**Comments of William P. Utt**
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**ELCON Workshop**
**New Orleans, Louisiana**
**June 21, 2005**

Thank you for that kind introduction. As mentioned earlier, I am also Chair of the Electric Power Supply Association. Also with me are John Shelk, President and CEO of EPSA, and Michael Sparks in Government and Regulatory Affairs at SENA. I appreciate the opportunity to visit with you and talk for a moment or two about competitive markets, things which we agree on, and maybe a few things we need to keep talking about.

My plan is to talk for a bit and then hopefully we'll have some substantial question and answer time.

Let's talk for a second about historical perspective. The electricity industry is not the first regulated industry to try to move from a more integrated, regulated industry structure to a restructured, market-based pricing environment. We are only the most recent of these travelers. And like our predecessors in trucking and airlines and telecommunications, the trajectory has not been a smooth curve. Rather, the process has been rife with fits and starts; moments of great progress and times of annoying stasis.

But in our case, as in the other cases, the momentum has always been forward. Mostly because the underlying idea was and is sound: competition works better for consumers than regulation. Competition works better for society than regulation. Competition means lower costs, faster introduction of technology – which, in our instance, means competition is better for the environment, and the proper allocation of risks and rewards.

Certainly, it was imperative for the utility industry to become better in order to better serve all customers, particularly those in the industrial sector for whom the cost of electricity is a major cost of doing business.

I have heard a lot of conversation in the last few years about the deficiencies of various aspects of the ongoing restructuring of the electricity industry. But I am still waiting to hear someone say that they want to go back to old days of cost-plus regulation. That is probably because the happy experiences of a rate-regulated regime are still in living memory. Base load power plant construction overruns? Ratepayer problem. Environmental mismanagement? Ratepayer problem. Technological backwardness? Ratepayer problem. Operating system inefficiencies? Ratepayer problem.

That's why I congratulate ELCON for being one of the first voices for competition. You realized early on that there was a potential for the electric power industry to be better.

We realized the same thing a little later.

And it is better than it was. Our assessments are completely deficient and wrong if we fail to recognize that. Every study I have seen indicates that competition saves consumers money. Everyone without exception. In fact, a new study on wholesale market operations in the Eastern interconnection, that will be released shortly, indicates that customers there saved more than 15 billion dollars from 1999 to 2003 as a result of competition in the wholesale power markets.

What can we learn from this history? Can we agree on any lessons learned?

I think we can, and before I get into that, I want to talk for a second about the world we live in now, about the terrain on which we find ourselves.

As everyone realizes, significant oversupply has depressed prices in wholesale markets now for a few years. That situation has been masked totally by the huge increases in natural gas prices, nationally, and in spot prices for eastern coal. As demand catches up with supply, those depressed prices and spark spreads will end eventually, but probably not for a few more years. Just as Socrates noted that only the dead have the end of war, we can be sure that we have not seen the end of the demand for new supply. The Nation will grow and it will need new power plants.

Meeting that demand is going to be complicated by the fact that everyone's planning horizon is vastly different than it used to be. I think most people – on both the demand and the supply side – now think in horizons of three years, rather a dozen or two dozen years. That comports with the compression of product cycles that has occurred more or less globally in the last few generations.

I think that excessive market and price mitigation in wholesale markets, along with oversupply, has removed price risk from retail loads. Industry participants can argue about the extent of that mitigation, and they can argue about the effect of it, but I am not sure that they can argue about the fact that it exists and has had an effect on market operations.

I think we are all struggling with how to pay for needed capacity and the need for load to hedge its short position. In the regulated world that preceded us, everyone paid for the price hedge through base rates that were ultimately passed through to consumers. That is a wildly inefficient way to arrange the world.

Finally, it is clear that generators are attempting to recover significant capital requirements in this depressed wholesale market. That poses some real challenges for us, and some odd optics for the industry. It seems to me that the high dollar per megawatt hour pricing is misleading in a couple of ways. First, old investor-owned utilities had plants with $10,000/MWh pricing buried in rate design. They were there, it just wasn't obvious. Second, it could be that brief, "needle peak" periods of triple-digit pricing are necessary because they allow for adequate capital recovery. Either way, such pricing is always a relatively short-term phenomenon in daily market operations.

With that as context, let's talk about a few things on which we can agree.

First, I think we all agree that we need to move forward toward more efficient and transparent competitive markets. I am not even sure that needs to be said, but in many instances we tend to lose sight of what is substantial and central and what is ancillary. The value and wisdom of competition is central. Issues within that context, while tremendously important, are just that – issues within that context. We need to keep our eyes on that ball.

Second, I think we can all agree that improvements and adjustments to market design, market rules and the infrastructure status quo need to be made. That, to me, seems to be an unremarkable comment. It is difficult to think of many things in our society that could not stand to be improved. For that matter, it is difficult to think of many things in any society, or even in any individual life, that could not stand to be improved. So, I think we agree that improvements need to be made.

Let's talk for a minute about specifics. ELCON is concerned about having access to bilateral contract options in the context of organized spot markets like PJM. We, too, are highly motivated to that end – if only for strengthening customer interface and financing capability. The problem, of course, is that when spot market prices are lower than contract prices – and supply is not a concern – the wholesale and large retail buyers will gravitate to that spot market. As yet, there hasn't been a self-correcting mechanism to reduce customer reliance on spot markets. However, I believe that as supply and demand move toward a proper balance, this phenomenon will cease to prevail day in and day out.

ELCON is also concerned about transmission infrastructure. So are we. It has become apparent that improved and additional transmission infrastructure will be necessary if markets are to realize their promise. Far from being mutually exclusive, competitive markets and improved reliability in the form of sufficient supply and additional transmission investment are actually mutually reinforcing. It also is obvious that some of the incumbent utilities will not hesitate to use their control over transmission systems as a weapon against potential competitors. We obviously need some sort of regulatory and policy approaches that both encourage – and perhaps compel – additional investments in transmission.

ELCON is concerned about RTO management and accountability. So are we. As best I understand, ELCON believes that RTO management needs to be more inclusive, responsive and accountable to transmission customers of all stripes. That is a goal we share.

ELCON is concerned about the regulatory friction between the states and the federal government. Just let me say that no one spends more time between that rock and hard place than the folks who work for me on these issues, so I completely agree that the friction needs to be reduced.

ELCON is concerned about market-based rate authority being more tightly controlled. We agree. We think FERC needs to be consistent – and as prompt as it can be -- in treating companies who have failed their market power screens.

Having said all this, I would like to mention a few areas where our thinking seems to diverge a bit.

First off, I am pretty sure that whatever wholesale price increases we have experienced are due to the increase in natural gas and coal prices, and not through market design. Very few market participants were talking about market design in 2001 when prices were low in the eastern United States. I am happy to admit that the market design may not be perfect – few things are – but I think we need to recognize that however high the prices may be now, they would be worse – probably considerably worse -- under the old regime. Because first, market design apportioned all risk to ratepayers and created a management that was indifferent to consumers; and second, competitive suppliers have absorbed some of the fuel price increases, rather than passing along the entire increase to retail customers. Think about it for a moment. How many utilities ever went bankrupt under cost of service rate structures? How many competitive generators? Say what you want about market design, at least it punishes incompetence.

Second, if one considers the fundamental, essential objectives, I think they would see that capacity markets and payments do not represent cost increases. They are simply different ways to pay for and incentivize investment. Capital costs will be recovered whether through fixed payments, or through costs in markets without caps. But if you have caps, and you don't allow for capacity markets, then companies can't build. Capacity markets and payments are a necessary and unfortunate response to price controls on energy. In the industry, we call those controls either price caps or the more euphemistic "market mitigation measures," but they are price controls.

Simply put, if you really believe in competition and free markets, we need to get rid of those price controls, capital needs to flow to where it can be put to best use – in economic terms to where it can make the most money. As long as the price controls stay, people will require some alternative way to recover their costs. However, in truth, price controls will remain a political reality for the foreseeable future, therefore we must, in practice, seek to minimize the impact of price caps in our markets.

Third, there is a lot of talk about locational marginal pricing. I don't think LMP provides the economic incentive to avoid long-term contracts, as some would suggest. If anything, I think that markets with price controls have removed the element of risk that encourages load to secure long-term contracts. If you know the supplier can only charge so much, what is the point of hedging? If the regulatory entity is going to limit your pain, why should you take steps to limit your pain? Again, I think LMP provides a better congestion management alternative than physical curtailment, as well as providing information to capital. In a well-functioning market, that sort of information is essential, and, over time, it will help normalize costs.

Let me finish with a few thoughts, and then we'll open the floor to questions.

First, I think we need to realize that there are more things – and more important things – on which we agree than on which we disagree. The value of competition, the central role of the customer, the need to apportion risk properly, the encouragement of technological innovation, and the realization of environmental improvements are all things that we realize the necessity of and strive together to achieve.

Second, there is no going back to the old model of command and control over customer needs. As Saint Paul wrote, "When I became a man, I put away the things of a child." So it is with us. There will be no reconstruction of the old regime. We must move forward.

Third, and finally, with respect to those issues under discussion, I think that it is important for us to listen to each other and understand that both parties must want and need for the other to be satisfied with the policy direction and market outcomes. We, as independent power producers, are heavily aware of ELCON and positions related to Regional Transmission Organizations, Energy-Only Markets, Demand Response and market Power Mitigation. These points are not on the surface, unreasonable; however, only through active and cooperative efforts on the part of organizations like ELCON, the Electric Power Supply Association, and others in and around the industry, can we achieve success on these issues. It will be only through this cooperation that we will succeed. After all, we cannot have well functioning electric markets without suppliers and consumers who each feel they receive fair value for the electricity bought or sold in the market.

Thank you again for inviting me.