

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE
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October 25, 2004

Chair of NYISO Board
c/o: Robert E. Fernandez
NYISO General Counsel
New York Independent System
Operator, Inc.
290 Washington Ave. Ext.
Albany, New York 12065
(via e-mail and overnight mail)

Re: ICAP Demand Curve Comments - Responsive
Supplemental Information

Dear Chair of NYISO Board:

Please find the attached Comments of the Staff of the New York State Department of Public Service regarding the above-entitled matter. Should you have any questions, please feel free to contact me at (518) 473-8986.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Raj Addepalli'.

Raj Addepalli
Manager, Staff ISO Team

Attachment

**COMMENTS OF THE STAFF OF THE
DEPARTMENT OF PUBLIC SERVICE
OF THE STATE OF NEW YORK**

The Staff of the New York State Department of Public Service (DPS Staff) appreciates the opportunity to submit this response to parties' Initial Supplemental Information for consideration by the New York Independent System Operator, Inc. (NYISO) Board of Directors (Board). In particular, we would like to respond to several parties concerns with the Rest of State (ROS) Demand Curve's zero crossing point (i.e., the percent of capacity above the minimum reserve requirement where the demand curves reach \$0).

As Central Hudson Gas & Electric, Long Island Power Authority, New York State Electric & Gas, Niagara Mohawk Power Corporation, and Rochester Gas & Electric argue, "NYISO Staff did not conduct an analysis of the zero-crossing point...for the NYCA ICAP demand curve that supports its recommendation not to change the zero-crossing point." These parties also provide an analysis that purports to justify a reduction in the zero-crossing point through an examination of the net reduction in purchase costs versus the potential costs resulting from the exercise of market power by a single large supplier.

Despite these assertions, the NYISO Staff properly relied upon its independent consultant, Levitan & Associates, Inc.

(LAI), which performed a comparable analysis of the cost impact of different zero-crossing points (See LAI Final Report at pp.52-66). While LAI found similar short-term cost impacts, the consultant stressed that additional analyses would be needed concerning other market impacts before recommending any change to the zero-crossing point. Specifically, LAI indicated that:

A comprehensive review of alternative zero-crossing points needs to consider the long-term capacity market impacts. For example, an alternative zero-crossing point may appear to reduce total capacity costs in the near term after withholding is considered, but, the revised demand curve may alter retirement and entry decision criteria for existing and proposed units, respectively. (LAI Final Report at p.66).

DPS Staff concurs with LAI's observation.

A key objective of the Demand Curve is to bring greater stability to capacity prices. The zero-crossing point determines the relative stability of capacity prices as supply varies over time. A lower zero-crossing point means a steeper Demand Curve and thus greater price volatility. Such increased volatility may raise the cost of capital to new generation and thus, escalate long-term costs to consumers. Even the apparent short-term savings from a steeper Demand Curve could be completely nullified if it forces some existing units into retirement.

DPS Staff agrees that a comprehensive review of alternative zero-crossing points is desirable. However, such a review must

take into consideration all of the implications on the long-term viability of the capacity market. The existing analysis, which is limited to the market power of individual suppliers, is insufficient to recommend any change to the zero-crossing point.

Moreover, there is a substantial benefit to providing stability to the zero-crossing point so that market participants can make rational predictions as to the amount of capacity that can be supported by the market. Changes to the zero-crossing point during the middle of this three-year update period would produce confusion, and sacrifice the very stability and predictability the Demand Curve is intended to provide.¹

Therefore, DPS Staff recommends that the existing zero-crossing points be maintained for the full three-year update period.

Respectfully submitted,



Raj Addepalli
Manager, Staff ISO Team

¹ Under the NYISO tariff, the zero-crossing point is fixed at the current level through the 2005-2006 capability year, but could be revised for the last two years of the update period.