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August 1, 2005

Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

New York Independent System Operator, Inc., ER05-428-000

Dear Ms. Salas:

In a letter to Ms. Anna Cochrane, Director of Tariffs and Market Development - East, dated May 10, 2005 ("May 10 Letter"), the New York Independent System Operator, Inc. ("NYISO") notified the Commission of certain issues raised by certain stakeholders in the markets administered by the NYISO concerning possible revisions of the installed capacity demand curves ("ICAP Demand Curves") approved by the Commission in an order issued on April 21, 2005 in this docket.[1] Specifically, the May 10 Letter noted that certain stakeholders have expressed concerns about the differentials between the summer and winter capacities of generators located in New York reported in the NYISO's 2005 "Load and Capacity Data Report," commonly referred to as the "Gold Book." The May 10 Letter stated that the NYISO intended to convene a stakeholder process to discuss the implications, if any, of the 2005 Gold Book for the recently-approved ICAP Demand Curves, and undertook to report to the Commission on the results of that stakeholder process, and the NYISO's conclusions on whether the ICAP Demand Curves should be revised.

Subsequently, in its Partial Response to Request to Reopen Record of Independent Power Producers of New York, Inc. and Request for Procedural Schedule, filed on June 7, 2005 in this docket, the NYISO requested an opportunity to respond on the merits to the assertions of the

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[1] *New York Independent System Operator, Inc.*, 111 FERC ¶ 61,117 (2005) ("April 21 Order"). Unless otherwise specified, capitalized terms used in this letter have the meanings specified in the NYISO's Market Administration and Control Area Service Tariff ("Services Tariff").

Independent Power Producers of New York, Inc. ("IPPNY") about the 2005 Gold Book. The NYISO requested that it have this opportunity after completion of the stakeholder process described in the May 10 Letter.

The stakeholder process included an opportunity for the submission of written comments and reply comments to the NYISO and its Board of Directors ("Board"). Oral presentations before the Board took place on Monday, July 18, 2005. Based on those presentations, the advice of the NYISO's independent Market Advisor, Dr. David B. Patton, and the other information available to it, the NYISO concluded that a change in the ICAP Demand Curves was not warranted by the capacity data in the 2005 Gold Book. This letter is submitted to inform the Commission of the reasons for the NYISO's conclusion, and to provide the Commission with an affidavit from Dr. Patton setting forth the reasons for his advice that the ICAP Demand Curves should not be revised. If and to the extent that the Commission decides to reopen the record to consider IPPNY's assertions about the 2005 Gold Book, the NYISO requests that this filing be accepted and considered as well.[2]

I. Documents Submitted

The NYISO submits the following documents:

1. this letter;
2. affidavit of Dr. David B. Patton (Attachment A);
3. affidavit of Mr. John Charlton (Attachment B).

II. Copies of Correspondence

Communications regarding this proceeding should be addressed to:

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[2] *See, e.g., Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.*, 93 FERC ¶ 61,017 at 61,036 (2000) (accepting an answer that was "helpful in the development of the record . . . ."); *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 at 61,797 (2000) (allowing "the NYISO's Answer of April 27, 2000, [because it was deemed] useful in addressing the issues arising in these proceedings . . . ."); *Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138 at 61,381 (1999) (accepting prohibited pleadings because they helped to clarify the issues and because of the complex nature of the proceeding).

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III. NYISO Assessment of 2005 Gold Book Issues

Standard for Review of Gold Book Issues. The NYISO's Services Tariff specifies that the ICAP Demand Curves are to be set for three year periods.[3] The three year period was established to provide a stable and predictable basis for financial expectations based on the curves. The Services Tariff further specifies that the three-year review process is to "include stakeholder input in accordance with the ISO procedures."[4] These provisions necessarily imply that once a given set of curves has been developed on the basis of information reviewed by the stakeholders, they should not be changed except for reasons sufficiently compelling to override the benefits of stable and predictable curves. This is confirmed by the NYISO's ICAP Manual, which was developed under the authority of the Services Tariff and approved by the Market Participants to implement the details of the ICAP process. The ICAP Manual states that ICAP Demand Curves are binding for a three year period, and are not subject to change, absent "exigent circumstances."[5]

The 2005 Gold Book data does not present an exigent circumstance warranting change of the recently-approved ICAP Demand Curves for two principal reasons:

- The 2005 Gold Book does not provide a representation of winter/summer capacity market differentials that would lead to materially different ICAP Demand Curves.

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[3] Services Tariff § 5.14.1(b).

[4] *Id.*

[5] ICAP Manual § 5.6.

- The Demand Curves were developed in a fair and open stakeholder process that ended long before the 2005 Gold Book data was available, and was based on a range of data that may change over the three year life of the curves.

Use of the Gold Book Data in Setting ICAP Demand Curves. As recognized in the April 21 Order, each ICAP Demand Curve is determined by (i) a point on the vertical axis equal to the Annual Reference Value (costs of a new peaking unit less a Net Revenue Offset to account for energy and ancillary services revenues), and (ii) a point on the horizontal axis at which additional installed capacity is deemed not to have significant value (the "zero crossing point").[6] In practice, however, capacity auctions occur monthly, so the annual Demand Curve values need to be translated into monthly values. As stated in the April 21 Order, in the monthly translation process "the Demand Curves are adjusted upward so that the resulting summer and winter capacity prices will, on average, equal the Annual Reference Value."[7]

An upward adjustment is warranted because historically, more supply has been available in the winter capacity markets than in the summer, with correspondingly lower prices in the winter. Part of this seasonal supply difference is attributable to the increase in Dependable Maximum Net Capability ("DMNC") available from many generators in the winter because of the lower ambient temperatures. DMNC values are reported to the NYISO by the generation owners, and are compiled in the Gold Books. The 2004 Gold Book was used in the stakeholder process for the recently approved Demand Curves as a starting point for assessing the differences between the supplies of capacity available in the winter and summer markets.[8]

The 2004 Gold Book only provided a starting point because other factors, such as the availability of imports, also affect the differential between the winter and summer markets. The 2004 Gold Book reported an increase of 1400 MW in winter over summer capacity from units in the NYCA. Historically, however, the winter supply offers have exceeded the summer offers by only approximately 500 MW to 600 MW.[9] As the Commission stated in the April 21 Order, additional adjustments are needed because "the Gold Book data overstates the actual seasonal

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[6] April 21 Order at P 41, 46-48, 84.

[7] April 21 Order at P 52.

[8] *New York Independent System Operator, Inc.*, New York Independent System Operator, Inc. Tariff Revisions to Implement Revised ICAP Demand Curves, Docket No. ER05-428-000, at Attachment IV at pp. 1-3 (Jan. 7, 2005) ("NYISO Jan. 7 Filing").

[9] Patton Affidavit at ¶ 10.

difference in capacity available to and clearing in the NYCA [New York Control Area] capacity auctions."[10] This adjustment is known as the Winter Revenue Benefit,[11] and takes the form of an increase in the Net Revenue Offset.[12]

The 2005 Gold Book does not Support a Material Change in the Demand Curves. The 2005 Gold Book reports a difference between winter and summer DMNCs of 2100 MW, as opposed to the 1400 MW reported in the 2004 Gold Book. Thus, as indicated by Dr. Patton, the relevant question is whether the 2005 Gold Book indicates that the winter capacity market should be expected to increase by 700 MW over the level indicated by the 2004 Gold Book (2100 MW - 1400 MW = 700 MW). Dr. Patton concludes that it is more reasonable to expect that the winter/summer differential will grow by only 300 MW, and that an increase of this magnitude has already been accounted for by the Winter Revenue Benefit adjustment. Thus, the 2005 Gold Book does not support a change in the recently approved Demand Curves.

As shown in the table accompanying his affidavit, Dr. Patton concludes from his analysis of the 2004 and 2005 Gold Books that only about 300 MW of the increase in the 2005 Gold Book is material and indicative of future expectations for capacity market offers. The 300 MW are attributable to the Ravenswood and Athens plants, for which the 2005 Gold Book is more representative of their sustainable capability. Dr. Patton concludes that of the remaining 400 MW, 300 MW are attributable to the variability in DMNC tests from year to year, and to an apparent anomaly in the 2005 data for the St. Lawrence plant. This is a hydroelectric facility that typically would be expected to offer less in the winter than the summer, while the 2005 Gold Book shows an increase.

The NYISO's Demand Curve proposal used a Winter Revenue Benefit value of $5. At an empirical rate of $1/kW-year for each decrement of 110 MW of supply participation below 1400 MW, this translates to a decrease in the winter/summer differential implied by the 2004 Gold Book from 1400 MW to 850 MW.[13] As noted above, however, the actual historical supply differential has been about 500 MW. Thus, the NYISO's Winter Revenue Benefit anticipated an increase over past levels of supplies of about 350 MW. This correlates very closely with the market expectations determined by Dr. Patton from his comparison of the 2004 and 2005 Gold Books. As a further check, Dr. Patton requested the NYISO staff to determine the actual

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[10] April 21 Order at P 53.

[11] *Id.*

[12] An increase in the Net Revenue Offset serves to lower the Annual Reference Value.

[13] April 21 Order at P 55.

difference between supply offers in the winter of 2003/2004 as compared to the summer of 2003. The difference was 600 MW, which again correlates closely with the assumptions underlying the Demand Curves.[14] Dr. Patton therefore concludes that the Demand Curves should not be modified because of the 2005 Gold Book data.

The April 21 Order decreased the Winter Revenue Benefit proposed by the NYISO from $5 to $4.[15] This has the effect of increasing the assumed winter/summer differential by another 110 MW. IPPNY has nonetheless asserted in its Request for Rehearing of the April 21 Order, and in its written comments to the NYISO and in its presentations to the Board, that the remaining Winter Revenue Benefit should be eliminated. To assess the consequences of this assertion, the NYISO staff developed *pro forma* capacity clearing prices under a NYCA Demand Curve adjusted by elimination of the Winter Revenue Benefit.[16] This adjustment would raise the NYCA Annual Reference Value from $68 to $72/kW-year, and the Monthly Reference Point from $6.88 to $7.25/kW-month.[17] An increase of $0.37 in the Monthly Reference Point would result in a slightly steeper Demand Curve, as shown on the *pro forma* curves submitted with Mr. Charlton's affidavit. The supply curves derived from the offers into the May, June, July, and August 2005 monthly capacity auctions, however, have resulted in markets that have been clearing quite far down and to the right on the Demand Curve, as also shown on the *pro forma* curves, with prices at $2.00, $1.96, $1.00, and $1.00 for each of the four months respectively.[18] Using the hypothetical, slightly steeper curve resulting from elimination of the Winter Revenue Benefit, these prices would have increased by $0.10, $0.04, $0.02, and $0.03.[19] The staff anticipates that prices at the lower end of this range would prevail for the rest of this summer and beyond, given that 750 MW from a new combined cycle unit was initially offered in the July market and is expected to remain in future markets. This implies hypothetical clearing prices in the range of $0.02 to $0.03/kW-month higher, which would yield increased capacity revenues of not more than $18,000/month for a 600 MW generator.[20] Price changes in this range are less

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[14] Patton Affidavit at ¶ 17.

[15] April 21 Order at P 63.

[16] *See* Affidavit of Mr. John Charlton, Attachment B hereto.

[17] Charlton Affidavit at ¶ 5.

[18] *Id.* at ¶ 6.

[19] *Id.*

[20] *Id.* at ¶¶ 7-8 .

than the normal variability in clearing prices resulting from variations in the supply offered into the market.[21] Equally important, Dr. Patton's analysis shows that the 2005 Gold Book data does not justify eliminating all or even part of the $4 Winter Revenue Benefit.

Procedural and Financial Stability Militate Against Revising the Demand Curves. The stakeholder process that resulted in the recently approved curves started in the late summer of 2004, and culminated in oral presentations to the NYISO Board on November 15, 2004.[22] The Board approved the Demand Curves as proposed by the NYISO staff on December 21, 2004, and they were filed on January 7, 2005. As reported in the May 10 Letter, in the ordinary course of the Gold Book publication process, preliminary data from the 2005 Gold Book was made available on the NYISO's website in early March 2005, and the final 2005 Gold Book was published on April 15, 2005. These dates are long after the completion of the stakeholder process. Any adjustment to the Demand Curves based on data first available at those late dates would not have been subject to the stakeholder review contemplated in the tariff process for determining the Demand Curves.

In addition, any revision in the Demand Curves sometime after mid-April would contradict the principle of establishing curves for three year periods. As stated by Dr. Patton in his affidavit, uncertainties associated with midstream changes in the Demand Curves would tend to cause Market Participants to discount their future capacity revenue expectations, with potentially adverse effects on investment decisions.[23] Correspondingly, stable and predictable Demand Curves provide significant benefits for the New York capacity markets. Thus, Dr. Patton would support only material changes in the Demand Curves, the benefits of which clearly outweigh the costs of bringing an extra measure of uncertainty to the capacity markets.[24] As discussed above, Dr. Patton concludes that the 2005 Gold Book data does not meet this standard. Moreover, the Gold Books are revised every year, and constitute just one part of the data considered in setting the Demand Curves. Thus, revisions based on the 2005 Gold Book data would create significant uncertainty about whether the door had been opened to further revisions at almost any time, based on changes in the data considered in setting a given set of three year curves.

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[21] *Id.* at ¶ 8.

[22] NYISO Jan. 7 Filing at pp. 3-4.

[23] Patton Affidavit at ¶ 20.

[24] *Id.*

IV. Service List and Request for Waiver

As it has done with numerous recent filings, the NYISO will electronically serve a copy of this filing on the official representative of each of its customers, on each participant in its stakeholder committees and on the New York Public Service Commission. The NYISO respectfully requests a waiver of the requirements of Rule 2010 so that it may use electronic service methods. The NYISO's use of such methods has been convenient for both the NYISO and for the recipients of the service, and to date it has engendered no complaints. Allowing use of electronic service would also be consistent with the spirit of the Commission's recent Notice of Proposed Rulemaking on service and notification procedures.[25] The NYISO will also serve a copy on the electric utility regulatory agencies of New Jersey and Pennsylvania.

[25] Electronic Notification of Commission Issuances, Notice of Proposed Rulemaking, 107 FERC ¶ 61,311 (2004).

Respectfully submitted,

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