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COMMENTS OF INDEPENDENT POWER PRODUCERS OF NEW YORK, INC. AND CONSUMERPOWERLINE, INC. ON A RECENT STATUTORY CHANGE TO THE NEW YORK CITY INDUSTRIAL AND COMMERCIAL INCENTIVE PROGRAM AND ITS SIGNIFICANT IMPACT ON THE INSTALLED CAPACITY DEMAND CURVES FOR NEW YORK CITY

INTRODUCTION

Over the past year, the New York Independent System Operator, Inc. ("NYISO") undertook two significant and related actions with respect to the New York City capacity market. The first was to complete the reset process for the Installed Capacity Demand Curves ("Demand Curves").[1] One of the largest individual factual inputs to the calculation of the net cost of new entry ("Net CONE") for the New York City Demand Curves ("NYC Curves") was the property tax exemption awarded to new generating facilities under New York City's Industrial and Commercial Incentive Program ("ICIP Exemption").[2] The ICIP Exemption expired on June 30, 2008,[3] and the replacement exemption program enacted as of the same date expressly excludes

[1] *See New York Independent System Operator, Inc.*, 122 FERC ¶ 61,064 (2008).

[2] New capital investments in existing generating facilities were also eligible for ICIP property tax exemptions.

[3] Real Property Tax Law §489-eeee(1).

generating facilities.[4] Thus, the ICIP Exemption is no longer a valid factual input to the Net CONE for the NYC Curves for the nearly three years that they will be in place.[5]

The second action taken by the NYISO was in response to the Federal Energy Regulatory Commission's ("FERC") decision ". . . to investigate the justness and reasonableness of the New York ISO's in-city ICAP market, and whether and how market rules need to be revised to provide a level of compensation that will attract and retain needed infrastructure and thus promote long-term reliability while neither over-compensating nor under-compensating generators."[6] In accordance with the FERC's directives in that proceeding,[7] the NYISO proposed a comprehensive mitigation structure that was designed to ensure adequate price signals to incentivize investment in new and needed existing generation in New York City.

As demonstrated herein and in the accompanying affidavit of Mr. Mark D. Younger, sworn to on July 31, 2008 ("Younger Aff."), the statutory elimination of the ICIP Exemption requires the Net CONE, and correspondingly, the NYC Curves, to be increased by $47.74/kW-year, or 38.8%.[8] In other words, the change in the law has caused a substantial deviation between the NYISO's administratively determined Net CONE and the actual Net CONE that would be experienced by any developer seeking to enter the New York City market.

The failure to immediately adjust the NYC Curves to recognize the change in law will have potentially deleterious consequences on the NYISO's short term and long term markets and on generators' and developers' investment decisions in New York City. It may also adversely

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4 *See* Chapter 119 of the Laws of 2008; Real Property Tax Law §489-cccccc(3)(b).

5 As of the date these comments are submitted, only three months of the three-year term of the Demand Curves will have elapsed.

6 *New York Independent System Operator, Inc.*, 118 FERC ¶ 61,182 (2007) ("In-City ICAP Proceeding), P 17.

7 *New York Independent System Operator, Inc.*, 120 FERC ¶ 61,024 (2007), P 15.

8 Younger Aff., ¶¶ 17, 20. The 2009 and 2010 New York City Demand Curves would be increased by the same amount multiplied by the applicable inflation factors; the 2010 Curve would also be modified due to the application of a different summer-winter adjustment factor.

impact demand response providers' decisions to participate in the New York City capacity market. Further, and equally as important, because the capacity market structure for New York City and the administratively-set clearing price levels operate hand in hand, it will lead to the under-compensation of generators and frustration of the buyer-side mitigation measurers, in direct contravention of the FERC's express directives and decisions in the In-City ICAP Proceeding.[9]

These significant adverse impacts rise to the level of exigent circumstances requiring the NYISO's Board of Directors to take immediate action to correct the NYC Curves. Accordingly, in accordance with the Board's Notice to Market Participants, dated July 17, 2008, the Independent Power Producers of New York, Inc. ("IPPNY"), on behalf of its members, and ConsumerPowerline, Inc. ("ConsumerPowerline")[10] jointly submit these comments and the accompanying affidavits of Mr. Younger, Liam T. Baker, sworn to on July 31, 2008 ("Baker Aff."), and Lee Davis, sworn to on July 31, 2008 ("Davis Aff."), in support of its request that the Board determine at its August meeting that: (1) the elimination of the ICIP Exemption requires the correction to the administratively-determined Net CONE for New York City to include property taxes on the proxy unit; and (2) exigent circumstances justify an immediate application to the FERC to make corresponding modifications to the NYC Curves and the price signals they convey to the marketplace. IPPNY and ConsumerPowerline further respectfully request that the NYISO thereafter expeditiously make its exigent circumstances filing with the FERC.

BACKGROUND

9 *See also New York Independent System Operator, Inc.*, 122 FERC ¶61,211 (2008).

10 ConsumerPowerline is a full service strategic energy asset management firm and a leading provider of demand response solutions in the United States with more than 750 MWs under management.

Pursuant to Real Property Tax Law §489-eeee(1), eligibility for the New York City ICIP Exemption expired on June 30, 2008, thereby eliminating the ability of electric generating companies, developers of electric generating facilities, and public utilities from reducing their property tax burdens on new investments within New York City. Simultaneous with the cessation of the ICIP, Governor Patterson signed into law Chapter 119 of the Laws of 2008, which added Title 2-F to the Real Property Tax Law and creates a new Industrial and Commercial Abatement Program within New York City. Importantly, new Real Property Tax Law §489-cccccc(3)(b) provides: "[n]o abatement benefits under this title shall be provided for utility property." Under §489-aaaaaa(17), the term "utility property" is broadly defined and includes equipment and structures used in the generation of electricity. Accordingly, no generator considering major capital improvements to, and no developer considering the construction of new, fossil-fueled electric generating facilities in New York City will be able to secure any as-of-right property tax exemption for their projects.[11]

Due in large part to the relatively short term nature of its capacity markets, the NYISO relies on administratively determined Demand Curves to establish the clearing price for capacity. In 2007, the NYISO conducted a stakeholder process and retained independent consultants to assist it in developing new Demand Curves covering the Capability Years 2008-2009, 2009-2010, and 2010-2011. That process culminated in a FERC Order issued January 29, 2008 approving the Demand Curves as proposed by the NYISO.

[11] The only exceptions to this statement pertain to qualifying waste treatment and air pollution control facilities, which are exempt under Real Property Tax Law §477 and §477-a.

In calculating the NYC Curves, the NYISO and NERA Economic Consulting ("NERA"), one of its consultants, assumed "[t]he continuous renewal of the ICIP in future years . . . ."[12] As explained by Mr. Younger, the computer model developed by NERA to calculate the Demand Curves includes a binomial variable that allows for the inclusion and exclusion of the ICIP input without changing any other variable or assumption.[13] Changing this single variable to "turn off" the ICIP Exemption results in an increase to the 2008-2009 NYC Curve of $47.74/kW-year, or 38.8%.[14] In other words, the NYC Curve must be increased by 38.8% for it to reasonably reflect the actual Net CONE in New York City.

ARGUMENT

A. This Matter Is Within The Exigent Circumstances Provision Of The NYISO Agreement

The role of the NYISO is to: ". . . maintain the reliable, safe, and efficient operation of the NYS Power System . . . ."[15] The responsibility of the NYISO's Board of Directors is to ensure ". . . the effective implementation of [the NYISO's] basic responsibilities, including, but not limited to: the reliable, safe, and efficient operation of the NYS Power System."[16] This role and responsibility includes monitoring issues that could adversely affect the continued viability of the wholesale markets and taking reasonable and appropriate steps to prevent harm to the marketplace.

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12 *See* "Independent Study to Establish Parameters of the ICAP Demand Curve for the New York Independent System Operator," dated August 15, 2007 ("NERA Report"), p. 38; included as Exhibit B to Attachment 3 of the NYISO's November 30, 2007 tariff filing in Docket No. ER08-283-000.

13 Younger Aff., ¶¶ 18-19.

14 *Id.*, ¶¶ 17, 20.

15 NYISO Agreement, dated July 3, 2007, Section 2.01.

16 *Id.*, Section 5.08.

The NYISO Agreement approved by the FERC specifies that as a general matter and in the ordinary course of events, the NYISO shall be precluded from seeking to change its tariffs under Federal Power Act ("FPA") §205 unless it first obtains approval from the Management Committee.[17] Because circumstances could arise wherein the NYISO must take immediate action to preserve or protect the reliability of the electric system and/or the NYISO's competitive wholesale markets, the NYISO Agreement provides the following exception:

> Notwithstanding the foregoing, the ISO Board may submit to the Commission a proposed amendment to the ISO OATT, the ISO Services Tariff or the ISO Agreement under Section 205 of the FPA, without the concurrence of the Management Committee, under the following circumstances: the ISO Board certifies that (1) 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; and (2) the urgency of the situation justifies a deviation from the normal ISO governance procedures.[18]

The NYISO has previously exercised its authority to unilaterally submit an FPA §205 filing to the FERC under exigent circumstances seeking to modify its market rules to address the administration of its competitive wholesale markets. Indeed, as recently as July 21, 2008, the Board exercised its responsibility to ensure the reliable and efficient operation of the electric system and the wholesale markets and applied the exigent circumstances exception when it filed tariff amendments to preclude Market Participants from scheduling transactions across eight specified paths around Lake Erie.[19] The Board cited to cost considerations as constituting the exigent circumstances in that matter and explained the imminent need for action as follows:

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17 NYISO Agreement, dated July 3, 2007, Section 19.01. It should be noted that the resetting of the Demand Curves is the single market rule that, by the express terms of the NYISO's Market Administration and Control Area Services Tariff ("Market Services Tariff"), the Board is required to submit to the FERC under FPA §205 without a 58% concurring vote of the Management Committee.

18 *Id.*

19 *New York Independent System Operator, Inc.,* Docket No. ER08-1281-000.

> Unless something is done to end the scheduling of these transactions . . ., their scheduling will continue to adversely affect the operation of the NYISO markets.[20]

IPPNY and ConsumerPowerline respectfully submit that the change in law that eliminated the ICIP exemption for generating facilities presents similar cost-based and market efficiency reasons as were identified by the Board in Docket No. ER08-1281-000. For this reason, and as more fully discussed below and in the accompanying affidavits, the same exigent circumstances found by the Board in that docket justify taking immediate action in this matter to reconcile the NYC Curves with the statutory elimination of a core factual input thereto.

B. This Matter Is Within The Exigent Circumstances Provision Of The ICAP Manual

Section 5.6.7 of the ICAP Manual reflects the provisions of the NYISO Agreement and provides that "[o]nce 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." The NYISO and the FERC have already had one occasion to address this very provision, and IPPNY and Consumer Powerline respectfully assert that the arguments raised by the NYISO in that matter compel it to take action here.

In 2005, the NYISO completed its first Demand Curve reset process and filed its then-proposed Demand Curves for Capability Years 2005-2006, 2006-2007, and 2007-2008 with the FERC.[21] Shortly after the FERC accepted the proposed Demand Curves, the NYISO notified the agency that more recent data appeared to contradict its findings concerning generator ratings – a factor that varies year to year, and thus, must be estimated when setting the Demand Curves. Based on this new data, IPPNY sought rehearing of the FERC's decision regarding the adjustment for the winter-summer differential.

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[20] Docket No. ER08-1281-000, NYISO Filing Letter, dated July 21, 2008, p. 12.

[21] *New York Independent System Operator, Inc.*, Docket No. ER05-428-000.

The NYISO opposed this request, arguing that "whether revisions should be made must consider the following factors: (1) potential anomalies in the 2005 data, and whether the data is representative of typical conditions; (2) the inclusion of a 300 MW increase in winter capacity already included in the recently approved Demand Curves; (3) consideration that the recently approved Demand Curves were intended to be in place for three years and the benefits of making after-the-fact revisions must be weighed against the effect this would have on stability and certainty; and (4) other factors and costs that might change during the three year period, and offset the revisions requested by IPPNY."[22] The NYISO also argued that exigent circumstances for modifying the Demand Curves did not exist because the new data would not cause a material change to the Curves and because the Curves were based on a range of data that may change over time.[23] In support of the NYISO's position, Dr. David Patton asserted that stability is critical "because the revenue expectations from this market play an important role in providing incentives for investing in new capacity and incurring major maintenance expenditures at existing facilities."[24] He urged the FERC to ". . . place a high premium on decreasing regulatory uncertainty associated with the capacity market and only intervene when the results of such intervention would be material."[25]

Based on the NYISO's own assessment of the criteria that warrant application of its exigent circumstances authority, immediate corrective action must be taken here. The first factor cited by the NYISO is whether the new data is "representative of typical conditions." Clearly, the change in law represents the conditions to be experienced by existing generators and

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22 *New York Independent System Operator, Inc.*, 112 FERC ¶ 61,283 (2005), P 9.

23 *Id.* at P 34.

24 Docket No. ER05-428-003, Affidavit of David B. Patton, sworn to on July 29, 2005, ¶ 20; attached to the NYISO's August 1, 2005 letter to the FERC as Attachment A.

25 *Id.*

developers for the foreseeable future. While some may argue that the Legislature could again change the law and that the recent action is therefore not representative, such arguments lack merit. The Legislature did not just allow the ICIP to expire; it enacted a replacement program that provides for property tax exemptions for virtually all commercial and industrial properties formerly covered by the ICIP, except for utility properties.[26] Given that action, and the Legislature's express decision to exclude generating facilities and other utility property, there is no reasonable basis to believe that the new abatement program, which has a sunset date of June 30, 2013, will be expanded to mirror the ICIP.[27]

The second factor, and one of the two reasons why the NYISO claimed in the former matter that there were no exigent circumstances, relates to the magnitude of the proposed change. In that matter, the NYISO argued that a 300 MW change was not material because its effect on the Curves was minimal (less than a 6 % change). Here, Mr. Younger has calculated that the loss of the ICIP Exemption equates to a 38.8% change in the Demand Curve. The elimination of the Exemption immediately and directly increases the cost of new generation in New York City. No one could legitimately argue that a change of this magnitude is immaterial.

The third factor, which is also one of the primary concerns raised by Dr. Patton, relates to stability and certainty. As discussed throughout these comments and the accompanying

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26 The Senate Introducer's Memorandum in Support of the legislative bill that became Chapter 119 explains that "[t]his bill will transform ICIP from an inefficient drain on the City' budget to a program that creates significant new economic activity at the lowest possible cost, saving City taxpayers hundreds of millions of dollars in the short term."

27 It should be noted that the City of New York expressly recommended excluding utilities from the new abatement program, while the Business Council, Energy Association of New York, and Consolidated Edison Company of New York, Inc. objected to its passage. The enactment of the legislation over this opposition lends further support for the assertion that it will not be expanded. While IPPNY and ConsumerPowerline acknowledge that in supporting the legislation, the City suggested that it will consider other financial support for utility projects under its Industrial Development Agency ("IDA"), the City has not offered any information as to the nature or extent of that support. There is absolutely no evidence that it will equal, or even approach, the benefits formerly provided by the ICIP exemption. Moreover, unlike the ICIP Exemption which provided a blanket exemption applicable to all such projects, the provision of IDA benefits are discretionary and made on a case-by-case basis.

affidavits, the change in law to eliminate this major factual input to the NYC Curves has created tremendous instability and uncertainty because the NYC Curves are no longer representative of the Net CONE for the New York City market. The NYISO's failure to adjust the NYC Curve to reflect this material change would exacerbate this instability and uncertainty because suppliers will lose confidence in the ability of the markets and the NYISO to convey reasonable price signals. Failure by the NYISO to act now would ensure only one certainty – that the NYC Demand Curves will be *wrong* for 34 of their 36 month life span. Indeed, the failure to act could increase, not decrease, regulatory risk because it would greatly diminish investors' view of the revenue expectations from the NYISO's capacity markets. Moreover, as discussed by Messrs. Younger, Baker, and Davis, the failure to act may well create disincentives to, and lead to reductions in, new capital investments – the very harm Dr. Patton sought to protect against in 2005 and a consequence that can be ill-afforded at this time in light of the impending need for new capacity in New York State, particularly in New York City.[28]

The fourth factor pertains to the potential for offsetting changes. As explained in more detail in Point D, below, the ICIP Exemption was a known factual input, not an estimate. At this time, there are no indications that there will be decreases in any of the other pivotal factual inputs in the NERA model over the next two plus years that would offset the loss of the ICIP Exemption.

In accordance with Dr. Patton's admonition that there should be a "high premium on decreasing regulatory uncertainty associated with the capacity market," and for all of the reasons

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[28] The NYISO's 2008 Gold Book references a need of 600 MW in New York City by 2015 to preserve the 80% Locational Capacity Requirements (Younger Aff., ¶ 32), and its 2008 Reliability Needs Assessment, dated December 10, 2007, p. I-19, identifies a reliability need of 1,000 MW of new capacity resources in New York City in 2015. In response to these needs, developers have proposed four generation projects located wholly or partially in New York City and three controllable transmission lines from PJM to New York (one of which is related to one of the proposed generation projects) as market-based solutions. By definition, such solutions rely solely on the revenues received from the markets.

stated herein, the NYISO Board must proceed with its exigent circumstances authority and seek immediate modification of the NYC Curves to remove the ICIP Exemption.

C. The Change In Law Requires An Immediate Adjustment To The Demand Curves

Generators are presently evaluating whether to make capital investments in existing New York City facilities, generation developers are evaluating whether to invest in New York City, and demand response providers are considering whether to participate in the New York City capacity market as suppliers. All of these entities need assurances regarding the stability and continued viability of the marketplace and that the NYISO is proactively working to provide a reasonable degree of regulatory certainty, including that its administratively determined price signals reflect the actual Net CONE. The latter assurances are especially critical in the New York City capacity market, where there is extensive mitigation in the energy and ancillary services markets. Thus, within the capacity markets, one of the NYISO's most important responsibilities is ensuring that its administratively determined price signals are indicative of real world conditions. Accordingly, it is neither just nor reasonable to wait nearly three years before accounting for the elimination of the ICIP Exemption.

Evidence of the substantial impact that the ICIP Exemption had on the calculation of the Net CONE in New York City can be found in the NYISO's own documents. The NERA Report, which was submitted by the NYISO to the FERC to support the reasonableness of the Demand Curves, states the following regarding the ICIP Exemption:

> The ICIP property tax abatement in New York City has a significant effect on the carrying charge rates. Over the 15-year amortization period, the ICIP reduces the levelized carrying charge rate by 23%.[29]

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[29] NERA Report, p. 47.

As noted above, Mr. Younger has calculated that this significant effect on the carrying charges equates to $47.74/kW-year, or 38.8%, on the 2008-2009 NYC Curve.

A substantial deviation between the price signals conveyed by the NYC Curves and the actual Net CONE experienced by developers is clearly a market inefficiency that must be corrected. In this case, there is no good reason to avoid or delay making the correction as it does not involve subjective considerations, significant programming changes, or a substantial commitment of NYISO resources. Further, as discussed above, the change in law constitutes an exigent circumstance within the meaning of the ISO Agreement and ICAP Manual, for which immediate redress is required.

Additionally, the Baker Aff. and Davis Aff., submitted concurrently with and as a part of these comments, demonstrate that decisions regarding future capital investments by two of three largest generation owners in New York City are being made now. As these and Mr. Younger's affidavits demonstrate, it is imperative to the continued viability of, and investors' confidence in, the NYISO markets that there is no delay in effectuating the removal of the ICIP Exemption from the calculation of the Net CONE for the NYC Curves.

D. The Demand Curves Must Be Based On Factually Correct Inputs

The Demand Curves are comprised of objective inputs and subjective assumptions and estimates. That is, the Demand Curves contain inputs that are based on clearly demonstrable and indisputable facts as well as assumptions and estimates that, by definition, must be based on the opinions and judgment of the NYISO, its Board, and its consultants. An example of the former type of input is the income tax component of the carrying charges. Examples of the latter type of input include the material and labor costs of constructing the proxy unit and the calculation of the net energy and ancillary services charges.

The input for the ICIP Exemption falls squarely under the former category. At the time NERA prepared its Report, and thereafter when the NYISO first proposed and then finalized and submitted its proposed Demand Curves to the FERC, the amount of the ICIP Exemption was a known figure. It was neither subject to interpretation nor required to be estimated. Indeed, the exemption amount to be applied each year was established as a matter of law in Real Property Tax Law §489-bbbb. It was also commonly believed that the ICIP, which had been in existence for over 20 years and was extended as recently as 2007, would remain in place for the term of the Demand Curves (*i.e.*, through April 2011). Accordingly, there was no dispute among the NYISO, its consultants, or any Market Participants that the ICIP Exemption should be captured in the Net CONE for the NYC Curves.

Because the law has changed and the ICIP Exemption has been eliminated, there is no legitimate or reasonable basis for the NYISO to assume or assert that the Net CONE in New York City will or should any longer reflect this Exemption. To the contrary, any such assumption or assertion would be erroneous as a matter of law. Indeed, if the Demand Curves were being established today, there would be no dispute among the NYISO, its consultants, or any Market Participants that no ICIP-type exemption should be reflected in the Net CONE for the New York City market. That the Curves were accepted six months ago does not justify ignoring or disregarding this pivotal change in circumstances. That is, as applied prospectively, the inclusion of the ICIP Exemption in the calculation of the Net CONE in New York City causes the NYC Curves to be unjust and unreasonable because they would be neither market-based nor cost-of-service based. *Cf Consumers Energy Co. v. FERC*, 367 F.3d 915, 922-923

(D.C. Cir. 2004). Accordingly, the NYISO cannot base its administratively determined Net CONE, the NYC Curves, or the capacity prices that will result therefrom, in part, on an element that, as a matter of law, does not and cannot apply.

During the FERC proceeding related to these Demand Curves, a number intervenors objected to various aspects of the development or components of the Curves. The NYISO countered those objections by asserting that ". . . it is important to use the most accurate and timely information available in the ICAP development process."[30] It is equally as important that the factual underpinnings of the Demand Curves remain accurate throughout the term of their application.[31] Otherwise, the usefulness of the Demand Curves and market participants' confidence in both the NYISO's oversight of the markets, and the markets, themselves, will be greatly diminished and the primary purpose for which the Demand Curves were designed and intended – to retain needed existing generation in New York and encourage, when appropriate, investments in new generation – will be frustrated.

E. The Failure Of The NYC Curves To Provide Adequate And Accurate Prices For Capacity Will Adversely Impact the NYISO's Markets In The Short Term And May Have Deleterious Long Term Impacts

Some parties may attempt to argue that there is no reason to make any corrections to the NYC Curves for the next nearly three years. Rather, they may argue that this factual input can be eliminated during the reset process for the NYC Curves that will go into effect beginning with the 2011-2012 Capability Year. As demonstrated below, such an argument is fundamentally flawed. Failure to increase the NYC Curves until May 2011 will, in fact, adversely impact the

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30 Docket No. ER08-283-000, Motion for Leave to Answer and Answer of the NYISO, dated January 18, 2008, p. 7.

31 IPPNY and ConsumerPowerline acknowledge that because of the need for stability and certainty, the same argument may not hold true for the subjective forecasts and estimates that by their nature change over time.

NYISO's short term markets. In addition, depending upon the actions of loads during this period, it may also have long term repercussions.

In submitting the proposed Demand Curves to the FERC, the NYISO made the following initial statement:

> "The NYISO and its Board are fully committed to continuing this process and ensuring that the ICAP Demand Curves are calculated to promote the appropriate price signals to existing and potential new entrants to encourage efficient investment in generating capacity."[32]

IPPNY and ConsumerPowerline respectfully request that the Board adhere to this very principle in considering this matter. If the Board is truly committed to ensuring the adequacy and accuracy of the price signals conveyed by the Demand Curves and to encouraging efficient investment in New York, there is only one reasonable and rational course of action – modify the NYC Curves to eliminate the now expired ICIP Exemption for generating facilities.

1. The Failure To Modify the NYC Curves Will Have Adverse Short Term Impacts

In addition to the concerns stated above regarding investors' need for stability and confidence in the NYISO's markets, there are pressing short-term needs for adequate and accurate price signals. First, as demonstrated by Mr. Younger, the NYISO's 2008 Gold Book projects a capacity shortfall in New York City in the summer of 2010,[33] a time period during which the present Demand Curves would still be in effect. There are different types of suppliers that could satisfy this shortfall, one of which is comprised of providers of Special Case Resources ("SCR"). SCR capacity is very price sensitive,[34] and SCR providers could easily elect

[32] Docket No. ER08-283-000, NYISO Filing Letter, p. 1.

[33] Younger Aff., ¶P 32-33.

[34] *Id.*, ¶ 34.

to leave, or forego further entry into, the market if the administratively determined market clearing price under the Demand Curve is not consistent with actual market-based costs.

Second, the Linden Variable Frequency Transformer ("VFT") project is projected to commence commercial operation by the third quarter of 2009, about half way through the term of the present NYC Demand Curves. Generators in PJM will presumably review the NYC Curves and the Board's actions in this matter in determining whether to sell capacity in the New York City capacity market via the Linden VFT project. If the prices produced by the NYC Curves are not representative of the actual Net CONE, those generators may choose to sell their capacity in PJM instead.[35]

Third, as discussed in detail by Mr. Younger and the companies, expanding environmental regulations and policies, fuel prices, and the age of the existing fleet of NYC generating facilities all place financial pressures on generators. In considering whether to retrofit, overhaul, repower, or expand their existing facilities, the New York City generators must evaluate whether additional capital investments in these facilities (or major operations and maintenance expenditures, in the case of some overhauls) are economically justified.[36] Particularly, they are assessing the price signals conveyed by the Demand Curves and the manner in which the NYISO is overseeing and fostering the competitive markets to determine the likelihood that they will be able to secure a reasonable recovery of, and on, any additional investments. The failure of the NYISO to act now to address a clear and significant change in a substantial factual underpinning of the NYC Curves could result in the generators losing

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35 *Id.*, ¶ 35.

36 *Id.*, ¶¶ 36-38.

confidence in the NYISO and the NYISO's markets and cancelling, deferring, or refraining from making new investments.[37]

For these reasons, the NYISO and the Board cannot wait more than two and a half years before reconciling the Demand Curves with actual market conditions.

2. Failure To Correct The Demand Curves Could Also Adversely Affect Operation Of The In-City Mitigation Measures

As noted above, this year the FERC approved comprehensive revisions to the mitigation measures applicable to the in-City Installed Capacity market. Because aspects of those mitigation measures are linked to, and dependent upon, the NYC Curves, the failure to correct the Demand Curves could frustrate some of the protections they are intended to provide, and, over the long term, dissuade new investment in New York City.

To protect the integrity of the New York City capacity market from improper market manipulation, the NYISO recently proposed, and the FERC accepted, with certain modifications, both supplier-side and buyer-side mitigation measures. Recognizing that uneconomic entry by buyers poses substantial detrimental impacts to the market, the NYISO proposed requiring subsidized new entrants to be subject to an Offer Floor under certain circumstances.[38]

To determine if that mitigation is warranted, the NYISO will assess the potential future impact of the new entry based on forecasts made at the time a project is proposed (an "ex ante determination"). The forecast capacity prices are based on the Demand Curves, and if the expected date of new entry is later than the term of the existing Demand Curves, the NYISO will escalate the Curves to the expected date.[39] Thus, any project proposed over the next two and

37 *Id.*, ¶¶ 23, 27-29.

38 *Id.*, ¶¶ 42-43.

39 *Id.*, ¶ 44.

three-quarters years that requests an ex ante review will be evaluated based on the present Demand Curves.

To prevent net buyers from depressing the capacity clearing price, the mitigation measures require all new generation to bid no less than an Offer Floor set at 75% of the Net CONE in New York City. If the ICIP Exemption is not removed as a factual input into the calculation of the NYC Curves for the current and next two Capability Years, any ex ante determination will likely result in an artificially suppressed Offer Floor price. That is, because the continued inclusion of the ICIP Exemption will produce an estimated Net CONE for New York City substantially below the cost a developer would actually experience, the Offer Floor will be similarly depressed. Specifically, Mr. Younger has determined that the Offer Floor imposed on a new facility would effectively be set at 54% of the Net CONE.[40] Not only does this violate the mitigation construct approved by the FERC, it minimizes the effectiveness of the buyer-side mitigation measures and could allow buyers to exercise monopsony power. Additionally, depressing the clearing price will likely prevent market-based responses to the capacity needs identified by the NYISO as developers would not be able to recover their investments solely from market-derived revenues.

As discussed above, there is a need for new capacity in 2010. Additionally, the Gold Book demonstrates that the need is increasing, with over 600 MW of new capacity needed by 2015 to address the New York City Locational Capacity Requirement alone. When overall bulk power system reliability needs are taken into consideration, the amount of new capacity needed for New York City may be as high as 1,000 MW over the same period.[41] If developers lose confidence in the NYISO and face heightened investment risk (due to questionable recovery via

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[40] *Id.*, ¶¶47-48.

[41] *See* 2008 Reliability Needs Assessment, issued December 10, 2007, p. I-19.

market-derived revenues), they may not be willing or able to pursue market-based solutions to address reliability needs. This, in turn, may leave the NYISO unable to ensure system reliability and resource adequacy through competitive means. Rather, the NYISO would be forced to resort to regulatory backstop and alternative regulated solutions. According to Dr. Patton, reliance on such solutions ". . . signals a failure of the markets . . . and can be inefficient and destructive to the market process."[42]

[42] Comments of Potomac Economics on the 2008 Comprehensive Reliability Plan, dated May 30, 2008, pp. 1-2. https://www.nyiso.com/public/webdocs/committees/bic_espwg/meeting_materials/2008-07-08/IMA_Comments_on_2008_CRP_Draft2_5_30_08.pdf

F. The Principles Upon Which The Demand Curves Were Initially Developed Should Control The NYISO's Decision In This Matter

The Notice to Market Participants issued on July 17, 2008 indicates that the Board's decision in this matter may be guided by the impact of the change on load serving entities. While IPPNY and ConsumerPowerline can appreciate the Board's interest in this information, it should not be determinative in this matter. Increasing energy prices are a reality that we must all confront, but their associated impacts play no role in ensuring that the NYC Curves convey accurate and appropriate price signals. Rather, in deciding this matter, the Board should continue to adhere to the same principles upon which the Demand Curves were originally established.

In 2003, the NYISO explained to the FERC that the purpose of the Demand Curves is to ". . . promote greater stability in the Installed Capacity market, provide a more effective economic signal for new investment in New York generating facilities, and enhance reliability."[43] The NYISO further explained that:

> Financing of new facilities has essentially dried up, and investors do not see a reasonably reliable stream of revenues to justify investment in New York generating facilities. The current markets can be improved in this respect. The ICAP Demand Curve is one measure intended to cope partially with the current economic environment. . . . The ICAP Demand Curve is intended to enhance system and resource reliability by valuing the Installed Capacity available above the NYSRC requirements, and promote greater stability in the Installed Capacity market, resulting in a more effective economic signal for new investment"[44]

Some Market Participants objected to the institution of the Demand Curves in part on the basis that they would increase costs to load serving entities and customers. The NYISO Board,

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43 *New York Independent System Operator, Inc.*, Docket No. ER03-647-000, NYISO Filing Letter, dated March 21, 2003, p. 2.

44 *Id.*, pp. 3, 5.

and the FERC, rejected those concerns on the basis that the long term benefits provided by the Demand Curves outweighed their short term costs.[45]

Under the ISO Agreement and the governing Tariffs, the NYISO and the Board are charged with the responsibility of operating and maintaining the reliability of New York's bulk power system, and of administering the State's wholesale electricity markets. They are not responsible, however, for creating public policy, and their role does not include reconsideration or modification of the policies duly enacted or established by the Legislature or Governor.

In this matter, the Board is faced with implementing a policy decision made by the Legislature and Governor. Properly doing so will aid in preserving reliability, but it could also be controversial because of the price impacts attendant to the change. The Legislature must be considered to be cognizant of the impacts and ramifications of its decision, and it is not the role or duty of the Board to reconsider the policy implications of that decision in implementing it. Accordingly, the price implications of the Legislature's action should not influence the decision as to whether the expiration of the ICIP Exemption constitutes an exigent circumstance requiring the immediate correction of the NYC Curves.

The continued viability of the New York capacity markets depends on the confidence that developers and financial institutions have in the market to return capital invested in reliability-based assets, whether those investments take the form of generation or demand side resources. Failure by the Board to act in this instance when an unexpected change in law has resulted in the understatement of the Net CONE by 38.8% makes it a virtual certainty that the intended market-based process to set capacity prices will fail to accomplish its intended goal. Thus, the most important question confronting the Board is whether it intends to adhere to its market rules and

45 *Id.*, Attachments IV (Affidavit of David B. Patton, sworn to on March 21, 2003) and V (NYISO Board Of Directors Decision On Appeals Of The Management Committee Vote On The Proposed Installed Capacity Demand Curve, dated March 18, 2003).

ensure that the NYC Curves are based on, and representative of, the Net CONE that will be experienced by developers in New York City.

That is, since the inception of the Demand Curves in 2003, the Net CONE upon which they are based is expressly designed to, and must, serve as the proxy for a competitively bid unit.[46] This is especially important now as the financial markets are constricting while the State's capacity needs are growing. Thus, and as in 2003, the decision cannot turn on whether capacity prices will go up or down. The decision must turn on whether the capacity market is being administered correctly.

For these reasons, IPPNY and ConsumerPowerline respectfully urge the Board to continue to adhere to the principles it enunciated in 2003, and not be swayed by arguments that run contrary to those principles. By doing so, the Board will be properly fulfilling its responsibility to maintain the reliability of New York's bulk power system and preserve and foster the State's competitive wholesale markets.

CONCLUSION

For the foregoing reasons, IPPNY and ConsumerPowerline respectfully request that the NYISO's Board of Directors determine at its August Board meeting that there are exigent circumstances associated with the change in law which eliminated the ICIP Exemption and caused the administratively determined Net CONE to no longer reflect the actual Net CONE in New York City. These exigent circumstances require immediate revision of the NYC Demand Curves for the remainder of the 2008-2009 Capability Year and the 2009-2010 and 2010-2011 Capability Years. IPPNY and ConsumerPowerline further respectfully request that the Board

[46] See Market Services Tarff Section 5.14.1(b).

expeditiously seek FERC approval under FPA §205 of the revised NYC Curves that result from the elimination of the ICIP Exemption.

Respectfully submitted,

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/s/
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Dated: July 31, 2008
Albany, New York