POWER MOVES!

Newsletter of the New York Energy Buyers Forum

Fall/Winter, 1999

Clearing the "Fog" Around Steam

As most Forum members know, two of Con Edison's power plants (East River and Waterside) are responsible for generating most of the steam sold by that utility. Since the price of steam has historically been subsidized by the electric side of Con Ed (by up to 25%) the divesting of such steam/electric plants under deregulation has been of concern to many Forum members. The Forum has been involved in this process as an advocate to ensure reliable service and stable steam prices through both regulation and competition.

The original Con Ed proposal for separating the electric and steam systems involved selling the East River generating plant to a third party and buying back the steam it produced, and completely divesting the Waterside plant. Both the Forum and PSC questioned this proposal, since any third party steam contract would only be in place for 5-10 years. The Forum raised such issues earlier this year and Con Ed's August filing answered them, concluding that the third party contract was not a solution. The plan now is to re-power East River with new generators and to sell Waterside.

During that proceeding, the concept of opening the steam system up to competition was raised. Con Ed's consultant, Putnam Hayes Bartlett (PHB), studied this option. Based on rather cursory assumptions and conclusions, PHB concluded that neither wholesale nor retail competition was viable. Even Con Ed conceded that the study "needed work." During this discussion, it became obvious that Con Ed was extremely reluctant to un-bundle the transportation and delivery portions of its steam rate. The Public Service Commission accepted Con Ed's pleas to not push ahead with steam restructuring at this point, but held the option open for later review.

In the end, very little was decided during this effort, with most topics delayed until the next steam rate case, presently scheduled for settlement by April 2000. In late November 1999, a Con Edison proposal was submitted which included an 8.5% cumulative rate increase over four years. This proceeding will also look at a variety of other steam issues including:

- performing a cost-of-service study on the steam system
- unbundling steam rates to examine transport, backup and other options
- How the costs of the East River upgrade will be allocated---and could the project become a new stranded cost?
- Con Ed has no steam marketing plan and is assuming no load growth, though the utility now states that a new steam business unit is being created
- The return of steam cooling incentives (a $2/Mlb summer discount has been proposed, but Forum analysis reveals that rate would not be adequate to attract new steam cooling customers/equipment)

The New York Energy Buyers Forum will remain at the forefront of this proceeding to ensure the needs of its members are properly represented.

Startup and Future of the New York Independent System Operator (ISO)

The long awaited startup of the NY ISO has at last occurred, a bit late, on November 15. Various market trials and software adjustments combined to push the original September date back. Many power marketers have chosen to wait for other bugs to be worked out before jumping in. Such items as the calculation and handling of Locational Based Marginal Pricing (LBMP) remain stumbling blocks to clear market pricing.

Despite these loose ends, control of the assets of the New York Power Pool were turned over to the NY ISO, hopefully making access to the transmission system open to all power suppliers, whether or not they have any affiliation with owners of the transmission system (i.e., the remaining NY utilities and the New York Power Authority). Through its alliance with Multiple Intervenors, a similar group in upstate New York, the Forum holds a seat on the New York State Reliability Council (advisor to the ISO) and also a seat on the ISO's governance structure.

While transmission access is now becoming available, a true power market does not yet exist due to the lack of an operating power exchange. The Automated Power Exchange (APX), which is a private firm operating independent exchanges in CA and PA, plans to provide such a facility in New York soon, but is presently looking only at providing "contracts for differences" at the wholesale level for specific power plants. Such a system would be used by marketers and aggregators, but not individual end users.

Since the NY ISO is chartered and regulated by the Federal Energy Regulatory Commission (FERC), it is subject to a proceeding presently before that federal body. FERC is looking at ways to push all utilities to join Regional Transmission Organizations (RTO), even in states that are not deregulating, as a way to foster interstate transmission access and reliability. While all NY environmental compliance, and control costs more effectively than municipal systems.

utilities are members of the ISO, this proceeding would also push small ISO's (such as those operating in NY, the PA/NJ/MD area, and New England) to develop into fewer larger entities. Implementing this kind of structure could impact Forum members by increasing access to cheaper power through interconnections with those bordering ISOs.

In that proceeding, the Forum and the City of New York indicated that they did not believe the NY ISO met the conditions that FERC is proposing for determining when an existing ISO is a true RTO. The Forum and City maintain that an ISO cannot simultaneously cover only one state and still claim to meet the "regional" nature of FERC's emerging standard. FERC expects to make a decision by early 2000, which could impact the development of the NY ISO and the wholesale power market in our area.

Privatizing Utility Water Systems

By Daniel Levin, Great Forest Inc.

At its Sept. 15th meeting, the Forum heard about water system privatization from Daniel J. Kucera of the Chicago law firm of Chapman and Cutler. Many members of the Forum think of water as another utility that needs attention and believe that taking it out of the hands of government (i.e., privatization) could be a possible solution.

Mr. Kucera (shown in the picture to the right) began with an overview of water system ownership and economics. Ownership typically takes two forms: municipal-owned systems and investor-owned systems. Of approximately 8,000 private water systems in the United States, most spend more on capital expenditures, have better

An early example of privatization can be seen in

Hawthorne, California, the first city in that state to lease back the operation of its water system on a long-term basis to a private company. The city signed a 15-year lease and received $6.5 million up front, in addition to an annual payment of $100,000. Unfortunately for the citizens of Hawthorne, the company raised water rates 14 percent after taking over the system.

Nevertheless, the trend seems to be continuing. On Nov. 23 of this year, Consumers Illinois Water Company, a subsidiary of Philadelphia Suburban Corp. (coincidentally known by the initials PSC) purchased the water system of the Village of Bradley in Pennsylvania. PSC is headquartered in Bryn Mawr, Pennsylvania, and is one of the largest investor-owned water utilities, currently serving 1.8 million people in Ohio, Illinois, New Jersey, Maine, and Pennsylvania.

The economics of water systems can be complicated and as murky as a Louisiana bayou. Water systems must acquire raw water (from ground water, surface water, etc.), maintain an adequate transportation/delivery system, effectively operate water treatment facilities (creating finished water in compliance with all regulations), maintain and read meters, and bill customers on a regular basis. At any point in this process, problems can occur that affect the profitability and financial valuation of the system. This complexity is the most common reason for privatization.

Other reasons for privatization include:

- a need for capital funds
- a system that is not making money
- infrastructure requirements that become overbearing
- municipal management that is insufficiently sophisticated to deal with new regulations
- municipal ownership that denies customers the benefits of economies of scale
- the perception of the water supply as no longer satisfactory
- the perception that risks exceed benefits.

When a municipality decides to initiate the privatization process, the value of the system must be assessed. A key component of every water system is the infrastructure and the effectiveness of the metering/measurement systems. Since a large portion of the infrastructure is below ground and expensive to maintain, repair, or replace, a detailed survey is required. Also required is an inventory of assets and a review of current regulatory compliance and growth potential. Surprisingly, income is not much of a concern, because it can be modified at a later date. This process is, in essence, the reverse of municipalization of a private utility, wherein a government takes over a power company.

The privatization decision touches many parts of a municipality. As an income stream, the dollars from the water supply (once diverted in the privatization process) can cause budgetary and political problems. Frequently, a municipality feels that they are "giving something away" in the transaction, thereby complicating the process. If the municipality has bonds tied to the water system, the deal could evaporate. Any shift in employment could cause local people to lose their jobs or security. An alternative to outright sale of a system is "contract privatization," more commonly known as outsourcing.

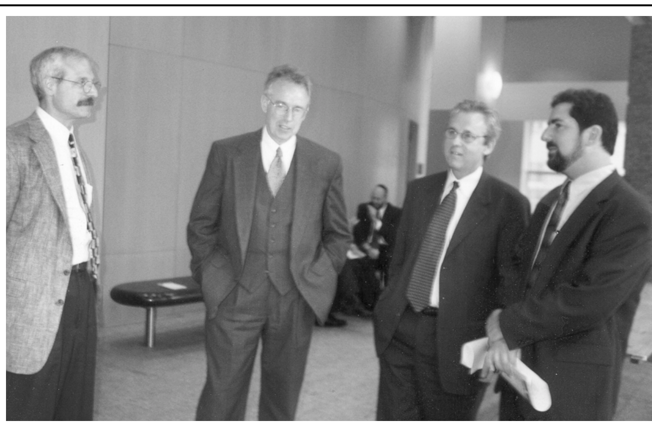
Like other parts of the utility industry, the future for water systems may be more consolidation between companies, more privatization, and reduced risk for municipalities that are facing tougher water standards.

The Con Edison Power Plant Auction: Show Us The Money!

Now that the sale of most Con Ed plants has been completed, questions are arising regarding just how much money over book value remains to help reduce electric rates.

Initial reports mentioned a revenue gain of $300 million, but later accounting (after attorney and other transaction fees, and taxes) ended up with only about $142M. Con Ed wants to allocate the remainder to Indian Point 2 decommissioning costs and other costs not fully explained in its filing to the PSC on this matter. Among those charges would be: over $45M for early retirements (read “golden parachutes”), $53M for possible lawsuits, and nuclear decommissioning funds beyond the $50M already promised for Indian Point 2. Under the Con Ed proposal, there may be little revenue left for direct ratepayer relief.

Since the rest of the money paid off a good portion of Con Ed’s stranded costs, some reduction could be seen in the “delivery” charge that is part of the Retail Access rate. Unfortunately, this is not what Con Edison has proposed. Under its Phase III filing, a number of “ISO Related” expenditures would be passed through the Fuel Adjustment charge. We expect that this pass through could result in significantly higher distribution charges.



Forum members (from left) Ken Luksin, Bill Gillen, Tony Campbell, and Dan Levin share views on energy.

Hearings on how to divide the net gains are scheduled for December. Early indications are that both the PSC and intervenors (including the Forum) will argue that Con Ed’s accounting leaves a great deal unexplained. Careful “bean counting” will likely result, but could take several more months.

The Forum will be working to alleviate cost impact from the Divestiture proceeding. That agenda will include an effort to increase non-retail access rate reductions (e.g., paying off deferred expenses that are embedded in the transmission and distribution rates), and working for an increase the backout credit or other credits in Phase III.

Also prominent in this proceeding will be the move by the Forum and other intervenors to accelerate retail access--by making all customers eligible in 2000.

New Power Plants and Expansions

When most of Con Ed’s power plants (and many of those owned by local Independent Power producers, or IPPs) were sold off earlier this year, several new names appeared. The three bundles of Con Ed plants were purchased by: Orion Holdings (a firm composed of Constellation Energy, which is the unregulated subsidiary of Baltimore Gas and Electric, and Goldman Sachs, a financial institution), NRG Energy (unregulated subsidiary of Northern States Power Company of Minnesota), and Keyspan Energy (the holding company that owns Brooklyn Union).

Other nearby plants have been purchased by a mix of out-of-state utilities and Independent Power Producers. Southern Energy (holding company of Southern Electric, a major regulated utility in the Southeast US) bought a plant from Orange & Rockland Utilities, Calpine (an IPP out of California) acquired small cogen plants in Brooklyn, and Enron (the largest independent power marketer) bought three plants from Cogen Technologies in NJ. The New York Power

Authority is discussing sale of its Indian Point 3 and Fitzpatrick nuclear plants, while rumors persist that Con Ed may do the same with Indian Point 2.

Most of these plants either directly supply the New York City metropolitan area, or the SENY (southeast NY) transmission region (seen as NYPP-E on wholesale spot market pricing charts). As a result, these new owners will be providing wholesale (and, through marketers, retail) power to Forum members in the near future. It is competition among them that will hopefully yield better commodity pricing.

Many of these firms have already announced expansions of those existing plants, through a combination of repowering (i.e., replacing old generators with new units that are more efficient, smaller, and cheaper to operate), additions, and improvements to increase output of existing generators. Total output is especially important during the summer peak.

Likewise, many new power facilities are being announced in our general area. A 600 MW underwater transmission line is planned between Connecticut and Long Island; a new 1,080 MW this savings would be passed along to plant is planned (by PG&E Generating) for Athens, NY (about 70 miles north of the City); Columbia Energy is planning a 550 MW unit in Haverstraw, NY (30 miles from the City). A 520 MW barge-mounted facility is also proposed at a Brooklyn pier. Most of these facilities are expected in the 2001-2003 time frame.

Just how many of these expansions will actually be completed depends on a variety of factors, including siting and environmental impact issues. It is clear, however, that the high power prices in our area have begun to attract many players who believe they can compete by offering lower cost power. The forces of competition are finally beginning to emerge.

Other Straws in the Wind

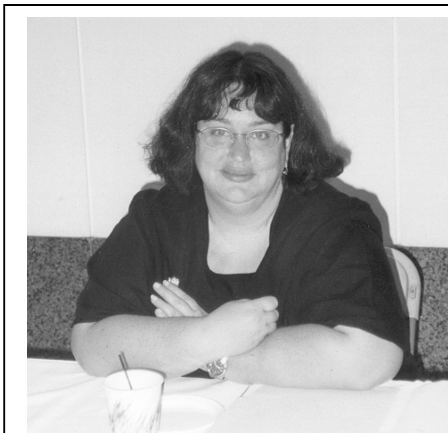
While the rumor mill is always grinding, the past few months have seen more than usual. Here are a few unrelated issues to watch for. Each could impact our pricing, in either the long or short term.

- Con Ed's purchase of Northeast Utilities transmission and distribution system in Connecticut. Con Ed is estimating $1.5 billion in savings as a result of this merger. How much of this savings would be passed along to customers?

- Economic Development Rates – If the New York Power Authority sells its nuclear plants, what happen to Power for Jobs, municipal power agreements, and other low economic development rates? Since some of that power would now be generated by new owners, it is not clear if those programs would continue to provide the same benefits seen today

- Sale of Indian Point 2 - Since it was not part of the 1997 settlement, how would the money for such a sale (especially if sold above its presently low book value) be handled? Could it also help cut stranded cost claims?

For those who thought that deregulation was a single act, think again. Many steps remain before we will see a fully competitive power market. That's why the Forum remains an essential way to maintain input into this ongoing process.



Forum Executive Director Catherine Luthin asks: "have you paid your dues yet?"