AUGUST 27, 2008

NYISO BOARD OF DIRECTORS DECISION
ON
WHETHER REPEAL OF THE ICIP REQUIRES RESETTING THE NYC ICAP DEMAND CURVE

Background

The current ICAP Demand Curves are based on economic and factual analyses that were completed last summer.[1] At that time, newly developed utility real property, including new generation, was eligible for a substantial reduction in real property taxes under the New York City Industrial and Commercial Incentive Program ("ICIP"). Consistent with the past practice of the New York State legislature, the Demand Curves were based on an assumption that the ICIP program, which started in the early 1990's, would be continued when it came up for renewal in June, 2008. This past June, however, Governor Paterson signed into law legislation to replace the ICIP with a new tax abatement program that excludes "utility property." This change is prospective only, and does not affect the tax status of current beneficiaries of the ICIP. The availability of the ICIP tax relief, however, was a significant factor in determining the cost of new entry (CONE) for a new peaking unit entering the market for Installed Capacity in New York City ("NYC"). Net CONE is in turn a critical factor in setting the level of the ICAP Demand Curve for NYC.

Issue to be Decided

Does the exclusion of new electric generators from the real property tax incentives that replaced the ICIP give rise to an "exigent circumstance" that warrants resetting the ICAP Demand Curve for NYC prior to the next regularly scheduled revisions of the Demand Curves?

Facts

In the process giving rise to the Demand Curves now in effect, the NYISO retained National Economic Research Associates ("NERA") as consultants to conduct an analysis of the level of the CONE on which the Demand Curves should be based. At the conclusion of its analysis, NERA produced a spreadsheet model for the calculation of a revised NYC Demand Curve. This included a true/false switch for the ICIP tax benefit. The Demand Curve for NYC that was adopted was based, among other considerations, on the assumption that the ICIP factor was true. Changing this factor to false in the NERA spreadsheet, without making any other changes, causes the net CONE to increase by approximately 39%. This would result in a

[1] Unless otherwise specified, capitalized terms have the meanings specified in the Market Administration and Control Area Services Tariff ("Services Tariff") of the New York Independent System Operator, Inc. ("NYISO").

concomitant increase in capacity payments under the Demand Curve to NYC ICAP suppliers of the same amount.

The NYISO staff has determined that changing the net CONE by 39% would, under current capacity market conditions, likely increase the current NYC clearing price from about $6/kw-month to about $8.34/kw-month. A price increase of $2.34/kw-month would translate into an increase of approximately $22 million per month in capacity payments, or $132 million for the 2008 Summer Capability Period. Since roughly 2,000 MW of capacity is owned by NYC LSEs, however, the net impact would be slightly over $100 million in additional payments to ICAP suppliers in NYC, collected from LSEs in NYC, but could be somewhat less depending on the hedging arrangements in bilateral contracts. It is also likely that capacity payments to NYC suppliers would increase in the Winter Capability Period as well, but the $100 million figure approximates a lower bound on the annual impact.

The NYISO staff has also advised the Board that capacity supplies in NYC are expected to remain at levels above the minimum capacity requirement through the period covered by the current Demand Curves, which extend to the end of the 2010-2011 Winter Capability Period. While the surplus will likely decrease over this period, supplies will nonetheless exceed the minimum locational requirement for NYC.

In addition to obtaining information from the NYISO staff, the Board has considered the comments and reply comments that it requested from interested stakeholders. The principal advocates of changing the Demand Curve were the Independent Power Producers of New York, Inc. ("IPPNY"), joined by several suppliers of Special Case Resources ("SCRs") (together "IPPNY Comments"). Comments opposing changing the Demand Curve were received from a coalition of LSEs and electricity consumers, as well as the New York Dept. of Public Service and the City of New York.

The IPPNY Comments assert that the NYISO's 2008 Load and Capacity Data Report ("Gold Book") projects a capacity shortfall in New York City in the summer of 2010, and therefore an "exigent circumstance" exists.[2] The Gold Book data does not, however, include capacity from Special Case Resources ("SCRs") or the Linden VFT project, both of which are reasonably expected by the NYISO staff to provided significant amounts of capacity in NYC. While the IPPNY Comments assert that SCRs could elect to leave, or forego further entry into, the NYC market if the Demand Curve is not revised, the comments provide no facts or other reasons to conclude that the Demand Curve at the current level will not continue to attract approximately 450 MW of SCRs, as has been the case. In this connection, the Board notes that SCRs are not "utility property," and thus would not be excluded from the replacement for the ICIP.

The comments received by the Board do not identify any specific new entrant that will be adversely affected, or deterred from entry, by the current set of NYC Demand Curves. Mr. Baker's affidavit in support of the IPPNY Comments contends that 100 MW of new capacity is being contemplated by US Power Generating Company ("USPG"), but states only that it is

[2] IPPNY Comments at 15.

USPG's "goal" to commence commercial operations by the summer of 2010. At the same time, the NYISO staff advises that this project has not yet completed the necessary steps for inclusion in Class Year 2009 for the requisite Feasibility Study for operation in 2010. The staff also advises that even if there were sufficient evidence that this project would be delayed because of concerns about the level of the current Demand Curve, NYC capacity levels would continue to be expected to exceed minimum requirements through the period covered by the current Demand Curves.

It is at best unclear whether the CONE for new generation entering NYC will increase by the full amount of the property taxes that would be payable in the absence of the ICIP. As indicated in the comments of New York City, new generator projects in NYC may be eligible for industrial development incentives in the absence of the ICIP.[3] In addition, other factors affecting CONE may have changed since the conclusion of the last Demand Curves reset process. Given these realities, the Board is not confident that the NYC Demand Curves could be accurately redetermined simply by changing the ICIP variable in the NERA model from true to false. Rather, a full analysis of the factors affecting the CONE for new capacity in NYC would be required.

The IPPNY Comments contend that if the current Demand Curve is not revised to reflect the repeal of the ICIP, the bid floor in the NYISO's proposed mitigation measures for NYC will artificially depress capacity prices in NYC.[4] None of the comments, however, identify any actual or planned facility that would be subject to a bid floor determined by the current set of NYC Demand Curves.

The "Exigent Circumstances" Standard

The ICAP Manual states that: "Once the ICAP Demand Curves have been approved by FERC, they shall remain binding for the 3-year period until the next review, absent exigent circumstances."[5] The ICAP Manual provides no further guidance on determining whether "exigent circumstances" exist.

The fundamental purpose of the Demand Curves is to preserve the reliability of the New York electric system by providing price incentives for the development of capacity that will meet or slightly exceed the applicable minimum Installed Capacity requirements.[6] The Board concludes from this purpose that a finding of "exigent circumstances" in this context should be reserved for situations in which there is a significant likelihood that reliability would be compromised because of a lack of capacity, and an off-cycle resetting the Demand Curve would materially contribute to reliability being maintained.

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[3] *See* NYC Comments at 4-5.

[4] IPPNY Comments at 18.

[5] ICAP Manual § 5.6.7.

[6] *See New York Indep. Sys. Operator, Inc.*, 103 FERC ¶61,201 (2003).

This conclusion is supported by the standard for action in "exigent circumstances" specified in § 19.01 of the NYISO Agreement. Section 19.01 states that the Board may take unilateral action to amend a NYISO tariff or certain other documents if "the proposed amendment is necessary to address exigent circumstances related to the reliability of the NYS Power System or to address exigent circumstances related to an ISO Administered Market." The Board's conclusion is also consistent with the recommendation of its independent Market Advisor on the application of the "exigent circumstances" standard in the context of revising the Demand Curves.

The Board is also mindful of the holdings of the Federal Energy Regulatory Commission ("Commission") on whether an asserted deficiency in a current Demand Curve warrants an off-cycle revision to the Demand Curves once they have been through the stakeholder process and approved by the Commission. This situation arose in 2005, in connection with changes in the data reported in the 2004 Gold Book, which was used in setting the Demand Curves, as compared to later data in the 2005 Gold Book. The Commission rejected arguments that the Demand Curves should be revised in light of the new Gold Book data, holding that "the entire ICAP Demand Curve process is based on the premise that it is important to the market to have price stability and certainty," and that "[s]tability and certainty would be sacrificed if . . . we acted prospectively but outside the envisioned three year process for developing ICAP Demand Curves."[7] The Commission was also concerned that revising the Demand Curve "would create a precedent for further—month-by-month, perhaps—adjustments as data and circumstances change in New York over the three year period, which would promote uncertainty rather than stability."[8] The Commission further noted that "as in a cost-of-service rate case involving test year data, at a certain point, a decision must be made based on the information on hand, and adjustments based on selected post test year data can throw off the balance between offsetting factors."[9] Finally, the Commission concluded that if a complex analysis of potentially off-setting facts and circumstances were required, that analysis should be reserved for the triennial update process.[10] Taken together, these holdings indicate that the Commission would give substantial weight to the values of stability and certainty inherent in the triennial reset cycle, and thus would be unlikely to approve an off-cycle revision to a Demand Curve in the absence of compelling evidence of an imminent and substantial threat to reliability for which a reset the Demand Curve could be readily determined and would provide a material remedy.

Analysis and Conclusions

Applying the facts discussed above to its analysis of the "exigent circumstances" standard, the Board determines that the repeal of the ICIP does not present an exigent circumstance that would warrant an off-cycle redetermination of the NYC Demand Curve. The

[7] *New York Indep. Sys. Operator, Inc.*, 112 FERC ¶61,283 at P 39 (2005).

[8] *Id.*

[9] *Id*. at P 38.

[10] *Id*. at P 40.

Board does not believe that the available facts show that there is an imminent and substantial threat to reliability over the remaining term of the current NYC Demand Curves unless those curves are redetermined. Longer term, the Demand Curves will continue to attain their purpose of attracting and retaining sufficient Installed Capacity to NYC by meeting expectations that in each reset cycle the Demand Curves will be set at appropriate levels based on a full consideration of all the relevant facts and circumstances bearing on the net CONE determination. The Board believes the NYISO has developed a good track record in meeting these expectations, and that entry by future generation projects will be based on those expectations rather than the level of current Demand Curves that will not apply to those projects.

The Board rejects any suggestion that a determination not to engage in an off-cycle redetermination of the NYC Demand Curve would in any way prejudge or compromise the determination of the CONE in the next regular reset process. Whatever the views of any group of stakeholders in the current controversy, the Services Tariff directs that the periodic review of the Demand Curves determine "the current localized levelized embedded cost of a peaking unit in each NYCA Locality and the Rest of State to meet minimum capacity requirements."[11] The Board fully expects that this determination will be made on the basis of a thorough evaluation of the available facts, including those relating to any tax or other benefits available to generation projects. The effects of the repeal of the ICIP, along with the availability of any other development incentives and other CONE factors should and will be considered in the next Demand Curves reset process.

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[11] Services Tariff § 5.14.1(b).