

September 21, 2000

Richard J. Grossi
c/o William J. Museler
Chairman, Board of Directors
New York Independent System Operator
3890 Carman Road
Schenectady, NY 12303

Re: Appeal of the NYISO Management Committee's
September 7, 2000 Decision to Seek Extension of Bid Caps

Dear Mr. Grossi:

H.Q. Energy Services (U.S.) Inc. ("HQUS") hereby appeals to the Board of Directors of the New York Independent System Operator ("NYISO") the decision of the NYISO's Management Committee at its September 7, 2000 meeting to seek an extension of bid caps in New York from October 28, 2000 through April 30, 2001.

Summary

On June 5, 2000, the NYISO Management Committee voted to institute bid caps in the NYISO-administered markets for the summer season. HQUS opposed this proposal, and filed an appeal with the NYISO Board on June 16, 2000. As explained therein, HQUS opposes bid caps on the sale of energy, as bid caps hinder the development of robust energy markets, adversely affect reliability, provide an unwarranted regulatory hedge, and conflict with the conditions under which various tariff-based transactions were conducted. A bid cap proposal was nevertheless submitted to the Federal Energy Regulatory Commission ("FERC"). In an order dated July 26, 2000 ("July 26 order"), FERC authorized bid caps in New York through October 28, 2000 based on the possibility of price increases during energy shortages and the effect of various unresolved market problems.¹ The present bid caps apply to the Day-Ahead Market, Ancillary Services, and the Real-Time Market, and include a \$1000/MWh bid cap for energy bids. At its September 7, 2000 meeting, the Management Committee approved a motion to extend the bid caps through April 30, 2001. To effectuate such an extension, the NYISO would have to request authorization from FERC pursuant to Section 205 of the Federal Power Act.

HQUS continues to oppose bid caps on energy sales in New York, and urges the NYISO Board to overturn the Management Committee's decision and refrain from filing any bid cap proposal at FERC. In deciding this issue, the Board must carefully consider whether there is in fact any legitimate need for bid caps for the winter. Despite the Management Committee's vote

¹ *New York Independent System Operator, Inc.*, 92 FERC ¶ 61,073 (2000), *rehearing pending*. HQUS did not seek rehearing of this order on account of the time the order was issued.

– which merely reflects the desire of energy purchasers for lower energy prices – no facts have been produced to justify bid caps for the upcoming winter season. The NYISO's own data suggests that loads will be significantly lower in the winter than in the summer, while generating capacity in the winter is even higher than in the summer. The effect of less load and more energy should be to further increase competition in the energy market. While FERC had cited the lack of demand-side responsiveness to price as a significant reason for authorizing bid caps, the absence of such formal mechanisms is obviated by the winter's reduced demand and increased energy supplies.

In addition, the NYISO has either resolved or is currently addressing the market problems discussed by FERC in the July 26 order. No showing has been made that the issues still under consideration by the NYISO warrant extending the bid caps into winter. Indeed, the continued excuse of unresolved market-related issues would likely mean that so long as the NYISO was working to improve its operations, proponents of bid caps could argue this was sufficient grounds for requiring bid caps in New York.

It is becoming clear that bid caps are nothing but an attempt by certain market participants to cap their exposure to higher prices through what amounts to a regulatory hedge. The NYISO Board should refrain from encouraging the creation of such regulatory hedges. Any energy purchaser unwilling to risk the inevitable fluctuations in the real-time market should instead obtain protection in the market, whether through bilateral contracts or availing itself of hedging products.

The perpetuation of bid caps in New York would also continue to harm market participants who took actions in reliance on the absence of bid caps. As HQUS pointed out in its June 16 appeal to the Board, imposing bid caps would cause significant financial harm to parties who purchased Transmission Congestion Contracts ("TCCs") through the auspices of the NYISO, and would contravene the basis of those sales under the NYISO's FERC tariffs.

This appeal is being submitted pursuant to the *Procedural Rules for Appeals to the ISO Board* (the "Procedural Rules"), and Section 5.07 of the ISO Agreement, which provides that the ISO Board shall review and determine appeals from actions of the Management Committee. In support of this appeal, attached as Exhibit A is the statement of Roy Shanker, Ph.D. HQUS requests expedited processing of this appeal pursuant to Article 2.06 of the Procedural Rules. HQUS reserves all its rights to pursue any other remedies concurrent to processing of this appeal. Pursuant to Article 5.01 of the Procedural Rules, HQUS requests a waiver of the 10-page limit under Article 2.04.

Basis for Appeal

1. No Facts Have Been Presented to Justify a Bid Cap for the Winter

The Management Committee majority has provided no evidence to support any need for bid caps for the upcoming winter. Rather, it appears that despite prior representations to the

contrary to this Board, the strategy of bid caps proponents is simply to roll-over the existing bid caps. Thus, regardless of actual need and irrespective of FERC's statement that it did not intend bid caps to "become a permanent measure" in New York,² these proponents of bid caps obviously intend to institutionalize bid caps. HQUS urges the Board to consider that if the facts do not indicate a need for bid caps, then there is no reason to impose such an artificial price control on the market. When FERC approved bid caps in the July 26 order it principally relied on two factors. First, FERC took into account that forecasts for the summer indicated that energy supplies were tight. It therefore concluded that price spikes could arise from the "combination of short supplies during peak periods and a lack of demand-responsiveness to price... ."³ Second, FERC noted the existence of various alleged market problems that had been raised by various market participants and not yet been resolved by the NYISO.⁴ Neither proposition justifies extending bid caps into the winter. As discussed below, there is no indication that there will be energy shortages this winter, which diminishes any immediate need for new demand-side mechanisms. Also, the issues still being addressed by the NYISO do not warrant extension of bid caps to the winter.

First, the proponents of bid caps have produced no evidence that price spikes are likely to occur in the winter. In fact, the NYISO's own projections show there will be sufficient energy supplies this winter to meet expected demand. The NYISO's July 1, 2000 *Load & Capacity Data* report shows that expected peak load for the winter 2000-2001 will be 24,250 MW.⁵ This is considerably less than the 28,114 MW peak load that occurred in the summer of 2000,⁶ and even more lower than the NYISO's projected peak load for the past summer, which was 30,200 MW.⁷ Also, according to the NYISO's own projections, the available generating resources for this winter are 36,735 MW, which is slightly higher than the generating resources available last summer.⁸ The net result is that loads in New York are significantly lower in winter than in summer, which, coupled with slightly more generation, makes the market even more competitive in winter than it is in summer. (R. Shanker ¶ 10-11).

The lack of formal demand-side mechanisms, in conjunction with predictions of tight supplies during the summer, was one of the main reasons for FERC's authorization of the current bid caps.⁹ As explained in the July 26 order, such mechanisms can help reduce load when energy prices are rising to levels at which loads may wish to reduce their energy consumption to

² 92 FERC at 61,305.

³ 92 FERC at 61,303.

⁴ 92 FERC at 61,298-300. .

⁵ *Load & Capacity Data* at 5.

⁶ This figure is obtained from the NYISO's website.

⁷ The NYISO's projection of a significantly lower load in winter than in summer is consistent with historical data for New York. For the ten years from 1990 to 1999 winter loads averaged only 85.95 % of summer loads. For the more recent years of 1997-19999, winter loads averaged only 81.12 % of summer loads. *Load & Capacity Data* at 6-7.

⁸ *Id.* at 74.

⁹ "We are similarly concerned that the lack of demand-side responsiveness to price and the predictions of tight supplies in the New York Control Area (NYCA) will exacerbate the potential problems for the NYISO this summer." 92 FERC at 61,302.

incur lower costs. This role of demand-side mechanisms means that they are not as important for periods when sharp price increases are not expected to occur, for the simple reason that if sufficient generating capability is available, there is no need for entities to reduce demand by decreasing their energy consumption. As discussed earlier, the NYISO's own projections indicate that there is more than enough generating capacity available to satisfy energy demands this winter, which obviates the urgent need for demand-side mechanisms under the circumstances described in the July 26 order. This in turn undermines any purported need for winter bid caps. In any event, as discussed below and in the statement of Dr. Shanker, there has been more than adequate opportunity for market participants to hedge their exposure to do so. Such longer term hedging is in fact a readily-available type of price sensitive demand response by load. (R. Shanker ¶ 15-16).

Second, the proponents of bid caps have not tied any of the remaining alleged market problems in New York to a need to extend the bid caps. FERC's July 26 order approving bid caps relied on a number of stated market problems that FERC concluded justified imposing the temporary bid caps. The July 26 order also directed the NYISO to file with FERC a status report on any changes or revisions it made to address these market problems. On September 1, 2000 the NYISO filed this compliance report.¹⁰ The NYISO reported that it had either corrected or was in the process of addressing the market problems discussed in the July 26 order.¹¹ Nothing in the compliance report indicated that the NYISO needed bid caps for the winter. Even those problems not yet resolved do not necessitate that drastic step. While it has become clear that proponents of bid caps will point to any unresolved issues as grounds for bid cap, the fact remains that no one has shown why bid caps are necessary to remedy any of these unresolved issues. In this connection, HQUS also believes that the NYISO, as well as FERC, should distinguish carefully between various kinds of market problems that are unlikely to have any significant effect on pricing and truly significant market flaws that may have such an effect. In this regard, many of the purported market "flaws" mentioned by bid cap proponents and cited by FERC appear to be nothing more than policy issues that are still subject to discussion, rather than being debilitating "flaws" in the market design. Such policy issues include, for example, the dispatch of fixed block generation, an issue that recently was the subject of a petition for rehearing to FERC by the NYISO, and appears to be the source of a legitimate policy disagreement between various parties rather than a major "market flaw."

The absence of facts supporting any need for bid caps conflicts not only with the July 26 order but also FERC's more recent rejection of another request for price caps. In ruling on a request to lower price caps in California, FERC emphasized that bid caps must be justified based on the record.¹² FERC pointed out that the proponent of the bid caps in California:

¹⁰ *New York Independent System Operator, Inc.'s Combined Compliance Filing and Report*, September 1, 2000, Docket Nos. ER00-3038, *et al.* The NYISO submitted a corrected compliance report on September 8, 2000.

¹¹ *Id.* at 33-61.

¹² *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 92 FERC ¶ 61,172 (2000).

has provided no evidence to demonstrate that all potential sellers are able to exercise market power, has not documented a single instance of a seller exercising market power during times of scarcity, and did not attempt to show that the conditions underlying the Commission's approval of market-based rates for public utility sellers of energy and ancillary services have changed.¹³

Similarly, proponents of extending the bid caps in New York to the winter season have produced no evidence that extension of the bid cap is warranted.

Finally, it bears emphasizing again that if the NYISO detects market problems during the upcoming winter, it has authority under its Tariffs to correct these problems. The FERC-approved Market Monitoring Plan enables the NYISO to mitigate conduct that would substantially distort competitive outcomes in the New York markets, while avoiding unnecessary interference with competitive price signals.¹⁴ The Market Monitoring Plan requires the NYISO to first identify the alleged offending conduct, and, after it is shown that the questioned conduct is not consistent with competitive behavior, allows the NYISO to apply mitigation measures that are appropriately tailored to respond to the specific problem it has identified. These steps are the exact opposite of imposing bid caps without factual support. In addition, the NYISO can use its Temporary Extraordinary Procedures authority (if extended further by FERC) to redress certain types of problems.¹⁵ However, as with the Market Monitoring Plan, the use of TEPs requires specific factual findings about market problems. Again, these fact-specific remedies contrast with the lack of facts justifying any kind of artificial price controls.

2. Market Participants Wishing to Hedge their Energy Purchases Should Obtain Hedging Products from the Market rather than be Given Regulatory Hedges

Bid caps are nothing but an attempt by certain market participants to cap their exposure to higher prices through a regulatory hedge. However, bid caps are neither necessary, nor appropriate for that purpose. There are ample private devices available to market participants who do not want to risk the price fluctuations inherent to the real-time market. These include bilateral contracts, forward contracts, and various hedging devices such as swaps and options. For example, in June of 2000, on-peak energy supplies in Zone J, the most expensive region of the state, were available for the fourth quarter at \$53.50 per MW, and for January and February on-peak energy supplies were available at \$67 per MW. In zone A comparable on-peak products were available at \$39.50 and \$44. (R. Shanker ¶ 15-16.) Market participants can use these and other strategies to protect themselves from the fluctuations in the real-time market. Accordingly a regulatory hedge is simply not necessary. Nor is it appropriate, because those parties that act prudently by hedging themselves against price fluctuations are now penalized by the gratuitous creation of a regulatory hedge. Moreover, market confidence is decreased by the uncertainty of unanticipated and arbitrary bid caps. (R. Shanker ¶ 9.)

¹³ 92 FERC at 61,606.

¹⁴ See New York Independent System Operator, *Market Monitoring Plan*, ¶ 1(a).

¹⁵ HQUS is concerned, however, that the NYISO not exceed the scope of the TEP authority granted to it by FERC by impermissibly "correcting" prices with which it does not agree.

3. Imposing Bid Caps Would Cause Harm to Market Participants Who Purchased Long-Term TCCs in Reliance on Existing Market Conditions under Rules Proposed and Implemented by the NYISO

Extending the bid caps in New York would continue to cause significant financial harm to entities that engaged in various transactions in the spring of 2000 with the expectation that there would be no bid caps in the New York energy markets. As HQUS explained in its June 16 appeal, parties selling ICAP and purchasing TCCs last spring valued these assets based on a market without bid caps. The value of TCCs and ICAP was significantly affected by the subsequent imposition of bid caps. With respect to ICAP, the damage has already been done, as the 2000 ICAP period expires on October 31, 2000.¹⁶ However, last spring parties also purchased TCCs of up to two years duration, with the expectation that no bid caps would limit their value. To extend the bid caps would continue the devaluing of these TCCs.

In March and April of 2000, the NYISO sponsored auctions for the sale of TCCs, including TCCs with two-year terms expiring on April 30, 2002. The value of a TCC is based on the difference between the energy price at the point of injection and the point of withdrawal. In evaluating what to pay for TCCs, HQUS estimated the potential congestion rents for the duration of the TCCs, based on the projected spread between energy prices on either side of a transmission constraint during various times, including the peak summer season. The presence or absence of a bid cap is essential to properly valuing a TCC, because a bid cap would cap the spreads between these energy prices, and thus cap the value of the TCC. HQUS and other purchasers of TCCs last spring had no notice that bid caps would be imposed. Instead, in making their financial decisions for the TCC (and ICAP) transactions, HQUS and others relied on existing market conditions and provisions in the FERC-approved Open Access Transmission Tariff (“OATT”) and Market Administration and Control Area Services Tariff (“Services Tariff”). Based on these conditions, including the absence of bid caps, HQUS and others spent tens of millions of dollars to purchase TCCs, including two-year and shorter-term TCCs. (R. Shanker ¶ 15-16.) Had bid caps been in effect, the TCC prices would without doubt have been lower. Within weeks of these auctions, however, the NYISO decided to impose bid caps that in effect retroactively change the financial terms of the TCC (and ICAP) transactions. The bid caps

¹⁶ As HQUS explained in its June 16, 2000 appeal, the sale of ICAP by energy suppliers to Load Serving Entities (LSEs’), which was sponsored by the NYISO pursuant to Sections 5.9 – 5.15 of the Services Tariff, was predicated on the absence of bid caps. The maximum call price for energy under ICAP therefore stood to be \$9,999/MWh. Based on this premise, HQUS and other energy suppliers sold significant amounts of ICAP to LSEs for the period May 1 to October 31. ICAP providers thereby obligated themselves to allow the NYISO to call the energy associated with that capacity in the day-ahead market and during emergencies – in exchange for receiving “market rates for meeting their ICAP responsibilities.” 90 FERC ¶ 61,319 at 62,063 (2000). The subsequent imposition of bid caps effectively changed the terms of the ICAP contracts, because the maximum call price was reduced by a factor of 10. Although the value of capacity sold with an energy call of \$1,000 is significantly greater than capacity sold with an energy call of \$9,999, ICAP providers were not compensated to reflect that they had to provide a much higher valued service than what they originally sold under the NYISO Services Tariff auction. In contrast if the NYISO had already proposed bid caps at the time of the ICAP sales, ICAP suppliers would have insisted on higher prices because the value of the right to call would have been greater under a bid cap.

in place during the summer severely compromised the value of the TCCs, and extending these bid caps to the winter would continue harming holders of two-year TCCs.

4. Bid Caps Would Reduce Energy Supply and Harm Reliability in New York

HQUS believes that if competitive markets are to develop in New York, the NYISO must allow the market to determine prices free of the market distortions entailed by artificial price limits. Rather than protecting the market, bid caps may in fact harm the market, both in the short and long-term. First, at times of the highest energy demand, energy suppliers will seek the highest price they can obtain for energy. Bid caps in New York will therefore encourage energy sales to be made outside New York by out-of-state suppliers, as well as in-state suppliers who have flexibility to bid elsewhere. It is therefore likely that a large amount of energy supply will avoid the New York market. If supply is reduced in this way, energy prices in New York may in fact consistently rise closer to the \$1000 level than would occur in the absence of bid caps. Second, imposing bid caps and the ensuing possibility that they will be re-instituted at some future time will create long-term uncertainty regarding the New York market. Whereas correct price signals would encourage development of new generation in New York, bid caps would have just the opposite effect, because energy suppliers will have a reduced incentive to sell energy in New York. (R. Shanker ¶ 19.) Finally, the reduced energy supply in New York created by bid caps will threaten reliability in New York, and thus further harm consumers.

Conclusion

The proponents of bid caps have offered no evidence to justify bid caps in the upcoming winter in the NYISO-administered markets, and indeed there is none. HQUS respectfully urges the NYISO Board to overturn the decision of the Management Committee.

Sincerely,

Joel F. Zipp
Gunnar Birgisson

Counsel for
H.Q. Energy Services (U.S.) Inc.

Attachments

cc: Robert E. Fernandez
Ira L. Freilicher

Statement of Roy J. Shanker

1) My name is Roy J. Shanker. I reside at 9009 Burning Tree Road, Bethesda, MD, 20817.

2) I am self-employed as a consultant in the natural resources area, with the majority of my work related to the electric utility and natural gas industries. I have worked in these areas for approximately 27 years.

3) I have worked as an independent consultant since 1981, conducting over 400 engagements for a wide range of independent power developers, electric utilities, regulators, private investors, and financial institutions. In this capacity I have been associated with the development of numerous power facilities representing thousands of megawatts of electric generating capacity.

4) Currently I am extensively involved in the restructuring of the wholesale power markets in both the New York Independent System Operator (NYISO) and the Pennsylvania, New Jersey and Maryland Office of Interconnection (PJM OI). In New York I participated for several years in the stakeholder process leading up to the activation of the NYISO in November 1999. I am a member of the NYISO's Business Issues Committee and participate in a number of working groups including the Scheduling and Pricing Working Group, the Market Structure Working Group and the Installed Capacity Working Group. In PJM I participate in the Energy Markets Committee, Tariff Advisory Committee and Member's Committee as well as special committees on a variety of issues including the sale of ancillary services such as regulation.

5) I have served as an expert witness on numerous occasions before state and federal regulators and in various state and federal courts. A more detailed summary of my education and experience is provided as Exhibit 1.

6) I was retained in this matter by Hydro Quebec Energy Services (U.S.) Inc. (HQUS). I was asked by HQUS to review the proposed extension of the original bid cap that is currently in effect for the NYISO. The original price cap was approved by the FERC on July 26, 2000, and would have expired on October 28, 2000. The proposed extension was adopted at a meeting of the NYISO Management Committee on September 7, 2000. In summary, the proposal would extend until April 30, 2001 the current “temporary” cap that is scheduled to expire at the end of the summer capability period, on October 28, 2000. I was asked by HQUS to comment on the impact of the extension of the bid cap on (1) the original adverse effects I identified in a previous statement to the Board; and (2) the justification of the extension in terms of the original reasons stated by the Board and the FERC for approving the bid cap.

7) My conclusion is that the proposal is harmful to market participants, including both those that made commercial transactions under the tariff as well as others. Further, there has been no demonstration of any continuing need for such bid caps. The main elements that both the Board and FERC relied on as justifying the imposition of caps during the summer period have not been demonstrated to exist for the winter. In particular, the basic supply demand conditions that were thought to potentially “strain” the system during the summer will not exist during the winter capability period; the reliability of the NYISO’s performance has improved, and the NYISO staff itself has indicated in its filings to FERC that it believes that it has corrected most of the major problems that it has faced; and most importantly, there has been ample opportunity for market demand participants to have engaged in longer term price responsive behavior to protect themselves from any significant price excursions that may occur. In the following sections I discuss each of these items.

8) With respect to potential harm to market participants, the same basic adverse effects that I discussed in my previous statement to the Board are still true today. (See Statement of Roy J. Shanker, Exhibit A to Appeal of HQUS, filed June 16, 2000). Parties who purchased rights in the NYISO markets that extend into the winter period will be directly harmed, e.g. TCC holders who purchased long term TCC's in the spring auction. This is because the potential for higher prices and levels of congestion that could exist without the bid cap were factored into the prices they paid. Further, the imposition of bid caps will again directly penalize any parties that behaved responsibly and attempted to hedge their positions in expectation of the removal of the bid cap. This is because the prices parties paid for energy hedges or longer term bilateral capacity purchases likely reflected the potential removal of the bid caps. Accordingly, by attempting to insulate themselves from speculative market exposure, these parties will have been penalized by the imposition of the further bid caps.

9) It would be inequitable for the Board to take actions that would have the effect of penalizing parties for responsible market behavior. This type of arbitrary extension of the bid caps when there is no direct need only will also tend to increase the risks associated with buying and selling hedges for energy and capacity. This makes it more difficult to obtain risk management products in the future, as participants have to somehow factor in the potential arbitrary imposition of price controls. This in turn sets the stage for a potentially destructive cycle where market participants who fail to hedge, again lobby the Board for bid caps, not out of any concern for market flaws, but simply out of political and economic self-interest. Ultimately, this places the Board in a position not of protecting the functioning of the market it oversees, but rather of making political decisions about who will be the "winners and losers" in the market place.

10) It is important to recognize that the basic elements cited by the Board and FERC in justifying the existing bid caps simply no longer exist. One of the key reasons cited for

imposing bid caps was the need to maintain an orderly market when the potential supply and demand balances were severely stressed, e.g. during the times of highest summer demand. No such concern arises for the winter capability period. As identified in the Load and Capacity Data report the base case forecasted peak demand for summer 2000 was 30,200 MW for the NYCA, and 31,100 MW for the “NYCA Extreme Weather” case. Total Summer generating resources were expected to be 36,117 MW. This resulted in a forecasted reserve of about 5,900 MW for the base case.

11) In comparison, the forecasted peak demand for the 2000-2001 Winter Capability period is only 24,250 MW for the base case, and 24,650 MW for the Extreme Weather case. Winter generating resources were forecast to be slightly higher than summer at 36,735 MW. This results in 12,500 MW of reserves for the winter, an excess of 50%. This change of circumstances from the summer should eliminate any concerns with respect to the system being under “stress” for the winter capability period.

12) Another predicate of the need for bid caps was the belief that the NYISO operating capability was potentially inadequate, and that the staff and models had not been tested under extreme conditions. The actual performance of the NYISO this past summer, coupled with the continuing efforts of the staff to improve the operations of the underlying technical software refute the continuing validity of this argument. While weather conditions this summer were mild, this doesn’t change the fact that the basic system performed reasonably well. Except for several extreme weather situations, there were not extreme price excursions in the market place. This observation was confirmed by the recent staff report to the President (September 7, 2000), according to which the average prices for the first eight months of the year were approximately \$46 for all hours. Further, it was noted that the performance of the NYISO systems was continually improving, with the need for price reservations having been reduced to only one half of a per cent of all hours. Further, in the NYISO’s compliance filing of September 1, 2000 to FERC (as corrected September 8), the NYISO explained at length the numerous

improvements that they have made to increase the reliability and performance of the market systems.

13) The statements by the NYISO in the September 1 FERC filing were also illuminating with respect to the need and appropriateness of bid caps in the market place. In addressing the need for continuing bid caps in the reserve markets, the NYISO was explicit in its belief that the caps should be raised and then removed, noting that there were potentially long term adverse effects from leaving such caps in place, and that leaving the caps in place might bring into question the desire of the NYISO to ever remove the caps, whether needed or not. The NYISO also properly observed that it would ultimately be impossible to tell if the changes they had made to the market design would work without removing the caps from the market.

14) While the NYISO made these statements with respect to the reserve markets, they apply equally well to the energy market. To maintain a bid cap in place without need undermines the willingness and determination of market participants to return to a true market environment. It also delays coming to grips with the basic question as to whether or not the NYISO's improvements have been successful. The absence of extreme demand on the system during the winter capability period coupled with the broad improvements put in place by the NYISO represent exactly the right conditions to return to a full market structure. Not doing so would simply provide grounds for bid cap proponents to argue next summer that absent a full test of the system under extreme conditions the caps should remain through the next capability period. This type of logic is sure to be the bootstrap to ultimately making such caps permanent.

15) The final leg of the conditions cited by the Board and FERC related to the inability of load to respond to price. While there might have been some merit to this argument for the past summer, it is inapplicable to the winter. This entire argument rests on the belief that the only response that load can make to price increases is to decrease its demand real

time. This is incorrect. Market participants can also counter possible price increases by entering into longer term hedging agreements that lock in prices regardless of the clearing prices in the day ahead and real time markets. If someone expects to have 100 MW of load during the winter, they can easily enter into agreements to fix the price of 100 MW of supply for the entire winter. While some parties may not have understood the need for such actions in time to prepare for their needs this last summer, this certainly cannot be the case with respect to this winter. Everyone in the market has been on full notice of the potential for high prices, and similarly all parties were fully aware of the potential for hedging the price risk associated with their energy requirements. At present, no one can argue ignorance of these types of risk management strategies - anyone who hasn't hedged at this point must have made a conscious effort to speculate in the energy markets.

16) To confirm the availability of reasonable hedging options I reviewed broker bid sheets for futures contracts from June 1 through September 1, 2000. The results are telling, particularly in the context of the all-hours average of \$46 per MWH reported by the NYISO for the first eight months of the year. In June of 2000, on-peak energy supplies in Zone J, the most expensive region of the state, were available for the fourth quarter at \$53.50 per MW, and for January and February on-peak energy supplies were available at \$67 per MW. In zone A comparable on-peak products were available at \$39.50 and \$44. Given that the peak period accounts for slightly less than half of the hours, parties could have locked in prices that were about the same or lower than the average prices experienced for the first eight months of the year, without having any exposure to potentially high market prices.

17) The pricing for futures contracts were also comparable for September 1, 2000, well after the imposition of the summer price caps. Fourth quarter on-peak prices for Zone J were about \$60.5, and January and February on peak prices were about \$78. Zone A on-peak prices for the fourth quarter were about \$33 and \$43 for January and February on-peak. It is also interesting to note that contracts were available in Zone A for all hours of

calendar 2001 at an average peak and off peak price of approximately \$30.52. (Summaries of these bids sheets are attached.)

18) It is clear that reasonably priced hedging options were available to all market participants that wished to avail themselves of these opportunities. At this time there is simply no excuse for a party fearing the risk of purchases from the day ahead or real time markets to not have hedged itself. The Board should not act in a fashion to protect those parties that chose to speculate in the energy markets, particularly at the expense of other parties that have acted at their own initiative to lock in future prices.

19) The imposition of bid caps on a long term basis will also eventually lead to significant reliability problems for the NYCA. Rational sellers will continue to search for the best pricing they can receive for their products. With the existence of bid caps, sellers will have a significant motivation to sell capacity elsewhere than New York. This is a rational economic response. For example, the price of Installed Capacity for the summer capability period was approximately \$1.50 per KW month. This is the equivalent of about \$2 per MWH for all hours of the month. If a seller can recognize this much of a premium for sales outside of NYCA, it makes no sense to dedicate capacity into the New York market. This is particularly true as such resources would not be subject to the bid caps. Ultimately, as discussed in my previous testimony, this will result in increased emergency purchases by the NYISO, the costs of which will be borne by all market participants, including both those that acted responsibly by hedging their purchases and those who did not. Conversely, if the market price were set by these same generators as internal load, the cost would be borne only by those parties that failed to hedge their supplies.

Roy J. Shanker

September 21, 2000

NYPP

Month(s)	Demand Period	Bid (MWh)	Ask (\$/MWh)
<u>Zone A</u>			
Bal June	5x16	\$44.00	\$57.00
Jul-Aug	5x16	\$88.00	\$98.00
Jul-Aug	5x8/2x24	\$26.00	\$31.00
Sept	5x16	\$39.00	\$42.50
Q4	5x16	\$38.00	\$41.00
Jan-Feb	5x16	\$40.00	\$48.00
Cal 2001	5x16	\$43.50	\$45.50
Cal 2001	5x8,2x24	\$20.00	\$23.00
Cal01-04		\$39.00	\$41.00
Cal01-09		\$37.50	\$40.50
<u>Zone C</u>			
Jul-Aug		\$88.00	\$96.00
<u>Zone G</u>			
Jul-Aug	5x16	\$115.00	\$125.00
Q4	5x16	\$45.00	\$48.00
<u>Zone J</u>			
Jul-Aug	5x16	\$124.00	\$134.00
Sept	5x16	\$51.00	\$59.00
Q4	5x16	\$50.00	\$57.00
Jan-Feb	5X16	\$62.00	\$72.00
<u>ICAP</u>			
Nov-Apr		\$1.05	\$1.35

NYPP

Month(s)	Demand Period	Bid (MWh)	Ask (\$/MWh)
<u>Zone A</u>			
Jul	5x16	\$68.00	\$72.00
aug	5x16	\$58.00	\$66.00
sep	5x16	\$37.00	\$41.00
Q4	5x16	\$30.00	\$31.50
Jan-Feb	5x16	\$38.00	\$42.00
Cal 2001	5x16	\$39.00	\$41.00
Cal 2001	5x8,2x24	\$20.50	\$21.50
Cal 01-09	5x16	\$37.00	\$40.50
<u>Zone C</u>			
<u>Zone G</u>			
Jul	5x16	\$120.00	\$135.00
Aug	5x16	\$105.00	\$120.00
Sept	5x16	\$56.00	\$60.00
Q4	5x16	\$43.00	\$48.00
Cal01	5x16	\$52.00	\$57.00
<u>Zone J</u>			
Jul	5x16	\$115.00	\$130.00
Aug	5x16	\$110.00	\$120.00
Sept	5x16	\$58.00	\$63.00
Q4	5X16	\$50.00	\$57.00
Jan-Feb	5x16	\$55.00	\$67.00
<u>ICAP</u>			
Nov-Apr		\$1.10	\$1.30

NYPP

Month(s)	Demand Period	Bid (MWh)	Ask (\$/MWh)
<u>Zone A</u>			
BalAug	5x16	\$42.00	\$49.00
BalAug	5x8,2x24	\$20.00	\$23.00
Sep	5x16	\$34.50	\$35.50
Sep	5x8,2x24	\$18.00	\$21.00
Q4	5x16	\$29.00	\$31.00
Q4	5x8,2x24	\$18.50	\$20.00
Jan-Feb 01	5x16	\$35.50	\$37.50
Jun	5x16	\$41.00	\$49.00
Cal 2001	5x16	\$34.00	\$38.50
Cal 2001	5x8,2x24	\$20.00	\$21.00
Cal 01-09	5x16	\$36.00	\$40.50
<u>Zone G</u>			
BalAug	5x16	\$68.00	\$74.00
Sept	5x16	\$43.00	\$48.00
Q4	5x16	\$40.50	\$42.00
Jan-Feb	5x16	\$49.00	\$51.00
Cal01	5x16	\$48.25	\$49.00
Cal02	5x16	\$41.50	\$45.50
Cal03	5x16	\$40.00	\$44.50
<u>Zone J</u>			
BalAug	5x16	\$70.00	\$80.00
Sept	5x16	\$45.00	\$55.00
Q4	5X16	\$45.00	\$46.50
Jan-Feb	5x16	\$55.50	\$57.50
<u>ICAP</u>			
Nov-Apr		\$1.10	\$1.30

NYPP

Month(s)	Demand Period	Bid (MWh)	Ask (\$/MWh)
<u>Zone A</u>			
Bal Sep	5x16	\$37.00	\$39.00
Q4	5x16	\$32.50	\$34.00
Q4	5x8,2x24	\$19.50	\$21.50
Jan-Feb 01	5x16	\$42.00	\$44.00
Jun	5x16	\$44.00	\$52.00
Cal 2001	5x16	\$39.00	\$43.00
Cal 2001	5x8,2x24	\$20.00	\$22.00
<u>Zone G</u>			
Bal Sep	5x16	\$53.00	\$59.00
Q4	5x16	\$52.00	\$53.00
Jan-Feb	5x16	\$63.50	\$65.00
Mar	5x16	\$48.50	\$49.50
Apr	5x16	\$47.00	\$48.00
May	5x16	\$49.00	\$50.00
Jun	5x16	\$74.00	\$78.00
Jul-Aug	5x16	\$95.00	\$100.00
Sept	5x16	\$47.00	\$49.00
Q4	5x16	\$43.00	\$45.00
Cal01	5x16	\$59.00	\$61.00
<u>Zone J</u>			
Bal Sep	5x16	\$58.00	\$63.00
Q4	5X16	\$56.00	\$59.00
Jan-Feb	5x16	\$76.00	\$80.00
Jul-Aug	5x16	\$115.00	\$120.00
<u>ICAP</u>			
Nov-Apr		\$1.00	\$1.15
May-Oct		\$1.50	\$1.80