

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

GARRY A. BROWN
Chairman
PATRICIA L. ACAMPORA
MAUREEN F. HARRIS
ROBERT E. CURRY JR.
Commissioners



PETER McGOWAN
Acting General Counsel

JACLYN A. BRILLING
Secretary

October 30, 2008

SENT VIA ELECTRONIC FILING
Honorable Kimberly D. Bose, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Room 1-A209
Washington, D.C. 20426

Re: Docket Nos. EL07-39-002; ER08-695-000;
ER08-695-001 - New York Independent System
Operator, Inc.

Dear Secretary Bose:

For filing, please find the Request for Rehearing 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,

A handwritten signature in black ink that reads 'David G. Drexler'.

David G. Drexler
Assistant Counsel

Attachments

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System)	Docket Nos. EL07-39-002
Operator, Inc.)	ER08-695-000
)	ER08-695-001

REQUEST FOR REHEARING
OF THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK

Pursuant to 16 U.S.C. §8251(a), and Rule 713 of the Federal Energy Regulatory Commission's (FERC or Commission) Rules of Practice and Procedure, the New York State Public Service Commission (NYPSC) hereby submits its Request for Rehearing of the Commission's Order on Rehearing and Further Order on Compliance Tariff Sheets, issued September 30, 2008 (September 30, 2008 Order).

BACKGROUND

On March 7, 2008, the Commission issued an order approving mitigation measures that were proposed by the New York Independent System Operator, Inc. (NYISO) in order to prevent pivotal suppliers from exercising market power by withholding Installed Capacity (ICAP) within New York City (NYC).¹ The Commission's order found that "it is appropriate for NYISO to

¹ 122 FERC ¶61,211 (March 7, 2008 Order).

determine pivotal suppliers based on control of capacity resources."²

The NYISO submitted a compliance filing on March 20, 2008, designed to implement the mitigation measures approved by FERC. In relevant part, the NYISO proposed to define a pivotal supplier as a market party that controls 500 MW or more of Unforced Capacity (UCAP), and controls a portion of UCAP necessary to meet NYC locational minimum ICAP requirements.³ The NYISO sought to define "control," with respect to UCAP, as either: 1) the ability to determine the quantity or price of offers to supply UCAP, or 2) the right to revenue or other financial benefits from such UCAP. As the NYISO explained, a pivotal supplier "could readily use such a retention of rights to extend the benefits of withholding some or all [UCAP]."⁴

The September 30, 2008 Order rejected the NYISO's proposal to define "control" to include the retention of rights to revenue or other financial benefits from UCAP. The Commission determined that the NYISO's definition of control went beyond the scope of the March 7, 2008 Order.

² March 7, 2008 Order at ¶66.

³ Essentially, UCAP is determined by adjusting ICAP for forced outages.

⁴ NYISO March 20, 2008 Compliance Filing at p. 6.

STATEMENT OF ISSUE

Whether the Commission's September 30, 2008 Order inappropriately excluded the retention of rights to revenue or other financial benefits from UCAP in defining a pivotal suppliers' "control" of capacity resources.

SPECIFICATION OF ERROR

The Commission erred in defining a pivotal suppliers' "control" of capacity resources to exclude the retention of rights to revenue or other financial benefits from UCAP, where allowing the retention of such rights leaves a gap in the NYISO's mitigation measures that allows a UCAP supplier, which would otherwise be a pivotal supplier, to engage in economic withholding of capacity in order to increase prices.

DISCUSSION

The Commission Failed To Adequately Address Economic Withholding Of ICAP In NYC By Allowing Pivotal Suppliers To Circumvent Otherwise Applicable Bid Caps By Transferring ICAP Bidding Rights To Separate Entities, While Allowing Pivotal Suppliers To Retain Financial Interests In The ICAP

This proceeding was born out of legitimate concerns that one or more pivotal suppliers of ICAP in NYC were exercising market power by engaging in economic withholding of capacity, and thereby artificially and inappropriately inflating the price of ICAP. It would be ironic, to put it mildly, if the very rule by which the Commission sought to lay those concerns to rest opened a regulatory gap that explicitly allows an entity, which would otherwise be a pivotal supplier, to engage in new forms of economic withholding. However, that is precisely the consequence which the September 30, 2008 Order

poses. We urge the Commission to reconsider its September 30, 2008 Order, and prevent such an outcome from occurring.

It is undisputed that pivotal suppliers of ICAP in NYC possess market power. Indeed, this was recognized by the Commission when it imposed bid caps on these suppliers.⁵ Absent effective mitigation measures, these suppliers may inappropriately profit by raising their bids, thereby foregoing sales on a portion of their ICAP, in order to increase the market clearing price received on their remaining supply (i.e., economic withholding). The bid caps applicable to pivotal suppliers, which the Commission approved in its March 7, 2008 Order, properly mitigated this type of withholding.

However, by narrowly defining a pivotal suppliers' "control" of capacity resources as the ability to determine the quantity or price of UCAP bids, the Commission has created a regulatory gap by which a pivotal supplier may easily evade the bid caps. This is because an otherwise pivotal supplier could merely transfer "control" over bidding a sufficient portion of its UCAP to another entity, so that it maintains less than 500 MW (i.e., the threshold for imposing mitigation), while economically withholding the UCAP it does retain by bidding far

⁵ March 7, 2008 Order at ¶1 (finding that mitigation measures were needed to "prevent sellers with market power from artificially raising capacity prices").

above its going-forward costs and reaping a windfall on the transferred MWs due to its retained financial interests.

Prior to the March 7, 2008 Order, pivotal suppliers had an incentive to engage in economic withholding. To illustrate, suppose a pivotal supplier owned 2000 MW, and had going-forward costs below \$5/kW-month. If the supplier bid its going-forward costs, and the competitive market clearing price was \$5/kW-month, the supplier would have received \$10 million per month in ICAP payments (2,000,000 kW x \$5/kW-month). However, since the supplier was allowed to bid above its going-forward costs, it could economically withhold some supply and thereby increase the market clearing price on the remaining portion of its supply that was needed to clear the market. If the supplier withheld 400 MW (20%), the market price would increase by \$3.32/kW-month (4 x \$0.83/kW-month), or 67%.⁶ If the supplier sold its remaining 1600 MW at \$8.32/kW-month (i.e., 67% above its competitive price), it would have received a payment of \$13.3 million per month, which is a 33% increase in payment. The March 7, 2008 Order addressed this inappropriate incentive by establishing effective bid caps for pivotal suppliers.

⁶ For the NYC ICAP market, each 100 MW reduction in supply translates to an increase in the market price of about \$0.83/kW-month.

Under the September 30, 2008 Order, pivotal suppliers would have a new method by which they could engage in economic withholding. For example, a pivotal supplier could sign a financial contract with a marketer for 1600 MW, in which the marketer takes "control" of 1600 MW, but agrees to pay the pivotal supplier the market-clearing price for all 1600 MW. As long as the marketer sells all 1600 MW into the market, which it could do by bidding it in at zero, it would receive the market-clearing price. The marketer would not bear any financial risk, while the pivotal supplier could compensate the marketer for its efforts by paying a small fixed fee. Meanwhile, the otherwise pivotal supplier would now only "control" the bidding for 400 MW, and would thus be exempt from the Commission-approved bid caps. However, the supplier would have exactly the same financial incentives as it did when it controlled all 2000 MW.

Because exempted from the bid caps, the otherwise pivotal supplier would be allowed to bid \$10/kW-month or higher, causing its 400 MW to fail to clear the market, and thereby raising the market price to \$8.32/kW-month (400 MW x \$0.83/kW-month per 100 MW equals \$3.32, added to \$5/kW-month competitive price). By withholding, the supplier would forego the revenues from the 400 MW it withheld, but would enjoy higher revenues from its financial contract for the 1600 MW it transferred "control" over. In fact, its profit would be almost as great as

before, \$13.3M per month (1,600,000 kW x \$8.32/kW-month) less the fixed fee paid to the marketer, or 33% (less the fixed fee) above the profit it would have earned by offering at a competitive bid.

The Commission should recognize that financial swaps, which have already been employed by two pivotal suppliers (i.e., Reliant and KeySpan), have the same potential to exacerbate market power as if actual ownership were transferred. Thus, financial contracts, such as swaps, must be considered along with ownership and bidding rights as part of any comprehensive market power analysis.

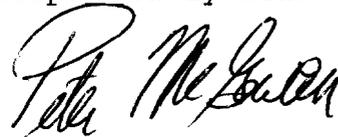
The NYISO's proposed definition of "control" ensured that pivotal suppliers could not take advantage of a regulatory gap by utilizing financial instruments to evade the bid caps. Notwithstanding the manifest need for a broad definition of "control," the Commission found that the NYISO's definition went beyond the scope of the March 7, 2008 Order. Therefore, the Commission should reconsider its September 30, 2008 Order, and find that the NYISO's definition of "control" is both reasonable and necessary to address the problem of economic withholding of ICAP in NYC. This definition is consistent with the Commission's finding in its March 7, 2008 Order that pivotal suppliers should be determined "based on control of capacity

resources."⁷ Accordingly, under the circumstances present in the NYC ICAP market, the Commission should define a pivotal suppliers' "control" of capacity resources to include not just the ability to determine the quantity or price of UCAP, but also the retention of rights to revenue or other financial benefits from UCAP.

CONCLUSION

In accordance with the above discussion, the Commission should grant the NYPSC's Request for Rehearing and adopt the definition of "control" proposed by the NYISO for purposes of identifying pivotal suppliers.

Respectfully submitted,



Peter McGowan
Acting General Counsel
Public Service Commission
of the State of New York

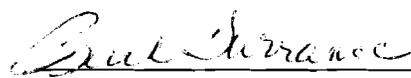
By: David G. Drexler
Assistant Counsel
3 Empire State Plaza
Albany, NY 12223-1305
(518) 473-8178

Dated: October 30, 2008
 Albany, New York

⁷ March 7, 2008 Order at ¶66 (noting that under Order 697, 119 FERC ¶61,295, "the determination of control is appropriately based on a review of the totality of circumstances on a fact-specific basis").

CERTIFICATE OF SERVICE

I, Ruth Tarrance, do hereby certify that I will serve on October 30, 2008, the foregoing Request for Rehearing 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.


Ruth Tarrance

Dated: October 30, 2008
Albany, New York