

**Comments on NYISO Staff's Proposed Installed Capacity Demand Curves for the 2008-09, 2009-10  
and 2010-11 Capability Years**

**Submitted by Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, LIPA, New York Power Authority, New York State Electric & Gas Corporation, Orange & Rockland Utilities, Inc., and Rochester Gas & Electric Corporation (the Transmission Owners)**

**October 1, 2007**

**I. Introduction**

The NYISO adopted ICAP demand curves in 2003. Those who supported them contended that they were in the best interests of New York consumers because they would reduce the incentive for suppliers to exercise market power in order to artificially increase ICAP prices, reduce volatility in the ICAP market, and provide a steady stream of revenues that would facilitate the financing of new resources, which ultimately would result in lower energy and capacity prices. Experience under the demand curves, however, has not resulted in a general consensus that they have served the interests of New York consumers well. The NYISO Board's approval of the revised demand curves proposed by NYISO staff would further undermine the credibility of the demand curves in that they would significantly increase the cost of electricity in New York without sufficient justification.

The proposed demand curves reflect numerous judgments made by the NYISO's consultant, NERA, and the NYISO staff, including: the type of generation equipment a new generator would choose and how much it would cost, what the energy and ancillary services prices will be in the future and how much revenue a supplier would earn in those markets, and the future rates of inflation. These and other determinations ultimately affect the cost of electricity for New York consumers and businesses. Consequently, the NYISO Board has a responsibility to prudently exercise the authority it has assumed under the demand curve process and to ensure that its judgments with respect to the demand curves do not impose excessive costs on New York consumers. As stated below, we believe that several determinations made by the NYISO's consultant and staff are inconsistent with the NYISO's Services Tariff or are otherwise incorrect.<sup>1</sup> We estimate that the aspects of the proposed demand curves that we have identified alone could impose excessive and unnecessary costs on New York consumers of close to \$380 million over the next three years.

As the Board is aware, the benefits of competitive electricity markets are being questioned in various parts of the United States, most notably in New York. Currently, the ability of deregulated markets under the administration of independent system operators to produce reasonable electricity prices is being questioned. In this context, it is extremely important that the NYISO Board demonstrate its vigilance in not approving any proposed change to the demand curves that would further increase the price of electricity in New York unless the necessity for such a change is supported by clear and convincing evidence. Unfortunately, the proposed demand curves do not reflect this approach. Instead, they are based on a decisional process that appears to be biased in favor of granting suppliers higher ICAP revenues and increasing ICAP prices without any meaningful consideration of the resulting impact on New York consumers.

It also is important to note that there is no justification for the Board to accept changes in the demand curves that would increase ICAP prices on the basis that it is better to err on the side of higher prices in order to ensure that we have sufficient resources to meet reliability criteria. The NYISO already has in place a Comprehensive Reliability Planning Process (CRPP), which ensures that resources will be provided to meet all reliability criteria.

The specific issues discussed below demonstrate that several aspects of the proposed demand curves have not been adequately justified, are based on flawed analyses, and would impose unnecessary costs on New York consumers and businesses. The NYISO Board should revise the proposed demand curves consistent with these comments to ensure that the interests of New York consumers are fairly considered.

## **II. Summary**

The ICAP demand curves that NYISO Staff has proposed for the 2008-09, 2009-10, and 2010-11 capability years are seriously flawed, and would impose excessive costs on New York consumers for the following reasons:

- The NYISO consultant has drawn the ICAP demand curves with the intent of inducing development of considerably more capacity than is needed to meet minimum ICAP requirements, thereby causing a significant upward shift in the demand curves. This is contrary to the provision in the NYISO's

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<sup>1</sup> These comments address errors in the recalculation of the demand curves and should not be construed as an

Control Area Administration and Market Services Tariff (“Services Tariff”), which requires the NYISO to determine the cost of developing sufficient capacity to meet minimum capacity requirements.

- The proposed demand curves underestimate the energy and ancillary services revenues that would be earned by a new supplier because they are based on the assumption that there will be considerable amounts of excess capacity in the future, which is unreasonable and inconsistent with the Services Tariff. The proposed demand curves also overestimate the costs to be incurred by a new supplier by arbitrarily reducing the amortization periods used for power plant investments in the current demand curves.
- The demand curves are based on an inflation adjustment factor that assumes that the short-term increases in cost of power plant construction will continue in the future, which is inconsistent with reliable long-term data.
- The adjustment to account for seasonal differences in ICAP prices used in the demand curves is significantly larger than needed to offset the effect of those seasonal ICAP price differences.
- The proposed zero crossing point (the point at which the ICAP demand curves reach a price of zero) has not been supported by any analysis, despite the fact that the zero crossing point has a significant effect on the demand curves.

In each of these cases, the proposed demand curves have been supported by little or no analysis, despite the directive in FERC’s order approving the current demand curves that future filings contain support for their recommendations.<sup>2</sup> Moreover, these proposals will lead to significant and unjustifiable cost increases for New York consumers. We estimate that the net impact of these overstated demand curves over

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endorsement of the desirability or effectiveness of the demand curves.

<sup>2</sup> Specifically, FERC stated, “[W]e suggest that in future filings NYISO lay out exactly what considerations lead it to reach its conclusion regarding each issue, along with supporting documents backing up each conclusion. This would be much more helpful than a flat conclusory statement that each conclusion was based on the NYISO’s best judgment and was fully debated in the stakeholder process.” Order Accepting ICAP Demand Curves, as Modified, Removing Refund Condition, and Dismissing Motion and Request for Rehearing, Docket Nos. ER05-428-000 and -001, Apr. 21, 2005 (“April 2005 Order”), P 85.

the next three years will be close to \$380 million. Consequently, we urge the NYISO Board to modify the proposed demand curves as recommended herein.

### III. Comments

#### A. *The Proposed Demand Curves Would Require LSEs to Fund Excessive Amounts of ICAP on Behalf of New York Consumers*

##### 1. *Target ICAP Levels Exceeding the Minimum ICAP Requirement Are Inconsistent with the Services Tariff*

The NYISO's Services Tariff clearly provides that the periodic review of the ICAP demand curves shall assess "(i) the current localized levelized embedded cost of a peaking unit in each NYCA Locality and the Rest of State *to meet minimum capacity requirements* <sup>3</sup>.

Despite this clear provision in the Services Tariff, the proposed demand curves would establish capacity prices that are intended to support considerably more capacity than the amount required to meet minimum ICAP requirements. Specifically, the proposed ICAP demand curve for the NYCA has been developed with the intent that 102.8 percent of the ICAP requirement for the NYCA will be provided, on average. This important parameter has not been given a name, so we will refer to this amount as the target ICAP level for the NYCA, since it is, in fact, the ICAP level that the proposed demand curves target for the NYCA. Similarly, the ICAP demand curves for New York City and Long Island are designed so that 104 percent of the ICAP requirements for those localities will be provided, on average.<sup>4</sup>

The proposed demand curves also violate the Services Tariff because they are based on annual Energy and Ancillary Services revenue adjustments using projected data over a 30 year period as opposed to the "the period covered by the adjusted ICAP Demand Curves,"<sup>5</sup> which is three years. This is another example of how NERA and staff's proposal is inconsistent with the provisions of the Services Tariff.

Unless and until the Services Tariff is amended, the NYISO is bound by its filed tariff. It cannot unilaterally decide that it should re-design the ICAP demand curves so as to acquire more ICAP than the

<sup>3</sup> Services Tariff, Seventh Revised Sheet No. 157 (emphasis added).

<sup>4</sup> Proposed NYISO Installed Capacity Demand Curves for Capability Years 2008/2009, 2009/2010 and 2010/2011 ("NYISO Staff Proposal"), Aug. 31, 2007, at 10.

<sup>5</sup> Services Tariff, Seventh Revised Sheet No. 157.

amount required by its tariff. Consequently, the prices in the demand curves must be recalculated to correspond to 100% of the minimum ICAP requirement as mandated by the Services Tariff, rather than the higher percentages proposed by NERA.

2. *Target ICAP Levels Exceed the Amounts Required to Meet the Resource Adequacy Criterion*

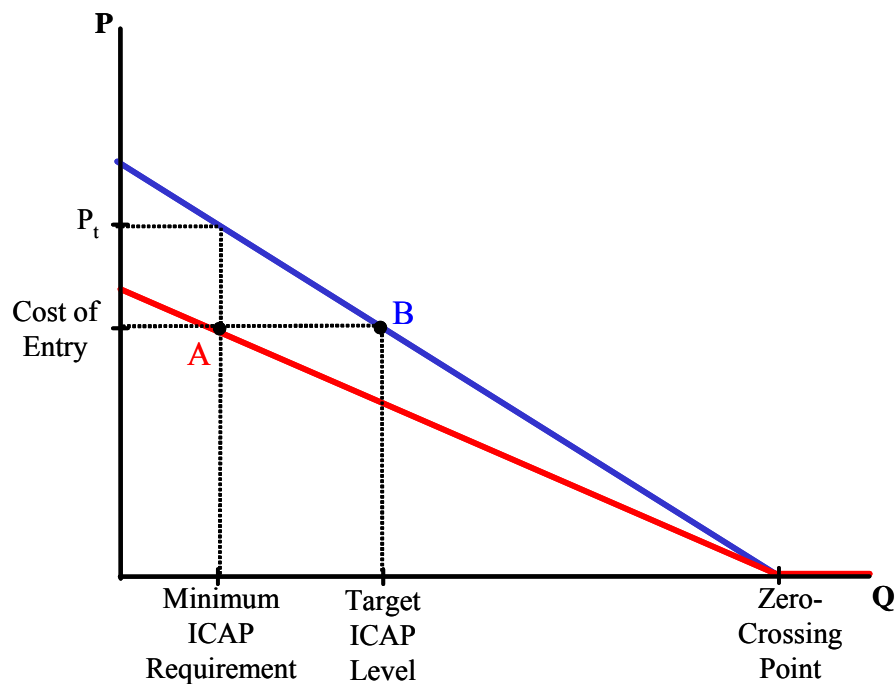
The New York State Reliability Council establishes an installed reserve requirement (IRM) for the New York Control Area (NYCA). The NYSRC evaluates the IRM on a probabilistic basis and establishes the IRM so that the probability of disconnecting any firm load due to resource deficiencies shall be, *on average*, not more than once in ten years (NYSRC Reliability Rule A-R1, emphasis added). But under the proposed demand curves, the amount of capacity maintained would far exceed the amount needed to ensure that the minimum ICAP requirement is met. The proposed demand curves have been designed with the intent of ensuring that 97.5 percent of the time the amount of ICAP provided will exceed the amount required to meet the one-day-in-ten-years loss of load exception criterion. Staff offers no support for its contention that actual capacity should fall below minimum requirements no more than 2.5% of the time. Consequently, the amount of ICAP provided *on average* would be far more than is needed to meet this criterion.

3. *Targeting Higher Capacity Levels Imposes Excess Costs*

Targeting a capacity level above the installed capacity requirement will impose excess costs on New York consumers. The cost of entry is defined as the minimum amount of ICAP revenue that will induce developers to build new capacity, after taking into account margins earned from the sale of energy and ancillary services.

Consequently, developers will have an incentive to develop additional capacity whenever the revenue they expect to earn from the sale of ICAP exceeds the cost of entry. If the ICAP demand curve is intended to induce development of the amount of ICAP that is needed to meet the minimum ICAP requirement, (as required by the Services Tariff) then the demand curve can be drawn through a point whose

x-coordinate is the minimum ICAP requirement and whose y-coordinate is the cost of entry. This point is called point A on the diagram below. Then, whenever the amount of ICAP provided was less than the minimum ICAP requirement, the price of ICAP would increase above the cost of entry, which would give developers an incentive to build additional capacity.



But if a target ICAP level in excess of the minimum ICAP requirement (as proposed by NERA) is established, then the ICAP demand curve must pass through a point whose x-coordinate is the target ICAP level—not the minimum ICAP requirement—and whose y-coordinate is the cost of entry (which is point B on the diagram). Such a demand curve ensures that developers have an incentive to develop additional capacity whenever the amount of capacity provided falls below the target ICAP level, because the price rises above the cost of entry whenever the amount of capacity provided falls below the target ICAP level. As the diagram makes clear, this can cause the price that corresponds to the minimum ICAP requirement, called  $P_t$  in the diagram above, to be much higher than the cost of entry needed to meet the minimum ICAP requirement. And this does not take into account the fact that establishing a target ICAP level that exceeds the minimum ICAP requirement will drive down energy and ancillary services prices, which in turn will decrease the margins on energy and ancillary services that the developer of a new generator would expect to receive. This will increase the cost of entry, which would cause point B on the preceding diagram to be

higher than point A, and that, in turn, would cause  $P_b$ , the price corresponding to the minimum ICAP requirement, to be even higher than illustrated in the diagram. Therefore, establishing target ICAP levels in excess of minimum ICAP requirements can cause substantial increases in consumer payments under the ICAP demand curves.

*B. The Proposed Demand Curves Overestimate Generator Costs And Would Impose an Unjustified “Risk Premium”*

*1. Estimated Generator Costs*

NERA also erred in estimating generator costs. The current demand curves assume a 20 year amortization period for plant investment. NERA has proposed a carrying charge methodology that has not been adequately explained or justified and that would significantly reduce the amortization period for the recovery of plant investment. The reduced amortization periods would increase the cost of capacity under the demand curves. NERA’s proposed reduction in the amortization period for the Frame 7 from 20 years to 14.5 years would have significant impact on consumers in the ROS region. The reduced amortization periods are the result of NERA’s introduction of a new methodology that determines the amortization period considering the risk of excess capacity, which the demand curves proposed by NERA would encourage. NERA has not provided adequate explanation or support for this new methodology. Furthermore, if there is excess capacity, the demand curves should not be providing sufficient revenues to support the cost of new entry. Revenues sufficient to support the cost of new entry should be sufficient to meet the minimum installed reserve requirement, as required by the Services Tariff. However, NERA is proposing that the amortization period be shortened so that a new supplier would be able to recover the cost of new entry even though there is capacity in excess of 100% of the minimum requirements. This approach is inconsistent with the basic objectives of the demand curve and will impose excessive costs on consumers.

*2. NERA’s Proposed “Risk Premium” is Unjustified and Should Be Rejected*

In order to implement its flawed proposals to target capacity above required levels, to reduce the amortization periods for investment recovery, and to project energy and ancillary services revenues based on unreasonable estimates of excess capacity, NERA has proposed the adoption of a carry charge “premium”.

This premium significantly increases the levelized carrying charges for projected investments and thereby increases capacity costs in New York. For example, the premium would increase the carry charges for the ROS region from 12.95% to 15.36%, an increase of 241 basis points. A fair return on equity already compensates suppliers for risks associated with the capacity market. Unlike the proposed target capacity level, the return on equity can be determined in a transparent verifiable manner. This proposed premium is based on unsupported proposals by NERA and should be rejected.

*C. The ICAP Demand Curves Reflect an Excessive Adjustment for Inflation*

NYISO Staff's proposal applies an inflation rate for power plant construction costs of 7.8 percent per year, which is roughly three times the forecasted general rate of consumer inflation. This proposal was not discussed at any ICAP Working Group meeting and was not prepared by an experienced economic consultant. As a result, it is not adequately supported and is not consistent with any recognized industry practice for forecasting inflation.

The basis for NYISO Staff's proposal is, superficially, the Handy-Whitman index of construction-related costs. Although the Handy-Whitman does not forecast future inflation rates, NYISO Staff observed that the cost of power plant construction, as measured by the Handy-Whitman index, had climbed by an average of 5.1 percent per year in inflation-adjusted (i.e., real) terms per year over the most recent two-year period. Based on only two data points, the NYISO then concluded it would be reasonable to assume that construction costs would continue to increase at 5.1 percent per year, in real terms, through 2011.<sup>6</sup> However, NYISO Staff has not demonstrated that the taking the average increase in the Handy-Whitman index over the last two years is a reliable indicator of future inflation rates.

NYISO Staff does not seem to realize how remarkable the series of real cost increases it has forecasted would be, but the chart from which NYISO Staff took its data, which is reproduced below, provides some indication.<sup>7</sup> The graph remains relatively constant over a 30-year period, fluctuating around 100 units. As it shows, costs increased in 1975 for two years, leveled off, and then decreased for the next 25

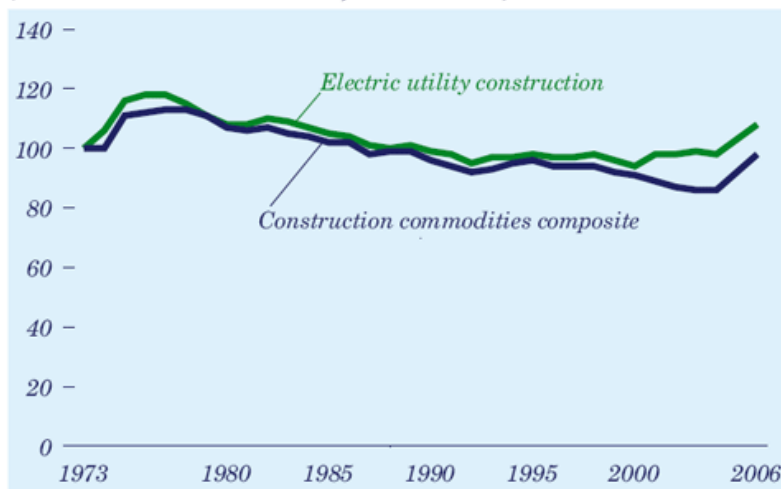
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<sup>6</sup> NYISO Staff Proposal, App. D.



years. In other words, over that 30-year period, the real cost of power plant construction increased at roughly the same rate as general consumer inflation. NYISO Staff ignored this 30-year history in its projection and based its projection on just the last two years; as a result, as the graph in Appendix D of the NYISO Staff Report shows, it projected that the real cost of power plant construction would reach approximately 140 units in 2011, so the real price increase in power plant construction costs that the NYISO Staff is projecting dwarfs anything that has occurred over the 33 years represented in these data. NYISO Staff is, in effect, saying that the ICAP demand curves should be calculated under the assumption that such unprecedented increases in real power plant construction costs are the most likely scenario.

**Figure 14. Changes in construction commodity costs and electric utility construction costs, 1973-2006 (constant dollar index, 1973=100)**



Of course, this is not the most likely scenario, as the historical evidence shows. Instead, as the chart above indicates, sustained real price increases over a long period of time are quite unusual. This occurs because suppliers respond to increased prices for their goods and services by increasing production. In fact, the Energy Information Administration report from which the NYISO took its data states, “Currently, new construction in the electric power industry is slowing down.... It is typical for investment in the power industry to cycle through patterns of increased building and slower growth....”<sup>8</sup>

<sup>7</sup> Annual Energy Outlook 2007, Energy Information Administration. U.S. Department of Energy, Feb. 2007, at 41.

<sup>8</sup> *Id.*

It is important to note that NYISO Staff did not rely upon a generally recognized approach or an authoritative source in arriving at their hastily assembled inflation forecast. Accordingly, the inflation adjustment used to develop the ICAP demand curves for 2009-10 and 2010-11 should only reflect the 2.7 percent per year expected inflation.

*D. Adjustment for Seasonal Differences in ICAP Revenues*

*Purpose of Adjustment*

Resources that provide ICAP to the NYISO must undergo Dependable Maximum Net Capability (DMNC) tests, which establish the amount of energy they can produce (or the amount by which demand response resources can reduce consumption). DMNC tests are performed twice per year, once during the summer capability period, and once during the winter capability period. For many generators, winter DMNCs tend to be higher than summer DMNCs. For example, in winter months, temperatures are lower, which allows many gas and oil-fired units to operate at higher outputs, and conditions are windier, which allows wind generators to produce more.

Since more generating capacity is available during winter months, capacity prices for the winter capability period tend to be lower than prices for the summer capability period. It is necessary to adjust the ICAP demand curves to take these seasonal variations in ICAP prices into account; otherwise, ICAP revenues would not be sufficient over the course of a year to ensure that generators earn the cost of new entry when capacity supplies are exactly sufficient to meet the summer peak, thus, discouraging development of the desired amount of capacity to meet the summer peak.

The focus of the dispute regarding the proper procedure for adjusting these demand curves pertains to the difference between the ratio of the amount of ICAP that is available during the winter as compared to the summer (i.e., the amount of ICAP that *could* be sold into the New York market in the winter versus the summer) and the ratio of the amount that *actually* is sold into the market in the winter versus the summer. The procedure for adjusting the demand curves should be based on the quantities and prices of capacity that will likely clear the capacity market in the summer and winter capability periods, since those figures determine what adjustment is necessary to offset the impact of seasonal differences in ICAP prices; this, in

turn will ensure that suppliers expect to earn the cost of new entry over the life of a new facility when new entry is required in order to continue meeting ICAP requirements, just as would have happened if there had not been any seasonal difference in ICAP prices. The NYISO Staff, by contrast, argues that the summer-winter differential should be estimated based on the projected level of capacity that would be offered, but not necessarily accepted, in the summer and winter periods. They assert that the Transmission Owners' proposed approach violates tariff requirements and a recent FERC order, and that, in any case, it is difficult to forecast what suppliers' bids would be accepted in the summer and winter capacity markets.

The two approaches are likely to produce significantly different capacity prices. Using the methodology recommended by NYISO Staff, the price of ICAP in the Rest-of-State (ROS) region when the amount of capacity provided is exactly equal to requirements would be from \$14/kW-yr. to \$18/kW-yr. higher over the course of the year than is needed to offset the effect of seasonal price differences. Similarly, the price of ICAP in New York City when the amount of capacity provided there is exactly equal to requirements would be from \$8/kW-yr. to \$12/kW-yr. higher than needed, and the price of ICAP in Long Island when the amount of capacity provided there is exactly equal to requirements would be \$5/kW-yr. to \$6/kW-yr. higher than needed. That means that consumers would pay approximately \$129 million more necessary in the ROS market to encourage new entry, \$31 million in the New York city market, and \$13 million in Long Island markets over the three-year life of the proposed demand curves than is necessary to encourage new entry when it is needed.<sup>9</sup>

#### *Alternative Adjustment Procedures, and the Implications of FERC's Order*

Staff's arguments that the NYISO is not permitted, by Commission order or by its tariff, to calculate the winter to summer ratio based on the supplies expected to be selected to provide capacity are in error. When this matter was raised at the Commission during the last demand curve reset process, FERC declined to rule in favor of either the Transmission Owners or suppliers who, in contrast, argued that winter to summer ratios should be determined based on the units that submit capacity offers. As IPPNY

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<sup>9</sup> These calculations assume that the other modifications the TOs have recommended in these comments are adopted. If those modifications are not adopted, failure to adopt the TO proposal regarding this issue would have an even more significant impact on customer costs.

acknowledged in the comments it recently submitted to the NYISO on the NERA study earlier this year, “[R]ather than decide the matter, FERC determined that ‘the prudent course is to revisit the issue during the next periodic review of the ICAP Demand Curves, after experience has been gained with the Demand Curves that are currently in effect, and with all NYISO stakeholders having an opportunity to express their views on this issue.’”<sup>10</sup>

NYISO Staff also argues that its Services Tariff forbids it to base its summer-winter adjustment on only the supply projected to clear the market:

The Services Tariff specifies that the translation of the annual net revenue requirement into monthly values take into account ‘seasonal differences in the amount of capacity available in the ICAP Spot Market Auctions.’ The NYISO has interpreted the amount of capacity available as that amount of capacity that could be offered into the ICAP Spot Market Auctions.<sup>11</sup>

The Transmission Owners believe NYISO Staff misinterprets the tariff. While the tariff states that the winter to summer ratio may only consider “available” capacity, it does not state that “available” capacity necessarily includes supplies that do not actually provide ICAP. Since the intent of the seasonal adjustment is to produce revenues as close as possible to the cost of new entry over the course of the year, when capacity levels exactly equal requirements, an adjustment based on the supply quantities that actually clear the market and actual market clearing prices are the most appropriate.

#### *Correct Application of Winter/Summer Ratio*

The NYISO Staff has also expressed concern as to whether it can reliably project what supply resources will clear the marketplace. Since only minor changes are expected to occur in the market over the three-year reset period, historical market results should be a reliable guide. Over the four capability years in the demand curve era for which we have data, the winter-to-summer ICAP supply ratio for the NYCA has

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<sup>10</sup> IPPNY 2007 Comments, at 7, quoting Order Conditionally Accepting Tariff Revisions, Docket No. ER05-428-005, Dec. 15, 2005 (“Dec. 2005 Order”), P 18.

<sup>11</sup> NYISO Staff Proposal at 12.

averaged about 101.4 percent. The winter-to-summer ICAP supply ratio has not varied significantly from year to year, despite the fact that average ROS ICAP spot market prices have varied from \$0.79/kW-mo. (during the 2004-05 capability year) to \$2.48/kW-mo. (during the 2006-07 capability year). NYISO Staff's own calculations do not indicate any significant changes to capacity level differentials or the quantity of bids that will clear.<sup>12</sup> Therefore, we do not expect any significant changes to the winter to summer ratio. Since this ratio could tend toward the higher end of the historical range of values, we recommend that the NYCA ICAP demand curve be translated under the assumption that the amount of ICAP supplied during the winter will be 101.8 percent of the amount supplied in the summer, which is the winter to summer ICAP supply ratio for the 2006-07 capability year, the highest ratio for the four capability years for which we have data. For New York City and Long Island, NYISO Staff's analysis does not show any significant changes in the ratio of the amount of ICAP available in the winter to the amount available in the summer. The summer-winter differential might increase in the future for New York City and Long Island if ICAP prices increase, but ICAP prices in New York City and Long Island are not likely to increase much and may even decrease slightly if the demand curve is based on the LMS 100 generator. Therefore, we recommend that the New York City ICAP demand curve be translated under the assumption that the amount of ICAP supplied during the winter will be 106.9 percent of the amount supplied in the summer, which is the average winter to summer ICAP supply ratio for the 2003-04 through 2006-07 capability years. ICAP prices on Long Island are likely to decrease under the new demand curves, so we recommend that the Long Island ICAP demand curve be translated under the assumption that the amount of ICAP supplied during the winter will be 103.1 percent of the amount supplied in the summer, which is the winter to summer ICAP supply ratio for the 2005-06 capability year, the lowest ratio for the three capability years for which we have data (excluding data for 2003-04, which appears to be an outlier).

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<sup>12</sup> NYISO Staff Proposal, at 17.

*E. Staff Failed to Analyze Moving The Zero-Crossing Point*

It is important that the NYISO fully and carefully analyze the potential impacts of the proposed zero-crossing point. While the flatter demand curves that result from the proposed 112% crossing point in the NYCA-wide market and 118% in the New York City and Long Island markets may provide more stable prices, that benefit should be balanced against the resulting economic costs to consumers. Incremental ICAP above the minimum requirement may have some value to end-use consumers, but reliability benefits fall off quickly as the amount of ICAP purchased exceeds requirements, and there has been no evidence produced to date showing that substantial energy cost savings result from the purchase of additional ICAP. The economic costs associated with the flatter demand curves resulting from the 112% statewide and 118% locational market zero-crossing points must be counterbalanced against the perceived benefits when determining the optimal slope.

In its order accepting the ICAP demand curves that were produced as the result of the last periodic review, FERC stated, “[W]e encourage NYISO and its stakeholders to continue their evaluation of Zero Crossing Points for the next three-year review. The Zero Crossing Points and the resulting slope of the Demand Curves have effects on investment financing costs and reliability, as well as on the incentives to exercise market power. We urge NYISO and its stakeholders to include estimates of these effects in the next three-year review and the associated proposals for Zero Crossing Points.”<sup>13</sup> Despite this directive from the Commission, the current NYISO Staff Proposal does not include any such analysis.

NYISO Staff argues for the current zero crossing points on the ground that a more steeply sloped curve would encourage the exercise of market power by ICAP suppliers. The Transmission Owners disagree with the premise of NYISO Staff’s argument. While flattening the ICAP demand curves may reduce the incentive for exercise of market power, it will not eliminate it. Furthermore, it should be assumed that the NYISO will effectively monitor the ICAP markets for the exercise of market power and mitigate when appropriate. In addition, the NYISO has not conducted any analysis to demonstrate that the costs that would result from withholding of capacity would outweigh the savings resulting from a more steeply-sloped curve.

While we recognize that the NYISO must specify zero crossing points in the filing it will make at the end of November, there seems to be little chance that the determination of the zero crossing points will be based on analysis that is sufficient to make a well-informed decision on this topic. To comply with FERC's instructions on this matter, the Board must commit to make a supplemental filing evaluating alternative demand curve shapes within 90 days of its November filing. This period will provide sufficient time for additional analysis and stakeholder review.

#### **IV. LMS 100 Costs Should Not Be Revised**

In addition, NYISO Staff apparently plans to update its estimate of the cost of building an LMS 100 generator.<sup>14</sup> This is inconsistent with the procedure for developing ICAP demand curves that is called for by the ICAP Manual, under which market participants are supposed to have 30 days to review the NYISO Staff's proposed ICAP demand curves. In addition, it is fundamentally unfair to review factors that might cause the ICAP demand curve to rise unless the NYISO also plans to review factors that might cause them to fall, such as the EFORd rates that NYISO Staff has assumed for new generators.

#### **V. Cumulative Impact of Demand Curve Errors**

While space limitations prevent us from including all of the details of the calculations here, we have calculated the impact of the changes to the NYISO Staff Proposal that we proposed above, using the final version of the model NERA has made available to market participants.<sup>15</sup> Those calculations are presented in the table below, which illustrates the prices on the ICAP demand curves that correspond to minimum ICAP requirements after each of these three changes is made.<sup>16</sup> As shown, the primary errors that we have discussed above have significant cost impacts.

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<sup>13</sup> April 2005 Order, P 87.

<sup>14</sup> NYISO Staff Proposal at 7.

<sup>15</sup> The underlying calculations will be provided to the Board upon request.

<sup>16</sup> Distinguishing the impact of individual changes is complicated by the fact that these changes interact with each other: Eliminating the excess purchase of ICAP, for example, reduces the net cost of entry that has been estimated for 2008-09, which changes the impact of reducing the inflation adjustment for subsequent years. In the table, changes to the price corresponding to the minimum ICAP requirement have been calculated under the assumption that the excess purchase of ICAP has been corrected first, followed by the elimination of the excess inflation adjustment, and concluding with recommended changes to the adjustment to account for seasonal differences in ICAP revenues.

Prices on ICAP Demand Curves Corresponding to ICAP Requirements (\$/kW-yr.)									
	2008-09			2009-10			2010-11		
	NYCA	NYC	LI	NYCA	NYC	LI	NYCA	NYC	LI
ISO Staff Proposal	109.10	151.77	82.35	121.56	163.61	88.77	131.84	181.64	95.69
After Eliminating Excess Purchases of ICAP	87.17	119.10	69.35	97.14	128.39	74.76	105.35	142.54	80.59
After Eliminating Excess Purchases of ICAP and Excessive Inflation Adjustment	87.17	119.10	69.35	92.54	122.31	71.22	95.62	129.37	73.14
After Eliminating Excess Purchases of ICAP and Excessive Inflation and Seasonality Adjustments	73.55	111.44	63.94	75.54	114.45	65.67	77.58	117.54	67.44

The financial impact of these errors on New York consumers is estimated to be about \$378 million over the next three years, as illustrated by the table below.

Estimated Total Impact of Overstated ICAP Demand Curve Proposal on Costs of Purchasing ICAP (millions of dollars)				
	ROS	NYC	LI	Total
Excess Purchases of ICAP	64	79	23	166
Excessive Inflation Adjustment	15	18	7	40
Excessive Seasonality Adjustments	129	31	13	172
Total	207	128	43	378

## VI. Conclusion

The Transmission Owners respectfully request that the NYISO Board revise the proposed demand curves as indicated in these comments, in order to avoid the imposition of excessive capacity costs on New York consumers.