Restructuring Issues for 2003

By Craig G. Goodman, President & CEO, National Energy Marketers Association (NEM)

After twenty five years of being directly engaged in deregulating and restructuring the US markets for liquid, liquefiable, gaseous and electrical energy, the multiple crises that have befallen this industry in the last eighteen months, in my opinion are unprecedented. In 2002, the wholesale marketers for natural gas and electricity have faced credit, liquidity, accounting, disclosure, pricing, and credibility crises (of enormous proportion). And yet, the industry has survived, albeit humbled, reorganised, wiser and far more cautious. It is critical that our country's wholesale markets are stable, reliable, liquid, transparent and financially credible. FERC is attempting to fully integrate the country's electricity grid and to establish uniform rules, trading hubs and operating processes, but time is of the essence.

In a very real sense the industry has returned to its basic strengths. Wholesale suppliers and traders are reducing debt, trading more around hard assets and implementing trading, risk management, credit and disclosure polices that will rebuild both investor and regulator confidence in the year(s) to come. None of these changes were optional - they were all mandatory – not by regulation, but by market forces. These forces extracted enormous penalties on those companies that were unprepared for both the volatility and downturn in energy prices plus the unexpected and widespread ripple effects of the failures of former giants within the industry.

Entering 2003, the market is reorganising, consolidating, trimming costs, restructuring debt, shoring up balance sheets, forming new business alliances and implementing business and accounting practices, procedures, codes of conduct and developing clearing, netting, and settlement solutions as well as reliable price indices that should return the industry to profitability within the next few years. But make no mistake, 2003 will be a pivotal, perhaps defining, year for both energy suppliers and consumers. By the end of the first quarter, world energy prices should have discounted the effects of Iraq's actions, and many if not most of the fallout from past business and accounting mistakes and failures should be obvious and hopefully behind us. Given the enormity of the stakes involved, a number of Federal and State actions can be expected in the year(s) ahead.

FEDERAL & WHOLESALE MARKET ISSUES

First, I firmly believe that the federal regulatory framework for a standardised, competitively neutral, liquid, transparent and price competitive wholesale energy market will be well on its way to implementation. Market oversight by the FERC as well as coordination with the CFTC, SEC and FTC will help restore both confidence in a competitive energy market as well as increased consumer and investor confidence in the surviving companies.

Second, tax and energy legislation will likely become two of the early issues for the 108th Congress. Regardless of whether Congress tackles the details of restructuring, one thing is abundantly clear, the US Supreme Court has clarified several vital issues that have heretofore slowed the restructuring of the wholesale electricity markets. There is no longer a legal question as to whether FERC has jurisdiction to implement a standard market design for interstate transmission and possibly also for delivery of electrical energy. When a regulated entity makes a sale of electricity that includes a bundled sale of transmission, the FERC clearly has jurisdiction over that transaction, possibly all the way down to the ultimate end-user. The only question that remains is whether 'energy politics' rather than 'energy economics' will force the FERC to build into its final market design - price or allocation controls that will ultimately produce less than economically efficient, energy production, transportation and delivery decisions as well as undermine competitively priced energy supplies to consumers.

The fears that remain from the California debacle, the Enron collapse, and ongoing investigations could produce anomalous sub-optimal results for both energy suppliers and consumers. NEM has strongly supported the direction that FERC has charted but concerns remain about the impacts and economic distortions that energy politics can extract.

To be clear, North America is blessed with abundant domestic supplies of natural gas and electricity. Natural gas producers respond quickly to higher prices and supplies can be brought to market quickly. However, generation investments are far more difficult to plan, capitalise, permit, interconnect and transport to market. The longer it takes to implement standardised contracts, electronic protocols and competitively neutral and liquid trading hubs and delivery points around which both financial and physical contracts for power can rely – the longer it will take for competitively priced power to reach the ultimate consumer.

Fortunately, there are enormous demand side, load shifting, conservation, distributed generation and other high tech solutions available to the marketplace immediately. But, without a reliable and standardised regulatory framework, processes, procedures, interconnections, data protocols and possibly even investment incentives, many of the technology investments that are needed will not be made.

In the interim before the final implementation of FERC's SMD rules, industry based efforts to restore stability, reliability, liquidity, transparency and financial credibility to the markets will continue in 2003. NEM has formed two new Policy Development Teams on Clearing, Netting and Settlement as well as Risk Management, Disclosure, Price Indices and FASB 133 Implementation. The Policy Teams are currently preparing recommendations for release in the early part of the year. Furthermore, the new financial products, services, clearing, netting and settlement solutions, energy price databases, electronic trading exchanges, accounting expertise as well as expert risk management consulting services and software development expertise provided by NEM members will be critical in addressing both the credit and liquidity crises currently facing our industry.

Lastly, America's transmission infrastructure is sorely in need of upgrading to meet the needs of a high-tech 21st century economy. And, given the financial crises facing the industry - the Federal government should develop a number of investment incentives to attract and lower the cost of capital necessary to implement improvements not only in added infrastructure and security, but to modernise the entire backbone and legacy systems that are currently in place. I fully expect tax incentives for investments in energy-related products, services, information and technologies to be introduced in the 108th Congress.

STATE – RETAIL ENERGY MARKET ISSUES

Twenty four states and D.C. have either enacted enabling legislation or issued regulatory orders to implement retail access. In 2002, numerous states began to develop unbundled rates for distribution, transmission and competitive products and services. Fully allocated embedded cost-based unbundled rates are the foundation for a Standard Competitive Retail Energy Market Design, and state commissions have determined such rates to be "just and reasonable." The quantification and implementation of unbundled rates for competitive products, services, information and technologies based on utilities' embedded costs will continue to be issues of vital importance in 2003 and beyond.

As many states are at or near the end of the deregulation transition period, the competition for and proper pricing of POLR services will also be a key issue. Some states have already implemented or plan to implement a competitive bidding process for POLR service. It is imperative to eliminate the cross-subsidies embedded in the rates for POLR services which currently penalise consumers who decide to buy competitively priced energy related services from NEM member companies.

NEM and its members will continue efforts to reform anti-competitive rules and practices that confront retail marketers in virtually every market that is opening to competition. It is hard to believe, but there are still basic operational issues like a marketer's ability to collect payments from customers in a timely fashion or to enroll customers on a cost-effective basis that continue to be debated. Also, POLR and bundled utility rates that penalise customers for switching by imposing extra stranded cost charges, exit fees, and other regulatory fees must be eliminated.

However, it is important that all stakeholders keep focused on the ultimate goal – that is to bring the lowest cost, competitively priced energy and related value added services and technologies to every US consumer. This is why the National Energy Marketers Association was founded and this is what its members have invested billions of dollars to accomplish.

NEM urge suppliers and consumers to contact our headquarters at T: +1 202-333-3288 or email us at:
E: info@energymarketers.com
to help us continue to help FERC, CFTC and State PUCs to develop and implement competitively neutral and competitively priced markets for both wholesale and retail energy related products, services information and technologies at the earliest possible time.