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June 25, 2007

VIA HAND DELIVERY

Hon. Jaclyn A. Brillling
Secretary
New York State Public Service Commission
Executive Office 14th Floor
3 Empire State Plaza
Albany, New York 12223-1350

Re: Case 06-M-1017 - Proceeding on Motion of the Commission as to Policies,
Practices and Procedures for Utility Commodity Supply Service to
Residential and Small Commercial and Industrial Customers
Reply Comments

Dear Secretary Brillling:

Enclosed for filing in the above-referenced proceeding are the original and ten copies of the: (i) Reply Comments of ASTORIA GENERATING COMPANY, L.P., a US POWER GENERATING COMPANY; and (ii) accompanying Affidavit of Mark D. Younger.

Please date stamp the enclosed copy of this letter and return it to our messenger as proof of filing. If you have any questions with respect to this filing, please call or email me.

Very truly yours,

GREENBERG TRAUIG, LLP



Doreen U. Saia

DUS/aaw

Enclosures

cc: Official Service List (via U.S Mail & email; w/enc.)

ALB 1107212v1 6/25/2007

**NEW YORK STATE
PUBLIC SERVICE COMMISSION**

Case 06-M-1017 - Proceeding on Motion of the Commission as to the Policies, Practices and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers

**REPLY COMMENTS OF ASTORIA GENERATING
COMPANY, L.P., A US POWER
GENERATING COMPANY**

June 25, 2007

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**NEW YORK STATE
PUBLIC SERVICE COMMISSION**

Case 06-M-1017 - Proceeding on Motion of the Commission as to the Policies, Practices and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers

**REPLY COMMENTS OF ASTORIA GENERATING
COMPANY, L.P., A US POWER
GENERATING COMPANY**

In accordance with the schedule established by this Commission in its “Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II To Address Longer Term Issues” (“Long Term Contracts Order”) issued in the above-captioned proceeding, Astoria Generating Company, L.P., a US Power Generating Company (“Astoria Generating”), hereby submits Reply Comments focused specifically on claims made by a limited subset of parties concerning New York’s capacity markets.¹ As demonstrated, *infra*, while a comprehensive review of the sufficiency of both supply side and load side mitigation provisions for the New York City capacity market is appropriate and currently is properly before the Federal Energy Regulatory Commission (“FERC”),² there is simply no basis to seek to replace, or otherwise undercut the effectiveness of, FERC-approved

¹ Astoria Generating submitted Initial Comments in this proceeding with a group of suppliers known as the New York Suppliers. Astoria Generating fully supports the Reply Comments being filed contemporaneously in this proceeding by the New York Suppliers. Astoria Generating also supports the comments being filed contemporaneously in this proceeding by the Independent Power Producers of New York, Inc. However, the capacity issues raised in a small number of Initial Comments submitted in this proceeding also warrant response. Initially, Astoria Generating notes that, contrary to the position taken by the Staff of the New York Department of Public Service (“DPS Staff”) in footnote 16 of its Initial Comments, resource adequacy issues fall squarely within the Federal Energy Regulatory Commission’s (“FERC”) jurisdiction. Because parties raised these issues in this proceeding as well, however, Astoria Generating has responded to them herein to allow for a more deliberative proceeding.

² See FERC Docket Nos. ER07-360-000, EL07-39-000, New York Independent System Operator, Inc. (hereinafter “FERC In City ICAP Proceeding”).

capacity markets in New York -- including by attempting to take any measures that will artificially suppress market clearing prices derived thereunder.

I. EXECUTIVE SUMMARY

From the inception of the New York Independent System Operator, Inc.'s ("NYISO") markets, New York's capacity markets appropriately have recognized the locational value of capacity through the use of three separate capacity zones, New York City, Long Island and Rest of State. In 2003, the NYISO made a significant change away from its initially implemented but flawed vertical curve capacity structure to a gradually sloping installed capacity ("ICAP") Demand Curve structure.³ By its design, the ICAP Demand Curve structure recognizes the value of capacity beyond the minimum installed reserve requirement levels. This change was supported by market participants from all five market sectors as well as this Commission.

The combination of a locational capacity market that is implemented using the ICAP Demand Curve structure effectively has limited price volatility in the capacity markets and has produced price signals that have served to support bilateral capacity contracts, maintain needed existing generation and encourage new generation projects to be proposed.⁴ Due to the effectiveness of the combination of these structures, New York to date, unlike its neighboring regions, has not been forced to rely on out-of-market, band-aid solutions, like reliability must run contracts, to avoid losing capacity that remained needed on the system but was not being adequately compensated for providing such services under the market rules.⁵

³ See FERC Docket No. ER03-647-000, New York Independent System Operator, Inc.

⁴ The fact that a limited amount of new generation has come on line in New York is attributable to many factors including, but not limited to, surplus capacity conditions, regulatory uncertainty and the limited availability of capital.

⁵ See FERC Docket No. ER03-563-000, Devon Power LLC, et al., "Order Accepting in Part, Requests for Reliability Must Run Contracts and Directing Temporary Bidding Rules," 103 FERC ¶ 61,082 (2003) (hereinafter "ISO-NE RMR Order").

Notwithstanding the fact that New York's capacity markets generally have operated effectively since implementation of the ICAP Demand Curves, DPS Staff takes the extreme -- and wholly unsubstantiated -- position in its Initial Comments that "[a] long term contracting process is better suited than ISO capacity pricing arrangements to both ensuring reliability and advancing public policy goals." (See DPS Staff Initial Comments at 24.) Unless properly structured -- and DPS Staff is showing no inclination in its Initial Comments to do so, this proposed approach will artificially suppress market clearing prices below -- and perhaps, well below -- economically efficient results. The effect of this misguided approach would erode competitive markets. New units that were fortunate enough to get a contract clearly would be compensated under different terms and conditions than new merchant and existing generation in violation of long-standing FERC precedent. Moreover, the risk of generation investment decisions will be shifted away from private investors right back to the pocketbooks of captive ratepayers. Doing so eliminates a key benefit emphasized by this Commission when it made its decision to supplant its failed cost of service model with retail competition.⁶

Relying on long term contracts as the panacea, DPS Staff further takes the position that proposed load side capacity mitigation measures are not needed⁷ because the long term contracts that are hand-picked through its proposed command and control "Dynamic Electric Planning

⁶ See PSC Case 94-E-0952, In the Matter of Competitive Opportunities Regarding Electric Service, "Opinion and Order Regarding Competitive Opportunities for Electric Service" (issued May 20, 1996) (hereinafter "Competitive Opportunities Order").

⁷ In its Initial Comments, DPS Staff appears to acknowledge that the FERC is the body that may have jurisdiction over capacity issues. (See DPS Staff Initial Comments at 23.) However, DPS Staff further states that the FERC "should be urged to defer from intruding upon State prerogatives to advance reliability and public policies through the use of long term contracts." (Id.)

Process” or “DEPP” will more optimally address capacity needs.⁸ (See DPS Staff Initial Comments at 23-24.) Equally unavailing is the opposition waged against these measures in the Initial Comments of DPS Staff, Multiple Intervenors and the City of New York on the grounds that load capacity mitigation measures improperly will increase costs, require consumers to “double-pay” for capacity and unnecessarily will “shield” generators from the effects of regulatory policy. As evidenced, infra, and in the accompanying Affidavit of Mr. Mark D. Younger (“Younger Affidavit”), such statements reveal either a fundamental misunderstanding or misstatements concerning the underlying purpose of, and scope for, such mitigation mechanisms. The assertions of these three parties notwithstanding, load side bidding mitigation mechanisms are expected to be expressly tailored to prevent the exercise of market power and the associated artificial suppression of market clearing prices below -- and perhaps, far below -- competitive levels that would otherwise result.

As has been true as the New York markets have evolved over the past ten years, further refinements to improve the capacity markets may be needed. Such refinements may include consideration of some form of a forward capacity market that goes beyond the current three year ICAP Demand Curve reset process and the adoption of additional measures to be applied to the New York City market to be determined by the FERC in the FERC In City ICAP Proceeding. However, the wholesale replacement of existing capacity markets -- either in form or substance - - is not warranted at this time.

⁸ In its Initial Comments, DPS Staff recognizes that the capacity market pricing arrangements for the NYCA market are working well, and thus, DPS Staff does not recommend modifications to these markets. (See DPS Staff Initial Comments at 25-26.) However, as DPS Staff is well aware, changes to the New York City capacity markets will have an impact on the NYCA markets.

II. REPLY TO INITIAL COMMENTS

A. Long Term Contracting Processes Are Not Better Suited Than the FERC-Approved ICAP Markets To Efficiently Address New York's Resource Adequacy Needs

In its Initial Comments, DPS Staff summarily states that its DEPP proposal which will use long term contracts as the primary vehicle to bring new facilities on line will produce more effective results than the competitive ICAP market structure. (See DPS Staff Initial Comments at 24.) DPS Staff then asserts that its command and control, long term contracting approach is also the most effective way to address “current inequities” in the New York City capacity market. (Id. at 25.) Acknowledging that entering into discriminatory long term contracts with new units may give rise to revenue shortfalls to existing units, DPS Staff’s solution is to hand-pick which existing generators provide sufficient “long-term value to the City and its residents” to merit receiving a cost-based, long term contract and award such contracts accordingly. (Id.) However, DPS Staff’s proposal runs counter to established FERC precedent and will unnecessarily erode the competitive capacity markets in New York.⁹

1. Unless Properly Structured, Relying Exclusively on Hand-Picked Long Term Contracts To Address Resource Adequacy Issues Will Artificially Suppress Market Clearing Prices Which Is Likely To Lead to the Need For Additional Contracts

As discussed herein, by structuring its capacity markets properly, New York, to date, has been able to avoid entering into out of market contracts to keep needed units on line that were not otherwise receiving adequate revenues under the market rules. Yet DPS Staff’s proposal

⁹ Niagara Mohawk Power Corporation (“Niagara Mohawk”) raised similar concerns in its Initial Comments, stating, “A return to IRP would mean abandonment of competitive markets and likely an eventual return to full regulation.” (See “Initial Comments of Niagara Mohawk Power Corporation” at 29.)

inexplicably will back New York into this exact result¹⁰ -- a result that already has been determined to be a far inferior alternative to the ability of competitive markets to produce the most efficient prices for the benefit of consumers.

Specifically, the FERC was presented with these very issues when it received the first of what later became many filings seeking reliability must run (“RMR”) type agreements in New England. Finding that such contracts should only be entered into as a last resort, the FERC established that competitive markets produce the most effective and efficient results, holding,

In short, extensive use of RMR contracts undermines effective market performance. In addition, suppressed market clearing prices further erode the ability of other generators to earn competitive revenues in the market and increase the likelihood that additional units will also require RMR agreements to remain profitable. Therefore, we believe that ISO-NE, rather than focusing on and using stand-alone RMR agreements, should incorporate the effect of those agreements into a market-type mechanism.

(See ISO-NE RMR Order at 9.)

New England market participants then spent the better part of three years developing capacity market mechanisms designed to provide adequate payments to maintain needed generation. In the meantime, FERC’s findings concerning the deleterious effects of RMR contracts on competitive markets came to fruition. As reflected in the ISO-NE 2005 Annual Report, at the end of 2004, 2,100 MW of New England capacity were in RMR contracts. (See 2005 Annual Report at 4.) By 2006, including all agreements effective or pending before the FERC, that figure had more than tripled to nearly 7,000 MW of capacity. (*Id.* at 4-5)

¹⁰ In its Initial Comments, Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. (collectively, “Con Edison”) raised similar concerns, stating, “...if there is a policy requiring long-term contracts, it will be difficult to develop a policy that will facilitate market financing of energy infrastructure because those long-term contracts would inevitably eliminate the market for the financing of new projects and have an adverse impact on the economics of existing projects. ...Indeed, one could be left with a “market” where there are new generators that have long-term contracts to operate, existing generators with reliability contracts, and very few generators left that operate in a purely competitive manner.” (See “Initial Comments of Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. Concerning Long Term Contracts” at 17-18.)

The experience of neighboring regions must be heeded. The answer for New York is not to attempt to unwind -- either in form or in substance -- the existing, well-structured capacity markets. Rather, to the extent that long-term contracts are utilized going forward, they must account for and otherwise accommodate the measures being developed at FERC to ensure that such contracts are consistent with competitive markets.

2. Attempting To Use Long Term Contracts To Supplant the Existing Capacity Markets Violates Longstanding FERC Precedent

While not stated explicitly, it appears that DPS Staff seeks to award long-term contracts to new facilities on terms that may be more attractive than otherwise would be available in the market.¹¹ (See DPS Staff Initial Comments at 24.) Under DPS Staff's proposal, such contracts would then be bid into the market at zero cost, artificially depressing the price available to existing units. (Id. at 24-25.) However, as determined by the FERC, there is absolutely no basis to treat new and existing resources differently.

When the ICAP Demand Curve changes were before the FERC, protests were filed arguing that existing units should not be paid the same price as new units. Soundly rejecting this position, the FERC expressly held, “[t]he Commission finds that all capacity suppliers, regardless of the age of their resources, are entitled to the same treatment in the ICAP markets. ... The Commission does not see how [new] generators could receive ICAP revenues that were

¹¹ In its Initial Comments, the NYISO cautions against taking this approach, establishing, “As a general matter, the PSC should avoid requiring the use of long term contracts for investments that would have been uneconomic in the NYISO markets. Uneconomic contracts will ultimately impose substantial risks and unnecessary costs on consumers, and often create unforeseen consequences....In the short term, consumers being served under the uneconomic contract may have higher all-in costs. If the depressed market prices cannot support private market-based investment, new privately funded projects will disappear. Over the long term, the State’s willingness to impose policies that override market functions is likely to act as a deterrent to future private investment.” (See “Responses of the New York Independent System Operator, Inc. to the Commission’s April 19, 2007 Request for Responses” at 7.)

fundamentally different from those paid to other generators.”¹² (See New York Demand Curve Order at 30.)

The Commission recently reaffirmed this precedent in the PJM proceeding addressing its proposed capacity market revisions (“PJM RPM Proceeding”), finding, “In a competitive market, prices do not differ for new and old plants or for efficient and inefficient plants; commodity markets clear at prices based on location and timing of delivery, not the vintage of the production plants used to produce the commodity.”¹³ (See PJM RPM Order at 57.) As was the case as recently as six months ago, under a competitive market construct, there is no basis to pay new and existing suppliers different capacity prices to provide the same reliability service.

3. Attempting To Use Long Term Contracts To Supplant Existing Capacity Markets Will Sacrifice A Primary Benefit of Competitive Markets and Force Consumers To Bear Far More Risk

In its Competitive Opportunities Order, this Commission emphasized that a primary benefit of competitive markets was that the risks associated with generation investment decisions were shifted from captive ratepayers to private investors. (See Competitive Opportunities Order at 30-31.) If adopted, DPS Staff’s proposal would shift these risks right back to the ratepayers.

In proposing this approach, DPS Staff wholly ignores New York’s past failures when politicians and regulators have attempted to direct energy planning. As many parties submitting comments made it abundantly clear,¹⁴ New York’s consumers are still paying for those mistakes.

¹² See FERC Docket No. ER03-647-000, *supra*, “Order Conditionally Accepting for Filing Tariff Revision,” 103 FERC ¶ 61,201 (2003) (hereinafter “New York Demand Curve Order”).

¹³ See FERC Docket Nos. ER05-1410-001, EL05-148-001, ER05-148-000, *PJM Interconnection, L.L.C.*, “Order Denying Rehearing and Approving Settlement Subject to Conditions,” 117 FERC ¶ 61,331 (2006) (hereinafter “PJM RPM Order”).

¹⁴ See, e.g., NMPC Initial Comments; “Initial Comments of Multiple Intervenors on Phase II Issues.”

Indeed, this Commission abandoned the failed cost of service approach in favor of retail competition in large measure due to the debilitating rate impact caused by such mistakes.¹⁵

Nor does Staff's summary statement that the "utility's approach to procurement can be carefully reviewed and adjusted to protect the public interest" bring any comfort. (See DPS Staff Initial Comments at 19.) Staff suggests that its new procurement approach will "assure" that each contract will receive a "full and adequate review of its impacts." (Id.) It is at best to think that past contracts that ultimately failed were not reviewed carefully. The degree of care is not the issue. Rather, the issue is that circumstances and market conditions can -- and almost always do -- change.¹⁶ The benefit of competitive markets is that private investors make their best assessment of, and then fully bear, the risk of those changes. If their assessment turns out to be wrong, their shareholders -- and only their shareholders -- pay the price. The assurances of careful review contained in DPS Staff's Initial Comments do not -- and, indeed, cannot -- provide sufficient basis to shift that risk back to consumers.

B. Load Side Mitigation Measures Are Needed To Address the Potential Exercise of Market Power That Will Otherwise Act To Artificially Suppress Capacity Market Clearing Prices and Ultimately Erode the Competitive Markets

As reflected in the pleadings that were filed before the FERC in the proceeding that led to the FERC In City ICAP Proceeding,¹⁷ the terms under which 1,000 MW of new generation was

¹⁵ See Competitive Opportunities Order at 28.

¹⁶ See also "Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc." at 3-4 ("...while well-intentioned, IRP provides little ultimate value as it is based on incorrect assumptions that central planning and government-run procurement processes can outperform the market. ... However, these actions tend to be outdated shortly after being written. Such prescriptive and rigid directives are unable to respond quickly to the realities of the market on a real-time basis. However, the market itself can more effectively and efficiently respond to changes in fuel price, the development of new technologies, the imposition of new environmental regulations, short- and long-term weather patterns, and other such variables.").

¹⁷ See, e.g., FERC Docket No. ER07-360-000, *supra*, "Protest of the NRG Companies" (dated January 24, 2007) at 5; see also, FERC Docket No. ER07-360-000, *supra*, "Protest of KeySpan Ravenswood, LLC To New York Independent System Operator, Inc.'s Tariff Revisions to Modify Installed Capacity Market Mitigation Measures

built in New York City and by whom, the manner in which such capacity was then bid into the market and its resultant effect on the auction clearing prices revealed a design flaw inherent in the current capacity market structure for New York City. Specifically, under the rules now in place, a large regulated or governmental entity may enter into an above-market discriminatory contract, receive cost recovery for such contract, bid the associated capacity into the market in a way that is the equivalent of a \$0 price bid, artificially suppress the auction clearing prices by sending the ICAP Demand Curves out well beyond the economically efficient point and reap the benefit of these artificially suppressed prices for the remainder of its -- what is still likely to be very sizeable -- load.

As demonstrated in detail by Mr. Younger in his attached Affidavit, allowing the load side to have the unconstrained ability to exercise market power in this way will have devastating impacts on the competitive markets over the long run, including the need for premiums to be placed on contract price and term, and potentially, earlier generation retirements the decision to forego investment in New York State altogether. (See Younger Affidavit at ¶¶ 26-28.)¹⁸ Thus, load side capacity mitigation measures must be implemented to allow the continued development of the competitive markets in New York State.¹⁹

Notwithstanding the need to implement load side mitigation measures to prevent the exercise of market power, DPS Staff, MI and NYC oppose these measures in the Initial Comments that each of these parties filed in this proceeding. As Mr. Younger delineated in the

Applicable to Certain In-City Generating Units” (dated January 24, 2007) at 4-5; see also, FERC Docket No. ER07-360-000, supra, “Comments of Astoria Generating Company, L.P.”

¹⁸ Niagara Mohawk identified the same concerns, cautioning, “Any resource adequacy mechanism should also be carefully tailored to avoid problems with premature retirement of existing capacity suppliers, increased cost associated with maintaining excess capacity, timing and other effects.” (See NMPC Initial Comments at 12.)

¹⁹ These measures currently are properly before, and are expected to be addressed as an integral part of , the pending FERC In City ICAP Proceeding.

attached Affidavit, such opposition appears to be based on the following three premises: (i) all new contracts would be affected thereby forcing loads to “double-pay” for the capacity associated with such contracts; (ii) such rules will result in higher prices; and (iii) such rules only will serve to “shield” merchant generators from the effects of new generation when they should have anticipated that such generation would be added to the system. (See Younger Affidavit at ¶ 11.) Such arguments wholly lack merit.

Turning first to the claims that all new contracts will be affected (see, e.g., DPS Staff Initial Comments at 23), such claims ignore the narrowly tailored, targeted nature of these mitigation provisions. The goal of these mechanisms is to continue to allow bilateral capacity contracts to go forward but to prevent such contracts from artificially altering competitive market results. Accordingly, load side mitigation measures are expected to be designed to address the following: (i) there is a discriminatory procurement (i.e., it is not open to both new and existing capacity suppliers); (ii) the resulting contract is an above market contract; and (iii) the contracting party is otherwise able to recover the associated out of market costs. (See Younger Affidavit at ¶14.) Put simply, load side mitigation measures cannot and will not be applied to all new contracts unless all new contracts are structured in a way that leads to the potential exercise of market power. (Id. at ¶ 12.)

Equally unpersuasive is MI’s opposition to these measures on the grounds that they will lead to higher prices. (See MI Initial Comments at 21.) Exercising buyer-side market power produces artificially suppressed prices. Preventing market power from being exercised produces competitive and efficient -- albeit, higher -- prices. Indeed, while MI expresses concern that such measures will come at the expense of consumers, the price of leaving this market power unchecked is likely to be much higher in the long run. As noted, supra, and demonstrated by Mr.

Younger in his Affidavit, new contracts will have to take these factors into account which will add to their costs. (See Younger Affidavit at ¶¶ 26-27.) Existing units also will be forced to respond, including by potentially retiring units when faced with significant plant investment or currently marginal operations. (Id. at ¶ 26.) Neither result will produce the most economically efficient outcome for consumers in the long run.

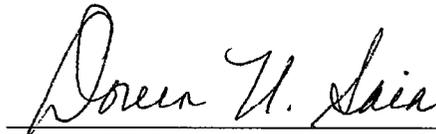
Nor are the “you should have known” arguments any more compelling. (See, e.g., MI Initial Comments at 21-22; NYC Initial Comments at 18.) In a competitive market, merchant parties that enter the market do so knowing full well that they must compete with each other -- including new facilities -- to provide energy, capacity and ancillary services to meet the electricity needs of New York’s consumers. They do so by making decisions concerning, inter alia, fuel and resource type, location, operating efficiencies, environmental upgrades and maintenance investments -- all of which are appropriate in competitive markets. State-sanctioned, or worse State-sponsored, load side market power, however, is not. (See Younger Affidavit at ¶¶ 23-25.)

For New York’s competitive markets to continue to develop and retain their premier status, a level playing field must be maintained between supply side and load side interests. Thus, if any long-term contracts ultimately are issued in connection with this proceeding, such contracts must account for, and otherwise accommodate, the load side mitigation measures that are being addressed in the FERC In City ICAP Proceeding.

III. CONCLUSION

As demonstrated at length in the Initial Comments filed in this proceeding by a broad range of parties that often otherwise have competing interests, New York's markets currently are well-recognized to be the premier competitive markets in the country. They produce the most competitive and efficient results which inures directly to the benefit of New York consumers. To the extent that a design flaw reveals itself over time, a process has long been in place to make the necessary corrections. As such, there is simply no basis to attempt to make wide-ranging, wholesale changes to these markets -- including, most specifically, by adopting or in any way endorsing DPS Staff's DEPP proposal -- at this time.

Dated: Albany, New York
June 25, 2007



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AFFIDAVIT OF MARK D. YOUNGER

Mark D. Younger, having been duly sworn, deposes and states as follows:

1. My name is Mark D. Younger. I am employed as Vice President of Slater Consulting. My business address is 69 Werking Road, East Greenbush, New York 12061.
2. My entire professional career has been devoted to matters relating to electric generation and the development of competitive electricity markets. For the past ten years, I have been an active participant in various working groups refining the New York Independent System Operator, Inc. ("NYISO") market structure and developing methods to improve the market design. My resume is attached as Exhibit MDY-1.
3. I write this affidavit in support of the Reply Comments being submitted by Astoria Generating Company, L.P., a US Power Generating Company, in the New York Public Service Commission's Proceeding on Motion of the Commission as to Policies, Practices and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers (Case 06-M-1017).
4. My affidavit responds to certain statements contained in the initial comments submitted by the Staff of the New York Department of Public Service ("DPS Staff"), Multiple Intervenors ("MI"), and the City of New York ("NYC") that oppose adopting any load side mitigation measures for New York's capacity market.

BACKGROUND

5. In 2003, the New York ISO implemented its Demand Curve structure for the capacity market with the strong support of the New York Public Service

Commission. The Demand Curve is designed to provide a more stable signal concerning the need for, and the value of, capacity resources. Under the Demand Curve, the price for capacity rises as the amount of capacity in the market declines towards the minimum installed capacity requirement. The curve is explicitly designed to ensure that it will provide a price that supports new entry consistent with assuring that the minimum installed capacity requirements are met. As the curve goes out beyond the minimum requirement, the price paid for capacity declines. The shape of the Demand Curve is meant to allow the price to move up and down as capacity is added to properly represent the value of new capacity and to reduce the incentive to add capacity as the market gets longer and it is no longer economically efficient to do so.

6. The need for load side mitigation measures in the capacity market is one of the issues that is properly before, and is expected to be addressed in, the pending Federal Energy Regulatory Commission (“FERC”) proceeding concerning the New York City capacity markets (“FERC In City Capacity Proceeding”). (See FERC Docket Nos. ER07-360-000, EL07-39-000, New York Independent System Operator, Inc.).

NEED FOR LOAD SIDE CAPACITY MITIGATION PROVISIONS

7. The need for a mitigation measure arises because certain large regulated or governmental entity market participants have the potential to artificially drive down the market clearing prices by entering into an above market contract but being assured recovery of their out of market costs. Under the current NYISO rules, the market clearing price in the capacity spot market auction would be artificially depressed by such an action because the above market contract would effectively be

bid into the NYISO market at zero cost. The resulting significant addition of MWs into the market directly causes the market to go longer than would otherwise be economically efficient in a competitive market thereby producing an unjustifiably lower price. The market participant is then able to avail itself of this lower price to serve the remainder of its load obligations.

8. Getting out of market recovery for an above market contract and using that contract to depress the capacity clearing prices to serve the entity's remaining load is a clear form of market power abuse. Market mitigation measures must be adopted to prevent such market power from being exercised.
9. The contracts to which such measures would be applied would be limited to above-market contracts procured by an entity through discriminatory processes (i.e., not open to all suppliers) for which the entity then receives out of market recovery. If the load side of the contract does not have monopsony power or the ability to recover out of market costs, there is no need to mitigate its contracting behavior because the normal market discipline associated with entering into out of market contracts is sufficient to ensure economically efficient behavior by the market participant.
12. FERC has already approved a load side mitigation measure to address the above issues as part of the ISO New England capacity market. See FERC Docket No. ER03-563, ISO-New England, Inc., "Order Accepting Proposed Settlement Agreement," 115 FERC ¶ 61,340 (2006), reh'g pending. This measure was adopted because of the recognition that including load side mitigation in the market was necessary to provide merchant generators assurance that the value of their investment could not be improperly depressed by load side interests.

INITIAL COMMENTS ON LOAD SIDE CAPACITY MARKET MITIGATION MEASURES

11. The comments submitted by DPS Staff, MI and NYC in this proceeding concerning the load side mitigation measures (“Comments”) appear to raise three primary points: (i) such rules would be applied to all new contracts causing loads to “double-pay” for capacity; (ii) such rules will result in higher prices; and (iii) generators should not be “shielded” from regulatory policies by implementing such rules because generators were on notice that new generation would be built in New York. The Comments reflect either a fundamental misunderstanding or material misstatements concerning the underlying design of, and scope for, such measures.

THE PROPOSED MITIGATION MEASURES ARE LIMITED IN SCOPE TO PREVENT THE EXERCISE OF MARKET POWER

12. The Comments correctly state that the mechanism that is likely to be used to apply this mitigation would be a floor price. However, the Comments overstate the contracts to which such mitigation measures are likely to be applied. As demonstrated, *infra*, contrary to the statements of these parties, this mechanism would not be applied to all new contracts. Rather, it only would be applied to those new contracts that led to the potential to exercise market power.
13. For example, the DPS Staff Initial Comments state that:
- If such a floor price proposal is adopted, however, all buyers in the New York City spot capacity markets would be required to, in effect, purchase capacity at or above that floor price. Such a system could act as a disincentive to entry into bilateral long-term contracts for capacity, because market participants could be forced to pay for capacity twice --

once through the mandatory NYISO capacity market mechanism and again through their bilateral long-term contract. (See DPS Staff Initial Comments at page 23.)

14. The above representation ignores the targeted nature of the load side capacity market mitigation measures. The final structure for this mechanism has not yet been developed. However, the floor price proposal that has been proposed in pleadings that have been filed in the FERC In City ICAP Proceeding would apply to contracts where:
 - the procurement was closed to existing suppliers (i.e. it is a discriminatory procurement open to new suppliers only);
 - the awarded contract is above the market clearing price; and
 - the load side of the contract has monopsony power or otherwise has the ability to recover its out of market costs of the contract.
15. The design of this mitigation measure is limited to directly addressing the load side market power that is described in paragraphs 7 and 8 above. It does not otherwise deter parties from entering into bilateral contracts. The only contracts that would be affected are those where parties have the ability to exercise market power.
16. Contracts where the load side does not have either monopsony power or the ability to otherwise recover the out of market costs of the contract are exempt from the mitigation measure.
17. Likewise, the mitigation measures would not apply to any bilateral contract that was awarded pursuant to a competitive solicitation process that was open to all existing and new suppliers. Allowing existing suppliers to compete for the contract ensures

that the contract cannot be used to artificially force the market to carry uneconomic excess capacity and thereby depress the capacity price from competitive levels. Consequently, the mitigation measures would not apply to contracts for new capacity as long as existing capacity was able to compete on a level playing field in an open and transparent process for the contract award.

18. In addition, the market mitigation measures approved by the FERC to date in adjoining regions place the floor bid on discriminatory contracts for new entry at a value that is below the net cost of such new entry (e.g., on the order of 80%). The floor bid combined with an appropriately designed demand curve is expressly designed to allow for normal fluctuations around the net cost of new entry that would be expected to result from lumpy generation additions without having a significant likelihood of the floor bid being binding. Applying a floor bid, rather than an outright prohibition against these contracts, permits discriminatory contracts aimed at new entrants to go forward without also having the deleterious effect of taking the market artificially long.
19. Consequently, this allows the contracting behavior but limits the ability to artificially depress the market price, i.e. it allows parties to contract but prohibits the artificial suppression of the price as a result of the exercise of market power.
20. In fact, with a load side capacity market mitigation measure such as is under consideration for New York, the only time there would be a potential that a load would run the risk of “paying twice” for capacity would be instances where the capacity addition was purchased under a discriminatory procurement process and

resulted in taking the market well beyond the minimum requirement to ensure reliability.

21. Lastly, in its Initial Comments, MI states that generators would presumably be accorded an opportunity to participate in RFPs, and, therefore, may have an opportunity to benefit from an increased reliance on long-term contracts. (See MI Initial Comments at 21.) As described in detail above concerning DPS Staff's claim, if the competitive solicitation that leads to the contract award is open to both new and existing suppliers, load side mitigation measures would not apply to those transactions.

THE PROPOSED MITIGATION MEASURES ARE DESIGNED TO ENSURE THAT COMPETITIVE MARKET PRICES ARE PRODUCED

22. In its Initial Comments, MI asserts that load side capacity market mitigation measures should not be applied because the relief would likely come at the expense of consumers. (See MI Initial Comments at 21.) As described above, the proposed mitigation is targeted only at forms of contracting that lead to the potential to exercise market power. The fact that consumers may receive some financial benefit -- albeit, likely short term for the reasons discussed infra -- from the temporary, artificial suppression of market clearing prices due to the exercise of market power provides no basis to allow such market power abuse to occur in direct contravention of competitive market outcomes.

**THE PROPOSED MITIGATION MEASURES ARE NEEDED TO “SHIELD”
MARKET PARTICIPANTS FROM THE EXERCISE OF MARKET POWER,
NOT APPROPRIATELY DESIGNED REGULATORY POLICIES**

23. In its Initial Comments, MI further asserts that when existing generators purchased or constructed their facilities, they did so assuming a certain level of regulatory and business risk that includes, *inter alia*, the adoption of new policies by the Commission and/or the construction of additional generation projects. (See MI Initial Comments at 21-22.) While the market participants properly could have expected that there would be regulatory risk, the changes that have been made to date have generally been to make the market more efficient and competitive. No market based generators could or should have expected that regulatory risk also would include the state sanctioned exercise of market power.
24. Likewise, NYC states, in its Initial Comments, that neither the Commission, nor any other party, guaranteed any particular set of capacity prices or market conditions to the owners of existing generation when they bought or built their plants. (See NYC Initial Comments at 18.) Here, too, this misrepresents the focus of the load side capacity market mitigation measure. These measures are not designed to ensure a particular capacity price or market condition. Contracts that are consistent with competitive markets are exempt from application of the mitigation measures. The proposed measures simply protect the market price from being inappropriately depressed by the application of market power.
25. Lastly, MI states in its Initial Comments that generators should not be shielded from the impacts, if any, of regulatory policies designed to ensure that adequate generation is developed in New York. (See MI Initial Comments at 22.) However, by design,

the proposed mitigation measures do not interfere with ensuring adequate generation. By applying a floor price below the net cost of new entry, the measures allow for both the ability to procure adequate generation to meet the control area and locational capacity requirements and to allow for the lumpiness of capacity additions.

FAILING TO IMPLEMENT THE LOAD SIDE CAPACITY MARKET MITIGATION MEASURES EXPOSES THE NEW YORK MARKETS TO MARKET POWER ABUSE TO THE SIGNIFICANT DETRIMENT OF THE CONTINUED DEVELOPMENT OF THESE MARKETS

26. The parties that oppose implementing a load side capacity market mitigation measure grossly understate the potential harm that could result to the market without this protection. The threat that the value of merchant investment could be substantially eroded by a market power exercise of this nature will significantly increase the risk and cost of merchant development. For new generation, this will manifest itself in both a greater hesitancy to commit to the market and an increase in required return for the investment (i.e. it will increase the cost of entry). For existing generators, such increased risks result in greater potential for existing unit retirement whenever the unit faces significant plant investment. Additionally, existing units that are marginally economic today may choose to shut down when faced with a future where they believe they have less likelihood of a fair market clearing price.
27. Allowing this kind of market power will also affect the contracts under consideration in this proceeding. Without assurance of a fair market when the contract ends, contracting suppliers will be required to demand longer contract terms and higher contract prices to address the post contract risk.

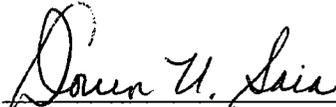
28. For the reasons presented above, the Commission should not attempt to sanction in any way -- whether in form or substance -- the market power that results from discriminatory contracts for new generation and regulated recovery of the out of market costs. Thus, any contracts executed as a result of this proceeding must account for and otherwise accommodate appropriate load side capacity market mitigation measures being developed at FERC.

29. This concludes my affidavit.



Mark D. Younger

Sworn to before me this
25th day of June, 2007.



Notary Public

ALB 1107211v1 6/25/2007

DO NOT REMOVE THIS
Notary Public, State of New York
Qualified in Albany County
No. 02UN5024300
Commission Expires ~~March 7, 20~~
April 18, 2008

MARK D. YOUNGER

Mr. Younger is Vice President of Slater Consulting and has over twenty-five years of experience in energy analysis.

EDUCATION

MBA, Cornell University, 1983

M.E., Operations Research
Cornell University, 1983

B.S., Engineering, Major - Operations Research
Cornell University 1981

PROFESSIONAL EXPERIENCE

Vice President

Slater Consulting (1994 - Present)

Specialist on electric deregulation, market structure issues and deregulated electric energy, ancillary service and capacity market design. Specialist in electric utility system planning and simulation modeling. Specialist in New York Independent System Operator rules and operation. Extensive modeling experience of California's utilities and the New York Independent System Operator Market. Experienced with PROMOD, ELFIN and EGEAS production cost models.

Senior Project Manager

Morse, Richard, Weisenmiller & Associates, Inc. (1986-1994)

Head of MRW's New York office. Responsible for directing MRW's projects on production cost modeling. Directed MRW's analysis of East Coast utility operations. Prepared extensive analysis on avoided costs in California, New York, Pennsylvania and New Jersey. Prepared expert witness testimony on avoided costs in California and New York. Performed analyses of electric utility emissions reductions associated with cogeneration projects.

Energy Economist

Pacific Gas & Electric Company (1983-1986)

Responsible for developing models and methods for integrated supply and demand-side resource analysis. Performed least-cost utility resource planning. Developed and performed an analysis of resource planning under uncertainty using Monte Carlo techniques. Performed extensive analysis for electric peak and load shape forecasting.

Research Specialist

Duane Chapman, Professor of Resource Economics

Cornell University (1982-1983)

Formulated the financial simulation section of the University Research Group on Energy's (URGE) integrated model of the electric utility industry. Performed an analysis of the impact on New York Pollution levels and New York utilities of proposed acid rain abatement strategies.