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August 16, 2011

VIA HAND DELIVERY

Mr. Robert Hiney
Chairman of the Board of Directors
c/o Mr. Stephen G. Whitley
President and CEO
New York Independent System Operator
10 Krey Boulevard
Rensselaer, NY 12144

Re: Appeal of the Management Committee's Decision Regarding The Rate Schedule 1 Cost Recovery Allocation Approved at its July 27, 2011 Meeting.

Dear Chairman Hiney:

On August 10, 2011, the Independent Power Producers of New York, Inc. ("IPPNY") filed an appeal of the Management Committee's July 27th vote on modifications to allocation of the recovery of Rate Schedule 1 costs between loads and suppliers.

Pursuant to the "Procedural Rules for Appeals to the ISO Board," Multiple Intervenors and the City of New York submit this Motion in opposition to IPPNY's appeal. Multiple Intervenors and the City respectfully request that the New York Independent System Operator, Inc.'s Board of Directors consider the arguments presented in the attached Motion in its consideration of the appeal.

This Motion is being provided electronically to NYISO's Management Committee Liaison. Multiple Intervenors and the City respectfully request that she distribute this document to the members of the Management Committee and NYISO Staff.

Thank you for your consideration of this Motion.

Sincerely,

COUCH WHITE, LLP

Kevin M. Lang

KML/glm
Enclosure
cc: Debbie Eckels (via e-mail)
Michael Mager (via e-mail)
Michael Delaney (via e-mail)
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MOTION IN OPPOSITION OF MULTIPLE INTERVENORS AND THE CITY OF NEW YORK

Pursuant to Section 4.01 of the Procedural Rules for Appeals to the New York Independent System Operator, Inc. ("NYISO") Board of Directors ("Board"), Multiple Intervenors and the City of New York ("City") hereby submit this Motion in Opposition to the appeal filed by the Independent Power Producers of New York, Inc. ("IPPNY") of the decisions of the Management Committee ("MC") at its July 27, 2011 meeting to approve Motion No. 5 and defeat Motion Nos. 5A and 5B, all of which pertain to Rate Schedule 1 cost recovery allocations.

A. Background

The NYISO's annual operating expenses, including Federal Energy Regulatory Commission ("FERC") fees, are recovered from market participants through Rate Schedule 1. Initially, 100% of the NYISO's operating expenses were allocated to loads. Shortly after the NYISO commenced operations, the allocation of its operating expenses was modified such that 85% was recovered from loads and 15% from suppliers ("85/15").

In response to stakeholder concerns that the 85/15 allocation was not equitable, the NYISO retained an independent consultant, R.J. Rudden & Associates ("Rudden"), to conduct a cost study and provide recommendations on the allocation of NYISO operating expenses between load and supply. That study, completed in 2004, recommended that NYISO operating expenses be allocated 77% to loads and 23% to suppliers ("77/23"). Stakeholders from numerous sectors had concerns regarding the Rudden study. Following extensive settlement negotiations, the MC approved a motion calling for an allocation of 80% from loads and 20% from suppliers ("80/20").

At its July 21, 2010 meeting, the MC approved, with 67.75% of the vote, a motion directing the NYISO to undertake a new cost study of its operating expenses and allowing for the

80/20 allocation to be modified, if warranted by the results of the new study, effective January 1, 2012. At meetings on August 12, 2010 and September 24, 2010, the Budget and Priorities Working Group ("BPWG") worked with the NYISO to establish the parameters of the new cost study. Pursuant to that study scope, the consultant would be asked to perform a "[c]omplete study with data supporting both an unbundled rate structure and a revision to current allocation percentages."[1]

Consistent with the motion approved by the MC and the study scope established with the BPWG, the NYISO retained an independent consultant, Black & Veatch ("B&V"), to conduct the new cost study and make recommendations as to how the NYISO's operating expenses should be allocated. In July 2011, B&V issued its Rate Schedule 1 Study Final Report ("B&V Report"). With respect to the allocation factor between loads and suppliers (putting aside non-physical transactions for which no structural modifications were proposed), B&V concluded that: (a) under one scenario, an 80/20 allocation between loads and suppliers would be appropriate; (b) under a second scenario, a 63% loads/37% suppliers ("63/37") allocation would be appropriate; (c) the two scenarios bound a range of reasonable values; (d) the midpoint of the two scenarios is a 72% loads/28% suppliers ("72/28") allocation; and (e) an allocation near the midpoint is reasonable. (B&V Report at 29).

At the July 27, 2011 MC meeting, NYISO Staff presented the B&V Report and recommended adoption of a 72/28 allocation. The MC then approved Motion No. 5, adopting the 72/28 allocation effective January 1, 2012. Motion No. 5 passed with 67.03% affirmative votes. On a pure numeric basis, 43 votes were cast in support of, and 14 votes were cast in opposition to, Motion No. 5. Prior to the MC's approval of Motion No. 5, the MC voted to

[1] "Rate Schedule 1 Study Scope – Proposal," Presentation by the NYISO to the Budget and Priorities Working Group, dated September 24, 2010, at 3.

reject: (a) Motion No. 5A, seeking to table Motion No. 5, which received only 44.15% affirmative votes; and (b) Motion No. 5B, seeking to allocate to loads a far-greater share of NYISO operating expenses than that recommended by B&V and NYISO Staff in 2012, 2013 and 2014, which received only 37.62% affirmative votes.

B. IPPNY's Appeal Should Be Denied

IPPNY raises numerous arguments on appeal. Each of those arguments lacks merit and should be rejected. The appeal should be denied in its entirety.

1. The MC Motion Does Not Result In A Substantial Shift In The Cost Allocation To Suppliers

Initially, IPPNY argues that Motion No. 5 would result in a "substantial shift of RS1 cost allocation from loads to suppliers." (IPPNY Appeal at 3). That argument lacks merit. The Rudden study, completed in 2004, indicated that a 77/23 allocation was appropriate. The B&V Report, completed in 2011, indicated that a 72/28 allocation was appropriate. The fact that two independent consultants – both retained by the NYISO – came to only slightly different conclusions seven years apart hardly is surprising. Importantly, NYISO Staff also recommended the 72/28 allocation as reasonable.

Moreover, IPPNY's reliance on the Rudden study, or even the 80/20 allocation that was the result of the 2004 settlement, is misplaced. B&V was directed to conduct a comprehensive, independent, new cost study in 2011. B&V was <u>not</u> tasked with conducting an incremental analysis of, or building on, the Rudden study, or conducting any comparative analyses between the NYISO's operating expenses in 2004 and its operating expenses in 2011.

IPPNY's portrayal of the magnitude of the change in the allocation is misleading in at least two respects. First, the NYISO's operating expenses represent only a small fraction of wholesale electricity prices. Assuming annual NYISO operating expenses of $150 million, the difference between an 80/20 allocation and a 72/28 allocation is $12 million, divided over the megawatt-hours injected and withdrawn over a 12-month period. This equates to pennies per megawatt-hour. When the shift is put in a proper context, it cannot be considered significant, nor should it have any material impact on the markets or on any NYISO initiatives, particularly its broader regional markets efforts.

Second, in its efforts to avoid an allocation consistent with the B&V Report and NYISO Staff recommendation, IPPNY disregards the fact that since 2004, loads have been paying an 80/20 allocation when the Rudden study indicated that a 77/23 allocation was appropriate. The fact that the current allocation has been more favorable to suppliers than what the Rudden study recommended should not be used now as an impediment to reflecting the results of a new cost study.

2. The Existence Or Absence Of Market Changes Since 2004 Is Irrelevant

IPPNY argues that there have been no "material changes to the market since 2004 that would have caused a substantial re-allocation of NYISO resources." (IPPNY Appeal at 1; *see also* IPPNY Appeal at 5-7). IPPNY's argument is a red herring. Loads have been concerned for years that the 80/20 allocation no longer was equitable, which belief was a major factor in their push for the NYISO to conduct a new cost of service study. As discussed above, B&V was retained to conduct a <u>new</u>, comprehensive cost study, not critique the old study or limit its analysis to changes since 2004. The B&V Report confirmed that the loads' concerns were well-founded, and that a readjustment of the allocation is in order.

Additionally, a review of the results of the two analyses demonstrates that IPPNY's claims are exaggerated and do not form any basis for the Board to set aside or countermand the MC's approximately two-thirds majority vote. In 2004, Rudden concluded that NYISO expenses should be allocated 77/23. In 2011, B&V concluded that NYISO expenses should be allocated 72/28, a difference of only five percentage points. These results are not so different that they amount to a "substantial re-allocation of NYISO resources."

IPPNY's assertions regarding the comparison between the Rudden study and the B&V Report are similarly inapposite. IPPNY had both studies and could easily have performed whatever comparison it wanted on its own – it did not need the NYISO to do so. Moreover, because the present decision was based on the new B&V Report, a review or reconsideration of the Rudden study was neither warranted nor relevant.

There cannot be any legitimate dispute that suppliers and supplier interests play a major role in the NYISO's incurrence of operating expenses. Indeed, given the amount of NYISO time and resources expended on "supplier issues" (*e.g.*, demand curves, buyer-side mitigation, new capacity zones), an allocation factor for suppliers well in excess of 28% could be justified. Indeed, the B&V Report indicated that as much as 37% of the NYISO's operating expenses could be allocated to suppliers and be within a range of reasonableness.[2]

3. IPPNY Had A Full Opportunity To Review And Raise Concerns With The B&V Report

IPPNY argues that "significant concerns with the B&V Report remain unresolved." (IPPNY Appeal at 1; *see also* IPPNY Appeal at 5-7). This statement does not apply to the majority of market participants, as evidenced by the MC vote. Further, this claim is belied by the activities and schedule surrounding the B&V Report and should not cause the Board to reverse

2 To the extent the NYISO Board grants any credence to IPPNY's argument, it should recognize that there have been changes to the NYISO's markets since 2004 warranting a greater allocation to suppliers. The most controversial issues confronting the NYISO and the Board relate to disputes and litigation commenced by suppliers regarding the installed capacity markets, particularly the development of demand curves and new entrant market power mitigation measures (which did not exist in 2004). The capacity markets serve as a primary revenue source for many suppliers, and the amount of effort devoted to them has substantially increased.

or remand the MC decision. The schedule for this matter was first presented by NYISO Staff to market participants on July 21, 2010,[3] and the NYISO has adhered to this schedule since that date. The first iteration of the B&V Report was distributed to market participants on or about April 15, 2011, so IPPNY has had approximately three months to raise concerns with B&V, and the NYISO, regarding the B&V Report. Indeed, other market participants, including Multiple Intervenors and the City, raised concerns during the time period, which resulted in some changes to the B&V Report.

While suppliers, and loads, might have preferred that the final B&V Report reflect more extensive modifications from the drafts based on stakeholder input, the fact that the independent consultant declined to modify its conclusions and recommendations does not warrant upsetting the will of the MC, which approved an allocation consistent with the midpoint of B&V's recommended range and NYISO Staff's recommendation.

The Board should also look at the nature of the "concerns" raised by IPPNY and whether its concerns could be addressed by reversal of the MC's decision. The only concern IPPNY raises, though, is that the B&V Report lacks "reasonable support". (IPPNY Appeal at 3). This concern is no more than a subjective critique of the B&V Report, and the Board's reversal of the MC's decision will not result in changes to the B&V Report, which is now final.

4. Potential Impacts On A Small Number Of Individual Market Participants Should Not Be A Determinative Factor

IPPNY complains that the MC-approved allocation would impact certain suppliers negatively because they sell electricity under longer-term bilateral contracts. (IPPNY Appeal at 4). While the outcome of the MC's vote may have a greater impact on some suppliers compared

[3] "Rate Schedule 1: Allocation of NYISO Budget," Presentation by the NYISO to the MC, dated July 21, 2010, at 7.

to others, for numerous reasons that consideration does not warrant modification of the MC's decision. All market participants, including suppliers, have been on notice for many years that loads had concerns with the equity of the 80/20 allocation and that it was subject to future modification. Thus, the fact that certain suppliers chose to enter into bilateral contracts that do not provide for any adjustment of pricing provisions if Rate Schedule 1 changed are business decisions made by those suppliers. Suppliers, and loads, entering into fixed-price bilateral contracts do so assuming certain business and regulatory risks. The NYISO Board, therefore, should not reverse the MC's decision, to the detriment of all loads, in order to remedy the business decisions of a select few generators.

5. B&V's Scenario 2 Should Not Be Rejected

IPPNY complains that B&V's "Scenario 2" assumptions should be disregarded because it does not accept B&V's allocation of common costs equally between loads and suppliers. (IPPNY Appeal at 6). This subjective, self-serving position should be rejected. As explained above, B&V was asked to perform an independent review and it did so. As part of that independent review, B&V determined that it would be a reasonable alternative approach to allocate costs that are common in nature on an equal basis. That no other region does so is irrelevant because the NYISO need not use the same allocations or allocation methodologies as the other regions. The different allocations of operating expenses among regions does not create a seams issue. In fact, there are numerous aspects of the NYISO markets that benefit suppliers more so than in other regions.[4] If the Board were to grant IPPNY's appeal on this basis, by logical extension, those attributes should be revisited and perhaps eliminated.

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[4] According to the NYISO's Market Monitoring Unit, "[t]he performance of the New York markets is enhanced by a number of attributes that are ***unique*** to the NYISO [including, for example] [a]n optimized real-time commitment system that starts gas turbines, flexible hydroelectric generators, and some combined cycles and

As discussed above, that the Rudden study used a different approach is also irrelevant. Multiple Intervenors and the City assert that it is reasonable to equitably allocate those costs that cannot be directly assigned because those costs relate to activities that provide shared benefits to loads and suppliers. Indeed, IPPNY did not offer any rationale as to why an equitable allocation is inappropriate – its argument is only that no other region does so. There is no legal requirement that all regions treat all costs exactly the same, just like there are no legal requirements that all regions adopt the exact same market rules. The different allocations of operating expenses among the regions has never been identified as a seams issue, nor have they been raised in the context of the broader regional markets initiative as a problem. Thus, IPPNY's argument lacks a substantive basis, is not meritorious, and should be rejected.

6. The Claims About FERC Fees Are Misplaced And Inapposite

IPPNY also complains that B&V fails to allocate 100% of FERC fees incurred by the NYISO to loads. (IPPNY Appeal at 7). IPPNY's argument regarding FERC fees lacks merit for numerous reasons. First, the NYISO always has allocated FERC fees similar to other NYISO operating costs. Neither B&V nor IPPNY or any market participant has presented any compelling reason for changing that approach. To the contrary, it is equitable to allocate FERC fees similar to other operating costs, and IPPNY has offered no factual evidence or substantive arguments in support of its position that all such fees should be allocated to loads. FERC regulates the NYISO's administration of competitive markets, and, as demonstrated above, those markets benefit suppliers as well as loads. Therefore, there is no reason to treat this one expense

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schedules external transactions economically. [emphasis added]" Potomac Economics, "2010 State of the Market Report New York ISO Electricity Markets," dated April 2011, at 3.

any differently than any other expense.[5] Finally, for the same reasons noted above, the manner in which other regions allocate FERC fees is irrelevant.

7. IPPNY's References To Allocations In Other Regions Disprove Its Arguments

According to the analysis prepared by B&V, PJM and ISO-New England use allocations that date back to the inception of those organizations in the late 1990s, whereas the California ISO adopted a new rate design in 2008.[6] When the allocations by region are viewed in context with the time frames in which they were adopted, the MC Motion gains more support and IPPNY's position is substantially weakened.

At its inception, the NYISO allocated 100% of the costs to loads. The NYISO's market participants wisely recognized the inequitable nature of that allocation and changed it over time. PJM and ISO-New England have not engaged in similar reviews. However, the California ISO has acted similarly to the NYISO, and it has adjusted the allocation over time to fairly recognize the work it performs for loads and suppliers. Indeed, the allocation there, which was developed in 2008, is about 67% loads and 33% suppliers, making it very comparable to the B&V Report results.[7] Accordingly, even if the NYISO Board were to look to other regions, it should more heavily weight the more recent California cost allocation than the stale cost allocations used in PJM and ISO-New England.

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5 In this regard, it is noteworthy that IPPNY did not attempt to explain why suppliers should be completely exempt from FERC fees when they clearly derive benefits from FERC-regulated markets.

6 Black & Veatch, "Rate Schedule 1 Study Status Update Review of Other ISO/RTO's," dated March 2011. No information was provided regarding the genesis of the cost allocations in the MISO, ERCOT, or SPP.

7 For these reasons, the NYISO Board should not view the California ISO allocation as an "outlier" as suggested by IPPNY. (IPPNY at 8). Indeed, that allocation is perhaps the most comparable and shows that the recommended 72/28 allocation is generous to suppliers.

C. Conclusion

For all the foregoing reasons, Multiple Intervenors and the City respectfully request that the NYISO Board deny IPPNY's appeal in its entirety. The 72/28 allocation: (a) is consistent with the analysis and recommendations of the NYISO's independent consultant; (b) is supported by NYISO Staff; (c) was approved by a two-thirds vote of the MC; (d) results in a relatively small reallocation of NYISO expenses between loads and suppliers; and (e) will not jeopardize other efforts of the NYISO, such as its broader regional markets initiative.

Respectfully submitted,

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