City of New York

September 15, 2004

Via E-mail and U.S. Mail

Mr. John Charlton
New York Independent System Operator
3890 Carmen Road
Schenectady, NY 12303

Re: Further Comments by New York City Re: Demand Curve Value Calculation

Dear John:

The City of New York hereby submits additional comments in response to the discussion concerning demand curve calculations had at the ICAP Working Group meeting on September 10.

In establishing its preliminary demand curve for Zone J, the NYISO proposed a net revenue offset of $50/kW-yr. At the last Working Group meeting, David Patton provided estimates of 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, which values included Patton's estimated scarcity adder of $10/kW-yr. For the following reasons, the NYISO should adopt an offset value that is approximately the mid-point of Patton's estimates, or $75/kW-yr.

1. 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, 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 experienced during the 2000-03 period. In making this adjustment, Patton first removed actual scarcity hours for the 2000-03 period, and then added in 20 scarcity hours priced at $600/MWh to reflect tight conditions. Second, Patton 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 per contiguous multi-hour block of run time.

2. It is reasonable to assume that investors will seek to build in the sub-pocket that provides the highest return on that investment. Since investment costs are unlikely to vary significantly between sub-pockets, the higher the net revenue, the higher the 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. Patton's concern that using the net revenue from a higher-value sub-pocket will 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 indicated by the reference price.

3. Although investors will seek to build in the highest-value sub-pocket, such entry will reduce congestion into these sub-pockets, and thus reduce the net-revenue differential between the 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. Specifically, the NYISO should adopt a net-revenue value of $75/kW-yr for Zone J, reflecting the approximate average of the 345 kV net revenue of $55/kW-yr and the Astoria East net revenue of $100/kW-yr.

Very truly yours,

/s/ Michael J. Delaney

Michael Delaney, Esq.
City of New York