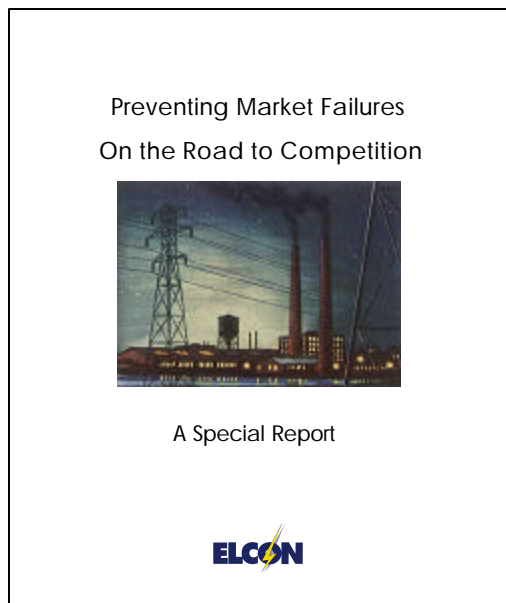




2001 ACCOMPLISHMENTS REPORT

ELCON RESPONDS TO CALIFORNIA CRISIS AND OTHER MARKET FAILURES

The sudden collapse of the California power market challenged the credibility of electric industry restructuring policies. ELCON responded by posting a timely analysis and chronology of the origins of the market failure on the organization's popular website.



ELCON staff also used their long-standing relationships with trade press journalists to ensure that the media's coverage of the crisis was balanced and factual.

Under the leadership of the ELCON Technical Committee, ELCON published in May 2001 a white paper, ***Preventing Market Failures On the Road to Competition***, targeted at regulators and other policy makers who were becoming increasingly skeptical of industry restructuring. The special report is a collection of short briefing papers on the causes of market failure in California and elsewhere, and recommendations on preventing market failures and ensuring that competitive markets are formed.

In April 2001, an early draft of the ELCON white paper was given to the staff of the **Federal Trade Commission** as part of their inquiry into the status of retail competition in the electric industry. The ELCON paper was extensively cited in the September 2001 FTC staff report, ***Competition and Consumer Protection Perspectives on Electric Regulatory Reform: Focus on Retail Competition***.

ELCON URGES NEW FUNCTION 9 FOR RTOs: "MAKE CUSTOMER LOAD RESPONSE A PART OF EVERY MARKET"

At the beginning of the year, ELCON retained Tabors Caramanis & Associates to define the parameters of a new, ninth RTO function, Customer Load Response (CLR). The objective is to require RTOs to establish markets for CLR—also known as **demand response**—on a comparable basis with the energy and capacity markets normally available to suppliers of generation. During the year, ELCON staff and ELCON members have met with each of the FERC commissioners and commission staff to promote the concept. The Commission, at ELCON urging, added demand response to the roster of measures included in FERC's orders attempting to mitigate price spikes in the Western markets. ELCON also recommended that the Commission host a technical conference on demand response. The FERC accepted the recommendation and the conference is scheduled for February 2002.

NEW FERC CHAIRMAN AGREES WITH ELCON THAT FEWER RTOs IS BETTER; ORDERS NORTHEAST & SOUTHEAST RTOs


One of the first policy shifts at **Federal Energy Regulatory Commission** (FERC) under the chairmanship of Pat Wood has been the abandonment of the "let a thousand flowers blossom" philosophy of RTO formation. Chairman Wood—like ELCON—believes that the fewest possible number of RTOs is the best way to ensure that large seamless regional markets are established. ELCON was the first national organization to recommend that RTOs should be established on an interconnection-wide basis—or at least the functional equivalent of an interconnection-wide transmission operator. That recommendation was first published in 1999 in ELCON's ***Profiles On Electricity Issues: Regional Transmission Organizations***.




The FERC policy shift was first applied in two orders in July directing mediation efforts for establishing two huge RTOs in the Northeast and Southeast. ELCON staff and counsel actively participated in all of the negotiating sessions during the six-week process.

THE RESPONSIBILITY OF ELCON IS TO HELP LOWER GENERATION AND DELIVERY COSTS

ELCON identifies key issues affecting generation and delivery costs and represents the interests of industrial power purchasers and cogenerators in the appropriate arena to ensure that these costs are minimized.

TYPE OF COST	ISSUES THAT AFFECT COST	WHERE ISSUE GETS RESOLVED
<p style="text-align: center;">DELIVERY COSTS</p>  <p>Before electric industry restructuring, transmission and distribution costs were combined with the generation commodity cost into a single, bundled rate. Now these costs are being unbundled and line-itemized on customer bills.</p> <p>Delivery costs include:</p> <ul style="list-style-type: none"> ▪ Transmission (OATT, OASIS and congestion costs) ▪ Distribution ▪ Ancillary services and energy balancing market ▪ Congestion management ▪ ISO/RTO uplift charges ▪ Transmission owner incentives 	<ul style="list-style-type: none"> ▪ RTOs (including Transcos and ITCs) ▪ Open Access Transmission Tariff (OATT) (e.g., network versus PTP services) ▪ OASIS ▪ Standards of Conduct ▪ “Native load” exemption ▪ Business and market interface practices (e.g., tagging and electronic scheduling) ▪ Reliability standards ▪ Locational pricing ▪ Congestion management (e.g., market redispatch, LMP, and TLR) ▪ Transmission rights (e.g., financial transmission rights or FTRs, financial congestion hedges or FCHs, physical transmission rights or flow rights) ▪ Auctions for transmission rights ▪ Secondary markets for transmission rights ▪ Markets for price-responsive loads (a.k.a., demand response) ▪ Functionalization of transmission and distribution facilities ▪ Incentive regulation (including PBR) ▪ Governance of reliability and commercial practices standards setting body (NERC & NAESB) ▪ Implementation of new NERC Control Area Criteria ▪ Multi-state siting compacts and other regional regulatory bodies ▪ Development of “merchant” transmission facilities and new technologies for maximizing throughput ▪ Cogenerator access to grid services and markets ▪ Capacity Benefit Margin (CBM) 	<ul style="list-style-type: none"> ▪ FERC - A new commission with an activist approach to industry restructuring has created unprecedented opportunities for ELCON to influence the agency’s policies and regulations for establishing competitive power markets. In 2002, a series on new rulemakings will be adjudicated on: <ul style="list-style-type: none"> B RTO Standard Market Design B New OATT B Standards of Conduct B Standardized Generator Interconnection Agreement B Market Power Screens and Mitigation Policies ▪ State PUCs - Many states continue to usurp control over transmission by refunctionalizing transmission as distribution, and adding “public benefit” charges to distribution rates. ELCON targets its policies and position papers at NARUC and state PUCs. ▪ NERC/NAESB - NERC and the new North American Energy Industry Standards Board are vying for the role to set standards for grid operation including business practices. ELCON represents the industrial perspective at each venue and advocate that only one organization be responsible for drafting North American reliability and business standards. ▪ Congress - Legislation will ultimately be necessary to resolve many jurisdictional problems in the marketplace. ELCON operates a full-time lobbying presence in Washington and on the Hill. ELCON staff monitors the progress of legislation, analyzes bills, and engages in coalition building to leverage its positions. ▪ RTO Collaborative Processes - Regional collaborative efforts require coordination by entities with a “national” perspective to ensure uniform market standards.

TYPE OF COST	ISSUES THAT AFFECT COST	WHERE ISSUE GETS RESOLVED
<p style="text-align: center;">GENERATION COSTS</p>  <p>Generation commodity costs are being completely deregulated and the “price” paid by consumers dictated wholly within the marketplace.</p> <p>ELCON is working to ensure that the markets for generation services are competitive and access to these markets is fair and nondiscriminatory for both buyers and sellers.</p>	<ul style="list-style-type: none"> ▪ Exercise of market power ▪ Market design for real-time energy markets (e.g., day-ahead & spot) ▪ Energy imbalances ▪ Liquidity of forward markets ▪ Markets for operating reserves (e.g., installed capacity markets or ICAP) ▪ Standardized generator interconnection agreement ▪ Market monitoring ▪ Market power mitigation policies ▪ Construction of new generating capacity (including siting issues) ▪ Fuel supply (e.g., natural gas supplies) and fuel diversity ▪ Viability of nuclear plants (including relicensing and waste disposal) ▪ Industrial cogeneration and distributed generation ▪ Industry consolidation/mergers ▪ Clean Air Regulations ▪ Environmental uncertainties 	<ul style="list-style-type: none"> ▪ FERC - FERC has limited jurisdiction over generation, but it does have the authority to allow market-based pricing of generation sales and to order interconnections. ELCON supports policies that eliminate or mitigate generator market power. ▪ Congress - The President has sponsored legislation to implement a new National Energy Plan—a plan with a strong emphasis on new energy supply resources. ELCON will continue to advocate federal legislation that ensures adequate supply of generating resources and fuel, and necessary infrastructure. ▪ FTC/DOJ - Restructuring is creating new corporate structures with both regulated and unregulated affiliates. ELCON supports full antitrust review of such entities to maintain consumer protections. ELCON staff will also maintain its close working relationships with the agencies’ staff on critical emerging issues. ▪ NRC and EPA - ELCON’s Washington base makes it easy to monitor and influence the policy-making process at these and other agencies on an as-needed basis.

ELCON Products & Services for Members

<p>MAJOR PUBLICATIONS & POSITION PAPERS:</p> <ul style="list-style-type: none"> ▪ <i>Preventing Market Failures On the Road to Competition</i> ▪ <i>Profiles on Electricity Issues: Regional Transmission Organizations (RTOs)</i> ▪ <i>Profiles on Electricity Issues: Eliminating Market Power in the Transition to Competition</i> ▪ <i>Profiles on Electricity Issues: Performance-Based Regulation</i> ▪ <i>Profiles on Electricity Issues: Competition Can Enhance Bulk-Power Reliability</i> ▪ <i>An End-User Guide to FERC’s Pro Forma Open-Access Transmission Tariff</i> ▪ <i>Bulk-Power Ancillary Services for Industrial Consumers</i> ▪ <i>Policy Choices for Electric-Utility Stranded Costs</i> <p>ELCON SERVICES ON-LINE:</p> <ul style="list-style-type: none"> ▪ www.elcon.org and the Members’ Homepage <p>FULL-TIME FEDERAL LOBBYING EFFORT, WASHINGTON UPDATES, COALITION BUILDING & ANALYSES OF MAJOR RESTRUCTURING BILLS</p>	<p>LEGAL INTERVENTIONS:</p> <ul style="list-style-type: none"> ▪ Interventions in All Major Rulemakings and Policy Inquiries; RTO Compliance Filings; and Other Proceedings with a Potential for Setting Major Policy Precedents ▪ ELCON has frequently defended its policies on constitutional grounds before U.S. Supreme Court ▪ Ten Issues of <i>Electricity Law Developments</i> report <p>MEMBER-ONLY WORKSHOPS:</p> <ul style="list-style-type: none"> ▪ Two to three workshops a year that focus on cutting edge technical issues and tools related to power procurement <p>NERC & NAESB REPRESENTATION:</p> <ul style="list-style-type: none"> ▪ ELCON staff and members represent the industrial perspective at standards setting bodies <p>THE ELCON SEMINAR:</p> <ul style="list-style-type: none"> ▪ For two decades, one of the industry’s premiere conferences on electricity issues <p>THE ELCON REPORT AND MEMO TO MEMBERS</p> <ul style="list-style-type: none"> ▪ Up to date communications to policy makers and members
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EFFORTS TO MOVE BAD FEDERAL LEGISLATION CONTINUE TO FAIL

Old guard utilities and advocates of states rights continued to pressure the 107th Congress to enact federal electricity legislation that would restrict the ability of the Federal Energy Regulatory to establish broad regional electricity markets. ELCON and its free-market allies worked for pro-competition legislation, and progress was made. Comprehensive electricity restructuring bills introduced in 2001 were more positive – or at least less negative – than those proposed previously.

IN THE HOUSE – After a series of hearings (ELCON testified three times) and draft bills, **Rep. Joe Barton** (R-TX), chairman of the House Energy & Air Quality Subcommittee, introduced a comprehensive bill (*HR 3406*) in early December. That bill is a vast improvement of the bill he authored two years ago (*HR 2944*), although it still reflects to some degree the states rights orientation of many Republican members of his Subcommittee. But with ELCON's strong support, the bill includes language directing FERC to establish large RTOs. Earlier, Barton was reluctant to support large RTOs and, although the new proposal is far from perfect, it reflects a trend in the House acknowledging the interstate nature of the electricity grid.

IN THE SENATE – ELCON efforts in the Senate met success in the bill introduced (*S 1766*) early in December by Majority Leader **Tom Daschle** (D-SD) and Energy Committee Chairman **Jeff Bingaman** (D-NM). ELCON worked with Bingaman—who spoke at ELCON's Seminar—and testified at Energy Committee hearings, urging that legislation not cut back on FERC's authority to create large, independent RTOs. From ELCON's perspective the bill is a vast improvement over many earlier proposals put forth in the Senate that would have restricted FERC authority in favor of State regulation. In addition, although the Senate Banking Committee approved legislation early in 2001 to repeal the Public Utility Holding Company Act, ELCON and allied groups succeeded in keeping the bill from being considered by the full Senate.

ELCON MEMBERS FILE AFFIVADITS ON ISO MARKET DESIGN FLAWS

In response to a pending new FERC rulemaking on RTO **Standard Market Design**, six ELCON members prepared and filed on November 26 detailed affidavits on selected market design flaws of the PJM ISO. With strong support from generators and marketers, the bid-based PJM market design is being considered as the “preferred platform” for the market design of other RTOs. FERC has committed to initiate a rulemaking in 2002 on the RTO Standard Market Design and has asked market participants and other interested parties for advanced input on threshold issues. Within days of the filing, senior FERC staff contacted ELCON staff to begin a dialogue on the problems and their solutions.

The affidavits were sponsored by: *Occidental Chemical Corporation, Ford Motor Company, International Paper Company, MG Industries Inc., Praxair, Inc., and BOC Gases*. In addition, other ELCON members endorsed the comments and affidavits: *Anheuser-Busch Companies, Inc., Bethlehem Steel, and Eastman Chemical Company*.

The PJM market was one of the first ISO-based markets to be established and, after several years of operation, a growing number of ELCON members are discovering inadequacies with

the original market design. These include the lack of liquidity in forward markets, the lack of meaning customer demand response in the short-term energy or capacity markets, and the mechanism used to establish the market clearing price in the day-ahead and spot markets. Developing workable solutions to these flaws and convincing FERC to consider them will be a major challenge to the organization in 2002.

ELCON DEFENDS RIGHTS OF INDUSTRIAL COGENERATORS IN TRANSITION MARKETS

In April 2001, ELCON intervened at FERC in support of 14 **PURPA** qualifying facilities (QFs) in Texas that were at risk of losing their PURPA rights—including mandatory purchase obligation—because the state had adopted retail competition. PURPA is a federal law enacted in 1978 that prohibits utilities from discriminating against on-site industrial cogeneration. Since enactment, ELCON has consistently defended these hard-won statutory rights in various judicial or regulatory challenges to the law. The Public Utility Commission of Texas (PUCT) filed a petition with FERC (*Docket No. EL01-60*) to waive the rules under PURPA that require public utilities to buy power from QFs. The PUCT claimed that the state's restructuring law supplants those requirements. ELCON argued that “unless and until Congress repeals PURPA protections, Texas utilities must continue to purchase QF power.” In a major victory for ELCON and industrial cogenerators, FERC denied the Texas Commission's request for waiver in a May 2001 order. In July, the Commission summarily denied the PUCT's request for rehearing in a one-sentence order, thereby reaffirming the historic May decision.

NERC BOARD OF TRUSTEES ADOPTS ELCON RECOMMENDATIONS TO EMBRACE NEW INDUSTRY STRUCTURE

In September 2001, ELCON recommended to the Board of Trustees of the **North American Electric Reliability Council** (NERC) that NERC adopt a series of measures that would make the organization more responsive to a new competitive electric industry. Since ELCON members and staff began participating in NERC in 1997, ELCON has actively promoted reforms at NERC to eliminate its “country club” utility mindset. Under intense pressure from ELCON and other market participants and policy makers, NERC has diversified the representation on its standing committees, but ultimate governance—and control—of the organization remained with large transmission owners or the regional councils. NERC is also being challenged by a new organization created by the **Gas Industry Standards Board** (GISB) that seeks to be the sole industry standards body for reliability and commercial practices.



At its October meeting, the NERC Board approved the following recommendations that ELCON deems as pre-conditions to NERC becoming the single industry venue for the development of reliability standards and commercial practices: (1) requirements that all NERC security coordinators be independent of any wholesale or retail merchant businesses; (2) certain market interface principles that ensure that reliability standards do not unduly interfere with market operation; (3) a new organization standards process based on the widely used ANSI standards; and (4) the adoption of standing committee voting procedures based on balanced representation of stakeholder sectors, including end-use customers. ■