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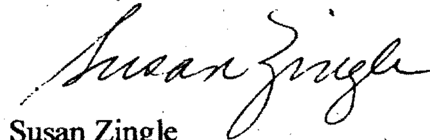
October 12, 2000

Dorothy Gunn, Clerk
Illinois Pollution Control Board
100 West Randolph St.
Suite 11-503
Chicago, IL

Dear Ms. Gunn:

At last week's "peaker" plant inquiry hearings in Springfield, I was asked to provide the date of the article that included the map "The Status of U.S. Electricity Deregulation." It originally appeared in the Wall Street Journal on August 14, 2000. A copy is enclosed.

Sincerely,



Susan Zingle
Executive Director

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World-Wide
Asia
Europe
The Americas
Economy
Earnings Focus
Politics & Policy

Editorial Page
Leisure & Arts
Voices

Weekend Journal.

WSJ.com Audio:
Business Update
Markets Recap
WSJ on Audible
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Journal Atlas:
Table of Contents
Headlines
Business Index
Search
News Search
Past Editions
Briefing Books
Quotes

Resources:

XTREME SUCCESS: WICKEDLY LOYAL CUSTOMERS

August 14, 2000

Volatile Electricity Market Forces Firms To Find Ways to Cut Energy Expenses

By JONATHAN FRIEDLAND
Staff Reporter of THE WALL STREET JOURNAL

Southern California's electricity woes are sending a jolt of anxiety through corporate suites nationwide, underscoring how important smart energy management is becoming in an era of deregulation.

Over the past few weeks, several of the 24 states that began opening their electricity markets to competition in 1996 have been struck by extreme price volatility and, in some cases, power shortages. At work is a combination of factors: higher-than-expected demand, fewer new generating plants than necessary to keep up with it and an interstate transmission network that wasn't built for a deregulated world. Complicating matters is the chaotic jigsaw of rules and regulations governing the transition from fixed to free pricing across the nation.

Nowhere has the situation been more critical than in the San Diego region, the first area of the country where retail electricity prices have been dictated solely by market forces. Consumers there have seen their bills double, setting off a political firestorm and causing legislators and regulators to scramble for ways to mediate the pain. Last week, a half-dozen plans were floated for rolling back rates, though none of them seriously confronted the key question of who would end up footing the bill for the difference between wholesale market prices and those paid by the newly protected user.

Heating Bills Could Swell as Much as 50% This Winter

Peco Energy Agrees to Purchase Assets From Sithe Energies for $682 Million

* * *

California Senate Clears Bill That Will Curb Power Costs (Aug. 11)

California's Governor Orders Regulators to Slash Electric Rates in Southern Areas (Aug.

Working Out the Kinks

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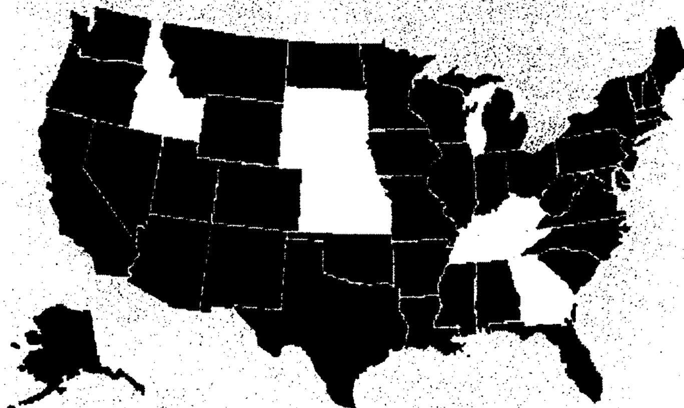
Corrections

San Diego's woes -- as well as less acute problems in the Northwest and Northeast of the country -- have driven home to corporate America that it is going to take awhile -- perhaps three to five years -- to work the kinks out of the nation's new electricity regime. "Word has spread around the country," says Dennis three to five years -- to work the kinks out of the nation's new electricity regime. "Word has spread around the country," says Dennis Moran, energy commodity team leader for hotel management company Marriott International Inc. "It's been such a shock."

It is a shock that is causing many to question their main assumption about deregulation -- that competition among power providers would lead to cheaper prices and greater efficiencies. And, as such, it is intensifying their search for solutions that will protect and, in the best of worlds, even enhance their bottom-line performance.



Those solutions range from the simple -- like turning down the air conditioning in offices and convenience stores -- to the highly sophisticated -- such as long-term contracts with energy wholesalers that include performance incentives and a complex array of hedging options. Although many companies give energy planning a higher priority nowadays, lots of them -- including some very big ones -- are still very much in the midst of figuring out the optimal combination for their needs.

"We've been in a robust economy where the primary focus has been on growing the top line, not on controlling expenses," says Craig Sieben, president of Chicago-based energy consultants Sieben Energy Associates LLC, which counts among its clients Starwood Hotels & Resorts, Lucent Technologies and Aimco, a real-estate investment

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trust that owns thousands of apartment units. "We're pretty amazed at how few firms have a comprehensive energy strategy," he adds.

That is changing fast -- particularly for big energy users, which run the gamut from classic Old Economy companies like Kaiser Aluminum Ltd. to such New Economy stalwarts as chip maker Intel Corp. They are throwing more executives into the task of strategy design or are hiring outside consultants. They are all trying -- in many cases through trial and error -- to select from a smorgasbord of measures to limit disruptions and damp the impact of higher prices.

Intel's Strategy

Intel is a good case in point. It uses a huge amount of juice to keep its highly automated, temperature and humidity-sensitive semiconductor-fabrication operations ticking along smoothly. So, it can't afford to enter in so-called interruptible supply contracts with generators in exchange for lower prices, an increasingly frequent arrangement in California that is used by more flexible users like the city government of San Francisco. For Intel, the cost of electricity pales in comparison to the benefits of operating around the clock to meet demand.

Instead, Intel has entered into a deal with its power suppliers to voluntarily scale back consumption when they request it, mainly by reducing lighting and air-conditioning levels at the one million square feet of office space it occupies at its Santa Clara, Calif., headquarters. It also works closely with equipment suppliers to design factory equipment that consumes less energy. Since such chip-making gear becomes outdated every three to five years, "the opportunity to build more efficient systems is significant," says spokesman Tom Beermann.

Honeywell International Inc. is another company that is adopting a varied approach. The big aerospace and automotive-systems maker, based in Morristown, N.J., generally modifies its production processes to limit exposure to hours when demand and prices are generally the highest, asking power companies for discounts in return. It has signed long-term fixed-price contracts in some areas and interruptible supply agreements in others. Overall, says Bill Ramsey, Honeywell's vice president, supply chain, the company hasn't seen any significant increases in electricity costs.

Ford Motor Co. has been able to do better than that, though not without some harrowing moments. The company, which spends around $300 million a year on power in North America, is entering into more expensive fixed-price contracts with suppliers to avoid having to rely on the spot market. But at the same time, it also reckons that continuing conservation measures -- plus some smart fixed-rate deals early on in the deregulation era -- means it will pay less for electricity than it did back in the days before there was

competition.

Pete Mehra, Ford's energy chief, said the auto maker has learned some hard lessons. Last summer, it was forced to briefly pay one of its suppliers rates of as much as $9,000 per megawatt hour to keep the lights on at its Kentucky truck plant, which makes the company's hugely profitable big pickups and sports-utility vehicles. Accustomed to paying around $40 per megawatt hour to power the plant, "that one week killed us," Mr. Mehra says.

Enron's Business Booms

While companies like Ford enter into long-term contracts only reluctantly -- a bad decision could put it at cost disadvantage to its competitors -- service companies generally have less qualms. Energy trading company Enron Corp., which signed contracts to supply $3.8 billion in energy and energy services to customers last quarter alone, is doing a bustling business offering security in times of uncertainty.

Depending on the client's appetite for risk, it offers packages that mix fixed and indexed rates much as a mortgage does. And it provides incentives to those firms that allow it to replace their energy infrastructure over time -- which, in turn, gives Enron a better sense of what the client will be spending. Among the companies that have signed up with the Houston-based company are Prudential Insurance Co. of America, Chase Manhattan Corp. and Simon Property Group, one of the largest U.S. REITs.

Companies for whom electricity is a make-or-break operating cost have less flexibility -- and are the ones that have been hit worst by current market conditions. Copper company Phelps Dodge Corp., Phoenix, has boosted in-house generation to reduce its reliance on commercial suppliers and is juggling its production schedules to shut down equipment at times when the cost of power outstrips the value of the ore being mined and smelted.

Rod Prokop, investor-relations director, says higher energy costs coupled with interruptions at its operations in Arizona and New Mexico, both deregulated markets, shaved around $5 million off Phelps's second-quarter earnings, leading to a $37.5 million loss in the period. Mr. Prokop adds that Phelps will likely feel the impact of volatile markets for the foreseeable future -- no matter what it does.

While the changed energy scenario has spooked executives, it hasn't generally turned them against deregulation. If anything, they see current problems resulting from the fact that legislators have been too timid in unleashing market forces.

-- Staff writers Karen Jacobs in New York, David Hamilton in San

Francisco, Susan Warren in Dallas, Gregory L. White in Detroit and Andy Pasztor in Los Angeles contributed to this article.

Write to Jonathan Friedland at jonathan.friedland@wsj.com

Return to top of page | Format for printing

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