STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350

Internet Address: http://www.dps.state.ny.us

October 31, 2001

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

Re: Docket No. ER01-3155-000 - New York Independent System Operator, Inc.

Dear Secretary Boergers:

For filing, please find the Motion to File an Answer and Answer 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. ER01-3155-000

MOTION TO FILE ANSWER AND ANSWER OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

Pursuant to Rules 212 and 213 of the Federal Energy Regulatory Commission’s (Commission or FERC) Rules of Practice and Procedure, the Public Service Commission of the State of New York (NYPSC) hereby submits its answer to protests in the above-captioned proceeding. Although Rule 213 does not ordinarily allow for answers to protests, the Commission has accepted such pleadings for good cause.[1] Good cause exists to allow this answer because it will assist the Commission’s understanding and resolution of issues and assure a complete record upon which FERC can base its decision.

---

[1] Cove Point LNG Limited Partnership, 97 FERC ¶ 61,043 (2001) (finding good cause to waive Rule 213 “in order to assure that the Commission has a complete record upon which to base its decisions”); New York Independent System Operator, Inc., 95 FERC ¶ 61,484 (2001) (allowing an answer “to the extent it provides certain clarifications”); Consumers Energy Company, Consumers Energy Company, Michigan Electric Transmission Company, 94 FERC ¶ 61,018 (2001) (permitting an answer to a protest to assist the Commission in understanding and resolving the issues raised).

BACKGROUND

On June 28, 2001, the Commission approved the New York Independent System Operator, Inc.'s (NYISO) proposal to implement the Automated Mitigation Procedure (AMP) until October 31, 2001.[2] The AMP is a critical tool that protects consumers from unreasonably high prices caused by the exercise of market power.

The AMP applies to the Day-Ahead Market (DAM) and is activated if the Locational Based Marginal Price (LBMP) in any area of New York exceeds $150. Once the AMP is activated, all bids are reviewed to determine whether the bids exceed the conduct threshold (i.e., the conduct threshold is $100 above the generator's reference price).[3] When one or more bids exceed the conduct threshold, mitigation will occur only if the clearing price, absent mitigation, would rise $100 or more above the mitigated price (i.e., impact threshold). If the group of bids causes the impact threshold to be exceeded, then all bids that exceed the conduct threshold are mitigated and a default bid based upon each market participant's reference price is substituted for each bid that is in excess of the conduct threshold.

[2] New York Independent System Operator, Inc., Docket No. ER01-2076-000, 95 FERC ¶ 61,471 (2001).

[3] The conduct threshold is also exceeded if a bid is more than 300% above the generator's reference price.

DISCUSSION

The NYPSC supports the September 28, 2001, filing of the NYISO to extend the termination date for the AMP in the DAM, until October 31, 2002.[4] A wide range of support was also voiced for the AMP by the NYISO, the New York State Consumer Protection Board, the City of New York, Consolidated Edison Company of New York, Inc., Orange and Rockland Utilities, Inc., and Multiple Intervenors. Several generators, including Dynegy Power Marketing, Inc. (Dynegy), Mirant Companies, AES Companies, the Independent Power Producers of New York, Inc. (IPPNY), the Electric Power Supply association (EPSA), Aquila Energy Marketing Corp., et al., Keyspan-Ravenswood, Inc., Williams Energy Marketing and Trading Company, and Enron Power Marketing, Inc. are opposed to continuation of the AMP. In particular, generators claim that the AMP improperly mitigates economically justifiable bids, does not provide adequate consultation with the NYISO prior to mitigation, exposes generators to undue risk and is not founded on structural market power problems. These arguments have been rejected by the Commission in its June 28th Order and should be rejected again. Continuation of the AMP is

---

[4] See Notice of Intervention and Comments of the Public Service Commission of the State of New York in Docket Number ER01-3155-000, dated October 19, 2001. The NYPSC also submitted pleadings in Docket Number ER01-2076-000 on August 24, 2001, and June 12, 2001.

necessary to ensure that wholesale prices are just and reasonable[5] in light of the tight supply situation and transmission constraints that continue to exist in New York.

I. The AMP Only Mitigates Against Market Power

A. The AMP Distinguishes High Prices Associated With Market Power From High Prices Associated With Scarcity

Several generators argue that the AMP mitigates prices that result from competitive conditions in the market.[6] The AMP, however, is tailored to only mitigate high prices resulting from the exercise of market power, while leaving high prices that result from competitive market conditions, such as true

[5] 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).

[6] Dynegy Power Marketing, Inc. (Dynegy) claims that the AMP "does not distinguish competitive market conditions from market power." Motion to Intervene and Protest of Dynegy (hereinafter Dynegy) at pp. 17-19. Similaryly, the Mirant and AES companies, and the Independent Power Producers of New York, Inc. (IPPNY) argue that the AMP mitigates economically justifiable bids. See Motion to Intervene and protest of Mirant and AES (hereinafter Mirant) at p. 2; see also Motion to Intervene and Protest of IPPNY (hereinafter IPPNY) at p. 5.

scarcity, undisturbed. The AMP is structured to only evaluate bidding behavior when market clearing prices are being set on the steep part of the supply curve (i.e., above $150/MWh). Although prices reached or surpassed the $150 threshold level 12 times during the summer of 2001, the AMP intervened on only four occasions. On the other eight occasions, the AMP did not mitigate because scarcity, not market power, was driving the high prices. For example, during hours 14 and 15 on August 9, 2001, the AMP did not mitigate, even though the price actually hit the $1,000 bid cap. On the other hand, when high prices result from abuse of market power, the AMP replaces uncompetitive bids with a generator’s reference price, which reflects what such a generator would be expected to bid under normal competitive bidding behavior. Thus, the AMP distinguishes high prices resulting from true scarcity and those resulting from market power.

B. The AMP Properly Evaluates the Combined Impact of Generators

At least one generator claims that the AMP improperly mitigates bids in situations where a bid by a single generator cannot, by itself, cause the price impact threshold to be exceeded.[7] Because the AMP mitigates all generators as a group, based on whether the cumulative impacts of the bids caused the

[7] IPPNY at p. 8.

price impact threshold to be exceeded, some generators may be mitigated as part of the group, even though a single generator acting by itself might not have caused the price impact threshold to be exceeded. The need for the analysis of the entire group is apparent from the fact that several generation owners may each withhold a block of capacity. If examined separately, each individual generator's conduct might not cause the impact threshold to be exceeded. As a group, however, the cumulative withholding could cause a combined price increase that passes the impact threshold, reflecting the larger impact of the group. This problem may occur even without collusion by a group of generators.

For example, a 1,000 MW generation owner can bid competitively and the market clearing price could be $150. Its total revenue would be $150,000. Alternatively, it could withhold 100 MW and, because the supply curve is so steep, drive the price up to $180. The withholding would raise its total revenues to $162,000, giving it a revenue increase of $12,000. This is an example of a generator exercising unilateral market power, which can occur at times when the market price clears on the steep portion of the supply curve.

If a number of generation owners simultaneously, but independently, pursued similar strategies, the benefits to each one of them can be much greater. Thus, four or five large generation owners, each withholding fairly small amounts, and each, on its own, having an impact that would not result in mitigation by the AMP, can result in a devastatingly large price impact that is indeed market power, and which should be mitigated. Therefore, it is necessary to let the AMP mitigate generators when the very large price impacts of $100 or more occur, based on an analysis of the group as a whole. Failure to judge the impact based on the joint impact of the generators' bids would expose consumers to potentially serious harm from market power.

C. The AMP is Necessary to Protect Consumers From Market Abuse

Generators have also argued that the AMP is not justified. Specifically, the Electric Power Supply Association (EPSA) claims that there is "no credible case to show that the market has experienced undue market abuse."[8] On June 26, 2000, before the AMP was in place, the impact of market power resulted in consumers paying $100 million in unwarranted energy costs because improper bids could not be mitigated without a day's lag.

The reason that such a large impact from market power can occur on a single day is that, at this stage in the transition

[8] Motion for leave to intervene and protest of EPSA at p. 4.

to competition, an important structural weakness exists in the marketplace during high load periods. At such times, the price elasticity of supply is low or non-existent due to the paucity of excess supply at such high load levels. This is combined with a very small price elasticity of demand that handicaps the ability of demand response to mute price increases and frustrate the exercise of market power. In combination, these two factors leave the market prices excessively vulnerable to the exercise of market power, even by generators with only modest market shares. While the $1000 bid cap protects against extreme price increases caused by market power, substantial harm from market power can occur in the $150 to $1000 range as evidenced by the experience of June, 2000.

The AMP addresses this structural infirmity. Under the AMP, generators know that very large increases in bids, which cause very large price increases, will not be allowed to prevail. This approach gives the generators an incentive to bid below the conduct threshold. Thus, the AMP has clearly altered bidding behavior since its inception, yielding protection from what otherwise could have been substantial harm from market power. Thus, while generators have been mitigated in the amount of only $11 million, the protection afforded by the AMP is likely much greater.[9]

II. The AMP Includes Substantial Protections Against Unreasonable Mitigation

The generators suggest that because there may be unreasonable mitigation, the AMP is flawed and should expire on October 31, 2001. There are many features of the AMP that were designed to protect against improper mitigation, and do so. Additionally, it is unrealistic to expect that errors will not occur. It is equally unreasonable to suggest that the only errors that need to be addressed are those which harm the generators. It is just as important to protect against the occurrence of market power that goes unmitigated. Absent the AMP, the error of permitting unmitigated market power would be far greater than any harm caused by improper mitigation. For example, in 2000, the harm from unmitigated market power from a single day equaled $100 million. In contrast, only $11 million was withheld from generators in 2001. Obviously, even if there was an error in 2001, the damage was insignificant in comparison

[9] Despite arguments to the contrary, the AMP is needed throughout the year. While the likelihood is greater that market power conditions will occur in the high-load summer months because supply is closer to demand, such conditions may also occur during shoulder months, when load may be lower, but there may be scheduled and unscheduled outages. Also, the existence of transmission constraints may limit competition in certain areas.

to the damage in 2000. The generators arguments have no merit.

A. The AMP Only Examines Bids When the Clearing Price is in Excess of $150

The $150 threshold reflects the NYISO's independent Market Advisor's judgment that at or above this price, elasticity of supply is low. During the summer of 2001, there were only 12 days when prices exceeded $150. On these days, loads were high enough to force the NYISO to select and dispatch generators in the steep part of the supply curve. For all other days, generators had no risk of being subjected to mitigation by the AMP. Thus, the overall possibility of mitigation is extremely small.

B. The $100 Threshold for Bid Conduct is More Than Reasonable

In addition, the AMP looks at a generator's bid to determine if it is $100 or more above that generator's reference price to determine whether the generator's bid could be subject to mitigation. If it is, then the AMP's conduct threshold criteria has been met. The conduct threshold provides substantial protection to generators since it will allow large bid increases, yet will not be activated. For example, bids that are $50, $70 or $90 above their reference price could likely reflect the exercise of market power, but are not even considered by the AMP, due to the extremely liberal $100 conduct threshold.

C. There Are Sufficient Opportunities for Consultation with the NYISO[10]

Moreover, if a generator anticipates submitting an unusually high bid, the AMP's rules provide generators with the opportunity to consult with the NYISO regarding the reasons for those bids in advance of being mitigated. Specifically, generators may consult with the NYISO to adjust their reference prices, which are compared with the bids to determine whether the AMP's conduct thresholds are exceeded. Each generator is uniquely situated to inform the NYISO of conditions that will legitimately cause its bids to exceed the conduct threshold in advance. Several generators have taken up this opportunity to consult with the NYISO.[11] Not one generator can point to a single instance in which it used the bid consultation procedures and was denied approval of its high bid. The NYISO as approved all such requests to date. Thus, claims that were made by

---

[10] Mirant argues that the AMP does not provide "a meaningful opportunity to explain its market behavior prior to the imposition of mitigation." Mirant at p. 2. Likewise, IPPNY claims that inadequate opportunities exist to "justify their conduct before being subject to mitigation." IPPANY at p. 5.

[11] Apparently, a generator that had its high reference price approved by the NYISO, may have been improperly mitigated due to an error in communicating the new data, and not due to a flaw in the AMP.

generators prior to this summer that the procedures were inadequate and would lead to substantial harm to generators have now, with experience, been proven to be without merit and should be rejected.

D. The AMP Only Mitigates When the Price Impact of Market Power Raises Prices by More Than $100

During the summer of 2001, of the twelve days in which the AMP was activated, mitigation occurred on only four days. On the other eight days, generators were not mitigated because the $100 price impact threshold was not breached. Thus, this feature of the AMP further limits its reach and shields generators from the possibility of improper mitigation on all of the other days of the year.

E. Generators Should be Able to Hedge Their Risk Through Virtual Bidding

Mirant takes issue with the possibility that the AMP "may artificially restrict opportunities to hedge between the DAM and [Real Time Market]."[12] Beginning in November, the NYISO will implement virtual bidding. Under virtual bidding, generators that are concerned with excessive exposure to risk in the DAM, because of financial commitments to supply energy at prices that

[12] Mirant at p. 25.

they believe do not reflect their exposure,[13] can hedge this risk by bidding virtual load in the DAM. Thus, the complaint that the AMP exposes generators to risk in the DAM is without merit. Furthermore, as noted in section II.B. above, generators may consult with the NYISO to obtain approval of exceptionally high reference prices.

CONCLUSION

The AMP is an effective tool that is unobtrusive and narrowly tailored to prevent specific instances of market power abuse. It is an interim measure that protects consumers during the transition to effective competition. The AMP provides ample protection for the generators. First, it is only triggered when price levels are above $150. There were only 12 of these days since it was implemented. Second, the AMP mitigates only when it finds that prices have increased $100, absent mitigation (this occurred on 4 out of 12 days). Third, on these 4 days an individual generator was subject to mitigation only if its bid was more than $100 above its reference price. Finally, the generator can justify to the NYISO why the high bid was reasonable, and only if the NYISO disagrees is it subject to mitigation. Under these circumstances, the harm to generators

[13] Mirant also claims that the AMP's reference bids do not incorporate "many of the important short-run marginal costs faced by bidders in the...DAM..., including opportunity costs and outage risk costs." Mirant at p. 5.

is minute in comparison to the risk to the demand side if the AMP is eliminated.

The Commission should grant the NYPSC’s motion and reject the arguments raised by generators for the reasons herein. Finally, the Commission should accept the NYISO’s filing and extend the AMP until October 31, 2002.

Respectfully submitted,

Lawrence G. Malone
General Counsel
By: David G. Drexler
Assistant Counsel
Public Service Commission
Of the State of New York
3 Empire State Plaza
Albany, NY 12223-1305
(518) 473-8178

Dated: October 31, 2001
Albany, New York

CERTIFICATE OF SERVICE

I, Naomi Tague, do hereby certify that I will serve on October 31, 2001, the foregoing Motion to File Answer and Answer 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 31, 2001
Albany, New York

Naomi Tague