



NEW YORK STATE LEGISLATURE

March 17, 2003

Richard J. Grossi
Chairman, Board of Trustees
New York Independent System Operator
390 Carman Road
Schenectady, NY 12303

Dear Mr. Grossi,

The "Demand Curve" proposal that will be coming before the Board of Directors of the Independent System Operator on March 18th has generated considerable controversy. As you may be aware, the extent of the controversy and concerns over the impacts on consumers and the industry led the Assembly Energy Committee to hold a public hearing on the issue on March 7th.

Having had time to digest much of the testimony both supporting and opposing the proposal, we write urging you not to rush to judgment in making this change.

This proposal has its origins in recent capacity market auctions that resulted in very low prices in that market. To a great extent, these low prices surely reflect the current extremely weak economic conditions in New York State. To administratively alter the results in these markets through implementation of the "demand curve" in a way that raises prices can only hamper any economic recovery. Any activity that aggravates the ability to stage an economic turnaround will only impede the ability of the capacity market to respond positively. As currently presented, the impact of the "demand curve" may result in a sacrifice of some business interests to the benefit of other businesses.

The problems of the electric generating industry go far beyond recent low capacity prices. Last Fall, in the Assembly report *New York's "Perfect Storm" An Industry in Crisis: The Financial Condition of Electric Generating Companies in New York State* (October 17, 2002), we detailed the severely depressed equity values and lower than investment grade bond ratings of many of the merchant generators doing business in New York. The "demand curve" and its impact on revenues cannot provide a panacea to these problems. Certainly from the testimony provided before the committee, it remains a dubious conclusion whether the "demand curve" will provide the impetus necessary to foster the construction of new electric generating capacity in New York State.

(continued)

Richard J. Grossi
Chairman
Page 2

Much of the testimony before the committee emphasized that the revenues jointly derived from the energy and capacity markets will influence the decisions by developers and bankers whether or not to build or finance new generation in the state. However, no analysis was presented that indicated how the interactions between these two markets would eventually affect the incentives for new capacity. Although somehow smoothing out the "boom and bust" cycles of revenues in capacity markets might have some salutary effect on how potential lenders view the industry, we have been told time and again that new capacity will not get built without long-term contracts that effectively guarantee a stream of revenues. If the "demand curve" simply raises costs to consumers in the short-run without yielding the long-term benefits that its proponents emphasize, then you will have placed an additional burden on consumers and on the state's economy at a most inopportune time, and all to the benefit of existing generating companies that may otherwise have to close their plants due to other industry-wide trends or failure of an upstate New York economy to recover.

Clearly, the ISO faces a difficult situation. We accept the opinions of the witnesses before the committee that the current market is flawed. Unfortunately, the boom and bust revenue cycle apparent in the current capacity market may reflect the underlying nature of that market. If that is the case, will this proposal actually solve the problems it is meant to rectify? Certainly, some of the ISO's members raised questions about potential impacts and estimated significantly greater costs to consumers. Furthermore, we could all be more confident in the analyses either supporting or attacking the "demand curve" proposal if the analyses were made more transparent and subjected to greater scrutiny regarding their underlying assumptions. Certainly a comparison of the proposed impacts of the "demand curve" proposal with the impacts of other proposals is warranted.

We understand further that the proposal before the Board represents a significant change from the one that was contemplated last Fall, in the sense that this version of the "demand curve" will be less onerous to consumers. Our point is that this proposal, despite being referred to as a "demand curve," is not the result of market forces, but rather represents simply one administrative solution to a problem. That being the case, we have to question whether other alternatives proposed by other members of the ISO have been given adequate consideration. In fact, there exist alternatives, such as a proposed one-year capacity procurement obligation, which may represent a "middle ground" approach, yet is an approach that does not place an onerous burden on consumers while potentially providing the price levels and stability that generators require.

(continued)

Richard J. Grossi
Chairman
Page 3

In the end, you may decide that this or some other variant of the "demand curve" will be your best solution. We ask that such a decision not be made at this time, in consideration of the possible great detriment to New York State families and businesses.

Sincerely,

<u>James Tonko</u>	<u>Paul Tonko</u>	<u>Audrey Peffer</u>
<u>Dan Claitor</u>	<u>Carey Forman</u>	<u>Barbara Lipton</u>
<u>Richard A. Stratton</u>	<u>Jean F. Brennan</u>	<u>[Signature]</u>
<u>[Signature]</u>	<u>Steven L. Yablonsky</u>	<u>Roger J. Zee</u>
<u>[Signature]</u>	<u>[Signature]</u>	<u>[Signature]</u>
<u>[Signature]</u>	<u>[Signature]</u>	<u>Paul Santolucito III</u>

Letter to Richard J. Grossi, ISO Demand Curve Proposal

March 17, 2003

Steven E. Bickel

Steff

Adelle Cohen

Ch. M. Cicci

Michael A. Berry

Robert M. Destito

John J. Fa

Steve Paul

William H. McLaughlin

Joseph J. ...

William J. ...

Michael Scaram

Joseph L. ...

Bob

Daniel O. ...

William A. ...

Margaret Harbey

...

Paul S. Toky

Dick Koon

Jeffrey ...

Letter to Richard J. Grossi, ISO Demand Curve Proposal

March 17, 2003

~~David J. Scott~~ David J. Scott Kevin Calwell

Patricia G. Ledwith Rhonda Jacobs Frank B. Peddie

W. W. [unclear] J. H. W. [unclear] Michael [unclear]

[unclear]

Rubens Jr.

[Blank lines for signatures]

George Omato

Ken Parker
