

LSE's and Hedging: Critical Regulatory Issues

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Two Contexts of LSE Hedging Activity

I. Fully Regulated Market

- Hedging at Management's Discretion

II. Retail Competition Market

- Consumer Discretion
- PLR Product a Policy Issue

Symmetries: The Triumvirate

- I. Regulatory Symmetry
- II. Risk/Reward Symmetry
- III. Competitive Symmetry

I. Regulatory Symmetry

Prudence Reviews

- Reviewing Hedging Activity
 - *ex-ante or ex-post*
- Reviewing Failure to Hedge

Evaluating Action and Inaction

- Historic Experience
- Analogy to Emissions Trading

continued ...

I. Regulatory Symmetry (cont.)

Economic Risks

vs.

Regulatory Risks

- Market Uncertainties
- Hedging/Not Hedging Equally Risky

- Administrative/Political Uncertainties
- Hedging Riskier Than Not Hedging

Shareholder Risks

- Non-Recovery
- No Upside Potential

Consumer Risks

- Price Volatility
- Self Choice of Supplier

II. Risk/Reward Symmetry

Prudent Protection of Position

- Socialized Risk
- Socialized Reward
- Potential for Sharing Risk/Reward

Speculation

- Privatized Risk
- Privatized Reward
- Self Choice of Supplier

Distinguishing Position Protection From Speculation

- Size and Scale of Positions
- Nature of Positions (e.g., covering what you have to sell)
- Articulated/Documented Strategy/Objectives
- Nature of Hedges
 - Forward Positions
 - FTR's
 - Capacity Arrangements
 - Self Generation
 - Contracts
- Demand Response Arrangements

III. Competitive Symmetry

- PLR Responsibility
 - Who Provides
 - Nature of Product
- Definition of Distributor Function
- Market Design Issues
 - Hedging PLR Product
- Wholesale (e.g., Horizontal and Vertical Market Power)
- Retail (e.g., Attractiveness of PLR Product)