STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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July 16, 2001

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

Re: Docket No.ER01-2489-000 - New York Independent System Operator, Inc.

Dear Secretary Boergers:

For filing please find the Notice of Intervention and Comments of the New York State Public Service Commission in the above-entitled proceedings. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Enclosures

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.	) Docket No. ER01-2489-000

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

Pursuant to a Notice of Filing, dated July 6, 2001, and Rule 214 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 Notice of Intervention and Comments in the above-captioned proceeding.

Copies of all correspondence and pleadings should be addressed to:

Lawrence G. Malone, Esq. David G. Drexler, Esq. Public Service Commission of the State of New York 3 Empire State Plaza Albany, NY 12223	Ronald Liberty Director Fed. En. Interv. Public Service Commission of the State of New York 3 Empire State Plaza Albany, NY 12223

On July 2, 2001, the New York Independent System Operator, Inc. (NYISO) filed with the Commission, pursuant to its Section 205 exigent circumstances authority, a proposal to impose financial penalties on market participants that repeatedly engage in conduct that triggers imposition of the NYISO's non-automated market mitigation measures (NYISO Exigent Circumstances Proposal). In its filing, the NYISO explained that “exigent circumstances exist in this instance because there is a material risk that prices in the NYISO-administered markets could be tainted by abuses of market power during at least some intervals in the high load periods of this summer.” Under this plan, first time offenses for economic withholding by generators would not be penalized, the penalties would not contain a multiplier of two until the third offense, and the names of bad actors would not be publicly disclosed.

While we agree with NYISO’s intentions to penalize repeat offenders, the Commission should adopt a more rigorous sanctions program. To be effective, a sanctions plan must reflect the realities of the market. The New York market is in a transition period: suppliers can exercise market power when supplies are tight and demand is great, particularly in New York City. Market power can only be mitigated on a going-forward basis and retroactive pricing is not permitted, except in limited instances. Consequently, a supplier who is found to have engaged in market abuse is free to keep its ill-gotten gains for past behavior, except in very limited instances. Under these circumstances, suppliers have little incentive to refrain from such behavior, unless there are effective sanctions which will make it unprofitable for them to engage in such behavior. Moreover, absent a strong program, market participants and consumers will be unfairly harmed. Market participants will be unable to count on rational market rules to plan their strategies and lack of confidence could seriously undermine the effectiveness of the wholesale market. Consumers, too, will bear the brunt of these behaviors by being forced to pay higher than reasonable prices.

The NYPSC respectfully submits that the exigent circumstances proposal is too weak to effectively deter improper behavior. On the other hand, the April 18, 2001 NYISO Management Committee Approved Plan captures the necessary ingredients for effective deterance and should be adopted by the Commission.

Background

A proposal to impose sanctions on suppliers was first introduced by the NYPSC in its Pricing Report issued in December, 2000, as part of a set of comprehensive plans to protect consumers against market abuse. After several months of working group and committee discussions, the Management Committee of the NYISO approved the April 18, 2001, motion of the New York State Consumer Protection Board to establish a penalty and public disclosure sanctions program (MC Proposal). This plan would have authorized the NYISO to financially penalize suppliers and disclose their names publicly if they repeatedly engaged in conduct that requires mitigation.[1] The MC Proposal would have also given the NYISO discretion to waive financial penalties or public disclosure if the NYISO determined that the sanctions were "onerous or provide no deterrent value." Moreover, the MC Proposal was targeted to behavior in the energy market, which was not subject to the NYISO's FERC-approved automatic mitigation process (AMP) in the day-ahead market and to the New York City - City mitigation requirements.

Under the MC Proposal, the financial penalties would begin immediately upon a violation. The first time a supplier was mitigated a penalty equal to two times the amount of the location-based marginal price at the mitigated generator's bus multiplied by the number of megawatts mitigated would be levied. For the second and third mitigation actions within 24 months of a prior action, the penalty would use multipliers of 3 times and 4 times, respectively. After the third offense, the bids of all of the generation firm's units would be constrained to its reference bid curve for a six-month period.

The Management Committee also approved a public disclosure requirement. The first time entities were mitigated, they would

[1] The sanctions regime, approved by the Management Committee, is attached as an Appendix. In addition to the proposal contained in the Appendix, the Management Committee adopted an amendment giving the NYISO discretion to waive the penalties and to provide for public disclosure.

not be named publicly. However, any entity that was mitigated twice by the NYISO within a 24 month period would be publicly named, and thereafter whenever mitigation occurs within 24 months of the previous action. Neither financial penalties nor public disclosure would be imposed while appeals of the NYISO's decision were pending.

After the MC Proposal was approved, with 60.66% of the vote, it was appealed to the NYISO Board. Subsequently, on May 15, 2001, the NYISO Board rejected the MC Proposal and remanded the sanctions issues back to the Management Committee with instructions to modify the Proposal.[2] The Board's concerns led to a compromise proposal which was rejected by the Management Committee. The compromise proposal received only 55.6% of the necessary 58% required for approval.[3] The exigent circumstances

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[2] The NYISO Board indicated that the Management Committee's Proposal should: cover abuses in the ancillary services markets; apply smaller financial penalties; eliminate the requirement that bids be constrained to their reference bid curve for six months after a third offense; limit repeat offenses to the same or the preceding capability period; further study the ramifications of public disclosure; require payment of penalties upon being assessed subject to refund in an alternate dispute resolution process; and apply the sanctions to the load.

[3] The compromise proposal incorporated the following changes: (1) the multiplier on the financial penalties was lowered so that the first penalty had a multiplier of 1, rather than 2; the second penalty had a multiplier of 2, rather than 3; (2) the component that lowered all of a generating firm's bids to its reference curve for a third offense was deleted; (3) penalty provisions that applied to loads were added; (4) disclosure was retained and was specified to occur upon a third offense; and (5) dispute resolution procedures were further developed and specified.

filing was defeated again by the Management Committee with support from only 10% of the stakeholders on July 12, 2001.

The Management Committee's Sanction Proposal Will More Effectively Deter Market Abuses

a. First Time Offenders Must Be Penalized

The plan filed by the NYISO absolves an entity from penalties for the first offense of economic withholding. As a consequence, a party that has market power can, if it so chooses, engage in economic withholding once every 12-18 months and keep its gains.[4] On the other hand, the MC Proposal would impose a penalty for first time offenses and provides the NYISO the discretion not to penalize the offending party. This approach puts parties on notice that they will be held accountable, but also recognizes that specific facts may warrant different outcomes.

According to the NYISO, imposing a first time penalty is unnecessary because "default bids are the primary means of mitigation for this type of conduct."[5] However, the default bid approach, since it is imposed only on a going-forward basis, fails to effectively deter the exercise of market power because it allows firms to keep their market power derived revenues from

[4] The NYISO proposal treats the balance of the capability period plus two succeeding capability periods (12-18 months) as the applicable time frame to measure a subsequent offense.

[5] A default bid is the price at which a generator is permitted to bid when it is mitigated.

the time they began exercising that power until the time their behavior is mitigated.

Furthermore, the Commission should reject any arguments that penalties are unwarranted for a first offense in order to put parties on notice. First, in order to be mitigated, a bid must violate the conduct threshold which is known by generators in advance.[6] Second, the NYISO and the party will consult about a problematic bid in advance of the mitigation. With these advance warnings, there is no basis for the claim that offending parties need advance notice through elimination of the first offense penalty.[7]

b. Penalties Must Be Large Enough To Deter Improper Behavior

The exigent circumstances proposal ignores the first offense for economic withholding, multiplies the penalty by one after the second offense, by two after the third offense and by three after the fourth offense.

While it is difficult to determine the exact level of penalties which will deter bad behavior, we know that a penalty

[6] The conduct threshold is the level above which mitigation may occur, as defined in the NYISO's Market Monitoring Plan Addendum A § 3.1.

[7] Moreover, the exigent circumstances proposal would sunset October 1, 2001 while the MC proposal provides no such end date. Given the relatively tight market we expect for the next few years, a sunset in two years is more realistic.

that does not begin immediately and ramps up slowly will not be very effective in these circumstances. Some generating firms will find it is profitable to exert market power a second or third time, even after accounting for the financial penalties.

In contrast, the need for multipliers of 2 and greater reflects how generating firms profit from economic or physical withholding. For example, a firm that owns 2000 MW of generation, which it sells into the spot market, may be able to sell all 2000 MW at a price of $500/MWh, or it may decide to exercise market power by withholding 300 MW to drive the price up to $800/MWh at peak times when supply is scarce. Exerting market power is profitable because the $300 increase in price yields higher revenues for the 1700 MW sold into the market than the amount of revenues lost by withholding 300 MW from the market. Seventeen hundred MWh sold at $800 results in $1,360,000 but 2,000 MWh sold at $500 would only result in $1,000,000.[8] In the absence of effective deterrence, consumers will pay millions unnecessarily.

To accommodate several objections regarding the penalties, the MC Proposal called for penalties to be applied to the MW

[8] This reflects that the entire market would pay the $800 per MWh rather than the $500 per MWh.

withheld from the market (300 MW in the above example).[9] Under this approach, the penalty must be strong enough to eliminate excess revenues resulting from an exercise of market power. In the above example, the penalty without a multiplier would be $800 per MWh times 300 MW of withheld capacity. This $240,000 penalty would still permit the offending party to net a $120,000 gain from its exercise of market power. On the other hand, a penalty of two times that amount would be large enough to reverse the profitable outcome of that behavior. Thus, in this example, a penalty that contains a multiplier of 2, at least for the initial offense, is needed to be a sufficient deterrent to the exercise of market power. Escalation of the multiplier to 3 and 4 for repeat offenders, as the MC proposes, better ensures that the penalty would be large enough to represent an effective deterrent for large firms.

c. Public Disclosure Is An Effective Deterrent

The exigent circumstances proposal does not call for public disclosure, while the MC Proposal provides for it. Public disclosure should be part of the sanctions package. If a firm

[9] An alternative approach to deter the type of market abuse in the above example is to establish penalties that would apply to the 1700 MW, which remain in the market, and receive the benefits of a $300 price increase. So long as the penalty is $300 or more and is applied to all of the firm’s MW that remain in the market, it eliminates the excess revenues derived from exercising market power.

knows that its name will be publicly aired and linked by the media and the public with improper behavior, it is likely that it will change its behavior. Firms do not want to see or hear their names cited in negative ways by the media. Companies work hard to foster their image as good corporate citizens and will balance a short-term attempt at extra revenues against the desire to preserve that image, but only if they know they will be publicly exposed for their improper behavior. Furthermore, companies do not want their behavior to have a negative effect on their relationship with government. For example, a firm that has filed to build one or more major new generating stations would be loath to provide its opponents with public information that it has been found by the authorities to have repeatedly violated market power rules. Similarly, since firms must return to FERC periodically to reaffirm their market pricing authority, they would prefer to avoid a publicly known track record of market power violations.

The NYISO should share its knowledge of who the bad actors are with the public. Keeping this information secret, especially at this time of public debate regarding electric competition policies, does not serve the public interest and can only breed distrust of the institutions that serve as market power watchdogs. FERC can remedy this situation by requiring public disclosure.

Finally, numerous protections have been built into the process to guard against the improper disclosure of a company's name. The mitigation never occurs in the first place without the company being fully aware that it is about to happen. Second, the NYISO's dispute resolutions procedures can be used, with the disclosure held in abeyance during that process. Finally, an appeal to the FERC is available. It is only after the NYISO and the FERC concur that the actual disclosure takes place. Consequently, a proper balance has been struck between the need to allow for disclosure as a deterrent and the need to protect against the potential harm of improper disclosure.

Conclusion

For all of these reasons, the NYPSC urges the Commission to approve the MC Proposal in lieu of the NYISO's sanctions filing.

Respectfully Submitted,

Penny Rubin for
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General Counsel
By: David G. Drexler
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Dated: July 16, 2001
Albany, New York

APPENDIX

Penalties and Public Disclosure
For Conduct That Results In
The Application of Market Mitigation

Materials for the April 18, 2001
Management Committee Meeting

The Consumer Protection Board proposes the following proposals for Penalties and Public Disclosure be adopted. The Business Issues Committee approved these proposals on April 16, 2001.

PENALTIES FOR CONDUCT THAT RESULTS IN THE APPLICATION OF MARKET MITIGATION

Proposal of NYS Consumer Protection Board

April 18, 2001 Management Committee

Background

The market mitigation authority held by the New York Independent System Operator (NYISO) is applicable on a prospective basis only. If the NYISO determines that a market participant has engaged in conduct that warrants market mitigation, it can take actions to prevent only the future reoccurrence of that conduct. [10]

Because of this gap in the NYISO's mitigating authority, a market participant knows that it can engage in conduct that warrants mitigation and receive the full financial benefit of doing so until its behavior is detected and mitigated. There appears to be no deterrent to engaging in such conduct. The goal of the penalty provisions described herein is to provide such a deterrent. Please note, however, that the goal of these measures is not to provide compensation to the buying side of the market for the inflated prices that were paid as a result of

[10] With regard to physical withholding or overproduction, the NYISO does have a mitigation measure that enables it to impose a financial obligation on the offending market party (Section 4.3 of the April 18, 2000 ISO Compliance Filing, Docket Nos. ER97-1523-020. . . et al.).

the conduct resulting in market mitigation. Revenues from penalties will go to offset NYISO Schedule 1 charges. Furthermore, these measures do not involve any correction or changes to prices.

Applicability

Initially, these penalty provisions are designed to apply only to the NYISO energy markets and would not cover the ancillary services markets. They cover both the day-ahead market and the real-time market. If experience demonstrates that it is necessary to design public disclosure and penalty provisions for ancillary services markets, then the market participants can consider them at a later time. Physical withholding (other than for reliability or safety requirements) or overproduction is currently mitigated through the imposition of a financial obligation (Section 4.3 of the NYISO's April 18, 2000 compliance filing on market mitigation measures). The portion of Section 4.3 related to the formula for calculating the financial obligation for physical withholding of generation would be eliminated and be replaced by the provisions described here.

Penalties

Penalties will gradually increase in severity, with a lesser penalty for the first time a market participant is mitigated by the NYISO, and larger penalties for the second time, third time, and so on.

The penalty for the first mitigation action during mitigated hours is as follows:

1st Penalty = (# of MW mitigated during mitigated hours) x (LBMP at the mitigated generator’s bus) x 2

MW mitigated by the NYISO is based on the MW amount of the firm’s generation capacity that exhibited the behavior that was found by the NYISO to warrant mitigation. The MW value is converted into a MWh value by applying it to the number of hours in which the conduct occurred, subject to the limitations described in the section below on the duration of market activities encompassed by the penalty.

LBMP is the hourly NYISO locational-based marginal price at each generating unit’s bus for each mitigated hour.

The NYISO would have the discretion to reduce or waive the penalty for the first mitigation action if it determines that the imposition of the penalty would be either onerous or unnecessary to deter such conduct.

The penalty for a second mitigation action within 24 months of the first mitigation action by the same generation owner is as follows:

2nd Penalty = (# of MW mitigated during mitigated hours) x (LBMP at the mitigated generator’s bus) x 3

The second penalty is larger than the first penalty in that the multiplier is 3 rather than 2. For purposes of these penalty provisions, a second (or third or fourth, etc) mitigation action means a second time in which the NYISO implemented mitigation that was applied to the same entity as the initial mitigation, or to an affiliate, parent, etc. It does not matter if the second mitigation is in a different market. Public disclosure would also apply for the second mitigation action. At the discretion of the NYISO, public disclosure could be deferred to the third mitigation action.

The penalty for a third mitigation action within 24 months of the second mitigation action by the same generation owner is as follows:

3rd Penalty = (# of MW mitigated during mitigated hours) x (LBMP at the mitigated generator’s bus) x 4

The third time a generation firm is mitigated by the NYISO, the bids of all of its generators would be constrained to its reference bid curve for a six- month period. It will also be levied a penalty equal to the 2nd penalty amount except that a multiplier of 4 rather than 3 would be used. Public disclosure occurs without the discretion of the NYISO. Additional mitigation actions beyond the third mitigation action that occur within 24 months of the previous mitigation action will be treated in the same way as the third mitigation action for the purposes of the calculation of penalties.

Trigger for Penalties

The imposition of a penalty will be triggered by an action by the NYISO to mitigate the behavior of a market participant. The market participant will have the right to appeal the NYISO action and take it to the NYISO Alternative Dispute Resolution (ADR) process for arbitration. The ADR process will decide whether the NYISO properly applied mitigation under its market monitoring authority. The penalty will not be implemented until the ADR process is complete. If the market participant is not satisfied with the outcome of the ADR process it can take the matter to FERC for resolution. If the market participant does not appeal the NYISO action to mitigate, the penalty will be automatically imposed.

These penalties shall not apply for mitigation that occurs through the use of the NYISO’s Automatic Mitigation Process (AMP) and the localized market power mitigation measures applicable to sales of capacity, energy, and certain ancillary services from specified generating units in New York City approved by FERC.

Duration of Market Activities Encompassed by the Penalty

Once a penalty is triggered, it is applicable to all previous market activities by the offending market party that: (1) are deemed to be of the same type as the activity that was mitigated; and (2) occurred prior to the implementation of mitigation by the NYISO, but not more than 14 days prior to the implementation of mitigation by the NYISO for physical withholding and not more than 5 days prior to the implementation of mitigation by the NYISO for all other mitigation actions.

APPENDIX

DISCLOSURE OF ENTITIES THAT ENGAGE IN CONDUCT THAT RESULTS IN THE APPLICATION OF MARKET MITIGATION

Proposal of NYS Consumer Protection Board

April 18, 2001

Background

To protect consumers from conduct that results in market mitigation, it is important to provide a deterrent to entities that may be considering the exercise of such conduct. . One component of a deterrent is created by publicly disclosing the identity of any entity that engages in conduct that results in market mitigation, and is found by the NYISO to have done so.

Procedure

1. The first time that an entity is mitigated by the NYISO, the entity will not be named.

2. If an entity is mitigated by the NYISO within 24 months of the first mitigation action, then it will be named. This second mitigation action applies to the same entity as the initial mitigation, or to an affiliate, parent, etc. It does not matter if the second mitigation is in a different market. For example, if entity A engages in conduct that results in market mitigation and is mitigated in the day-ahead ten-minute non-spin reserve market, then later entity A is mitigated in the real-

time energy market, this constitutes a second mitigation action for entity A. Entity A is named and is revealed to be the party involved in both the first and the second mitigation action. If the entity mitigated in the second mitigation action is entity B, and entity B is an affiliate of entity A, then both entity A and entity B are named, as well as the holding company that governs entity A and entity B. At the discretion of the NYISO, public disclosure could be deferred to the third mitigation action.

3. The entity will be named after all subsequent mitigation actions, whenever those actions occur within 24 months of the previous action.

4. No confidential information, such as bid prices, quantities, etc., will be revealed as part of the process by which the entity is named.

5. The NYISO will maintain a list of all mitigation actions on its website showing the dates and, where applicable, the names of the entities involved.

6. Mitigation that occurs through the use of the NYISO’s Automatic Mitigation Process (AMP) and the localized Market Power Mitigation Measures applicable to sales of capacity, energy and certain ancillary services from specified generating units in NYC approved by FERC would not be subject to this public disclosure mechanism.

7. Public disclosure will be delayed until an appealing party’s appeal has completed the NYISO’s dispute resolution process and any subsequent appeal to the FERC.

CERTIFICATE OF SERVICE

I, Naomi Tague, do hereby certify that I will serve on July 16, 2001, the foregoing Notice of Intervention and Comments 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: July 16, 2001
Albany, New York

Naomi Tague