

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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September 15, 2004

Attn: John Charlton
New York Independent System
Operator, Inc.
(via e-mail)

Re: ICAP Demand Curve Comments

Dear Mr. Charlton:

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,

/s/

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 or Staff) would like to thank the New York Independent System Operator, Inc. (NYISO) for the opportunity to provide these additional comments regarding the updated demand curve for installed capacity (ICAP DC). We would also like to acknowledge the NYISO's dedication to balancing the various competing perspectives shared by the parties and to put forth a proposal that is within a range of reasonableness acceptable to market participants.

For the sake of brevity, we are incorporating by reference our September 3, 2004 comments addressed to Mr. Charlton. However, we wish to raise a few new points at this time, which have arisen as a result of the additional information that has been put forward during meetings among the parties over the past week and a half.

Specifically, the parties now have before them three estimates of the installed costs of a peaker that are based on actual construction projects. These include: 1) DPS Staff's estimate of \$83.26 per kW-year (summer DMNC) based on the Jamestown facility; 2) Levitan's estimate of approximately \$97 per kW-year (summer DMNC) based on a midwest plant; and 3) the

ISO-NE estimate of approximately \$92 per kW-year (summer DMNC).¹ The Levitan estimate is the highest of the three and is the one the NYISO has chosen to rely on in its preliminary proposal. However, the Jamestown values are the only ones that are fully public and have been provided to all the NYISO Market Participants for their scrutiny. Thus, the NYISO should place greater weight on the Jamestown value as compared to the other two estimates, which the parties have not had a full opportunity to examine. To the extent the NYISO chooses to keep the Levitan-based number, it should acknowledge that it is picking the high end of the range presented to it and should take that fact into consideration when making changes to other components of the ICAP DC.

DPS Staff has continued to evaluate the energy and ancillary services (AS) offset approach that David Patton has put forward in order to assess the reasonableness of the NYISO's proposed energy and AS offset numbers. We support the Patton

¹ The testimony filed by ISO-NE at the Federal Energy Regulatory Commission on August 31, 2004 shows a number of \$92 for "Rest of Pool." This needs to be adjusted upward for the summer DMNC and then downward to reflect the exclusion of costs for dual fuel capability and to reflect the costs savings of a 2 X 7FA plant versus the ISO-NE's single plant. The upward adjustment for summer DMNC is about 10 percent. The downward adjustment for the other two factors is also about 10 percent. These two adjustments approximately cancel each other out, yielding a \$92 summer DMNC value that can be compared to the Jamestown and midwest estimates.

approach as a reasonable one that produces valuable corroborating information. His choice of 20 hours of shortage hour revenues strikes the appropriate balance by acknowledging the energy revenues that flow from price spikes, while maintaining a conservative approach that intentionally understates the energy revenues a peaker can expect to receive in a tight market associated with an 18 percent reserve margin.

DPS Staff's approach, as described in our September 3, 2004 comments, uses the actual energy revenues that a 7FA peaker would have received over the years 2000 to 2003 as its starting point. While Dr. Patton has provided the parties with 2000 to 2003 energy revenue estimates that have been stripped of their shortage hour revenues, he has not provided revised values for the 2000 to 2003 numbers containing the shortage hour price revenues. As such, without these numbers, it is not possible to recalculate how the estimates under our approach should be adjusted.

We respectfully request that the NYISO consider the following two points when contemplating revisions of its energy and AS offsets. First, based on our conversations with General Electric representatives, it appears that with a proper amount of maintenance over time, consistent with standard engineering practice, heat rate degradation should be approximately 1 percent, on average, over the unit's life. This is less than

the 3 percent degradation value contained in the Levitan report and used in the Patton methodology to develop the 2000 to 2003 energy and AS offset numbers. We recommend that a 1 percent, rather than the 3 percent, heat degradation assumption be used by Dr. Patton in developing any estimates as a check on the reasonableness of the NYISO's proposal. Second, we believe that Dr. Patton's use of a 2-hour block over which to spread the start-up costs is a reasonable choice. The method, by necessity, must make simplifying assumptions, and no information has been presented that supports a showing that this 2-hour spread is unreasonable. We believe that this approach produces a very valuable measure of the actual net energy revenues. As we have maintained throughout this process, the preference should be to rely on estimates based on actual experience, rather than hypothesized experience, so long as they are used in a reasonable manner.

Finally, DPS Staff believes the NYISO should embrace a principle of ensuring that the overall results that it produces are reasonable. Although there are numerous components, taken together, the final number should reflect a proper balance. While there are ranges of reasonableness for the individual components, the NYISO should avoid choosing components that are all set at the same end of those ranges. Avoiding such a one-

sided approach is essential to producing an overall set of demand curves that are reasonable.

We look forward to discussing these comments and any other aspects of this process with the NYISO and market participants.