

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

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DAWN JABLONSKI RYMAN
General Counsel

JACLYN A. BRILLING
Secretary

July 21, 2006

VIA ELECTRONIC FILING

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

Re: Docket No. EC06-125-000 – Notice of Intervention and Comments
of The New York State Public Service Commission

Dear Secretary Salas:

For filing, please find the Notice of Intervention and Comments of the Public Service Commission of the State of New York in the above-entitled proceeding.

Should you have any questions, please feel free to contact me at (518) 473-8123.

Very truly yours,

Handwritten signature of Danielle Rathbun.

Danielle Rathbun
Assistant Counsel

Attachment

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

KeySpan Corporation

)

Docket No. EC06-125-000

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

The New York State Public Service Commission (NYSPSC) hereby submits its Notice of Intervention and Comments pursuant to the Combined Notice of Filings #1 issued in the above-captioned proceeding on June 1, 2006, the Errata issued June 2, 2006, and Rule 214 of the Federal Energy Regulatory Commission's (Commission) Rules of Practice and Procedure.

Copies of all correspondence and pleadings should be addressed to:

Danielle Rathbun
Assistant Counsel
New York State Department
of Public Service
Three Empire State Plaza
Albany, NY 12223-1350
danielle_rathbun@dps.state.ny.us

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

BACKGROUND

On May 25, 2006, National Grid plc (National Grid) and KeySpan Corporation (KeySpan) submitted an application requesting that the Commission approve a proposed merger resulting in KeySpan becoming an indirect, wholly owned subsidiary of National Grid. A direct result of this proposed merger is that National Grid, which has subsidiaries that own transmission and distribution facilities in New York State, would also own and control KeySpan subsidiaries

that provide generating capacity within New York State. Consequently, the merged company would own generation, transmission and distribution facilities within New York.

DISCUSSION

We urge the Commission to carefully analyze the potential vertical market power impacts of the proposed merger. In its Merger Policy Statement, the Commission stated that competition has become the best way to protect the public interest and, as customer protection is increasingly dependent upon vibrant competition, it is critically important that mergers be evaluated on the basis of their effect on market structure and performance.¹ The Commission further noted that competition can be adversely affected if a merger increases the merged firm's ability or incentive to exercise vertical market power in wholesale electricity markets.² Therefore, it is essential that any such merger is carefully analyzed to ensure that it will not increase incentives to exert market power or engage in anti-competitive behavior.

The NYSPSC will also review the proposed merger, as required by state law, to determine whether it is in the public interest.³ As part of our review, we will likely be applying our Policy Statement Regarding Vertical Market Power (Policy Statement) which provides guidelines for the purposes of reviewing transfers of generation assets.⁴ The Policy Statement, which is attached as Appendix A, recognizes that where a transmission and distribution utility's affiliate owns a generating facility, the utility may be able to adversely influence prices in that

¹ FERC Merger Policy Statement, Order No. 592 at P19-20; 18 C.F.R. §33.2.

² *MidAmerican Energy Holding Co.*, 113 FERC 61,298 at P 17.

³ New York State Public Service Law §70.

⁴ Cases 96-E-0900, *et al.*, In the Matter of Orange & Rockland Utilities, Inc.'s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12, Statement of Policy Regarding Vertical Market Power (issued July 17, 1998), Appendix I, page 1.

affiliate generator's market to the advantage of the combined operation. To guard against this potential result, the NYSPSC created a rebuttable presumption that a transmission and distribution utility affiliate's ownership of generation would unacceptably increase the potential for vertical market power. As discussed in the Policy Statement, in order to overcome this presumption, the affiliate must demonstrate that the transmission and distribution utility could not exercise vertical market power because the circumstances do not give the utility an opportunity to exercise market power, or because other reasonable means exist to mitigate the potential for it to exercise market power.⁵ Alternatively, the transmission and distribution utility must demonstrate that substantial ratepayer benefits, along with mitigation measures, warrant overcoming the presumption.

Over the past decade, the NYSPSC has taken significant steps to restructure New York's electric industry and move toward a competitive market. These steps included encouraging and approving the divestiture of nearly all of New York electric utilities' generation assets.⁶ The proposed merger, as presented, which would place generation and transmission facilities in the hands of one entity, raises issues as to potential inconsistency with these restructuring efforts. That is, the merged entity would own generating facilities in the transmission-constrained New York City area and transmission assets in the upstate area. Thus, the entity may potentially be able to influence both the amount of electricity that may be transmitted into New York City and in-City electric prices. Since the transmission and generation facilities are located in different

⁵ Policy Statement, Appendix I, Page 2.

⁶ Cases 94-E-0952, et al., In the Matter of Competitive Opportunities Regarding Electric Service, Opinion and Order Regarding Competitive Opportunities for Electric Service (issued May 26, 1996).

zones, there may be no vertical market power issues, but such a potential situation requires analysis.

As the merged entity may conceivably be able to exercise vertical market power in wholesale electricity markets, and as required by the Commission's Merger Policy Statement, it is imperative that the Commission scrutinize the proposed merger and ensure that the merged entity would not be able to exert market power or engage in anti-competitive behavior.

CONCLUSION

The NYSPSC respectfully urges the Commission to carefully consider the impacts that the proposed merger may have on competition and ensure that the merged entity cannot exercise vertical market power. In conducting its evaluation, the Commission should apply the same or a similar market power analysis to that identified in our Policy Statement.

Respectfully submitted,



Dawn Jablonski Ryman
General Counsel
New York State
Public Service Commission

By: Danielle Rathbun
Assistant Counsel
Three Empire State Plaza
Albany, NY 12223-1350
(518) 473-8123

Dated: July 21, 2006
Albany, New York

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

- CASE 96-E-0900 - In the Matter of Orange & Rockland Utilities, Inc.'s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12.
- CASE 94-E-0098 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Service.
- CASE 94-E-0099 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Street Lighting Service.
- CASE 96-E-0891 - In the Matter of New York State Electric & Gas Corporation's Plans for Electric Rate/Restructuring Pursuant to Opinion No. 96-12.
- CASE 96-E-0897 - In the Matter of Consolidated Edison Company of New York, Inc.'s Plans for (1) Electric Rate Restructuring Pursuant to Opinion 96-12; and (2) the Formation of a Holding Company Pursuant to PSL, Sections 70, 108 and 110, and Certain Related Transactions.
- CASE 96-E-0909 - In the Matter of Central Hudson Gas & Electric Corporation's Plans for Electric Rate/Restructuring Pursuant to Opinion No. 96-12.
- CASE 96-E-0898 - In the Matter of Rochester Gas and Electric Corporation's Plans for Electric Rate Restructuring Pursuant to Opinion No. 96-12.

STATEMENT OF POLICY REGARDING
VERTICAL MARKET POWER

Issued and Effective: July 17, 1998

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Maureen O. Helmer, Chairman
John B. Daly
Thomas J. Dunleavy
James D. Bennett

- CASE 96-E-0900 - In the Matter of Orange & Rockland Utilities, Inc.'s Plans For Electric Rate Restructuring Pursuant to Opinion 96-12
- CASE 94-E-0098 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation For Electric Service
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STATEMENT OF POLICY REGARDING
VERTICAL MARKET POWER

(Issued and Effective July 17, 1998)

BY THE COMMISSION:

INTRODUCTION

By Notice Regarding Vertical Market Power (issued May 20, 1998), the Commission sought comments on a proposed guideline it intends to apply for the purposes of Section 70

review for the transfer of generation assets. Recognizing that divestiture of generation is a key means of achieving an environment where the incentives to abuse market power are minimized, the Notice proposed to establish a rebuttable presumption that the ownership of generation by an affiliate of a utility would unacceptably exacerbate the potential for market power.

Thirteen parties submitted comments and six of these parties submitted replies. The parties' comments have been reviewed and considered and are summarized in Appendix II. All of the nine non-utility parties support the Commission's proposal, three utility parties oppose it, and one utility party requests a clarification.

DISCUSSION

Existing Controls

The commenting utilities (Central Hudson, Con Edison, and NGE, an affiliate of NYSEG) argue that the New York State Independent System Operator (ISO), Federal Energy Regulatory Commission (FERC), and this Commission would have sufficient control over the T&D utility to prevent the exercise of vertical market power. The Notice had provided three examples where the T&D utility would have an incentive to use its control over transmission and distribution assets to take actions that increase the profits of its generation affiliates at an increased cost to ratepayers. The utilities contend that sufficient controls exist to prevent the exercise of vertical market power in all three cases. In particular, the utilities contend the following controls and responsibilities would mitigate any concerns about abuse:

1. FERC's open access tariff requires utilities to reinforce transmission and Section 210 of the Federal Power Act requires interconnection with new generators. Further, FERC could revoke market rate authority where it believed that an abuse of market power had occurred.

2. The ISO tariff addresses procedures for a new generator to obtain interconnection and, according to NGE and Con Edison, these procedures would make it impossible for the utility to restrict entry into its own market. The ISO would also have responsibility for making an independent review of the transmission system and making proposals for relieving congested interfaces. The ISO would also have a monitoring function. Finally, the weighted voting on the ISO and its Reliability Council would ensure that no single participant, even if it represented both a T&D utility and its generation affiliate, could impose an outcome on the market.
3. The New York Commission would retain regulatory oversight of the T&D utility and would act as arbiter of disputes between the ISO and the Reliability Council. Codes of conduct for affiliate relations have been developed and the penalties for violations are spelled out in the Commission Rate/Restructuring decisions.

While the utilities are correct that regulatory controls and enforcement mechanisms exist, the degree to which these mechanisms can be effective is subject to debate. For example, the ISO can recommend, and FERC or this Commission can direct, that a utility reinforce its transmission system. That utility, however, must go through the siting process for authorization, and its role as a possibly reluctant sponsor could introduce complexities and delays in the process. It is also difficult for regulators to detect an inappropriate failure to act when critical information resides with the T&D utility.

The ISO would provide information on market prices and transmission requirements, but it would not act as a shadow regulatory body. The task of uncovering vertical market power abuses would remain with the regulator. Such regulation is likely to be costly and create conflict. It is preferable to avoid the incentive for abuse unless there are demonstrable efficiency gains and adequate mitigation procedures. It is that

demonstration which a purchasing utility could make in rebutting the presumption in a particular case.^{1/}

The May 20, 1998 Notice, by way of example, indicated that generation ownership by a T&D company would conflict with its role as a participant in the ISO and Reliability Council. Namely, that additional generation ownership conflicts with its participation in establishing installed capacity requirements. Since the establishment of installed capacity requirements cannot be controlled by any one T&D company, the risk of abuse is minimized, provided there are not multiple T&D companies with affiliate interests in generation. Moreover, the process of determining the installed capacity requirements is subject to review by the ISO and the Commission. Therefore, we have deleted the example from the final Statement.

Efficiency Gains

Con Edison and NGE argue that the proposed guideline would result in losses for ratepayers. First, the numbers of eligible bidders participating in the generating auctions would be reduced, decreasing the potential sales prices. Second, the existing T&D utilities have track records, are familiar with environmental issues, and have a capable, trained workforce.

It is because of our concern about encouraging a robust auction that we have tailored this as narrowly as possible. It should also be noted that results from auctions in other states have shown that there is no shortage of qualified bidders who also have track records elsewhere as operators and are environmentally sensitive. Further, the capable workforce is ordinarily transferred with the plant at the time of sale. We

^{1/} For example, a relatively small T&D utility in a large market area which has little control over the constraining transmission interfaces, little ability to restrict new entry into the broader market by making it costly to interconnect in its service territory, and little voting leverage in the ISO, should be able to rebut the presumption that the benefits of efficiency gains are outweighed by the costs associated with the potential for vertical market power.

recognize, however, that a T&D company affiliate could, as a winning bidder, provide substantial ratepayer benefits. We will, therefore, allow a T&D company to include in its Section 70 presentation, in addition to necessary mitigation proposals, a demonstration that the auction proceeds are substantially higher than they would be otherwise. This could occur if the T&D company affiliate is the winning bidder by a substantial amount.

Finally, we acknowledge Con Edison's suggestion that the proposed guideline creates an appearance that we do not favor investment in New York by New York utilities. We note that the new owners of the generators, even New York companies, are not bound to reinvest profits in New York. In any event, we have drawn the final policy narrowly to permit investment by New York utilities where competitive concerns are not exacerbated.

Lack of a Factual Basis

Con Edison claims that there is no factual basis for the presumption that the potential for vertical market power would be unacceptably exacerbated by affiliate ownership of generation, and without such a factual basis the proposed guidelines would be unlawful. Con Edison argues that vertical market power is not inherently anti-competitive and cites numerous cases where courts have supported vertical mergers and claims that without such a factual basis, the proposed guideline would be unlawful.

This case differs from the many cited by Con Edison in that here a monopoly, the T&D utility, has a strong influence on market conditions. In these circumstances, vertical integration creates incentives for T&D utilities to act or fail to act so as to increase the profitability of their parent at the expense of ratepayers. Utilities have proven the effectiveness of profit incentives through their responses to service and reliability standards and other forms of performance based regulation. While regulatory controls can limit the negative impact of poor incentives, they are costly and are not as effective as a clean separation of the T&D utility from generation ownership. As New

York City noted in its comments: "Vertical market power, or even the perception or threat of it, can directly impact the functioning of these markets, discourage new entrants, and increase customer bills."

The Commission, in evaluating the need for the proposed guidelines, must evaluate the unique characteristics of the electric marketplace and gauge the effect of certain generation ownership arrangements on future just and reasonable rates. We find that certain ownership arrangements could reasonably be expected to adversely affect the provision of electric service at just and reasonable rates.

Rebutting the Presumption

Both Central Hudson and NGE attempt to rebut the proposed presumption claiming that, given their unique situations, they have no opportunity to exert vertical market power. For example, Central Hudson cites its relatively small size and its lack of control over transmission. NGE cites NYSEG's agreement to divest to third parties all fossil units in its own territory, its lack of control over the critical Central East transmission interface, its provider of last resort (POLR) obligation, and the rate cap plan contained in its Rate/Restructuring Agreement.

While we note that many of the benefits of NYSEG's agreement to divest its fossil generation would be undone, effectively, if it turned around and purchased generation in an adjoining territory, this is not the appropriate forum to determine whether the presumption is properly rebutted. But the additional guidance provided by this Statement should assist these and other parties in evaluating areas of concern and how to overcome the presumption. In addition, parties may wish to

consult with our staff regarding the applicability of the Statement to particular circumstances.^{1/}

Consistency with the Rate/Restructuring Agreements

The utilities claim that the guideline is inconsistent with the terms of their respective Rate/Restructuring Agreements.

The guideline is not intended to override specific terms or conditions adopted by the Commission in approving those agreements. In particular, the guideline does not override terms approved in the rate/restructuring order for Con Edison.^{2/} Further, because it establishes a rebuttable presumption, affiliates of New York T&D utilities may continue to participate in auctions to the extent that they believe that the Commission can be satisfied that vertical market power cannot be exercised.

Procedure

Central Hudson, with support from NGE, argues that the proposed rebuttable presumption is a "rule" within Section 102(2) of the State Administrative Procedure Act (SAPA), in that it would "directly and significantly affect the rights of or procedures or practices available to the public" and therefore must be noticed. NGE, while supporting Central Hudson on SAPA requirements, also calls for expedited Commission action so that the utility auctions can proceed as now scheduled.

Establishing a statement of policy and a rebuttable presumption is not a "rule" subject to SAPA. Rather, through the Statement the Commission is providing policy guidance to the

^{1/} This conclusion extends as well to the horizontal market power guidelines adopted in conjunction with the various utilities' auction plans. See, e.g., Case 96-E-0098, Niagara Mohawk Power Corporation, Order Authorizing Process For The Auctioning of Generating Facilities (issued May 6, 1998).

^{2/} Cases 96-E-0897 and 96-E-0916, Order Adopting Terms of Settlement Subject to Conditions and Understanding (issued September 23, 1997); Confirming Order (issued October 1, 1997); and Opinion No. 97-16 (issued November 3, 1997).

public on how it intends to address vertical market power issues in any Section 70 review.

Application

Several parties raised comments about the applicability of the proposed rule. MarketSpan asked that the Commission clarify that the proposal would apply only to affiliates of New York T&D electric utilities. CPB asks that it be applied to the purchase of generating assets by utility affiliates in adjoining states. NYC asks that the proposal also apply to marketing affiliates of utilities.

Regarding MarketSpan's request, the guidelines issued for comment in these proceedings pertain only to affiliates on electric T&D utilities. No policy guidelines pertaining to electric generation affiliates of gas utilities are being adopted at this time.

As for the requests of the other parties, there is no reason to rule on CPB's request at this time. The extent of jurisdiction over activities of New York T&D utility affiliates in other states should await the presentation of concrete facts under particular circumstances. For the present, the Commission's Statement is restricted to the purchase of generating assets in New York by affiliates of New York T&D utilities.

New York City's requested expansion to prohibit a marketing affiliate from operating within that T&D utility's service territory is beyond the scope of the Section 70 review covered by the proposed guidelines. Authority to operate marketing affiliates of a T&D utility in its own territory was provided under the respective Rate/Restructuring Agreements.

CONCLUSION

To guide generation auction participants, the Commission adopts the Statement of Policy Regarding Vertical Market Power set forth in Appendix I. This general policy will be used in reviewing requests to transfer works under Public Service Law Section 70.

(SIGNED)

JOHN C. CRARY
Secretary

STATEMENT OF POLICY REGARDING VERTICAL MARKET POWER

In creating a competitive electric market, the Commission has viewed divestiture as a key means of achieving an environment where the incentives to abuse market power are minimized. Recognizing that vigilant regulatory oversight cannot timely identify and remedy all abuses, it is preferable to properly align incentives in the first instance.

Vertical market power occurs when an entity that has market power in one stage of the production process leverages that power to gain advantage in a different stage of the production process. A transmission and distribution company (T&D company) with an affiliate owning generation may, in certain circumstances, be able to adversely influence prices in that generator's market to the advantage of the combined operation. Two examples are given below:

- The affiliate's generator is located in the same market as the T&D company. The T&D company has an incentive to make entry by generators into its own territory difficult, and therefore, expensive for a new entrant by either delaying or imposing unrealistic interconnection requirements, and thereby raising prices in the region. A T&D company affiliate that owns generation in an energy market in which it has only a small T&D service territory in that market (in terms of the market's square miles) could overcome the presumption, described below, by showing that the percentage of the overall market that the T&D company controls via its service territory is insubstantial; provided, however, that if the energy market is a high cost market the T&D company must also have no ability to influence transmission constraints into the high cost market.
- The affiliate's generator is on the high cost side of a transmission constraint and the T&D company has the ability to influence the transmission constraint. The T&D company has the incentive to retain the constraint to keep the market price high on the high cost side of the constraint.

To guard against undesirable incentives, a rebuttal presumption will exist for purposes of the Commission's Section 70 review of the transfer of generation assets, that ownership of

generation by a T&D company affiliate would unacceptably exacerbate the potential for vertical market power. To overcome the presumption the T&D company affiliate would have to demonstrate that vertical market power could not be exercised because the circumstances do not give the T&D company an opportunity to exercise market power, or because reasonable means exist to mitigate market power. Alternatively, the T&D company would need to demonstrate that substantial ratepayer benefits, together with mitigation measures, warrant overcoming the presumption. Possible means of mitigating market power include:

- Limitation on the degree of control over the constraining transmission interface held by the T&D utility.
- A pledge by the T&D utility to pursue transmission projects recommended by the Commission or by the ISO, together with a proposal that would neutralize profit maximizing incentives on generation that is within the market power control area pending the completion of all reasonable efforts by the T&D company to complete recommended transmission projects.
- An agreement by the T&D company to participate in a binding arbitration in the event of a dispute over a new generator's interconnection requirements in the T&D utility's territory.

Party Comments

Party comments were received from thirteen parties concerning the Commission's proposal to establish a rebuttable presumption for §70 review purposes that the acquisition of generation assets by affiliates of T&D companies will unacceptably exacerbate the potential for vertical market power. The thirteen parties providing comments were:

Central Hudson Gas and Electric Corp. (Central Hudson)
City of New York (NYC)
Consolidated Edison Company of New York, Inc. (Con Edison)
New York State Consumer Protection Board (CPB)
Enron Corp. (Enron)
MarketSpan Corp. (MarketSpan)
Multiple Intervenors (MI)
National Energy Marketers Association (NEMA)
NGC Corp. (NGC)
NGE Enterprises, Inc. (NGE)
Office of New York State Attorney General (OAG)
Owners Committee on Electric Rates (OCER)
SEFCO Corp. (SEFCO)

Central Hudson states that neither application of the proposed presumption to Central Hudson, nor of any other presumption, is justified. Central Hudson complains that the proposed presumption lacks clear definitions of "affiliate owning generation," and "market power," making the presumption difficult to rebut. Furthermore, it states, the absence of any empirical basis for the proposed presumption impinges on the constitutional prohibition against classifications which are arbitrarily employed to burden a particular group.

According to Central Hudson, proceedings in the Central Hudson restructuring case included a showing that Central Hudson lacks the resources to dominate the generation market, and in other proceedings, FERC has found that Central Hudson lacks market power in the wholesale markets. Since the Commission's proposal does not contain any contrary showing, Central Hudson submits that it is inappropriate for the Commission to apply the proposed market power presumption to it.

Central Hudson asserts that the three situations in which the Commission concluded that potential exists for market power abuse by a T&D company with an affiliate owning generation are speculative, uncertain and hypothetical. Central Hudson argues that T&D utilities have a legitimate interest in implementing reasonable interconnection requirements, even if those requirements cause generators to spend more and thereby increase prices in the region. Central Hudson believes that even unrealistic requirements should not be deemed inappropriate from a vertical market power perspective, as long as such requirements were imposed on all generators, including that owned by the affiliate.

Central Hudson expresses doubt that a T&D utility would be liable under the Sherman Anti-Trust Act if it did not act to remove a transmission constraint, even if its affiliate were to benefit from this. According to Central Hudson, this is simply a competitive advantage of broad-based activity, and cannot by itself be considered an abuse of monopoly power.

Central Hudson acknowledges a potential relationship between advocacy of a high reserve margin and generators. However, it states that given the Commission's reliability concerns, efforts by a T&D utility to address reliability should not automatically fall under the proposed presumption.

Finally, Central Hudson argues that the proposed presumption constitutes a rulemaking, and is subject to the provisions of SAPA, which were not followed.

NYC endorses the Commission's proposed presumption. It believes that enforcing codes of conduct imposes a considerable regulatory burden, and cannot be as effective a solution to vertical market power as divestiture. NYC recommends applying the proposed presumption to Con Edison's proposal to transfer in-City generating capacity to its affiliate, as well as extending its application to the marketing of power by unregulated affiliates, not just ownership of generation. Unless those steps are taken, NYC believes that additional vertical market power problems arising from regulated utility control of distribution

services must also be addressed. Finally, NYC submits that a high standard should apply in determining whether the market power presumption may be overcome in particular instances.

Con Edison opposes the Commission's proposed presumption. It argues that vertical integration can foster efficiencies that generate consumer benefits, and cannot, either as a matter of economic theory or as a matter of law, be presumed to have an adverse effect on the market. If such arrangements are not inevitably anti-competitive, Con Edison argues that the Commission cannot lawfully establish its proposed presumption.

Examining the three situations in which the Commission concluded that potential exists for market power abuse by a T&D company with an affiliate owning generation, Con Edison argues that these examples ignore the independence and authority of the ISO, an entity whose primary purpose and reason for being, according to Con Edison, is to mitigate any remnants of transmission market power that were not already mitigated by FERC's open access transmission requirements.

Con Edison states the potential for market power abuse under the Commission's examples is non-existent, because the ISO can dictate interconnection procedures, address transmission constraints and establish installed capacity requirements. Moreover, Con Edison states that the installed capacity requirement will be promulgated by the New York State Reliability Council. Finally, according to Con Edison, all of the scenarios further ignore that the T&D utilities will continue to be subjected to a high level of FERC and Commission oversight.

In addition to depriving customers of the potential benefits of vertical integration, Con Edison asserts that the proposed presumption also would be contrary to the compact underlying Con Edison's settlement agreement, which permits the company to transfer a portion of its generation assets to its unregulated affiliate.

CPB recommends the Commission adopt the proposed presumption. Reviewing the three situations in which the

Commission concluded that potential exists for market power abuse, CPB asserts that the ISO would not have prevented the abuse of vertical market power in any of these examples. CPB also believes that the purchase of generation assets by utility affiliates in adjoining states should be subject to the same rebuttable presumption as the purchase of in-state generation.

Enron supports the Commission's proposed presumption. It supports the rights of transmission utilities to own generation as long as they cannot exercise market power, but believes that the Commission's three examples indicate ways in which the continued ownership of generation by the incumbent utilities' affiliates may not be consistent with a competitive electric market.

MarketSpan recommends that the Commission clarify that its proposed presumption applies only to affiliates of T&D companies, and not affiliates of gas utilities or other generators.

MI strongly endorses the Commission's proposed presumption. MI believes that a case-by-case approach gives the Commission the necessary flexibility to prevent the exercise of vertical market power by T&D companies and their affiliates, and also to encourage generation asset acquisitions by an affiliate of a T&D company, when such acquisition will foster the development of a competitive market.

NEMA recognizes that effective separation and control over generation and transmission systems is essential to creation of an efficient electric market, and that a massive swap between utilities of generation capacity during the upcoming auctions would defeat this goal. NEMA also recognizes that formation of the ISO is by itself insufficient and that significant additional work needs to be done for the creation of a competitive and efficient market.

NEMA endorses a reasonably crafted presumption against generation asset swaps among divesting utilities, and a requirement that affiliates of T&D utilities demonstrate that there is no issue of market power before they can close on the purchase of generating assets. NEMA also urges the Commission to adopt and enforce a national uniform code of conduct drafted by NEMA.

NGC supports the Commission's proposed presumption. It believes that the basic structure of the utility industry is not conducive to robust competition, and that the ISO alone cannot provide sufficient safeguards against the potential exercise of market power.

Nor does it believe that codes of conduct or regulatory oversight will suffice. NGC asserts that over time, oversight wanes; and as good as any code may be, it is no substitute for appropriate market structure and incentives.

When evaluating the extent of potential market power by an affiliate, NGC recommends using tests similar to those utilized by FERC when evaluating mergers and determining market power for purposes of allowing the charging of market-based rates.

NGE argues that the proposed presumption is unnecessary, since sufficient restrictions are in place to prevent abuse of vertical market power. It states that FERC's exercise of its jurisdiction over transmission will render the opportunity for such abuse remote, and that the implementation of the ISO will further reduce or eliminate such potential.

Furthermore, NGE states, the Commission has precluded T&D companies from bidding in their own auctions, and has placed other restrictions on interactions between the T&D utilities and their affiliates. Finally, it argues that for utilities subject to rate caps, the requirement to purchase power to serve their native load will provide a countervailing incentive to keep market prices low.

NGE believes that the proposed presumption is not in the public interest, since by eliminating utilities as bidders, they would decrease auction competition. NGE also believes that other prospective bidders may abstain, if they perceive a hostile regulatory environment in New York. Finally, NGE believes that the proposed presumption, rather than enhancing competition, unfairly excludes utilities from participating.

NGE requests an expedited resolution of these issues, so that auction processes can move forward without prejudice to utilities or their affiliates seeking to bid. It also asks that any guidelines be sufficiently clear so that auctioning utilities do not reject any bids made by affiliates of T&D utilities.

OAG urges the Commission to adopt its proposed presumption, and to avoid situations in which audits would be necessary to determine self-dealing between regulated T&D companies and unregulated affiliates. OAG states that such cases are resource-intensive and difficult to prove, and that by the time self-dealing comes to light, the harm may be irreversible.

OCER notes that the Commission has recognized New York City as representing one of the largest and most significant of the state's load pockets. Taken together with Con Edison's intention to transfer a portion of its generation assets to its unregulated affiliate, OCER expects that further development is needed before a competitive market is achieved in New York City. OCER urges the Commission to retain some form of regulatory control over capacity in this and other service areas where a competitive market may not exist.

SEFCO supports the Commission's proposed presumption. If a utility overcomes the presumption and is permitted to own generation, SEFCO proposes certain mitigation measures that are designed to ensure that T&D utilities expeditiously and consistently process interconnection requests and construct interconnection facilities for developers of new generation. These include the assignment of specific personnel and

establishment of specific procedures and standards for responding to interconnection requests.

Reply Comments

Reply Comments were received from six parties concerning the Commission's proposal: Central Hudson, NYC, Con Edison, CPB and MI.

Central Hudson asserts that none of the comments present any facts or information to show that Central Hudson possesses market power in any market. Noting that its facilities are small and are not located so as to significantly impact transmission interfaces or known constraints, Central Hudson believes that the proposed presumption is both unnecessary and disproportionately burdensome to small utilities such as itself. Central Hudson also states that since its settlement agreement was intended as a permanent resolution of issues surrounding its right to own generation, the proposed presumption would be inconsistent with its settlement agreement.

NYC replied primarily to Con Edison's comments. NYC is skeptical that Con Edison has demonstrated that the Commission's proposed presumption is unlawful, and in particular finds that the courts may indeed presume anti-competitive effects of vertical integration in the case of regulated monopolies, unless regulatory authorities possess certain powers over price and other terms of sale.

NYC argues that the ISO, as presently proposed, is not adequately independent to prevent the exercise of market power. It states that the ISO lacks the explicit authority to mandate increases in transmission capacity, absent cooperation of the transmission owners. According to NYC, placing authority for setting installed capacity requirements with NYSRC exacerbates the installed capacity problem, since the existing transmission owners effectively exercise control over NYSRC rulemaking.

NYC acknowledges some economies of scope in vertically integrated operation, but believes that these may derive, in

part, from inappropriate activities such as preferential treatment of an affiliate. NYC believes that the public interest will best be served if Con Edison applies its experience and skills in fostering a competitive market, rather than participating in it.

Con Edison is dismayed to find among the proposal's supporters several signatories to its approved settlement agreement, including MI, CPB, OAG and OCER. Reiterating that the agreement gives it the right of ownership of generation by its affiliate, Con Edison notes that it has far exceeded its commitments in implementing the terms of the agreement, and can find no justification for these parties having, in Con Edison's view, abrogated the agreement's terms.

Addressing NYC's recommendation to extend application of the proposed presumption to affiliated marketers as well as generation owners, Con Edison points out that the Commission rejected this argument in the generic gas restructuring case. It also states that FERC has relied on codes of conduct to address market power concerns, rather than imposing territory restrictions on utility marketing affiliates.

Con Edison agrees with the assertion by NYC and others that regulatory oversight of affiliate ownership may be burdensome, but argues that the Commission accepted this burden in approving the company's settlement agreement. In addition, Con Edison notes that NYC would be satisfied that the proposed presumption of vertical market power is rebutted upon a showing that the ISO has a truly independent management structure and the ability to compel utilities to construct new transmission capacity. According to Con Edison, NYC explicitly acknowledges that its market power concerns have been addressed, since the ISO clearly will meet these criteria.

In order to allay any concerns regarding unreasonable interconnection requirements, Con Edison agrees that the Commission could establish additional procedures such as those proposed by SEFCO.

CPB agrees with Con Edison that vertical market power is not illegal per se. However, CPB views the Commission's proposal only as alerting utility affiliates seeking approval for a generation that they would have to show why undue market power would not result. Since the Commission has not declared that vertical integration is anti-competitive, CPB concludes that Con Edison's arguments are misplaced.

CPB also agrees with Central Hudson that efficiency gains are not at issue, provided they are not achieved through undue market power. CPB disagrees with Central Hudson that the Commission's proposal constitutes a rulemaking; rather, it sees the Commission giving policy guidance which is specifically permitted under SAPA.

Addressing the comments of all of the parties opposed to the proposed presumption, CPB states that all of the parties would rely on various control mechanisms and oversight provided by the ISO, the Commission and FERC. CPB would prefer that anti-competitive incentives be removed at the outset rather than rely on controls or regulatory oversight.

MI responded to assertions that the proposed presumption would preclude T&D utility affiliates from owning generation. MI states that it would only require a showing that the acquisition would not exacerbate the potential for vertical market power. MI agrees with OAG that if the Commission were to wait until vertical market power is exercised, the harm inflicted on the market and the public would be irreversible.

MI disagrees with CPB's proposal to extend the proposed presumption to out-of-state utility affiliates. It states that CPB has not provided any basis for this proposal, and that such an extension to out-of-state entities may violate the commerce clause of the U.S. Constitution, as well as significantly limiting bidders in the divestiture auctions.

NGE states that its supporters offer no analysis or substantive justification to support the proposed presumption. In particular, NGE states that MI fails to recognize the numerous

safeguards that place a check on T&D company behavior. NGE complains that its proponents also fail to reconcile the presumption with utility settlement agreements.

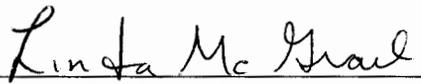
NGE also complains that to overcome the presumption, affiliates must prove that it cannot exercise vertical market power, a task made more daunting in the absence of specific guidance from the Commission as to what evidence would overcome the presumption. NGE agrees with Con Edison that the proposed presumption is unwarranted under anti-trust law or economic theory.

It also agrees with Central Hudson that the Commission has not complied with SAPA notice requirements. NGE again requests expedited Commission action on this matter before utilities develop short lists for auction bids--as soon as July 13, 1998. NGE urges the Commission to either decline its proposed presumption, or issue an interim order that clarifies its intent to seriously consider affiliate bids and not to prejudice such affiliates.

CERTIFICATE OF SERVICE

I, Linda McGrail, do hereby certify that I will serve on July 21, 2006, 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: July 21, 2006
Albany, New York


Linda McGrail