

September 29, 2000

Via Hand Delivery
Ira Freilicher, Esq.
New York ISO Board Counsel
Hunton & Williams
200 Park Avenue, 44th Floor
New York, NY 10166

Dear Ira:

The City of New York (“City”) respectfully submits its “Motion in Opposition” to Hydro Quebec Energy Services (U.S.), Inc.’s September 21, 2000 appeal to the New York ISO Board to overturn the ISO Management Committee’s September 7, 2000 decision to extend bid caps until April 30, 2001. Enclosed is the original document plus ten copies (one for each ISO Board member).

Pursuant to our exchange of e-mails on September 28, 2000, I am serving the original and ten copies at Hunton & Williams’ New York office and sending a copy to ISO staff member Robert Fernandez via Federal Express. Please contact me at (212) 312-3787 if you have any questions.

Yours Very Truly,

Jay L. Kooper, Esq.
Energy Policy Advocate

cc: Robert Fernandez (New York ISO)

**MOTION OF THE CITY OF NEW YORK IN OPPOSITION TO
THE APPEAL OF THE MANAGEMENT COMMITTEE'S
SEPTEMBER 7, 2000 DECISION TO EXTEND BID CAPS
AND REQUEST FOR LOWER CAPS.**

The City of New York ("City") submits this "Motion in Opposition" pursuant to §§ 1.03 and 4.01 of the New York Independent System Operator's ("NYISO") Procedural Rules for Appeals. The City requests that the Board reject Hydro Quebec Energy Services (U.S.), Inc.'s ("HQUS") appeal to overturn the Management Committee's September 7, 2000 decision to extend the \$1000/megawatt-hour ("MWH") bid cap for the NYISO's energy and specified ancillary services markets from October 28, 2000 until April 30, 2001. In addition, the City requests that the Board begin investigating whether lower caps are necessary.

In the absence of the bid caps, New York City's electricity consumers will be fully exposed to the price spikes that have resulted from the NYISO's wholesale market. If not for the cool summer in New York City, energy prices would have increased by more than 70%. In San Diego, which had significantly warmer summer temperatures, electricity consumers were not so lucky. Moreover, there have been a number of significant NYISO price spikes during off-peak periods, demonstrating that price caps are also necessary during the non-summer months. Given the promise to consumers that deregulation would lower electricity prices, it should come as no surprise that the price spikes of this past summer have seriously eroded public confidence in electric deregulation.

The Board should therefore uphold the Management Committee's decision to extend the bid caps until April 30, 2001 and immediately begin investigating whether a lower bid cap is necessary.

BACKGROUND

In NYSEG v. NYISO, Federal Energy Regulatory Commission (“FERC”) Docket No. EL-00-70-000, several parties noted various design and software implementation flaws that have adversely affected the operation of the NYISO markets.¹ On June 5, 2000, in response to these market flaws, the Management Committee voted to implement a \$1000/MWH bid cap for the NYISO’s energy and ancillary services markets. After an appeal, the Board subsequently approved a \$1300/MWH bid cap and filed its proposed bid cap with the FERC on June 30, 2000.

On July 26, 2000, the FERC authorized a \$1000/MWH bid cap in the NYISO markets through October 28, 2000, and directed the NYISO to submit a status report on its efforts to correct the design and software implementation flaws affecting the NYISO markets. See NYISO, 92 FERC ¶ 61,073 (2000), reh’g pending. On September 1, 2000, the NYISO submitted to the FERC a “Combined Compliance Filing and Report,” (“Compliance Report”) that contained a status report on its efforts to correct these flaws. In this report, the NYISO acknowledged that its “efforts to improve its markets are by no means complete, and...participants in the NYISO-administered markets are still adversely affected by market flaws.” Compliance Report at 2-3. Specifically, the NYISO reported that it is still working to address the software problems that cause hour-ahead forecasts to deviate from real-time prices, and that it is working to implement a formal demand-side responsiveness mechanism no later than June 1, 2001. Id. at 3, 34. In addition, the NYISO

¹ See, e.g., NYSEG v. NYISO, FERC Docket No. EL00-70-000, Complaint of NYSEG (April 25, 2000); Motion To Intervene of the National Energy Marketers Ass’n, (May 8, 2000); Motion To Intervene of the Member Systems of the Transmission Owners Committee of the Energy Ass’n of New York State, (May 10, 2000); Notice of Intervention and Comments of the New York Consumer Protection Board, (May 25, 2000); Notice of Intervention and Comments of the New York State Public Service Commission, (May 25, 2000).

admitted that its staff has “identified certain, previously undetected market flaws that...have resulted in substantial increases in Bid Production Cost Guarantee (“BPCG”) charges over the past few months.” Id. at 3.

On September 7, 2000, the Management Committee, in response to the Compliance Report, voted to extend the \$1000/MWH bid caps from October 28, 2000 to April 30, 2001. On September 21, 2000, HQUS filed its appeal.²

² The NYISO deemed HQUS’ notice of its appeal to be received by the members of the Management Committee on September 22, 2000. Thus, under Section 4.01 of the Procedural Rules For Appeals, motions in support or opposition to HQUS’ appeal are due on September 29, 2000. See <http://www.nyiso.com/topics/whats_new/whatsnew.html>.

DISCUSSION

I. THE BOARD SHOULD REJECT THE APPEAL AND BEGIN CONSIDERING WHETHER TO IMPOSE A BID CAP OF \$250 PER MWH THAT WILL BE GRADUALLY RAISED AS MORE GENERATION IS BUILT IN THE STATE AND DEMAND-SIDE RESPONSE IMPROVES.

The price controls that exist in the wholesale power market ultimately determine the electricity prices paid by the retail customers. New York State currently has a \$1000/MWH bid cap. California, however, has a \$250/MWH cap for some of its markets. See Morgan Stanley Capital Group v. California ISO, 92 FERC ¶ 61,112 (2000). Given that prices have significantly increased during a period of moderate demand, notwithstanding the \$1000/MWH cap, it appears that a lower cap is necessary.

In order to understand why a lower cap is necessary, it is necessary to review why the FERC decided to impose a \$1000/MWH bid cap. NYISO, 92 FERC ¶ 61,073 (2000). The FERC summarized its reasons as follows:

Given that NYISO's energy market is currently undergoing significant revisions to correct for existing market flaws, and the fact that there is a lack of demand-responsiveness to price, we find that to ensure just and reasonable rates during the summer period, it is necessary to implement some form of bid cap. . . . We are similarly concerned that the lack of demand-side responsiveness to price . . . will exacerbate potential problems [given] that overall supplies are tight.

Id., slip op. at 13. As the FERC explained, there are three significant problems facing the New York market: (1) market flaws; (2) inability of customers to respond to high prices by reducing demand on a real-time basis; and (3) a shortage of electric generation capacity. The FERC should have also mentioned the almost total lack of a competitive retail market in New York State.³ A vigorous retail market, with many different load serving entities

³ According to the most recent information posted on the New York Public Service Commission's web site (June 2000), only 2.5% of utility customers are purchasing electricity from an alternative supplier. See <http://www.dps.state.ny.us/Electric_RA_Migration.htm>.

competing to obtain the lowest possible price in the wholesale market, can also help to reduce wholesale market prices. See Goulding, Ruffin & Swinand, “The Role of Vibrant Retail Electricity Markets in Assuring That Wholesale Power Markets Operate Effectively,” The Electricity Journal Vol. 12 No. 10, at 61 (Dec. 1999).

The FERC’s primary justification for imposing the \$1000/MWH cap in New York is that it was the same as the \$1000/MWH cap that had been in effect in the Pennsylvania-New Jersey-Maryland (“PJM”) ISO since 1997. 92 FERC ¶ 61,073, slip op. at 15. The FERC’s ruling, however, ignored that the New York market does not function as well as the PJM market because the NYISO market is newer and having significant start-up problems.⁴

Given these differences, it makes sound common sense for the NYISO to use lower bid caps than PJM in the short-term. For example, the PJM ISO used cost-based bidding for its first 16 months of operation. PJM, 81 FERC ¶ 61,257, slip op. at 69-70 & n. 174 (1997). According to the PJM 1999 State of the Market Report, \$130/MWH was the highest cost-based bid in 1999. Id. at 7. It was only after the FERC agreed that the market was functioning properly that it decided that the PJM ISO could end cost-based bidding. See PJMII, 86 FERC ¶ 61,248 (1999).

The choices made to deregulate the wholesale generation market in New York State were not preordained. The process could have been much different. For example, the deregulation of the natural gas commodity was slowly phased in from 1978 to 1993. See Phillips, Charles F., Jr., THE REGULATION OF PUBLIC UTILITIES, at 586-94 (1984); Natural Gas Wellhead Decontrol Act of 1989, 15 U.S.C. §§3311-3320, 3331-3333 (1999),

⁴ For example, the average wholesale generation price in the Northern New Jersey zone of the PJM ISO for June and July of this year was \$27.73/MWH, while the average price in New York City was \$54.12/MWH.

Pub. L. No. 101-60, 103 Stat. 157 (1989), 1989 U.S.C.C.A.N. 51. The question that should be asked now is why the same approach was not used for the deregulation of the electric commodity.

Indeed, because the electric commodity is an inherently more difficult commodity to expose to free-market forces than natural gas, it would have been prudent to move more slowly with the deregulation of electricity than had occurred with the deregulation of natural gas. As stated recently in one article,

In general, the non-storability of electricity, combined with very little demand elasticity and the need for real-time supply/demand balancing to keep the grid stable, has made restructuring of electricity markets a much greater challenge than was inferred from experience with natural gas, airlines, trucking, telecommunications, and a host of other industries.

Borenstein and Bushnell, "Electricity Restructuring: Deregulation or Reregulation," *Regulation, The Cato Review of Business and Government*, Vol. 23, No. 2, at 46 (2000).

The Board should therefore give serious consideration to imposing a bid cap of a maximum amount of \$250/MWH or such lower amount as may be necessary to protect consumers. This cap would be slightly higher than the 1999 highest cost-based bid in PJM -- \$130/MWH -- adjusted for the increase in fuel costs that has occurred since then. This cap will help to protect consumers in the short-run and give them time to adjust to the new world of deregulation. These caps can be raised as the market situation improves in the important areas discussed above: (1) elimination of the NYISO's market flaws; (2) improved ability of customers to respond on a real-time basis to price spikes; (3) an increase in generation and/or transmission capacity; and (4) an open and functioning competitive retail market.

CONCLUSION

The City remains convinced that electric deregulation will benefit all consumers in the long-run. The question is how the NYISO will manage the transition between regulation and deregulation. Price spikes resulting from an imperfect wholesale market are particularly unfair when customers are still paying for stranded cost recovery. The extension and lowering of the NYISO market bid caps is the only practical way to protect New York City consumers in the short run and ensure the ultimate success of deregulation.

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