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VIA EMAIL

Mr. David J. Lawrence
New York Independent System Operator, Inc.
10 Krey Boulevard
Rensselaer, NY 12144

Re: Draft Recommendations of the New York Independent System Operator, Inc. Staff for the Installed Capacity Demand Curve Reset for the 2011/2012, 2012/2013 and 2013/2014 Capability Years

Dear Dave:

In accordance with the revised 2011-2014 Installed Capacity ("ICAP") Demand Curve Development Schedule, the City of New York ("City") hereby submits these comments in response the Draft Recommendations of the New York Independent System Operator, Inc. ("NYISO") issued August 13, 2010 with respect to the 2011-2014 ICAP demand curve reset process. The City generally supports NYISO staff's draft recommendations. Specifically, the City expresses its full support for NYISO staff's recommendation regarding the treatment of tax abatement for the proposed New York City ("NYC") peaking unit to reflect the recent amendments to the Uniform Tax Exemption Policy approved by the Board of Directors of the New York City Industrial Development Agency. In addition, the City strongly supports NYISO staff's recommendations regarding the exclusion of deliverability costs from the cost of new entry for the proposed New York Control Area ("NYCA") peaking unit.

Despite its general support for NYISO staff's draft recommendations, the City urges NYISO staff to adopt the following modifications to its draft recommendations: (i) adjust the assumed lease rate for the proposed NYC peaking unit downward to reflect the assumption that the lessee will be responsible for site remediation costs; (ii) reduce the assumed level of excess in calculating the projected energy and ancillary services revenues earned by the proposed NYC peaking unit to 0.5%; and (iii) reduce the proposed escalation factor to 1.7 percent.

TAX ABATEMENT

The City is in full accord with NYISO staff's recommended treatment of property tax abatements for the proposed NYC peaking unit. As acknowledged by NYISO staff's draft 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 awardance of IDA benefits are subject to the ultimate exercise of discretion by 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 proposed NYC 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 program, 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 costs provided under the former ICIP.

NYISO staff's recommendation regarding the treatment of tax abatement for the proposed NYC peaking unit is both reasonable and equitable. Furthermore, NYISO staff's recommendation 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 NYISO staff's proposed recommendation with respect to this matter.

DELIVERABILITY COSTS

The City strongly supports NYISO staff's recommendation 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.[1] As properly recognized by NYISO staff, including deliverability costs in the NYCA ICAP demand curve would directly contradict this fundamental purpose because it would shift such costs back onto consumers.

In addition, the inclusion of deliverability costs within the NYCA ICAP demand curve would violate the cost allocation principles adopted by the Federal Energy Regulatory Commission ("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.[2] 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 existing generators.

LEASE RATE

At the August 20, 2010 Installed Capacity Working Group meeting, NYISO staff and its consultants indicated that the land costs associated with the proposed NYC peaking unit would be adjusted to include a 50 percent adder for assumed site remediation costs. In the

[1] *New York Independent System Operator, Inc. and New York Transmission Owners*, 126 FERC ¶ 61,046 at P 8 (2009).

[2] *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).

event that NYISO staff continues to believe that this cost adder is appropriate, the City urges NYISO staff to adopt a proportionate decrease to the assumed lease rate to reflect the obligation of the lessee to assume liability for such costs.

The underlying assumption for land costs associated with the proposed NYC 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 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, if NYISO staff adopts an assumption that the lessee will assume responsibility for the site remediation costs, it must also assume 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 and its consultants have presented no evidence to support an assumption that the lessee would pay fair market value for the lease, and assume all liability for site remediation. Absent such evidence, NYISO staff must include a significant downward adjustment to the proposed lease rate to reflect the liability assumed by the lessee with respect to site remediation costs.

LEVEL OF EXCESS CAPACITY

While the City supports NYISO staff's recommendation to reduce its consultants' assumed level of excess capacity over the final 27 years of the nominal life of the proposed NYC peaking by 50 percent, the City maintains that NYISO staff's proposed level of excess is still too high. Accordingly, the City recommends that NYISO staff apply the same 0.5 percent assumed level of excess for the entire nominal life of the proposed NYC peaking unit as assumed for the first three years.

Utilizing the 0.5 percent assumed level of excess ensures consistency with the requirements of the NYISO's tariff, while avoiding the unintended consequence of providing artificially-high price signals that would exacerbate the current and projected levels of substantial excess capacity in New York. FERC has previously determined that the requirement of Section 5.14.1.2 of the NYISO Market Administration and Control Area 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 peaking unit.[3] Accordingly, because the same tariff requirement applies to the entire nominal life of the proposed NYC peaking unit and the NYISO 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 proposed NYC 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's tariff.

In addition, 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 proposed NYC peaking unit than that assumed for the first three years. The unjustified assumption of additional excess artificially increases capacity prices to consumers, while facilitating the continuance of significant levels of excess capacity by providing artificially-inflated price signals regarding the value of excess capacity. Accordingly, the City urges NYISO staff to apply the assumed 0.5 percent level of excess capacity to the entire nominal life of the proposed NYC peaking unit.

ESCALATION FACTOR

NYISO staff proposes to utilize an escalation factor of 2.4 percent to determine the parameters of the 2012/2013 and 2013/2014 ICAP demand curves. This proposed escalation factor represents 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. While the City does not oppose the use of a forecast of inflation to determine the appropriate escalation factor, the City contends that NYISO staff must utilize an escalation factor that is more representative of the 2011-2014 period covered by the current reset process.

NYISO staff has 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. Furthermore, NYISO staff's proposal to use an escalation factor derived from only a single data source, which covers a period of time irrelevant to the 2011-2014 period of the current reset process, results in inappropriate, artificially-inflated capacity prices. In addition, the City notes that the data source utilized by the NYISO in calculating its proposed 2.4 percent escalation rate is already outdated. The Federal Reserve Bank of Philadelphia has since published a more recent Survey of Professional Forecasters revising the forecasts relied upon by NYISO staff downward to reflect less optimistic projections for the country's economic recovery. Although the longer-term 10-year forecast utilized by the NYISO was reduced by only approximately 5 percent in the latest version of the Survey of Professional

[3] *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,064 at P 31 (2008).

Forecasters, the near-term forecast for the 2010-2014 period was reduced by nearly 10 percent.

The City contends that a more representative escalation factor of 1.7 percent should be utilized. This recommended escalation factor was derived from the average forecasted inflation rates during the 2010-2014 of three representative forecasts, including recently updated forecasts from the data relied upon by NYISO staff.[4] 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.

If you have any questions regarding these comments or would like to discuss them further, please do not hesitate to contact me directly.

Respectfully submitted,

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[4] *See* 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").