STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350

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

PUBLIC SERVICE COMMISSION

WILLIAM M. FLYNN
Chairman
THOMAS J. DUNLEAVY
LEONARD A. WEISS
NEAL N. GALVIN

DAWN JABLONSKI RYMAN
General Counsel
JACLYN A. BRILLING
Secretary

June 9, 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 Motion for Leave to file Supplemental Comments and the Supplemental 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 Regional Transmission Organizations and Independent System Operators	))))	Docket No.PL05-6-000

MOTION FOR LEAVE TO FILE SUPPLEMENTAL COMMENTS
AND SUPPLEMENTAL COMMENTS
OF THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK

INTRODUCTION

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 invited 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. The New York State Public Service Commission (NYPSC) submitted its Notice of Intervention and Comments in response to the Notice on May 2, 2005. On or around the same date, various parties also filed comments on the Notice. We address several of these comments herein.

In particular, we respond to the suggestion of the Electric Power Supply Association (EPSA) that Automated Mitigation

Procedures (AMP),[1] act as price caps, thereby suppressing price signals necessary for the market to function properly. Similarly, Reliant Energy, Inc. (Reliant) argues that energy market price signals are depressed because Reference Price levels do not account for scarcity rents. While the AMP is not the subject of this proceeding, we are compelled to respond to these arguments so that there will be a complete and accurate record in this proceeding. Accordingly, these comments demonstrate that the AMP does not act as a price cap, or prevent scarcity prices and the associated market signals, in markets such as the New York Independent System Operator, Inc.'s (NYISO) that have scarcity pricing rules in place. With these types of rules in place, Reference Prices and the AMP can distinguish between prices caused by legitimate scarcity and prices caused by the impermissible exercise of market power.

EPSA further suggests that Reference Prices do not adequately compensate generators. We respond by indicating that, in New York, generators are adequately compensated between Reference Prices for energy and ancillary services, the NYISO's scarcity pricing rules, Locational-Based Marginal Prices

[1] The AMP is an automated version of the conduct and impact tests used in determining whether mitigation should be applied by replacing a generator's uncompetitive bid with its Reference Price.

(LBMPs), and the Installed Capacity (ICAP) market. Accordingly, these arguments should be rejected.

MOTION FOR LEAVE TO FILE SUPPLEMENTAL COMMENTS

The NYPSC respectfully moves for leave to file these Supplemental Comments out-of-time, pursuant to Rule 212 of the Commission's Rules of Practice and Procedure. Because this proceeding involves a Notice for Comments and is not a contested docket, parties will not be prejudiced by the Commission's acceptance of these Supplemental Comments out-of-time. Moreover, good cause exists to accept these Supplemental Comments, which, as described below, contribute to the development of a complete and accurate record, provide useful information, and assist the Commission's understanding and deliberation on this matter.[2] Accordingly, the Commission should grant the NYPSC's Motion for Leave to File Supplemental Comments.

[2] The Commission has previously granted motions to file supplemental comments on similar grounds. See, Transcontinental Gas Pipe Line Corporation, 42 FERC ¶63,024 (issued March 2, 1988); AES Power, Inc., 69 FERC ¶61,345 (issued December 15, 1994); and Wyoming Interstate Company, Ltd., 91 FERC ¶63,014 (issued June 28, 2000).

SUPPLEMENTAL COMMENTS

I. The NYISO's Reference Prices and Mitigation Procedures Do Not Function as Price Caps Or Prevent Scarcity Pricing

EPSA argues that the AMP[3] functions as a price cap, thereby artificially dampening prices that are needed to elicit "adequate supply, infrastructure, demand response [and] investment" in the market.[4] Based on these claims, EPSA asks the Commission to "reevaluate the AMP mechanism altogether."[5] Reliant further claims that as a result of the AMP, "energy market price signals are depressed because reference price levels do not account for scarcity rents."[6] Although the AMP is not the subject of this proceeding, we are responding to ensure a complete and accurate record, and to ask that EPSA's arguments be rejected in a market such as the NYISO's, which has pricing rules in effect that allow generators to be paid scarcity prices despite the use of mitigation measures.

Contrary to EPSA's claim that the AMP functions as a price cap, the effect of the NYISO's use of mitigation measures, through Reference Prices and the AMP, is to mitigate bids and

---

[3] As noted above, the AMP is merely an automated version of the conduct and impact tests used in determining whether mitigation should be applied by replacing a generator's uncompetitive bid with its Reference Price.

[4] EPSA comments at 5-6.

[5] EPSA comments at 5-6.

[6] Reliant comments at §1(c).

not prices. In other words, mitigation of a generator's bid, which occurs when such bid results in an exercise of market power, does not mean that the market price will necessarily be capped. In fact, all generators, including those that are mitigated, get paid the market clearing price regardless of what they bid. Thus, while the AMP may mitigate bids, it does not limit a generator's ability to obtain the market clearing price.

Reliant and EPSA both argue that the AMP does not permit market prices to reflect scarcity conditions. However, the use of conduct and impact thresholds, in combination with the NYISO's scarcity pricing rules,[7] enables the AMP to distinguish between high prices due to scarcity and high prices associated with artificial scarcity caused by market power. During a time of true scarcity, the NYISO's scarcity pricing rules set prices. These rules cover price responsive load programs (e.g., the Emergency Demand Response Program (EDRP) and Special Case Resources), and ancillary services shortages. For example, regardless of whether mitigation occurred, when electricity supplies are scarce, EDRP allows large-use consumers to reduce consumption and set the market clearing price at $500 MW. Under such conditions, all generators receive this market clearing price. Likewise, when the NYISO is short of meeting the

[7] See, NYISO Services Tariff, Attachment B, and NYISO Open Access Transmission Tariff, Attachment J.

required amount of operating reserves, a shortage cost of up to $1,750 per MWh is automatically incorporated into the energy price for the period in which there is a shortage, notwithstanding mitigation. Thus, during such a period, all generators could bid just $1 per MWh and the price would still reach $1,000 MW or higher due to the scarcity pricing rules. As such, there is no need for scarcity to be incorporated into any generator's bid or into any generator's Reference Price in order for generators to receive scarcity prices.

There is also evidence that under real-world conditions, the AMP focuses only on high prices caused by market power and does not limit legitimate high prices caused by true scarcity. For example, on August 9, 2001, when day-ahead prices reached the $1,000 bid cap, the AMP mitigation was not triggered because the exercise of market power was not observed. This evidence supports our contention that the AMP properly distinguishes between market power and scarcity conditions.

Furthermore, despite Reliant's claim that reference price levels do not account for scarcity rents, certain Reference Prices already reflect higher costs associated with the emergency segment of a generator's output. The NYISO specifically uses these high costs for the tail-end capacity segment for some generators when determining an appropriate Reference Price.

Regardless of where a generator's Reference Price is set, there are significant protections in place for generators to recover their costs if their Reference Price is outdated. Because a generator is told its Reference Price that may be used when competitive market conditions do not exist, the generator has the option to consult with the NYISO and seek a change, as conditions warrant.[8] Moreover, the generator may bring a dispute to the NYISO for resolution of whether its bid was improperly mitigated.[9]

In sum, mitigation under the conduct and impact threshold approach provides significant protections for consumers against market power, while preserving scarcity pricing. The AMP simply automates the process. Although this is most useful in markets where competition is limited, such as in New York City, it is also useful in more competitive markets, during those specific times when the market is not competitive. While there is significant risk that consumers may be subjected to market power without the AMP, there is little risk that the AMP will act as a price cap or prevent scarcity prices.

---

[8] NYISO Services Tariff, Attachment H, §3.3.

[9] Id. at §6.

II. The Reference Prices Established By The NYISO Adequately Compensate Generators

EPSA erroneously suggests that Reference Prices may not adequately compensate generators for their costs. According to EPSA, "[c]ompensatory prices must include all aspects of marginal value, including capacity value, start up costs, scarcity, opportunity costs, risk, transmission constraints and emission offsets."[10] Contrary to this suggestion, all of these elements are already captured between the Reference Prices for energy and ancillary services,[11] the NYISO's scarcity pricing rules,[12] LBMPs,[13] and the ICAP market.[14]

---

[10] EPSA comments at 7 (footnotes omitted).

[11] Under Attachment H, §3.1.4, of the Services Tariff, the NYISO computes Reference Prices for each component of a generator's bid, including energy and minimum generation bids, start-up costs bids, and ancillary services bids. The Reference Price for a generator's energy bid reflects their marginal costs, including an assessment of the generator's incremental operating costs, such as fuel costs, emission allowance costs, other variable operating and maintenance costs, and other factors the NYISO deems appropriate (e.g., opportunity costs and risk premiums).

[12] See, NYISO Services Tariff, Attachment B, and NYISO Open Access Transmission Tariff, Attachment J.

[13] The LBMPs determined by the NYISO in setting energy prices paid to generators reflect transmission constraints. NYISO Services Tariff, §2.27.

[14] As the Commission recently observed, ICAP values reflect an "estimate of the annual capital and fixed operation and maintenance costs, including a return on investment, to construct a typical new peaking unit…less an offset for projected energy and ancillary services revenues, net of variable operating costs, that a new peaking unit could expect

Moreover, the ICAP market was created in such a manner to enable efficient generators to receive sufficient revenues to cover their annual costs, including fixed costs, of doing business. Because the NYISO's $1,000 bid cap could otherwise limit scarcity revenues and the ability of some generators, namely peaking units, to earn a sufficient revenue stream, the ICAP market was specifically designed to address this problem by producing another source of revenues. In fact, the pricing parameters of the NYISO's ICAP market are explicitly designed to take into account the energy revenues of peaking units in a regime that limits energy bids to $1,000. Since the NYISO's ICAP market is intended to provide compensation for fixed costs associated with capacity, it would be inappropriate to include capacity related costs in Reference Prices in New York. Accordingly, EPSA's suggestion should be rejected where ICAP markets exist.

CONCLUSION

For the above reasons, the Commission should accept the NYPSC's Motion for Leave to file Supplemental Comments and

---

to earn in the New York markets." New York Independent System Operator, Inc., 111 FERC ¶61,117 (issued April 21, 2005).

incorporate these Supplemental Comments into its decision-making process.

Respectfully submitted,

Dawn Jablonski Ryman
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: June 9, 2005
Albany, New York

CERTIFICATE OF SERVICE

I, Shirley Rabideau, do hereby certify that I will serve, on June 9, 2005, the foregoing Motion for Leave to file Supplemental Comments and the Supplemental Comments of the Public Service Commission of the State of New York, upon each of the parties of record indicated on the official service list compiled by the Secretary in this proceeding.

Date: June 9, 2005
Albany, New York

Shirley Rabideau