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To: John Charleton, NYISO

From: Tim Foxen, NRG Energy, Inc.
Director of New York State Regulatory Affairs

Date: August 6, 2004

RE: NRG Comments on LAI Draft Demand Curve Report

This letter supplements those filed by IPPNY. NRG contributed to and supports the IPPNY comments on this subject but is emphasizing and elaborating on some additional items below.

1. NYISO should carefully evaluate demand curve slope to the right of the equilibrium point. L&A points out that the zone J slope is steep, reflecting potential sharp drop-off in price when capacity additions yield surpluses. Given economies of scale likely to be pursued by developers of combined cycle plants, where 500 MW projects are typical, capacity prices could be excessively "lumpy" in this zone. Excessively sharp price drop-offs might conflict with intended purpose of the demand curve to stabilize capacity prices.

2. Net energy revenues and peaker unit replacements over time – NRG believes that the substantial uncertainties associated with forecasting net energy revenues for a peaker lend itself to endless debate and are too uncertain for inclusion in the levelized cost calculations. NRG agrees with the IPPNY comments which provide specific reasons why net energy revenues are likely to be overstated.

The margins L&A incorporates with cases IIa and IIb represent "economic rent" equal to the difference between a generator's bid and the clearing price. Clearing price equates to the bid of the highest price unit selected for that hour. NRG believes clearing prices, adjusted for changes in fuel price, will be driven down due to replacement of old GTs with new more efficient ones. In addition, the number of hours for which GTs will set clearing price will diminish as combined cycle units are added to the generation mix. The L&A Figure 21 and Figure 22 shows net revenues on a $/kw/year increasing throughout the 20 year time life of the peaker. NRG believes it is more realistic that the spread between high cost and low cost units will be reduced as time goes on.

In addition, the L&A study assumes no mitigation needs to be modeled because bidders will bid at cost. NRG does not refute the assumption, but points out that as hours with economic rent are reduced, market participants would be more inclined to attempt to recover other costs in their energy bids, which would, in turn, trigger market monitoring review, offsetting the potential for any economic rent outside of production cost spreads. This is consistent with NYISO policy for only accommodating reference price levels based on variable costs.

3. So-called "Gap Solutions" in NYISO's approved Comprehensive Planning Process (CPP) will negate any capacity payments above the reference price equilibrium point. NYISO anticipates filing its CPP with FERC this year in the form of new sections to the Services Tariff. The process includes a provision for use of "gap solutions" when a reliability violation is identified and a solution is needed more quickly than can be accommodated through a market solution. The best recent examples of a reliability violation are locational requirements not being met for an upcoming summer capability period.

Up to now, without any formal planning process in place, anticipated locational shortfalls have been met through fast track gas turbine installations by NYPA and LIPA. The CPP will formalize fast track resolution of reliability violations. In either case – past experience with LIPA and NYPA or the gap solution provisions in the soon to be filed CPP – supply will not be allowed to shift to the left of the reference price point in New York City or Long Island. Therefore, an assumption that higher capacity prices in periods of shortage will offset the lower prices in periods of surplus will not hold. NRG agrees with IPPNY that long term revenues should assume that the capacity clearing price is shifted to the right of the reference price.

Please feel free to contact me if you have questions at 612-940-1867 (mobile).