

October 25, 2004

Hand Delivered

Mr. John W. Boston  
Chairman – NYISO Board of Directors  
C/o  
Robert E. Fernandez, Esq.  
General Counsel  
New York Independent System Operator, Inc.  
290 Washington Avenue Extension  
Albany, NY 12065

Re: IPPNY Responsive Supplemental Information on NYISO Staff Proposed Demand Curves

Dear Chairman Boston:

On behalf of its members, the Independent Power Producers of New York, Inc., is pleased to submit an original and two copies of its Responsive Supplemental Information pertaining to the NYISO Staff's proposed New York Control Area Demand Curve.

Thank you for your attention to this matter. Please don't hesitate to contact me with any questions or comments.

Sincerely,

*/s/Glenn D. Haake*

Glenn D. Haake  
General Counsel

## **Responsive Supplemental Information of the Independent Power Producers of New York, Inc., Concerning the NYISO Staff's Proposed NYCA Demand Curve**

On behalf of its members, the Independent Power Producers of New York, Inc., (“IPPNY”) offers the following Responsive Supplemental Information (the “Responsive Filing”) for the consideration of the NYISO Board of Directors (“Board”) as it evaluates the NYISO staff’s (“Staff”) proposed installed capacity (“ICAP”) demand curve for the New York Control Area (“NYCA” and “NYCA Demand Curve”).

### **Executive Summary**

In this Responsive Filing IPPNY will focus on three issues: (1) the levelized carrying cost of General Electric’s Frame 7FA simple-cycle gas turbine peaking unit (the “GT” and the “GT Cost”) and the comments related thereto in the initial supplemental information (“Initial Filings”) of several market participants; (2) several New York transmission owners’ (the “NYTOs”)<sup>1</sup> estimated net energy and ancillary services revenues (“Net Revenues”) available to the GT; and (3) the NYTOs’ proposed change to the NYCA Demand Curve’s \$0 intercept.

IPPNY will demonstrate that, based on the record before the Board, Staff’s estimated \$87/kW-year levelized GT Cost,<sup>2</sup> although likely understated for the reasons asserted herein and in IPPNY’s Initial Filing, is the best available evidence of the GT Cost. Alternative bases for estimating the GT Cost cited by the NYTOs and others are inappropriate, because they are either preliminary estimates (in the Case of PJM) or are based on different technology and circumstances.

Concerning Net Revenues, IPPNY will show that the NYTOs’ arguments<sup>3</sup> are fatally flawed because they fail to account for the GT’s start-up cost, start-up time and minimum-run time constraints and include a double-counting of scarcity revenues. The NYTOs’ suggestion that the Board should consider OTC forward market prices must be rejected, because (1) those markets are extremely thinly-traded, and (2) there is no way to determine whether the fuel price forecast underlying the Levitan & Associate Inc.’s (“LAI”) Final Report and Staff’s Net Revenue estimate are consistent with assumptions underlying these forward prices.

Finally, because IPPNY has demonstrated in its Initial Filing that the Board should endorse a Net Revenue offset in the NYCA of no more than \$10/kW-year, there is no basis for diverting from Staff’s recommendation that the \$0 intercept of the NYCA Demand Curve should not be changed.

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<sup>1</sup> These NYTOs are: Central Hudson Gas & Electric, LIPA, New York State Electric & Gas, Niagara Mohawk Power Corporation, and Rochester Gas & Electric.

<sup>2</sup> Unless otherwise noted, all GT Cost figures referenced in this Responsive Filing are stated on the basis of ISO conditions (59° Fahrenheit) and, consistent with existing procedures, must be adjusted (1) to summer DMNC figures, (2) to reflect the summer/winter capacity differential, and (3) from an ICAP to UCAP basis, for the purposes of establishing the NYCA Demand Curve.

<sup>3</sup> This Responsive Filing does not address the NYTO’s arguments supporting Staff’s proposed \$5/kW-year “winter capacity benefit.” The error of that adjustment is fully addressed in the Initial Filing of IPPNY-members Entergy Corporation, the Mirant companies and Sithe Energies, Inc.

## Responsive Supplemental Information

### 1. The GT Cost

As IPPNY argued in its Initial Filing, Staff's \$87/kW-year GT Cost estimate is likely understated due to (1) the use of a 20 year financing term (versus the 15 year term assumed for the original NYCA Demand Curve), (2) LAI's unreasonably low financing rate assumptions, and (3) the fact that recent capacity additions will likely cause a shift in the predominant transmission congestion point in the NYCA from Central-East to the lower Hudson Valley, which suggests that, in order to realize appreciable Net Revenues, the GT would need to be constructed in the lower Hudson Valley where much higher construction and labor costs pertain. However, on the record before the Board, IPPNY contends that the LAI/Staff \$87/kW-year GT Cost estimate is the best evidence of the NYCA GT Cost.

The LAI estimate adopted by Staff is the only estimate available to the Board that is based explicitly on the cost of constructing a Frame 7FA GT in New York State.<sup>4</sup> The other estimates cited by the NYTOs and others either are based on different technology or are premised on costs that exist in other states. The Board should not reject the New York State-based Frame 7FA GT Cost analysis of the independent consultant retained by Staff that was heavily debated over several months by market participants via the NYISO committee process, in favor of estimates based on inappropriate assumptions.

#### A. NYTO Recommendation

The NYTOs have suggested that the Board should use a simple average of figures presented by ISO-NE, PJM and the staff of the New York State Department of Public Service ("DPS Staff"), instead of the analysis conducted by the consultant NYISO Staff retained to conduct an evaluation based on New York State conditions and Frame 7FA GT Costs. The NYTOs' analysis is flawed, as described below, and cannot be relied upon by the Board.

ISO-NE developed an estimated cost of \$92/kW-year to construct a single Frame 7FA unit in the New England "rest-of-pool" ("ROP") region. The NYTOs propose to reduce this estimate to \$82.59/kW-year, pursuant to a DPS Staff method intended to account for putative economies of scale related to a paired Frame 7FA unit. IPPNY would note that even if one assumes that DPS Staff's method of accounting for these alleged economies is appropriate, the resulting \$82.59/kW-year number is remarkably close to LAI/Staff's \$87/kW-year estimate.

More importantly, while the NYTOs have proposed one downward adjustment to the ISO-NE estimate, they have not proposed necessary upward adjustments to reflect the higher construction, labor, and transmission system upgrade costs that exist in New York, particularly in the lower Hudson Valley. Nor have they proposed to adjust the ISO-NE estimate to reflect the higher tax rates that exist in New York, despite the fact that such an adjustment was done when the original Demand Curve was developed.<sup>5</sup>

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<sup>4</sup> The LAI estimate is based on an actual Frame 7FA project constructed in the Midwest. LAI then adjusted this estimate to reflect New York tax rates.

<sup>5</sup> The original NYCA Demand Curve was loosely based on a study by E-Acumen of the cost of constructing a GE

IPPNY suggests that if all relevant adjustments were made to the ISO-NE ROP Frame 7FA cost estimate to reflect New York State conditions and costs, the resulting estimate would, if anything, likely exceed LAI/Staff's \$87/kW-year figure. Thus, rather than support a downward revision to Staff's figure, the ISO-NE study cited by the NYTOs confirms the reasonableness of Staff's estimate.

The NYTOs' reference to the PJM "estimate" also is unpersuasive and not germane. The PJM "estimate" was first presented to PJM's stakeholders at PJM's September 24, 2004 PJM-RAM Stakeholders Working Group (the "PJM-RAMWG").<sup>6</sup> In comparison with LAI's detailed 66-page, single-spaced comprehensive Final Report, the estimate produced for PJM is merely a 15-page PowerPoint presentation. This work-product was not developed pursuant to a request for proposals ("RFP") process, so market participants had no hand in developing the scope of the PJM study, unlike the comprehensive study LAI conducted.

Moreover, the estimate that was produced for PJM has not yet been subjected to a process that incorporates market participant input to any meaningful extent. A review of the PJM-RAMWG's agendas indicates the estimate has not been discussed at any meeting since the September 24, 2004 meeting.<sup>7</sup> IPPNY understands that at the sole meeting held thus far to discuss the PJM "estimate" market participants raised numerous concerns with the legitimacy of that estimate. As such, the PJM cost figure is a very preliminary estimate, not based on New York State costs and conditions, and lacking the check of meaningful market participant debate and input. IPPNY contends that the Board cannot give credence to such a preliminary PJM estimate when developing a GT Cost for the NYCA Demand Curve.

Finally, as discussed below, the DPS Staff's estimated GT Cost is flawed in a number of serious respects. Thus, the NYTOs' recommendation that the DPS Staff estimate should be part of the calculus used to determine the NYCA GT Cost must be rejected. Once again, it would be arbitrary, capricious and unreasonable for the Board to reject the results of its independent, New York-based study, determined following extensive market participant input, in favor of *ad hoc* estimates based on the wrong technology located in other regions. In effect, these other estimates are based on the wrong technology, in the wrong place, at the wrong time.

#### B. DPS Staff Estimate

DPS Staff presented an estimate of the development and construction cost for a Frame 7FA GT equal to \$74.74/kW-year. IPPNY asserts that the flaws in the DPS Staff's analysis render it an improper basis on which the Board may support a divergence from the LAI/Staff \$87/kW-year estimate.

First, DPS Staff's estimate is based on the same aggressive set of financing assumptions that underlie the LAI study, but the downward bias that these assumptions affect is exacerbated

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Frame 7 unit in New England. NYISO staff adjusted this estimate upward to reflect New York's higher tax rate.

<sup>6</sup> See, PJM New Entry CT Revenue Requirements, September 24, 2004, available at: <http://www.pjm.com/committees/working-groups/pjmramwg/downloads/20040924-item-2-new-entry-ct-presentation.pdf>.

<sup>7</sup> See, <http://www.pjm.com/committees/working-groups/pjmramwg/pjmramwg.html>

by several other inconsistencies in the evidence relied upon by DPS Staff. DPS Staff's estimate is based on a development project conducted by the Jamestown Board of Public Utilities ("Jamestown"), which constructed an LM6000 gas turbine (not a Frame 7FA) on an existing site, with existing interconnection infrastructure. Further, DPS Staff's estimate is not derived from a simple-cycle GT application, which is mandated by the NYISO tariff. Rather, the Jamestown installation is a combined-cycle plant which is markedly different than the required surrogate. Thus, DPS Staff's estimate is based on the wrong technology and unrealistic assumptions about pre-existing infrastructure improvements.

While DPS Staff attempted to correct for the factors that render the Jamestown experience inapt for estimating a merchant developer's cost of constructing a Frame 7FA on a green-field site, each of these adjustments are "judgment calls." Indeed, DPS Staff recognized that there are a range of reasonable assumptions pertaining to interest rates and other factors and acknowledged that changes to the financing assumptions can significantly affect the GT Cost.<sup>8</sup>

For example, both the DPS Staff estimate and the LAI/Staff \$87/kW-year GT Cost estimate are based, in part, on an assumed return on equity ("ROE") of 12.5%. DPS Staff noted that increasing this ROE to 13.5% -- a rate more consistent with the level of risk associated with a merchant investment (particularly one that relies on substantial Net Revenues to cover debt service and fixed operating costs), as opposed to an investment by a municipal utility whose returns are assured in advance -- would increase its GT Cost estimate (and by implication, LAI/Staff's) by \$4/kW-year.<sup>9</sup>

In this regard, the Board should note that FERC recently authorized New England transmission owners an allowed ROE for regulated transmission investments of 12.8% and set for hearing aspects of an incentive program that could boost that ROE to 14.3%.<sup>10</sup> Clearly, the ROE appropriate for a merchant generation investment is significantly higher than that available to a regulated, rate-based transmission investment.

In addition, in its initial GT Cost estimate presented at the August 20, 2004 ICAP working group meeting, DPS Staff found that the appropriate GT Cost was \$89/kW-year.<sup>11</sup> The DPS Staff issued this estimate at a time when the LAI estimate was \$116/kW-year. In calculating this estimate, DPS Staff assumed a 15% factor to convert LM6000-based costs for the Jamestown unit to a Frame 7FA GT Cost.

In DPS Staff's subsequent analysis which underlies the figures contained in its Initial Filing -- issued shortly after LAI dropped its GT Cost estimate dramatically from \$116/kW-year to \$87/kW-year -- DPS Staff increased this conversion factor from 15% to 20%, without explanation. DPS Staff has acknowledged that this change is a "judgment call" and implicitly

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<sup>8</sup> See, DPS Staff Initial Filing, p. 2.

<sup>9</sup> Id.

<sup>10</sup> See, Order Granting RTO Status Subject to Fulfillment of Requirements and Establishing Hearing and Settlement Judge Procedures (106 F.E.R.C. P61,280). See also, Midwest Independent System Operator, Inc., 100 F.E.R.C. P61,292 at P 31 (2002), authorizing a 12.38% ROE for regulated transmission investments in MISO

<sup>11</sup> This estimate was handed out at the August 20, 2004 ICAP working group meeting, but it is unfortunately not included with the meeting materials for that date on the NYISO website.

found that reverting to its original 15% conversion factor would increase its GT Cost estimate by \$4.35/kW-year.<sup>12</sup>

Finally, a review of its September 4, 2004 comments on LAI's Final Report will show that DPS Staff assumed \$4 million for electric system upgrades (which, based on the experiences of its members, IPPNY believes is understated). More importantly, DPS staff has confirmed that this line-item covers only direct interconnection facilities, known as "Attachment Facilities" under Attachment S to the NYISO's Services Tariff. DPS Staff failed to include a line-item for interconnection system upgrade facilities ("SUFs"), which are required under Attachment S to NYISO's Services Tariff and which can be very substantial, particularly in the lower Hudson Valley.<sup>13</sup> IPPNY believes that reflecting a more appropriate interconnection cost and adding necessary SUF costs would increase DPS Staff's GT Cost by approximately another 4\$/kW-year. In conversation, DPS Staff agreed with IPPNY that it has not reflected SUF costs in its GT Cost estimate.

Adding the above-described adjustments to DPS Staff's GT Cost estimate would yield an estimate of over \$83/kW-year. This estimate is quite close to, and supports, the LAI/Staff \$87/kW-year GT Cost estimate.

### C. The Impact of Correcting to a 15-Year Financing Term

The estimates proffered by LAI, Staff, ISO-NE, DPS Staff and PJM all are based on a 20-year financing term. IPPNY strongly believes that -- particularly in light of the difficult financing environment that merchant plant developers currently face and are likely to face in the indefinite future -- a 15-year financing term is the most appropriate assumption for calculating the GT Cost. It is noteworthy that in establishing the original Demand Curves, the NYISO assumed a 15-year financing term. None of the entities that have blithely assumed a 20-year term have presented any evidence or analysis supporting this increased term.

In support of a 15-year term, IPPNY notes that KeySpan's consultant, PA Consulting, Inc., identified the following facts:

- *First, the IRS uses a 15-year depreciable life for peaking plants.*
- *Second, the investment community has widely accepted a 15-year life for financing peaking plants.*
- *Third, the majority of a peaking plant's revenue comes from the ICAP market, thus there is an investment risk associated with fluctuations in market reserve margins, which applies to peaking plants more so than baseload generation. There is a disincentive to invest in new peaking plant capacity if entities cannot gain full returns on their investments in 15 years. Using an industry standard 15-year life on peaking plants increases the levelized capacity revenue requirement by approximately 15%.<sup>14</sup>*

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<sup>12</sup> See, DPS Staff Initial Filing, p. 3, ( $\$0.87/\text{kW-year} * (20-15) = \$4.35/\text{kW-year}$ ).

<sup>13</sup> See, Comments of DPS Staff, September 4, 2004, Appendix 1, available at:

<sup>14</sup> See, KeySpan Initial Filing, pp. 6-7

Applying a 15% adjustment to reflect a 15-year term, consistent with the analysis proffered by PA Consulting, would result in the following figures for the GT Cost estimates:

- LAI/Staff: \$87/kW-year plus 15% = @\$100/kW-year
- ISO-NE as adjusted by NYTOs plus 15% = @\$95/kW-year
- DPS Staff: \$74.74/kW-year, plus 15% = @\$86/kW-year
- DPS Staff as adjusted by IPPNY: \$83/kW-year plus 15% = @\$95/kW-year

Each of these figures supports the contention that the LAI/Staff estimated GT Cost of \$87/kW-year is reasonable, if understated. Accordingly, IPPNY requests that the Board retain the LAI/Staff \$87/kW-year GT Cost in setting the NYCA Demand Curve.

## 2. Net Revenue Forecasts

IPPNY commends the DPS Staff for the intellectual integrity reflected in retaining the method it consistently has used to calculate Net Revenues. In its Initial Filing, DPS Staff explained that it now has incorporated Dr. Patton's updated calculations that partially reflect the Frame 7FA's start-up and minimum-run cost and operational constraints. DPS Staff now estimates that the GT would realize Net Revenues of \$12.50/kW-year.<sup>15</sup> While DPS Staff's updated Net Revenue estimate is substantially more accurate than its earlier estimate, the DPS Staff Net Revenue estimate still remains significantly overstated due to (1) its reliance on 2000 to 2003 historical energy and ancillary service revenues that are likely to be poor predictors of future revenues, and (2) its failure to correctly reflect start-up cost, start-up time and minimum-run time considerations.<sup>16</sup>

The NYTOs' Net Revenue estimate is, by comparison to DPS Staff's, fatally flawed. The NYTOs actually present a couple of different methods of estimating Net Revenues. First, the NYTO's suggest that in calculating Net Revenues during non-scarcity periods Staff should have used the LAI Stochastic Model's \$7/kW-year estimate of Net Revenues rather than LAI's Deterministic Model of \$2/kW-year. To this figure they would add Staff's \$10 premium to reflect 20 scarcity hours, resulting in a Net Revenue estimate of \$17/kW-year, compared to Staff's \$15/kW-year.

The NYTO analysis is totally improper because it double-counts scarcity-related Net Revenues. Staff added a \$10/kW-year scarcity premium to LAI's Deterministic Model results because that model allegedly fails to incorporate scarcity conditions. Conversely, LAI's Stochastic Model was developed precisely because it does reflect scarcity conditions.<sup>17</sup> Indeed, IPPNY explained in its Initial Filing that the later years of the LAI Stochastic Model, on which IPPNY based its \$10/kW-year Net Revenue recommendation, already contain 29 scarcity hours,

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<sup>15</sup> DPS Staff Initial Filing, p. 2. It should be noted that this estimate corroborates the calculation proffered by IPPNY. See, IPPNY Initial Filing, p. 7, citing Younger affidavit, ¶ 21, p 5.

<sup>16</sup> For a more detailed explanation of the errors characteristic of Dr. Patton's analysis (and by implication DPS Staff's), please see IPPNY's Initial Filing.

<sup>17</sup> See, LAI Final Report.

a nearly 50% increase over the 20 scarcity hours endorsed by Dr. Patton and Staff.<sup>18</sup> Thus, the NYTO proposal would double count scarcity-related Net Revenues.

The NYTOs proceed to argue that even the \$17 figure they derive by double-counting scarcity-related Net Revenues is too low. They suggest that the Stochastic Model does not reflect situations in which quick-start gas turbines must be started during non-scarcity conditions in the real-time market (“RTM”), either because the day-ahead market (“DAM”) commitment under-forecast actual load or because of a forced generation or transmission outage. To address this alleged deficiency in the LAI Stochastic Model’s forecast of GT Net Revenues, the NYTOs propose that the Board should reflect OTC broker forward prices when it sets the Net Revenues that the GT can be expected to receive.

The NYTOs claim, without providing any substantiation or evidence that the Board could rely upon,<sup>19</sup> that OTC broker prices for 2005 and 2006 in zone G are \$56.10/MWh and \$53.81/MWh, respectively. Based on these figures, they suggest there actually are more scarcity hours than Staff and Dr. Patton assumed and that the appropriate range of Net Revenues is \$17/kW-year (based on their double-counting methodology) to \$37/kW-year. They therefore urge the Board to adopt a minimum Net Revenue estimate of \$22/kW-year, plus \$5/kW-year associated with Staff’s proposed “winter capacity benefit” fudge factor that was fully discredited in the Initial Filing of Entergy, Mirant and Sithe, resulting in a total of \$27/kW-year.

The NYTOs’ argument advanced above fails for at least three major reasons. First, it does not account for the fact explained in IPPNY’s Initial Filing that the Frame 7FA-based GT lacks the operational flexibility (due to its start-up time, start-up cost and minimum-run time) to respond to transitory, non-scarcity-related, RTM price spikes.<sup>20</sup> IPPNY noted that the Frame 7FA GT has a two to four-hour minimum-run time, a 30-minute start-up time, high start-up costs and one of the poorest heat rates of the upstate market fleet. The ISO-NE evaluation confirmed that the Frame 7FA has a three to four-hour minimum-run time.<sup>21</sup> We further noted that under NYISO market rules, a bid production cost guarantee in the RTM is only available for a maximum of a one-hour minimum-run time.

Given these constraints, it is clear that the GT can only be assured of realizing Net Revenues in the RTM if the energy clearing price exceeds its operating cost plus its full start-up cost in a single hour.<sup>22</sup> This is the reason that the GT can only be expected to realize appreciable Net Revenues during periods of scarcity that are forecast in the DAM.

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<sup>18</sup> IPPNY Initial Filing, p. 8, citing Younger Affidavit, at ¶ 11, p. 3.

<sup>19</sup> The NYTOs submitted no evidence regarding these putative OTC prices. Are these quotes, bids, offers or completed transactions? If the latter, how many transactions and at what volumes constitute the sample size cited by the NYTOs? Clearly, the Board cannot rely on such unsupported, anecdotal evidence to estimate Net Revenues.

<sup>20</sup> IPPNY Initial Filing, p. 3, citing Younger Affidavit, ¶¶ 6, 7, pp. 1-2.

<sup>21</sup> See, Prepared Direct Testimony of John J. Reed on Behalf of ISO New England, Inc., August 31, 2004, p. 12, available at: [http://www.iso-ne.com/FERC/filings/Other\\_ISO/LICAP\\_Testimony\\_ER03-563-030/Prepared\\_direct\\_testimony\\_Reed.DOC](http://www.iso-ne.com/FERC/filings/Other_ISO/LICAP_Testimony_ER03-563-030/Prepared_direct_testimony_Reed.DOC)

<sup>22</sup> IPPNY Initial Filing, p. 3, citing Younger Affidavit, ¶ 7, pp. 1-2.



It is noteworthy that the NYTO filing effectively acknowledges this point:

*It is difficult to say exactly what effect higher prices would have on the margins for a Frame 7. If all of the price difference applies to hours in which the Frame 7 would not operate, then there would be no effect on its margins”<sup>23</sup>*

Thus, the NYTOs have acknowledged that the alleged higher prices in the OTC broker market may result from hours when the GT would not run. This is precisely what IPPNY has shown.

A much bigger flaw in the NYTO argument to consider OTC prices, however, beyond the fact that its reported pricing is completely unsupported, is that its comparison of the Staff and LAI forecast of energy prices with putative OTC broker quotes constitutes an “apples to oranges” comparison. There is no way to determine whether these OTC broker forward prices and the LAI/Staff Net Revenue estimates are based on consistent assumptions regarding fuel forecasts and other necessary key elements. In fact, the LAI Final Report shows that LAI has assumed fuel prices will decline dramatically in the next several years. Given the recent trends in natural gas and oil prices it is very likely that the fuel forecast underlying the OTC market is higher than LAI’s.

The NYTOs also have failed to acknowledge that increased input fuel cost concerns, the most likely driver of higher prices in the OTC market, would most likely decrease the Net Revenues for a Frame 7 FA GT. The increased fuel costs would cause the Frame 7FA GT to have increased operating costs, due to its poor heat-rate. However, the \$500/MWh price during EDRP events, which determines most of the Net Revenues for the Frame 7FA GT, would remain frozen at the EDRP bidding cap. Thus, the GT’s profit margin would decrease with higher fuel prices because its increased operating costs would erode its Net Revenues during EDRP events. Without correcting for potential differences in fuel price assumptions, it is impossible to draw any legitimate conclusions regarding the Net Revenues the GT would realize based on OTC forward market prices.

Another problem with the NYTOs’ use of the OTC market results is that there is no support for the presumption that the changes in the OTC results provides any indication of the likely revenues for a Frame 7FA (or any other peaking unit). The NYTOs have made the bold presumption that much of the difference in two estimates of energy costs are associated with high priced hours where a GT could get additional Net Revenues. There is no support for this supposition.

In addition, the shift in the predominant congestion point from Central-East to the lower Hudson Valley mentioned previously suggests that OTC broker prices for zone G are no longer germane to the Net Revenues that will be realized by an upstate GT. Finally, IPPNY understands that the OTC broker market cited by the NYTOs is an extremely thinly traded and illiquid market characterized by large bid/offer spreads. As such, it is not a satisfactory basis for estimating future Net Revenues. Thus, because we cannot determine that the fuel cost forecast assumptions underlying the OTC broker market prices are consistent with those employed by LAI and Staff, and because the OTC market is thinly traded, the prices produced by the OTC

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<sup>23</sup> NYTO Initial Filing, p. 7.

broker market simply are not competent evidence on which the Board may rely in setting a Net Revenue estimate.

### 3. The \$0 Intercept Should Not Be Changed

IPPNY appreciates that, contrary to the position they advanced when the Demand Curve was under development, the NYTOs now acknowledge that procuring ICAP in excess of the NYCA minimum ICAP requirement “*has some positive value to end-use consumers, both in terms of improving reliability and reducing energy costs.*”<sup>24</sup> Notwithstanding that recognition, however, the NYTOs have proposed to shorten the NYCA Demand Curve from the current 112% to 109% of the NYCA minimum ICAP requirement, based on the argument that such a shortening of the Demand Curve would produce consumer savings. IPPNY believes the Board should endorse LAI’s and Staff’s recommendation to maintain the current \$0 intercept point.

First, we should note that the Services Tariff requires that the current \$0 intercept point be maintained for Capability Year 2005-2006. This was a fundamental element of the original Demand Curve proposal and should be maintained. Second, IPPNY notes that a shortening of the Demand Curve could well result in the retirement of a large generator in the NYCA. While this would be a normal market outcome of shortening the Demand Curve, it suggests that shortening the Demand Curve may actually have the opposite effect than the NYTOs predict; it may result in higher costs to consumers than would occur if the \$0 intercept point is maintained and no retirements or import reductions occur.

Third, the NYTOs’ argument for a shorter Demand Curve is based in large part on the artificially depressed “Reference Value”<sup>25</sup> they have recommended based on unreasonably high Net Revenue estimates and an unduly low GT Cost. The NYTOs proposed zero crossing point results in too steep a curve when its proposed \$0 intercept is combined with more reasonable estimates of the GT Cost, Net Revenues and the associated Reference Value.

Fourth, shortening the Demand Curve in the manner recommended by the NYTOs would exacerbate the impact of the “lumpiness” issue associated with capacity additions and the other matters identified in Section 2.B of IPPNY’s Initial Filing. A shorter Demand Curve would cause capacity additions of the size of the GT to significantly depress ICAP clearing prices under the Demand Curve even if the system were in equilibrium at the time of such additions.

Finally, the City of New York has suggested that the \$0 intercept should be retained for Capability Year 2005-2006 but subject to revision for the following two Capability Years based on a study it proposes the NYISO undertake. The uncertainty engendered by such an approach would undermine the effectiveness of the Demand Curve, because parties would not have available the forecast of likely ICAP market clearing prices that the Demand Curve provides. This would impede the ability of buyers and sellers to enter bilateral ICAP contracts for the period beyond the 2005-2006 Capability Year. It also would impede the development of new capacity and continued investment in needed existing resources because it introduces a

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<sup>24</sup> NYTO Initial Filing, p. 9.

<sup>25</sup> The “Reference Value” refers to the result of reducing the GT Cost by estimated Net Revenues and is the value that is placed at the location on the Demand Curve that represents the minimum ICAP requirement.

heightened concern about regulatory risk. Balanced against these impacts, the City of New York has produced no compelling evidence that LAI's and Staff's conclusions as to the appropriateness of current \$0 intercept are in error. Accordingly, the Board should reject proposals to change or leave undefined the Demand Curve's \$0 intercept for the second and third Capability Years.

### **Conclusion**

For the foregoing reasons and the reasons stated in IPPNY's Initial Filing, IPPNY again respectfully requests that the Board (1) endorse the LAI and Staff GT Cost estimate of \$87/kW-year, (2) adopt the LAI Stochastic Model results at equilibrium conditions of \$10/kW-year, and (3) determine a resulting Reference Value of \$77/kW-year for the NYCA Demand Curve at the minimum NYCA ICAP requirement.<sup>26</sup> This is a reasonable estimate based on realistic forecasts and consideration of all other material issues. The \$10/kW-year Net Revenue proposal is integral to the \$87/kW-year GT Cost estimate and cannot be viewed or used independently.

Dated:           October 25, 2004  
                  Albany, New York

Respectfully submitted,

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Glenn D. Haake, Esq.  
General Counsel

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<sup>26</sup> These figures are presented on an ISO 59° Fahrenheit basis. See, footnote 2.