

restructuring TODAY

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New Paradigm sees more bankruptcy, strong survivors

Competitive telecoms who survive will emerge from the shakeout bigger and more aggressive than ever, says New Paradigm Resources Group (NPRG).

Many more players are to get pulled under as expected but the combination of more fleet-of-foot bankruptcy survivors, massive competitors and alternative access cable players will ensure the industry's survival and eventual prosperity, the group wrote.

About 40 such upstarts have declared bankruptcy since January of last year with a number of them folding entirely (Chapter 7) but the Chapter 11 reorganizations are emerging with restructured business plans, operations and management, says NPRG in Chicago.

The stronger ones are being re-capitalized and are re-entering markets with better networks and almost no debt.

"These are companies that will be able to stick to their plans to undercut incumbent prices, all the while sticking to their plans to become cash-flow and net-income positive within a reasonable timeframe," says NPRG.

It reports that new life can be pumped into CLECs such as Covad, ICG, McLeodUSA and XO.

Those re-capitalized CLECs can prolong the telecom depression by keeping excess capacity in the market at competitive prices, NPRG added.

With simplified plans, stronger operations and much better finances, these CLECs could do a better job of weathering the storm than their competitors, the consultants added.

NPRG cites the public's willingness to shop for local phone service from alternative sources even cable and broadband carriers or from traditional long distance servers.

AT&T for instance had \$16 billion in competitive voice, data and access revenue last year -- about 30% of the CLEC industry's \$53 billion in revenue.

That's equal to 5 million local access lines. As the industry's evolution snakes its way through the swamp of massive bankruptcies and constant uncertainty, "it is not going to die," NPRG predicted.

Roger Gale is back

Roger Gale, the energy forecaster, is heading a new firm he calls GF Energy (GF = gale force) in the nation's capital.

He had founded and run the Washington International Energy Group that he later sold to Hagler Bailly where he ran the energy consulting until it was merged into PA Consulting.

It was popular with Japanese utilities. He had lived in Japan for years. His specialty?

One is giving clients a heads up on where the industry is headed -- an even greater need now that the future is so unclear.

But unlike at WIEG he intends to customize the predicting to each client and not make it public -- "highly proprietary" because of the growing competitive nature of the industry.

"Timing will be everything," he predicted, with the first mover advantage out in front.

Typically where a company has a proposal it's weighing or a new product or is developing a new technology, GF will be hired to take an independent look at the idea and work up the numbers to guide the firm.

What is his team like?

Fifteen people, some in-house and some outsourced from firms where he has worked giving him the ability to do very detailed financial and technological reports.

Strategy is done in-house by his own team.

Where are markets headed?

"The consensus is that deep down underlying things, competition is still the driving force and will continue to be and it's an overall social policy plus.

What does he see?

Gale predicts a latent boom in mergers and acquisitions trying to break forth. He sees too many technologies on the verge of commercialization.

He's done a good bit of nuclear research and is intrigued at the potential for new nuclear generation orders in light of growing gas prices and demand.

Operation of the fleet since Three Mile Island shows the industry has learned how to run them, Gale said.

How will these trends play out in the world of the traditional, legacy utility? That's what he does.

A year ago unbundling generation and wires was a no brainer, Gale reminded us, yet today people are rebundling as a short-term solution to get financing.

His job is to tell "where do we go from here" on a fairly sophisticated basis (rgale@gfenergy.com).

What should power industry look like?

CAEM probes needs of this century

The Center for the Advancement of Energy Markets won the support of 50 stakeholders to look into the balance of this century to see what utilities are going to be like in the new world.

The forum of utilities, producers, marketers and others found after a year of exploring 170 issues to be resolved. The findings are called *The DISCO of the Future*.

They agreed that competition serves customers best and most cheaply but the barriers put up by creaky, old-fashioned regulation have crippled many markets at birth.

Regulator failures made restructuring natural gas painful, CAEM CEO Ken Malloy noted, even as it succeeded.

PG&E's bankruptcy is an indicator that the same pain will be repeated in the electricity sector, it was noted.

America was "largely unprepared for what was to come," Malloy noted, with "ubiquitous" confusion and disagreements over details.

Even as early as the mid-1970s Congress recognized the failure of traditional regulation to provide cheap energy and to avoid shortages -- hence the Natural Gas Policy Act of 1978, a grand step away from regulation.

Investment in energy infrastructure is not going to happen without "good government policy and progressive regulation," project Chairman Branko Terzic explained.

Terzic is a former FERC and Wisconsin PSC commissioner, former president of Yankee Gas Systems and now director of regulatory services for Deloitte & Touche.

To prove the point, Terzic cited a Deloitte survey of 170 industry executives that found the number one factor affecting their energy investment decisions in 2010 will still be government regulation.

Yet government regulation, he finds, has been fraught with mistakes in various state efforts to open markets nowhere with a more chilling impact than the setting of low default and provider-of-last-resort rates, he said.

The real fault in default rates, Terzic noted, is that they follow neither of the

traditional rate-setting models.

Default rates, he counseled, **don't meet a cost-of-service or market-based test.**

The fatal flaw in public policy was that commissioners wanted rates for everyone to be lower today rather than some time in the future, he added, reflecting how this intrusion "artificially handicapped" competitive markets from the start as many default rates were fixed as well as low.

QUOTE OF THE DAY: The nature of monopolies is not to introduce competition.

Branko Terzic at press conference presenting the CAEM report.

Several state regulators were active in the forum that produced the study, among them Chairman Angel Cartagena of the District of Columbia PSC.

Blaming regulators doesn't solve the problem, Malloy asserted. Who is helping state regulators take the next steps, Malloy asked, especially in the absence of federal leadership?

He was critical of our energy-savvy president from one of the most boldly competitive states — and "not a penny has been allocated to help states take care of this."

The position of the DC commission is to "forge ahead" in spite of California and Enron "because we believe very strongly that our citizens will benefit from competitive markets," Cartagena noted.

"Sometimes the strongest voices have to come from regulators who buy into a vision of competition," Cartagena vowed, adding that regulators need to overcome their reluctance — through fear or lack of courage — to "stay the course."

Commissions, he urged, need to address price issues with great care so real costs of providing services are reflected in rates and customers have true choices among levels of service.

He's referring to concepts like

interruptible service for residential customers at lower overall rates or with a credit each time service is interrupted.

Companies have done all the restructuring so far, Cartagena noted, and it's time agencies restructured so they can "get out of the way."

Regulators might do a better job if they work together more and there he sees a role for FERC by including state regulators in the commission's decision making.

FERC's new office of state relations was a good start in his view.

Favors regional entities:

Cartagena singled out the New Jersey-New York Port Authority as a good example of taking a regional approach or the Mid-Atlantic Conference of Regulatory Utility Commissioners, a group Cartagena is active in.

A CAEM forum committee led by John Howe, vice president at American Superconductor and a former chairman of the Massachusetts utility commission, looked at the role technology can play in boosting competition citing network-based industries being restructured worldwide.

Howe pointed to airlines, telecom and natural gas where each has relied on technology for innovation and infrastructure developments — airport runways, fiber optics and gas storage.

The overworked, inadequate grid, not generation scarcity, is responsible for highly volatile wholesale prices, Howe added.

Distribution companies?

The old-style hierarchical radial design utility won't support technologies that can multiply the value and efficiency of distributed energy or provide consumers with price signals they need to make energy choices in his view.

Old wires cripple demand management efforts such as central control of energy-hogging appliances like water heaters and central air during peak hours, he noted, citing demand

management as an example of many technologies not widely deployed in part because regulation has actually blocked wider acceptance.

Public understanding of these programs is low and public distrust has grown in his view.

The regulatory model, said Howe, needs to balance risks of competitive markets and allow solutions for metering and billing, on-site energy, power quality and new service offerings to be provided by the market.

"Utilities are struggling to figure out what business they're in," noted Jamie Wimberley, CAEM president.

One forum subgroup led by Steven Agresta, a Swidler & Berlin attorney, looked at risk profiles for new utility models.

This group had the most difficulty reaching a consensus.

Instead, it came up with an intellectual framework for a "continuum of structures" defined by the services they offer and the risks they take on.

The models ranged from pipes and wires or pipes, wires, metering and billing companies shouldering no supply risk to distribution companies offering supply or vertically integrated discos that own generation as well.

Depending on the model, regulators need to weigh options for workable competition or formerly regulated services, guarding against self-dealing through unregulated marketing affiliates and assuring that companies bearing the financial risks of supply are adequately compensated.

Those utilities that continue to manage supply need to have the ability to hedge their risk — a practice that is not allowed in many states.

Agresta cited the great expense of not hedging risk yet hedging has its own costs that need compensation.

Supply may be a passthrough item for utilities without generation but IOUs in California and Nevada found themselves in the financially risky position of being unable to recover supply costs.

Who manages the risk and can it be managed at all, Agresta asked, noting that the great debate of utilities has moved from the loss of economies of scope and scale to supply risk.

More important for regulators, how do you allocate risks between consumers and utilities and what level of risk is acceptable for consumers, he asked.

Regulators also are very sensitive to the fact that consumers hate volatility more than they hate high rates, Agresta noted. The full report of the CAEM

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forum is available free at www.caem.org.

"This needs to be under every regulator's Christmas tree early this year," Cartagena quipped.

Firm signs Atlantic

City casino: Marina Energy (South Jersey Gas) is to manage heating and cooling systems for Resorts International Hotel & Casino in Atlantic City. Under the 20-year deal, Marina will begin operating the chilled water systems and steam plant and work with DCO Energy to replace or improve the equipment.

Merging MISO-PJM-SPP moves on with or without AEP

AEP's decision to join PJM will have no impact on the timetable for the creation of a single marketplace covering the PJM, Midwest ISO (MISO) and SPP grids, planners contend.

AEP can join PJM, then come into the larger market when the three are fully integrated in 2005, the design group told reporters yesterday.

The ISOs have a joint project management office with staff from the three while subgroups are focusing on market participant readiness, the development of the locational marginal price model, financial transmission rights (FTRs) and technology issues.

One working group is building an interface market portal to allow PJM/MISO/SPP people to learn a common set of applications that will become the front end for the merged market.

Another group is exploring MISO/SPP rules for the real-time and day-ahead markets.

That group will try to learn over the next two weeks whether PJM rules should trump the others upon merging then be modified by what's good in MISO.

And could a firm like Enron do the kind of market manipulation it's been accused of in California?

No, replied a spokesman.

To him, the practices sounded like the exploitation of California ISO market rules.

PJM doesn't have anything like that, he added.

Concerted effort

cut demand in '01: The American Council for an Energy-Efficient Economy documents how reliability-

focused, demand-management programs in just three key regions — California, New York and the Pacific Northwest — last year reduced peak demand by more than 4,300 mw keeping the lights on. The report is available free at www.aceee.org/pubs/u021full.pdf.

DSM vs market thinking

People hear about air conditioning in Maine

Central Maine Power customers opening their bills this month find an ad with this headline:

"Can you believe it ... 90° in Maine on April 17th?"

CMP is using that record-breaking heat wave to push the merits of air conditioning, a technology considered a novelty in many Maine homes.

For just 63¢ a night, the stuffer says, everyone can get a good night's sleep and cope with health problems, such as asthma.

The sales job for air conditioning mirrors similar campaigns in past bill stuffers for electric grills, electric heat and additional outdoor and indoor lighting.

Kids can even get a free CD boom box for winning an essay entitled:

"What would your day be like without electricity?"

Environmental groups and some state lawmakers aren't so thrilled with efforts to boost power sales.

They're still back in the Carter years when commodity markets were young and corporate boards hadn't dictated sales gains.

CMP since 1983 has led heavily publicized efforts to cut electricity use.

The utility used ratepayer money with the blessing of the feds and state spending \$29 million a year to insulate water heaters and pipes and put in efficient lighting in factories.

But Maine today is one of the top four states in the CAEM red index and DSM is out the window.

State lawmakers thus decided to take away energy conservation programs from utilities and give the responsibility to the Maine PUC where the issue is to be politicized.

The new law says the PUC has to develop and carry out conservation programs that meet a variety of standards, including being cost effective.

Hearings are set for June and new

programs are to be up and running next year.

Interim programs, still run by CMP and the utilities, will continue until then.

Meanwhile the commission faces the thorny issue -- should it cut T&D rates? In part by letting CMP refund its pool of conservation money to ratepayers? Or should regulators keep more of the money, and use it for stronger, state-run conservation programs?

The public can meanwhile sort through the confusion.

Kansas town weighs broadband muni

The City of Chanute, Kan, has decided to take a hard look at setting up its own community broadband utility.

Businesses are saying they are at a competitive disadvantage because neither AOL Time Warner, the cable company, nor SBC, the phone company, have shown an interest in providing high-speed internet access to the town of 9,488 residents.

Five local internet service providers offer only dial-up speed access.

Schools, the community college, the city and others see a missed opportunity to share resources, software and expertise.

Thus when the City of Chanute power division decided to expand its fiber optic lines to new plants, forward-thinking city officials decided to include extra fiber for future expansions and the possibility of an additional service to the community.

Randy Riggs, Chanute's city manager told the annual meeting of the Kansas Municipal Utilities (KMU) in Wichita Kansas yesterday that the potential for a community broadband service may be warranted.

Consultant Virchow, Krause & Co of Madison, Wisc, was hired to help assess opportunities and risks.

Quanta ekes out income from outsourcing

John Colson runs Quanta Services of Houston, one of the largest US utility contractors, a firm that's made it through the telecom recession by picking up outsourcing contracts.

Utility outsourcing is up 14% in a down market.

Quanta reviewed five major utility outsourcing RFPs in the past two weeks

as gas and electric companies see big savings in today's harsh market.

His first quarter revenues are \$449 million, down from \$519 million a year earlier but utility work was up 53% versus 29% in last year's fourth quarter.

A multi-billion dollar deal may be announced soon, Colson hinted.

Quanta in Houston started from scratch just a few years ago, buying up 60 of the best US contractors who do utility work primarily in gas, electric, pipeline, CATV and telecom -- to capitalize on the wildly escalating fiber build in 2000. Colson forecasts the

telecom slump will go away by the second half of this year as the bad debt problem eases and acquisition of 30+ telecom contractors proceeds.

Its lead customers are telecom firms and utilities such as Entergy, Puget Sound Energy, Arizona Public Service and San Diego Gas & Electric.

Companies like AT&T -- formerly Quanta's biggest customer -- aren't doing any significant building, he added.

Worldcom, Sprint, Verizon, SBC, Qwest & AT&T have announced layoffs of 2,000 to 6,000 and the jobs that have to be done are being outsourced to highly

competitive bidding.

He figures capital spending is down by \$27 billion just in telecom.

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