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October 8, 2010

**VIA E-MAIL AND HAND DELIVERY**

Ms. Karen Antion  
Chair, NYISO Board of Directors  
c/o Mr. Stephen G. Whitley  
President and CEO  
New York Independent System Operator, Inc.  
10 Krey Boulevard  
Rensselaer, New York 12144

Re: Comments of the City of New York Regarding the 2011-2014 Installed Capacity Demand Curve Reset

Dear Chair Antion:

In accordance with Section 5.14.1.2.9 of the New York Independent System Operator, Inc. ("NYISO") Market Administration and Control Area Services Tariff and Section 5.6.6 of the NYISO Installed Capacity Manual, enclosed please find an original and two copies of the comments of the City of New York ("City") in response to NYISO Staff's final recommendations regarding the installed capacity ("ICAP") demand curves for the 2011/2012, 2012/2013 and 2013/2014 capability years issued September 7, 2010. In addition, the City respectfully requests the opportunity to participate in oral argument before the Reliability and Markets Committee of the NYISO Board of Directors with respect to the 2011-2014 ICAP demand curve reset.

If you have any questions regarding this matter, please feel free to contact me directly.

Respectfully submitted,

COUCH WHITE, LLP

*Kevin M. Lang by GEB*

Kevin M. Lang  
Counsel for the City of New York

KML/GEB/dap

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## **PRELIMINARY STATEMENT**

The City of New York (“City”),<sup>1</sup> acting on its own behalf as one of the largest electricity consumers in the New York City (“NYC”) locality (*i.e.*, NYISO Load Zone J) and in a representative capacity on behalf of its residential, commercial, institutional and industrial electricity consumers, hereby submits its comments to the NYISO Board of Directors (“Board”) in response to NYISO Staff’s final recommendations regarding the installed capacity (“ICAP”) demand curves for the 2011/2012, 2012/2013 and 2013/2014 capability years issued September 7, 2010 (“Final Recommendations”).

There is a continued need for the provision of reliable, lower-cost electricity to consumers throughout New York State, including the City. However, the prices paid by electricity consumers in New York City are among the highest in the continental United States. Despite the current projections of significant capacity excess in NYC during the 2011-2014 period, indicating a lack of need for new capacity resources to ensure system reliability, the Final Recommendations propose a significant increase to the current annual revenue requirement of the NYC proxy peaking unit. Given the current projected system conditions for the years 2011-2014, this significant increase merely results in an unjustified wealth transfer to existing capacity suppliers for the provision of the same service currently being provided by such resources – and doing so to the detriment of, and at a great additional costs to NYC electricity consumers. In fact, the increase to the current annual revenue requirement of the NYC proxy peaking unit proposed by the Final Recommendations, if adopted by the NYISO Board, would increase

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<sup>1</sup> The City is a municipal corporation of the State of New York, and an active participant in the stakeholder process of the New York Independent System Operator, Inc. (“NYISO”). The City has some eight million residents, is a critical world financial and commercial center, and has innumerable industrial, commercial, and retail entities located within its jurisdiction.

electricity costs for NYC consumers by more than \$690 million over the 2011-2014 period – more than \$230 million annually, on average, for the three capability years encompassed by the this reset process.<sup>2</sup>

Accordingly, the City contends that no increase to the current annual revenue requirement of the NYC proxy peaking unit is warranted or reasonable, and that the current NYC ICAP demand curve should be maintained, without adjustment, for the 2011-2014 period. As further described below, the City’s recommended disposition of this matter is in full accordance with the NYISO’s tariffs and Federal Energy Regulatory Commission (“FERC”) precedent relating to the ICAP demand curves and the demand curve reset process.

If, *arguendo*, the NYISO Board determines that modifications to certain parameters and assumptions underlying the NYC ICAP demand curve are warranted, which the City does not concede, the City recommends that the NYISO Board: (a) adopt the following aspects of the Final Recommendations: (i) the proposed treatment of tax abatement for the NYC proxy peaking unit, (ii) the proposed exclusion of deliverability costs from the annual revenue requirement of the New York Control Area (“NYCA”) proxy peaking unit, and (iii) the proposed 1.7 percent escalation factor used to determine the parameters of the NYC ICAP demand curve for the 2012/2013 and 2013/2014 capability years; and (b) adopt the following modifications to the Final Recommendations: (i) reject NYISO staff’s unrealistic assumption that the lessee will be responsible for site remediation costs and the cost adder to the lease rate for the NYC proxy peaking unit associated therewith, or, alternately, if the NYISO Board determines that such an assumption is appropriate, adjust the proposed lease rate for the NYC proxy peaking unit

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<sup>2</sup> The cost impact estimates provided herein were calculating utilizing the ICAP demand curve model developed by National Economic Research Associates, Inc. (“NERA”) and the peak load levels projected by the 2010 Reliability Needs Assessment (“RNA”) for the 2011-2014 period.

downward accordingly to reflect such assumption, and (ii) reduce the proposed level of excess capacity assumed in calculating the projected energy and ancillary services revenues earned by the NYC proxy peaking unit to 0.5 percent.

### **BACKGROUND**

In accordance with the requirements of Section 5.14.1.2 of the NYISO Market Administration and Control Area Services Tariff (“Services Tariff”), during the third quarter of 2009, NYISO staff commenced the required triennial review of the ICAP demand curves to determine the parameters thereof for the 2011/2012, 2012/2013 and 2013/2014 capability years. To assist in this reset process, NYISO staff engaged the services of NERA and Sargent & Lundy LLC (“S&L,” and together with NERA referred to collectively as the “Consultants”) to develop an independent report regarding the methodologies that should be utilized for determining the parameters of the ICAP demand curves for the 2011-2014 period, as well as recommendations regarding such parameters. The Consultants issued their initial draft report on July 1, 2010. After review of the Consultants’ initial draft report and market participant comments regarding the same, on August 13, 2010, NYISO staff issued its draft recommendations regarding the ICAP demand curves for the 2011-2014 period (“Draft Recommendations”).

On August 27, 2010, the City filed comments with NYISO staff in response to the Draft Recommendations. In its comments, the City expressed support for NYISO staff’s proposals regarding the treatment of tax abatement for the NYC proxy peaking unit, and the exclusion of deliverability costs from the annual revenue requirement of the NYCA proxy peaking unit. In addition, the City urged NYISO staff to adopt the following modifications to the Draft Recommendations: (a) a downward adjustment to the proposed lease rate for the NYC

proxy peaking unit to address the assumption that the lessee will be responsible for site remediation costs: (b) a reduction in the proposed level of excess used in calculating the projected energy and ancillary services revenues earned by the NYC proxy peaking unit to 0.5 percent; and (c) a reduction of the proposed escalation factor to 1.7 percent.

After review of the City's and other market participants' comments in response to the Draft Recommendations, NYISO Staff issued the Final Recommendations, together with the Consultants' final report, triggering the 30-day period for comments to the NYISO Board regarding the disposition of the 2011-2014 demand curve reset process.

## **ARGUMENT**

### **POINT I**

#### **THE NYC ICAP DEMAND CURVE DOES NOT WARRANT ADJUSTMENT FOR THE 2011-2014 PERIOD**

In 2003, the NYISO proposed the utilization of the ICAP demand curves for the NYISO-administered capacity markets with FERC. FERC has described the purpose of the ICAP demand curves as follows: "[t]hey were intended to improve system and resource reliability by valuing the ICAP resources available above the system's required levels, and providing more effective economic signals for new investment."<sup>3</sup> To fulfill their purpose, the economic signals conveyed by the ICAP demand curves should seek to produce an appropriate and reasonable market result, considering the state of the market and the projected needs for new capacity to ensure reliability. Clearly, therefore, the development of ICAP demand curves that

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<sup>3</sup> *New York Independent System Operator, Inc.*, 110 FERC ¶ 61,201 at P 7 (2005) (emphasis added).

signal a need for new capacity when no such need exists cannot be justified as being consistent with the rationale under which the ICAP demand curves were initially implemented in 2003.

The recently approved 2010 RNA projects substantial capacity excess within NYC during the 2011-2014 period subject to this reset. In fact, the 2010 RNA projects an average capacity excess of slightly more than 12 percent above the current locational minimum ICAP requirement for NYC during this period.<sup>4</sup> Based on the substantial levels of excess capacity projected during the period covered by this reset, there is no need for additional capacity resources in NYC from a reliability perspective. Indeed, the 2010 RNA concluded that there was no need for new resources in New York from a reliability perspective for at least the next 10 years.<sup>5</sup> Accordingly, the NYC ICAP demand curve developed for the 2011-2014 period should be designed to provide effective economic signals reflecting the lack of need for new resources.

However, despite the projected levels of significant capacity excess and lack of need for new capacity resources from a reliability perspective during the 2011-2014 period, the Final Recommendations propose a substantial increase to the current annual revenue requirement of the NYC proxy peaking unit. Specifically, the Final Recommendations propose to increase the annual revenue requirement of the NYC proxy peaking unit for the 2011/2012 capability year by nearly 12 percent above the currently-effective requirement.<sup>6</sup>

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<sup>4</sup> NYISO, *2010 Reliability Needs Assessment – Final Report* (September 2010) at 20.

<sup>5</sup> *Id.* at 30.

<sup>6</sup> After accounting for the escalation factor applied to the remaining two capability years covered by the reset, the Final Recommendations propose to increase the annual revenue requirement of the NYC proxy peaking unit for the 2012/2013 and 2013/2014 capability years by 13.6 percent and 15.5 percent, respectively, compared to the currently-effective annual revenue requirement of the NYC proxy peaking unit.

The substantial increase proposed by the Final Recommendations has a significant detrimental financial impact on NYC electricity consumers. In fact, the proposed increase translates into a cost increase of more than \$690 million over the three-year period covered by the reset, or more than \$230 million annually, on average. Coupled with the projected lack of need for new resources from a reliability perspective during this period, the proposed increase results in an unjustified wealth transfer from NYC electricity consumers to existing capacity suppliers, which would receive a substantial increase in compensation to provide the exact same service such resources have demonstrated a capability and willingness to provide based on the currently-effective annual revenue requirement.

Moreover, the unwarranted increase proposed by the Final Recommendations is inconsistent with the purpose of the ICAP demand curves. Increasing the annual revenue requirement of the NYC proxy peaking unit provides a signal to the market that new capacity resources are needed. However, as demonstrated above, the NYC market is projected to be significantly long during the 2011-2014 period, with no projected need for new capacity resources from a reliability perspective during this period. Thus, the significant increase to the annual revenue requirement of the NYC proxy peaking unit is completely contrary to the purpose of the ICAP demand curves.<sup>7</sup> Accordingly, the NYISO Board should reject the Final Recommendations' proposed increase and maintain the currently-effective annual revenue requirement of the NYC proxy peaking unit for the 2011-2014 period to ensure that the NYC

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<sup>7</sup> In fact, despite the projected significant excess during the 2011-2014 period, substantial amounts of new capacity are proposed to be added in NYC during this period, indicating that the currently-effective NYC ICAP demand curve is providing sufficient, and likely artificially-high, price signals to investors. Specifically, the Astoria Energy II and Bayonne Energy Center facilities are expected to add more than 1,000 MW of new capacity to the NYC market early in the 2011-2014 period. This substantial amount of new capacity is equivalent to more than 10 percent of the projected NYC peak load during that period.

ICAP demand curve produces effective economic signals indicating the lack of need for new resources during this period, and avoid untoward consequences for NYC electricity consumers.

Significantly, as announced at the September 29, 2010 Management Committee meeting, the NYISO recently adopted a modification to its mission statement to expressly recognize that providing benefits to consumers is a core function of the NYISO. The City fails to comprehend how the adoption of an unjustified \$690 million increase in cost for NYC electricity consumers is consistent with the NYISO's revised mission statement. In fact, the City submits that the unwarranted proposal to significantly increase costs to NYC electricity consumers is exactly the type of ill-conceived action that the recent modification to the NYISO's mission statement is intended to guard against. Indeed, such unwarranted actions, with enormous resulting detrimental impacts to consumers, merely serve to embolden the perception that the NYISO fails to fully consider the impacts of its actions on consumers.

Furthermore, a decision by the NYISO Board to simply maintain the currently-effective annual revenue requirement of the NYC proxy peaking unit for the 2011-2014 period is in accord with the NYISO Services Tariff, and FERC precedent relating to the ICAP demand curves and the demand curve reset process. Both the NYISO Services Tariff and FERC precedent are clear that, while the triennial review process of the ICAP demand curves is mandatory, adoption of adjustments to the currently-effective parameters of the ICAP demand curves is discretionary. Specifically, Section 5.14.1.2 of the NYISO Services Tariff states: "[a] periodic review of the ICAP Demand Curves shall be performed every three (3) years in accordance with the ISO Procedures to determine the parameters of the ICAP Demand Curves for the next three Capability Years." Section 5.14.1.2 does not mandate adjustments to the ICAP demand curves as a result of the mandatory triennial review process. Moreover, the ICAP



Manual (*i.e.*, the “ISO Procedures” referenced in Section 5.14.1.2) clearly articulates the discretionary nature of adjustments to the ICAP demand curves. Section 5.6 of the ICAP Manual expressly states that “[a]n independent review of the ICAP Demand Curves will be performed every three (3) years to determine whether the parameters of the ICAP Demand Curves should be adjusted ...” (emphasis added).

FERC precedent regarding the ICAP demand curves confirms the discretionary nature of adjustments to the ICAP demand curves as a result of the mandatory triennial review process. FERC has repeatedly indicated that, while the triennial review process is mandatory, adjustments to the ICAP demand curves resulting therefrom are discretionary.<sup>8</sup> For example, in approving the ICAP demand curve recommendations from the last reset process, FERC stated: “[s]ection 5.14.1(b) [since renumbered as Section 5.14.1.2] of the Services Tariff [footnote omitted] requires NYISO to perform a triennial review to determine whether the parameters of the ICAP Demand Curve should be adjusted.”<sup>9</sup> Moreover, FERC declared that “[t]he Services Tariff includes factors to be considered ... during the period review; it does not limit the use of other factors.”<sup>10</sup>

In the case of this reset, a critical additional factor that must be accounted for is the projected state of the system during the three years encompassed by the reset. As demonstrated above, the NYC market is projected to experience substantial levels of excess capacity during the 2011-2014 period, thereby indicating a lack of need for new capacity

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<sup>8</sup> See, *e.g.*, *New York Independent System Operator, Inc.*, 103 FERC ¶ 61,201 at P 10 (2003); *New York Independent System Operator, Inc.*, 105 FERC ¶ 61,108 at P 39 (2003); and *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,064 at P 3 (2008).

<sup>9</sup> *New York Independent System Operator, Inc.*, 125 FERC ¶ 61,299 at P 3 (2008) (emphasis added).

<sup>10</sup> *Id.* at P 37.

resources during this period to assure that reliability is maintained. Accordingly, in consideration of this factor, the purpose of the ICAP demand curves, and the detrimental impacts to NYC electricity consumers that would result from an unwarranted increase in the annual revenue requirement of the NYC proxy peaking unit, the City urges the NYISO Board to reject the Final Recommendations' proposal with respect to the NYC ICAP demand curve, and, instead, direct the maintenance of the currently-effective parameters of the NYC ICAP demand curve for the 2011-2014 period.

## **POINT II**

**IF THE NYISO BOARD DETERMINES THAT  
ADJUSTMENTS TO THE NYC ICAP DEMAND CURVE  
PARAMETERS ARE WARRANTED, THE BOARD  
SHOULD ADOPT THE CITY'S RECOMMENDATIONS  
REGARDING ANY SUCH ADJUSTMENTS**

Despite the foregoing, if, *arguendo*, the NYISO Board determines that adjustments to the parameters of the current NYC ICAP demand curve are warranted, which the City does not concede, the City urges the NYISO Board to adopt the following recommendations: (a) adopt the following aspects of the Final Recommendations: (i) the proposed treatment of tax abatement for the NYC proxy peaking unit, (ii) the proposed exclusion of deliverability costs from the annual revenue requirement of the NYCA proxy peaking unit, and (iii) the proposed 1.7 percent escalation factor used to determine the parameters of the NYC demand curve for the 2012/2013 and 2013/2014 capability years; and (b) modify the following aspects of the Final Recommendations: (i) reject NYISO staff's proposal that the lessee would assume full liability for site remediation costs and eliminate the cost adder to the lease rate for the NYC proxy peaking unit associated with such assumption, or, in the event that the NYISO

Board determines that NYISO staff's proposal is appropriate, adjust the proposed lease rate for the NYC proxy peaking unit downward to reflect the assumption that the lessee will be responsible for site remediation costs, and (ii) reduce the proposed level of excess capacity assumed in calculating the projected energy and ancillary services revenues earned by the NYC proxy peaking unit to 0.5 percent. The adoption of the City's recommendations are necessary to mitigate the detrimental impacts of an unreasonable decision to adjust the current NYC ICAP demand curve parameters.

**A. NYISO Staff's Proposal Regarding the Treatment of Tax Abatement Is Reasonable and Should Be Adopted by the NYISO Board**

The City fully supports NYISO staff's recommended treatment of property tax abatements for the NYC proxy peaking unit. As acknowledged by the Final Recommendations, the New York City Industrial Development Agency ("IDA") offers benefits that may include both a property tax abatement on all land improvements, as well as the deferral of mortgage recording taxes, and a sales and use tax exemption on construction materials.

Because of the unique nature of each application and the inability to anticipate and address in a policy statement all potential circumstances that may arise, the award of IDA benefits are subject to the inherent discretion of the IDA Board of Directors ("IDA Board"). However, recent IDA Board action clearly demonstrates its willingness to provide significant tax benefits to qualifying generation developers. Specifically, on August 3, 2010, the IDA Board, by a unanimous vote of approval, adopted a significant revision to the Uniform Tax Exemption Policy ("UTEP") – the central tax exemption policy document establishing available IDA benefits – to include a specific tax benefit program exclusively for electric generation

developers. By its action, the IDA Board developed and promulgated an affirmative policy statement recognizing the value of new peaking generation facilities, such as the NYC proxy peaking unit, in helping the City to meet its public policy goals. Importantly, this IDA Board-approved program establishes transparent, specific and particularized criteria by which electric generation developers can qualify for IDA assistance.

It is important to note that there is nothing unique or irreplaceable with respect to the property tax benefits that were available under the former Industrial and Commercial Incentive Program (“ICIP”). In fact, at least two forms of available IDA incentives – the mortgage recording tax exemption (“MRT”) and the construction materials sales and use tax exemption (“STE”) – were unavailable under the former ICIP, which was strictly limited to property tax benefits. Accordingly, awarded IDA benefits could well exceed those that were available under the former ICIP. Moreover, these available IDA benefits, unlike those associated with the former ICIP, accrue at the outset of a project rather than being realized over a term of years as annual property tax obligations become due. Thus, the already substantial additional value of the newly available MRT and STE are magnified by the immediacy of those benefits as opposed to the discounted value of avoided future property taxation obligations provided under the former ICIP.

Moreover, it is critical to recognize the impacts to NYC electricity consumers of a failure to adopt NYISO staff’s recommendation regarding the treatment of tax abatement for the NYC proxy peaking unit. The failure to include tax abatement, as proposed by the Final Recommendations, would result in more than a 38 percent increase in the annual revenue requirement of the NYC proxy peaking unit. Such a massive increase would translate into nearly \$1 billion of additional annual costs for NYC electricity consumers, compared to the currently-

effective annual revenue requirement of the NYC proxy peaking unit – or nearly \$3 billion in additional costs over the three years encompassed by this reset.

For all the foregoing reasons, the Final Recommendations’ proposed treatment of tax abatement for the NYC proxy peaking unit is both reasonable and equitable. Furthermore, this proposal appropriately accounts for both the IDA Board policy statement regarding tax benefits for qualifying generation developers, as embodied in the recently adopted amendments to the UTEP, and the additive effects of significant IDA benefits that were unavailable under the former ICIP. Accordingly, the City wholly endorses the Final Recommendations’ proposal with respect to this matter, and urges the NYISO Board to adopt the same.

**B. The NYISO Board Should Adopt the Proposal to Exclude Deliverability Costs from the NYCA ICAP Demand Curve**

The City strongly supports the proposal of the Final Recommendations to exclude deliverability costs from the NYCA ICAP demand curve. The fundamental purpose of the deliverability requirements is to require new generators seeking to provide capacity service in New York to pay for the costs of any transmission system upgrades necessary to make the capacity from their facility deliverable, thereby shifting such costs away from consumers.<sup>11</sup> As properly recognized by the Final Recommendations, including deliverability costs in the NYCA ICAP demand curve would directly contradict this fundamental purpose because it would shift such costs back onto consumers.

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<sup>11</sup> *New York Independent System Operator, Inc. and New York Transmission Owners*, 126 FERC ¶ 61,046 at P 8 (2009).

In addition, the inclusion of deliverability costs within the NYCA ICAP demand curve would violate the cost allocation principles adopted by FERC with respect to deliverability costs. The cost allocation methodology approved by FERC provided that consumers would only be exposed to deliverability costs in one circumstance – where the minimum feasible highway upgrade exceeds the minimum upgrade required to make the generator’s capacity deliverable.<sup>12</sup> The inclusion of deliverability costs in the NYCA ICAP demand curve would require consumers to pay for all deliverability costs in direct contravention of FERC’s approved cost allocation methodology. Such an outcome would be grossly inequitable to consumers.

Furthermore, it is important to note that in implementing the deliverability requirements, all then existing generators were granted deliverability rights at no cost. Therefore, the inclusion of deliverability costs in the NYCA ICAP demand curve would result in substantial windfall profits to the incumbent generators.

For the foregoing reasons, the City urges the NYISO Board to adopt the proposal of the Final Recommendations to exclude deliverability costs from the NYCA ICAP demand curve.

**C. The Escalation Factor Proposed by the Final Recommendations Is Reasonable and Should Be Adopted**

In its comments in response to the Draft Recommendations, the City, together with Multiple Intervenors, urged NYISO staff to reduce its proposed 2.4 percent escalation factor utilized in determining the parameters of the ICAP demand curves for the 2012/2013 and

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<sup>12</sup> See, e.g., *New York Independent System Operator, Inc. and New York Transmission Owners*, 122 FERC ¶ 61,267 at P 30-32 and 46 (2008); and *New York Independent System Operator, Inc. and New York Transmission Owners*, 126 FERC ¶ 61,046 at P 43-44 (2009).

2013/2014 capability years to 1.7 percent. NYISO staff's initial proposed escalation factor represented the average forecasted inflation rate for the 2010-2019 from a single data source – the Survey of Professional Forecasters published by the Federal Reserve Bank of Philadelphia. However, NYISO staff failed to provide any credible justification regarding the relevance of projected levels of inflation in 2015-2019 to the current reset process covering only the 2011-2014 period.

In its comments in response to the Draft Recommendations, the City urged NYISO staff to adopt a more representative forecast of inflation for the period encompassed by this reset equal to 1.7 percent. This recommended escalation factor was derived from the average forecasted inflation rates during the 2010-2014 of three representative, publicly available forecasts, including recently updated forecasts from the data relied upon by NYISO staff.<sup>13</sup> The average inflation rate forecasted by SPF, OMB and CBO for the 2010-2014 period were 1.9 percent, 1.7 percent and 1.5 percent, respectively, with a resulting average forecasted inflation rate of 1.7 percent for the 2010-2014 period across all three data sources.

The Final Recommendations adopted the joint recommendation of the City and Multiple Intervenors. The utilization of an average forecast of inflation for the period encompassed by this reset from three publicly available data sources is a reasonable and justified approach to determining an appropriate escalation factor. Moreover, such escalation factor

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<sup>13</sup> Federal Reserve Bank of Philadelphia, *Third Quarter 2010 Survey of Professional Forecasters* (August 13, 2010) at Table Seven, available at <http://www.phil.frb.org/research-and-data/real-time-center/survey-of-professional-forecasters/2010/spfq310.pdf> (hereinafter, "SPF"); U.S. Office of Management and Budget, *Mid-Session Review: Budget of the U.S. Government – Fiscal Year 2011* (July 23, 2010) at 9, available at <http://www.whitehouse.gov/sites/default/files/omb/assets/fy2011/msr/11msr.pdf> (hereinafter, "OMB"); and U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2010) at 78, available at <http://www.cbo.gov/ftpdocs/117xx/doc11705/08-18-Update.pdf> (hereinafter, "CBO").

provides meaningful savings to NYC electricity consumers, compared to the unreasonable, artificially-high escalation factor initially proposed by NYISO staff. In fact, adoption of the escalation factor proposed by the Final Recommendations would result in more than \$42 million in savings for NYC electricity consumers over the final two years covered by this reset, compared to NYISO staff's initial proposal – more than \$21 million in average annual savings over the 2012/2013 and 2013/2014 capability years. Based on the foregoing, the NYISO Board should adopt the 1.7 percent escalation factor proposed by the Final Recommendations.

**D. The NYISO Board Should Reduce the Proposed Lease Rate for the NYC Proxy Peaking Unit**

The Final Recommendations include a 50 percent adder to the land costs of the NYC proxy peaking unit to account for NYISO staff's assumption that the owner of such unit, as lessee, would accept full responsibility for all site remediation costs. As further discussed below, NYISO staff's assumption is unreasonable and should be rejected by the NYISO Board, together with the cost adder to the lease rate for the NYC proxy peaking unit associated therewith. However, in the event that the NYISO Board determines that NYISO staff's assumption is appropriate, which the City does not concede, the City urges the NYISO Board to adopt a proportionate decrease to the lease rate for the NYC proxy peaking unit to reflect the obligation of the lessee to assume full liability for site remediation costs.

The underlying assumption for land costs associated with the NYC proxy peaking unit is that the land on which the peaking unit will be constructed would be leased rather than purchased by the owner of the unit. This assumption directly impacts the validity of the assumption that the owner of the NYC proxy peaking unit would be liable for any or all required site remediation costs. Site remediation results in permanent improvement to the underlying real



property (*i.e.*, the property of the lessor to which the lessee has no right upon expiration of a lease), and, thus, absent an agreement to the contrary between the lessee and lessor, would ordinarily be considered the responsibility of the lessor. Accordingly, the NYISO Board should reject NYISO staff's assumption and remove the cost adder associated therewith to, more appropriately, reflect that the lessor would retain liability for site remediation costs.

If, *arguendo*, the NYISO Board adopts the proposal of the Final Recommendations that the lessee will assume responsibility for the site remediation costs, it must also adopt a concomitant reduction in the lease rate paid by the lessee. Given that site remediation will provide enduring benefit to the lessor and provide no benefit to the lessee upon expiration of the lease, a lessee would not assume liability for site remediation absent a bargained-for reduction in the lease rate to account for the cost of such remediation. NYISO staff has presented no evidence to support its unrealistic proposal that the lessee would pay fair market value for the lease, while simultaneously assuming all liability for site remediation. Accordingly, if the NYISO Board determines that NYISO staff's assumption is appropriate, it should adopt a significant downward adjustment to the proposed lease rate for the NYC proxy peaking unit to reflect the liability assumed by the lessee with respect to site remediation.

**E. The NYISO Board Should Reduce the Final Recommendations' Unjustified Proposal Regarding the Assumed Level of Excess Capacity**

In its Draft Recommendations, NYISO staff proposed to assume a 2 percent level of excess capacity over the final 27 years of the nominal life of the NYC proxy peaking unit in determining the projected energy and ancillary services revenues such unit would earn from participation in the NYISO-administered markets. The level of assumed excess capacity has a

direct impact on the annual revenue requirement of the NYC proxy peaking unit. Specifically, the greater the level of assumed excess capacity, the lower the projected energy and ancillary services revenues earned by the NYC proxy peaking unit, thereby placing additional upward pressure on the annual revenue requirement of such unit to the detriment of electricity consumers. While the City applauds and supports NYISO staff's recommendation to reduce the assumed level of excess capacity over the final 27 years of the nominal life of the NYC proxy peaking unit from 2 percent to 1.1 percent in the Final Recommendations, the City urges that the NYISO Board adopt a uniform assumed level of excess capacity over the entire nominal life of the NYC proxy peaking unit equal to 0.5 percent.

Adoption of a uniform 0.5 percent assumed level of excess ensures consistency with the requirements of the NYISO Services Tariff, while avoiding the unintended consequence of providing artificially high price signals that would further exacerbate the current and projected levels of substantial excess capacity in NYC. FERC has previously determined that the requirement of Section 5.14.1.2 of the Services Tariff that energy and ancillary service revenue projections for the peaking unit be estimated "under conditions in which the available capacity would equal or slightly exceed the minimum Installed Capacity requirement" applies equally to the entire nominal life of the proxy peaking unit.<sup>14</sup> Accordingly, because the same tariff requirement applies to the entire nominal life of the NYC proxy peaking unit and NYISO staff acknowledges that the assumption of 0.5 percent excess comports with the tariff, this assumed level of capacity excess should apply to the entire nominal life of the NYC proxy peaking unit. It is important to note that the City is not aware of any market participant contending that this assumed level of excess is inconsistent with the requirements of the NYISO Services Tariff.

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<sup>14</sup> *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,064 at P 31 (2008).

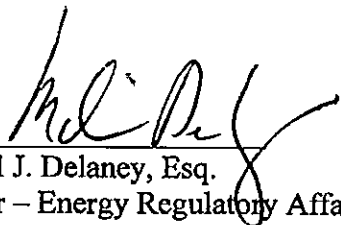
NYISO staff has failed to provide any compelling justification for the need to assume a greater level of excess during the remaining 27 years of the nominal life of the NYC proxy peaking unit than that assumed for the first three years (*i.e.*, 0.5 percent). Moreover, in consideration of the buyer-side mitigation rules in effect for the NYC market, which effectively foreclose entry by new capacity resources except for when the market is at or near the locational minimum ICAP requirement, assuming any level of excess greater than 0.5 percent appears unwarranted.

Furthermore, the unjustified assumption of additional excess unnecessarily increases capacity prices to NYC electricity consumers, while facilitating the continuance of significant levels of excess capacity by providing artificially inflated price signals regarding the value of excess capacity. In fact, adoption of the Final Recommendations' proposed 1.1 percent assumed level of capacity excess will result in approximately \$324 million in additional, unwarranted costs for NYC electricity consumers during the 2011-2014 period, compared to utilizing a uniform assumed level of capacity excess equal to 0.5 percent. Accordingly, the City urges the NYISO Board to reject the Final Recommendations' proposal relating to the assumed level of capacity excess, and adopt a uniform 0.5 percent assumed level of excess capacity during the entire nominal life of the NYC proxy peaking unit.

## CONCLUSION

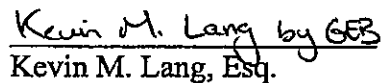
For all the foregoing reasons, the City urges the NYISO Board to maintain the currently-effective NYC ICAP demand curve for the 2011-2014 period. However, if, *arguendo*, the NYISO Board determines that adjustments to parameters of the NYC ICAP demand curve are warranted, the City recommends that the Board: (a) adopt the proposal of the Final Recommendations relating to tax abatement for the NYC proxy peaking unit; (b) adopt the Final Recommendations' proposal to exclude deliverability costs from the NYCA ICAP demand curve; (c) adopt the 1.7 percent escalation factor proposed by the Final Recommendations; (d) reject the assumption that the lessee will be responsible for all site remediation costs and eliminate the cost adder to the lease rate for the NYC proxy peaking unit associated therewith, or, alternatively, if the NYISO Board determines that NYISO staff's assumption is appropriate, reduce the applicable lease rate accordingly to reflect such assumption; and (e) adopt a uniform assumed level of excess capacity utilized in calculating the projected energy and ancillary services revenues earned by the NYC proxy peaking unit equal to 0.5 percent.

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