STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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May 14, 2002

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

Re: Docket Nos. ER01-3155-000, ER01-1385-001, EL01-45-001 - New York Independent System Operator, Inc.

Dear Secretary Salas:

For filing please find the Motion to file Answer and Answer to Protests 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) 486-2652.

Very truly yours,

Saul A. Rigberg
Assistant Counsel

Enclosure

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.	)	Docket No. ER01-3155-000
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.	)	Docket Nos. ER01-1385-001 & EL01-45-001

MOTION TO FILE ANSWER AND ANSWER OF THE NEW YORK STATE PUBLIC SERVICE COMMISSION TO PROTESTS

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Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, the Public Service Commission of the State of New York ("NYPSC") hereby submits its motion to file an answer and its answer to the Protests submitted by various parties[1] on April 23, 2002, in response to the Mitigation Measures Compliance Filing of the New York Independent System Operator ("NYISO"). Although Rule 213(a)(2) does not permit answers to protests unless otherwise ordered by the Commission, the Commission has accepted pleadings for good cause, such as when the information would ensure a complete and accurate

[1] Independent Power Producers of New York, Inc. ("IPPNY"); Dynegy Power Marketing, Inc. ("Dynegy"); NRG Power Marketing, Inc., Arthur Kill Power LLC, and Astoria Gas Turbine Power LLC [collectively, "NRG"]; KeySpan-Ravenswood, Inc.'s ("Ravenswood"); Reliant Energy Power Generation, Inc. ("Reliant"); Electric Power Supply Association ("ESPA"); Constellation Power Source, Inc. ("Constellation"); Morgan Stanley Capital Group, Inc. ("Morgan Stanley"); AES Eastern Energy, L.P. ("AES"); Mirant Companies ("Mirant"); PPL EnergyPlus, LLC ("PPL"); and, Aquila Merchant Services, Inc., Edison Mission Energy, Inc., and Edison Mission Marketing and Trading [collectively, "Aquila"].

record, clarify issues and factual evidence, and aid the Commission in its understanding and resolution of the issues.[2]

Good cause exists to allow the NYPSC's answer because it will contribute to the development of a complete and accurate record and assist the Commission's understanding and deliberations on this matter. The Generators' claims of flaws in the NYISO's Mitigation Measures Compliance Filing are based on factual errors, erroneous or unproven assumptions, skewed logic, and arguments previously rejected by the Commission. Their Protests should be rejected.

Our answer is limited to the major problems contained in the Protests of the Generators. First, we explain why there is no merit to the assertion that New York City generators cannot exercise market power. Second, we show why the allegation that their revenues are inadequate not only continues to be unsupportable by the Generators, but also is wrong. Next, we demonstrate that the five-percent annual price impact curve, preferred by the Generators, would lead to unjust and unreasonable prices in New York City. Fourth, we discuss why

[2] The Commission has accepted answers when the responsive pleading would assist in the Commission's analysis, provide useful and relevant information, or would otherwise facilitate a full and complete record upon which the Commission can base its decision. *See, e.g.*, *East Tennessee Natural Gas Co.*, 81 FERC ¶ 61,219 at n.4 (1997); *National Gas Pipeline Co. of America*, 81 FERC ¶ 61,216 at n.3 (1997); *Pacific Interstate Transmission Co.*, 81 FERC ¶ 61,369 at n.2 (1997); *Florida Gas Transmission Co.*, 79 FERC ¶ 61,147 at n.7 (1997).

the Generators' claims of alleged "flaws" in the setting of Reference Levels are baseless. Finally, we explain that the Generators' criticisms of the AMP are ill founded.

I. THE GENERATORS' CLAIM THAT THE NEW YORK CITY MARKET IS WORKABLY COMPETITIVE IS NOT CREDIBLE.

Several generators suggest that the New York City market is workably competitive and that their ability to exercise market power has been overblown.[3] Accordingly, they assert, special In-City mitigation measures are not needed. The facts, presented by the NYISO in its Mitigation Measures Compliance Filing (at 38-39), in the affidavit of Dr. David Patton, the NYISO's Market Advisor (at ¶¶ 42-55), and by the NYPSC in its Protest (at 7-9), paint a different picture.

A. With Only One To Five Generation Owners In Its Nine Load Pockets, The New York City Market Frequently Is Not Workably Competitive.

New York City has a total of nine load pockets. They are: 1) 345kV In-City; 2) 138kV In-City, which encompasses almost half of the City and contains most of the small subpockets

[3] For instance, NRG (at 15-17) states that "the NYISO has exaggerated an In-City generator's ability to exercise market power and fails to provide any meaningful evidence that the bidding thresholds in the statewide mitigation measures must be drastically reduced to address supposed concerns about the exercise of market power by In-City generators." Ravenswood (at 14-19) asserts that "In-City generators cannot exercise significant market power" in the 345kV load pocket or in the Real-Time Market (RTM).

within it; 3)Astoria East/Corona/ Jamaica; 4) Astoria West/Queensbridge; 5) Astoria West/Queens-Bridge/Vernon; 6) Vernon/Greenwood; 7) Greenwood/Staten Island; 8) Staten Island; and 9) East River. In several of those load pockets only three generation owners provide energy, allowing them to have power over the price in high-load conditions.[4]

Dr. Patton also analyzed the market shares of the In-City generators against the Commission's new Supply Margin Analysis Screen to assess whether a market participant has generation market power.[5] Under this new analysis, a market participant is considered pivotal if its generation portfolio exceeds the market's surplus of capacity above the peak demand. A market participant is pivotal when it is in a position to demand a high price above competitive levels and be assured of selling at least some of its capacity.

Dr. Patton concludes that a single supplier would be pivotal in the entire New York City area two to six percent of

[4] See NYPSC Protest at 8.

[5] Order on Triennial Market Power Updates and Announcing New, Interim, Generation Market Power Screen and Mitigation Policy, 97 FERC ¶ 61,219 (November 20, 2001).

the hours.[6] He illustrates the significance of this finding by showing that a supplier that is pivotal in four percent of the hours that uses this capability to raise prices in the constrained area to $1,000 would raise the average annual spot price for energy in that area by 70 percent.[7] Dr. Patton also indicates that although this pivotal supplier analysis could not be done for the sub-load pockets, because load data for these narrower areas was not available, suppliers in these areas are likely to be pivotal more frequently than they are in New York City as a whole because the constraints bind much more frequently and the concentration of supply is much higher.[8]

Thus, some of each of KeySpan's, Orion's, and NRG's capacity must be used to meet demand and each of these generation owners is a pivotal market player as defined by the Commission. Absent mitigation measures, therefore, each of these owners would have the unlimited ability (up to the $1,000 bid cap) to set the market-clearing price in some hours because

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[6] Six percent equates to 526 hours on an annual basis. The proposed In-City Mitigation Measures employs a focussed structural trigger that activates only for hours in which New York City transmission constraints are present. The overall New York City pocket was constrained for 572 hours in 2001, or 6.5% of the time. Patton Affidavit at ¶ 70.

[7] Patton Affidavit at ¶¶ 48-50.

[8] See Patton Affidavit at ¶ 51.

each of these owner's amount of capacity exceeds the supply margin.

B. The Generators' Claim That Market Power Does Not Exist In New York City Is Based On Flawed Analyses.[9]

Relying upon the analysis of its consultant, Ravenswood (at 15-16) asserts that no generator has market power in the 345kV load pocket when the New York Interface is constrained. The consultant used a simulation technique that led him to conclude that the price impacts are all below five percent.[10] His analysis is incorrect, because it significantly overstates a crucial input, the price elasticity of demand.

Ravenswood's consultant bases his conclusion on computer simulations of the New York City market, which purport to demonstrate that unmitigated profit-maximizing strategies by the divested suppliers (Ravenswood, NRG, and Orion), acting

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[9] Assertions that market power cannot be exercised in New York City are an inappropriate response to the NYISO's Compliance Filing because the Commission has already determined that the potential for the exercise of market power exists in New York City markets. *See, e.g., Consol. Edison Co. of N.Y., Inc.*, 96 FERC ¶ 61,095 at 61,384 (2001). As directed by the Commission in its November 27 Order, the NYISO has filed revised tariff sheets combining the In-City Mitigation Measures in Con Edison's rate schedule with the NYISO's statewide mitigation measures. The proper vehicle for attacking the need for In-City mitigation measures is not a protest regarding the NYISO compliance filing, but, rather, a new Section 206 complaint, in which the party would be required to prove that the mitigation measures are unjust and unreasonable.

[10] Ravenswood implies that price increases due to market power below five percent are acceptable.

collusively would only increase annual average prices in New York City by 2.23% (on-peak prices increase by 2.79%). Therefore, any mitigation, he argues, should be limited to only the subpockets, which he has not modeled.[11]

These simulations, however, contain a crucial flaw. The consultant assumed a New York City price elasticity of demand, which reflects how load responds to higher prices, of -0.26, based on data presented in the NYISO Price Responsive Load Program Evaluation Final Report, dated January 8, 2002. This -0.26 assumption is about 100 times too large because the consultant confused price elasticity of supply in the Report with price elasticity of demand. Since peak loads in New York City are over 10,000 MW, and prices in high-load periods increase well over 100%, the analysis effectively yields load reductions of well over 2600 MW in New York City in response to price spikes.[12] The actual load reduction in New York City last summer was 37 MW.[13] If demand elasticity were as large as the

[11] Affidavit of Aleksandr Rudkevich, at 6-8.

[12] Estimated as 100% price change times –0.26 (% change in demand / % price change) times 10,000 MW.

[13] NYISO Price Responsive Load Program Evaluation Final Report, at E-5.

consultant assumed, there might indeed be no need to mitigate the New York market. That, however, is not the case.[14]

Ravenswood (at 17) further asserts that "[a]s with the 345kV market, the NYISO offers no analysis of market power in the RTM. The NYISO asserts that the frequency of congestion into and within New York City creates opportunities for a persistent exercise of market power, but this claim is completely unsupported." According to Ravenswood (at 18-19), the RTM is a distinct product market, with unique supply and demand characteristics; it is too small and either too unpredictable or too easily hedged for generators to exercise market power in it, because the RTM accounts for only about eight percent of the energy sold in New York State. Ravenswood continues (id.):

> For example, a hypothetical example suggested by Dr. Patton, states that, if suppliers are pivotal in 4% of the hours of the year and are able to drive real-time prices to the $1,000/MWh bid cap, the average real-time price for the year would increase by approximately 70%.[15] However, because the 70% figure is for the small RTM only (i.e., approximately 8% of purchases), this real time

[14] This crucial error severely overstates the market's ability to fend off the exercise of market power. The NYPSC readily accepts that, if real-time pricing and other demand-side initiatives were yielding a demand response of 2,600 MW for New York City, a reasonable argument could be made for a lack of supplier market power.

[15] Patton Affidavit at ¶ 50.

> price increase would raise customers' annual energy costs by only 5.6%, i.e., 70% x .08.

The analysis of Ravenswood's consultant, on which its assertion is based, is flawed.

The consultant states that the RTM is a separate market from the DAM, and should be analyzed separately. However, arbitrage, for example, through Virtual Bidding between the DAM and RTM, ensures that any price increases in the RTM will eventually show up in the DAM (and in other forward markets as well). Therefore, the argument that a 70% increase in RTM prices would only lead to a 5.6% increase in overall prices is wrong.[16]

Ravenswood (at 19) incorrectly contends that if suppliers exercised market power in the RTM, others could counter this market power through Virtual Bidding, by purchasing energy in the DAM and selling in the RTM. However, Virtual Bidding, which is solely a part of the DAM, does not supply any physical energy in the RTM. Thus, it cannot directly affect the RTM price

[16] Generator parties cannot have it both ways. Regarding some topics, such as Day-Ahead AMP mitigation, arguments are made that protection of the DAM from market power is not needed since buyers can simply shift their purchases to the RTM. Conversely, Ravenswood argues that a 70% increase in the RTM is inconsequential because buyers can always buy in the DAM.

(which is determined by the intersection of physical supply bids and actual load). Virtual Bidding simply adjusts the DAM price to better equate it to the expected RTM price. It can only mitigate market power in the DAM, not in the RTM.

II. THE GENERATORS HAVE NOT PROVIDED RELIABLE EVIDENCE TO SUPPORT THEIR CLAIMS THAT THEIR REVENUES ARE INADEQUATE.

Several generator parties (for example, NRG at 18-22) argue that the NYISO's proposed mitigation measures would result in generators not recovering all their fixed costs and would discourage the siting of new generation.[17] They fail, however, to offer any viable factual support for these allegations.[18] We urge the Commission to review generator costs, sales and revenues before accepting such claims.

As support for the assertion that its revenues from current generation are inadequate to support new generation, NRG provided an affidavit based upon a flawed analysis. NRG's

[17] Similarly, Aquila (at 33-35) asserts that the AMP is a barrier to entry. But, the AMP imposes no new thresholds; all the AMP does is prevent one day's worth of market power prices by simply automating the existing and long-standing market mitigation measures. It is not acceptable to allow unjust and unreasonable prices, even for one day.

[18] The Generators also ignore other sources of revenue. For example, generator costs are expected to be recovered from both the energy and capacity markets, as well as from the ancillary services market and bid production cost guarantee payments.

consultant assumed a peaking unit built in New York City at the cost of $981/kW. This assumption was based on the construction cost for NYPA's new plants.[19] NYPA, however, paid a premium for labor, equipment and other project components in order to build these plants in an extremely short amount of time. Costs for a project constructed under normal time constraints would likely be on the order of 25 percent less.[20]

The consultant also made two fundamental mistakes. First, in assuming that the new peaker's energy price would equal its bid price, he ignored the fact that the market-clearing price for energy would govern the energy revenue stream. Second, he failed to acknowledge the significant revenue stream that the peakers derive from ICAP payments.[21]

This new peaking unit would have a heat rate (around 10,000 BTU/kWh) that is much less than older In-City peakers (16,000 BTU/kWH). As we pointed out in our Protest (at 20), during many hours, therefore, it would receive payments based on an LBMP that was set by a less efficient unit, or set at an even higher

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[19] Felder Affidavit at ¶¶ 44-45.

[20] *See, e.g., Market-Based Coal Power Systems*, Final Report-May 1999, at Section 9, U.S. Department of Energy; www.fe.doe.gov/coal_power/special_rpts/market_systems/market_sys.shtml. The costs contained in this study were increased significantly to account for the higher cost of operation in New York City.

[21] New York City generation owners receive the highest ICAP payments in the country.

level by true scarcity. Payments, therefore, would on average be higher than the generator's bid price.

Finally, based on the operation of peakers in New York City in recent years, the consultant assumed that the new peaking unit would operate 400 hours per year in the 138kW-load pocket. This approach is flawed as well. With the low heat rates of new efficient units, the new peaking unit may actually run substantially more than the assumed 400 hours since it would be more efficient than many of the In-City peaking and baseload plants. More realistic estimates of costs and revenues would have produced favorable returns.

All together, these flaws constitute significant shortcomings in the study. Without actual financial data provided to the Commission by the generators unsubstantiated claims of inadequate revenues must be dismissed.

Similarly, Reliant's consultant errs in stating "[t]he thresholds are lowest in the subload pockets and therefore provide the strongest disincentive for siting new capacity exactly where we should be giving the greatest incentive to build new capacity."[22] This statement ignores the fact that a load pocket receives mitigation when its price exceeds the price outside the pocket.

[22] Affidavit of Mark Younger at 6.

As such, by definition, the prices inside a load pocket with market power exceed the prices outside the pocket, even in the presence of mitigation. For example, New York City, during 2001, was both the most heavily mitigated market in New York State and the highest-priced market in New York State. The true facts, therefore, are that the highest prices are, and will continue to be, signaled for new generation, inside the load pockets, even in the presence of mitigation. All the mitigation measures do is lower the prices from an unreasonable high level to a reasonable high level.

III. A FIVE-PERCENT ANNUAL PRICE IMPACT CURVE WOULD LEAD TO UNJUST AND UNREASONABLE PRICES IN NEW YORK CITY.

The Generators claim that a five-percent curve is necessary to accommodate sudden increases in operating costs. However, they fail to provide any support for this claim. In contrast, as we stated in our Protest (at 10-14), a two-percent curve is more reasonable because it balances the generators' need for bidding flexibility and for adequate revenues to encourage the siting of new generation with the Commission's responsibility to protect against non-competitive and unreasonable prices.

Reliant (at 7-9), for example, supported by the affidavit of its consultant, asserts that there are several imperfections (fuel price lags, operational risks, etc.) in estimating a

generating unit's Reference Levels.[23] It is argued that these imperfections, coupled with the use of $3/MWh thresholds in sub-load pockets, would lead to over-mitigation. Reliant proposes that its concern be addressed by raising the thresholds through the use of a five-percent price impact curve rather than the NYISO's proposed two-percent price impact curve.

Imperfections are part of any mitigation measure. Reliant's comments focus only on the former. The inability to obtain a perfect Reference Level in each and every hour of the year does not mean that the mechanism, on balance, over the course of the year will over-mitigate. Hours in which actual marginal costs are below the Reference Levels will yield allowable bids by generators that are higher than the level intended by the mitigation measures. The presence of such hours will harm consumers, by raising prices relative to competitive levels, but will be offset by the effects of the other hours on which Reliant and its consultant focus so heavily. On balance, both generators and consumers receive fair treatment.

Further, there are two levels of cushion that are built into the proposed mitigation measures to protect generators from over-mitigation. First, the formula for setting Reference Levels includes various adders, and, second, mitigation is not imposed until the large conduct and impact thresholds over the

[23] Younger Affidavit at 3-5.

Reference Levels are exceeded. In a transmission-constrained market beset with market power, as is the case during certain hours in New York City, the Generators' approach would fail to adequately protect consumers from the exercise of market power. The Commission should recognize the need to maintain a careful balance regarding mitigation and resist the urge to raise thresholds above the NYISO's proposed level.[24]

Moreover, as noted in our Protest (at 16-19), even without further modification generator revenues will increase if the compliance filing is adopted. For instance, prices would increase due to new Day-Ahead Market Reference Levels that would reflect variable O&M costs greater than $1 per MWH, emissions cost, and other new factors not included in the current New York City formula for Reference Levels. Computer programming changes that minimize out-of-merit dispatch and permit separate pocket market clearing prices will increase locational-based marginal prices (LBMPs). The eventual use of a non-zero threshold above Reference Levels in the DAM should also increase market prices, as will an increase in the congestion trigger from 105% to 107% of the LBMP's at Indian Point 2 bus.

[24] The NYISO has proposed changing the Reference Levels (raising them) from the current strict formulaic ones (originally adopted by the Commission in 1998) and raising the thresholds from their current level of zero in the New York City DAM market. Both of these proposals address the concern about over-mitigating and, in so doing, raise prices to New York City consumers.

The exact magnitude of the price increases will depend on a number of factors but the increases will be substantially greater than two percent. Consequently, these increases not only provide bidding flexibility for generators, they also further encourage the siting of new generation. Approval of the five-percent curve threshold, as the Generators propose, is unreasonable given the record in this proceeding.

Furthermore, if the generators are concerned about sudden changes in operating costs, they can easily avail themselves of the well-established process by which they can contact the NYISO either through telephone communication or electronic mail communication as late as 1:00 a.m. on the day of the DAM run (bids close at 5:00 a.m.[25]) to advise the NYISO of changes in the cost of inputs and ask that the Reference Levels be adjusted accordingly. The NYISO has been amenable to such changes in the

[25] Technical Bulletin No. 68.

past (responding quickly and affirmatively to the two requests received last year).[26]

Finally, the Generators complain (for example, Ravenswood at 20) that Dr. Patton "concedes" that with the two-percent curve the overall prices will not rise by two-percent. The key is not to provide revenues to generators at prices in excess of competitive levels, but to provide adequate revenue, to induce new generation. Prices reflecting market power should not be the expectation of any market participant.[27] Such pricing would be economically inefficient.

[26] Similarly, generators maintain control over many other areas of their operation. For instance, IPPNY, AES, and NRG oppose the NYISO proposal that all units in constrained areas be placed "on dispatch" if they are physically capable of doing so. These parties argue that placing some units on dispatch can cause excessive costs related to turning units on and off frequently or to steep ramping of the unit's output. These operations are really under the control of the owner, which can specify the minimum run time of its units or the ramp rate that units can tolerate without incurring extra costs. Accordingly, there is no merit to this argument.

[27] Aquila (at 32-33) complains that In-City mitigation measures will reduce volatility. The Commission's goal should be a normal, competitive level of volatility, not excessive volatility that flows from the exercise of market power. Aquila incorrectly argues that forward contracting and other forms of hedging can protect against market power. All of the NYISO's markets are inter-related; the existence of market power in any one market will skew upward prices in the other markets.

IV. THE GENERATORS' CLAIMS OF ALLEGED "FLAWS" IN THE SETTING OF REFERENCE LEVELS ARE WITHOUT MERIT.

Dynegy asserts that the process by which Reference Levels are set is flawed because market prices in adjacent markets are not considered and the use of accepted bids should be modified to include year-old bids. Both of these proposals would cause an unreasonable and non-competitive increase in LBMPs.

A. Including Geographic Opportunity Costs Would Encourage The Exercise Of Market Power.

Dynegy (at 8) argues that the Commission should direct the NYISO to develop an administrative process that would allow Reference Levels to be adjusted quickly to account for short-term opportunity costs. It asserts: "If Reference Levels cannot be adjusted more timely or flexibly when price spreads between regions are observed, seams between regions will not closed because the AMP will prevent the efficient allocation of resources on a inter-regional basis."[28]

Dynegy would apparently replace a market solution with a cumbersome administrative process. Currently the trading of power among and between markets generally yields prices that reflect the marginal costs in adjacent markets. While seams issues presently render imperfect the transfer of market impacts from one market to another, there is, nonetheless, a strong interdependence that works well much of the time, causing the

[28] Id.

LBMP in a generator's home market to rise and fall as a function of factors at play in nearby markets. Relying on the market in this manner is more efficient than attempting to manage an entirely new system for estimating geographic opportunity costs.

In contrast, Dynegy's proposal would require the generation owner and the NYISO each day to make their own predictions of market prices in nearby markets for each hour of the next day. The generator would then request to bid at prices that reflect its forecast and the NYISO would thereafter establish Reference Levels that reflect the NYISO's own forecast of market prices in other geographic areas. The NYISO would then compare its estimate to the generator's bid to determine which bids are non-competitive and require mitigation.

Even if the market price in a neighboring market could be predicted, and agreed to both by the NYISO and the generation bidder, setting Reference Levels equal to geographic opportunity cost allows bids to be $99 above the opportunity cost and still be immune from mitigation (given the $100 conduct threshold). This would allow every generator, in every hour, to economically withhold generation (up to $99), and exercise market power, while being free from mitigation.

B. Dynegy's Proposal To Use Year-Old Bids In Setting Reference Levels Will Result In Unjust And Unreasonable Prices.

Currently, in setting Reference Levels, the NYISO uses a bidding history based on the previous 90 days of accepted bids for similar hours and load levels, adjusted for fuel prices. Dynegy (at 12-13) asserts that in order for the AMP to distinguish between market power and scarcity, the bidding history should be based on bids accepted during comparable times of the year, when supply and demand conditions are similar.

The proposal does have some attractive features for baseload units, which almost always have their bids accepted and have a strong bidding history, but the approach would be disastrous for peaking units. Peakers by their very nature do not have their bids accepted frequently. When their bids are accepted it is because the market is on the steep part of the supply curve and market prices are quite high. It is precisely when this market condition occurs that generators can most easily exercise market power. The season of the year is not particularly relevant because tight conditions can occur, under certain circumstances, any time of the year.

For instance, Dynegy's proposal could encourage a generation company that owned a fleet of units including baseload and peakers to bid its peakers at, for example $500 at all times and find itself only occasionally being chosen. Over

time, under Dynegy's proposal, this conduct would establish unreasonable Reference Levels,[29] which in turn, would result in unjust and non-competitive prices on high load days.

IV. THE GENERATORS' CRITICISMS OF THE AMP ARE ILL-FOUNDED.

Aquila, IPPNY, AES, and Dynegy, among others, oppose continuation of the AMP for the same reasons the Commission has repeatedly rejected.[30] In particular, the claim that mitigation measures like the AMP would discourage new generation must be evaluated in context. First, generator owners possessing market power have little incentive to add capacity since new capacity may have the effect of diluting their market power. Second, the claim can become a self-fulfilling prophecy in that generation owners can delay new projects for whatever reason and attribute blame for the delay to the mitigation measures.

[29] We urge, moreover, as we stated in our Protest (at 14-16), that the Commission evaluate the NYISO's current Reference Level administrative (non-market) determinations on a case-by-case basis to ensure that each unit's Reference Levels are appropriate and that non-competitive conditions did not improperly result in unreasonable Reference Levels.

[30] Aquila (at 25-36), IPPNY (at 22-25), AES (at 16-18), Dynegy (at 2-5).

A. Practice, The AMP Focuses Only On High Prices Caused By Market Power And Does Not Limit High Prices Caused By Scarcity.

Aquila (at 30) claims that "the record of market prices does not validate Dr. Patton's conjectures regarding the ability of the conduct impact framework to discriminate between market power and scarcity rents." Aquila supports its conclusion with the observation that when the New York Control Area was in a period of true scarcity during the week of August 6, 2001, only in a few hours on those days did spot prices ever approach the $1,000 per megawatt hour bid cap.[31] This observation is not relevant because what is important is whether the AMP was triggered during this period of scarcity. In fact, according to the NYISO in its September 28th, 2001 filing to extend the AMP, although prices reached or surpassed the $150 threshold level twelve times during the summer of 2001, the AMP intervened only four times. For example, for hours 14 and 15 on August 9, 2001, the AMP did not mitigate even though the price actually hit the $1,000 per kilowatt-hour bid cap. Thus, high prices by themselves do not cause imposition of the AMP.

B. Mitigating When Bids Collectively Exceed The Impact Threshold Ensures That Prices Are Just And Reasonable.

IPPNY (at 24-25) and AES (at 16) assert, as a significant flaw, the process by which the AMP would mitigate bids that

[31] Id.

exceed the conduct threshold, but that individually do not exceed the market impact threshold. As the AMP is applied today and as the NYISO is proposing to continue, if the combined result of the bids that exceed conduct thresholds yield a price increase that exceeds the market impact threshold (that is, drive prices up by more than $100 per MWh), then the NYISO would mitigate all of those bids regardless of whether any of the individual bids would have, on its own, caused a price increase that exceeded the market impact threshold. The Generators claim that this is completely unfair in that the NYISO, they suggest, is prejudging that collusion would have taken place among the generators. This analysis is flawed.

At times when the market is tight and is clearing on the steep part of the supply curve, any one generator's economic withholding may cause a significant increase in price, albeit one that is below the impact threshold, but several generators each acting independently at the same time (without any collusion) could raise prices dramatically above competitive levels. For instance, four pivotal players independently bidding may each cause an $80 impact on prices paid by consumers. Together, they may raise a competitive price of $100 to an uncompetitive price of $420 [$100 + ($80 x 4)]. Although no collusion has taken place, it cannot be concluded that a price of $420 that consumers must pay under these circumstances

is just and reasonable. The existing AMP and its large impact threshold properly address this circumstance by mitigating only when the impact on buyers of electricity is significant.

C. The AMP Process Allows Generators To Demonstrate That Reference Levels Should Be Adjusted Upwards.

IPPNY (at 22-23) and Dynegy (at 14) argue the AMP process is flawed because there is not adequate opportunity for generator consultation with the NYISO. The facts belie this claim because actual practice has shown this to be unfounded. The NYISO stated that there were only two instances in the entire 2001 summer period when a generator requested that the NYISO adjust its Reference Levels upwards. In both cases, after consultation with the generator, the NYISO granted the request.

D. The AMP Must Apply To All Megawatts Not Just UCAP Megawatts.

Dynegy (at 14-15) asserts that the AMP should not apply to megawatt levels above a unit's UCAP amount and that non-UCAP generators should not be subject to the AMP. Its position confuses installed capacity "must-bid" rules with prohibitions against market power. The purpose of measures like the AMP is to prevent the exercise of market power. Installed capacity rules are designed to ensure reliability.

Generators determine how much, if any, of each of their units' capacity would be subject to UCAP requirements, for which they receive generous UCAP payments. Under Dynegy's proposal, a

generator could analyze its ability to obtain market power prices as a pivotal player and balance that potential with UCAP payments to determine whether to become a UCAP provider and, if so, how much capacity to subject to UCAP. The AMP, therefore, must apply to all situations, regardless of the UCAP applicability.

CONCLUSION

For the reasons expressed above, the Protests of the Generators should be rejected.

Respectfully submitted,

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(518) 473-8178

Dated: May 14, 2002
Albany, New York

CERTIFICATE OF SERVICE

I, Karen Houle, do hereby certify that I will serve on May 14, 2002, the foregoing Answer of the Public Service Commission of the State of New York by depositing a copy thereof, first class postage prepaid, in the United States mail, properly addressed to each of the parties of record, indicated on the official service list compiled by the Secretary in this proceeding.

Date: May 14, 2002
Albany, New York

Karen Houle