NEW YORK INDEPENDENT SYSTEM OPERATOR
BOARD OF DIRECTORS

Strategic Power Management, Inc.'s Motion to Dismiss and in Opposition to Entergy and NY Municipals Appeal of the Management Committee's on the Rate Schedule No. 1 Cost Allocation Proposal

Dated: June 25, 2004

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INTRODUCTION

By letters dated June 17, 2004, Entergy[1] and the NY Municipals[2] filed notices of appeal of the Management Committee's decision to approve Motion No. 4 at the June 4, 2004 meeting. The motion proposed to allocate Rate Schedule No. 1 charges and FERC fees 80% to load and 20% to supply starting in 2005 and for five years thereafter, absent a significant change in the market that would render such an allocation unfair. This compromise proposal was reached in view of the support of the R.J. Rudden study which concluded that Rate Schedule 1 and the FERC fees should be allocated 77% to load and 23% to supply. The current allocation is 85% to load and 15% to supply.

The NY Municipals appeal on the grounds that this proposal "discriminates" against bilateral contracts and "forces those parties to unduly subsidize parties in the NYISO's markets." [3] Entergy states that the approved proposal "erroneously and disproportionately allocates the costs of credit risk and billing services for the LMBP market to parties that are not participating in this market and have already covered their credit exposure in their bilateral contracts."[4]

Both complain that the NY ISO is in violation of FERC orders to unbundle Rate Schedule No. 1 services. Entergy urges that the current sharing methodology remain in

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1 Collectively for Entergy Nuclear Indian Point 2, LLC, Entergy Nuclear Indian Point e, LLC and Entergy Nuclear Fitzpatrick, LLC.

2 Collectively including the City of Jamestown Board of Public Utilities, the Village of Freeport Electric Department, and the Village of Rockville Center Electric Department, among others.

3 NY Municipals Notice of Appeal at page 1.

4 Entergy Notice of Appeal at page 2.

place while the unbundling is accomplished, while the NY Municipals support the 80%/20% approved cost sharing proposal to go into effect without the five year freeze, pending the unbundling.

THE BOARD IS URGED TO DENY BOTH APPEALS

Strategic Power Management, Inc. ("SPM") urges the Board to deny both appeals. First, the Management Committee approved the compromise proposal by a vote of 87.63%. This is an unusually high percentage given the inherently controversial nature of cost allocation issues. Second, while unbundling is theoretically sound, implementation from a billing perspective will cost more than the expected benefits associated with greater cost allocation precision. Third, the resources of the NY ISO are better spent on higher priority projects at the present time and for the foreseeable future.

All sectors supported the compromise, some unanimously even though it would mean increased costs for certain market participants. This shows again that the majority of MPs have the long term best interests of the market place firmly in sight, even when it may mean increased costs in the short run. An affirmative vote of over 87% demonstrates quite an extraordinary level of support which the Board should respect.

NY ISO staff estimated that implementation of the programming associated with unbundling Rate Schedule No. 1 charges would cost at least $1 million. This is a significant cost that need not be incurred at the present time. Any form of cost allocation necessarily involves judgment. Reasonable and well versed analysts can and do come up with different allocation formulas even when starting with the same information. For example, is it fair to allocate certain costs on the number of bills or the number of market participants? How best to assign costs to those who are benefited? How does one quantify benefits? Anyone who remembers the never ending debates on cost allocation issues in major rate proceedings during the 1970s and 1980s, will surely find the compromise under attack here to be appropriate and reasonable at the present time. It will add certainty which is always desirable in any business context. All MPs will know what their share of the day to day costs of running the NY ISO will be for the next five years. This is extremely helpful to enable MPs to design market products that can have terms greater than the currently prevalent 1 or 2 year deals.

In addition, RJ Rudden's study, as reflected in the motion itself, states "further recommendation that reasonable modifications to the percentage allocation would be justified due to the significant number of assumptions that formed the basis of the Rudden Study." The BS&P found the some costs could reasonably be placed in categories other than those selected by Rudden; thus, arriving at an 80%/20% allocation proposal.

More importantly, unbundling Rate Schedule No. 1 services, would involve jumping priority on other projects which most MPs and the NY ISO Staff deem more important to the overall efficiency of the market place. Over 87% of the MPs supported the 80%/20% sharing formula and that vote should be upheld by this Board.

APPELANTS HAVE BASED THEIR APPEAL ON MISTAKES OF FACT AND HAVE OFFERED NO CONCRETE SUPPORT FOR THEIR APPEALS

Entergy alleges that the cost of credit risk and billing services for the LBMP market is disproportionately borne by parties not participating in the market or who have covered their credit exposure in their bilateral contracts. All Market Participants benefit from NY ISO existence and services. Just because a party may have a bilateral today, does not mean it may not be using the Day Ahead or Real Time Markets, tomorrow. Certainly, ancillary services are offered and purchased through the NY ISO by parties that have bilateral contracts. So there appears to be a factual error to Entergy's position regarding billing services. Billing services are not avoided even if a party has a 100% bilateral position. The size of the bill does not drive the cost of the billing system.

With respect to credit exposure, the NY ISO backs out the bilateral in the credit requirement. For example, if the credit requirement for non-rated companies is 2.5 times the estimated or actual peak load, then the cash deposit or letter of credit will be 2.5 the anticipated transaction size. In the case of a bilateral contract, the NY ISO does not ask for credit support, other than that required to cover the ancillary services exposure. More importantly, as a significant supplier, Entergy is the primary beneficiary of NY ISO administered credit requirements. So on its face an 80%/20% sharing of this particular cost appears to be quite reasonable from Entergy's perspective.

The NY Municipals simply opine that the 80%/20% compromise discriminates against bilateral customers who subsidize the other market participants. There are no facts presented to support that position. The cost of operating the NY ISO should be allocated fairly over time to all of the Market Participants who benefit from the totality of the services. Just because an MP has a predominant position in bilateral transmission transactions today, does not mean the situation cannot change tomorrow. Some of the NY Municipals also own generating facilities that are interconnected with the New York Control Area and fall under NY ISO administration.

The bottom line is that there is no perfect cost allocation methodology. With an over 87% approval rating, the proposal at issue here is probably as good as it gets, especially when one considers the diversion of funds and resources to obtain the precision that the NY Municipals seek.

CONCLUSION

The Market Participants having carefully reviewed the compromise proposal on Rate Schedule No. 1 cost allocation, overwhelming supported it. It is fundamentally fair and represents an efficient way of charging NY ISO operational costs to MPs while simultaneously avoiding cash outlays for reprogramming and upsetting well established project priorities.

Accordingly, SPM urges the Board to deny the appeals of Entergy and the NY Municipals and to petition FERC for relief from implementing unbundling at this time.

Respectfully submitted,

Daniel P. Duthie

Dated: June 25, 2004

Goshen, New York

DPD:bsb