

125 FERC ¶ 61,299
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

New York Independent System Operator, Inc.

Docket No. ER08-283-002

ORDER ON REHEARING

(Issued December 18, 2008)

1. In this order the Commission denies in part and grants in part the requests for rehearing of the Commission's January 29, 2008 order¹ submitted by KeySpan-Ravenswood, LLC (KeySpan) and by New York Transmission Owners (Transmission Owners).² The January 29, 2008 Order accepted the New York Independent System Operator's (NYISO's) revision to its tariff, which updated the Installed Capacity (ICAP) Demand Curves for the 2008/2009, 2009/2010, and 2010/2011 capability years.

I. Background

2. In 2003, the Commission accepted tariff sheets to NYISO's Market Administration and Control Area Service Tariff (Services Tariff) which established the ICAP Demand Curve.³ ICAP Demand Curves define the amount of ICAP that each load serving entity (LSE) has to obtain for the following month. They are intended to improve system and resource reliability by valuing the ICAP resources available above the system's required levels, and providing more effective economic signals for new investment. The ICAP Demand Curves are used in monthly ICAP spot market auctions.

¹ *New York Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,064 (2008) (January 29, 2008 Order).

² The New York Transmission Owners are: Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., Long Island Power Authority, New York Power Authority, New York State Electric & Gas Corporation, Orange and Rockland Utilities, Inc., and Rochester Gas and Electric Corporation.

³ *New York Indep. Sys. Operator, Inc.*, 103 FERC ¶ 61,201, *reh'g denied*, 105 FERC ¶ 61,108 (2003).

3. Section 5.14.1(b) of the Services Tariff⁴ requires NYISO to perform a triennial review to determine whether the parameters for the ICAP Demand Curve should be adjusted. NYISO completed its first triennial review and filed revised tariff sheets to implement ICAP Demand Curves for Capability Years 2005/2006, 2006/2007, and 2007/2008, which the Commission accepted with modifications.

4. In the instant proceeding, NYISO filed a revised tariff to update its ICAP Demand Curve following its second triennial review. NYISO's filing included detailed reports from its consultants and NYISO staff as well as testimony from NYISO's Independent Market Advisor. In the January 29, 2008 Order, the Commission found NYISO's proposed revisions to the ICAP Demand Curves to be just and reasonable, and that, while protestors recommended alternative assumptions, they did not show NYISO's assumptions to be unreasonable. The Commission stated that it must approve NYISO's proposals if supported as just and reasonable even if there are other just and reasonable proposals.

5. The Commission found that NYISO's proposal to use the LMS100 peaking unit for New York City and Long Island was reasonable. The Commission found that the LMS100 now represents the peak technology with the lowest fixed cost, replacing the LM6000, which was used for developing ICAP Demand Curves for the previous three years. The Commission rejected protestors' arguments that the LMS100 unit lacked sufficient cost and operating history. The Commission stated that, although a new technology, the LMS100 unit located in Groton, South Dakota has been operating without any recurring issues or major problems, with reliability trending up, and availabilities in the upper 80 percent range. The Commission found this to be an adequate track record and thus found the use of this technology in developing the capital costs of a peaking unit for New York City and Long Island to be reasonable and consistent with the Services Tariff.

6. Timely requests for rehearing of the January 29, 2008 Order were filed by KeySpan and Transmission Owners on February 28, 2008. On March 14, 2008, Transmission Owners filed an answer to KeySpan's request for rehearing. On March 19, 2008, KeySpan filed an answer to Transmission Owners' request to file an answer.

II. Discussion

A. Procedural Matters

7. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2008), prohibits an answer to a request for rehearing. Accordingly,

⁴ New York Independent System Operator, Inc., FERC Electric Tariff, Original Volume No. 2 (Services Tariff), Seventh Revised Sheet No. 157.

Transmission Owners' answer will be rejected and KeySpan's answer to Transmission Owners' request to file an answer will be dismissed.

B. KeySpan Request for Rehearing

8. KeySpan states that its request for rehearing is limited to the Commission's acceptance of NYISO's selection of the commercially unproven and not "economically viable" LMS100 peaking technology as the reference unit used in resetting the Demand Curve for the New York City (in-City) ICAP market. KeySpan asserts that the Commission erred in failing to apply the "economically viable" standard. KeySpan requests that the Commission order selection of the LM6000 as the reference peaking unit to be used in resetting the in-City Demand Curve. In the alternative, KeySpan requests that the Commission find that there are issues of material fact relating to the economic viability of the LMS100 technology for merchant development of a new peaking facility in New York City, and that it establish hearing procedures to resolve whether the LMS100 peaking technology is currently economically viable.

9. KeySpan states that the NYISO Services Tariff specifically requires a determination that the reference peaking technology not only have the lowest fixed costs and the highest variable costs among candidate technologies, but that the reference technology be "economically viable."⁵ KeySpan adds that NYISO's Demand Curve filing and the consultants' study underlying the filing failed to assess the economic viability of the LMS100 technology for merchant development in New York City or elsewhere. Consequently, according to KeySpan, the Commission did not make, nor did it have substantial evidence on which to make, an independent determination that the LMS100 technology is economically viable for merchant development in New York City.

10. KeySpan states that the relevant test of the economic viability of a candidate peaking technology must be whether the estimated levelized capital costs and the dependable operating performance of the candidate technology are established with sufficient certainty, presenting commercially manageable risks, such that merchant developers and institutional lenders would be willing to invest in development of a new peaking unit using that technology in New York City. KeySpan asserts that there is nothing in the record to indicate that the LMS100 units that the Commission references in the January 29, 2008 Order are being developed as *merchant* generating plants that will be exposed to competitive market risks. According to KeySpan, they are likely being developed pursuant to cost of service regulation or under some form of subsidized arrangement.

11. KeySpan further states that the Commission erred by not examining the pertinent market risks of commercial development of a LMS100 facility in New York City, and by

⁵ *Id.*

failing to address the extensive record of risk factors introduced by KeySpan and others that demonstrated that merchant developers and lenders would not be willing to risk their capital on development and operation of a new peaking unit using the LMS100 technology. KeySpan further states that neither the Commission nor NYISO contradicted the statement in the McCabe Affidavit that developers would not choose to develop a LMS100 peaking facility in New York City⁶ due to its highly uncertain capital costs, immature performance history, and an overall level of risk that makes it unfinanceable on competitive terms. According to KeySpan, all NYISO determined was the practicality of constructing the LMS100 peaking facility, not whether it is economically viable.

12. KeySpan asserts that the Commission further erred by relying on a thin track record without clearly articulating the standard by which the track record is adequate, and by ignoring the substantial evidence submitted by KeySpan, which, conclusively demonstrated that the LMS100 technology is not economically viable for merchant development in New York City. KeySpan states that the Groton, South Dakota facility is the single LMS100 facility in operation in the United States, it has only 584 hours of operation and 107 starts during a twelve-month period, and it is a non-merchant unit. KeySpan states that this does not provide a basis upon which merchant developers and lenders can meaningfully assess and manage the operating performance risks or economic viability of the LMS100 in the NYISO competitive market, particularly in comparison to the LM6000 which has over 200 units in operation and over 3.1 million operating hours. Moreover, according to KeySpan, there is no basis to assume that the next few LMS100 units installed will not face more serious performance difficulties impairing availability and efficiency than this single LMS100 has faced during its limited hours of operation.

13. In addition, according to KeySpan, the Commission failed to consider the reasons given in the McCabe Affidavit as to why the track record of LMS100 components in aircraft and industrial applications is inapplicable here. KeySpan points to Mr. McCabe's explanation that while the LMS100's engine has a performance track record in aircraft, and its compressor has been used in industrial applications, the LMS100's performance as an electric generating facility will depend upon the combination and integration of three major components – aeroderivative engine, industrial compressor, and an intercooler – in an entirely new application.⁷ KeySpan states that historical engineering experience proves that performance of a new application that integrates existing technology components will not usually follow the historic performance of the components in uncombined applications. Consequently, according to KeySpan, merchant developers, lenders, and insurers would not be able to predict New York City operating

⁶ KeySpan December 31, 2007 Protest, Attachment A, at P 7.

⁷ *Citing id.* P 12.

performance and economics based on the South Dakota experience and, therefore, the commercial marketplace in New York City would attach a substantial risk premium to the operating performance record.

14. KeySpan also contends that operation by a load-serving cooperative in rural South Dakota is not comparable to operation in an ISO market dependent on competitive market clearing prices for revenues and thus the brief performance history should have little relevance. KeySpan lists three reasons why the LMS100's operating performance in New York City would differ from that in South Dakota: (1) stringent New York City environmental requirements require generating facilities to operate with selective catalytic reduction (SCR) technology to control nitrogen oxide (NOx) emissions while South Dakota has no similar environmental requirements necessitating SCR and also uses a simpler water injection technology to control NOx emissions, thus the integration of an SCR with an LMS100 in New York City increases the forced outage rate and generally reduces that generator's availability rating; (2) while, the South Dakota LMS100 has nominal dual fuel capability, the facility has not run on fuel oil, and does not have a tank for fuel oil, but New York has been requiring peaking units to switch from natural gas to oil on short notice, with a resultant increased need for maintenance and repair; (3) the South Dakota LMS100 uses a much simpler cooling system than the more complex system which would be used in New York City. KeySpan argues that the Commission's January 29, 2008 Order does not consider the differences in performance capabilities of the LMS100 technology in New York City compared to South Dakota, and that, based on all of these locational differences, the South Dakota LMS100 prototype's historical performance is not substantial evidence of the operational performance risks expected to be faced by merchant developers of a LMS100 unit in New York City.

15. KeySpan states that the January 29, 2008 Order also seems to rely on the fact that certain LMS100 units have been sold in California and Canada, although the Commission does not articulate why this is substantial evidence of the "economic viability" of the LMS100 for merchant development in New York City, and no evidence in the record suggests that the other proposed LMS100 units will be developed as merchant facilities or will even be exposed to competitive market risks. Thus, according to KeySpan, the fact that as many as 11 LMS100 units may have been sold, but are not clearly being developed as merchant units, cannot be substantial evidence that the technology is economically viable for merchant development in New York City. KeySpan also states that the NYISO filing identified five LMS100 projects in the NYISO interconnection queue, but NRG has now withdrawn those projects indicating that they are no longer economically viable because, "no rational investor and certainly not NRG would invest in this market on a merchant basis based upon the proposed market design."⁸ KeySpan

⁸ *Citing* Affidavit of W. Lee Davis, NRG Companies November 19, 2007 Protest, Docket No. EL07-39-000 at P 23.

reiterates its Protest filed in the initial stage of the proceeding stating that NRG's development costs are equal to or greater than the current Cost of New Entry (CONE), yet NYISO's proposed CONE for the 2008/2009 Demand Curve is 21 percent less than the current CONE. Thus, KeySpan concludes that the only record evidence before the Commission regarding potential merchant development of LMS100 projects in New York City is that the technology is not economically viable in New York City and the Commission omitted consideration of this record evidence.

16. KeySpan asserts that the LMS100's actual track record of a 12 percent forced outage rate is conclusive evidence that the LMS100 technology is not economically viable technology in New York City. KeySpan states that, by comparison, the LM6000 has an engine availability of 96.8 percent and engine reliability of 98.8 percent.⁹ KeySpan asserts that it is critical that merchant peaking facilities remain available during high stress and peak pricing periods to realize revenues through the energy and ancillary services markets. According to KeySpan, it is similarly essential that merchant generation have high availability ratings to maximize revenues in the in-City capacity market, upon which peaking facilities would be dependent for financing. KeySpan adds that Mr. McCabe and common sense suggest that the LMS100's poor availability rates would conclusively render such technology nonviable economically.

17. KeySpan also states that the cost estimations of the LMS100, relied upon by NYISO, are flawed and unreliable, and thus, do not provide substantial evidence of economic viability of the LMS100. KeySpan asserts that NYISO consultants relied only on price quotations from a single manufacturer, and price quotes for new technology are unreliable since manufacturers typically offer a discount to gain entrance to the market. Further, according to KeySpan, the NYISO consultants' study underestimated recent increases in equipment, materials, and labor costs for development in New York City, it inappropriately applied the same 12 percent rate of return to the risky LMS100 that it used for the well-established LM6000, and it contains equivocations in the cost conclusions that introduce even more uncertainty. KeySpan states that when the consultants compared the costs of the LMS100 to the LM6000, they emphasized the significant uncertainty surrounding the LMS100 costs.¹⁰ Moreover, according to KeySpan, they provided more updated cost data in October 2007 that showed an additional 6.35 percent increase in total installed costs for the LMS100 over the costs

⁹ Citing NERA Economic Consulting, *Independent Study to Establish Parameters of the ICAP Demand Curve for the New York Independent System Operator* at 25 (Aug 15, 2007), available at: http://www.nyiso.com/public/webdocs/committees/bic_icapwg/meeting_materials/2007-08-24/ICAPWG_Demand_Curve_Study_Report_final_82407.pdf (NERA Study).

¹⁰ Citing NERA Study at Executive Summary P 4.

reflected in their study. Keyspan states that the consultants further elaborated that the LMS100 costs in the study reflect a 7 percent increase from February 2007 through May 2007. Keyspan argues that these accelerating rates of increase in capital costs for construction of a new LMS100 create further uncertainties that imperil the economic viability of the LMS100 technology.

18. Keyspan states that, in sum, these factors present merchant developers and lenders seeking to invest in merchant generation in New York City with substantial risks, which the January 29, 2008 Order failed to address and which contribute to the record evidence that investment in LMS100 technology in New York City is not economically viable. Accordingly, Keyspan requests that the Commission grant rehearing and order selection of the LM6000 as the reference peaking unit to be used in resetting the in-City Demand Curve.

Commission Determination

19. On rehearing, Keyspan argues that the Commission failed to apply the “economically viable” standard when it relied on a “thin” and inapplicable track record, did not clearly articulate the standard by which this track record is adequate, and ignored substantial evidence submitted by Keyspan demonstrating the absence of economic viability for merchant development in New York City. We disagree. NYISO’s Services Tariff states that “[f]or purposes of [the review of the ICAP Demand Curves], a peaking unit is defined as the unit with technology that results in the lowest fixed costs and highest variable costs among all other units’ technology that are economically viable.”¹¹ Keyspan’s objection focuses on the question of economic viability. Keyspan interprets the tariff provision to require “an independent determination that the LMS100 technology is economically viable for merchant development in New York City.”¹²

20. The NYISO tariff does not specify a definition of “economic viability,” nor does it specify a definition of “independent determination.” Economic viability is a matter of judgment. We believe NYISO’s selection of the LMS100 peaking unit is based on sound analysis. The NYISO consultants’ study eliminated from consideration any unit that could not be practically constructed in a particular location, and considered only reasonably large-scale generating facilities that are standard and replicable. The study examined four types of units which between them represent two technology options, large-scale combustion turbines (Frame 7EA and Frame 7FA) and aeroderivatives (the LM6000 and the LMS100). The Frame 7EA and Frame 7FA were not practical choices for New York City and Long Island for environmental reasons, which left a choice between the LM6000 and the LMS100. The NYISO consultants’ study concluded that

¹¹ Services Tariff, Seventh Revised Sheet No. 157.

¹² Keyspan February 28, 2008 Filing at 3.

the LMS100 has higher simple-cycle efficiency than current aeroderivative machines; fast starts; and high availability and reliability.¹³ The LMS100 has lower capital and operating costs on a per KW basis than the LM6000 and a better heat rate that results in a higher capacity factor and energy revenues on a per kW basis.¹⁴

21. KeySpan argues that NYISO's cost estimates are unreliable, and thus do not provide substantial evidence of the economic viability of the LMS100. KeySpan points to the 6.35 percent increase provided in the updated cost data provided by the consultants in 2007. However, the NYISO consultants state that the LMS100's margin of efficiency over the LM6000, due to its lower heat rate, is such that even a higher price for equipment would not unduly suppress demand.¹⁵

22. KeySpan argues that the LMS100 has a thin track record and that it lacks a basis on which lenders and merchant developers can assess the operating performance risks. We disagree. The LMS100 is a relatively new technology with little operating history but its components are based on the 6FA and LM6000. In addition the CF6 gas turbine has over 100 million hours of operating experience in both aircraft engines and industrial applications. While it is accurate that this combination of the technology is new and may not follow the historic performance of the components in uncombined applications, we disagree with KeySpan's statement that this track record is inapplicable. The reliability of the components provides confidence in the combined application. This level of confidence is increased by the fact that the LMS100 has been operating without any recurring issues or major problems, with reliability trending up and availabilities in the upper 80 percent range. Further, according to the consultants' study, uncertainties in the LMS100 cost and performance estimates are no different from those of the LM6000 since major components of the LMS100 technology are based on the 6FA and LM6000 designs. KeySpan also argues that the availability rate is higher for the LM6000 than for the LMS100. However, what is relevant ultimately for purposes of selecting the appropriate peaking technology underlying the Demand Curve are the comparative costs per kW of available capacity. The comparatively higher LM6000 availability rate is

¹³ *Id.*

¹⁴ *Id.* at 5–6.

¹⁵ *See* NYISO November 30, 2007 Filing, Exhibit B at 26.

offset by its comparatively higher costs per kW of installed capacity. Keyspan has not demonstrated that the expected cost per kW of available capacity is likely to be lower for the LM6000.¹⁶

23. Keyspan also argues that there is no basis to assume that the next few LMS100 units installed will not face more serious performance difficulties. However, Keyspan offers no evidence that new technology, in general, faces increasing outage rates and we agree with NYISO that, contrary to Keyspan's assertion, outage rates generally improve with experience, as indicated by the trends in the operating data for the LMS100.

24. We also disagree with Keyspan's contention that the experience with the LMS100 in Groton, South Dakota is inapplicable to a merchant facility in New York City. Keyspan points to the SCR and the dual fuel system.¹⁷ The LMS100 was selected in part because it uses the SCR technology, and thus meets New York City's environmental requirements. Keyspan argues that in South Dakota, in contrast to New York, the LMS100 unit might be operated even if its emissions controls were out of service for maintenance or repair. Thus, according to Keyspan, integration of an SCR with an LMS100 in New York City could increase the forced outage risk and reduce the generator's availability as compared with the same technology used in South Dakota. We believe that such an argument is unduly speculative and, in any event, a precise calculation of the effect on the forced outage risk is beyond the level of precision appropriate in the model. We agree with the NYISO consultants that

there are numerous small effects which are unmodelled and which, by the law of large numbers, should roughly cancel one another out. Excessive focus on particular small issues raise the possibility of an unbalanced look at the problem in which the noise generating [sic] by the estimation process exceeds the signal generated. Consequently, the generation of net revenue estimates, while scientific, nonetheless calls for a good deal of judgment, as does almost any hypothetical modeling exercise.¹⁸

¹⁶ The NERA study notes an availability for the LM6000 of 96.8 percent compared to an LMS100 availability in the upper 80 percent range, for a differential of about 10 percent. By contrast, the NERA study lower bound of the estimated total cost for the LM6000 (\$920/kW) is 7 percent higher than the comparable figure (\$860/kW) for the LMS100, and the upper bound cost for the LM6000 (\$1360/kW) is 15 percent higher than the comparable figure (\$1190/kW) for the LMS100.

¹⁷ Keyspan also asserts that the cooling system in the South Dakota LMS100 may be simpler than that which would be used in New York City. Keyspan's claim is unsupported and amounts to speculation.

¹⁸ NYISO November 30, 2007 Filing, Exhibit B at 48.

25. The LMS100 also meets New York City's requirement for dual fuel capability that will enable it to move between natural gas and fuel oil. KeySpan's observation that this capability has not been called into service in South Dakota and that the South Dakota facility does not have a tank for fuel oil does not refute the fact that the capability exists, and that NYISO's cost calculation for the LMS100 included dual fuel capability for New York City. Thus we believe that the NYISO consultants' model accounted for the differences between the two markets that could affect the operating performance of the LMS100.

26. Finally, KeySpan's contention that no evidence in the record suggests that the other proposed LMS100 units will be developed as merchant facilities is incorrect. The NYISO consultants' report notes that in May 2007 GE reported that at least 13 other units had been sold and five units are in the NYISO queue. While NYISO does not specifically name these 13 facilities or clarify whether any of these are merchant facilities, it does specify the 500 MW Astoria Repowering Project, which is a merchant project, as being one of five LMS100 units in the NYISO Queue at the time of the study.

27. Both the consultants and the NYISO Independent Market Advisor agree that there is enough certainty surrounding this type of unit for purposes of setting the ICAP Demand Curve reference values in New York City and Long Island. The Independent Market Advisor adds that the higher fixed costs of the LM6000 produce sharp increases in the New York City and Long Island Demand Curve reference values (which would increase the height of the Demand Curve) that are unlikely to accurately represent the costs for efficient new entry in light of the new, more efficient technology represented by the LMS100.

28. Accordingly, we find that NYISO's selection of the LMS100 is a reasonable choice and that KeySpan has failed to show that it is unreasonable. Thus, we deny KeySpan's request for rehearing.

C. Transmission Owners Request for Rehearing

29. Transmission Owners argue that there is no record basis to support the Commission's conclusion that NYISO's procedures for forecasted increases in the CONE are reasonable, and that newly available information demonstrates that NYISO's proposed escalation factors are inaccurate and unreasonable. Transmission Owners disagree with NYISO's proposal to escalate the CONEs for the 2009/2010 and 2010/2011 years by the 5.1 percent increase reflected in the Handy-Whitman Index plus the forecasted inflation rate of 2.7 percent, for a total increase of 7.8 percent per year.

30. Transmission Owners argue that the average increase in the Handy-Whitman Index reflects past increases that may have resulted from temporary circumstances and that there has been no evidence, supplied by NYISO or any other party, that those temporary circumstances are still present. Thus, according to Transmission Owners,

there is no valid basis in the record for assuming that costs would continue to increase at the rate observed from 2004 to 2006 plus inflation; in fact, there is no basis for any other escalation factor in addition to general inflation. Transmission Owners state that newly available information demonstrates that electric generation cost escalation is likely to be less than half of the NYISO proposed escalation rate of 7.8 percent per year.

Transmission Owners submit a January 13, 2008 report issued by Citi Investment Research that forecasts an 11 – 12 percent escalation rate for simple cycle gas turbine generating plant costs over the next three years, or about 3.4 percent per year.

31. Transmission Owners state that the Commission also erred in concluding that NYISO's ICAP Demand Curves are consistent with section 5.14.1(b)(ii) of the Services Tariff. They state that this provision only allows NYISO to assume a slight excess of capacity when estimating *energy and ancillary services* revenues, not revenues for *capacity* markets. They argue that excess capacity requirements will dampen earnings.

32. Additionally, Transmission Owners contend that 1.5 percent and 4 percent capacity surpluses were assumed for purposes of computing the levelized annual embedded cost of a new entrant, not the energy and ancillary services profits that will be earned in the next three years. Transmission Owners assert that section 5.14.1(b)(i) of the NYISO Services Tariff requires NYISO to assume that there is no capacity surplus when developing the levelized annual cost of a new gas turbine installation.

Transmission Owners state that the Commission found that NYISO's estimate of energy and ancillary services profits was reasonable because the energy and ancillary services revenues based on a 30-year average is more representative than a three year average. According to Transmission Owners, the Commission mischaracterizes their protest in that they did not object to using a 30-year average of energy and ancillary services market revenues, but rather objected to NYISO's attempt to amortize recovery of thirty years of projected market losses over the three year reset period as part of the annual carrying charge. Thus, Transmission Owners contend, the January 29, 2008 Order does not address the correct issue and they request that the Commission grant rehearing.

Commission Determination

33. The Commission in the January 29, 2008 Order rejected Transmission Owners' arguments that the escalation factor was excessive because it was based on recent short-term increases in the cost of power plant construction instead of data representing a longer historical period. The Commission noted in the January 29, 2008 Order that the choice of an escalation factor is essentially a judgment informed by analysis of cost and inflation trends, and it accepted as reasonable NYISO's use of the sum of the estimated percentage change in the Handy-Whitman Index for power-plant construction and an overall measure of inflation. The Commission also concluded that NYISO's use of recent data in calculating the average change in the Handy-Whitman Index was reasonable in light of fundamental changes in equipment and raw material costs over the last few years.

34. The Commission may reject evidence proffered for the first time on rehearing.¹⁹ This is because other parties are not permitted to respond to a request for rehearing.²⁰ Further, “such behavior is disruptive to the administrative process because it has the effect of moving the target for parties seeking a final administrative decision.”²¹ Accordingly, we will reject the Citi Investment Research report submitted by Transmission Owners.

35. NYISO’s choice of a 7.8 percent escalator is based upon Handy-Whitman Index national data that accounts for all elements of engineering, procurement, and construction costs. Since the Handy-Whitman Index provides changes in real terms, NYISO adjusted for the overall inflation rate of 2.7 percent. The NYISO data source is specifically tailored to the industry, is widely used by the industry and thus is an appropriate data source for NYISO’s purposes. Further, NYISO evaluated other escalation scenarios using both nonlinear modeling and Northeast region-specific data. These evaluations all resulted in a higher figure than the 7.8 percent that NYISO used. Accordingly the Commission finds the choice of a 7.8 percent escalator to be reasonable.

36. As noted above, Transmission Owners contend that the Commission’s January 29 Order mischaracterized their protest regarding NYISO’s assumed capacity surpluses. Transmission Owners argue that NYISO calculated the levelized annual embedded cost of a new entrant under the assumption of a capacity surplus, contrary to the provisions of its tariff, and that NYISO unreasonably amortized recovery of thirty years of projected capacity market losses that would result from the capacity surplus entirely over the three-year reset period for which the demand curves are being established in this proceeding.

37. We do not agree with Transmission Owners’ general contention that NYISO’s Services Tariff prohibits considering the likelihood of capacity surpluses and the resulting reduction in capacity market revenues in its methodology for determining the ICAP Demand Curves. The Services Tariff includes factors to be considered in determining the parameters of the ICAP Demand Curves during the periodic review; it does not limit the use of other factors. Section 5.14.1(b) states, in part:

A periodic review of the ICAP Demand Curves shall be performed every three (3) years ... to determine the parameters of the ICAP Demand Curves for the next three Capability Years. The periodic review shall assess:

¹⁹ *Entergy Nuclear Operations, Inc. v. Consolidated Edison Co. of New York, Inc.*, 112 FERC ¶ 61,117, at P 39 (2005) (*Entergy*).

²⁰ 18 C.F.R. § 385.713(d) (2008).

²¹ *Entergy*, 112 FERC ¶ 61,117 at P 39 (citing e.g., *Cities and Villages of Albany and Hanover, Illinois*, 61 FERC ¶ 61,362, at 62,451 (1992)).

(i) the current localized levelized embedded cost of a peaking unit in each NYCA Locality and the Rest of State to meet minimum capacity requirements; (ii) the likely projected annual Energy and Ancillary Services revenues of the peaking unit over the period covered by the adjusted ICAP Demand Curves, net of the costs of producing such Energy and Ancillary Services, under conditions in which the available capacity would equal or slightly exceed the minimum Installed Capacity requirement;... and (iv) the appropriate translation of the annual net revenue requirement of the peaking unit determined from the factors specified above, into monthly values that take into account seasonal differences in the amount of capacity available in the ICAP Spot Market Auctions.

38. NYISO's proposed parameters for the Demand Curve take into account the likelihood that the level of capacity in either a Locality or in the NYCA would not be allowed to fall below the minimum requirement, and thus that the average level of capacity over time will be above the minimum requirement. Because of the likely surplus of capacity over time, the average price received in the capacity market will likely be below the price established on the Demand Curve at the minimum requirement. If the capacity price at the minimum requirement were established at the level that just recovers a new entrant's costs based on amortizing the entrant's costs over its full useful life (and after adjusting for energy and ancillary service revenues), the entrant would not expect to recover its costs over time. We agree with NYISO that such a result would not be reasonable, and that it would fail to provide sufficient revenue to attract entry when capacity is needed. We agree with NYISO that it is reasonable to establish Demand Curve parameters that produce revenues over time that allow a new entrant a reasonable opportunity to recover its costs in light of the likely capacity conditions.

39. It would be reasonable to establish Demand Curve parameters that raise the height of the Demand Curves to account for the effects over time of surplus capacity on capacity revenues. Such a method would establish a capacity price on the Demand Curve at the minimum capacity requirement that reflects a levelized portion of the revenue deficiency that would otherwise occur due to expected capacity surpluses over time. The result would be a capacity price that is slightly higher than the price that would be calculated if such revenue deficiencies are not accounted for.

40. However, as noted in Transmission Owners' rehearing request, NYISO's proposal would recover the full amount – and not merely a levelized portion – of the expected future revenue deficiencies over the three-year reset period covered in the instant docket. This feature of NYISO's proposal is not reasonable, because it overstates the levelized price that a new entrant would need to obtain, given the expected level of surplus capacity over the useful life, in order to recover its net cost of entry. Therefore, we direct NYISO to recalculate its Demand Curve parameters so that they reflect a levelized portion of the revenue deficiency that would otherwise occur due to expected capacity

surpluses over time.²² We direct NYISO to file to change the Demand Curve parameters within 30 days. The resulting changes in the Demand Curves shall be prospective from the date of acceptance of the compliance filing. We conclude that it would not be reasonable to require a change in the Demand Curves for auctions that have already been completed. That is because such a change would have an adverse effect on market certainty and the expectations of market participants, resulting in increased risks and costs for suppliers, and higher prices in future auctions.

41. Accordingly, Transmission Owners' request for rehearing is denied, in part, and granted, in part.

The Commission orders:

(A) The requests for rehearing are hereby denied, in part, and granted, in part, as discussed in the body of this order.

(B) NYISO is hereby directed to make a compliance filing within 30 days of the date of this order to recalculate its Demand Curve parameters, as more fully discussed in the body of the order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

²² We note that our action in another order issued today in Docket No. EL09-4-000 denying a complaint that argued the subject demand curves should be adjusted following the elimination of a New York City tax exemption for utilities is distinguishable from the instant case in that the instant case concerns a correction of the underlying ICAP Demand Curve methodology while Docket No. EL09-4-000 concerns a request to correct for a change in the value of an input to the methodology. *Indep. Power Producers of New York, Inc., et al. v. New York Indep. Sys. Operator, Inc.*, 125 FERC ¶ 61,311 (2008).