

**Why China Didn't Discover America** *By Dr. Robert Michaels*

The FERC wants to see everyone in an RTO, but we still don't know the degree to which it can and will compel membership. Now an equally important controversy has arrived, fortunately some time before most of us expected it to. Specifically, what rights should a utility have to leave an RTO in order to join another? Two weeks ago, Illinois Power (IP) announced its intention to leave the nascent nonprofit Midwest Independent System Operator (MISO) and join the for-profit Alliance RTO, which still seeks a final go-ahead from the FERC. IP asserts that the Alliance's rate designs and its presence in states that have instituted retail choice will produce benefits that MISO cannot possibly offer.



MISO challenges Illinois Power on two grounds: first, it asserts that Dynegy's acquisition of IP's parent is legally not an event that triggers a rule allowing an acquired system to rethink its membership. Second, MISO believes that IP has violated an unarticulated standard of camaraderie. A MISO spokesperson told *Electric Power Alert* that "it opens Pandora's box. It can lead to animosity and RTOs raiding each other's partners."

Anyone suspect that person once worked for a utility? This looks like competition, where rivals look out for themselves, dislike their opponents, and work hard to steal one another's customers. MISO has reason to worry,

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## PowerMart on Our Mind

**The Build Up at This Point is Pretty Thick.** The weeks and days leading up to a big event like PowerMart 2000 typically sends normal anticipation levels over the top. In the past few days the market has been flooded with new product announcements, executive moves, acquisitions, and related teasers that in one way or another promises to make the whole four-day experience in Houston that much more full. Much like PowerMart '99, we find that much of the advance buzz targets new software offerings. Several of the new companies we've profiled in the past couple of weeks, FriedWire, e-Acumen, ConfirmationClearing and others will have their wares on display at PowerMart, most of which will be available for a road test. **And though we're sorry to report that the seminar we assembled for the day-ahead seminar block on weather derivatives was cancelled, all is not lost. The good folks at *FT Energy* have reserved a room on the main conference floor so that some of the original presenters can make available their weather modeling and risk-management systems for all the world to see.** We understand that the official unveiling of the Zai*Net Weather Delta application will be on Wednesday, Oct. 18 in room 301-D. Other applications that may be available in the room as well include, Weather Risk Advisory's *WeatherSuite system; Aquila Energy's guaranteedWeather.com*; WSI's *new Energycast Trader system; and* Risk Management Solutions' *Climetrix risk management system.* See the Conference Daily for demo times and other listings.

Amerex's Mike Moore will lead a jammed session on Bandwidth trading on the 17th. The seminar agenda is one of the best we've seen – we recommend that you sit in on that one, whether your company is planning such a play or not. If nothing else, you'll see which of your competition is taking notes.

For the past couple years we've tracked the movements of e-Acumen's Phil Chang. Earlier this week we were given a bit of detail about the forthcoming launch of several new initiatives at the SF-based software developer. For one, the company now has a new consulting and asset

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## Klaassen's Theory of Connectivity, Part 1

**At the Recent Power Marketing Association Meeting in Washington, D.C.,** Allegro Development Founder and Chief Exec Eldon Klaassen offered his view on the future of enterprise connectivity. The following is an abstract from that speech.

"...We're at a point in the industry where we're seeing an energy business that is continually changing and at a fairly rapid rate. We're no longer in a situation in energy where competition is limited to a few players. There's very fierce global competition. At the same time, we're seeing the advent of Web-based technologies that allow the Internet to be used in a lot of different ways. We're seeing use of the Web to filter into lots of different areas of what a power-trading company does. And with that, we know that the future belongs to those who are going to be able to quickly and concisely harness these technologies in the best possible way. Which of course begs the question then, exactly how do you exploit these emergent technologies with your information technology strategy? And that's a big question, but I would turn that around and ask an even different question. And that is: How do you exploit these in your business strategy? Because the use of the Web is no longer strictly an information technology issue. No longer just a matter of systems. It's a matter of fundamental business practice and it's a matter of how you run your business. And where you see your business model taking you..."

*We plan to run the balance of Klaassen's speech in next week's issue.*

## Seminar and New Book Bits

**SAVA Risk Management's** "Energy Options" seminar, featuring the *Assets as Options*™ **track is slated for November 16-17, 2000 in Chicago. Registrations are limited to 32 people; this popular event sold out the last time it was offered.**

*For more information call 847/256-8040 or e-mail John Wengler at* ***john@sava.com***

**Derivatives Book Available.** Global Change Associates Inc., announced the publication of its latest book, ***Energy Derivatives: Trading Emerging Markets***, earlier this month. Authored by Peter Fusaro and Jeremy Wilcox, the book explores the commoditization of the emergent energy and ancillary markets, including bandwidth, weather, emissions and coal. The book costs $85 and can be ordered online at **www.global-change.com**.

THE DESK

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more efficient, or at the very least, more secure. But, digital certificates have a long way to go if real-time commodity markets hope to adopt the process in a more widespread way. While some of the bigger marketing and trading firms already have secure transaction procedures in place with the top few counterparties they regularly deal with, few digital transaction/confirmation procedures are available today that can handle large numbers of counterparties, securely and quickly.

"We do," Papousek says, "and no digital signature is required.

"What governs the process is the confirmation clearing agreement. What that is, is a trilateral agreement between us, counterparty one and counterparty two. The agreement specifies how the data should look, how it should be sent and when it should be sent, in addition to all the legal language either party wants to include. Currently when you fax a confirm to a counterparty, typically the term sheet is one page and the legal language is five pages. We eliminate all of this. You can load as many variations of a contract as you like on the system and all you have to do is electronically reference and specify which one applies to a particular transaction."

Regardless of the transaction size, Papousek charges a low transaction fee, which is more akin to the various consumer trading hubs out there. And better still, if 10 trades are involved in a single transaction, you're still only charged for one deal. While doing some market research for the product, he polled a number of companies on what the average cost of a transaction is, once you factor in time and overhead. He reckons that transaction costs vary from $25 to $50 under normal circumstances. But if you ask the same companies to factor in errors, suddenly the number may jump into the hundreds of dollars, or more, when you consider the notional value of some of these power and gas transactions.

"If you don't detect an error early in the confirmation process, which often takes up to a week or more, you'll find it at settlement, much later down the line. And when you think about how a market can move in the period leading up to settlement, errors could be potentially huge. Million dollar errors are not exactly rare..."

To mitigate this sort of risk, the confirmation clearing process matches up trades in real time and scans contracts for errors. If an error is detected, for instance a field is clicked "Buy" instead of "Sell," or 50MW instead of 100MW, the system automatically sends an e-mail alert to both counterparties to fix the problem. Actually, the transaction won't be completed until both sides sign off on the correction.

Rather than go it alone, as many new, smaller trade services companies make the mistake of doing, Confirmation Clearing has teamed up with DataReturn (a Level 3 partner company) to provide and manage the backbone for the system and necessary security. All applications are written in XML, the site is insured by AIG.

The company has thus been far been self-funded by Papousek. He is currently weighing possible venture opportunities.

*Chris Papousek can be reached at 713/526-3000 or e-mail to cep@confirmcorp.com.*

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evaluation arm based in Colorado, Acumen Energy Advisors. New e-Acumen CEO Gary Dorris (an appointment also announced this week) created the new practice as well as the unit's flagship product – AcuVal. But the big news for Chang and company is the launch of AcuPower 2.0, a Web-based price modeling and load forecasting set of applications. We spoke to Chang and Dorris earlier this week as they prepared for the big show in Houston.

"The most dysfunctional part of any organization is dealing with consistency of data across the enterprise. By moving to an ASP environment, this key operational risk, data consistency, is mitigated. So organizations can go back to focusing on their core competencies. We provide the best data and, we think, some of the most rigorous analytics for load forecasting available," Dorris says. Edison Mission and Calpine had a hand in co-development.

A second new product launch is called BestWeather, a new Web application set – skill-rating and brokerage service – for weather forecasts.

In all cases, these new products will be available for demo at PowerMart. We plan to run a more in-depth interview with Dorris and Chang in a future issue.

KWI this week formalized its acquisition of Idaho-based EnerX Development. EnerX is one of few vendors out there (SunGard is the other) that has dedicated applications to help energy execs muddle through the morass of FAS133 compliance. EnerX staff will remain in Idaho. KWI will also be demo-ing its growing set of applications at its booth on the main floor at PowerMart.

For all of you out there thinking, "Swell, great application buddy, but how do I make it sing on top of my current risk-management system," well, know that help is on the way. Earlier this week we spoke to Andrew Bruce, the CEO of startup software developer, Tradewell Systems. Founded late last year, the Houston-based company recently received a sizeable cash infusion from Texaco Natural Gas. So what do they do? Leading edge, Internet-based integration systems – in other words, these folks have figured out a way to seamlessly bolt together any sort of commercial (or proprietary we're told) grade trading and risk applications, data feeds and the like so that enterprise system of yours can finally hum.

"Much the same way Microsoft Windows offers ubiquitous access to the PC platform, our product, EnyWare, provides you with ubiquitous access to the enterprise. The deals and other transactions you might run through an exchange can now automatically interface with your other in-house applications, whether you're operating off of a Caminus, Altra, KWI platform, it doesn't matter. It allows the customer to have access to and truly utilize the best of breed from any of them, Web-based or otherwise," Bruce says.

We're aware that several of the major vendors are working on similar applications – to create a standard of sorts – now that the idea of best of breed has again raised its head around the market. So far as we know, this is the first interface on the market, and if Texaco is any indication, the first on the market to actually work.

The object-oriented solution set is described as "affordable, fast and available now."

Questions? TradeWell's applications can be seen at booth 138 at PowerMart.

The newly merged Caminus/Nucleus mega-house will be out in force we're told, under a new combined logo. We expect some new sales to be announced at the big show.



## Darwinian Theory vs. Wild West

**You Don't Have to Put on a Headband and Buy a Harley** to be first into the new competitive telecom market, Comm/delta CEO Carlos Alarcon says, but you are going to have to take some risks.

"Every entity that participates in telecom can take advantage of the discontinuity in our marketplace. But they have to be bold and they have to be first-in – there's only so much room for first in," he says.

Popular notions of the emerging competitive market as the Wild West are good PR, but not much more than that, says Alarcon. Ample opportunity in the market doesn't mean telecom cowboys should start new telecoms and build new networks, but that legacy players with networks in place need to learn to optimize what they have. "It's not taking new risk, it's optimizing the risk you have at hand," he says.

Alarcon prefers a Darwin analogy to the common cowboy one. Darwin found that the most adaptable survive, and that same principle – combined with supply, demand and allocation – is at work here. "Neither size nor technology are going to win in and of themselves, but the ability to adapt – to effectively participate in a different, highly competitive market – will through natural selection choose the survivors," he says. "Or establish a new and different hierarchy."

Smart and opportunistic by nature, carriers understand that the disruptive marketplace requires a new set of business processes for effective competition, says Alarcon. "We will soon discover what the pain threshold is."

But the basic look of a typical capacity transaction isn't going to change, he says. The next six months will bring announcements of structured deals as carriers experiment with financial engineering solutions. "For the first time, two telecom firms will be able to say both of their requirements were satisfied through this structure," he says. "But I don't believe the telecoms are going to jump into the competitive market to do city pairs."

*Alarcon is at 212/481-3256. Or reach him by e-mail at Comm.delta@worldnet.att.net*

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since the news is now out that ComEd, Ameren, and other systems in the area may follow IP's lead.

We should presume that competition among organizations is as desirable as competition among businesses. An RTO that wants to retain members and add new ones competes by constructing more attractive rules and rates. We don't want a totally free market – a decision to switch can't be made lightly, and there should surely be notice (and maybe even stranded cost) requirements. My reading is that the FERC wanted MISO to succeed in the biggest possible way. If choices become available and enough dominos fall, MISO becomes a casualty of competition and the FERC learns a valuable lesson.

But RTOs are monopolies, comes the response. Right. And all the stories we used to tell about abusive, inefficient, uninnovative transmission-owning utilities can surely apply to RTOs after minor changes in wording. Ages ago Alfred Kahn explained why things got better when regulators allowed whatever competition was possible in restricted situations. Unlike so many economists' stories, Kahn's proved to be non-fiction in industries like airlines, telecom and gas.

For reasons best understood by lawyers and psychiatrists, regulators don't like disorder. FERC will rest easier if only it can freeze the country into a set of RTOs that stay put and have identical rules and motivations. Back before long-distance transactions became feasible we had a system like that, populated by self-sufficient utilities. A few extremists claimed that they "Acaptured" the regulatory process to benefit themselves and exclude efficient competitors, but we all know that can't possibly happen with RTOs, don't we?

Whatever happens to IP, we already have competition among RTOs. What better description for the frenzied efforts by everyone on the other side of the California state line to escape its expansion-minded ISO? Nobody, including the FERC, can do more than conjecture about the shape of the most efficient organization(s) to operate the far west. Even after the RTOs are formed, no plausible reasoning justifies freezing their boundaries So why not keep the competition going indefinitely by allowing transmission owners to change their affiliations?



Finally, China. Before about 1400 it was Europe's clear technological and military superior. China had gunpowder, compasses, canal locks, movable type, paper, printing, remarkable bamboo gas pipelines, and the pasta that Marco Polo took home to Italy. It had 400-foot long ships that dominated the Indian Ocean and probably made it to Hawaii. China's monarchy was the sole government for thousands of miles in every direction. Then, around Columbus's time, a new dynasty took over. It chose to suppress new technologies, wall off the country, and literally sink the fleet that might have founded Oakland.

In *Guns, Germs, and Steel* (Norton, 1998), UCLA historian Jared Diamond argues that competition among governments explains why China failed and Europe ascended. Europe's seeming anarchy of governments competing for territories and technologies fostered innovations and industries that China's superficially attractive unity could not. Leonardo Da Vinci moved between Florence, Milan, Venice, Pisa, and France as he struck bargains to design public works and weapons. Governments fell behind at their own risk. And Columbus? He was from Genoa, whose government had no use for a westward voyage when its primary interest was defeating Venice. Columbus tried five different governments before getting Spain to fund him, and Spain only bit on the second try. Think how different the world might have been – Chinese tycoons building the transcontinental railroad, obliterating thousands of inexpensive Europeans as they blasted through the Sierras. Don't push the analogy too far, though. I don't want to know the electrical equivalents of the eternal celestial dynasty and that big useless wall.

*Dr. Robert Michaels is professor of economics at California State University, Fullerton and Resident Scholar at the Center for Advancement of Energy Markets. E-mail Michaels at rmichaels@fullerton.edu.*

## Complaint Against NYISO Denied

### *Or, a Marketer Gets Spanked...*

Morgan Stanley is not amused with the NYISO. In an Oct. 5 order, the FERC denied Morgan Stanley's high-profile complaint against the system administrator, scheduled for the Oct. 11 meeting agenda. The complaint contended that the NYISO's limitation of participation in the day-ahead and real-time markets to physical entities (i.e., those who physically consume or supply energy) impedes marketers ability to hedge risks and gives unduly discriminatory market power to load-serving entities. (Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc., Docket No. EL00-90-000, 93 FERC ¶ 61,017)



The FERC concluded that the parties disagreement arises over the timing for implementing bidding by non-physical entities, not whether such bidding should be permitted. The NYISO has a plan to correct market design flaws that hopefully will be ready sometime this fall. In its answer to the complaint, the NYISO said that it had reached a consensus with market participants to defer the issue of non-physical bidding until after its first summer of operation. Morgan Stanley requested that non-physical bidding be implemented as of August 1.

The FERC held that Morgan Stanley had not demonstrated an overriding immediate need to implement a non-physical bidding structure that would take priority over correction of market design flaws. It is requiring the NYISO to file a progress report on its implementation of non-physical bidding by Jan. 1, 2001. The Chairman said that the debate over this order which questions the timing of the NYISO s revisions that will broaden market participation illustrates why Regional Transmission Organization ( RTO ) filings need to borrow workable solutions from existing power markets in order to facilitate timely implementation.