

ARE OPEN MARKETS THE ANSWER?

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It depends ... on your perspective

- ❑ Many shareowners or executives of formerly-regulated companies, and other “proponents of open markets”, **secretly long** for “the good ole days” of regulated returns and a simpler life! ...
- ❑ Critics love to point out problems experienced with open markets, particularly during periods of restructuring ... because open markets are messy and confusing.
- ❑ Others point to reduction of service quality, general frustrations, and price spikes as reasons why open markets are a failure ... including other industries ...
 - Airlines (have you flown lately ... and how much did YOU pay?)
 - Telecom (telemarketer calls, slamming, etc.)
 - Financial Services (a dizzying array of options, new charges, less personalized touch, etc.)

Many Enjoyed the Benefits of Regulated Markets

- ❑ Generally steady, consistent, predictable prices ... that escalated over time as new investments were made.
- ❑ Centralized planning, reduced the need for many customers to be responsible for their own energy strategy or plans.
- ❑ Providers were rewarded for meeting prescribed levels of service.
- ❑ Less confusion existed over who was responsible for addressing a variety of issues (one-stop convenience).
- ❑ Protection of smaller or less fortunate consumers was built-into the system.
- ❑ Stability of service providers – no need for customers to evaluate multiple suppliers.
- ❑ No phone calls during supper asking you to switch service providers.

By Comparison, Open Markets

❑ Are Messy

- Lack of centralized planning.
- Lack of clearly defined “service territories”.
- New competitors enter and exit markets.
- Competitors decide what levels of service to provide ... based on what they perceive customers value and are willing to pay for.
- Buyer be ware ... aggressive, sometimes confusing messages and business practices ... tough to sort out.

❑ Are Unpredictable

- New competitive entrants without well defined track records.
- Pricing of products and services done through bilateral negotiations, doesn't necessarily reflect “costs”.

Open Markets ...

❑ Are Unforgiving

- Expose weak players.
- Can cause financial hardships or bankruptcy to those who make poor decisions.
 - Suppliers or customers

❑ Are Volatile

- Without the built-in dampening effect of regulated prices, markets react swiftly to short-term aberrations in supply and demand.
- Prices reflect the impact of changes to related products and inputs (e.g. natural gas serves as a proxy for electricity prices and is becoming a key variable in marginal production).

❑ Create Winners & Losers

- Industry in 2003 looks much different from the energy industry of 1998 ...

BUT ... Open Markets Provide Significant Benefits

- ❑ Generally result in lower prices for end-user consumers.
- ❑ New competitors create new products and services.
- ❑ Encourage the development or substitution of new products or services.
- ❑ Provide better market signals of supply and demand to drive behavioral choices (high prices drive investment and lead to stabilization and longer term lowering of prices).
- ❑ Rewards accrue to those who invest the time and effort to get information and use intelligence (risk management).
- ❑ Ability to manage more effectively (large scale retailers can reduce costs of managing a variety of different utility services).

Open Markets ...

- ❑ Can work and should work ... in tandem with regulation.

- ❑ Because they are messy, it takes courage, conviction, and true leadership by regulators to encourage open markets.

- ❑ Regulations should focus on:
 - Safety
 - Reliability
 - Environmental Protection
 - Consumer Protection

Some Good Things & Lessons Learned

- ❑ Open Markets transfer many of the risks away from customers/ratepayers onto the backs of suppliers
 - Contrast the financial hit absorbed by power generation/marketing companies over past 2 years (open market driven) to the past hits ratepayers took from overly ambitious build programs of utilities.
- ❑ As a merchant generator/marketing company, the key to survival and success is “drive costs out of the system” ... to be able to compete in a low-cost environment.
- ❑ Use of technology to improve service and lower costs.
- ❑ With real price signals, customers may alter their buying behavior (or, if not, then it’s clearly not as important to them as some other attribute).
- ❑ Smaller, more nimble plants are better than gigantic central power stations.
- ❑ Suppliers can select markets and deliver what they perceive as value - not the old rule of make it and they’ll beat a path to your door.

Consumer Benefits from Other Industries

☐ Airlines

- More people travel today than in years past & fares are generally, substantially lower.
- Technology has improved (not only aircraft, but related services – check the status of aircraft).

☐ Telecom

- Cellular Services – replacing traditional land-lines and increasing convenience and security, caller ID, three way calling.

☐ Financial Services

- Additional products to manage a variety of risk profiles and levels of involvement.

☐ Energy Sector

- New risk management tools, borrowed from financial industry, to manage a variety of risks and objectives.

So, Are Open Markets the Answer?

- I believe, yes, they are ... in tandem with strong regulatory agencies who focus on safety, reliability, environment, health, and licensing/certification.