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August 10, 2011

VIA E-MAIL & HAND DELIVERY

Mr. Robert Hiney
Chairman of the Board
c/o Mr. Stephen G. Whitley
President and Chief Executive Officer
New York Independent System Operator, Inc.
10 Krey Boulevard
Rensselaer, NY 12114

Re: Notice of Appeal of Management Committee Decisions of July 27, 2011 (Motions #5, #5A, #5B) on Rate Schedule 1 Cost Recovery Allocation

Dear. Chairman Hiney:

Pursuant to the Procedural Rules for Appeals to the ISO Board, on behalf of the Independent Power Producers of New York ("IPPNY"), enclosed are the originals of IPPNY's Notice of Appeal of the Management Committee's July 27, 2011 decisions concerning the Rate Schedule 1 recovery cost allocation (Motions #5, #5A, #5B).

Motion #5, recommending that the Board approve a substantial shift in Rate Schedule 1 recovery cost allocation from loads to suppliers for filing under Federal Power Act Section 205 as described in the presentation made to the Management Committee on July 27, 2011, was approved. Motion #5A to table the motion to allow further review of the RS1 Study and Motion #5B to provide a three year phase-in period were both rejected.

IPPNY respectfully requests that it be given the opportunity to present oral argument before the Governance Committee with respect to this appeal.

A copy of the enclosed Notice of Appeal has been delivered to Deborah Eckels, Leigh Bullock and Kate Hockford today for circulation to all members of the Management Committee via electronic mail.

Very truly yours,

/s

David B. Johnson

Enclosures
cc: Deborah Eckels, via e-mail
Leigh Bullock, via e-mail
Kate Hockford, via-email

NOTICE OF APPEAL

Independent Power Producers of New York, Inc. ("IPPNY"),[1] hereby appeals the MC's rejection of motions #5A and #5B and the MC's vote -- cast on straight load vs. supply lines -- to approve Motion #5 at its July 27, 2011 meeting. Motion #5 recommends that the NYISO Board of Directors ("Board") approve a substantial shift to the Rate Schedule 1 ("RS 1") cost allocation from 80% load/20% supplier to 72% load/28% supplier to be filed under Section 205 of the Federal Power Act. Defeated Motion #5A sought to table the motion to allow for further review of the underlying study. Defeated Motion #5B proposed to amend the RS 1 motion to allow for a three-year phase-in period.

If implemented, Motion #5 will result in a 40% increase in RS1 cost to suppliers despite there being no accompanying material changes in the market since 2004 that would have caused a substantial re-allocation of NYISO resources. The resulting 28% cost allocation is well in excess of the levels allocated to suppliers in the neighboring regions, a factor that requires review given the NYISO's broader regional markets efforts.

At the May 18, 2011 Business Planning Working Group ("BPWG meeting"), many market participants, both loads and suppliers, identified potential flaws in the Black & Veatch draft RS1 study ("Draft Study"). Efforts to remedy these flaws were, however, put on hold to allow for settlement discussions, which ultimately were not fruitful.

The final B&V study presented to the MC ("B&V Final Report") was not changed despite the concerns with the Draft Study that were raised at the May 18 BPWG meeting. Thus, significant concerns with the B&V study remain unresolved. However, the MC rejected a

[1] IPPNY is a not-for-profit trade association representing nearly 100 companies involved in the development and operation of electric generating facilities and the marketing and sale of electric power in New York. It submits this appeal acting through its members on the Management Committee ("MC").

motion to table the vote to allow an additional month for further review so that these flaws may be adequately addressed.

IPPNY respectfully requests that the Board decline to endorse the B&V Final Report and remand the matter back to the BPWG for further review. In the alternative, IPPNY requests that the Board provide for a reasonable three-year phase-in period along the lines presented in Motion #5B with a supplemental study to be conducted during that time to implement an RS 1 cost allocation beginning in 2015 (Year 4).

A. If Approved, the Results of the B&V Final Study Will Have Significant Impacts on Suppliers Even Though the Report Contains Material Flaws That Have Not Been Addressed

B&V presented its draft studies for discussion as an agenda item at the April 20, 2011 and May 18, 2011 BPWG meetings. At both meetings, substantial concerns were raised by both loads and suppliers with the assumptions that B&V had made as well as the conclusions that were reached.

In addition, at the outset of this process, IPPNY and individual suppliers requested that B&V identify major differences in its results as compared to the results of the 2004 Rudden Study.[2] This request was reiterated during the working group meetings this spring when the RS1 issues were addressed. However, the B&V/Rudden comparative analysis was not produced for review until shortly before the June 21, 2011 BPWG meeting ("Comparative Assessment") -- a meeting that was held by conference call. Because settlement negotiations were still ongoing at that time, there were no substantive discussions about any RS 1 issue (including the newly issued but unreviewed Comparative Assessment) during the June 21st meeting.

[2] While review of the Rudden Study was never completed because a settlement was reached, the Rudden Study was used, in part, as support that the settlement that had been reached in 2004 fell within a reasonable range.

Further review of the B&V Draft Study and the subsequently issued Comparative Assessment was delayed to allow the parties the opportunity to continue to attempt to reach settlement on the RS I cost allocation issues. Unfortunately, in or about mid-July, settlement discussions initially reached impasse and were terminated. However, by that time, no further BPWG meetings were scheduled to allow for further review of the B&V Draft Study. Instead, the B&V Final Report -- unchanged from the B&V Draft Report -- was posted as a meeting material for the July 27th MC meeting just days later and was identified as the consultant's "Rate Schedule 1 Study Final Report."

While IPPNY continues to review the B&V Final Study, as set forth, infra, it has identified a number of shortcomings in it. These concerns include the lack of reasonable support for B&V's overall recommendation, "[u]ltimately, if bundled rates are to be continued, we recommend a change from the current 80/20 split to a split that is at or around the midpoint of 72/28" between "the upper and lower bounds of the studies" - a back-of-the-envelope analysis that B&V characterizes as "a reasonable settling point."[3] The NYISO did not retain B&V to defend a settlement (there is none, at least yet) but rather to perform a type of cost-of-service study.

The proposed, substantial shift in RS1 cost allocation from loads to suppliers and the underlying study that produced this result, which load interests pushed through the MC over the objections of suppliers on a vote that was cast along straight load vs. supplier lines, were not adequately vetted.[4] Indeed, despite significant concerns raised about the B&V Draft Study by

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[3] See B&V Final Study at 2.

[4] IPPNY would note that the RS1 vote marked yet another time when demand response providers have voted in concert with loads. In fact, one of the end-use consumer representatives carried the proxy for a number of these entities (Enernoc, Integrys, Viridity). IPPNY would further note that the RS 1 vote marked yet another time among many (e.g., the votes taken on the load side mitigation rule changes last fall, some of which were sponsored by the

both loads and suppliers, the B&V Final Study presented to the MC remained completely unchanged.

It also must be understood that this proposed substantial, but inadequately justified, shift in the RS1 cost allocation will have a significant adverse impact on a subset of suppliers. Specifically, while the MC RS1 Presentation correctly notes that RS1 costs are a variable cost that must be included in generation reference levels,[5] not all suppliers sell into the spot market, and thus, not all suppliers can recover these costs. For those suppliers selling under longer-term (> 1 year) bilateral contracts, this proposed substantial shift in cost allocation results in a 40% increase in RS 1 costs without any ability to recover them. Longer term bilateral contracts provide substantial hedging benefits to consumers. The balance of benefits under such contracts should not be lightly upset, particularly when a structured phase-in[6] is an available option.[7]

Given these concerns, IPPNY submitted comments to the Management Committee requesting a one month deferral to allow for adequate review of the B&V Final Study and the Comparative Assessment to address the flaws that had been identified. In its Comments, IPPNY noted that a one month delay would not adversely affect a January 2012 implementation of any revised RS 1 cost allocation that is approved by the FERC. NYISO Staff confirmed this fact at

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NYISO over the MMU's objection as well as traditional supplier objection) when the vote fell directly along load and supplier lines on a core pocketbook issue.

[5] See NYISO Management Committee Meeting Presentation, [http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2011-07 27/agenda_05_072711_MC_presentation_on_RS1_FINAL.pdf](http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2011-07-27/agenda_05_072711_MC_presentation_on_RS1_FINAL.pdf) (hereinafter, "MC RS1 Presentation").

[6] IPPNY would note that the NYISO has relied upon phase-in structures in the past to address changes in rates. See, e.g., FERC Docket ER03-647-000, New York Independent System Operator, Inc. (providing for a three year phase-in to new Demand Curve pricing in capacity market).

[7] At the MC meeting, Entergy Nuclear Power Marketing, an IPPNY member, sought to amend Motion #5 to allow for a three year transition period as follows: Year 1, 80% load/20% supplier; Year 2, 78% load/22%; and Year 3, 78% load/22% supplier. This phase-in generally tracks the term of longer term bilateral contracts that are currently in place.

the July 27th MC meeting. Motion #5A to table the RS 1 motion for one month was, nonetheless, rejected with no reason given for denying the postponement to allow all parties sufficient time and opportunity to work with B&V and analyze the B&V Final Study and the Comparative Assessment.

It is incumbent on the NYISO to administer the markets and base decisions on sound, factually supported data. Where, as here, the study report remains incomplete, IPPNY respectfully requests that the Board direct management to resolve the deficiencies identified in the B&V Final Report prior to adopting any recommendation for a change in the RS 1 cost allocation between loads and suppliers.

B. The B&V Study Has Significant Deficiencies That Have Not Been Addressed

Based upon its limited review, IPPNY has identified a number of significant shortcomings in the B&V Final Study.

For example, Market Participants were advised that, for both the 2004 and 2010 studies, the study consultant interviewed key NYISO personnel concerning the manner in which the resources under their supervision were used. In the 2004 Rudden Study, the consultant was able to identify and directly allocate nearly half (47.1%) of the NYISO's total administrative costs to five service categories with the remaining 52.9%, referred to as "Management Services," allocated generically across all five service categories. Inexplicably, six years later with essentially no major changes to the NYISO's market design, B&V was able to identify and directly allocate only 27.4% of the NYISO's total administrative costs, coined "Shared Services," to six services categories. This left the lion's share of the NYISO's administrative costs, 72.6%, not directly attributed to any distinct service category. No explanation was given for this difference. Indeed, when specifically asked during the July 27th MC meeting whether there were major changes in the NYISO's market design in the intervening period that would explain this substantial differential, NYISO Staff responded that, while it had not done a line-by-line analysis, it did not know of any such changes.

This shortcoming was then further exacerbated by the manner in which these costs were proposed to be allocated. Specifically, one of B&V's proposed alternative methods for allocating indirect costs was to split these costs -- again, which amount to nearly three-quarters of the NYISO's total administrative costs -- approximately evenly between load and supply ("Scenario 2"). B&V provided no particular support for adopting this approach. This results in an overall cost allocation between load and supply of 63%/37%. Using this disparate cost allocation as a "bound" allows B&V to then come to an overall 72%/28% "mid-point."

The 63%/37% load/supply ratio "bound" is well outside the range of cost allocation ratios employed at all the other ISO/RTOs B&V reviewed.[8] The California ISO has the lowest load share at 67%, still 4% higher than the Scenario 2 results. Thus, while B&V asserts that Scenario 2 bounds the limit of a reasonable cost allocation, the outcome is not just and reasonable in comparison to other ISOs/RTOs. Therefore, Scenario 2 should not be used in any manner to support an RS-1 cost allocation. Indeed, allocating Shared Services in the same proportion as the direct costs -- B&V's Scenario 1 and Rudden's approach to addressing Management Services, the functional equivalent of Shared Services -- results in an overall 80% load/20% supplier allocation, confirming the reasonableness of the level that has been in place since 2005.

As a second example, as reflected in the Comparative Assessment, B&V has determined that the Rudden Study categories of system reliability, real time operations and energy and ancillary services markets would have produced a 78% load/22% supply split. B&V proposes to assign costs for these same categories on a 72% load/28% supply basis. B&V, however, fails to

[8] See B&V Final Study at 4.

provide an adequate justification for such a significant shift in costs, particularly given the fact that there have been no major changes to the market design in the intervening period. These costs, however, account for nearly 70% of the NYISO's administrative budget. Thus, the proposed change in their allocation substantially drove B&V's proposed 8% shift in the RS 1 costs allocated to suppliers from 20% to 28%, which equates to a 40% increase -- again, when there have been no major changes in the market design, and hence, no re-allocation of New York resources, to account for such a substantial shift.[9]

Another example is in the area of FERC fees. While FERC fees were indisputably at issue in this analysis, B&V failed to study the treatment of FERC fees by other ISO/RTOs. In the other Eastern RTOs, the FERC fees are 100 percent allocated to load.[10]

B&V provides no data to support its proposed allocation of FERC fees of 67%/27%/6%. Indeed, its total review of this issue is limited to just two paragraphs of the Final Study. While some may attempt to argue that FERC fees always have been allocated in the same proportion as the overall administrative costs, B&V was directed to review all allocations. Had it done so, it should have determined that these costs should be assigned 100% to loads as the other ISOs have correctly determined.

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[9] Some may attempt to argue that a comparable analysis was beyond the scope of the consultant's efforts. That is not true. B&V was not starting from a clean slate. There is, in fact, a rate allocation in place today that previously has been accepted as just and reasonable. While produced through a settlement, that rate was, in part, supported by the 2004 Rudden Study. Without any major substantive change in the NYISO's market design in the intervening period, the proposed 40% increase in RS 1 costs attempted to be foisted off on the suppliers by virtue of the load-driven MC vote on Motion #5 is not just and reasonable.

[10] *See*, PJM Open Access Transmission Tariff, Schedule 9, pages 551-552, available at: http://www.pjm.com/documents/~/media/documents/agreements/tariff.ashx; *see also*, ISO-NE Transmission, Markets & Services Tariff, Section IV.A, Rate Schedule 4, available at: http://www.iso-ne.com/regulatory/tariff/sect_4/sect_iva.pdf

C. The Proposed 28% Cost Allocation for New York Suppliers Falls Well Outside The Percentage Applied To Suppliers In the Adjoining Regions

As part of its analysis, B&V reviewed the cost allocation percentages of all other ISOs. Taking out the outliers on both sides (ERCOT and SPP at 100% to loads and California at 67% to loads), the New England, PJM and MISO markets provide a legitimate basis for comparison. As reflected in the B&V Final Study, the supplier shares in these markets are 22%, 21% and 25%, respectively. While specific rules vary from market to market, importantly, each of these markets have the same basic cost centers as the NYISO. Were the B&V Final Report to be accepted, New York would jump from the lowest of the four adjacent ISOs to the highest -- and by significant margins as compared to New England and PJM. Again, this would take place in the absence of any significant changes to the NYISO market design in the intervening period to warrant such a substantial change in the allocation of RS 1 costs.

Moreover, as the RS1 MC Presentation correctly notes, as a variable cost, RS1 costs are included in generator reference levels. Thus, this substantial shift in cost allocation without any phase-in will immediately increase LBMPs, all else being equal. As a result, the proposed 40% increase in RS 1 costs allocated to suppliers would skew the relative economics and efficiency of imports from adjoining regions. In other words, by artificially increasing the costs of New York generators, and thus, their bids, it would make some offers from the adjoining regions appear economic when, in fact, they are not. This is particularly important given New York's emphasis on broader regional market initiatives. Yet when B&V was asked at the July 27th MC meeting whether it had taken this into account, they replied that they had not done so. This dynamic must be taken into account in formulating any recommendation for a change in the RS1 cost allocation between suppliers and loads.

CONCLUSION

Based on the foregoing, IPPNY respectfully requests that the Board decline to endorse the results of the B&V Final Study pending further review. To provide for adequate review, IPPNY requests that the Board remand the matter back to the BPWG to address the open issues with the B&V Final Study. In the alternative, IPPNY respectfully requests that the Board also propose a reasonable, three-year, phase-in period to allow a transition period for parties with bilateral contracts along the lines proposed in Motion #5B with a supplemental study conducted during the interim period, with the results of the interim study to be implemented beginning January 1, 2015 (Year 4).

Respectfully submitted,

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By: ____________________
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Dated: August 10, 2011
Albany, New York