STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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February 15, 2005

Honorable Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Room 1-A209
Washington, D.C. 20426

Re: Docket No. ER05-428-000 – New York Independent System Operator, Inc.

Dear Secretary Salas:

For filing, please find the Motion to File Answer and Answer of the New York State Public Service Commission in the above-entitled proceeding. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Attachment

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	) Docket No. ER05-428-000)

MOTION TO FILE ANSWER AND ANSWER OF THE NEW YORK STATE PUBLIC SERVICE COMMISSION

Pursuant to Rules 212 and 213 of the Federal Energy Regulatory Commission's (FERC or Commission) Rules of Practice and Procedure, the New York State Public Service Commission (NYPSC) hereby submits its Motion to File Answer and Answer in the above-captioned proceeding. Although Rule 213 does not permit answers to protests unless otherwise ordered by the Commission, the Commission has accepted pleadings for good cause, such as when the responsive pleading would assist in the Commission's analysis, provide useful and relevant information, or would otherwise facilitate a complete and accurate record upon which the Commission can base its decision.[1] Good cause exists to allow the NYPSC's Answer because it will contribute to the development of a complete and accurate record, provide

[1] See, e.g., East Tennessee Natural Gas Co., 81 FERC ¶61,219 at n.4 (1997); National Gas Pipeline Co. of America, 81 FERC ¶61,216 at n.3 (1997); Pacific Interstate Transmission Co., 81 FERC ¶61,369 at n.2 (1997); Florida Gas Transmission Co., 79 FERC ¶61,147 at n.7 (1997).

useful information, and assist the Commission's understanding and deliberations on this matter as described below.

INTRODUCTION

On January 7, 2005, the New York Independent System Operator, Inc. (NYISO) filed revised parameters (i.e., Demand Curves) for computing the payments to providers of installed capacity (ICAP) for the 12-month periods starting May 1, 2005, May 1, 2006 and May 1, 2007. The NYPSC submitted its Notice of Intervention and Comments in support of the NYISO's filing on January 28, 2005. On or around the same date, several parties filed protests to the NYISO's filing. We address several of these protests herein.

In particular, we respond to several parties' arguments to revisit the point at which the Demand Curve yields a price of $0 (i.e., the "zero-crossing point," which is currently set at 132% capacity on a state-wide basis). As explained below, a modification to the Demand Curve's zero-crossing point would alter market signals and likely compromise the very stability and predictability the Demand Curve is intended to provide. However, we recommend that NYISO institute the next phase of the process to address the zero-crossing point and all of the other Demand Curve issues associated with the May 1, 2008 revisitation. In addition, we respond to arguments that the Demand Curve updates will produce "seams." Contrary to these assertions, the Commission has already made a determination that the Demand Curve will not result in "seams." Finally, we address protests asking for a reduction in the energy and ancillary services revenue estimates for New York City (NYC). As explained below, such a reduction is not warranted given that the NYISO's approach reflected conservative estimates of such revenues. Accordingly, we ask the Commission to reject these claims and approve the Demand Curves, as filed by the NYISO.

DISCUSSION

I. Modifying The Zero Crossing Point Of The Demand Curve At This Time Will Likely Interfere With Its Benefits

In a protest filed on January 28, 2005, New York State Electric & Gas, Rochester Gas & Electric, Multiple Intervenors and the Municipal Electric Utilities Association of New York (collectively "Upstate Protestors") argue that "the NYISO has failed to provide any factual or analytical basis for the zero-crossing point that it has utilized."[2] Upstate Protestors also provide an analysis that purports to justify a reduction in the zero-crossing point from 112% to between 108% and 110% above the minimum capacity reserve requirement (currently set at 118% of

2 Upstate Protestors at 16.

peak load).[3] Similarly, the City of New York (NYC Protestor) argued in its January 28, 2005 comments that "[t]here was no reasonable basis upon which the NYISO concluded that there was no need to reexamine the zero-crossing point characteristic of the Demand Curve."[4]

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).

[3] The zero crossing point is currently defined as 112% of the minimum capacity reserve requirement. This is approximately 132% of forecasted summer peak load (i.e., 112% of the 118% minimum reserve requirement).

[4] NYC Protestor at 5.

The NYPSC 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 for 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.

More importantly, while the NYPSC agrees that a comprehensive review of alternative zero-crossing points is desirable in the future, we support maintaining the existing zero-crossing point for the three upcoming capability years. There is a substantial benefit to maintaining the zero-crossing point so that market participants can make rational predictions as to the amount of capacity that could be supported by the market in the next three years. Changes to the zero-crossing point during the middle of this three-year update period would alter market signals and likely compromise the very stability and predictability the Demand Curve is intended to provide.[5]

[5] Under the current 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.

Therefore, the NYPSC recommends that the existing zero-crossing points be maintained for the full three-year update period. However, we recommend that the NYISO be expected to begin the process with market participants to address modifications to the zero-crossing point, the peaking unit costs and revenue offset estimates, and all of the other issues associated with a Demand Curve revisitation. While the approach used by the NYISO resulted in a reasonable outcome for the period ending May 1, 2008, such a process, if started shortly, should produce Demand Curves that best reflect market conditions in the future.

II. Implementing Revised Demand Curves Will Not Produce New Seams

Upstate Protestors argue that the Commission should "delay any changes to the existing Demand Curve until greater information is available as to efforts currently underway in PJM and New England to ensure a regionalized approach and to avoid the introduction of new seams issues."[6] Contrary to these assertions, updating the NYISO Demand Curve will not cause any new seams issues.

The arguments raised by Upstate Protestors are not new. In fact, these same arguments were previously addressed and rejected by the Commission. During the initial proceeding that

[6] Upstate Protestors at 20.

resulted in approval of the NYISO's Demand Curve, several commenters raised issues regarding "[p]otential conflicts with ongoing multi-ISO capacity adequacy efforts," and that "the Demand Curve approach could create seams with existing ICAP markets in ISO-NE and PJM."[7] Despite these arguments, the Commission was "not convinced that the implementation of the ICAP Demand Curve will create seams with neighboring regions."[8] The Commission specifically found that "[t]he sale of ICAP into New York is a market response, is not an example of a seam, and is something that is made possible or is allowed by the tariffs in PJM and ISO-NE."[9]

The Upstate Protestors seem to be arguing that the reference price for capacity should be the same across regions. However, such price divergencies are normal and are, in fact, appropriate given the difference in the cost of building peaking units between different ISOs/RTOs. As the Commission previously stated, "[i]f the sale of ICAP into New York will cause a capacity deficiency in PJM or ISO-NE, [FERC] would encourage the

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[7] New York Independent System Operator, Inc., 103 FERC §61,201, Order Conditionally Accepting For Filing Tariff Revisions (issued May 20, 2003) (May 20 Order).

[8] Id.

[9] Id. We note that this seams argument was not raised in the pending court proceeding challenging the validity of the Demand Curve. See, Electricity Consumers Resource Council v. FERC, Docket No. 03-1449 (D.C. Cir.).

ISOs to explore and file proposed market solutions to retain capacity."[10] Accordingly, the Commission should reject Upstate Protestors arguments that revising the Demand Curve will likely introduce new seams.

III. <u>The NYISO's Estimates Of Energy And Ancillary Services Revenues Are Appropriate And Should Not Be Modified</u>

In a protest dated January 28, 2005, Keyspan-Ravenswood, LLC (Keyspan Protest) argues that the NYISO's proposed Demand Curves are "unjust and unreasonable,"[11] based on net energy and ancillary services revenues that are "optimistically high."[12]

First, Keyspan's argument, to the extent it appears to be claiming an entitlement to "just and reasonable" rates for ICAP, should be rejected. As the First Circuit Court of Appeals determined in <u>Sithe New England Holdings, LLC v. FERC</u>,[13] it is "fatally wrong [to] think that ICAP is any part of a supposed statutory entitlement." Moreover, the Court found that ICAP payments are "not part of the compensation to sellers required

[10] New York Independent System Operator, Inc., 103 FERC ¶61,201, Order Conditionally Accepting For Filing Tariff Revisions (issued May 20, 2003) (May 20 Order).

[11] Keyspan Protest at 2, 9.

[12] Keyspan Protest at 9.

[13] 308 F.3d 71, 77 (1st Cir. 2002).

by the statute."[14] Consequently, FERC should reject the argument that ICAP providers would not be properly compensated at a "just and reasonable" rate if the Demand Curve updates are approved.

Second, contrary to Keyspan's claim that the net revenue offsets for NYC are overstated,[15] the NYISO's estimates of energy and ancillary service revenues included several assumptions that resulted in a low estimate of such revenues. For example, the NYISO's consultant, LAI, did not reflect unanticipated real-time generator outages in its analysis. This modeling simplification reduced the amount of unforeseen real-time shortages, lowered the real-time energy price, and understated the number of hours that a peaking unit will typically run. Consequently, energy and ancillary services revenues were most probably understated.

Moreover, the offsets used by the NYISO are reasonable, as evidenced by the fact that they are even lower than Dr. Patton's lowest estimates of actual revenues. The actual NYC revenue offsets calculated by Dr. Patton show that they vary by NYC load pocket. The very lowest of them, which Dr. Patton used in his analysis, was related to the NYC 345 kV load pocket and had a

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[14] Id. The Court went on to indicate that "[i]f ICAP charges were abolished by FERC tomorrow, the sellers could object that FERC was behaving unreasonably in its 'on and off' regulatory policies but not that they were deprived of a just and reasonable rate." Id.

[15] Keyspan Protest at 18-20.

four year average of $55.70.[16] Yet, the other load pockets had higher estimates, including the large Astoria load pocket, which had a four year energy average of $99.80, and the Vernon/Greenwood load pocket, which was $61.38.[17] Clearly, Dr. Patton's analysis was being very conservative in supporting the NYISO's $50.00 revenue offset, in light of the much higher actuals that were available.

In addition, Keyspan takes issue with the assumed heat rates utilized in the LAI study. Keyspan recommends the use of a heat rate assumption of 10,400 Btu/kWh instead of LAI's 9,700 Btu/kWh heat rate. While Keyspan notes that the higher the heat rate, the lower the net energy revenue estimate, Keyspan fails to recognize that Dr. Patton's calculations (Attachment 5 of the NYISO filing) were based on a heat rate of 11,000 Btu/kWh in developing a $55.70 estimate for the 345kV NYC load pocket. Had Dr. Patton used the lower Keyspan recommended heat rate of

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[16] The net revenue offset of $55.70 was derived by taking the sum of $45.26 from the NYC energy market (345 kV system, non-price spike hours, 2000-2003 average), adding $0.44 from the 30-minute reserve market (2003), and including Dr. Patton's $10 estimate of price-spike hours (based on 20 shortage hours statewide).

[17] See, "Revised RT Net Revenue – 2000-2003 – David Patton – As Presented to WG on 9/14/04," posted at http://mdex.nyiso.com by following the links for "Committees," "Business Issues Committee," "Installed capacity Working Group," and then "Demand Curve Adjustment for 2005/2006, 2006/2007, and 2007/8 Capability Years." Dr. Patton also included a $10 scarcity adder to the figures reflected in these materials.

10,400 Btu/kWh, he would have obtained an estimate of energy net revenues even higher than $55.70. Thus, the NYISO's use of $50 for the NYC energy net revenues offset was not overstated.

Keyspan also attempts to calculate energy revenues for NYC based on our approach for upstate New York of reducing net energy and ancillary services revenues by 50% in order to be conservative (See NYPSC January 28, 2005 Comments at 5). However, Keyspan's decision to use the already low $55.70 estimate as the starting point, and to then reduce that amount by 50% is overly conservative. If a 50% reduction is to be applied in calculating NYC energy revenues, an appropriate starting point should recognize the much higher energy revenues available in NYC's other load pockets.

Lastly, in discussing the NYC actual energy net revenues, Keyspan criticizes the use of the year 2000, because it was one in which the NYC market was very tight (in fact, slightly deficient). Keyspan's calculations throw out year 2000 as unrepresentative. This approach fails to include the net energy revenues that a peaking unit might obtain from a tight market, and therefore, does not reasonably reflect the revenues such a unit would likely receive. In sum, Keyspan's attempts to pick only those estimates and methodologies most favorable to its position should be rejected.

CONCLUSION

For the above reasons, the Commission should reject the protests filed by the indicated parties and approve the ICAP Demand Curves filed by the NYISO.

Respectfully submitted,

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Dated: February 15, 2005
Albany, New York

CERTIFICATE OF SERVICE

I, Tammy Mentis, do hereby certify that I will serve on February 15, 2005 the foregoing Motion to File Answer and Answer of the Public Service Commission of the State of New York by depositing a copy thereof, first class postage prepaid, in the United States mail, properly addressed to each of the parties of record, indicated on the official service list compiled by the Secretary in this proceeding.

Date: February 15, 2005
Albany, New York

Tammy Mentis