POWER MOVES!

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Next Member Seminar – September 18th

NYEBF Upcoming Seminar Addresses Developing Energy Budgets For 2003

If you haven't started working on your budget, you are one of the few. Budget season is here and some of you are putting the last finishing touch on yours. Maybe you have saved the utility budget for last, so that you can consider this summer's high usage to gauge your demand for the Summer 2003. If that is the case, you will have an opportunity to sharpen your projections by attending the New York Energy Buyer's Forum "Developing Energy Budgets for the Coming Year" meeting held on Wednesday, September 18th, 2002. Learn all about budget preparation. What factors should be considered, i.e. load factor, historical data, tenant occupancy, and much more. This is an opportunity to improve your budget preparation skills and to learn specific information about planning for next year's energy market. The NYEBF would like to thank Ernst & Young Real Estate Advisory Services for sponsoring this event. Please join us for this timely and pertinent event.

Any members interested in attending the next Steering Committee meeting are welcome to come. The next meeting is October 2nd and the details can be obtained from Ted Lee of Mondre Energy. Contact Ted at ted.lee@nyebf.org.

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What Does the Power Marketer Meltdown Mean to You?

Many participants in the wholesale power marketplace (e.g., Enron, Reliant, Williams, etc.) have recently come under attack for questionable (and possibly illegal) actions - but what does that mean to a retail power customer in the New York metro area?

One significant impact in the wholesale/retail continuum is the drop in credit ratings for power marketers, which limits their access to capital needed for power plant construction or expansion. As Forum members heard at our June 4th seminar on Installed Capacity charges, the investment community was shocked by the rapid bankruptcy of Enron and the California power debacle, which resulted in bankruptcy for Pacific Gas & Electric, that state's largest utility.

When word came that profits claimed by most of the largest wholesale power suppliers were "cooked" to look better to investors, stock values of those firms dropped by over 70%, effectively shutting the door on further investment. Standard & Poor's credit rating service has reduced the credit rating for debt held by 5 out of 11 major power trader/suppliers to "junk" status, and lowered that of others to a lesser degree. When a credit rating drops below a certain level, investment firms may withhold capital or otherwise charge higher interest rates.

Meltdown (con't)

Two of the three firms that bought Con Ed's power plants are experiencing financial problems: NRG Energy has announced that it is selling many of its plants outside the City and may run out of money in October, while Reliant Energy has seen its stock value drop by more than 70% and laid off many of its power traders. Since access to capital is essential to building new plants, many construction projects (both locally and nationally) have been cancelled or put on hold. Other problems (such as neighborhood opposition and environmental rules) have also blocked installation of plants where they are needed most.

Impacts On Pricing And Reliability

Our area is already capacity-stretched, but the only significant new capacity added in the last two years is from the mini-plants installed last year by the New York Power Authority (NYPA), which has no plans for adding others. We had been expecting repowering of a closed Queens plant which was to add over 1,600 MW to the in-City grid, but progress on that Reliant Energy project has now been suspended. Other plants (e.g., Sunset Energy's 520 MW barge-mounted system in Brooklyn) have also been put on hold or dropped. In the meantime, peak demand continues to creep up, and increased demand from economic recovery will further strain the grid. A tight supply/demand margin also means less competition among existing generators, which means higher peak power prices, especially during the summer.

When the responsibility to build new generation was transferred from regulated utilities to the wholesale marketplace as part of deregulation, it was hoped that market forces (such as on-peak pricing) and guaranteed payments (such as ICAP charges) would provide sufficient incentives for installation of new plants where and when needed. It is now obvious that process has failed in the Con Ed territory.

A Bumpier Ride Ahead?

Downgrading of credit also impacts the ability to trade power, which often involves short-term use of large amounts of capital. Liquidity (i.e., amount of trading) at key trading hubs around the U.S. has dropped 70% from 2001, and some traders have completely left the marketplace, eliminating their trading staff. Less trading and fewer traders reduces the "smoothing" effects of multiple, smaller, and longer-term trades, potentially causing greater variations among deals, and possibly wider seasonal price swings (both wholesale and retail that has been indexed to the wholesale market or Con Ed's Market Supply Charge [MSC]).

The net result is that power costs may become more volatile and unpredictable, charges during system peaks may jump, and reliability may suffer. Since variations in wholesale power pricing can be passed through to Con Ed customers through both the Market Supply and Monthly Adjustment Charges (i.e., the MSC and MAC), month-to-month retail power pricing may become more volatile and difficult to predict, even if power is purchased from the utility. Bilateral contracts that are indexed to market pricing may also see unpleasant variations.

A Glimpse Of The Future

As the local economy recovers and demand again begins to grow over the next few years, we may see changes in the power industry similar to those that occurred in the airline industry: mega-mergers, fewer competitors, bankruptcies, sales of major assets (possibly to firms not presently part of the power industry), plus higher and/or more volatile pricing.

While FERC's proposed Standard Market Design changes are focused on eliminating some of the sources of that volatility, it will likely take several years before its proposals are ironed out and take

Meltdown (con't)

effect. In the meantime, how may a retail customer respond to such changes?

Improving one's knowledge and ability to control his electric loads, use of non-electric (e.g., gas-fired) chillers, and on-site generation (for peak shaving) may become appropriate. While one takes a risk that such investments may turn out to not be necessary (if new central generation eventually gets built), doing nothing could prove even riskier.

Changes in power procurement should also be considered. While indexed retail pricing (based on ISO pricing, a published index for power and/or natural gas, or the MSC) has recently been a good choice (because market pricing has generally remained low due to the recession), the forces described above will tend to disrupt that opportunity. Longer-term (i.e., several year) contracts, possibly with a tight collar (i.e., a narrow range between cap and floor) on pricing, may become appropriate to control price risk.

Recent Forum Activity: Addressing Emission's Permitting for Emergency/Backup Generators

Many of the past participants (of the Emergency Demand Response Program) have dropped out due to problems with NOx allowances and impacts on Title V boiler permits. Through emailed and paper letters signed by Judith Mondre, the Forum requested that a 120-day permit be provided that would allow operation of such generators for the remainder of the cooling season, with efforts to follow in ironing out the permitting problems. The letter followed numerous discussions with DEC by Forum members and others that pointed out the problems. The Forum took a leadership role on the 120-day permit option, and several energy marketers followed suit by supporting that option in letters to Erin Crotty (Commissioner of the NYS Department of Environmental Conservation DEC) and others involved in ensuring sufficient generating capacity.

Con Edison Sets Electricity Record

Con Edison has announced that electricity usage in its territory (NYC and Westchester) has set a record for the past three months. In June, July, and August, Con Edison delivered a total of about 17.5 million megawatt hours. This surpasses the previous (last year's) record of 16.8 million megawatt hours, and according to Reuters News Service is also more electricity than consumed in North and South Dakota for a full year.

ISO Update: The $10 million conundrum and other matters

According to the President's report of July 11, 2002, in May and June of 2000, Enron was erroneously given cash payments of about $10,000,000 to settle a transmission contract made with the ISO. Shortly thereafter, ISO staff caught the misbilling and similar errors were not repeated. However, the corrective billing was not issued until November 2001, a time beyond which Enron was capable of returning the funds to the ISO.

Since Enron is bankrupt, the odds of collecting this money are very slim and there is some difference of opinion as to whether the ISO is entitled to the refund, and whether it will cost more in legal fees to collect anything. At present, the $10,000,000 shortfall is slated for collection through Schedule 1, <u>*the charges paid by all of us.*</u>

The NYISO is in the midst of a comprehensive audit, which should help identify potential problems and facilitate general operations. The audit Committee (MPAAS) has been authorized to follow the findings of the individual auditing firms responsible for reviewing ISO procedures. Separately, a resolution was passed to reveal the pay and incentives of the top five board and executive persons. Interestingly, a group nominally known as the " New York Caucus" is promoting a resolution to link NYISO executive compensation with actual results. This group consisting of generators, end users, and ESCOS perceives that the leadership of the ISO is remiss in promoting the interests of the public.

Members are encouraged to assist with the next issue of Power Moves! Contact Daniel Levin at dan.levin@ey.com to suggest future topics that would be of interest to our membership, to contribute articles, or to provide other support towards the publication of this newsletter.

The New York Energy Buyers Forum is a non-profit corporation formed to help its members obtain lower utility costs.
For more information about the NYEBF or to join, please contact us or visit our website.

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