

Response to Multiple Intervenors' Straw Proposal and Transmission Owners' Comments

on behalf of

TransCanada Power, NRG Energy,
and US Power Generating Co.

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LEVITAN & ASSOCIATES, INC.
MARKET DESIGN, ECONOMICS AND POWER SYSTEMS

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Response to Multiple Intervenors' Straw Proposal

MI Straw Proposal – No Factual Basis

- ◆ MI offers 5 plants to support thesis that prices are adequate or “artificially-high”
 - SOM reports indicate inadequate market return
- ◆ 5 plants are either insulated from market prices or not under construction
 - 5 Plants do not support MI’s position
- ◆ Other economic data not consistent w/ MI position
 - Caithness Long Island has long term PPA w/ LIPA
 - Ratepayers pay above market PPA prices
 - Investment decisions made years ago not comparable to spot prices

MI Straw Proposal – No Economic Basis

- ◆ Demand curve goal is appropriate price signal
 - Net CONE independent of capacity need
 - Consumer costs or economic environment irrelevant
 - Wrong prices will lead to inefficient decisions

- ◆ Proposal to trigger reset based on need inconsistent with FERC decision
 - FERC Order on Complaint re ICIP
 - Stability of triennial reset cycle

MI Straw Proposal – Selective Readings

- ◆ Tariff citation 5.14.1(b) is incomplete
 - “A periodic review of the ICAP Demand Curves shall be performed every three (3) years in accordance with the ISO Procedures...”
 - *Missing language*: “...to determine the parameters of the ICAP Demand Curves for the next three Capability Years.”
 - Tariff also specifies schedule and procedures to update curves

- ◆ Quote from ICAP Manual 5.6 is misleading
 - Manual is “for informational purposes”; Tariff is dispositive
 - “whether” was removed from Tariff in 2005

- ◆ MI selected FERC misquote of Tariff
 - FERC had correct Tariff quote (w/o “whether”) in ¶37

MI Straw Proposal – Regulatory Risk

- ◆ Straw proposal unnecessary
 - Mechanism lowers prices when there is excess capacity
 - Heightening regulatory risk will raise costs
 - Increased financing costs ultimately borne by load

- ◆ Stable mechanism with periodic updates
 - Mechanism balances interests of all stakeholders
 - Stakeholders must be able to rely on unbiased reset process

- ◆ Capacity price decreases when excess exists due to sloped demand curve

Response to Transmission Owners' Comments

TOs' Comments – Cost of Generation

- ◆ Two LMS100s require 6 - 6½ acres
 - LMS100 units are twice the size of LM6000 Sprint
 - Plus LMS 100 intercooling requires cooling systems

- ◆ Actual plant data
 - Basin Electric: 7.7 acres for 2 x LMS100 w/o oil tank
 - South Pier: 2.6 acres for 1 x LMS100 + oil tank = 3.5 acres
 - Braintree Electric: Too difficult to squeeze 1 x LMS100 on 4 acres
 - Clover Bar: 2 x LMS100 on 6+ acres w/o oil storage or dry cooling

- ◆ NERA must exercise professional judgment re what is reasonable pertaining to tax abatement
 - BNYCP unusual; generous tax breaks to spur redevelopment
 - TransCanada Ravenswood and US PowerGen pay substantial taxes
 - Over time, average taxation levels by zone give more meaningful basis

TOs' Comments – Financing Assumptions

- ◆ Financing assumptions must reflect merchant risks
 - Investment decisions based on project risk irrespective of corporate structure
 - Even if CAPM model is appropriate, must account for merchant risk of proxy unit

- ◆ Cost of Debt
 - Bank loans are used differently than bonds
 - Cost must reflect project economics, not IPP financials

- ◆ Cost of Equity
 - Removing RRI from the IPP average due to 'high' beta is arbitrary
 - If RRI removed from the average, remove low beta outlier as well
 - Ignores issue of merchant plants versus contracted plants
 - Ownership structure does not trump underlying investment risks

TOs' Comments – Deliverability Costs

- ◆ Deliverability upgrades required even w/ capacity surplus
 - Deliverability interconnection standard is a Tariff requirement
 - CY08 ROS resources required SDUs @ \$178/kW
 - Existing deliverability rights have “tradeable” value
- ◆ All UCAP supply should receive same price for capacity
 - CONE reflects changes in costs, performance, emission controls, etc.
 - Capacity payments not adjusted based on resource costs
- ◆ New units not required for reliability is not relevant
 - Resource adequacy is not tantamount to no deliverability problems
 - Inter-zonal (RNA) analysis does not address plant deliverability
 - Deliverability rights of retiring plants have value
- ◆ Exclude deliverability costs unless “future reliability violation”
 - RNA based on inter-zonal LOLE analysis, not intra-zonal
 - SDUs are no different than AFs and SUFs
- ◆ Resource must pay for SDUs to receive capacity payments

TOs' Comments – Excess Capacity Assumption

- ◆ Capacity market will almost never be “short”
 - NYISO will not permit an unreliable system
 - TOs and EDCs have stepped in when necessary
 - NYPA PowerNow! program in 2001
 - Con Ed Astoria I
 - LIPA Fast Track program in 2002
 - Recent and expected RPS RFPs

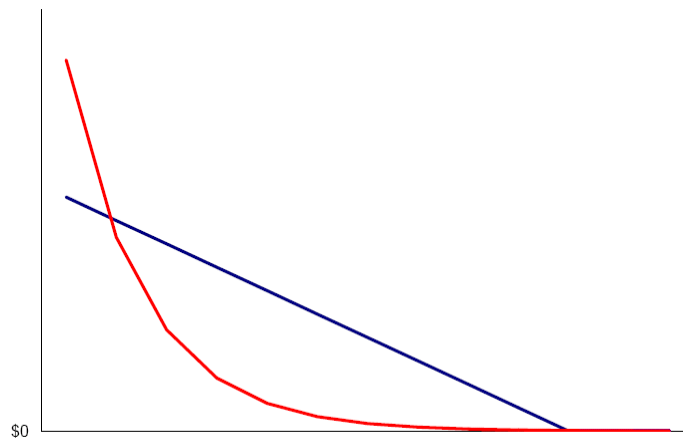
- ◆ Recent history bodes poorly re gencos' ability to recover cost

- ◆ 1.5% excess capacity is reasonable
 - Dr. Patton “...within a reasonable range...toward the low end...”

TOs' Comments - Seasonality Adjustments

- ◆ Reference Point calculation based on winter / summer ratio
 - Capacity values from Gold Book
- ◆ Proposal to establish ratio based only on capacity sold
 - Unclear why this would be better; no support provided
 - Would require additional forecast; more uncertainty
- ◆ Proposal could make prices more volatile
 - Decreasing ratio by 0.1 (10%) reduces reference point by nearly 30%

TOs' Comments – Demand Curve Shape/Slope



- ◆ Curve is steep in sections
 - Price volatility; opportunities for market power (Stoft)
- ◆ Setting curve impractical
 - Non-linear curve more difficult to parameterize and certainly contentious
 - Increased regulatory risk
- ◆ Proposal to shift zero-crossing point previously addressed
 - NERA studied but found no basis for change
 - LAI studied but found no basis for change
 - FERC rejected 2005 load proposal to shift zero-crossing point

Summary

Summary – Key Points

- ◆ Demand curve goal is to set appropriate price signals to ensure long-term resource adequacy
 - Do not over compensate or under-compensate generators
- ◆ Actual capacity payments are down over past decade
- ◆ Ratepayers are protected
 - Sloped demand curve lowers total payments if excess capacity
- ◆ Stability and certainty of triennial review cycle benefits all stakeholders

MI Straw Proposal – Summary

- ◆ No solid factual or economic basis
- ◆ Selective readings of Tariff and FERC filings / orders
- ◆ Is unnecessary, will heighten regulatory risk and raise costs

TOs' Comments – Summary

- ◆ 2 x LMS100 requires at least 6 - 6½ acres
- ◆ Full tax abatement cannot be assumed
- ◆ Deliverability costs are required by the NYISO Tariff, needed in spite of surplus, and are no different than other costs
- ◆ Capacity will almost never be short; 1.5% surplus reasonable
- ◆ Seasonality adjustments unsupported; increases volatility
- ◆ Changing slope and shape will cause, not solve, problems