



Independent Power Producers of New York, Inc.

Gavin J. Donohue
President and CEO

Via Email

March 31, 2006

Mr. Mark S. Lynch
President and CEO
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, NY 12303

Re: Operating Committee's Revision of Minimum Locational Capacity Requirements

Dear President Lynch:

At 6:30 P.M. on March 28, 2006, the New York Independent System Operator, Inc. ("NYISO") announced via the Technical Information Exchange that the NYISO Board is providing market participants until 5:00 P.M. on March 31, 2006 to submit substantive comments on the NYISO Operating Committee's ("OC") March 27, 2006 decision to revise the minimum locational capacity requirements ("LCRs") that were established this past February. The NYISO indicates that the NYISO Board is suspending the appeal process and notice periods set forth in the NYISO's governance procedures so that it can act on an urgent basis to determine final minimum LCRs in time for the monthly and spot installed capacity auctions scheduled to occur in April, 2006. The NYISO states that a two business day comment period leaves "ample opportunity" for market participants to prepare and file substantive comments.

At the outset, the Independent Power Producers of New York, Inc. ("IPPNY")¹ notes that it supports the principle that errors which undermine efficient and accurate market signals, particularly those which also have the potential to adversely impact system reliability, must be rectified expeditiously, when it is practicable to do so. However, this principle must be applied consistently, for all major issues. The NYISO has not exhibited a willingness to commit extraordinary efforts similar to those it has taken in connection with the instant issue in order to correct errors that artificially suppress prices, such as, by way of example, errors related to the operation of the NYISO's reserve demand curves, as will be discussed in greater detail below.

IPPNY, acting through its members on the OC, strongly objects to the NYISO Board's unauthorized attempt to contravene the appeal rights granted to market participants by the

¹ IPPNY is a not-for-profit trade association representing more than 100 companies involved in the development and operation of electric generation facilities and the marketing and sale of electric power in New York.

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NYISO's governance procedures. Contrary to the NYISO's claim, the Board's action effectively eliminates any reasonable opportunity for market participants to provide meaningful comments, as two business days is not nearly sufficient to prepare substantive comments on this matter.

The Board's action violates the NYISO Agreement and the OC and Management Committee ("MC") by-laws. As mandated in the ISO Agreement, the MC and OC by-laws provide market participants ten business days to file appeals of actions of the OC and MC to the MC and Board, respectively.² The OC by-laws also provide that OC actions shall not become effective until 30 days after OC has acted, or, if no appeals of the action have been timely filed, one business day after the time for a timely appeal has passed.³

The NYISO has no authority under the NYISO Agreement or any other governance procedures to circumvent market participants' appeal rights and the time at which OC actions become effective. Section 5.07 of the NYISO Agreement provides that the Board "may suspend an action by any ISO Committee pending appeal," "may review any matter, complaint, or Committee action on its own motion" and "shall establish procedures for reviewing such matters." These provisions are designed to provide a means for the Board to suspend and review committee actions if no appeals of the action are filed. They do not permit the Board to vitiate or truncate market participants' appeal rights.

Further, the Board has not established procedures to review OC actions on its own motion, as it is required to do under the NYISO Agreement. The only procedures implementing Section 5.07 are the Procedural Rules for Appeals to the NYISO Board. These rules provide that the Board may review MC actions on its own motion.⁴ However, the rules provide that when the Board does so, market participants may file motions in opposition or support of the NYISO's review within five business days of the NYISO's notice of its review to the MC. The NYISO's action providing only two business days for market participants to comment on the OC's revision of the LCRs fails to comply even with the timeframe adopted in the Board's own procedural rules regarding review of MC actions.

The NYISO's action, if allowed to stand, establishes a troubling precedent that may lead to future, improper Board interference with market participant governance. The NYISO's "emergency" action is especially troubling because it has failed to allege facts and circumstances that constitute an emergency. The NYISO's proposed action is not needed to maintain system reliability. The NYISO's action merely provides a potential economic benefit to one side of the market. The revised LCRs approved by the OC would reduce the amount of capacity load serving entities in Long Island and New York City would need to procure from within those localities. The LCRs approved by the OC in February actually enhance reliability by ensuring additional capacity will be available this summer in the localities, where additional capacity provides the greatest contribution to reducing loss of load probability.

In addition, minimal, if any, harm to the market will occur if the Board allows the appeal process to proceed as established in the ISO Agreement and the MC and OC by-laws. If no

² By-Laws of the Management Committee, Section 15.02; By-Laws of the Operating Committee, Section 13.01. These by-law provisions are mandated by the ISO Agreement.

³ By-Laws of the Operating Committee, Section 4.13.

⁴ Procedural Rules for Appeals to the NYISO Board, Section 1.05

party appeals the OC's decision, its action will become effective on April 11. If appeals are filed at both the MC and the Board, the revised LCRs still could become effective in time for the June ICAP monthly and spot market auctions. Thus, the worst case scenario is that loads would be required to procure three percent more locational capacity in NYC and seven percent more on Long Island, for a one month period. It is noteworthy that the total amount of capacity procured by NYC and LI loads would not change, only the relative share that is procured within versus outside the locality would be affected. This hardly constitutes an emergency.

The NYISO's action is troubling for a second reason. It illustrates that the NYISO will take extraordinary action and efforts to address issues that, although not constituting a threat to reliability, would increase market costs -- to the extent of running roughshod over market participant rights -- while the NYISO has exhibited no such willingness to commit extraordinary efforts to correct errors that cause prices to be improperly suppressed. IPPNY notes that for months it has repeatedly implored the NYISO to address and correct market flaws that have caused reserves pricing to fail to appropriately reflect scarcity conditions, as identified in by the NYISO's Independent Market Advisor back in January.⁵

This issue has been raised with NYISO senior management at each MC meeting since Dr. Patton's January report was issued. Given the critical role that scarcity revenues play in a supplier's ability to meet its annual revenue requirement, it is crucial that this problem be corrected before the start of the summer capability period on May 1. Unfortunately, despite our repeated requests, the NYISO has not even made Dr. Patton available at a working group meeting to address this critical problem.

During the same period that suppliers have sought NYISO assistance in correcting this critical problem, and been largely rebuffed, the NYISO has expended extraordinary resources in intensive efforts to re-run the MARS model used to establish the IRM and minimum LCRs, not once, but twice since December (first to address LIPA's exceedingly late UDR election and then the LCR recalculation). The difference in the effort expended by the NYISO to address the reserve demand curve issue, versus its intense efforts relating to re-running MARS, is stark.

For the foregoing reasons, the NYISO should allow the appeal process to proceed as established in the ISO Agreement and the MC and OC by-laws. Regardless of the NYISO's decision with respect to the LCR matter, IPPNY expects that the NYISO will exercise the same level of intensity and resource commitment to correct market errors, including the reserve demand curve problem, that artificially reduce market clearing prices, that it has undertaken to re-run the MARS model.

Please do not hesitate to contact me, if you have any questions or comments.

Respectfully submitted,

s/Glenn D. Haake/

Glenn D. Haake
General Counsel

⁵ See Six Month Assessment of the NYISO Markets Under SMD2, David B. Patton, Ph.D (January 25, 2006) at 70-78 for a discussion of reserves pricing errors.