



**Economic
Evaluation Of
Municipalization**


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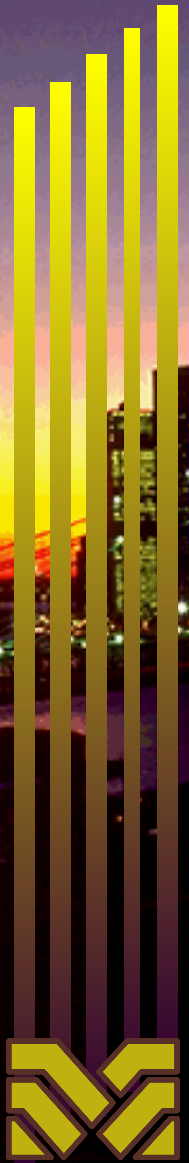
Economic Evaluation of Municipalization

- What are we municipalizing?
- Principal cost components
- Replacement versus condemnation
- Power markets
- Regional opportunities



What Are We Municipalizing?

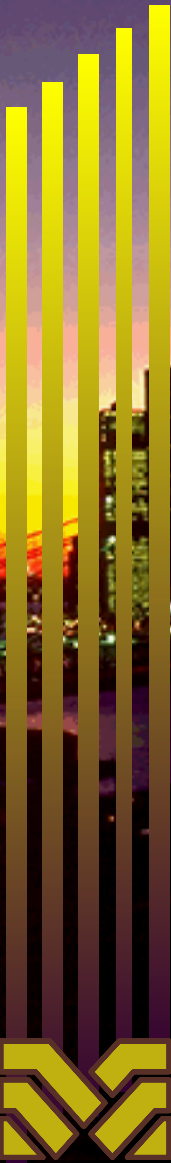
- In a restructuring universe, what does the serving utility own?
- How long will the status quo last?
- How will the presence of restructuring change the valuation?





In a restructuring universe, what does the serving utility own?

- The serving utility no longer possesses a long term monopoly franchise
- The generation market is entirely liquid
- Local distribution equipment is usually more expensive and less efficient than its modern replacements



How long will the status quo last?

- Estimates vary from zero -- most Northwestern states
- Less than one year -- California and Massachusetts
- One to five years -- everywhere but Utah, Nebraska, and Tennessee
- Forever -- some states treasure the current high prices and poor levels of service



How will the presence of restructuring change the valuation?

Absolutely

- Restructuring has eliminated the monopoly valuation debate in condemnation
- Alternative power supplies are now readily available
- FERC 888 exit fees on transmission are now the major decision variable in most cases

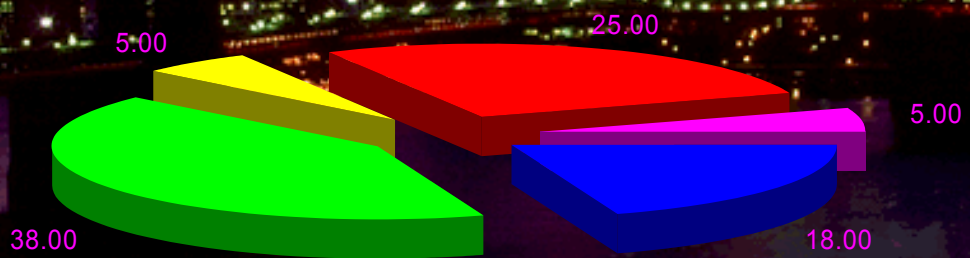


Principal Cost Components

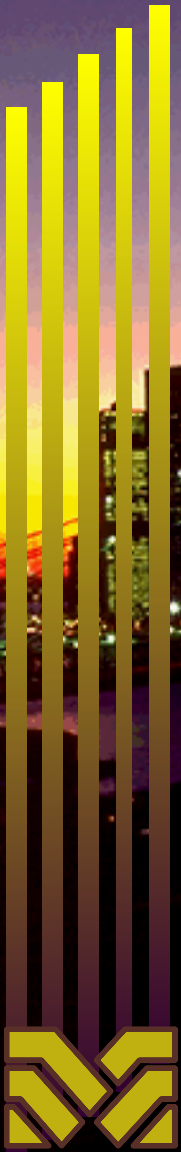
- Distribution Costs
- Transmission Costs
- Exit Fees
- Power Supply
- Lost Benefits



Cost Components



- Commodity
- Exit Fee
- Transmission
- Distribution
- Lost Benefits





Distribution Costs

Traditional debates concerning the valuation of utility power generally revolved around monopoly valuation

- Post-restructuring debates will move the equipment debate back to where it should be -- the value of the equipment
- Most states with restructuring proceedings are explicitly unbundling utility services
 - Unbundling provides an external valuation of distribution property
 - Unbundling also separates overall business value from the distribution business



Transmission Costs

- FERC Order 888 also provides a straightforward evaluation of transmission costs
- However:
 - Transmission through the existing suppliers system will be subject to an exit fee
 - Transmission terms and conditions may be arbitrary and capricious and may only be mitigated by a FERC appeal
- Pursuit of third party wheeling is likely to become the rule rather than the exception



Exit Fees

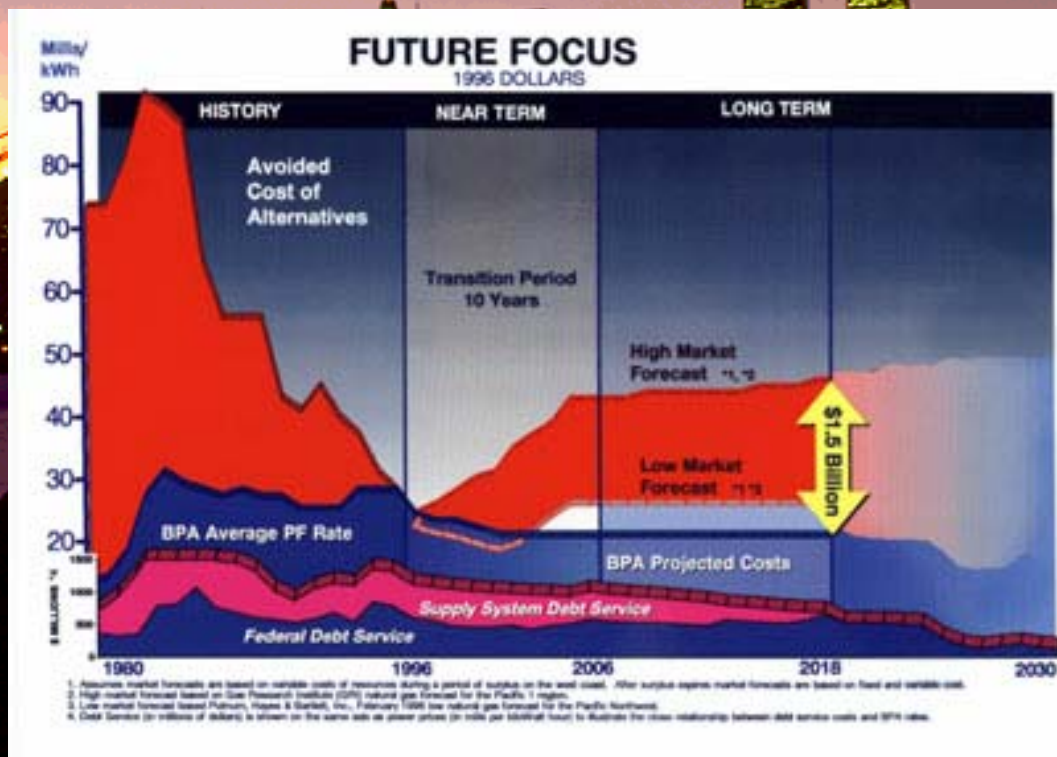
- FERC Order 888 does not provide for a mechanism for the application of exit fees except in the context of a transmission request
- The fundamentals are summarized by the following rule:
Anybody's transmission is less expensive than the current providers.



Power Supply

- As a general rule, power supply has been two thirds of the total end-user bill
- Five year power supplies have fallen dramatically over the past five years
- Ten year power supplies have fallen dramatically over the past ten years
- Twenty year power supplies have fallen dramatically over the past twenty years

BPA's View





Ancillary Services

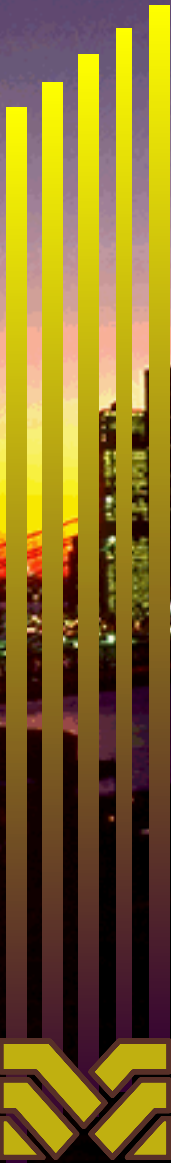
- Ancillary services are the industry's analog for the question of "Who's buried in Grant's tomb?"
- The answer is that very few ancillary services are surviving the rigors of the market
- Full ancillary services have been bid down to less than a mill in most cases
- Recent California experience has ancillary services at .5 mill

A nighttime photograph of a city skyline, likely New York City, featuring the Manhattan skyline and the Manhattan Bridge. The sky is dark with a hint of sunset or sunrise. The city lights are illuminated, and the bridge's lights are visible. The water in the foreground is dark.

Lost Benefits

- Franchise fees
- Ad valorem taxes
- Social programs





Replacement Versus Condemnation

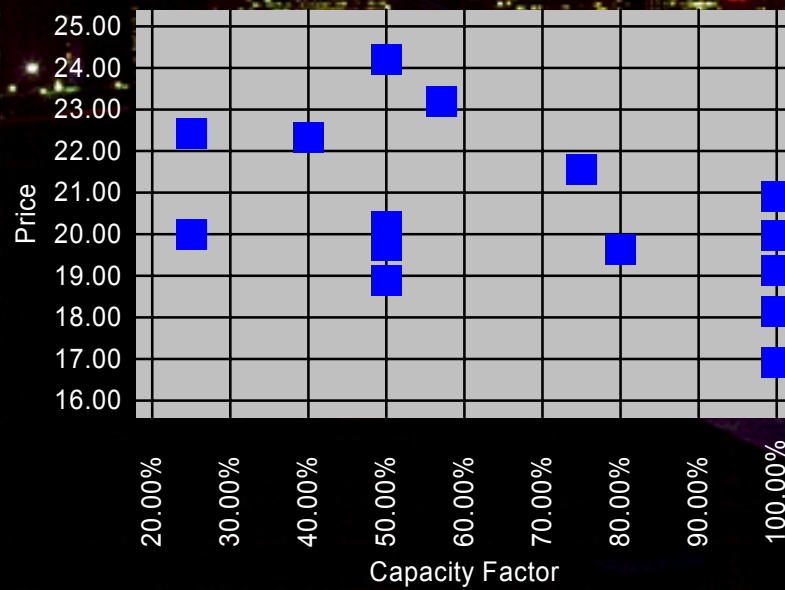
- In our two most recent experiences with municipalization, both cities have seriously considered simple replacement
- Why?
 - Modern technology has reduced replacement costs considerably
 - Litigation is expensive and costly
 - Replacement will lead to better service and higher reliability



Power Markets

- Current prices range from 20 mills (delivered to the point of delivery) on the west coast to 30 mills (delivered to the point of delivery) on the east coast
- These prices reflect a 50% load factor with substantial seasonality

Market Overview





Regional Opportunities

- The bottom line:
 - West Coast: 50 mills
 - East Coast: 60 mills
- Assuming:
 - Third party transmission
 - Distribution replacement
 - Five year energy supplies