

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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PUBLIC SERVICE COMMISSION

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December 12, 2007

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 No. EL07-39-000 - New York Independent
System Operator, Inc.

Dear Secretary Bose:

For filing, please find the Reply Comments 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) 473-8178.

Very truly yours,

A handwritten signature in cursive script that reads 'David G. Drexler'.

David G. Drexler
Assistant Counsel

Attachment

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System) Docket No. EL07-39-000
Operator, Inc.)

**REPLY COMMENTS OF THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK**

Pursuant to the Federal Energy Regulatory Commission's (FERC or Commission) Notice of Extension of Time, issued December 10, 2007, the New York State Public Service Commission (NYPSC) hereby submits its Reply Comments in response to various parties' initial comments on the New York Independent System Operator, Inc.'s (NYISO) October 4, 2007 filing (October 4 Filing).

INTRODUCTION AND EXECUTIVE SUMMARY

The October 4 Filing proposes to prevent the economic withholding of ICAP in New York City (NYC) by, in effect, reducing the bid caps imposed on pivotal suppliers. According to the NYISO, this will ensure that pivotal suppliers' bids will be consistent with the conduct expected in a competitive market. However, the NYISO also insists that the new bid caps render the existing revenue caps imposed on pivotal suppliers unnecessary. In addition, the NYISO advocates imposing a minimum bid floor on

new resources participating in ICAP markets, because, it asserts these resources can "depress" ICAP prices in NYC. Moreover, the October 4 Filing failed to propose that refunds be made to consumers that purchased ICAP at prices that were excessive and unreasonable because pivotal suppliers had engaged in economic withholding.

On November 19, 2007, the NYPSC filed a Protest, which, although supporting the proposal to, in effect, reduce the bid caps for pivotal suppliers, opposed lifting the revenue caps for those suppliers, since the NYISO's proposal did not address the ability and incentive of suppliers to exercise market power through physical withholding.¹ In addition, the NYPSC opposed the imposition of a minimum bid requirement on new ICAP resources because that requirement would interfere with the ability of New York to promote new resources that are consistent with legitimate public policy interests, such as increased fuel diversity and reduced environmental emissions, by preventing the counting of those resources towards the State's resource adequacy requirement in certain excess capacity situations. Under those circumstances, Load-Serving Entities (LSEs) would be prevented from self-supplying ICAP purchased through a bilateral

¹ A complete discussion of the background and the NYPSC's positions in this proceeding are contained in our November 19, 2007 Protest (NYPSC Protest).

contract, and forced to pay twice for ICAP necessary to meet the State's adequacy needs.

Furthermore, the NYPSC requested that consumers be refunded amounts paid beyond what a competitive market would otherwise have yielded in the absence of the on-going exercise of market power. Because of this anticompetitive behavior, the prices consumers paid were unjust and unreasonable, and suppliers were over-compensated. Consumers should be afforded refunds accordingly.²

Various parties also filed comments in response to the October 4 Filing. The NYPSC responds to those comments that propose that: 1) minimum bid requirements are necessary for capacity additions on the alleged grounds that such additions are intended to depress ICAP prices; 2) additional components should be recognized in the definition of "going forward costs" used to mitigate pivotal suppliers' bids; and, 3) the NYISO should be directed to implement a "forward capacity market" in a "compliance filing."

Contrary to these assertions, a minimum bid requirement is not appropriate for new resources since LSEs

² Estimates indicate that since the 2006 summer capability period, consumers have paid as much as \$267 million in additional costs attributable to economic withholding. Approximately \$110 million of this amount was incurred after the Commission's refund effective date of May 12, 2007.

should be allowed to self-supply capacity needed to serve their customers and to achieve legitimate public policy goals.

Allowing LSEs to self-supply this capacity by bidding it into ICAP markets at zero is fundamental to ensuring their capacity will be counted toward the resource adequacy requirements, while any additional generation needed to meet the adequacy requirement will be appropriately compensated under the Demand Curve. Because the Demand Curve ultimately sets the price for ICAP based upon the level of available resources in relation to the resource adequacy needs, it would be inappropriate to artificially raise prices for existing suppliers that may not be needed to meet adequacy needs by imposing a minimum bid requirement on new resources.

In addition, the NYISO's proposed definition of going forward costs is appropriate, and should not be revised as suppliers demand. Their unjustified claims could have the effect of significantly raising the proposed bid caps that mitigate pivotal suppliers and rendering that mitigation ineffective.

Finally, the NYPSC asks the Commission to reject suppliers' proposition that a forward capacity market should be implemented through a compliance filing here. The creation of such a market raises many complex issues that cannot be adequately vetted in a compliance filing. Moreover, a forward

capacity market could have a significant impact on market participants that are not parties in this proceeding. The NYISO's development of such a market should proceed, if at all, through the NYISO stakeholder process.

DISCUSSION

I. **The Commission Should Reject Minimum Bid Requirements For New ICAP Supplies Because Appropriate Prices Are Determined Under The ICAP Demand Curve**

Several suppliers suggest that buyers are attempting to "depress market capacity prices,"³ as evidenced by recent LSE capacity additions (i.e., Consolidated Edison Company of New York, Inc's (Con Edison) contract with Astoria Energy, LLC's 500 MW unit and the New York Power Authority's (NYPA) construction of the 500 MW Poletti facility). These suppliers characterize the additions as "buyer-subsidized arrangements," and ask that the Commission go beyond the NYISO's proposal to impose a minimum bid floor of 75% of the Cost-Of-New-Entry (CONE) on all new ICAP resource bids by mandating a bid floor equivalent to 100% of the CONE.⁴ They further request that the 1000 MW of

³ See, Protest of the NRG Companies and Proposed Reforms to the In-City Capacity Market (NRG) (dated November 19, 2007) at p.3.

⁴ October 4 Filing at pp.28-29. CONE is net of energy and ancillary services revenues. See, Comments of Astoria Generating Company, L.P. (Astoria) (dated November 9, 2007) at p.5.

recent capacity additions owned by Astoria Energy, LLC and NYPA be subjected to these minimum bid requirements.⁵

The suppliers' claims that the recent addition of 1000 MW of new capacity was intended to flood the ICAP market and depress prices are unfounded and unrealistic. In fact, as a condition of NYPA's approval for construction of the new 500 MW facility, NYPA agreed to shut down its existing Poletti facility, which represents about 890 MW of ICAP, by February 2008, unless the NYISO determined that retiring the "old" Poletti facility would cause Locational Capacity Requirements to fall below needed levels for upcoming periods. The NYISO certified that was the case on May 8, 2006, and March 16, 2007. Regardless, NYPA agreed to permanently cease operation of the existing Poletti facility by no later than February 2010.

As to Astoria Energy, that 500 MW facility was built in response to a Con Edison solicitation for new capacity that was based on Con Edison's obligations to ensure adequate and reliable service to its customers. From these actions taken to ensure reliability in NYC, suppliers would have the Commission infer some improper intent. It is unrealistic to believe, however, that 1000 MW would flood the market when this amount is

⁵ Astoria at p.5.

roughly equivalent to the amount of capacity NYPA intends to remove from service in early 2010.

Moreover, as explained in the NYPSC's November 19, 2007 Protest, a minimum bid requirement for new resources would prevent resources, which may be preferable from a public policy perspective (e.g., increased fuel diversity or improved environmental characteristics), from counting towards New York's resource adequacy requirements or receiving ICAP payments when excess capacity causes clearing prices to fall below the minimum bid requirement.⁶ The proposal has the effect of guaranteeing that existing resources continue to receive ICAP payments, and discouraging the new entrants that would not receive ICAP payments.⁷ To avoid these discriminatory impacts, which are not characteristic of competitive markets, the Commission should continue to allow LSEs to bid resources into the ICAP market at zero.

⁶ The NYPSC is implementing a "Renewable Portfolio Standard" (RPS), which is designed to increase the proportion of electricity attributable to renewable resources to at least 25 percent of electric energy used in New York by 2013. The objectives of the RPS include improving New York's environment, and increasing energy security and independence. See, Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, Order Regarding Retail Renewable Portfolio Standard (issued September 24, 2004); see also, NYPSC Protest, Paynter Aff. at ¶¶22, 28-33.

⁷ See, NYPSC Protest, Paynter Aff. at ¶¶26-27.

Finally, the concern that new entry may depress prices is already addressed by the Demand Curve, which requires LSEs to purchase all quantities of ICAP that clear the auction at administratively-determined prices.⁸ While LSEs may bid in new capacity resources at low prices (or zero) to ensure it is counted toward their ICAP requirements,⁹ and this may cause prices to decline as additional ICAP clears the market, it also leads to purchases of greater amounts of ICAP, which offset the price decline through higher volume.¹⁰ Therefore, ultimately, it is the Demand Curve, which has been approved as "just and reasonable,"¹¹ that sets the price of ICAP. As a result, the Commission should not adopt the NYISO's proposal, or the suggestions by suppliers to go beyond the NYISO's proposal,

⁸ Dr. Patton concludes that LSEs are not able to exercise market power "given the auction design because the quantity that the LSEs must obtain is determined by the demand curve." October 4 Filing, Attachment 1 (Affidavit of Dr. David B. Patton), ¶62.

⁹ The NYISO's proposal to mitigate the bids of new entrants could prevent LSEs from self-supplying ICAP that they either own or have purchased, thereby preventing the counting of the capacity towards meeting the State's resource adequacy standard and requiring consumers to pay twice for capacity. See, NYPSC Protest, Paynter Aff. at ¶¶22-23.

¹⁰ It is also unlikely that buyers could "profit from a long-term strategy of depressing the market price." See, NYPSC Protest, Paynter Aff. at ¶33.

¹¹ Docket No. ER03-647, New York Independent System Operator, Inc., Order Conditionally Accepting for Filing Tariff Revisions (issued May 20, 2003) (finding that "the ICAP Demand Curve is a just and reasonable proposal").

since the Demand Curve ensures that existing suppliers that clear the market are appropriately compensated.

II. The Proposed Supplier-Side Mitigation Measures Are Reasonable And Should Be Approved

The NYISO's proposal to mitigate the market power of pivotal suppliers includes a modified bid cap set at the greater of the expected ICAP Demand Curve clearing price that would prevail if all qualified ICAP were sold or the net "going-forward" costs of a particular unit. Under the NYISO's proposal, going-forward costs are the "costs that could be avoided if a unit is mothballed rather than being maintained as an active market participant in order to provide capacity." Examples of such avoidable costs include "labor for routin[e] operations and maintenance, routine materials and contract services, administrative and general costs, and insurance."¹²

Several suppliers claim that additional components should be included within the definition of going forward costs, such as "lost opportunity costs," "property taxes, site leasing, land ownership and equipment costs."¹³ Rather than attempting to evaluate each of these components individually, the Commission should find that the NYISO has adequately supported the package

¹² NYISO Filing at pp. 21-25. Suppliers would be required to provide adequate support for their going forward costs.

¹³ Astoria at pp. 7, 38.

of components included in its proposed definition as appropriate and reasonable. Expanding the scope of the definition would only increase costs beyond the level that is adequate to support continued existing generation operations. Therefore, the Commission should not include the additional cost components, which could render the bid caps designed to prevent economic withholding meaningless if raised too high.

III. A Forward Capacity Market Should Be Developed, To The Extent Appropriate, Through the NYISO's Stakeholder Process

Various suppliers request that the NYISO be directed to implement a forward capacity market in a "compliance filing."¹⁴ Requiring the creation of such a market through a compliance filing would circumvent the NYISO's stakeholder process designed to ensure that interested parties, including parties not actively participating in this proceeding, can provide valuable input.

At least one supplier recognizes that the NYC market has "impacts and repercussions on the entire [New York Control Area] market," and suggests that "the Commission should not view this matter solely as an isolated, narrowly-focused dispute."¹⁵ This point is especially true with the development of a forward

¹⁴ See, NRG at p. 6; see also Astoria at p. 7.

¹⁵ See, Comments of Dynegy Northeast Generation, Inc. and Coral Power, L.L.C. at p. 2.

capacity market, which raises potentially significant consequences for the entire New York market that should be addressed by all market participants through established processes. Thus, the Commission should not mandate a compliance filing.

CONCLUSION

In accordance with the above discussion, the Commission should accept the NYISO's proposed mitigation measures for pivotal ICAP suppliers, while rejecting the proposals to lift the revenue cap on DGUs, impose minimum bid requirements on new ICAP resources, and expand the definition of

going forward costs. The Commission should also allow the NYISO stakeholders to address the design of forward capacity markets.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Peter McGowan". The signature is written in a cursive, flowing style.

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: December 10, 2007
Albany, New York

CERTIFICATE OF SERVICE

I, Ruth Tarrance, do hereby certify that I will serve on December 12, 2007, the foregoing Reply 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: December 12, 2007
Albany, New York


Ruth Tarrance