HALF-MEASURES DIDN'T WORK FOR PERESTROIKA AND WON'T WORK FOR ELECTRIC DE-REG

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THE AES NewEnergy COMMERCIAL

- AES NewEnergy is the leading national competitive retail electricity provider.
- Usually positioned second to local utility affiliate
- AES-NE in IL,OH,NY,PA,NJ,MA,ME,TX,CA
- NewEnergy is affiliated with AES CILCO & IPL
- AES-NE is is offering first competitive voluntary curtailment products to reduce peak load.
- AES-NE manages supply risk for its customers.
- AES is a global power firm: 53,000 people, 58,000 MW, 18,000,000 distribution customers.
- AES unique values & methods apply well to retail: social responsibility, integrity, fairness & fun.

WHAT IS A FREE MARKET IN ELECTRICITY?

- Customers & providers can contract freely
- Entry and exit are reasonably open.
- Economic regulation limited to essential facilities and monopoly activities (delivery).
- Tying arrangements between delivery and commodity are prohibited.
- Stranded cost fees are structured to allow headroom for competition to develop.
- Opportunities to develop new commodity sources are not excessively limited.

HAS CALIFORNIA BEEN A FREE MARKET?

- CPUC continually interfered with contracting.
- The PX structure created a straightjacket that limited price hedging contracts.
- CPUC designed stranded cost fees to float relative to load factor, wiping out most savings potential.
- CPUC gave utilities excessive leeway in restricting and delaying market/customer relations.
- CPUC kept regulated retail rates below not only market prices and even below costs of production.
- Virtually no new power plants or gas pipeline capacity added in the past decade.

CALIFORNIA’S PERFECT STORM: BAD WEATHER

- “Half-measure” market only part of the problem.
- Regional reliance on hydro at risk from droughts.
- California’ heavy reliance on gas generation ran risks due to price volatility & delivery limits.
- Gas prices doubled & tripled in the US but in Calif. have been twice the national average.
- Regional seasonal exchange system collapsed.
- Reliance on generation in other states reached limits due to other Western states’ growth.
- Booming economy pushed demand and usage up.

CALIFORNIA'S PERFERCT STORM: DRUNKEN SAILORS

- Early 2000 San Diego storm warning was ignored.
- Utility requests for partial release from PX and for hedging flexibility were largely rejected.
- PG&E & SCE requests for an end to stranded cost charges to allow for market rates denied by CPUC
- Policy makers foolishly promised no rate increase.
- When generators starting bidding less than day ahead projected needs, ISO bought power at any price, thereby raised all prices to marginal cost.
- No action taken on new plants until recently.
- With utility credit ruined, State credit on the line.

HOW FREE IS THE ILLINOIS ELECTRIC MARKET?

- Customers and providers are not locked into excessive rigidity in contracting.
- Utilities vary in their use of market power and regulation to limit customers' competitive options.
- CTCs are volumetric and discriminate against high load factor customers but, on average, provide some competitive headroom & savings potential.
- New generation coming on-line despite problems of local opposition and permitting uncertainties.
- PPO tends to be underpriced due to miscalculation of off-peak prices and optionality values.

COMPETITIVE RESULTS: ILLINOIS v. CALIFORNIA

- In May 2000, 15% of total California load was on delivery service (1/3 over 500kW).
- Today, while Calif. delivery service load has shrunken to nearly zero due to crisis, ½ of ComEd large C&I and ¼ of small C&I load is on delivery services delivery service.
- California has suspended customer choice in order to assure recovery of billions in new stranded costs incurred by utilities and the state.
- Generators are off-line in the face of shortages because the financial system has collapsed.
- Customer choice and the credit system are in fair working order continue in Illinois

WHAT'S THE MIDWEST WEATHER REPORT?

- MAIN estimates 18% reserve for 2001
- Significant new (mainly gas) generation is being built and planned in Illinois by non-utilities (IPPs).
- Wisconsin considering WEPCO plans for new 2800 MW of generation – 60% coal.
- Coal and uranium prices may rise but unlikely to spike since delivery & storage constraints are few.
- Virtually no reliance on hydro and, while gas fuels most new generation, gas is still at the margins.
- There is still not an operating transmission organization and there are capacity bottlenecks.

THE MIDWEST: SAFE HARBOR OR SCYLLA & CHARYBDIS?

- In trying to avoid a Perfect Storm which basic conditions make nearly impossible, will the Midwest inadvertently induce shortage and higher than necessary prices than would full open access?
- Will aversion to adoption of retail open access in some Midwest states lead to commodity illiquidity and spotty generation development?
- Will regulators falter when asked raise rates to pay for plants in rates or allow rates to market prices?
- Will regulators exercise eminent domain powers for new essential facilities (wires and pipes)?

THE ICC IS NOW ASKING THE RIGHT QUESTIONS

- April 2001 ICC assessment report to the General Assembly is on the right track.
  - Why are there so a few competing suppliers?
  - Why is competition mainly in ComEd's area?
  - Is generation ownership too concentrated?
  - Is reliance on gas for new generation risky?
  - What will happen to prices in 2005?
- ICC starting to focus on tearing down competition barriers rather than erecting them.
- ICC is recognizing value of market monitoring.

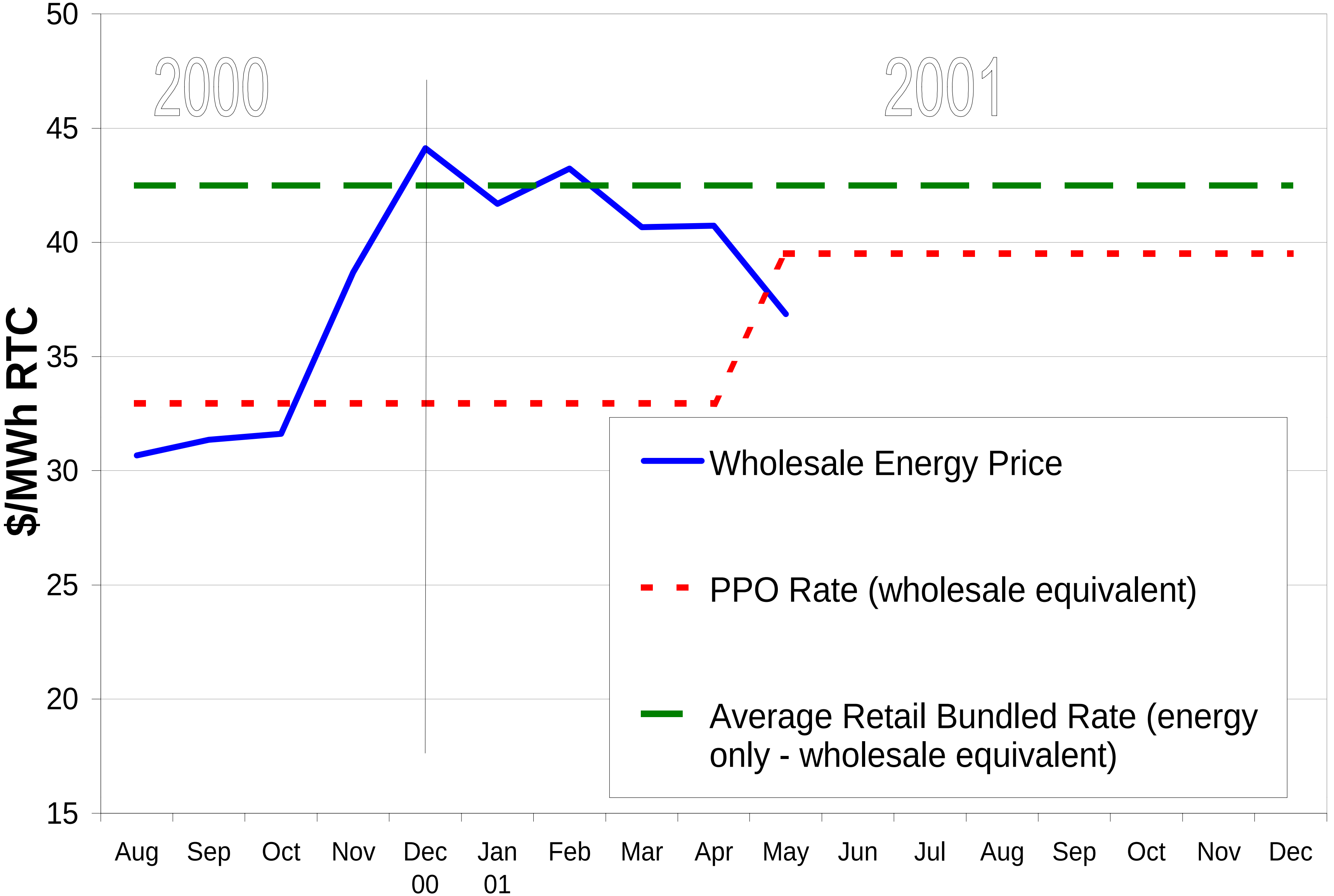
WHY SO FEW SUPPLIERS?

- There may not be enough business yet to sustain more than a handful of RES/ARES
- The PPO has 40% of the market and tends to undercut ability of RES/ARES to operate.
- Some national players are exiting retail.
- Illinois has some unnecessary entry barriers.
- Start-up is expensive and complex.
- The wholesale market is illiquid.
- Downstate competition will slowly develop as special utility contracts run their course.

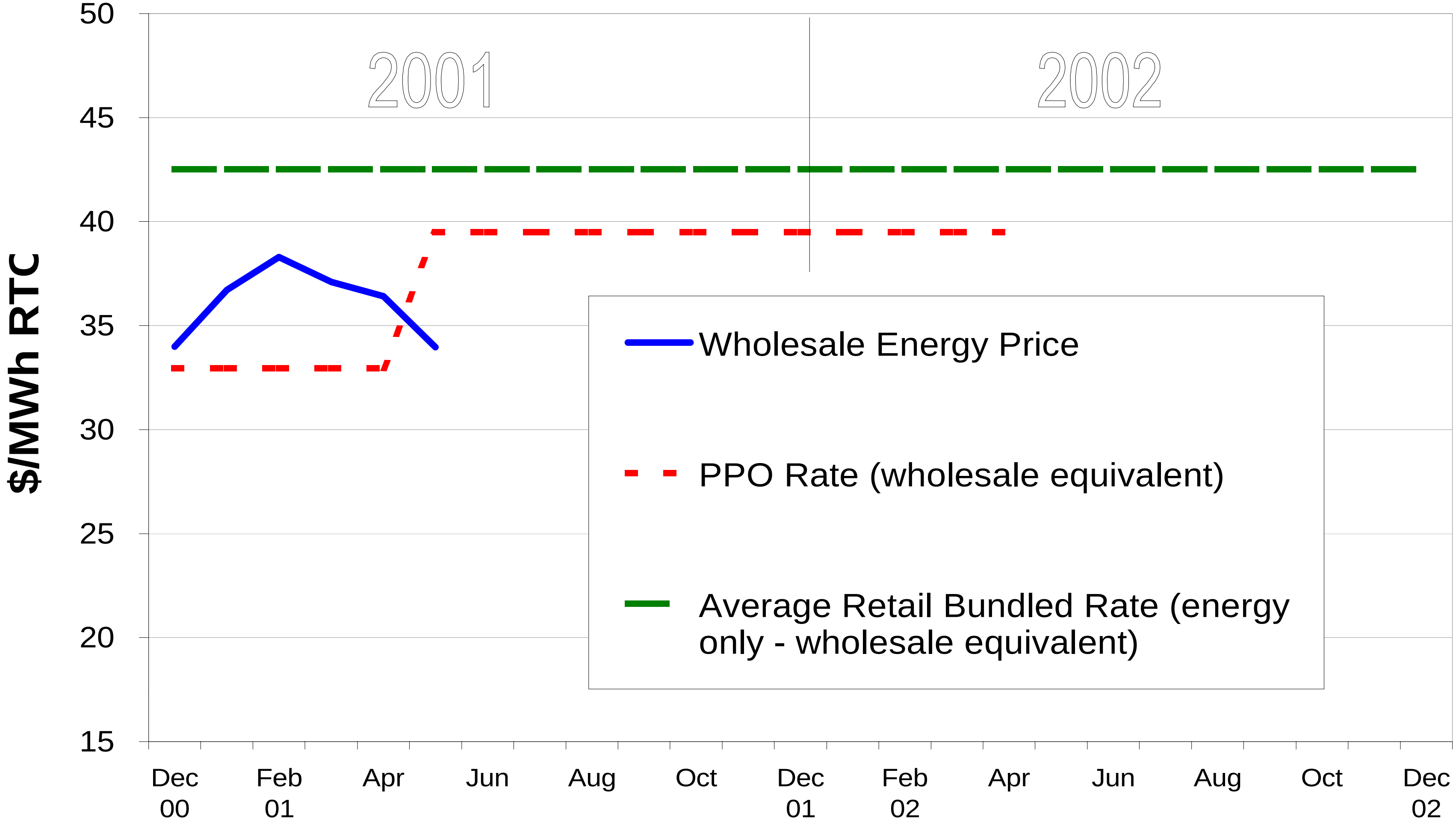
WHAT IS THE EFFECT OF SO MUCH CONCENTRATION OF GENERATION OWNERSHIP?

- The truth is that right now we do not know.
- Current concentration a direct result of the the de-reg law approach to restructuring.
- The only serious condition for transfers of assets to affiliates or sales to other parties were transition period power contracts.
- Current wholesale illiquidity makes it difficult to buy off-peak power and to serve longer term.
- More transmission and an operating RTO/ISO are necessary to mitigate generator market power.
- Bidding out residential load may help.

Wholesale Cal '01 Market - PPO Comparison



Wholesale Cal '02 Market - PPO Comparison



WILL GAS PRICES DRIVE UP ELECTRIC PRICES?

- After the first sustained gas price spike since 1983, users will hedge portfolios.
- There is evidence of new supplies coming.
- FERC certification of new pipelines will be easier than State siting of new transmission.
- Enviro concerns creating new gas markets.
- Lower emission limits will continue to cut against new coal plants but as baseload need develops there will be a place for coal.
- It is time for a serious discussion of nuclear.

PRICES POST-MANDATORY TRANSITION: 2005

- Electric prices have fallen against inflation for over a decade due to facts of surplus supply and low fuel costs and artifact of frontloaded regulated cost recovery.
- Electric prices are likely to rise against inflation for several years as supply comes into balance or is short, fuel prices reflect world Btu price & as value pricing emerges.
- ICC needs to start an education and preparation effort for approving post-transition provider of last resort rates, ending the PPO and accommodating new wholesale contracting & hedging.

WORDS OF WISDOM FROM THE WEST: Load Reduction

- "We reject the notion that companies must be paid to do the right thing - to reduce load on those days when electricity reserves become sparse." CPUC President Loretta Lynch 8/2/2000
- "Instead of paying exorbitant rates to out- of-state generators. I'd rather pay California consumers to conserve." Gov. Gray Davis 2/13/2001
- "It's questionable how residential people are going to benefit. Big businesses have meters and keep track of such things." Calif. Senate President Pro-Tem John Burton of San Francisco
- "By giving rebates, we will let individual consumers figure out the best way to conserve, rather than have big gov't programs." Sen. Jim Brulte

WORDS OF WISDOM FROM THE WEST: New Power Deals

- “We’re trying to stabilize prices. In the first two, three years, they will pay less, but in later years they may be paying a little more. I think that is a bargain most Californians would want.” Gov. Gray Davis 3/5/2001
- “A long-term strategy to address a short-run problem. It’s a very poorly conceived strategy.” UC economist Peter Navarro 3/5/2001
- “I don’t know what the price is going to be eight years from now. But all these yahoos who are so certain that the price will be below $60 don’t know either.” David Freeman.
- “Oh, No.” Michael Shames UCAN 3/5/2001

WORDS OF WISDOM FROM THE WEST: Regulation v. Competition

- “I think we’re way beyond regulation. I think it’s a hybrid of reregulation and public power.” Sen. Steve Peace 3/14/2001
- “Do I have a preference, long term, for a deregulated market over a regulated market? No, except I believe at least until we have a clear surplus of power over demand - and I mean 15% - there should be an active role by a public power authority that makes sure we build enough plants.”

  Gov. Gray Davis 3/14/2001
- “Believe me, if I wanted to raise rates I could have solved this problem in 20 minutes.” Gov. Gray Davis

WORDS OF WISDOM FROM THE WEST: “What Crisis?”

- “There is a shortage of electricity in this state. This is a fact. The general public doesn’t seem tp believe it., but it’ true.” David Freeman LADWP 3/19/2001
- “I guess it’s a big deal, because I sell sewing machines and I can’t show or repair either. We usually sell eight vacuums a day; today I sold two. So I’m down six vacuum sales.” Jerry Stephens SF 3/19/2001
- “We had blow dryers going. We were in mid-color on several clients. We had to send one woman out with wet hair. She wasn’t thrilled.” Beth Busbee LA 3/19/2001
- “It’s highly suspicious that we have so much capacity offline.” Loretta Lynch, CPUC President 3/19/2001
- “Our gas supplier cut us off because of nonpayment by PG&E. If we can get a creditworthy customer, our gas supplier will turn us back on.” Martin Quinn, Ridgewood Power 3/19/2001

WORDS OF WISDOM FROM THE WEST: Bankruptcy & Expropriation

- "I reject the irresponsible notion that we can afford to allow our major utilities to go bankrupt. Our fate is tied to their fate." Gov. Gray Davis, Jan. 8 2001
- "PG&E" was not pushed into bankruptcy, but plunged themselves into bankruptcy for their own strategic advantage – not the best interests of the people of California." Gov Gray Davis, April 6, 2001
- "Step One is to seize a few power plants. That would let (the generators) know we mean business." Senate Pres. Pro-Tem John Burton April 16, 2001.
- "We ought to levy an excess profits tax and if they (the generators) don't take their foot off our throat, seize a plant or two to sober them up." State Treasurer Phil Angelides April 16, 2001