



A COMPARISON OF RESTRUCTURING in the NATURAL GAS & ELECTRICITY INDUSTRIES

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INTRODUCTION

- Gas industry restructuring commenced in the 1970's as a way of coping with major shortages of the commodity
- Power industry restructuring, though antecedents go back to the 1970's, really commenced in the 1990's as a way of reducing power bills
- In the gas industry, the only retail markets that were initially developed were the large industrial and large commercial markets
- This allowed time for wholesale markets and necessary infrastructures to develop
- In the power industry, all retail markets were opened simultaneously
- Wholesale power markets and infrastructures are yet in the infancy stages
- Insufficient or incomplete attention to wholesale markets is a major cause for the ineffectiveness of both power and gas competitive retail markets



A LITTLE BIT OF HISTORY

- As recently as the 1970's, both industries were characterized by the absence of markets and the dominance of monopolistic utilities
- In power, the monopolies were vertically integrated such that the four basic functions – production, transmission, distribution, and sales – were accomplished by one entity
- In gas, the functions were spread out among three different entities – gas producers, interstate pipelines, and local distribution utilities
- Federal regulation extended in gas to production and transmission, with state regulation covering distribution and sales
- Federal regulation in power only went to part of transmission (wholesale transactions), with the remaining functions subject to state regulation



GAS INDUSTRY RESTRUCTURING

- Though signs of gas shortages first appeared in the late 1960's, and wellhead gas prices were administratively increased during the 1970's, the NGPA of 1978 began the process of wellhead price decontrol
- Throughout the 1980's, the FERC changed the nature of the pipeline industry, in essence turning them into common carriers, as a result of unpredicted excess of gas, and the need to allow prices to fall
- The Henry Hub futures market was established in 1990
- With price transparency established, and the ability to transport gas on pipelines, a competitive retail market for industrial and commercial customers was established
- Many marketers got in the business in the 1980's and 1990's
- The creation of GISB helped create the necessary infrastructure through the establishment of standard business practices



GAS INDUSTRY RESTRUCTURING CONTINUED

- State legislatures began to restructure their gas utilities, and how gas is to be distributed and marketed
- Georgia: The All-at-one-Time model
- Ohio: When there's sufficient competition established, the utility can exit that particular function
- New York: Administrative restructuring on a utility by utility basis
- Pennsylvania: 1999 Legislation to allow all consumers the ability to choose among competing gas vendors



ELECTRICITY INDUSTRY RESTRUCTURING

- Antecedent – Ottertail Power Supreme Court Decision
- Antecedent -- PURPA of 1978, EPACT of 1990, and the creation of IPPs
- Antecedent – the evolution of power pools
- Though the FERC continued through the 1990's in rationalizing wholesale transmission, the impetus for power industry restructuring has come from the states
- California: the surprise of power demand; developing the wholesale markets; maybe wholesale-only is good enough
- Various states' legislative efforts (NY, the only one to restructure regulatorily) have not spawned competitive markets, though it appears that such a conclusion is arguable
- In PA, after an early "successful" start, interest has waned



ELECTRICITY INDUSTRY RESTRUCTURING CONTINUED

- The FERC's Standard Market Design as being perhaps good theory, way too prescriptive, and, as we're finding out, politically unacceptable
- We need to establish some rationality with regard to the geographic scope of RTOs.
- Managing large RTOs may be a technological challenge
- Marketers' ability to establish competitive positions is in part driven by the rulemaking process, a process at which they generally are not present



THE UTILITY INDUSTRY RESTRUCTURING PROCESS

- In states, the restructuring process is driven by the regulatory players
- The regulatory players are Commission staff, the OCA, and the OSBA, attorneys for the incumbent utilities, and – sometimes – representatives (or attorneys) from marketing entities
- The process is an adversary one, as is common in regulatory proceedings
- Even with statewide deregulation legislation, restructuring is more often than not accomplished one utility at a time
- “Deals” are cut among the regulatory players based upon expectations of coming competitive markets
- There are few opportunities to revisit those deals in the light of new information



THE ENERGY DEREGULATION TRAINWRECK

- First, there was California
- Then, there was the collapse of Enron
- Accusations of impropriety destroyed wholesale market trading
- The impact of 9/11 and our increased willingness to live with governmental inefficiencies (TSA)
- The comfort of rate caps
- Incumbent-driven regulatory procedures precluded, in part, the necessary proliferation of marketers
- Retail competition – in gas and power – is struggling, except for the historic industrial gas market, and there are signs that this market is contracting as well, though some might argue that GA in gas, and TX in power are doing well



ROOT CAUSE ANALYSIS – WHAT REALLY CAUSED THE TRAINWRECK?

- The inability to let go – state commissions are not convinced that markets protect consumers better than regulation
- Wholesale markets, in gas and power, are not yet functional
- These two root causes show the need for coordination between the FERC and state utility commissions



THE INABILITY TO LET GO

- Command & control regulation never did go away
- A chicken and egg syndrome – how to let markets work when there's scant evidence in the energy industry that they do work (aside from the industrial gas market)
- The centrality of the POLR concept, and the difficulties in coming up with a working model
- The regulatory players have vested interests in the maintenance of the current system
- After Enron, marketers didn't have the resources to be a regulatory player, so the rules were made by the incumbents



PARTIALLY FUNCTIONING WHOLESALE MARKETS

- Strong wholesale power markets are yet forming
- State commissions have not yet accepted the need for regional organizations
- PJM, the model at this point, is proposing an awfully broad geographical coverage
- Wholesale markets need traders
- In gas, though there's a decent wholesale commodity market, there isn't a wholesale capacity market, as pipelines are felt to possess too much market power



CONCLUSIONS

- It is difficult to conceive of putting the genie back in the bottle
- FERC is going to continue to push for its SMD, unless it is politically precluded from doing so
- Hence, in the power industry, there will be an independent generation section, transmission as a part of a large regional organization, and distribution in metropolitan and rural areas
- In gas, the FERC needs to complete its work on establishing a competitive capacity market
- The POLR concept needs to be developed at the state level
- In the foreseeable future, no state commission, or legislature, is going to advocate for or accelerate competitive electricity and gas markets, though residual efforts are ongoing
- Competitive retail markets for residential customers are a long way away