City of New York

October 25, 2004

John W. Boston
Chairman, Board of Directors
c/o Robert Fernandez, Esq.
New York Independent System Operator
3890 Carman Road
Schenectady, NY 12303

Dear Chairman Boston:

Pursuant to the NYISO procedures established for the submission of responsive supplemental information by stakeholders concerning the Demand Curve values proposed on September 22, 2004, the City of New York hereby makes its submission in triplicate. Electronic service has also been made as reflected below.

Very truly yours,

/s/ Michael Delaney

Michael Delaney, Esq.

Enclosures

cc: Robert Fernandez, Esq. (via e-mail)
Mr. John Buechler (via e-mail)
Mr. Ernie Cardone (via e-mail)

City of New York

Summary of Responsive Supplemental Information to the NYISO Proposal for Recalculation of Demand Curve Values

October 25, 2004

This Responsive Supplemental Information submitted by the City of New York addresses the following aspects of the demand curves proposed by the NYISO, and the Supplemental Information thereon submitted by Market Participants for Board consideration on October 15, 2004:

1. The appropriate revenue offsets attributable to the sale of energy and ancillary services for NYISO Zone J.

2. The proposal to maintain the "zero-crossing point" of the curve at 18% above the in-City locational requirement, and the need to analyze and consider alternative crossing points for the 2006/2007 and 2007/2008 demand curves.

1. Appropriate Energy and Ancillary Service Offset Values

In establishing its preliminary demand curve for Zone J, the NYISO proposed a net revenue offset of $50/kW-yr. At an ICAP Working Group meeting, David Patton provided estimates of Zone J net revenues based on experience between 2000 and 2003 that ranged from approximately $55/kW-yr for the 345kV load pocket, to approximately $100/kW-yr for Astoria East sub-pocket - values that included Dr. Patton's estimated scarcity adder of $10/kW-yr. Rather than reducing the offset values, as some have suggested in Initial comments filed in this matter, the NYISO could reasonably have adopted an offset value for the New York City Zone that is approximately the mid-point of Patton's estimates, or $75/kW-yr. Such a course would have been reasonable for the following reasons:

David Patton acknowledged that his estimates were conservative in a number of respects. First, in adjusting actual net revenues to account for surplus conditions between 2000 and 2003, Dr. Patton did not account for the effect of tighter conditions on market prices in non-scarcity hours. Instead, he simply assumed that tighter conditions would result in more scarcity hours than were actually experienced during the 2000-03 period. In making this adjustment, Dr. Patton first removed actual scarcity hours for the 2000-03 period, and then added an additional 20 scarcity hours priced at $600/MWh to reflect tight conditions. Second, he assumed 20 scarcity hours in his estimate of the scarcity adder based not on an estimate of actual hours likely under tight conditions, but on his sense of how many hours would be reasonable for the purpose of signaling the need for new investment. Third, he assumed that the new GT would incur start costs in every hour of operation, rather than once for every contiguous multi-hour block of run time.

It is reasonable to assume that investors will seek to build in the sub-pocket that provides the highest return on that investment. Since in-City investment costs are unlikely to vary significantly between or among sub-pockets, the higher the net revenue, the higher should be the expected return. Thus, all else being equal, the reference price should reflect the net revenues associated with the higher-value sub-pockets. Otherwise,

investment in those high-value sub-pockets will garner windfall profits - itself a persistent problem with the entire Demand Curve concept, as the City and numerous others have long observed. Dr. Patton's stated concern that using the net revenue from a higher-value sub-pocket will tend to preclude investment in lower-value sub-pockets is without merit; investors will build in those sub-pockets to the extent that they can extract greater value, or are willing to accept a lower return than is indicated by the reference price.

Although investors will seek to build in the highest-value sub-pocket, such market entry will reduce congestion into these sub-pockets, thereby reducing the net-revenue differential between higher- and lower-value areas. However, we would then expect the differential to increase over time with load growth. On the other hand, the reduction in differential in one sub-pocket will simply increase the attractiveness of other sub-pockets that are higher value than the 345 kV pocket. As such, it is reasonable to base the reference price on the average of the net revenues for the lowest- and highest-value areas.

The analysis by Dr. Patton suggests that the NYISO should adopt a net revenue value of $75/kW-yr for Zone J, reflecting an approximate average of the 345 kV net revenue of $55/kW-yr and the Astoria East load pocket net revenue of $100/kW-yr.

As was noted in "Proposed NYISO Installed Capacity Demand Curves" report issued by the ISO Staff on September 22, 2004, at page 5, the stochastic analysis by Levitan & Associates (Levitan), as well as a review of historical market behavior yielded a Net Revenue (NR) figure of $63 for Zone J. While the NYISO Staff apparently chose to view that number as what it characterized as an "upper bound" for the City market NR, it is noteworthy that it is closer to the City's previously suggested figure of $75/kW-yr than to the $50/kW-yr NR ultimately selected by the NYISO Staff.

Moreover, no reasonable basis exists to utilize a figure of $25-$30/kW-yr for net energy and ancillary services credits for New York City. KeySpan-Ravenswood, LLC (KeySpan) urges the use of such a NR figure in its submission of Initial Supplemental Information, in large part based on the work of its own consultant, PA Consulting Inc.

(PA). KeySpan notes that it shared the PA analysis and findings with Market Participants and Staff, but claims that "the NYISO Staff did not consider them."

In fact, this alternative analysis has not been shown to warrant such consideration. While any Market Participant with the means to employ its own consultant to pursue an advocacy position is of course free to do so, it should not be a surprise if other parties view the results of such analysis with skepticism when viewed in contrast to a consultant retained by the NYISO as a presumably disinterested entity.

PA and KeySpan take the position that Levitan overstates expected energy revenues by using the load curve of an atypical year with greater than normal peak hours. They further argue that in so doing, Levitan overstates both deterministic and stochastic revenues – the latter being derived by adding uncertainty to a load that is already claimed to be too high. Based on PA modeling, KeySpan contends that using a historical average load shape reduces stochastic net revenues by 50%. As Levitan found deterministic revenues to be approximately half those of stochastic, KeySpan concludes that the deterministic model should be used by the NYISO.

However, as KeySpan acknowledged at the August 27, 2004 ICAP Working Group meeting, the analysis that it commissioned from PA did not use the same input data assumptions as did Levitan. In short, there was no benchmarking of the PA modeling to Levitan's process. PA's use of the same MarketSym (Henwood) model used by LAI, as cited by KeySpan in its Comments, fails to address the issue of inconsistent or varying input data.

For that reason, it cannot be said that merely changing the load shape will operate to reduce the Levitan revenue estimate by 36%. All KeySpan can credibly show is that its own estimate of revenues is reduced by 36%. Given differences in input assumptions, a change in load shape could have a dramatically smaller impact on the Levitan estimate.

Although, as shown above, it would be reasonable to calculate the New York City

reference price using a $75 value for the net revenue offset, the City recommended in its Initial Supplemental Information to derive the reference price using the NYISO's $50 offset value. When combined with our calculation of the winter revenue benefit for New York City, the NYISO's conservative assumption for net revenues provides a reasonable estimate of the reference price.

In a similar vein, the KeySpan and PA views concerning purported equipment service lives based on such dubious reflections of economic reality as Internal Revenue Service accelerated tax depreciation schedules, or purported claims of wide acceptance in the investment community do not bear scrutiny as reasons to revisit the analysis and findings of Levitan.

2. Zero-Crossing Point

The City submitted supplemental data and views on this issue in its Initial Supplemental Information of October 15, 2004, and will not reiterate that material here. The City simply notes the Submission of Central Hudson Gas & Electric (CH) *et al*. and asks the Board's consideration of the principles expressed therein for Zone J. While the CH parties understandably did not address the application of their argument concerning the zero-crossing point to the in-City market, the views they espouse have application there as well.

As did the City, the CH parties take the position that there was no compelling reason to decide that there was no reason to reconsider the zero-crossing point characteristic of the Demand Curve, particularly when such reconsideration was made an explicit part of the charge given to Levitan at the outset by the NYISO. In the assessment by the CH parties of the competing considerations of a too steep or too flat demand curve, they make the important point that the latter causes consumers to purchase greater amounts of ICAP that exceed the value of same to them by larger and larger margins as the crossing point is extended.

In urging the use of a 108 to 110 percent of minimum crossing point as opposed to

the 112% level proposed by Staff, the CH parties seek to strike a balance between an excessively steep curve that can encourage withholding, and one that imposes needless costs on consumers while providing little or no system benefit. It is for just this reason that the City urged reconsideration of the zero-crossing points in the last two years of the Demand Curve recalculation period. If anything, the concerns over a too steep in-City curve are somewhat less critical than those in the ROS market, given the existence of price caps in Zone J that limit the latitude of suppliers to game the market through withholding practices. Moreover, as noted in the City's original submission of Supplemental Information herein, the NYISO is using lower reference prices than did the Levitan analysis.

3. Correction to Supplemental Information submitted on October 15, 2004

The proposed numbers for ICAP Reference Prices for Capability Years 2005 through 2008 on page 3 of the Supplemental Information submitted by the City were inadvertently shown as kW-yr rather than kW-mo values.

4. Request for Oral Argument before the Board

The City requests an opportunity to discuss the foregoing issues before the Board, or an appropriate Committee thereof.

Respectfully submitted,

/s/ Jonathan Wallach

Jonathan Wallach

/s/ Michael Delaney

Michael Delaney
for the City of New York