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Memorandum

To: Budget, Standards & Practices Subcommittee
From: IPPNY – Carolyn Brown
Date: April 14, 2004
Re: History of current Rate Schedule 1 allocation

As the Budget, Standards, and Practices Subcommittee continues to work with Rudden Associates on developing the proper long-term allocation of NYISO overhead costs as recovered through Rate Schedule 1, we believe that it is instructive for all parties and the consultants to review how the original 85/15 division was arrived at. The current allocation of charges in rate schedule 1 between loads and suppliers was the result of an extensive review conducted by NYISO Staff of its administrative cost centers, market participant discussion and input and votes by both the NYISO Business Issues Committee and Management Committee. In fact, in approving the cost allocation pursuant to Section 205 of the Federal Power Act, the Federal Energy Regulatory Commission (“FERC”) expressly determined that the NYISO had provided sufficient support for the proposed 85/15 cost allocation, holding: “It is evident from both of the studies, based on an extensive review of its cost centers, that approximately 15 percent of NYISO’s overhead costs are incurred as a result of performing functions that most directly benefit suppliers.” No party sought rehearing of the FERC’s Order. With a FERC-approved structure in place, the current study effort will benefit from, and must be guided by, a review of that process and the results therefrom.

Again, of particular note is the fact that the 85/15 split was based on internal studies completed by the NYISO of its costs centers and specifically focused on the question of whether the costs incurred most directly benefited load or suppliers. The FERC accepted those studies and allocations and expressly rejected requests to hold hearings on the issue.

Below is a rough outline of the course of events beginning in 2001 that led to the current allocation. We request that the NYISO Staff share this memorandum with the Rudden team to ensure that we can make the best and most efficient use of our meeting on Friday.

- May 24, 2001 BIC meeting: The NYISO made a presentation to re-allocate Rate Schedule 1 costs, which, at that time, were assessed 100% to load. Based on the fact that a number of

questions were raised at the BIC meeting, the issue was deferred for further development at the next S&P meeting.

- June 15, 2001 S&P Meeting: The NYISO came forward with its analysis including the back-up spread sheets to support its proposed cost allocation for its administrative cost centers.

- November 15, 2001 BIC Meeting: Strategic Power Management brought a motion to allocate the NYISO's operating budget and FERC fees Schedule 1 costs between load and supply. Initially, SPM proposed a 50/50 split. However, given that there were no studies to support its proposal and no other basis for its proposal, SPM agreed to a friendly amendment to adopt the 85/15 cost allocation determined by the NYISO's study. Motion passed.

- December 5, 2001 MC Meeting: SPM brought the motion to allocate the costs on an 85/15 basis. During the presentation and in support of its motion, SPM noted that the NYISO Staff had done an earlier analysis and a comparison with PJM and had arrived at the 85/15 cost allocation. Motion passed.

- However, because the software needed to implement this proposal could not be developed, the ISO did not file the proposed tariff changes with the FERC. At the May 2, 2002 MC meeting, the MC passed a motion for the tariff changes to be filed seeking an effective date of June 1, 2002 even though the software would not be ready at that time. Motion passed.

- May 31, 2002 FERC Filing: The NYISO made a filing with the FERC under FPA Section 205 seeking approval of the tariff changes to implement the 85/15 cost allocation of its operational expenses between load and suppliers.

- July 5, 2002 FERC Deficiency Letter: FERC issued a deficiency letter requiring the ISO to provide the basis for the 85/15 reallocation.

- August 5, 2002 FERC Filing: The NYISO made a supplemental filing attaching the presentations from the June 15, 2002 S&P meeting. In the cover letter, the NYISO explained that, to develop the enclosed study, "the NYISO conducted an extensive review of its administrative cost centers."

- FERC September 25, 2002 Order: FERC approved the 85/15 cost allocation of its operational costs, holding, "It is evident from both of the studies, based on an extensive review of its cost centers, that approximately 15 percent of NYISO's overhead costs are incurred as a result of performing functions that most directly benefit suppliers." At that time, the FERC noted that the MC motion also included a provision to do a "further examination to determine whether the split is an appropriate long-term allocation." The FERC encouraged the NYISO to complete this examination and stated that it expected the NYISO to revise its cost allocation, if necessary. Addressing the protests, the FERC expressly rejected their request for hearings, finding, "**As we previously stated, we find that NYISO has provided sufficient support for the proposed 85/15 split.**" Again, please note that no party sought rehearing of the FERC's Order.

As we move forward with this analysis, it will be incumbent upon Rudden to demonstrate how and why a long-term allocation justifies any proposed departure from the FERC-approved cost allocation that currently is in place.