STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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October 22, 2001

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

Re: Consolidated Edison Company of New York, Inc.
Docket Nos. EL01-45-000 and ER01-1385-000

Dear Secretary Boergers:

For filing please find the Response of the New York State Public Service Commission in the above-entitled proceeding. Should you have any questions, please feel free to contact me at (518) 486-2652.

Very truly yours,

Saul A. Rigberg
Assistant Counsel

Enclosures

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.	) Docket No. EL01-45-000) Docket No. ER01-1385-000

RESPONSE OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK TO MOTION TO EXTEND AND EVALUATE LOCALIZED MARKET-POWER MITIGATION MEASURES AND REQUEST FOR EXPEDITED CONSIDERATION

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure (18 C.F.R. §385.214), the Public Service Commission of the State of New York (NYPSC) hereby submits its response to the October 5, 2001 motion of Consolidated Edison Company of New York, Inc. (Con Edison) to extend for one year the revised localized market-power mitigation measures (Revised LMMs) applicable to New York City. The NYPSC supports Con Edison's request for an extension of the Revised LMMs to ensure that wholesale electric prices remain just and reasonable throughout the year.[1] We also urge the Commission to direct the New York Independent System Operator, Inc. (NYISO) to implement all aspects of the Revised LMMs in the Real-Time Market (RTM) as

[1] These measures are important year-round, not just in the summer. Severe market power problems occurred in New York City in December of 2000, before implementation of the Revised LMMs.

soon as possible and certainly no later than May 1, 2002.[2] Finally, the NYPSC respectfully requests that the Commission convene a technical conference to explore the conditions under which the Revised LMMs could be removed.

BACKGROUND

The Commission approved the Original LMMs to "mitigate localized generation market power for sales" on September 22, 1998.[3] On March 1, 2001, Con Edison filed proposed revisions to the Original LLM in order "to close certain loopholes in their coverage that have become apparent during the first year and a half of NYISO operations."[4] Con Edison identified four deficiencies that it sought to correct: 1) the Original LMMs applied to localized market-power problems occurring in the Day-Ahead Market (DAM) but did not apply to those problems occurring

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[2] Although we would prefer that the Revised LMMs be implemented in the RTM immediately, we recognize that a considerable amount of time and effort will be required by the NYISO to complete this task. As discussed below, May 1, 2002 is a crucial implementation date because transmission constraints that contribute to a lack of market competitiveness are more likely in hot weather.

[3] *Consol. Edison Co. of N.Y., Inc.*, 84 FERC ¶ 61,287 at 62,354 (1998).

[4] Request of Consolidated Edison Company of New York, Inc. to Revise Localized Market Power Mitigation Measures at 1, Docket Nos. EL01-45-000 and ER01-1385-000 (Mar. 1, 2001) (Request to Revise LMMs).

in the RTM; 2) the failure of the Original LMMs to cover all in-City units; 3) the omission of mitigation measures to address situations where must-run conditions require in-City generation to be operated out of economic merit so as to meet reliability requirements; and, 4) the potential for circumvention of the Original LMMs by the submission of high bids for start-up and minimum generation.[5] On rehearing, the Commission approved the Revised LMMs through October 31, 2001, stating: "[T]he Commission had already agreed…that in-City sellers may have market power when there are transmission and reliability constraints and supply outside of the constrained area cannot compete for the last increment of demand."[6]

Although the NYISO has implemented most of the Revised LMMs' elements included in the Commission's order, it was unable to implement real-time in-City mitigation of market clearing prices.[7] This element will require a four-to-five month work effort, according to the NYISO. For the reasons discussed

[5] *See* Request to Revise LMMs at 3.

[6] July 20, 2001 Order, 96 FERC at 61,384 (emphasis added).

[7] While we use the phrase, "real-time in-City mitigation of market clearing prices," we understand that bids are mitigated, not prices. A more accurate (but longer) way of conveying this thought is "real-time mitigation of the bids of units that are economically dispatched in merit order and that may set the clearing price."

below, it needs to be implemented no later than next year's Summer Capability Period.

I. THE REVISED LMMs PREVENT THE EXERCISE OF MARKET POWER IN THE NEW YORK CITY LOAD POCKETS

A. The Revised LMMs Close Loopholes That Allowed The Exercise of Market Power in NYC

It is well established that the New York City wholesale market is often transmission-constrained from the rest of the New York State electric system, and when it is, a workably competitive market does not exist in New York City. When such a constraint exists, the preferable mitigation approach is the automatic, ex ante Revised LMMs that are currently in place. Allowing the Revised LMMs to expire would mean that the NYISO's generic measures with their very high thresholds (300% for bidding conduct and 200% for price impact) and their frequent implementation delay would amount to giving generators, which would then lack the threat of adequate competitive forces, opportunity to adjust their bidding behavior to raise prices in the RTM dramatically above competitive levels.[8]

An even more extreme market power problem exists within New York City whenever one of its subpockets is constrained, in which case as few as one generation owner controls the units that are available within the subpocket to meet the system's

[8] The Automated Mitigation Procedure (AMP) applies only to the DAM and not to the RTM.

needs.[9] These more extreme load pocket market power problems are properly addressed currently by the out-of-merit mitigation features of the Revised LMMs. In short, New York City is the perfect example of a market in which, under certain structural conditions, mitigation must offset the lack of competition in order for the market to yield reasonable prices. The Revised LMMs, having been constructed to activate only when a transmission constraint creates a need for them, represent a well-designed approach that mitigates only to the extent necessary.

Upon the divestiture of most of Con Edison’s NYC generation resources in 1998, the New York City market was left with four major wholesale providers. It was agreed, at that time, that four was an insufficient number of competing sellers to yield a competitive market during times in which the New York City market becomes separated from the rest of the northeast market by transmission constraints. Furthermore, as noted above, even fewer competitors were available in the smaller load pockets within New York City. As a result, the NYPSC required in-City mitigation measures as a condition of Con Edison’s divestiture,

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[9] These subpockets are the 138KV load pocket, the Staten Island load pocket, the Astoria load pocket, the Vernon load pocket, and the East River load pocket.

which the Commission subsequently adopted as a necessary tool to protect consumers from market power during constrained periods.[10]

The NYPSC's strategy has been to ensure the deployment of mitigation measures to protect customers in the short term, while pursuing long-term policies that will facilitate new entry of generation into the market so that sufficient competition will eventually develop to permit the removal of the mitigation measures.[11] However, market power conditions continue.

Absent sufficient new transmission and the entry of new generation owners, mitigation measures are needed to protect consumers in New York City from unjust and unreasonable rates. Until such time as new entry yields a workably competitive environment, the Revised LMMs must remain in place.

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[10] 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 No. 96-12; and (2) the Formation of a Holding Company Pursuant to PSL §70, §108 and §110, and Certain Related Transactions, Order Authorizing the Process For Auctioning of Generation Plant (issued July 21, 1998); Case 96-E-0897, Comprehensive Order Approving Transfers of Generating Facilities and Making Other Findings (issued June 17, 1999).

[11] The NYPSC worked with the NYISO and its Market Participants to establish demand side bidding and emergency load curtailment programs. These programs and other demand reduction activities provided over 1500 MWs of load relief during the summer of 2001. In addition, the New York State Board on Electric Generation Siting and the Environment (Siting Board) has approved two applications to construct electric generating units in New York City, totaling 610 MWs, and has received applications for three additional New York City projects, totaling 3,460 MWs.

B. The Mitigation Measures Should Continue to Apply To All In-City Generators

The Original LMMs applied only to Con Edison’s divested generators. This undermined the goal of the mitigation measures because undivested units not subject to the mitigation measures had opportunities to exercise market power and drive up prices. Thus, one unmitigated unit often set the market-clearing price for all units (including the divested units) in this transmission-constrained market. To allow this to reoccur would recreate a loophole that would harm New York’s economy through higher prices due solely to market power and not competition. Therefore, in-City mitigation measures should continue to apply to all generators.

C. The Revised LMMs Should Continue To Apply To Start-up and Minimum Generation Bids

The Original LMMs applied to DAM energy bids, but except for units added in the Citywide local reliability portion of the DAM model, did not apply to start-up and minimum generation bids. The absence of a competitive market allowed generators to artfully increase the start-up and minimum generation portion of their bids well above competitive levels. This practice may have been used by generators to either “extract higher payments from the NYISO under the Bid Production Cost Guarantee or to economically withdraw a unit and raise the price of in-City energy."[12] The Commission properly recognized that the Revised LMMs protect consumers by mitigating start-up and minimum generation bids. As long as there is an absence of meaningful competition, this provision should be continued.

D. The Mitigation Measures Should Continue To Apply in Real-Time To Must Run In-City Generation Required for Reliability Purposes

One of the serious shortcomings in the way the NYISO applied the Original LMMs to in-City generators in the DAM left the RTM vulnerable to serious abuses of market power, especially when Con Edison had to call on generators in the RTM that either were not scheduled in the DAM or were not scheduled at output levels sufficient to meet real-time reliability needs. This occurred because energy bids for a unit were mitigated in the DAM only for the amount of energy actually scheduled from that unit in the DAM. Bids for output above this level were unmitigated. In particular, gas turbines were seldom if ever mitigated in the DAM because they were generally not given a forward contract for energy. Instead, they were relied upon to be available in real-time if needed. Similarly, although the minimum generation and start-up bids for units scheduled in the DAM to meet local reliability rules were subject to mitigation, these units were seldom scheduled for energy above their minimum

[12] Con Edison March 1, 2001 Filing at 16.

load levels and hence their energy bids for output above the minimum generation levels were typically unmitigated.

Thus, in the RTM, units were free to raise their bids well above mitigated levels for any output that was above the level scheduled in the DAM. As Con Edison noted in earlier pleadings, it routinely found itself in situations where it had to rely on “must run” or “out of merit” units at levels above their DAM schedules in order to secure the New York City area in real-time. In such situations the market is vulnerable to the exercise of market power. The situations that gave rise to this problem frequently included the loss of a generating unit within a subpocket, a reduction in the transmission capability within the City, and an unanticipated increase in real-time load relative to forecast. All of these caused the system to have a real-time need for must run generation in excess of DAM levels within New York City.

In addition, there were instances where weaknesses in the NYISO’s DAM modeling caused a need for real-time operation of generation that the DAM modeling incorrectly concluded was not needed. For example, the simplified 24-hour look-ahead that takes place in the DAM modeling can lead to a DAM schedule that improperly shuts a unit down toward the end of the day, even though that unit, which may have a 24-hour minimum down time, is critically needed the next day to reliably serve load.

Under the Original LMMs, once a generator was called upon in real-time to meet in-City reliability requirements, it was aware that it was needed for reliability and could raise its bids in the RTM above competitive levels. Under the Revised LMMs, such generation is identified by Con Edison as out-of-merit generation, and is mitigated in the RTM. Thus, the Revised LMMs, which encompass the RTM mitigation of generation that must be operated to ensure reliability, should remain in place.

II. THE ABILITY TO APPLY THE LMMS TO MITIGATE REAL-TIME MARKET-CLEARING PRICES BY MAY 1, 2002 IS NECESSARY TO ENSURE THAT WHOLESALE ELECTRIC PRICES ARE JUST AND REASONABLE.

One key element of the Revised LMMs approved by the Commission, but not yet implemented by the NYISO, is the mitigation of Citywide market clearing prices during times when New York City as a whole is separated from the rest of the northeast by transmission constraints.[13] This part of the Revised LMMs is designed to be automatically triggered by the NYISO's own model’s detection of a real-time transmission constraint that separates the City as a whole from the rest of

[13] Under this measure, a market clearing price within New York City that exceeds the market clearing price upstate by 5 percent or more (sometimes called the 105 percent rule) is deemed evidence of a transmission constraint.

the northeast.[14] This differentiates it from the real-time mitigation of must-run generation, which is triggered by Con Edison when its more detailed modeling of the real-time New York City system detects a reliability deficiency in the NYISO's less detailed modeling that needs to be corrected by calling on out-of-merit generation. For several reasons, implementation of this part of the Revised LMMs is a critical consumer protection measure that must be put into place for the New York City market during the transition to a fully competitive market.

Most importantly, the proper economic relationship between the DAM and RTM vis-à-vis the operation of constraints and exercise of market power requires application of mitigation to the RTM. A well functioning RTM, either because it is competitive or properly mitigated, is the crucial foundation for forward/day-ahead market transactions to occur at just and reasonable prices as the Commission has noted.

Secondly, in the absence of the mitigation of real-time in-City market-clearing prices by the Revised LMMs, less effective mitigation currently occurs through the use of the NYISO's

[14] The ISO's real-time model, the Security Constrained Dispatch (SCD) model, cannot currently secure for transmission constraints that occur within the New York City system. As such, it sets real-time market clearing prices that do not reflect congestion caused by transmission constraints within the City.

generic mitigation measures. Given that the AMP applies only to the DAM, the NYISO's generic mitigation measures often contain a lag between observation of conditions that require real-time mitigation and commencement of mitigation. During this lag period, extremely high, uncompetitive prices can persist. In contrast, because the real-time market clearing price mitigation part of the Revised LMMs has been explicitly designed to activate as soon as transmission constraints cause the New York City market to lack competitiveness, its use is automatic, with no lag.

Furthermore, the NYISO's generic measures contain liberal thresholds that keep them from triggering except for only severe instances of market power abuse. Such an approach is not acceptable for the constrained New York City market in which the lack of sufficient competition is a regularly occurring problem.

Finally, the real-time market power problem is not indirectly solved by the in-City DAM mitigation measures. DAM in-City mitigation measures do not automatically mitigate real-time since (a) real-time circumstances can lead to transmission constraints (e.g., thunderstorm alert) on the same days that the day-ahead model fails to show transmission constraints, and therefore, fails to trigger the DAM in-City mitigation measures, and (b) the real-time bids of generators are not necessarily required to be less than or equal to mitigated day-ahead bids, even on days where the DAM is transmission constrained and DAM in-City mitigation is triggered.

Data publicly released by the NYISO provides dramatic evidence of the need for the market clearing price part of the Revised LMMs to be implemented in Real-Time. On many occasions this past summer (July 1, 10, 25, August 13, 20, 27), real-time prices in the New York City zone reached $700/MWh or more as a result of market power, and stayed at that artificially high level for several intervals until the initiation of the NYISO's generic mitigation, at which time they declined.[15] While this mitigation was warranted, the delay significantly harmed consumers. There are undoubtedly many other instances where the liberal thresholds of the NYISO's generic mitigation measures permitted higher than appropriate real-time prices to occur. Accordingly, we urge the Commission to establish a schedule by which the NYISO will commit to fully implement the Revised LMMs in real-time by May 1, 2002.

III. THE REVISED LMMS FOR NEW YORK CITY ARE CONSISTENT WITH THE COMMISSION-APPROVED PJM APPROACH FOR MITIGATION OF TRANSMISSION CONSTRAINED LOAD POCKETS.

The Revised LMMs bear a close resemblance to the mitigation rules the Commission approved for transmission-constrained load

[15] Due to confidentiality concerns, our statement encompasses only the real-time mitigation that the NYISO has made public. In addition, NYISO non-public data indicates there were similar delays in real-time mitigation.

pockets in PJM.[16] Both are structurally based and are triggered ex ante by transmission congestion that causes a departure from economic scheduling rather than by the ex post identification of specific instances of the exercise of market power. Further, they both: (1) mitigate bids (but not prices) to a level that is close to marginal costs; (2) apply to the DAM and the RTM; and (3) have provisions for mitigating bids for units that become must-run for reliability reasons. Given that the Commission has approved the PJM approach in this regard as well as generally in the context of a future RTO,[17] it is appropriate to continue the Revised LMMs.

IV. THE COMMISSION SHOULD CONVENE A TECHNICAL CONFERENCE TO EXPLORE THE CONDITIONS UNDER WHICH REVISED LMMs COULD BE REMOVED.

Currently, with just four major owners of generation, the New York City wholesale electric market does not contain the structural conditions necessary to alleviate the need for mitigation. As new generation owners contemplate entering the market, a fundamental question is under what conditions can the in-City mitigation measures be removed. This issue is of

[16] PJM Interconnection, L.L.C., Docket No. ER01-2473-000, Order Accepting Amendment, 96 FERC ¶ 61,233 (2001).

[17] PJM Interconnection, LLC, et al., Docket No. RT01-2-000, Order Provisionally Granting RTO Status, 96 FERC ¶ 61,061 (2001).

importance to all Market Participants, and is best addressed now.

For example, what level of generation concentration is low enough to support workable competition? Is the long-run solution in New York City’s small subpockets additional new generation owners or call-contracts with the subpocket generation owners similar to those used in upstate New York’s small load pockets? These and all other questions related to the conditions that must ultimately be achieved to bring about an unmitigated, workably competitive New York City market ought to be explored with the interested parties. Therefore, NYPSC recommends that the Commission convene a technical conference for this purpose.

CONCLUSION

The Revised LMMs should be extended until October 31, 2002 without interruption to protect consumers from paying excess prices derived from the exercise of market power. These ex ante mitigation measures, to which the Commission referred with approval in its August 31, 2001 Order On Tariff Filing,[18] will help ensure that wholesale electric prices in this crucial

[18] New York Independent System Operator, Inc., Docket No. ER01-2489-000, 96 FERC ¶ 61,246.

market are just and reasonable.[19] The NYPSC also requests the Commission to direct the NYISO to implement all aspects of the Revised LMMs in the RTM by May 1, 2002. Finally, the NYPSC respectfully requests the Commission to convene a technical conference to explore the conditions under which the Revised LMMs could be removed.

Respectfully submitted,

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Dated: October 22, 2001
Albany, New York

[19] Pursuant to Section 205 of the Federal Power Act (16 U.S.C. §824d), "[a]ll rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful." See also, Farmers Union Cent. Exch., Inc. v. FERC, 734 F.2d 1486 (D.C. Cir. 1984) (holding that the Federal Power Act requires market prices to be just and reasonable).

CERTIFICATE OF SERVICE

I, Karen Houle, do hereby certify that I will serve on October 22, 2001, the foregoing Response 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: October 22, 2001
Albany, New York

Karen Houle