

**NOTICE OF APPEAL OF MULTIPLE INTERVENORS  
ON THE DEMAND CURVE PROPOSAL**

**SUMMARY**

On behalf of its members who are members of the Management Committee (“MC”),<sup>1</sup> Multiple Intervenors, an unincorporated association of approximately 55 large commercial and industrial energy consumers with manufacturing and other facilities located throughout New York State, hereby submits to the Board of Directors (“Board”) of the New York Independent System Operator, Inc. (“NYISO”) this appeal of the disputed decision by the MC to approve Motion No. 2, the “Demand Curve” proposal, at its February 13, 2003 meeting. Members of Multiple Intervenors would be directly and adversely impacted by the incremental costs associated with the Demand Curve.

If implemented, the Demand Curve proposal would result in significant changes to the NYISO’s installed capacity (“ICAP”) market and impose substantial costs on New York consumers. The Board should reject the Demand Curve proposal because it: (a) was not approved at the MC pursuant to appropriate procedures; (b) is not needed and there is no evidence that it will achieve its stated purpose, *i.e.*, the siting of new generation in New York; (c) has not been justified adequately, given its potentially enormous impacts on consumers; and (d) is inconsistent with the Standard Market Design (“SMD”) proposed by the Federal Energy Regulatory Commission (“FERC”) and the ICAP markets of neighboring control areas.

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<sup>1</sup> Five members of Multiple Intervenors -- Alcoa/Reynolds Metals Company, IBM Corporation, Occidental Chemical Corporation, Praxair Inc. and Xerox Corporation -- are active members of the MC.

## ARGUMENT

### **A. The Demand Curve Proposal Was Not Approved at the MC Pursuant to Appropriate Procedures**

Initially, the Demand Curve proposal is highly controversial and is opposed by substantial constituencies in four of the five sectors. In fact, the Demand Curve proposal that is before the Board was not approved at the MC pursuant to appropriate procedures but, instead, was rejected when all of the votes were counted.

During the “special” MC meeting held on February 13, 2003 to consider the latest iteration of the Demand Curve,<sup>2</sup> objections were raised by Demand Curve proponents as to the voting eligibility of two members of the Other Suppliers sector. The Chair of the MC ultimately ruled that those two members, and two other members from the Other Suppliers sector, would be prohibited from voting on the Demand Curve proposal, notwithstanding the fact that two of those members had voted on the issue at the February 11<sup>th</sup> BIC meeting. The decision to prohibit the four members from voting was in error because: (a) there was no dispute that the parties are legitimate electricity suppliers; (b) upon information and belief, the four members were admitted as NYISO members prior to the MC meeting (*i.e.*, all paperwork was completed and their annual fees were accepted by the NYISO); (c) each party had an interest in the outcome of the vote; and (d) there is no NYISO rule explicitly precluding new members from voting.

The Demand Curve proposal “passed” at the MC only because of the erroneous decision to exclude certain parties from voting. When all MC members were

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<sup>2</sup> Notwithstanding the fact that an MC meeting already was scheduled for February 20, 2003 and the results of the February 11, 2003 Business Issues Committee (“BIC”) meeting were not yet known, the “special,” telephone-only MC meeting was scheduled over the objections of numerous parties.

included in the vote, the Demand Curve proposal was defeated.<sup>3</sup> There is no basis in the rules for the decision to preclude valid new members from participating in an MC vote (i.e., there is no waiting period). Therefore, the decision by the MC Chair to designate the exclusionary vote as the “official” vote was fatally flawed and the Board, as the independent arbiter of this issue, should ratify the inclusionary vote (i.e., with all members included) as the “official” MC vote.

**B. The Demand Curve Proposal Is Not Needed and Is Not Likely to Lead to New Investment**

The NYISO’s ICAP market is a competitive market, with bid-determined prices based upon supply and demand. Importantly, the NYISO’s ICAP market appears to be functioning as designed.<sup>4</sup> There is no evidence of market manipulation or inappropriate conduct affecting the ICAP market; nor is there any evidence that the market is producing prices for ICAP materially different from those available in neighboring control areas. Recent ICAP prices have been low on a relative basis, particularly in the Rest-of-State (“ROS”) region. However, given the current surplus capacity in the ROS region, coupled with the planned addition of new capacity, such low prices may reflect accurately the value of ICAP in the region. Indeed, no evidence to the contrary has been presented.

The proponents of the Demand Curve proposal argue that higher ICAP prices are needed to attract and retain generation in the State. However, those proponents have focused solely on increasing ICAP revenues and refused to recognize that revenues from the

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<sup>3</sup> A second vote taken at the MC meeting, which included the four newest members of the NYISO, confirmed that proponents of the Demand Curve lacked sufficient votes to pass the proposal unless some members were excluded from the vote.

<sup>4</sup> This is not to say that the ICAP market is perfect. The ICAP market can be improved, and Multiple Intervenors and other parties have advocated for alternate, market-based modifications that, unlike the Demand Curve proposal, would not result in radical changes to the existing market.

energy and ancillary services markets also affect whether generators begin or continue operations in New York. In this regard, it is important to note that the NYISO has not conducted or authorized a study which concludes that the overall level of revenues available to generators in New York is inadequate.<sup>5</sup>

To the extent that the Board is inclined to evaluate the issue of revenue adequacy for generators, that evaluation should not be limited to the ICAP market in isolation. Energy prices were extremely high in the second half of 2002 and continue to be high in early 2003.<sup>6</sup> In addition, the NYISO is in the process of implementing a number of market design changes that are certain to increase energy prices going forward, including: (a) adopting a scarcity pricing proposal that will result in higher energy prices during shortages of ten-minute reserves; (b) adopting modifications to the Special Case Resources program and Emergency Demand Response Program such that demand resources now can set the market clearing price; and (c) adopting modifications to modeling inputs to decrease out-of-merit calls that tend to depress prices. With respect to the ICAP market itself, the correction of the ICAP/UCAP translation error will shrink the ICAP resources that are available and, in theory, lead to higher auction prices this summer. Multiple Intervenors submits that the impact of these significant changes on the revenues that generators receive should be evaluated thoroughly before the expensive and controversial Demand Curve is adopted.

Moreover, focusing on revenues misses the point as to why there is a market for capacity in the first place. Load serving entities are required to procure capacity

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<sup>5</sup> For existing generators that are not financially-troubled, the Demand Curve represents a financial windfall.

<sup>6</sup> For the last six months of 2002, the NYISO-administered average total prices for energy and ancillary services were \$65.56, \$68.94, \$49.68, \$50.88, \$52.19 and \$56.63 per MWh, which are much higher than the comparable six-month period in 2001. The average price in January, 2003 was \$68.86 per MWh and there has been no perceptible drop-off in February, 2003.

calculated to justify a reserve level that corresponds to the probability of shedding load no more than one day in ten years. The purpose of the ICAP market is not to maintain some pre-determined level of revenues for existing generators but, rather, to preserve reliability. This purpose was recognized by the United States Court of Appeals for the 1<sup>st</sup> Circuit when it ruled recently that: “ICAP is not devised to compensate past investment, but to spur sellers to make new investment and buyers to meet their reserve capacity obligations (which indirectly has a similar effect).” Sithe New England Holdings v. FERC, 308 F.3d 71, 78 (1<sup>st</sup> Cir. 2002) (emphasis added). Given the existing excess capacity situation in ROS, the Demand Curve is not justified on reliability grounds.

Finally, there has been no demonstration that the Demand Curve would achieve its purported goal of encouraging new investment.<sup>7</sup> The NYISO’s ICAP market certainly is not the only, nor the most difficult, problem affecting the ability of generators to site new plants. In order to invest in new plants, among other things, generators must be able to demonstrate to lenders that they have a stable stream of revenues in order to amortize debt. The Demand Curve does not yield a stable stream of revenues (both the level and shape of the Curve are subject to change). In addition, as the Demand Curve proponents conceded during the February 13, 2003 MC conference call, the Demand Curve is subject to revision, or termination, at any time pursuant to governing NYISO procedures. Moreover, there may be better alternatives. As Dr. Carl Pechman stated in his report presented to the BIC and the MC:

If one of the objectives of market reform is to build investor confidence, that may be achieved more effectively by an alternate product definition. For example, longer term

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<sup>7</sup> There also are no guarantees that implementation of the Demand Curve proposal would keep financially-troubled generators in business. In any event, if that is a primary goal due to reliability concerns, a more targeted (and far less expensive) solution could be crafted.

instruments provide flexibility to tailor terms that match revenue streams with the needs of investing and maintaining new generation. However, alternatives based on a longer-term capacity instrument have not been evaluated.<sup>8</sup>

In light of the above, the Demand Curve is not likely to reassure nervous investors and lead to new investment.<sup>9</sup> Given the significant price tag associated with the Demand Curve (see below), this failure is critical and, alone, warrants rejection of the proposal at this time.

**C. Given Its Impact, the Demand Curve Proposal Has Not Been Justified Adequately**

In a one-page chart presented to the BIC and the MC, Dr. David Patton, the NYISO's independent market monitor, estimated that the first-year statewide cost of implementing the Demand Curve proposal would be \$152,995,055, with a maximum first-year cost of \$235,854,752.<sup>10</sup> Multiple Intervenors believes that these cost estimates are significantly understated.

In his report presented to the BIC and the MC, Dr. Pechman highlighted two problems with Dr. Patton's analysis of the Demand Curve impacts. First, Dr. Patton's

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<sup>8</sup> A Review of the Economic Analysis of the Demand Curve, Dr. Carl Pechman, Power Economics, Inc. ("Pechman Report"), pp. 6-7. Multiple Intervenors retained Dr. Pechman to investigate the analytical support for the Demand Curve. Dr. Pechman's report was presented at the February 11, 2002 BIC meeting and the February 13, 2003 MC meeting and is posted to the NYISO website at [www.nyiso.com/services/documents/groups/mgmt\\_comm/02\\_13\\_03/agenda2\\_demand\\_curve\\_pechman](http://www.nyiso.com/services/documents/groups/mgmt_comm/02_13_03/agenda2_demand_curve_pechman).

<sup>9</sup> There also has been no demonstration that inflating capacity payments to existing generators would lead to new facilities being constructed in New York. For instance, the Demand Curve proposal contains no obligation on existing generators to invest the increased revenues on maintaining or expanding generation in the State.

<sup>10</sup> These estimates were revised downward on the night before the BIC vote without explanation. Dr. Patton's prior estimates were a first-year statewide cost of \$179,331,774, up to a maximum of \$295,600,755.

estimates are for the first year only. Importantly, however, unless it is modified or terminated, the Demand Curve proposal is designed to increase capacity costs further in the second and third years of implementation. In the second year, the point where the curve crosses the 118% reliability requirement increases by 20% over the first year. Moreover, in the third year, it currently is expected to increase the point where the curve crosses the 118% reliability requirement by 25% to 50% above the second year.<sup>11</sup> Utilizing Dr. Patton's spreadsheet, Dr. Pechman estimated that the three-year impact of the Demand Curve would impose incremental costs of up to \$700 million on New York consumers (Pechman Report, p. 9). Thus, Dr. Patton's analysis understates the cost impacts of the Demand Curve proposal by not recognizing the impacts in the second and third years (and beyond).

Additionally, Dr. Pechman's report incorporated an estimate for the impact of the Demand Curve proposal on bilateral capacity contracts that expire. Expiring bilateral capacity contracts undoubtedly would be impacted by the existence of the Demand Curve – i.e., such capacity either would be sold in the ICAP market pursuant to the Demand Curve or through another bilateral contract priced in relation to the Demand Curve. Although difficult to quantify because he is not privy to the actual expiration dates in existing bilateral contracts, Dr. Pechman estimated that the impact of the Demand Curve proposal on expiring bilateral contracts could bring the three-year cost of the Demand Curve to \$1.0 billion (Pechman Report, p. 10).

Given these potential impacts, it is incumbent on this Board to ensure, at a minimum, that there is strong analytical support demonstrating that the Demand Curve proposal would produce at least commensurate benefits and accomplish its purported

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<sup>11</sup> An independent study would be undertaken to establish the third-year parameters.

purpose. Unfortunately, the Demand Curve proposal does not have the level of analytical support that is warranted when evaluating a potential investment of this magnitude.

Multiple Intervenors asked Dr. Pechman to evaluate whether the analysis presented to support the Demand Curve proposal is adequate. In his report presented to the BIC and the MC, Dr. Pechman concluded that:

[W]e do not believe the analytical support performed to date enables the NYISO to make a prudent decision as to the adoption of the Demand Curve proposal. First, the analysis of the Demand Curve proposal presented to parties has been limited and is missing key components that one would expect in a comprehensive analysis. Moreover, the portrayal of only the first-year costs yields an unrealistic and artificially-low estimate of the cost to New York consumers of implementing the Demand Curve proposal.

(Pechman Report, p. 2.) Dr. Pechman also concluded that: “It simply would be imprudent to commit to the Demand Curve in the absence of analytical support.” (*Id.*, p. 10.)

As detailed in Dr. Pechman’s report, there is very little analytical support for the Demand Curve proposal. As noted earlier, the one-page analysis of cost impacts presented to the BIC and the MC do not reflect: (a) costs beyond the first year (*i.e.*, when capacity prices under the proposal are expected to increase further); and (b) the impact of the proposal on expiring bilateral capacity contracts. Additionally, virtually no analytical support exists regarding the purported benefits of the Demand Curve proposal,<sup>12</sup> nor has there been cost/benefit analyses of, or comparative analyses with, alternative proposals that have been advanced by other parties.<sup>13</sup>

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<sup>12</sup> For example, Dr. Pechman noted that there was “no supporting analysis” for Dr. Patton’s claim that the Demand Curve would reduce annual cost spikes attributable to ICAP deficiencies. (*Id.*, p. 7.)

<sup>13</sup> A coalition of other parties, including Multiple Intervenors, advanced an alternative, more moderate proposal to the Demand Curve proposal. That market-based



Prudence requires that a business decision with the potential impact of \$1.0 billion must be supported by more than the scant material presented to support the Demand Curve. This proposal represents a fundamental restructuring of the ICAP market that has not been justified adequately. At a minimum, therefore, the Board should require additional, comprehensive analyses of the Demand Curve and other alternatives.

**D. The Demand Curve Proposal Is Inconsistent With FERC's SMD and the ICAP Markets of Neighboring Control Areas**

The Demand Curve proposal represents a fundamental departure from the NYISO's existing ICAP market. The proposal also is not consistent with the resource adequacy proposals advanced by FERC in its proposed SMD, nor is it consistent with the ICAP markets in place in neighboring control areas. If implemented, the Demand Curve proposal would send New York off in a direction different from its neighbors and what is favored currently by FERC, possibly creating more seams issues.

As the Board is aware, representatives from the NYISO, ISO New England, Inc. and PJM Interconnection, L.L.C. and interested market participants have been working on resource adequacy issues as part of the Resource Adequacy Model ("RAM") Group. The Demand Curve proposal, if adopted, could be inconsistent with the findings of the RAM Group and likely would be inconsistent with FERC's SMD. As the NYISO itself recently advocated in its Reply Comments on SMD issues:

A number of commenters have asked the Commission to push the RAM Group in their own preferred policy direction. Some have submitted complete and highly detailed resource adequacy proposals. For example...the New York State Public Service Commission ("NYSPC") backs many aspects of the RAM Group proposal but also backs a number of particular changes. While many of the ideas advanced by these and other parties

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proposal would have reverted to a six-month capacity market and utilized Summer DMNC ratings.

may be meritorious, it would be premature for the Commission to formally adopt any of them at this time. The better alternative would be to trust the RAM Group to consider all of these concepts and to let it formulate a consensus proposal for submission to [FERC]. [FERC] should give the RAM Group the time it needs to complete this work.<sup>14</sup>

In light of the above, implementing the Demand Curve at this time would be ill-advised. Thus, even if it is inclined to do so, the Board should not approve and file the Demand Curve prior to FERC's issuance of its final SMD rule.

### **CONCLUSION**

For the reasons set forth herein, the Board should reject the Demand Curve or, at a minimum, return it to the committee process for additional, more comprehensive analysis.

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Respectfully submitted,

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<sup>14</sup> FERC Docket No. RM01-12-000, Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design, Reply Comments of the New York Independent System Operator, Inc., p. 10 (footnotes omitted).