September 29, 2000

**VIA E-MAIL and FEDERAL EXPRESS**

Richard J. Grossi
Chairman
New York Independent System Operator
3890 Carman Road
Schenectady, NY 12303

c/o William J. Museler
President and Chief Executive Officer
New York Independent System Operator
3890 Carman Road
Schenectady, NY 12303

Re: Motion of the Transmission Owners, LIPA and the Power Authority of New York in Opposition to the Appeal by H.Q. Energy Services (U.S.) Inc. Regarding the Decision of the Management Committee to Extend Bid Caps through April 30, 2001

Dear Chairman Grossi:

Pursuant to the "Procedural Rules for Appeals to the ISO Board," the Transmission Owners[1], LIPA and the Power

[1] The Transmission Owners constitute all of the Members of the Transmission Owners Sector of the NYISO Management Committee. They include: Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation, Orange and Rockland Utilities, Inc., and Rochester Gas & Electric Corporation.

Authority of the State of New York[2] respectfully submit three copies of a Motion in Opposition to the Appeal to the NYISO Board filed by H.Q. Energy Services (U.S.) Inc.

A copy of the Motion in Opposition has been transmitted to Kristen Kranz of the NYISO staff who has agreed to serve it on each member of the Management Committee on this date.

Sincerely,

Paul L. Gioia
Counsel

cc: Kristen Kranz for distribution to Members of the Management Committee via e-mail

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[2] LIPA and the Power Authority of the State of New York are Members of the Public Power/Environmental Sector of the NYISO Management Committee.

**Motion of The Transmission Owners, LIPA and the Power Authority of the State of New York in Opposition to the Appeal of H.Q. Energy Services (U.S.) Inc. Regarding the Decision of the Management Committee to Extend Bid Caps Through April 30, 2001**

In accordance with Article 5 of the ISO Agreement and Sections 1.03 and 4.01 of the NYISO's Procedural Rules of Appeal, the Transmission Owners[1], LIPA and the Power Authority of the State of New York[2] (the "Member Systems") file this motion in opposition to the appeal of H.Q. Energy Services (U.S.) Inc. (the "Appellant") requesting that the Board of Directors of the New York Independent System Operator, Inc. ("NYISO") overturn the decision of the Management Committee to extend bid caps in the NYISO energy markets through April 30, 2001. The Member Systems are comprised of the eight electric systems in the State of New York which transferred operational control over significant portions of their transmission facilities to the NYISO and are the largest load serving entities ("LSE"s) in the

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[1] The Transmission Owners constitute all of the Members of the Transmission Owners Sector of the NYISO Management Committee. They include: Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation, Orange and Rockland Utilities, Inc., and Rochester Gas & Electric Corporation.

[2] LIPA and the Power Authority of the State of New York are Members of the Public Power/Environmental Sector of the NYISO Management Committee.

New York control area. The Member Systems urge the NYISO Board to reject the request to overturn the decision of the Management Committee.

## I. Background

On July 26, 2000 the Federal Energy Regulatory Commission ("FERC") approved the implementation of bid caps of $1,000 per MWh for energy in the NYISO Day Ahead and Real-Time markets through October 28, 2000.[3] FERC acted on a request of the NYISO Board, following a decision by the Management Committee to implement bid caps. The Management Committee voted on September 7, 2000 to take action necessary to prevent the FERC approved bid caps from expiring before April 30, 2001.

The Management Committee decision was based in its determination that the concerns that justified the implementation of bid caps during the summer capability period will continue to exist during the winter capability period, which begins on November 1, 2000 and, consequently, that it would be imprudent to allow the bid caps to expire on October 28. The Management Committee's decision to extend the bid caps will provide minimal protection for the public against unreasonable electricity prices while the NYISO markets continue to evolve and mature.

The arguments raised by the Appellant do not provide adequate justification for overturning the Management

[3] New York Independent System Operator, Inc., 92 FERC ¶ 61, 073.

Committee's decision. The Management Committee's decision has a sound basis and is a reasoned response to the current state of the NYISO markets and the current level of concern with respect to the adequacy of the protections provided the public in the deregulated electricity markets.

## II. Appellant Has Not Provided Adequate Justification For Overturning the Decision of the Management Committee to Extend Bid Caps Through April 30, 2001

### A. The Management Committee Action Has a Sound Basis

Appellant seeks to denigrate the Management Committee's action by stating that it "merely reflects the desire of energy purchasers for lower energy prices" and that no facts have been produced to justify bid caps for the upcoming winter season.[4]

To the contrary, there is a very sound basis for the Management Committee's action, which was clearly articulated and fully discussed at the Management Committee's meeting on September 7th. The bid caps currently in place are the result of actions taken by the Management Committee, the ISO Board and FERC. Implementation of the current bid caps was based on a recognition that the NYISO is in the process of addressing various problems in the NYISO markets and that the NYISO markets continue to evolve. The current bid caps also reflect an understanding that prudence requires that reasonable action be taken to protect the public from unreasonably high prices during the transition from regulated to deregulated electricity markets. It is clear that during the winter capability

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[4] Appeal, p 2.

period, the NYISO will continue to address concerns related to the NYISO markets and that the minimal protection provided to the public by the bid caps will continue to be warranted.

### B. Current Bid Caps Were Not Imposed Primarily To Address The Summer Peak

The Appellant mistakenly suggests that the primary reason for implementation of the current bid caps was the approaching summer peak and, therefore, that there is no justification for continuation of the bid caps past the summer capability period.[5]

What Appellant fails to acknowledge is that all of the concerns that led to implementation of bid caps, which have been documented in various FERC proceedings[6], and all of the events that underlie those concerns, occurred prior to the summer period. The oncoming summer peak did provide some urgency in the adoption of bid caps because of the reasonable expectation that the existing problems in the NYISO markets, and the consequences of those problems, would be exacerbated during the summer peak period. However, to suggest, as the Appellant does, that the end of the summer capability period automatically eliminates the legitimate concerns that justified the adoption of bid caps is totally incorrect.

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[5] Appeal, p 3.

[6] New York Independent System Operator, Inc., Docket No. ER00-3038-000; New York State Electric & Gas Corporation v. New York Independent System Operator, Inc., Docket Nos. EL00-70-000 and EL00-70-001, 92 FERC ¶ 61, 073.

### C. Flaws And Problems In The NYISO Market Continue To Be Addressed

The Appellant states that the Management Committee's decision is "not tied to any of the remaining alleged market problems in New York" and points to the NYISO compliance filing on September 1, 2000 as support for its contention that all of the concerns that justified the adoption of bid caps have been eliminated.[7]

The Member Systems agree that the ISO staff and the ISO committees continue to work to identify, analyze and address problems in the NYISO markets, and that progress is being made. It is incorrect, however, to suggest that all of the problems affecting the NYISO markets have been eliminated.

In its September 1 compliance filing, the NYISO acknowledged that "its efforts to improve its markets are by no means complete, and that participants in the NYISO-administered markets are still adversely affected by market flaws."[8]

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[7] Appeal, p 3.

[8] The Member Systems take exception to Appellant's characterization of dispatch of fixed block generation as a "policy issue" rather than a market flaw. In the Commission's order on bid caps, the Commission stated, "On this matter, however, the ISO Tariff is clear. If it is the case that generation resources, with lower bid prices, are dispatched downward to accommodate more expensive fixed block resources, then the marginal cost of supplying the next increment of load is equal to the bid price of the least expensive unit that has been backed down. ...[W]e direct NYISO to revise how it is setting the price of energy with respect [to] the dispatch of fixed block resources so that it is consistent with the Services Tariff." *New York Independent System Operator, Inc.,* 92 FERC ¶ 61,073 (2000) at 61,306.

Furthermore, the NYISO acknowledged that the NYISO staff recently identified certain previously undetected market flaws.[9]

In recent comments before the Business Council of New York State, Inc., President Museler discussed the efforts of the NYISO to address remaining market design flaws and to implement price sensitive programs before next summer. Mr. Museler stated that a preliminary analysis of NYISO's Market Advisor indicates that the New York market appears to be workably competitive at most times — but that the Advisor cautioned that the market is not, and probably will not be, workably competitive at all times.[10]

Mr. Museler went on to state that "the NYISO will work with Market Participants to design a 'circuit breaker' which would prevent non-competitively derived prices from occurring while at the same time ensuring that Market Participant interests are preserved." [11] President Museler advised that, "if this concept can be successfully deployed, it will eliminate any potential need for price caps that are disruptive to the development of effective markets."[12] Mr. Museler added that, while the NYISO's

[9] New York Independent System Operator, Inc.'s Combined Compliance Filing and Report, filed September 1, 2000, Filing Letter, pp 2&3; Resubmitted by Motion of New York Independent System Operator, Inc. For Permission to Submit Revised Tariff Sheets Out Of Time And For Permission To Submit A Corrected Combined Compliance Filing And Report, filed in September 8, 2000.

[10] Memo to Market Participants from Bill Museler, September 22, 2000, p 2.

[11] Museler Memo, p 2.

[12] Museler Memo, p 3.

economic consultants have surfaced several different concepts, the derivation of an effective "circuit breaker" will be very difficult and will require the active and objective participation of all Market Participants.[13]

It is clear to any objective observer that, despite the considerable efforts of the NYISO and Market Participants, serious concerns remain with respect to the operation of the NYISO markets. It also is clear that additional analysis is necessary to better understand the dynamics of the NYISO markets and to determine what, if any, mechanisms must be developed to ensure that consumers are not subjected to prices above those that would result from a fully competitive market. President Museler's suggestion that the NYISO develop some kind of "circuit breaker" is an important step in that direction. As President Museler indicated, however, the development of such a mechanism will be difficult and will require the dedicated time and effort of the NYISO and all interested parties.

With respect to the need to increase price-responsive load, which is generally acknowledged by the Management Committee, the ISO Board and FERC, a NYISO Price-Responsive Load Working Group has been formed. It is unrealistic, however, to assume that significant results in the development of price-responsive load will be achieved during the upcoming winter capability period.

It is patently clear, therefore, that the problems and concerns that justified the adoption of the current bid caps continue to exist, and will continue to exist during the winter

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[13] Museler Memo, p 3.

capability period.  Under these circumstances, continuation of the bid caps not only is justified, it would be imprudent to allow them to expire on October 28, 2000.

D. Miscellaneous Contentions

Appellant also raises several contentions that were previously raised with respect to the adoption of the current bid caps, and were rejected by the Management Committee, the ISO Board and FERC.  These include the contention that bid caps are necessary only to protect market participants who failed to protect themselves through the use of available hedging instruments;[14] that bid caps harm parties who engaged in transactions prior to the implementation of bid caps;[15] and that bid caps will adversely affect reliability in New York State.[16]

The contention that the serious problems that have been identified in the NYISO markets can be resolved simply by the use of available hedges is not realistic.[17]  The NYISO and most Market Participants are engaged in a good faith effort to identify and address problems in the NYISO markets.  Pretending

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14 Appeal, p 5.

15 Appeal, p 6.

16 Appeal, p 7.

17 Hedging product prices reflect unreasonably high prices resulting from market flaws and volatile prices in the RTM and other markets.  Hedging product prices derive from normally occurring prices, and when those prices are inflated, so are the hedging product prices.  Additionally, no LSE can avoid the highly volatile RTM, even if fully hedged.  In purchasing hedge products, the variables of weather, outages and other unpredictable events necessarily affect load forecasts.

that they do not exist may benefit the short-term financial interests of a limited number of Market Participants but it is shortsighted and will lead to more serious problems in the future, as well as a loss of public confidence in the NYISO.

The contention that parties engaged in transactions on the assumption that energy prices would exceed $1,000/MWh also is unreasonable.[18] Similarly, it is unreasonable to assume that such parties were not aware that the implementation of bid caps was a distinct possibility, especially since a similar bid caps already were in place in the neighboring PJM market.

Finally, the Appellant provides no credible basis for its contention that a $1,000/MWh bid cap on energy will adversely affect reliability in New York State. The parties who, unlike Appellant, have a statutory responsibility to protect the reliability of the New York Bulk Power System, including the Member Systems and the New York PSC, clearly disagree with this contention.

Conclusion

The Management Committee's action to extend the current bid caps on energy through April 30, 2001 was a reasonable response to problems in the NYISO markets that continue to be addressed, and to public concerns that consumers do not have adequate protection in the recently deregulated electricity markets. The

[18] There is no calculation in the Appellant's Motion to indicate that a $1,000 bid cap would have a significant economic impact on TCC holders. A $1,000 bid cap is sufficiently high to include the energy price plus applicable TCC congestion rents without breaching the bid limit. Had the market for TCCs anticipated energy prices often exceeding $1,000/MWh, bids for TCCs would have been much higher.

Appellant has presented no facts or arguments that would justify overturning the Management Committee's decision. The ISO Board has indicated that it will act on the appeal at its October meeting. Action by the ISO Board in October is essential for the bid caps to remain in effect for the winter capability period.[19]

The members of the Management Committee are no less committed to competitive markets than the Appellant. They realize, however, that the problems the NYISO markets are experiencing can not be ignored, but must be confronted and addressed, and that the public must be provided with some minimal protection as that process goes forward. In the long run, the frank acknowledgment of problems in the NYISO markets and an energetic effort to address them is the only way to ensure that the competitive markets will operate as intended and to earn public confidence in the NYISO.

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[19] It its Motion in Support of the Appeal, Aquila Energy Marketing Corporation proposes that the reports to the Board by the ISO staff and the Board's Market Performance Committee be subject to review and comment by market participants prior to the Board's determination of the appeal. Aquila's proposal is a transparent attempt to use delay to effectively overturn the Management Committee's decision to continue the bid caps into the winter capability period, which begins on November 1, 2000. The market participants already have spoken clearly on this issue through the Management Committee.