STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350

Internet Address: http://www.dps.state.ny.us

January 24, 2007

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

Re: Docket No. ER07-360-000 - New York Independent System Operator, Inc.

Dear Secretary Salas:

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

Very truly yours,

/s/

David G. Drexler
Assistant Counsel

Attachment

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	))	Docket No. ER07-360-000

NOTICE OF INTERVENTION AND COMMENTS
OF THE NEW YORK STATE
PUBLIC SERVICE COMMISSION

NOTICE OF INTERVENTION

The New York State Public Service Commission (NYPSC) hereby submits its Notice of Intervention pursuant to the Federal Energy Regulatory Commission's (FERC or Commission) Notice of Extension of Time, issued on January 5, 2007, and Rule 214 of the Commission's Rules of Practice and Procedure. Copies of all correspondence and pleadings should be addressed to:

David G. Drexler
Assistant Counsel
New York State Department
of Public Service
Three Empire State Plaza
Albany, New York 12223-1350
david_drexler@dps.state.ny.us

Raj Addepalli
Manager, Staff ISO Team
New York State Department
of Public Service
Three Empire State Plaza
Albany, New York 12223-1350
rajendra_addepalli@dps.state.ny.us

INTRODUCTION AND SUMMARY

On December 22, 2006, the New York Independent System Operator, Inc. (NYISO) filed revisions to its Market Administration and Control Area Services Tariff (Filing), seeking to modify the Installed Capacity (ICAP) market mitigation measures applicable to generating units within New

York City (NYC) that were divested by Consolidated Edison Company of New York, Inc. (Con Edison) in 1998. The proposed mitigation measures address the on-going exercise of market power by some divested generation owners (DGO), by replacing their ICAP bids with an $82/kW-year reference price in the event their unmitigated bids fail both a conduct and impact test.[1]

The need for the proposed mitigation measures stems from the fact that NYC is a large load pocket that requires about 9,300 MW of local ICAP, while about 5,900 MW of capacity in NYC is owned by three large DGOs (i.e., KeySpan, USPower Gen, and NRG). Each of these suppliers is pivotal in the sense that supply from each is needed in order to avoid a capacity deficiency.[2] As such, each supplier has the ability to exert market power and to set market prices.

In 2006, approximately 1,000 MW of new capacity entered service and was offered into the NYC ICAP market, leading to a reasonable expectation that capacity prices would decline, both in NYC and in the statewide market. However, the NYC ICAP spot market continued to clear at the highest of the DGOs' bid/price

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1 The conduct test evaluates whether a generators' bid is within a three percent threshold above its reference price, while the impact test measures whether generators' bids have the aggregate effect of raising total market costs more than three percent above the cost that would have resulted from offers at the reference price.

2 NYISO Filing, Affidavit of Dr. Patton, pp. 2-3.

caps,[3] despite this recent addition of capacity. The explanation for this result is that there has been a significant increase in economic withholding in the NYC market, impacting both the NYC and statewide capacity markets.[4]

The NYPSC supports the adoption of the proposed mitigation measures. Notwithstanding the NYISO's concerns, these measures are equitable, given that FERC stated early on that the current bid and price caps were subject to revision as market conditions warranted. When the sloped demand curve was introduced, the Commission and market participants both expected ICAP prices to move with the amount of supply.[5] Although 1000 MW was added in 2006, the capacity prices did not go down as expected due to economic withholding. There was also an expectation at the time of divestiture in 1998 that new entry into the market would discipline prices, so that the price cap of $105/kW-year, which

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[3] All of the DGOs have bid/price caps based on a $105/kW-year level (depending on Dependable Maximum Net Capacity), which was approved by the Commission in 1998. *Consolidated Edison Co. of New York, Inc.*, 84 FERC ¶61,287, at 62,357-358 (September 22, 1998). The individual DGOs' caps are differentiated based on their expected summer and winter Unforced Capacity (UCAP) levels.

[4] NYISO Filing, Affidavit of Dr. Patton, pp. 4-5. Dr. Patton concluded that "the ICAP Spot Market Auctions during the 2006 Summer Capability Period have been characterized by economic withholding of Capacity to exercise market power to the maximum extent allowed by the existing offer cap for the DGOs."

[5] *New York Independent System Operator, Inc.*, 103 FERC ¶61,201, at 61,754 (May 20, 2003).

was considered to be higher than the cost-of-new-entry (CONE), could be removed.[6] Therefore, given the prospect of lower capacity prices, it is questionable whether investors who purchased the divested generation assets would have expected capacity prices to remain at the price cap level indefinitely. The price paid for the assets would have reflected this risk. In addition, some of the divested generation assets have been resold, as recently as the fall of 2005, with the new buyers being fully aware of all the market rule changes since inception of the NYISO.

The proposed $82/kW-year reference price is reasonable to address the on-going exercise of market power by certain DGOs and protects consumers from paying artificially high prices as a result of uncompetitive market conditions. The proposal will result in prices that more closely reflect competitive market outcomes than the status-quo. The proposal was developed over several months of intense consultations with stakeholders, including the affected DGOs, and was supported by approximately 70% of the market participants. It carefully balances the concerns of both buyers and sellers, by offering some relief

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6 84 FERC ¶61,287, supra; KeySpan Hieronymus White Paper, posted as part of the NYISO's Management Committee meeting materials at: http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2006-0929/agenda_08_CRA_International_Summary_of_Findings.pdf.

from economic withholding, while preventing a price collapse. It also addresses NYISO staff's concerns regarding the difficulty of computing unit specific "To-Go" costs, by selecting a specific reference level amount, thus making it much easier to implement. Moreover, the revisions will not act as a deterrent to new investors, given that the mitigation measures will only apply to the three pivotal ICAP suppliers in the NYC spot market auction, and will provide price signals that more closely reflect market conditions.

We acknowledge that this proposal is a short-term solution and that other significant capacity market issues must also be addressed in the long-term. The NYPSC stands ready, willing, and able to work with market participants, the NYISO, and the Commission to reach this goal.

DISCUSSION

I. The Proposed Mitigation Measures Are Equitable

In its Filing, the NYISO asks that the Commission determine, as a threshold matter, whether equitable considerations preclude implementation of the proposed mitigation measures. Entities opposed to the mitigation measures argue that it would be "inequitable to deprive the DGOs and other investors of the past regulatory bargain they have relied upon, and that to do so would discourage future investment."[7] However, Con Edison's generation units were purchased with knowledge that the mitigation measures, which would be applied after divestiture, were subject to revision.

As the Commission expressly indicated, the bid cap was being adopted on a "preliminary [basis], but subject to reconsideration [as circumstances warranted, and that] interested parties [were allowed] to propose changes to the price cap."[8] In light of the Commission's remarks, the buyers of Con Edison's generation assets were put on notice that there could be market design changes, such as the mitigation measures proposed in the NYISO's Filing, at the time they purchased those assets.

Moreover, when Con Edison's units were purchased in 1998, there was an expectation that new entry into the market would discipline prices, so that the price of capacity would eventually be below the $105/kW-year cap, which was considered to be higher than the cost-of-new-entry (CONE).[9] The Commission indicated that although the $105/kW-year bid/price cap would set the market clearing price for some time, it expected prices to

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[7] NYISO Filing p. 9.

[8] 84 FERC ¶61,287, supra.

[9] 84 FERC ¶61,287, supra; KeySpan Hieronymus White Paper, posted as part of the NYISO's Management Committee meeting materials at: http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2006-0929/agenda_08_CRA_International_Summary_of_Findings.pdf.

go down in the future when sufficient supply became available to supplant existing capacity.[10] Therefore, it is unrealistic for the purchasers of Con Edison's assets to expect that capacity prices will remain at the $105/kW-year cap indefinitely. Notwithstanding, the DGOs have had the benefit of their bargain since the NYISO ICAP auction began functioning in May 2000,[11] and it is reasonable to modify the cap in light of what occurred after 1000 MW of new capacity was added to the market. For all the reasons above, the Commission should reject any arguments that equitable considerations preclude implementation of the proposed mitigation measures.

II. The Proposed Mitigation Measures Are Reasonable To Address The On-Going Exercise Of Market Power

The NYISO's Market Monitor concluded that the proposed $82/kW-year reference level for mitigating the DGOs' exercise of market power will result in capacity market clearing prices much closer to competitive levels than the status quo.[12] Thus, the mitigation measures are reasonable.

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[10] 84 FERC ¶61,287, supra.

[11] NYISO Filing p. 6 (noting the start of ICAP auctions).

[12] NYISO Filing, Affidavit of Dr. Patton, pp. 5-6. Dr. Patton concluded that "the proposal will produce outcomes that are decidedly preferable to the market outcomes under the current cap in that they are closer to competitive market results given the current levels of Capacity in New York."

The $82/kW-year reference price is the outcome of confidential negotiations between DGOs and stakeholders, and balances the interests of generators and consumers. Specifically, the reference level is set high enough to address concerns that a price collapse may occur if the level is too low, while it is set low enough to ensure consumers will be paying prices much closer to what competitive market conditions would yield.

The original proposal before the NYISO Business Issues Committee envisioned developing unit-specific reference bids, which were based on "To-Go" costs,[13] but was abandoned because of the NYISO's position that such costs were thought to be extremely difficult to estimate and would potentially result in excessive price volatility due to the reference levels being so low. The proposed mitigation measures avoid those problems by fixing the reference price at an amount well above the likely To-Go costs, net of energy revenues for the DGOs.

The $82/kW-year reference price is also rational because it generally comports with ISO-NE's methodology for ensuring that

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[13] "To-Go" costs generally include items such as property taxes, and fixed operation and maintenance expenses. A similar methodology was proposed by Pym's Market Monitor, as part of Pym's Reliability Pricing Model. See, PJM Interconnection, LLC filing dated August 31, 2005, in Docket Nos. ER05-1410-000 and EL05-148-000, Tab G - Affidavit of Joseph E. Bowring, p. 23-24 (defining avoidable costs similar to "To-Go" costs).

capacity prices do not collapse. The ISO-NE's approach under the Forward Capacity Market construct generally requires bids from new suppliers to be higher than 75 percent of the CONE to help prevent a price collapse below that level. While the reference level proposed in the Filing is applied to existing DGOs to help curb economic withholding,[14] the goal is comparable (i.e., to help prevent a price collapse below the reference level). Applying various assumptions about the NYC 2005 CONE and expected energy and ancillary services revenues yielded a reference level of $82/kW-year.

The Commission should reject claims that a number higher than $82/kW-year is appropriate. Increasing the reference price to account for other factors, such as inflation, would result in a mechanism that will fail to ameliorate the very problem of economic withholding that the Filing is designed to address.

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[14] If a DGO's bid fails both the conduct and impact tests, the bid will be mitigated to the reference level.

For instance, allowing a price of $90 per kW-year would permit the continued economic withholding of over 500 MW of ICAP.[15]

III. The Proposed Mitigation Measures Will Not Act As A Deterrent To New Investors

We agree with the NYISO's conclusion that "investment decisions will not be based on the [market power] mitigation of the three DGOs, but…longer-term factors." [16] It would be irrational for investors to project a revenue stream based on prices that reflect the exercise of market power. Rather than rely on inflated prices resulting from uncompetitive market conditions, potential developers will likely focus on long-term revenue and cost forecasts, and the ability of the market to function in a competitive manner.

Thus, it is essential that ICAP prices accurately reflect underlying market conditions. The proposed mitigation measures

[15] For example, during the summer of 2006, an annual ICAP price of $90/kW-year would represent approximately 68 percent of the annual ICAP Demand Curve reference price of $132/kW-year. Sliding 32 percent down the Demand Curve (i.e., to the right of the minimum requirement) results in 507 MW of additional UCAP that would clear on the UCAP Demand Curve. However, the minimum NYC UCAP requirement for summer 2006 was 8798 MW, while total available NYC UCAP was 9801 MW, implying an excess supply of 1003 MW UCAP above the minimum requirement. Thus, the higher mitigated price cap would have left 496 MW of UCAP unsold, which translates into over 500 MW of ICAP unsold. See, "NYISO Market Monitoring Review of Market Power Concerns in the In-City Capacity Market", presented at ICAP Working Group, Dec. 21, 2006, available at:http://www.nyiso.com/public/webdocs/committees/bic_icapwg/meeting_materials/2006-12-21/MMU_ICAPWG_12212006.pdf.

[16] NYISO Filing p. 11.

better reflect such conditions by producing market outcomes closer to those that would occur in a competitive market.[17] Moreover, the proposal only affects DGOs and does not mitigate new suppliers, who are free to bid their costs and receive the market clearing price.

IV. Additional Issues Regarding The ICAP Market Should Be Addressed Separately

It is anticipated that the DGOs will raise other issues with respect to the ICAP market, such as the slope of the Demand Curve and monopsony power,[18] and suggest that these issues be addressed before the proposed mitigation measures are put into place. Each of these issues, such as whether to adopt longer-term forward capacity markets, will likely be highly contentious and will require significant discussion among interested stakeholders. While the NYPSC is committed to working to address these issues in earnest, they should be carefully studied as part of the Demand Curve reset process already underway, and should not be used as a justification for delaying the implementation of the proposed mitigation measures. Thus, the proposed mitigating measures should be viewed as a short-

[17] NYISO Filing, Affidavit of Dr. Patton, p. 6.

[18] Generators have raised concerns at the NYISO working group meetings with respect to the slope of the NYC Demand Curve and the potential exercise of monopsony market power on the part of loads.

term solution to the on-going exercise of market power, while market participants work to address other issues facing the ICAP market separately.

CONCLUSION

Additional mitigation measures are warranted to curb the abuse of market power within the NYC ICAP market. The measures filed by the NYISO represent an equitable and reasonable approach for addressing uncompetitive market conditions within the NYC ICAP market, and should be approved while stakeholders continue to work on addressing additional issues within the ICAP market. Accordingly, the Commission should direct the NYISO to implement such measures by the requested effective date of March 7, 2007.

Respectfully submitted,

Peter McGowan

Peter McGowan
Acting General Counsel
Public Service Commission
of the State of New York

By: David G. Drexler
Assistant Counsel
3 Empire State Plaza
Albany, NY 12223-1305
(518) 473-8178

Dated: January 24, 2007
Albany, New York

CERTIFICATE OF SERVICE

I, Helen Kaplan, do hereby certify that I will serve on January 24, 2007, the foregoing Notice of Intervention and Comments of the New York State Public Service Commission upon each of the parties of record, indicated on the official service list compiled by the Secretary in this proceeding.

Date: January 24, 2007
Albany, New York

Helen Kaplan

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