STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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October 8, 2010

Diane Egan
NYISO Board Secretary
New York Independent System Operator, Inc.
10 Krey Boulevard, Rensselaer, NY 12144

Re: NYS Department of Public Service Staff Comments on NYISO's September 7, 2010 Report on Proposed Demand Curves

Dear Secretary Egan:

Attached, please find an original and two copies of the comments of the Staff of the New York State Department of Public Service regarding the NYISO's September 7, 2010 Report on Proposed Demand Curves. These comments are also being sent today via e-mail to the individuals copied below. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Attachment

cc: Dave Lawrence (dlawrence@nyiso.com)
Gloria Kavanah (gkavanah@nyiso.com)
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NYS Department of Public Service Staff Comments on NYISO's September 7, 2010 Report on Proposed Demand Curves

Location for Statewide CONE

The Statewide Cost of New Entry (CONE) should be based on the location within the New York Control Area with the lowest net CONE. NERA indicates that the lowest net CONE is on Long Island, due to its relatively high net energy revenues. Since generation on Long Island is also part of the statewide market, this location should be considered suitable for setting the Statewide CONE. This determination is consistent with historical trends, where, due to consistent energy flows into the major load centers of Southeast New York, most peaking units within New York have been built on Long Island or in NYC. This indicates that Long Island is a rational place to build peaking units, and should therefore be used in establishing the CONE, assuming Long Island is in fact determined to have the lowest net CONE.

Deliverability

Contrary to the arguments by various generators, deliverability costs associated with Capacity Resource Interconnection Service (CRIS) should not be included in setting the net CONE for the demand curve. Department of Public Service Staff (DPS Staff) concur with the NYISO's Report and the comments submitted on behalf of the New York Transmission Owners

on April 21, 2010, which provide the rationale for excluding deliverability costs in setting the net CONE.

IPPNY proposes to address deliverability by setting a higher statewide CONE based on costs in the Lower Hudson Valley (LHV). However, by paying the same price to upstate generators in zones A-F as generators in LHV, IPPNY's proposal would fail to provide an appropriate upstate locational price signal. Thus, even if the NYISO were to consider incorporating deliverability costs, the IPPNY proposal would be inappropriate. Instead, the advisability of creating a new capacity zone should be thoroughly evaluated as part of the stakeholder process investigating the development of criteria for new capacity zones, as indicated in the NYISO's Draft Report. Moreover, it should be recognized that because of the consistent flow of energy from the north and west into Southeast New York, peakers located on Long Island should satisfy deliverability requirements at least as well as peakers located in LHV.

Special Case Resources

While acknowledging that demand response is expected to increase, the final NERA Report indicates that no adjustment was made to energy revenues to account for this increase. The report states on page 49 that "[w]hile we recognize that special case resource calls would be expected to increase and more

revenue expected to be shifted to the energy market as special case resource penetration increases, those increases will materialize over time and be recognized over time." However, it is essential that this increase in energy revenues be reflected as part of the current Demand Curve reset process. The Demand Curve Model is designed to establish the annual CONE at the reference point in order to provide for the full recovery of capital costs over a 30-year capital recovery period, and therefore this expected shift in revenues to the energy market should be reflected in the energy offset used to calculate net CONE.

NYC Tax Abatement Issue

DPS Staff agrees with the NYISO Draft Report that property taxes should be excluded from the net CONE estimated for NYC, consistent with the New York City Economic Development Corporation (NYCEDC) tax abatement policy. The tax abatement policy recently approved by the New York City Industrial Development Authority, an agency administered by the NYCEDC, explicitly applies to the installation of new peaking units in NYC. While the abatement must be applied for (rather than "as of right"), the qualifications are clearly spelled out. Moreover, the generators have provided no evidence that NYC might engage in a "bait and switch" tactic (i.e., denying the

abatement after a unit has already been constructed). Clearly, any developer in NYC must work closely with the City to obtain permits and determine tax and other treatments before committing to construction. Moreover, from the language of the tax abatement policy, the City is clearly aware that any increases in property taxes on new entrants would lead to increases in net CONE, which would ultimately increase costs to end-use customers in the City. Therefore, the NYC net CONE should recognize the full impact of the tax abatement policy.

Expected Level of Capacity

DPS Staff agrees with the NYISO Report that the assumed level of excess capacity should reflect the size of the assumed peaking unit. To ensure reliability, it is only necessary that new entry occur when the level of excess capacity falls to zero. As the NYISO Report recognizes, in a steady state, the average level of excess capacity would be 0.5 times the MW size of the peaking unit. Therefore, DPS Staff supports the NYISO's assumed levels of excess capacity.

Some parties have argued that net CONE should reflect higher levels of capacity because actual levels of excess have tended to be significantly above the minimum levels, and that actual capacity prices have tended to be correspondingly lower than the Demand Curve reference prices. However, new entry is

not limited to peaking units; new combined cycle plants may enter based on their larger net energy revenues. Moreover, while the tariff requires setting the Demand Curves based on the cost of peaking units, it is possible that combined cycle plants have a lower net CONE, and thus may be a cheaper source of new capacity.

Finally, it should be recognized that many of today's "peaking" units are not new gas turbines but rather older plants that once operated more frequently. Due to technological progress, new plants have tended to have lower heat rates (as well as lower emissions) and have thus relegated the older plants to peaking duty. If new base-load entry continues, capacity prices may more properly reflect the cost of keeping older units available for peaking duty, rather than the cost of building new peaking units.

Escalation Rate

DPS Staff supports the NYISO Report's recommended escalation rate of 1.7%, which appears to be consistent with near-term conditions.

Regulatory Risk

DPS Staff agrees with the decision of NERA to exclude an additional adder for regulatory risks in the determination of

net CONE. Risk is already included in the projected return on equity and the average excess capacity assumptions, and it would therefore be duplicative to include such risk as a separate factor in net CONE. While there may be additional risks due to regulatory interventions, it must be recognized that all markets are impacted by decisions involving regulatory and other governmental agencies. Moreover, while some of these interventions could lead to temporary reductions in capacity prices, others could lead to increases in capacity prices. For example, environmental requirements may force the retirement of additional units, resulting in tighter markets and higher capacity prices. The NERA study provides no clear indication that regulatory risks will all affect capacity prices in one direction or another. Finally, it should be noted that the Comprehensive Reliability Planning Process limits regulatory backstop solutions to capacity needed to meet reliability needs, and therefore does not create a surplus warranting a risk factor.