Is Transmission an Enabler or a Competitor?

Massachusetts Restructuring Roundtable

Boston, MA

February 9, 2007

José A. Rotger

Energy Security Analysis Inc.

ESAI

Enabler or Competitor?

- Is the design, financing, construction, ownership and operation of transmission networks a natural monopoly?

Is Transmission a Natural Monopoly?

- YES!
  - Lumpiness of investment
  - Unintended (loop) flows and AC issues
  - Benefits are diffuse; beneficiaries hard to identify
  - Not a substitute for generation
  - Benefits of overbuilding far outweigh costs
- NO!
  - Technology addresses lumpiness and unintended flow issues
  - It is a substitute for generation & demand resources
  - No different than other networks
  - Can identify beneficiaries and make them pay

ESAI

Enabler or Competitor?

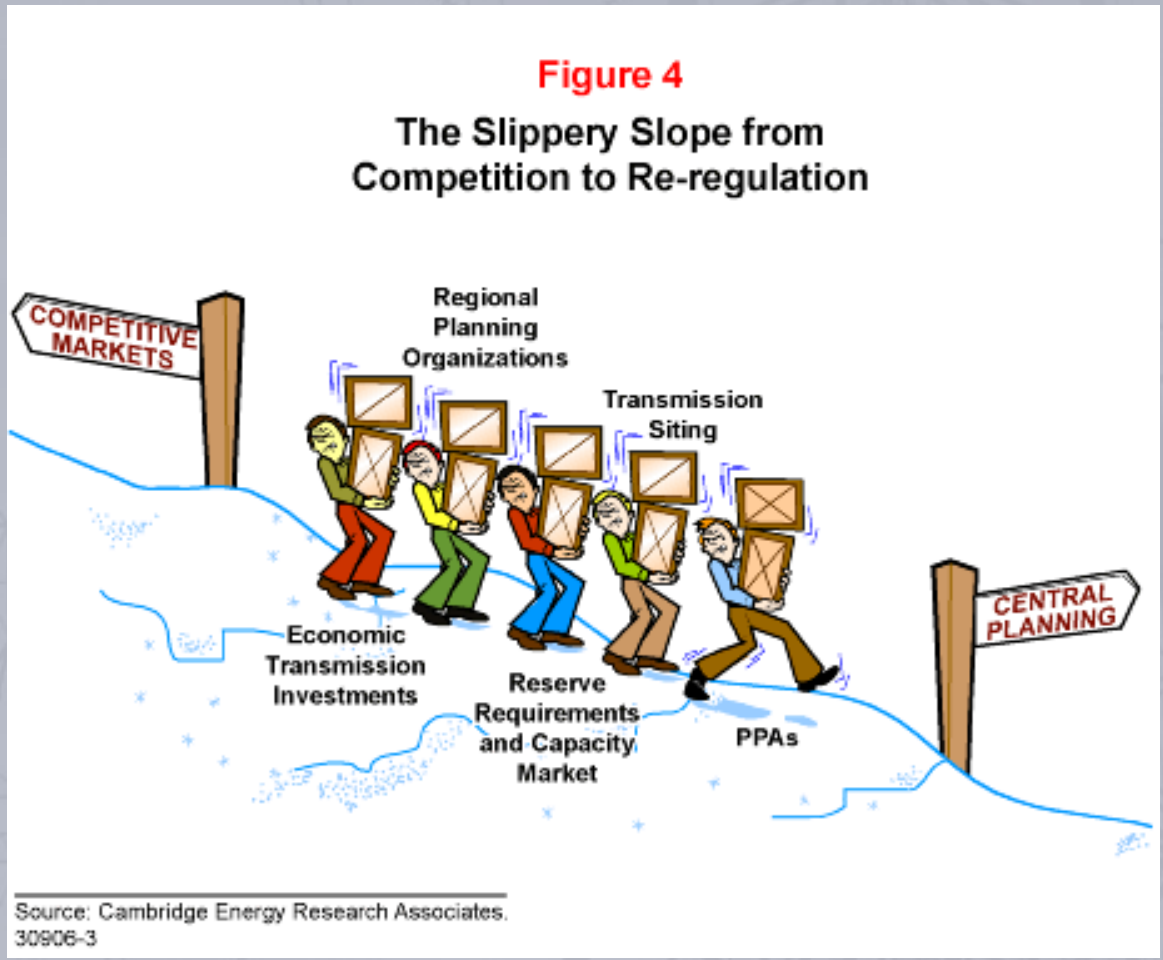
- As usual, the truth is somewhere in between
- Transmission is both a market participant (a resource) and a facilitator of competitive markets for resource procurement
- But, for practical purposes, current policy choices have answered the question

The Practical Reality

- Retreat from competitive market mechanisms effectively dictates the policy choice
  - Political intolerance of market outcomes
  - Regulatory flip-flops create too much uncertainty for investors
  - Push for activist central planning for both reliability and economics / market efficiency
  - Continued erosion of 'beneficiary pays' model towards socialization
  - Resistance to competitive solicitation for new transmission builds

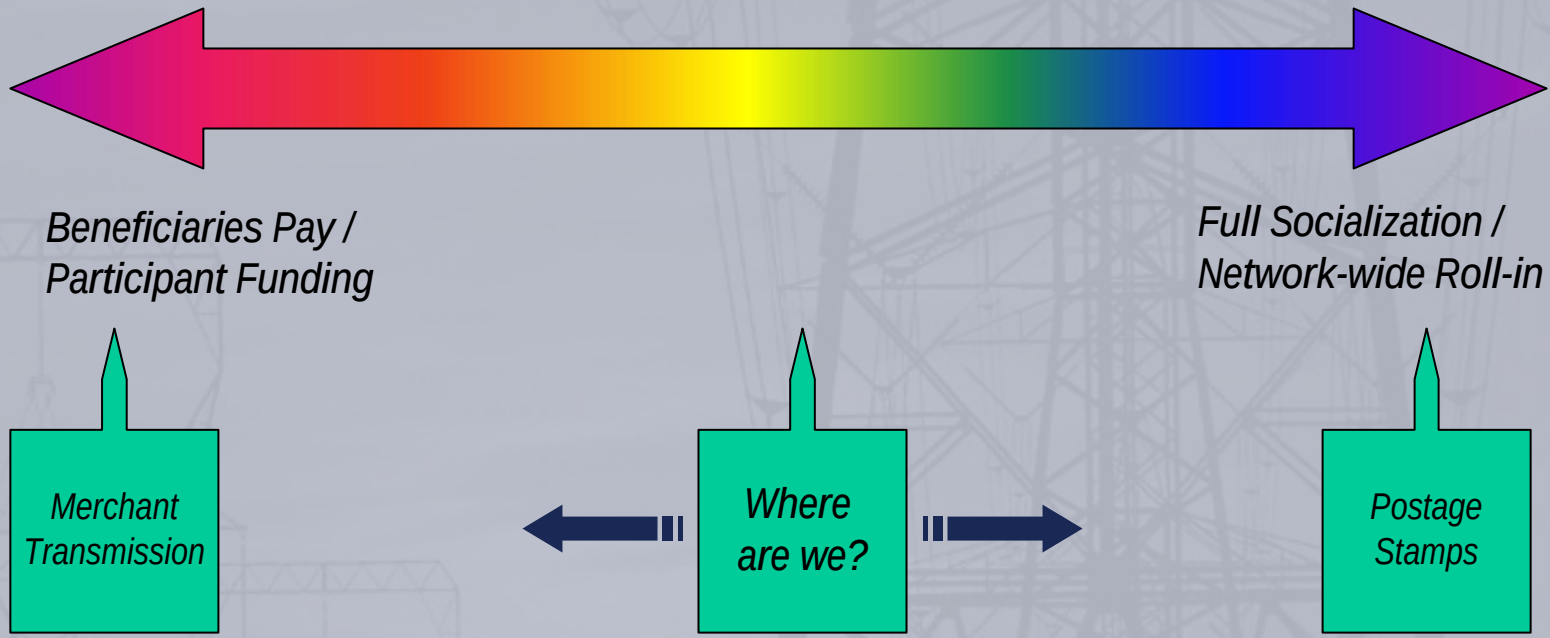
- The result: planning and resource procurement policies premised on transmission as an enabler of competitive generation markets

We're well down the slippery slope…



It's who pays

The Transmission Cost Allocation Spectrum



ESAI

Cost recovery is key

- Where you sit on the ‘spectrum’ determines where you stand on the debate
- The policy pendulum has swung away from ‘beneficiary pays’ (transmission as a resource) to ‘roll it in’ (transmission an enabler)
  - FERC’s SMD is dead and buried
  - Success of New England transmission build-out
  - AEP advocating postage stamps in PJM
  - Renewable trunklines (a so-called “third” category)

Conclusions

- Intentionally or not, we have a chosen an enabler role for transmission
  - The mix of socialization, economic planning, political intolerance of market outcomes, and virtually no RFPs for new transmission investment has effectively killed the market-based model for transmission investment
- Whether new entrants can build transmission on a socialized basis remains to be seen
- Lesson to Distributed Generation: recognize the policy swing and use it to your advantage

Thanks, and a Disclaimer

- The content and opinions in this presentation are solely my own and do not necessarily represent the views or opinions of ESAI or any of its clients.

- Contact info:

jrotger@ESAI.com; (781) 245-2036