

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350

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



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February 5, 2002

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

Re: Docket No. EL01-118-000 - Investigation
of Terms and Conditions of Public
Utility Market-Based Rate Authorizations

Dear Secretary Salas:

For filing, please find the Reply 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,

David G. Drexler
Assistant Counsel

Enclosure

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

INVESTIGATION OF TERMS AND CONDITIONS)
OF PUBLIC UTILITY MARKET-BASED) Docket No. EL01-118-000
RATE AUTHORIZATIONS)

**REPLY COMMENTS OF THE
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK**

Pursuant to the Order Establishing Refund Effective Date and Proposing to Revise Market-Based Rate Tariffs and Authorizations (Order) issued November 20, 2001, and the Notice of Extension of Time dated November 30, 2001, the New York Public Service Commission (NYPSC) hereby submits its Reply Comments.

INTRODUCTION

The Commission's Order proposes to revise all existing market-based rate tariffs and authorizations to include the provision that: "As a condition of obtaining and retaining market-based rate authority, the seller is prohibited from engaging in anticompetitive behavior or the exercise of market power. The seller's market-based rate authority is subject to refunds or other remedies as may be appropriate to address any anticompetitive behavior or exercise of market power."¹

¹ Order at p. 4 (hereinafter "condition" or "proposed condition").

As the NYPSC indicated in its initial Notice of Intervention and Comments dated January 7, 2002, the proposed condition is necessary to ensure that rates are just and reasonable under the Federal Power Act (FPA).² These replies address the claims made by the generators³ that the Order will have an adverse impact on markets and is unnecessary given existing market monitoring and mitigation measures.

Contrary to generators' arguments, this condition will not have a significant adverse impact on wholesale energy markets. Moreover, the condition will act as a backstop for addressing anticompetitive behavior that is either initially undetected or incapable of being mitigated due to the inherent limitations of any mitigation measures, including the New York Independent System Operator's (NYISO's) mitigation measures. Finally, we agree with the comments of the staff of the Bureau of Economics and the Office of the General Counsel of the Federal Trade Commission (FTC) that the Commission should stress structural approaches as a long-term solution, but in the short-term the Commission should implement the proposed condition.

² 16 U.S.C. §§ 824d and 824e.

³ Those generators include, in part, Mirant Americas, Inc. and Mirant Americas Energy Marketing, L.P., Independent Power Producers of New York, Inc., AES Companies, Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc., Southern Company Services, Inc., Duke Energy Entities, PSEG Companies, and Williams Energy Marketing & Trading Company.

DISCUSSION

I. The Proposed Condition Will Not Have A Significant Adverse Impact on Wholesale Energy Markets

Because the Commission's Order simply prohibits the exercise of market power and subjects rates derived from such improper behavior to refunds, it should not deter capital investment in wholesale energy markets. Tolerating anticompetitive behavior, in order to attract capital from a minority of investors who might be seeking short-term returns in excess of the amounts that would occur in a competitive market, would be counterproductive and an improper role for regulation.

Generators argue that they will be subject to refunds for minor abuses or behavior that may arguably be based on reasonable economic considerations.⁴ However, the proposed measure is only intended as a backstop in extreme cases. As the Commission is aware from its recent investigation of California's markets, proving abuse of market power is extremely difficult. Given these practical difficulties, generators' rates will likely be changed in only egregious circumstances.

⁴ See, comments of AES Companies, Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc., Southern Company Services, Inc., Duke Energy Entities, and Williams Energy Marketing & Trading Company.

Similarly, generators will likely be protected from refunds for minor abuses. On the other hand, the potential cost to ratepayers is significant if suppliers are allowed to retain profits derived from market abuse. Thus, the proposed condition strikes a proper balance between encouraging investment and protecting ratepayers.

II. The Proposed Condition Is A Necessary Addition To Existing Mitigation/Monitoring Measures

Some generators assert that the existing mitigation/monitoring measures designed to prevent market abuse are sufficient in an ISO/RTO market.⁵ The New York market is, however, in a transition period insofar as: suppliers can exercise market power when supplies are tight and demand is great, particularly in New York City. Even though the NYISO currently has mitigation measures at its disposal, market power may only be mitigated prospectively, except in limited instances that are unrelated to market abuse (i.e., the NYISO discovers software malfunctions or market design flaws). Because some mitigation measures do not take effect immediately,⁶ wholesale

⁵ See, comments of Mirant Americas, Inc. and Mirant Americas Energy Marketing, L.P., Independent Power Producers of New York, Inc., AES Companies, and PSEG Companies.

⁶ The Automatic Mitigation Procedures (AMP), which do mitigate instantaneously, only apply to economic withholding in the NYISO's day-ahead market.

(and subsequently retail) customers often pay unreasonable rates for the period between the occurrence of the anticompetitive behavior and the NYISO's detection and mitigation.

Consequently, in some instances, a supplier who is found to have engaged in market abuse is free to keep ill-gotten gains.

In sum, the proposed condition would act as a backstop for existing mitigation measures. Moreover, it would discourage suppliers from engaging in anticompetitive behavior because of the knowledge that they will forfeit their ill-gotten gains.

III. The Proposed Condition Should be Implemented While Structural Approaches Are Developed

We agree with the FTC's comments that suggest structural remedies such as easing entry conditions, eliminating transmission grid bottlenecks, and restructuring the ownership of generation are necessary to support effective competition. In fact, New York has implemented several of these structural approaches.

Such restructuring may, however, take several years to develop and implement. Subjecting ratepayers, in the meantime, to unjust (anticompetitive) prices while awaiting structural remedies would be unreasonable. Thus, the proposed condition should be adopted during the implementation of structural remedies. Once markets are determined to be sufficiently competitive, the proposed condition may no longer be necessary.

CONCLUSION

The proposed condition is necessary for the Commission to fulfill its statutory responsibility to ensure just and reasonable rates. Moreover, the condition will not have a significant adverse impact on the markets' development, as investors will still be able to seek reasonable returns on their investments. While the Commission develops long-term structural solutions, the proposed condition is a necessary addition to mitigation/monitoring measures for the short-term. As such, the Commission should require that the condition be made part of all market-based rate tariffs and authorizations.

Respectfully submitted,

Lawrence G. Malone
General Counsel
By: David G. Drexler
Assistant Counsel
Public Service Commission
Of the State of New York
3 Empire State Plaza
Albany, NY 12223-1305
(518) 473-8178

Dated: February 5, 2002
Albany, New York

