Attachment II

NYISO Board of Directors' Decision
On
Appeal of the Management Committee's July 27, 2011, Decision to Approve a Modified Rate Schedule 1 Cost Recovery Allocation

September 28, 2011

Introduction

The Independent Power Producers of New York, Inc. ("IPPNY") filed an appeal of the Management Committee's ("MC") actions on July 27, 2011, recommending that the New York Independent System Operator ("NYISO") Board of Directors ("Board") file revisions to Rate Schedule 1 of the NYISO Open Access Transmission Tariff ("OATT") pursuant to Section 205 of the Federal Power Act ("FPA"). The proposed tariff amendments would modify the current ratio for allocating the NYISO's annual operating costs between market participants that physically withdraw energy ("Loads") and market participants that physically supply energy ("Suppliers"). Specifically, the amendments would replace the current allocation ratio by which Loads pay 80% and Suppliers pay 20% of the NYISO's annual operating costs with a new ratio by which Loads pay 72% and Suppliers pay 28%. Three motions in opposition to IPPNY's appeal were submitted.[1] The Board heard oral arguments on this matter on September 21, 2011.

For the reasons set forth below, the Board denies IPPNY's appeal and directs NYISO management to file the tariff revisions recommended by the MC with the Federal Energy Regulatory Commission ("FERC") pursuant to Section 205 of the FPA.

Background

NYISO stakeholders have developed a specific process set forth in Rate Schedule 1 of the OATT for reviewing and modifying the allocation of the NYISO's annual operating costs among market participants. Pursuant to this process, NYISO stakeholders approved a motion in July 2010 requesting that the NYISO conduct a new study of the NYISO's annual operating costs and how these costs should be allocated among market participants. After issuing an RFP and considering several candidates with utility cost-of-service expertise, the NYISO retained Black & Veatch ("B&V") to perform the study ("Study").

Stakeholders in the MC's Budget & Priorities Working Group ("BPWG") thoroughly reviewed and vetted the scope, parameters, and results of the B&V Study. Between January and June 2011, B&V met with the BPWG to discuss study parameters and results. Based on communications with representatives of other RTO/ISOs and a review of their tariffs and regulatory filings, B&V provided market participants with a

[1] Motions in opposition were filed (i) by the New York State Department of Public Service Staff; (ii) jointly by Multiple Intervenors and the City of New York; and (iii) jointly by Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation d/b/a National Grid, Orange and Rockland Utilities, Inc., Rochester Gas and Electric Corporation, the Long Island Power Authority, and the New York Power Authority.

summary of the respective RTO/ISOs' rate recovery mechanisms and methodologies. B&V then (i) created a survey for market participants to identify priorities, (ii) conducted mini-sector meetings to get additional feedback and identify concerns, (iii) reviewed NYISO cost data for 2007-2010 historical periods as well as the 2011 budget year, and (iv) conducted interviews with members of NYISO management regarding NYISO's various services and cost centers. The B&V Study recommended a change in the cost allocation from an 80/20 split between Loads and Suppliers to a 72/28 split.[2] In July 2011, the MC considered, and a majority of its members (67.03%) affirmatively voted to approve, a proposal by NYISO management to implement B&V's recommendations and modify the allocation of the NYISO's annual operating costs to adopt the 72/28 split.

On August 10, 2011, IPPNY appealed the MC's actions approving the revised cost allocation. IPPNY argues that the B&V Study contains significant deficiencies that have not been addressed and that the new cost allocation resulting from this Study will have significant adverse impacts on Suppliers. IPPNY alleges that the proposed allocation would harm Suppliers selling under long-term bilateral contracts because those Suppliers cannot increase their offer prices to account for the additional costs in the way that Suppliers selling into the spot markets can. In addition, IPPNY argues that the revised cost allocation increases the costs assigned to Suppliers participating in the NYISO markets beyond the percentages assigned to Suppliers that participate in adjoining RTO/ISOs. Finally, IPPNY asserts that the increased allocation of the NYISO's annual operating costs would cause Suppliers in New York to increase their offer prices, thereby skewing the evaluation of imports from adjoining regions by artificially making them appear economic. IPPNY requests that the Board remand the matter to the BPWG for further review. Alternatively, IPPNY requests a three-year phase in period, with a supplemental study to be conducted during that time.

On August 16 and 17, 2011, three parties filed motions in opposition to IPPNY's appeal. The opposing parties argue that the appeal should be denied because the new cost allocation is reasonable and supported by the analysis and data in the new, independent B&V Study. They assert that the deficiencies IPPNY alleges in the B&V Study are not deficiencies, but rather conclusions with which IPPNY disagrees. The opposing parties also argue that the new cost allocation is reasonable as it falls within the range of allocations used by other RTO/ISOs. Finally, the opposing parties argue that the impact on Suppliers will be minimal and fair given the extent of the NYISO's activities that are focused on Supplier-related matters.

[2] The NYISO's current rate design for the recovery of its annual operating costs allocates 80% of the costs to Loads that physically withdraw energy and 20% of the costs to Suppliers that physically supply energy. The NYISO also recovers a small percentage of its annual operating costs from market participants that participate in non-physical market activity. To accomplish this, the NYISO recovers a tariff-specified amount from market participants that participate in non-physical market activity (Virtual Transactions and Transmission Congestion Contracts), the Special Case Resource program, and the Emergency Demand Response program. The NYISO then rebates the amount collected above 100% of the NYISO's annual operating costs to Loads and Suppliers using the same 80/20 ratio. The cost allocation percentages stated in this decision describe the percentages for allocating the NYISO's annual operating costs to Loads and Suppliers, and the percentage for allocating the rebate to Loads and Suppliers.

BOARD DECISION

We deny IPPNY's appeal. Absent a compelling showing that the revised cost allocation is improper or unreasonable, we are reluctant to overturn the MC's decision.[3] The MC's proposal is consistent with a specific tariff-based process established by NYISO stakeholders to review and, if warranted, modify, NYISO's Rate Schedule 1 allocation. For the reasons set forth below, we conclude that IPPNY has not adequately supported its assertions that the B&V Study was flawed or that the resulting 72/28 cost allocation is improper.

IPPNY argues that the B&V Study is flawed because it does not provide adequate justification for certain findings in its study that are different from findings in a previous study of the NYISO's operating costs and cost allocation conducted in 2004 by R.J. Rudden & Associates ("Rudden"). However, B&V was commissioned to conduct a new and independent cost allocation study of the NYISO's annual operating costs; its charge was not to consider or update the results of the Rudden study. All Stakeholders had ample opportunity to review and provide input on the scope and parameters of the B&V Study, which was a more rigorous examination of NYISO costs than the Rudden Study performed seven years ago.[4] B&V's analysis necessarily involved a degree of professional judgment which we believe B&V exercised rationally and equitably. The MC properly based its proposed cost allocation upon B&V's new, independent determination.

Similarly, IPPNY argues that there have been no "material" changes to the NYISO market design since 2004 that would justify revising the current cost allocation. In determining this appeal, however, we need not reach the issue of whether material changes have occurred. The NYISO tariffs do not require that there be a material change to the NYISO market design to support a change in the cost allocation. While Rate Schedule 1 previously required that there be a finding of a material change in the NYISO markets prior to studying a revised cost allocation, NYISO stakeholders amended Rate Schedule 1 in 2009 to establish the current process in which the tariff simply calls for a revision to the allocation of costs if "warranted by the results of the study." In accordance with the tariff, NYISO Staff determined, and a majority of the MC agreed, that a revised cost allocation was warranted by the results of the B&V Study.

IPPNY asserts that the proposed allocation would adversely impact Suppliers selling under long-term bilateral contracts, because these Suppliers may not be able to recover the additional costs under the terms of their agreements. In contrast, Suppliers selling into the markets can increase their offer prices by the amount of the revised allocation. It is important to put this increased cost into perspective. Based on NYISO's $150 million budget for 2010, the proposed cost allocation would allocate an additional $12 million of the NYISO's annual budget among all Suppliers, with a commensurate decrease to Loads. This translates into less than two/tenths of one percent of the NYISO's

[3] During oral argument both sides stated their view that the NYISO governance process, including the Board's role reviewing the MC's actions, is working.
[4] The prior allocation of 80/20 was the result of a negotiated consensus among market participants following the review of the Rudden Study.

2010 total market volume of $7 billion. Furthermore, we note that IPPNY, along with all market participants, has been on notice since 2004 that the NYISO would from time to time study and potentially adjust the allocation of its annual operating costs. It appears to us that all parties have had ample opportunity to plan for a reallocation of Rate Schedule 1 and attempt to account for potential rate increases in their commercial arrangements. Indeed, Appellants acknowledged during oral argument that the increased cost to suppliers with bilateral agreements was not significant.

IPPNY also argues that the revised cost allocation increases the share borne by Suppliers participating in the NYISO markets beyond the percentages applied to Suppliers in adjoining RTO/ISOs. A review of other RTOs' and ISOs' tariff provisions reveals that the proposed 72/28 split is well within the range of cost allocations used in other regions. While this amount is somewhat higher than the range used by certain RTO/ISOs, it is lower than the 33% borne by Suppliers under CAISO's recently revised cost allocation. Moreover, it is difficult to reconcile IPPNY's argument with its own proposal at the July MC meeting to adopt the 72/28 allocation after a three year phase-in period.

IPPNY also objects to funding a portion of the NYISO's FERC annual fees, noting that certain RTO/ISOs allocate FERC annual fees 100% to Loads. However, IPPNY fails to offer any substantive justification for its position that these costs should be allocated solely to Loads in New York or to explain why it is only now raising this issue after almost a decade of sharing these costs.

Finally, IPPNY asserts that an increased allocation of the NYISO's annual budget would cause Suppliers to increase their offer prices, thereby skewing the evaluation of imports from adjoining regions by artificially making them appear economic. This concern is unfounded. An increase in the allocation of the NYISO's annual operating costs to Suppliers would not distort the economic evaluation of imports from adjoining regions because the same cost allocation will be applied to both internal generator sales and import sales. All energy injections into the NYCA, including imports, are subject to the same allocation of the NYISO's annual operating costs. As a result, energy that is purchased from generators within the NYCA is treated the same as energy imported from another region. NY generators are not disadvantaged by the modified cost allocation. Both imports and internal generation will be assessed the 28% of the NYISO's annual operating costs allocated to Suppliers.

For the reasons discussed above, we deny the appeal. IPPNY has failed to demonstrate that the revised 72/28 cost allocation is improper or unreasonable or that the process by which it was developed was materially flawed. We are not convinced that further efforts to reach a consensus among stakeholders would be productive at this point, as several attempts facilitated by the NYISO have already failed. Relative to Suppliers' total market revenues, we do not believe that the relatively modest additional costs to be assigned to Suppliers must be phased in over time, especially as Suppliers have been on notice of a potential change for over five years. We believe the B&V Study is sound and the MC's proposal is reasonable.