

October 25, 2004

VIA HAND DELIVERY

Mr. William Boston
Chairman
c/o Robert E. Fernandez, Esq.
General Counsel
New York State Independent System Operator, Inc.
290 Washington Avenue Extension
Albany, New York 12203

Re: Proposed Demand Curves

Dear Mr. Boston:

Enclosed are the original and two copies of Multiple Intervenors' Reply Comments on the Demand Curves proposed by Staff of the New York Independent System Operator, Inc. Additionally, Multiple Intervenors hereby requests authorization to participate in oral argument on the Demand Curve for the Rest of State region.

Very truly yours,

COUCH WHITE, LLP

s/Robert M. Loughney

Robert M. Loughney

RML/vaf

Enclosures

cc: Robert E. Fernandez, Esq. (via E-Mail; w/enc.)

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PRELIMINARY STATEMENT

Multiple Intervenors, an unincorporated association of approximately 55 large commercial and industrial energy consumers with manufacturing and other facilities located throughout New York State, hereby submits its Reply Comments on the Demand Curves proposed by New York Independent System Operator, Inc. (“NYISO”) Staff. Additionally, Multiple Intervenors requests that it be allowed to participate in oral argument on the Demand Curve for the Rest of State (“ROS”) region.

NYISO Staff proposed that the ROS Demand Curve be set based on an estimated net cost of entry for \$67/kW-year. Multiple Intervenors is very concerned that a \$67/kW-year net cost of entry for the ROS region is overstated. Accordingly, Multiple Intervenors supported the Submission of Initial Supplemental Information filed by Central Hudson Gas & Electric Corporation, LIPA, New York State Electric Corporation, Niagara Mohawk Power Corporation and Rochester Gas & Electric Corporation (collectively, “Transmission Owners”), wherein it was demonstrated that: (a) NYISO Staff’s estimate of the net cost of entry for the ROS region is too high; and (b) the ROS Demand Curve should be based on a \$53/kW-year net cost of entry. (Transmission Owners at 2-7.) That submission also demonstrated that substantial customer savings could be achieved if the zero-crossing point for the ROS Demand Curve is reduced from 112% of the minimum New

York Control Area (“NYCA”) Installed Capacity (“ICAP”) requirement to between 108% and 110% of the minimum NYCA ICAP requirement. (Id. at 8-10.)

In addition to the Transmission Owners’ submission that was supported by Multiple Intervenors, initial submissions addressing the proposed ROS Demand Curve were filed by: the Independent Power Producers of New York, Inc. (“IPPNY”), the New York Municipal Power Agency (“NYMPA”), New York State Department of Public Service Staff (“DPS Staff”), and a group of generator owners dubbed, “New York Suppliers.”¹

In its initial submission, DPS Staff concludes that: (a) the net cost of entry for the ROS region is \$62/kW-year; and (b) the NYISO Staff’s proposed ROS Demand Curve, based on an estimated net cost of entry of \$67/kW-year, “falls within the range of reasonableness.” (DPS Staff at 2-3.) NYMPA advocates that the capital costs for installing peaking units embodied in the proposed ROS Demand Curve are overstated by a substantial amount. (NYMPA at 1-3.) IPPNY argues that the ROS Demand Curve should be based on an estimated net cost of entry of \$77/kW-year. In so arguing, IPPNY accepts the \$87/kW-year cost of peaking units utilized by NYISO Staff, but advocates that the energy and ancillary services revenue offsets (including the winter revenue benefit) factored into the ROS Demand Curve be reduced from \$20/kW-year to \$10/kW-year. (See IPPNY at 1.)

¹ New York Suppliers are comprised of Entergy Corporation, the Mirant Companies and Sithe Energies, Inc. Initial submissions regarding the Demand Curve proposed for New York City were filed by: the City of New York, KeySpan-Ravenswood, LLC, and NRG Energy, Inc. Multiple Intervenors takes no position on the appropriate Demand Curve for New York City.

Finally, New York Suppliers argue, inter alia, that NYISO Staff's use of a winter revenue benefit should be rejected. (New York Suppliers at 5-7.)

Multiple Intervenors' Reply Comments are limited to responding to selected arguments advanced by IPPNY and New York Suppliers in their initial submissions. Specifically, Multiple Intervenors hereby responds to:

1. New York Suppliers' argument that the Demand Curves proposed by NYISO Staff relied inappropriately on customer impact concerns (New York Suppliers at 2-5);
2. the arguments by IPPNY and New York Suppliers in opposition to the energy and ancillary services revenue offsets (including winter revenue benefit) utilized by NYISO Staff (IPPNY at 3-8; New York Suppliers at 5-7); and
3. the arguments by IPPNY and New York Suppliers that setting the ROS Demand Curve too low would harm reliability (IPPNY at 3-4; New York Suppliers at 8-9).

ARGUMENT

POINT I

**THE NYISO STAFF DID NOT RELY
INAPPROPRIATELY ON CUSTOMER IMPACT
CONCERNS**

In its initial submission, New York Suppliers take issue with NYISO Staff's consideration of customer impacts in setting the proposed Demand Curves. (New York Suppliers at 2-5.) In so arguing, New York Suppliers conclude, without any justification, that because such impacts were considered, the Demand Curves proposed by NYISO Staff do not reflect the full cost of new entry. (Id. at 4.) New York Suppliers' arguments – which rely on selected excerpts from the NYISO Staff's "Proposed NYISO Installed Capacity Demand Curves for Capability Years 2005/2006, 2006/2007 and 2007/2008" dated September 22, 2004 ("September 22nd Proposal") – are without merit and should be rejected. The ROS Demand Curve proposed by NYISO Staff is not based on any explicit downward "adjustment" for customer impacts (nor does the lower ROS Demand Curve advocated by the Transmission Owners and Multiple Intervenors rely on any such adjustment).

Setting Demand Curves at appropriate levels is not a "black" and "white" undertaking; there are numerous "gray" areas which require the exercise of reasoned judgment. In its September 22nd Proposal, NYISO Staff states that in addition to capital costs, energy and ancillary services revenue offsets and Demand Curve lengths and slopes, it "believes that other factors must be taken into consideration when adopting parameters for the Demand Curves. Relevant considerations include, but are not limited to, inflation or escalation, cost impacts on Suppliers and Loads, project development and financing costs, market dynamics due to relative/varying winter and summer Dependable Maximum Net

Capabilities ... imports and exports Limits, and other uncertainties.” (September 22nd Proposal at 3-4.)²

NYISO Staff proceeds to explain that “the new Demand Curve parameters proposed in the attachments hereto by the NYISO are intended to reflect a reasonable determination of typical costs and revenues that balances the objectives of providing appropriate compensation to generators while providing reliable service to energy consumers at a reasonable cost.” (September 22nd Proposal at 4.) New York Suppliers allege, without support, that the consideration of “reliable service to energy consumers at a reasonable cost” produces a balance that “will not allow developers to recover their investment even under equilibrium conditions.” (New York Suppliers at 4.) New York Suppliers’ fears are misplaced; NYISO Staff simply has attempted to balance competing interests in exercising its judgment on the numerous inputs to the Demand Curves that require such judgment.

As articulated in its September 22nd Proposal, which was clarified on September 30, 2004 (“September 30th Clarification”), NYISO Staff’s proposed Demand Curves are based on estimates of capital costs associated with peaking units and energy and ancillary services revenue offsets. There is no downward adjustment to the Demand Curves based on customer impacts. However, in exercising its judgment on the numerous inputs for which any one of a range of values would be appropriate, NYISO Staff attempted to balance

² Ironically, while New York Suppliers object to the consideration of “cost impacts on ... Loads,” they apparently do not oppose NYISO Staff’s consideration of “cost impacts on Suppliers.”

a number of competing factors. For example, it would have been inappropriate for NYISO Staff to have considered “cost impacts on Suppliers,” without also considering “cost impacts on ... Loads” (see September 22nd Proposal at 4). In any event, it is incorrect to state that NYISO Staff considered “cost impacts on ... Loads” in a vacuum, or that such consideration changed the proposed ROS Demand Curve.

Finally, relying on the decision by the Federal Energy Regulatory Commission (“FERC”) to adopt the Demand Curve, New York Suppliers argue that: “Approving the Demand Curve concept, the FERC focused on the fact that the increased stability in ICAP revenues that would be provided by the Demand Curve structure would contribute to generation investment in New York.” (New York Suppliers at 4.) However, thus far, while the Demand Curve concept has increased revenues to generators – and costs to consumers – there has been no demonstration that it has led to increased generation investment in New York. In fact, the NYISO recently was directed to report to FERC on the impact of the Demand Curve on new generation investment.³

Both the ROS Demand Curve proposed by NYISO Staff and the ROS Demand Curve advocated by the Transmission Owners and Multiple Intervenors are based on analyses of capital costs associated with peaking units and energy and ancillary services

³ See Docket No. ER03-647-004, New York Independent System Operator, Inc. – Reports on Implementation of the ICAP Demand Curve and Withholding Behavior Under the ICAP Demand Curve, Order issued September 22, 2004 (wherein FERC concluded that “it is too short of a time period to draw definitive conclusions about the long-term impact of the ICAP Demand Curve” and directed the NYISO to report on “the impact of the ICAP Demand Curve on new investment”).

revenue offsets. New York Suppliers' selective opposition to NYISO Staff's consideration of qualitative factors in exercising its reasoned judgment does not warrant any upward adjustment to the ROS Demand Curve.

POINT II

THE ENERGY AND ANCILLARY SERVICES REVENUE OFFSETS UTILIZED BY NYISO STAFF SHOULD NOT BE REDUCED

In their initial submissions, IPPNY and New York Suppliers attack the \$20/kW-year value for energy and ancillary services revenue offsets utilized by NYISO Staff, particularly the winter revenue benefit. (IPPNY at 4-8; New York Suppliers at 5-7.) For the reasons set forth below, those arguments should be rejected.

First, as demonstrated at pages 5-7 of the initial submission of the Transmission Owners supported by Multiple Intervenors, the \$20/kW-year figure relied upon by NYISO Staff is understated. NYISO Staff itself indicates that: (a) energy and ancillary services offsets in the ROS region, not including the winter revenue benefit, range from \$12 to \$18/kW-year; (b) the winter revenue benefit in the ROS region could range between \$0 and \$12/kW-year, and would be approximately \$7/kW-year based on the 2003/2004 capability year; and (c) the 20 hours of scarcity pricing used to calculate energy offsets is considered "conservative." (September 30th Clarification at 2-4.) Additionally, in evaluating the reasonableness of various estimates of energy and ancillary services revenue offsets, it is worth noting that the \$87/kW-year cost of peaking units for the ROS region utilized by

NYISO Staff is higher than similar results in the New England and PJM control areas and “may be in the upper area of the range of revenue requirement estimates.” (Id. at 2.)

Second, IPPNY’s criticisms of DPS Staff’s estimates of energy and ancillary services revenue offsets (IPPNY at 7) should be disregarded. DPS Staff has updated its estimates of the offsets. (See DPS Staff at 1-2.) Additionally, it is unfair to criticize one element of DPS Staff’s estimates while retaining other, related elements. For instance, DPS Staff’s updated analysis yields a \$25/kW-year offset for energy and ancillary services in the ROS region, which it reduces by 50% to be conservative. (Id. at 2.) It would be unfair to reduce DPS Staff’s \$25/kW-year estimate – as IPPNY advocates – while retaining the 50% reduction to the end result.⁴

Finally, both IPPNY and New York Suppliers assert that historic conditions should not be relied upon to calculate the winter revenue benefit. (IPPNY at 4-7; New York Suppliers at 5-7.) However, the historical data relied upon by NYISO Staff demonstrates unequivocally the appropriateness of the adjustment. In fact, if anything, that data in isolation would support a larger winter revenue benefit. While IPPNY and New York Suppliers may be correct that new generation has been added to the ROS region that is not reflected in historic data, their arguments as to the impact of that new generation on the appropriate winter revenue adjustment is sheer speculation. There has been no compelling

⁴ In evaluating DPS Staff’s estimates of energy and ancillary services revenue offsets, it also is important to bear in mind that DPS Staff’s estimated cost of peaking units in the ROS region is considerably lower than that relied upon by NYISO Staff.

demonstration that the adjustment is not warranted, and NYISO Staff's use of the \$5/kW-year value is appropriate.⁵

POINT III

REDUCING THE ROS DEMAND CURVE PROPOSED BY NYISO STAFF AS ADVOCATED BY THE TRANSMISSION OWNERS AND MULTIPLE INTERVENORS WOULD NOT HARM RELIABILITY

In their initial submissions, IPPNY and New York Suppliers argue for a higher ROS Demand Curve than that proposed by NYISO Staff, and contend that utilizing a ROS Demand Curve that is artificially low would harm reliability. (IPPNY at 3-4; New York Suppliers at 8-9.) For instance, IPPNY asserts that "if the Demand curve is set artificially low, it will jeopardize reliability." (IPPNY at 4.) Similarly, New York Suppliers argue that if the localized cost of new entry exceeds the \$67/kW-year ROS Demand Curve proposed by the NYISO Staff, "the repercussions will be severe" and "the result will be poor reliability and excessive price spikes." (New York Suppliers at 9.) For the reasons set forth below, the arguments of IPPNY and New York Suppliers should be rejected. There is no reason to expect that adoption of the ROS Demand Curve proposed by NYISO Staff, or a lower ROS Demand Curve, such as that advocated by the Transmission Owners and Multiple Intervenors, would harm reliability.

⁵ As detailed, supra, sole reliance on historic data would yield a \$7/kW-year winter revenue benefit. (September 30th Clarification at 4.)

Initially, the concerns of IPPNY and New York Suppliers are unfounded because, as demonstrated in the Transmission Owners' submission supported by Multiple Intervenors, \$53/kW-year is an accurate estimate of the net cost of entry in the ROS region. That submission demonstrated that, by correcting certain errors contained in the September 22nd Proposal, a ROS Demand Curve based on a net cost of entry substantially lower than the \$67/kW-year proposed by NYISO Staff is appropriate. Thus, the arguments of IPPNY and New York Suppliers that a ROS Demand Curve lower than that proposed by NYISO Staff would lead to reliability problems should be rejected.

Additionally, recent history demonstrates that the objections of IPPNY and New York Suppliers are without merit. Those parties argue that if the cost of new entry exceeds the \$67/kW-year figure proposed by NYISO Staff, reliability may be jeopardized. However, NYISO Staff's proposed Demand Curve for the ROS region is significantly higher than the current Demand Curve. Yet, even under the current Demand Curve, the ROS region presently is awash in capacity, resulting in consumers paying considerable sums of money for capacity that is well in excess of the NYCA's minimum ICAP requirement. Given the strong participation in the NYISO's ROS capacity auctions, it is difficult to conceive how increasing the current ROS Demand Curve by any amount could lead to reliability problems. If anything, increasing the ROS Demand Curve would cause the region to attract even more awash in capacity, thereby increasing the unnecessarily-costly capacity obligations paid by consumers.

The reliability arguments advanced by IPPNY and New York Suppliers have not been substantiated, particularly with respect to the ROS region. Those arguments are little more than scare tactics intended to lead to an artificial increase of the Demand Curve. Accordingly, those arguments should be rejected.

CONCLUSION

For the reasons set forth herein, Multiple Intervenors urges the NYISO to: (a) adopt the ROS Demand Curve advocated by the Transmission Owners and Multiple Intervenors; and (b) reject the arguments advanced by IPPNY and New York Suppliers to adopt a ROS Demand Curve higher than that proposed by NYISO Staff.

Dated: October 25, 2004
Albany, New York

Respectfully submitted,

s/Robert M. Loughney

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