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Secretary

May 2, 2005

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

Re: Docket No. PL05-6-000 - Establishing Reference
Prices for Mitigation in Markets Operated by
Regional Transmission Organizations and
Independent System Operators

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 proceedings. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Attachment

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

Establishing Reference Prices for)
Mitigation in Markets Operated by) Docket No.PL05-6-000
Regional Transmission Organizations)
and Independent System Operators)

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

On April 1, 2005, the Federal Energy Regulatory Commission (FERC or Commission) issued a "Notice Inviting Comments on the Establishment and use of Reference Prices" (Notice). The Notice invites comments on the use of Reference Prices by Regional Transmission Organizations (RTOs), Independent System Operators (ISOs) or their market monitors (or contractors) to mitigate bids in order to limit non-competitive results in wholesale electric markets.

NOTICE OF INTERVENTION

The New York State Public Service Commission (NYPSC) submits its Notice of Intervention pursuant to the Notice and Rule 214 of the Commission's Rules of Practice and Procedure.

Copies of all correspondence and pleadings should be addressed to:

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SUMMARY

The NYPS&C supports the use of Reference Prices as a reasonable proxy for competitive bidding behavior in the energy market when economic withholding would otherwise affect the competitiveness of market prices.¹ We also support the use of conduct and impact thresholds for detecting economic withholding that should be mitigated.

Where competitive conditions exist, the accepted bid or LBMP approaches to estimating Reference Prices should result in Reference Prices that reflect marginal costs and are therefore just and reasonable. However, when economic withholding occurs in non-competitive markets, where mitigation occurs most often and there tends to be insufficient data to establish Reference Prices through accepted bids or LBMPs, it is essential that

¹ Reference Prices do not impede scarcity prices. During a time of true scarcity, high priced generator bids are not needed for the setting of scarcity prices, since such prices are set by the NYISO scarcity pricing rules. See, NYISO Services Tariff, Attachment B, and NYISO Open Access Transmission Tariff, Attachment J.

estimates of cost-based Reference Prices developed by RTOs/ISOs reasonably reflect marginal costs.

Estimating cost-based Reference Prices can often be a complex inquiry into a generator's specific costs. Our comments focus on those Reference Prices and recommend that the Commission: 1) establish uniform inputs and methodologies to the greatest extent possible, so that cost-based Reference Prices are reasonable and determined in a consistent manner, 2) adopt a quality control mechanism for reviewing and evaluating cost-based Reference Prices to ensure they are just and reasonable, and 3) establish a process to determine appropriate posting of RTO/ISO mitigation activities in a timely fashion so that policymakers can make judgments about the competitiveness of the marketplace and market participants can better understand the mechanics of the marketplace.

BACKGROUND

When a generator attempts to artificially raise prices through economic withholding,² by submitting inflated bids into the energy market, Reference Prices (i.e., estimates of competitive bids) are used as a substitute for such inflated bids in order to ensure prices are just and reasonable. To

² Economic withholding of an electric facility is where unjustifiably high bids are submitted for that facility so that it will not be dispatched or scheduled, or the bids will set a market clearing price.

detect economic withholding and determine whether mitigation is warranted, each generating unit's actual bids are compared to its Reference Price(s) (also commonly referred to as Reference Levels).

The New York Independent System Operator, Inc. (NYISO) estimates Reference Prices for various generator bids, including energy and minimum generation bids, operating reserves and regulation services bids, start-up costs bids, and other bid parameters.³ For bids that fail the conduct test (i.e., whether a bid exceeds the Reference Price by a set percentage or dollar amount) and impact test (i.e., whether a bid changes market prices by a set percentage or dollar amount), the unit's Reference Price is applied as its default bid.⁴

If a generating unit's bid is mitigated and replaced by its applicable Reference Price, there are two possible outcomes. In one situation, the default mitigated bid will be below the margin and will exert a downward pressure upon prices, but the market clearing price will be set by another generator's bid. The other situation is where the default mitigated bid is on the

³ The NYISO estimates Reference Levels for other non-price bid parameters including, but not limited to, start-up times, minimum run times and minimum down times, and ramp rates and maximum stops.

⁴ The conduct thresholds are more stringent in New York City (NYC), as compared to the rest of the state, due to the limited number of generators competing within the NYC load pocket.

margin and the mitigated bid will set the wholesale market clearing-price.

The NYISO estimates Reference Prices through a number of methods, in order of preference. For energy bids, the first preferred method is the mean or median of a generator's accepted bids or bid components during competitive conditions. If there is insufficient data regarding accepted bids (e.g., a high cost generator that is rarely dispatched), the NYISO looks to the mean locational-based marginal price (LBMP) during hours that the generator was dispatched. Where insufficient data is available to use these methods, the NYISO determines a Reference Price by estimating a generator's marginal costs, including an assessment of incremental operating costs and such other factors the NYISO determines to be appropriate.⁵

DISCUSSION

I. The Commission Should Establish Uniform Inputs And Methodologies To Ensure Estimates of Cost-Based Reference Prices Are Just And Reasonable And Determined Consistently

Estimates of cost-based Reference Prices may vary significantly depending on the methods and data used to estimate generator-specific marginal costs. These Reference Prices must

⁵ The NYISO uses a formula that takes into account heat rate, fuel costs, emissions rate, emissions allowance price, and other variable operating and maintenance expenses. NYISO Services Tariff, Attachment H, §3.1.4.

be reasonable because they may play an important role in setting market prices. Furthermore, because the interaction of different generators' Reference Prices within an ISO/RTO may sometimes determine market prices, Reference Prices should be based on the same inputs and methodologies to simulate the interaction of competitive bids.

Specifically, we encourage the Commission to initiate a process for interested parties to evaluate the methodologies and the data sources for inputs used in estimating cost-based Reference Prices, including, at a minimum: 1) the duration of the historical data that should be used (e.g., one year, five years, or some other duration) for estimating various components of marginal costs, such as emission rates and variable Operation & Maintenance; 2) whether there should be especially high marginal cost estimates for the high-end operation of units to reflect the extreme stress when operated in that range and, if so, how high, and; 3) environmental compliance costs (i.e., emissions allowances). As a result of this process, the Commission should be better informed to establish uniform methodologies and input sources to be used by ISOs/RTOs in estimating cost-based Reference Prices.

We suggest that in establishing a set of uniform inputs and procedures, the Commission indicate a preference for the use of public data sources, such as Environmental Protection Agency

emissions rate data, and fuel price indexes, where appropriate. The Commission should also maximize the use of formulas for as many cost components as possible, in order to minimize discretion and ensure uniform application to all affected.

II. The Commission Should Establish A Quality Control Mechanism For Cost-Based Reference Prices To Ensure They Are Just And Reasonable

The NYISO currently does a full review and update of Reference Prices twice per year (once for the summer capability period and once for the winter capability period). The capability period updates are required because of seasonally-varying generator Demonstrated Maximum Net Capability (DMNC), which typically allows generators to achieve greater efficiency and thus maximum output during winter periods. The updates also recognize the associated costs of complying with seasonally-varying environmental regulations, such as NOx regulations during the ozone season. Further, the updates revise the fuel costs for some generators that tend to burn more oil during winter months. The NYISO also provides an extensive consultation process for individual market participants to update their Reference Prices at the beginning of capability

periods and during the course of capability periods where appropriate.⁶

A process for reviewing and evaluating cost-based Reference Prices is needed so that FERC can ensure that those Reference Prices are just and reasonable. Perhaps most importantly, a review process is needed for cost-based Reference Prices used in transmission constrained load pockets,⁷ where those Reference Prices are on the margin and thus set the market clearing price. In addition, by actively reviewing Reference Prices, the Commission will provide added confidence and faith in ISO/RTO markets. Therefore, we encourage the Commission to adopt a policy for reviewing the implementation of cost-based Reference Prices by ISOs/RTOs.

III. The Commission Should Establish A Process To Determine Appropriate Posting Of RTO/ISO Mitigation Activities In a Timely Fashion

While ISOs/RTOs may have mitigated generator's bids and those mitigated bids may have ultimately set market prices, the fact that this has occurred is not necessarily made known to market participants in a timely fashion. Thus, we encourage

⁶ Generation owners may request temporary changes in their Reference Prices during the course of a capability period in cases where circumstances may have a material effect on the generator's marginal costs. The NYISO may also update Reference Prices as necessary to reflect changes in gas and oil prices.

⁷ The cost-based Reference prices are especially important in New York City (NYC), where mitigation occurs most often.

FERC to initiate a process whereby ISOs/RTOs and their respective market participants can determine appropriate mitigation posting requirements, such as MWh's of bids mitigated, the number of hours in the year which mitigation occurred, the location (e.g., load pockets), the market (e.g., day-ahead and real-time), posting frequency, and posting method (e.g., website).⁸

It is important that interested parties are made aware of the mitigation activities taking place in the market. For instance, policymakers should know how often mitigation is taking place so that judgments about the competitiveness of the marketplace can reflect how often mitigation is needed. This type of information would better inform competitive policy decisions, including proposed mergers and siting decisions. Similarly, market participants, in their attempts to understand what drives prices in the marketplace, should know when a mitigation event has occurred that may have caused a sudden drop in prices. Otherwise, market participants are left attempting to make assumptions about the drop in prices which may cause

⁸ The posting requirements for areas that experience frequent mitigation may differ from the posting requirements for areas where mitigation occurs rarely. While the fact that mitigation has been applied should be made public, we do not suggest that the individual market participants that have been mitigated be identified at this time.

confusion and incorrect understandings of the marketplace mechanics.

CONCLUSION

For the reasons discussed above, the Commission should adopt the NYPSC's recommendations.

Respectfully submitted,

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Dated: May 2, 2005
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