

Restructuring Today

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Naeve doubts long-term outlook for merchant generation

Steven Naeve retired recently from Reliant Resources as vice chairman. He had been CFO then president and COO until April.

He had been responsible for management oversight of US and European power and gas businesses.

What went wrong with generation?

Those who put lots of money into merchant generation assumed, he said, that the market would be relatively unfettered. Many failed to see that regulators and others would step in to protect consumers, Naeve said.

Generation developers assumed customers would be allowed to interact with markets and respond to price. That, in Naeve's view, was a key missing piece in California.

FERC caps on wholesale power markets are a negative significant factor.

And in California customers were paying "10¢/kwh when it was costing a

hell of a lot more than that," he reminded.

If prices were allowed to rise, it would have taken very little for the high price to cut demand, he explained, and behavior would have been very different.

Another major error was to assume enough liquidity would be around to permit hedging the output by bilateral contracts and other tools, Naeve noted.

Then generators learned that volatility simply isn't politically acceptable, said Naeve.

Using caps has shielded buyers and sellers from the consequences of being wrong, he added.

Now peaking capacity "is not viable at all" since it may run only a couple hours of a year.

That means the generator has to get back all of his money — not just the return on capital but paying the people to hang around for those few hours to run

the plant — and you get a price "way, way higher than the price caps," Naeve added.

Then the price gets set by stranded-cost talks — a negotiated number — that doesn't reflect the market, Naeve cited as yet another flaw.

In most states the monopoly is the one that provides the commodity ... in a regulated fashion "with the price determined by a deal that was cut back when they determined stranded cost and in some cases these prices go on for 10-15 years."

Naeve finds it upsetting that regulators — not the market - - will have heavy input in how much capacity a utility can buy, what the reserve margin is, the fuel mix and hedging cost.

As long as the utility is a monopoly buying for customers "all those issues hit the table," he added.

That leads to integrated resource planning (IRP) including DSM so that the economic benefits expected from a merchant generation competitive model are lost.

"I'm pretty pessimistic," said Naeve. If you have a PUC setting the price for the utility, that "inevitably takes you down the path to "where we once were — the regulated utility."

"IRP, fuel mix — it's not letting the market decide," he added.

Pessimistic? He doesn't believe America's political leaders have "the will, the willingness and the patience to work through the problems — and the recognition that the benefits will ultimately pay off."

The great hope was to get regulators and politicians out of deciding when, where and how much generation should be built.

"The market can't decide that unless all participants in the market see the real price of electricity ... and respond accordingly," urged Naeve.

Attractive prices for merchant generators in a free market "will be crushed by people throwing capital at that opportunity," he explained.

"In Texas they threw capital at the opportunity to be there and have bid prices way down," Naeve reported.

Naeve's doesn't expect his hope that courageous regulators and politicians will

Hill set for final energy bill meeting Tuesday

FERC's Wood glum about bill contents

Energy bill conference committee Chairman Sen Pete Domenici, R-NM, set a final meeting for Tuesday.

"The tax writers should have completed their work in time to meet that schedule," Domenici predicted in a joint statement with Rep Billy Tauzin, R-La, chairman of the Energy & Commerce Committee.

Democrats can expect to see the final bill at least 48 hours in advance of the meeting, the pair promised, adding they don't see any "reason final passage of the bill can't occur soon after the conference is completed."

Final passage of an energy bill can't come soon enough for FERC Chairman Pat Wood who yesterday appeared resigned that the bill wouldn't give him everything he needs to effectively regulate energy markets.

"How many years have we been working on the energy bill," Wood asked reporters.

"We need to move on," a weary Wood urged.

He had talked with Domenici but said

he hadn't seen a text.

"The holding pattern" was "more than just a political game," Wood said, adding that delays stopped a "logical progression toward RTOs, investment and mergers."

Wood hinted that he expects some "sub-optimal decisions" to be made on the Hill.

Statutes can be challenged in court the same as FERC orders, Wood noted.

One sticking point in the bill was participant funding.

Sen Trent Lott, R-Miss, threatened to vote against the bill if incumbent utilities weren't given more control over who pays for transmission upgrades.

Lott cited a Duke Energy plant outside Jackson, Miss, that exports power out of state.

"The people that provide the power or get the power should pay the cost," Lott maintained.

Incumbent utilities want to stifle competition, IPPs contend, and eliminate FERC's role as a referee.

"We do not expect the transmission owners to be unbiased observers," said EPSA's Gene Peters.

A compromise was reached, Lott reported, but without everything the IOUs in the South wanted.

"The language is acceptable," Lott said, without disclosing details.

10 stories in 2.5 minutes

CORRECTION: David Byford at Dynege writes asking us to make known that Dynege is not in bankruptcy. We are embarrassed at the gaff on our part. That story was read by three editors who missed such a large error. Byford reminds us that Dynege has worked hard and successfully over the past 12-18 months to stabilize itself and improve its financial condition. "Our liquidity stood at \$1.3 billion as of our last analyst conference call Aug 13" and that's more than enough to run the business.

Select wins again: Select Energy (Northeast Utilities) will supply wholesale power for the Massachusetts Electric (National Grid) default-service load when Select's existing six-month contract ends next month. The 700-mw deal is valued at \$140 million and lasts through next October. Select is a major supplier to New England default service customers including NStar, Nantucket Electric, Western Massachusetts Electric, Fitchburg Gas & Electric and Connecticut Light & Power and several munis. It's serving some default-service customers in Maine after winning a couple of PUC retail service auctions there. Competition has expanded Select's base throughout the Northeastern US.

Ofgem relaxes controls

marketer rules: UK gas and power regulator Ofgem is confident enough of market power control that it's removing some of the limits on marketers who are generators supplying themselves. Restrictions were built into the market rules to avoid giving generators too much market power to hurt the competitive retail market. Now a healthy generation market and supply make the rules ineffective, Ofgem claimed, since the regulator has better tools to relieve market power issues. The rules create a distortion in the market since they only apply to some vertically integrated utilities, Ofgem added.

Michigan latecomer lands big Ford deal:

Constellation NewEnergy may be new to Michigan's choice market but it kicked off its market entry with a big coup — an energy supply contract

let the market speak — while risking price spikes — to happen.

"The only way you can be where you don't need price caps is to have a viable market that lets competition and its benefits flow all the way through to even small customers," he observed.

"For the most part the price in Texas is determined bilaterally," he added.

But the ultimate retail price is determined by regulators who set the price to beat, we responded.

Yet another major flaw is that "regulators want to regulate," he said.

"People believed that regulators and politicians would let the market work," said Naeve, and we remember the public statements by policymakers that they would.

If it's cheaper to make fertilizer someplace where gas is cheap and then

ship it here, that's what should happen, Naeve advocates.

"That's the way the world works," he added.

Trying to protect a non-economic niche "is just stupid" and leads to "higher costs for us as a society."

Having "that model will cause a higher cost of capital for the generation that's ultimately built and for the utility who's kind of the middle-man," Naeve predicted.

Despite his pessimism about the wholesale power market, we expect to hear lots more about Naeve who is only 56 and too young to retire.

Naeve has talked at length with his twin brother Mike Naeve, the Washington attorney and former member of FERC (now at Skadden, Arps), about the prospects for generation.

Navy asks RI PUC why it has to pay extra

The US Navy asked the Rhode Island PUC for the same treatment regulators give nearby large commercial customers who pay less for electricity.

The Navy pays a rate set for it in 2000 that adds up to an extra \$1.4 million/year, it argued.

"I see this as an investment opportunity and not a subsidy," said Keith Stokes, executive director of the Newport County Chamber, told the PUC.

Narrangansett Electric objected to the lower price because the Navy is part of a

pact between the state and the utility that lowers rates more than \$13 million through the end of 2005.

Moving the Navy to the lower rate harms the utility and other customers, warned Narrangansett.

The Defense Dept hunt for bases to close may be a factor in the Navy's request.

The money for the Navy's proposed rate cut should come from Narrangansett shareholders, urged the George Wiley Center in Pawtucket, an anti-poverty group.

Fuel cell turns greenhouse gas-leak into money

FuelCell Energy imagines new \$1 billion industry

It's a first, said FuelCell Energy of Danbury, Conn, yesterday.

The firm dedicated what it believes to be the world's first fuel cell power plant to run on coal-mine methane gas.

That gas is about 42-47% methane and is a greenhouse gas that's vented from working mines and often escapes from abandoned ones.

Not any more at AEP Ohio Coal's abandoned Rose Valley Site in Hopedale, Ohio, about 60 miles west of Pittsburgh.

AEP hired Northwest Fuel Development to turn the mine into a

source of revenue (while protecting canaries).

The firm installed a 200-kw Direct FuelCell from FuelCell Energy. DOE's National Energy Technology Laboratory co-funded the project to help show off a win-win idea.

The plant turns 55,000-80,000 cfd of coalmine gas into power that Northwest Fuel sells to AEP.

US coal-mine methane emissions are thought to be 500 mcf/day, said FuelCell Energy.

That firm figured that if you put a fuel cell like theirs on every coal mine in the top six coal-mining countries you could generate 1,000 mw — 300 mw of it in the US.

At \$1,000/kw that's a \$1 billion market, FuelCell Energy mused.

Negative ratings agencies hold back gas drilling, supply

Jackson Mueller, the Redmond, Wash, energy advisor for large buyers, reminded us that the rig count has been rising in response to stronger gas prices.

But he expects drilling to rise early next year when the impact of the major

ratings companies negative findings has been turned around.

Those who drill are trying to use as much revenue as they can to pay down debt to improve the standing of their stock, Mueller said Tuesday. That eats

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with a Ford Motor subsidiary in southeast Michigan. Constellation supplies Ford plants in Illinois and Texas and reports that nationwide it serves 3,900 C&Is with 5,500 mw of peak load. Constellation picked up another 1,100 customers in Illinois and Wisconsin this week by buying Blackhawk Energy Services and Kaztex Energy Management from Wisconsin Energy. Blackhawk is a full-service retail power and gas provider in Illinois. Kaztex is a gas marketer in Wisconsin. Bringing those two into Constellation's fold raises its retail gas business to 250 bcf/year, the firm reported.

BPU's third auction

set for February: The New Jersey Board of Public Utilities (BPU) yesterday set February for its third auction for basic generation service. BPU plans to hold two simultaneous, multiple-round, descending-clock auctions, one for hourly priced service for C&I customers and another for fixed-price service for residential and small to medium-sized businesses. BPU hopes to get 2,460 mw in the hourly auction and 15,460 mw for fixed-price customers for delivery beginning in June. BPU modified the rules to let commercial customers take part in the auction for hourly energy on a voluntary basis.

FERC gives nod

to pipeline project: FERC yesterday gave Cheyenne Plains Gas Pipeline preliminary approval for a 380-mile project from northern Colorado to southwestern Kansas. The pipeline is expandable to meet future demand, FERC noted. Final approval depends on an environmental review. Public comments are due Nov 24.

Tongren hunts for shredded report:

Ohio Consumers' Counsel (OCC) Robert Tongren responded to the furor over his shredding of a consultant's report by ordering a search of computer files that could have remnants of the report (RT, 10/21). The report cost taxpayers \$579,000 and found FirstEnergy's stranded costs should be no more than \$4

into money available to explore for gas and will continue until the balance sheets are generally fixed.

Meanwhile the rig count has grown all year from about 700 in January to 951 recently we noticed in Reliant Energy Solutions' Marketanalysis edited by Paul Roberts.

That bodes well for supply and prices. Roberts noted the NYMEX Henry Hub closing at \$5.036/mmbtu Oct 17.

Looking at the November-October (2004) average price in NYMEX contracts

shows \$4.998.

Roberts cited the heating degree days so far are 17% below the 1971-2000 average and additions to gas inventories since May 23 have been at "a historic high."

A turn around in the economy would make producers more attractive too and step up the demand for gas, Mueller noted.

But how long does it take from the financial turnaround until projects pick up?

"Six months to two years," Mueller replied.

Hourly rates for NJ C&I cause shopping frenzy

Putting New Jersey's biggest customers on hourly rates worked like a charm in getting the market shopping, Bureau of Public Utilities (BPU) figures show (see table).

The new hourly default rates went into effect Aug 1 and almost two-thirds of load and nearly half the affected customers shopped.

A dozen suppliers are taking advantage of the chance to offer large industrials a better deal including fixed-rate contracts, said the Alliance for Retail Choice whose members Constellation NewEnergy, Strategic Energy, Direct Energy (Centrica) and Green Mountain Energy serve more than 9,000 mw of competitive load in 16 states and provinces.

"We previously saw suppliers racing after businesses but I think we're going to see businesses racing after retailers," said Arthur Maurice, first vice president of the New Jersey Business & Industry Assn.

Now major marketers are asking that more customers — 750 kw plus — be put on hourly default rates.

Everyone's rates changed Aug 1 in New Jersey when new prices tagged to the state's basic generation service auctions instead of low frozen rates went into effect.

Once customers see their bills at the new rates shopping could pick up even for those still on fixed default rates, Maurice pointed out.

New Jersey Large-Customer Shopping — Sept 1

	Customers Shopping			Load (mw)		
	Total	Customers Shopping	%	Total	Shopping	%
Conectiv	54	33	61.1%	280	138	49.3%
JCP&L	490	300	61.2%	670	472	70.4%
PSE&G	1,201	480	40.0%	1,514	1,013	66.9%
Rockland	21	10	47.6%	28	17	60.7%
Total	1,766	823	46.6%	2,492	1,641	65.9%

EnergyWindow lets big retailers bid for energy

EnergyWindow signed a deal with one of the biggest internet business-to-business procurement portals to offer energy supply.

It's one of several firms offering web-based bidding services for businesses' energy needs.

The Boulder, Colo, firm counts retailers such as Lowe's, TJ Maxx and Target among its customers.

Many are multi-site firms with outlets in several states who found patchy results from shopping depending on the state, EnergyWindow's president, Jack Mason, told RT earlier this year (RT, 2/20).

Its new partner WorldWide Retail Exchange (WWRE) has 64 members on five continents, such as huge retailer JC

Penney.

That firm uses EnergyWindow to get energy bids and to channel some of their purchases through the buying group.

Penney's and another WWRE member saved \$9 million by using EnergyWindow for energy buying, Mason said.

WWRE members are to use EnergyWindow's online request-for-bids system to buy gas and power until a system they can access through WWRE's online bid system is built.

EnergyWindow's products include a real-time, online energy market database, an energy management data system and energy supply consulting.

It's handled more than 2,000 large energy transactions since its doors opened in 1999.

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billion instead of the \$8.7 billion OKd for the owner of three Ohio utilities. The consultant, LaCapra, is to search its files too. The report covered other restructuring topics, too, and its contents kept under wraps until it disappeared.

Enron wind power

sold to Florida: FPL Energy agreed to buy 130 mw of wind power assets in California from Enron for \$80 million, the firms said yesterday.

Dairyland Power seeks plot for plant:

Cooperative is looking for land in Wisconsin or Iowa to build a \$400 million coal-fired power plant in 2006 or later. The co-op hopes to generate up to 550 mw.

Southern Pines eyes

gas storage: SG Resources Mississippi (Southern Pines) signed a bi-directional pipeline hook-up pact with Gulfstream Natural Gas and Transcontinental Gas Pipeline. The pipelines would support plans to build salt-cavern storage in Greene County, Miss, to be ready in 2005 to store 12 bcf with imported LNG in mind. Florida Gas Transmission and Destin Pipeline have signed on, too. Southern Pines has FERC's OK to build.

Poor shopping leads Ohio to extend rate-setting

The PUC has decided to delay until 2006 the end of regulated rates for medium and large C&Is in Monongahela Power's (Allegheny) territory.

Those rates were to end next year.

The PUC blamed disappointing results from an RFP for the post-transition market-based standard service offer (MBSSO) (RT, 8/29) and zero shopping or offers.

Mon Power's MBSSO RFP went out for wholesale rather than retail supply with the PUC's OK disappointing potential supplier Constellation Energy at thus foiling the chance to gain experience with customers (RT, 6/11).

Big customer Energizer — the bunny

with the drum — argued for the delay calling C&I demand too small and market development too immature to give customers viable choices (RT, 6/27).

The law calls for either 20% of the market to be shopping or viable competition to exist before utilities can end their transition rates.

The winning bid in a small field of responses — offered by the utility's affiliate Allegheny Energy Supply — “would result in significant rate boosts for large” C&Is, the PUC found.

Mon Power can ask again to end its transition period when it can show effective competition exists on its turf, the PUC said.

Ohio lets Dominion sweeten price-to-beat

Wrong again.

Ohio regulators are letting Dominion East Ohio (DEO) fine tune its gas price-to-beat after the time-tested formula yielded a gas cost recovery (GCR) rate the LDC thought too high.

Dominion asked to re-compute the rate based on historical averages rather than its actual costs in the market and expense of refilling depleted storage. Adding a 12-month versus three-month recovery of costs let it trim more than a buck off its rates leaving marketers to compete with a price to beat of \$8.

Energy America (Centrica) and

Volunteer Energy Services — gas marketers on DEO's turf — told the PUC that DEO's fine-tuned price to beat “fails to send the appropriate price signals” and “makes it difficult to explain to customers why a marketer's rate may be higher than DEO's rate during the heating season (RT, 10/17).”

The rate is to be in effect during this winter's peak heating season (RT, 10/2) and could damage the inroads marketers and governmental aggregators made when they took away over half of DEO's residential and almost half of its C&I customers.

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

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