

Spike: A New Delinquent on the Electrical Scene. Who Sired Him?

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Reddy Kilowatt has a new, juvenile delinquent, possibly illegitimate brother, "Spike." Like a leading character on the TV cartooncom "South Park," his parentage is both uncertain and a matter of great speculation. Who bred Spike in '98? Will there be a proliferation? Since Linda Tripp could not get through to FERC Chairman Hoecker, there is no star witness, but merely a series of finger pointing accusations. Numerous deregulation-based commercial initiatives could be impacted: a matter of great significance to a variety of project privateer sponsors.

Whether the demise this year of the Schaefer deregulation bill on the Hill was the result of a certain nefarious non-gavel wielding Michigan Democrat (as the Republicans charged) or not, its Lazarus-potential quotient surely will be a function of the Spike Sire issue.

The deregulation legislation's godparents ELCON and the great industrial power users "know" who spawned Spike: it was large utilities that ignored their tight supply situation, and the absence of workable Midwest wholesale markets or any retail markets. The fix for this problem, then (drum roll please): accelerated deregulation of utility-owned generation, more independent system operators, and a wholesome (fatalistic?) tolerance of the fact that price spikes are a known risk of competitive markets. (Presumably, the industrials know whereof they speak, at least as it relates to them: for the first time since 1990, the retail rate for industrial consumers was considerably lower than the price IOUs paid for firm power.)

Perhaps deregulation is the answer. But in California, the first

Golconda of competition, the message from the ISOs is that slavish focus on deregulation may be a problematic conclusion. The California ISO sought and received from FERC the go-ahead to cap prices on ancillary services at any level and based on whatever factors it determined was necessary, in order to attract services into the market. The California ISO Board acknowledged that power price “caps” are not popular, but indicated that until it could learn why bids of such vast disparity had occurred during hot afternoon deliveries, it was an operational necessity.

How you feel about such caps on spikes, it seems, depends on whether you are the hammerer or the hammered. Dynegey announced that it may sue the California ISO for capping prices on ancillary services. In its view, that will prevent the market the opportunity to give correct price signals by functioning properly: the ISO should therefore stick to its reliability knitting.

Don’t tell either the ELCON or the Dynegey theory to the heat-waved—and economically burned—utilities. In blasting FERC’s “studied” response, the Chairman of Western Resources asserted his company had been subjected to price gouging: it had been forced to pay usurious rates because of its surviving public interest obligation to buy expensive marketplace power to serve traditional customers. He promised to visit the Justice Department. But, in deference to market principles, his proposed fix was to emulate the NYSE’s special rules for dealing with erratic markets, rather than the imposition of price caps.

Not even so moderate in their rhetoric were Democrat politicians such as Sen. Durbin and Congressman Dingell. They raised the gut issue: Are markets ready to make a smooth transition to full retail competition and, under the circumstances, should Congress pass legislation to compel States to adopt competition? Those embroiled in challenging proposed mega-mergers, like The Electric Clearinghouse, went further—challenging the AEP-CSW merger with alleged malfeasance via “hoarded capacity.” (To the delight of those of us condemned to follow power instead of Washington’s normal preoccupation, sex, merger opponents also managed to uncover trading tapes which needed to be saved as evidence in the proceedings.)

Of course, all of these competing allegations about Spike’s parentage may have more than a grain of truth. But then, obscure the still small voice of objective observations about the physical characteristics of the utility system on which the market is based, and the limits of any

system of regulation to mold it seem to get lost in the general hullaballoo. EIA's recent report, *Changing Structure of the Electric Power Industry Selected Issues 1998* highlights two of these:

- Opening generation to competition while keeping siting and licensing procedures for new power plants and transmission lines may limit the benefits of competition, i.e. facility owners could try to recover higher prices at times due to congestion on existing transmission lines.
- Not all utilities in each region are participating in ISOs, and this incomplete coverage may limit the gains expected in operating efficiency.

Moreover, as Robert McCullough suggests in *Public Utilities Fortnightly*: "Open access gives small bulk power suppliers an opportunity to obtain small amounts of capacity from larger-scale units. But this advantage is only as good as the availability of transmission and the success of OASIS."

(For all its market blood lust, Enron would seem to have a good awareness of this possibility too. It is challenging FERC's rules established to enable native load transmission providers ability to cut off transmission by other energy suppliers into or across its service territory whenever reliability is deemed to be challenged. Enron asserts that utility self-favoritism with respect to home-grown generation may have been a contributor to the Midwest summer's needle peaks.)

Finally, as a Justice Department official recently observed: Under Order 888, the transmission owner still has the ability to discriminate and it is very hard to structure meaningful remedies for time-sensitive transactions under those circumstances... "The Antitrust Division is skeptical about behavioral remedies such as those by FERC... to solve structural long-term, permanent anti-competitive effects of a merger." In short, deregulation without structural oversight may result in a Spike-spawning syndrome.

There is thus an emerging school of thought, transcending the self interested finger pointing, that something remains unsound in the way deregulation is being approached and implemented.

So, the question we all face is whether the squirt Spike is slated to grow up to be the bad seed whose behavior squelches future substantive

deregulation—including major Federal action? Or merely a troublesome tyke, highlighting for alert businessmen, as Enron has recently suggested, where the generation (note, not the transmission—construction) opportunities lie? The answer is obviously significant to private power developers because it affects the extent to which merchant plant receptive; national dispersed energy; and market share redistributive auction purchase strategies evolve.

It is reasonable to suspect that the ultimate answer will be political—reflecting far more the interest groups heard from in this summer's debate (among others) than the views of arguably petulant, self-seeking grid-fixated professorial analytic types. But it seems possible that one consequence of Spike's notoriety is that future debate will focus not just on supply shortage/price run-up scenarios, but on the deficiencies in transmission and regulatory transmission policy to respond in a timely manner to the stresses deregulation is placing on the system.

In other words, far from being a rambunctious toddler, Spike may really be an adolescent whose growing pain problems are systematic of on-going regional differential growth problems in dealing with deregulation.

It is important for private power developers to focus on these issues with these possibilities in mind, or the legislative/regulatory prospect at least in some venues, or it could, for private power developers, be "Spike Three, You're Out."