



Consolidated Edison Company
of New York, Inc.
4 Irving Place
New York NY 10003
www.conEd.com

October 23, 2006

Via Facsimile and Overnight Delivery

Ms. Karen Antion
Chair, NYISO Board of Directors
C/o Mr. Mark S. Lynch
President and CEO
New York Independent System Operator, Inc.
10 Krey Blvd.
Rensselaer, N.Y. 12144

**Re: Motion in Opposition to the Appeals
of KeySpan, NRG, IPPNY and ECS**

Dear Ms. Antion:

Attached is the Motion of Consolidated Edison Company of New York, Inc. and Orange & Rockland Utilities, Inc. in opposition to the appeals concerning the In-City capacity mitigation measures approved at the September 29, 2006 Management Committee.

A copy of this motion has been electronically mailed to NYISO staff for posting on the NYISO website. To the extent the Board decides to schedule an oral argument on this matter, we would like the opportunity to participate. Thank you.

Very truly yours,
/s/ Neil H. Butterkle
Neil H. Butterkle, Esq.
Associate Counsel
Consolidated Edison Company
of New York, Inc.
4 Irving Place, Room 1815-s
New York, N.Y. 10003
(212) 460-1089
(212) 677-5850 Fax
butterkleen@coned.com
Attorney for Con Edison and O&R

MOTION OF CON EDISON AND O&R IN OPPOSITION TO AN APPEAL

SUMMARY

Consolidated Edison Company of New York, Inc. (“Con Edison”) and Orange and Rockland Utilities, Inc. (“O&R,” collectively the “Companies”) hereby file this motion with the NYISO Board (“Board”) in opposition to the appeals filed by KeySpan-Ravenswood, LLC (“KeySpan”), some IPPNY members, NRG and ECS (collectively, “Appellants”) with respect to the Management Committee’s (“MC”) September 29, 2006 decisions (motions 4, 6 and 7), which approved a market mitigation proposal for the In-City capacity market (“Mitigation Measures”).

The MC approved the Mitigation Measures in order to combat the potential for the exercise of market power through economic withholding in the In-City capacity market. The MC’s actions will reduce the influence of market power in setting the clearing price of capacity. Appellants’ appeals should be rejected for the following reasons. First, Appellants’ assumptions that they are entitled to be paid at the price cap ad infinitum are unsupported. Second, given the increase in supply, the price of capacity was expected to decrease this year not increase as Appellants would have people believe. Third, it appears that economic withholding has kept capacity prices artificially high. Fourth, the Mitigation Measures represent a reasonable response to a demonstrated problem. The Mitigation Measures have broad support and will improve the competitive workings of the In-City capacity market without creating any adverse impacts on the market. Fifth, Appellants’ allegations regarding monopsony power are factually deficient and ignore legal standards. Accordingly, the Board should reject the appeals and file the Mitigation Measures with FERC under Section 205 of the Federal Power Act (“FPA”).

ARGUMENT

I. Generators Do Not Have A Vested Right To Artificially High Capacity Prices

The underlying premise of Appellants' appeals¹ is the misguided belief that they are entitled to get paid for capacity at or above the In-City price cap.² The fundamental problem with this argument is that it assumes that the price cap was meant to provide a never-ending assured stream of revenues for their generating plants. But, the price cap was not designed to ensure revenues to the Divested Generation Owners ("DGOs"), rather it was to help ensure that the DGOs could not exercise unmitigated market power. The price cap was created because the DGOs were pivotal suppliers that could exert market power in the In-City capacity market.

It was never expected that the DGOs would receive prices at their cap ad infinitum. The price cap was meant to be a transitional element. As recognized by Dr. Hieronymus "[i]t was also expected that the entry induced by the \$105/kW-year price would quickly create a capacity surplus and a reservoir of potential entry at prices below the cap that would make the caps unreachable and irrelevant."³

Appellants complain that the current price cap is unable to support new entry and is below cost. NRG in particular argues that additional mitigation would "alter the approved and established rules."⁴ Yet, as Dr. Hieronymus stated "the divorcement of costs and revenues is the desired consequence of competitive markets."⁵ Regulations, policies and tariffs change and Appellants cannot reasonably expect otherwise. Further, the fundamental purpose of a capacity market and capacity payments is not to reward

¹ It should be noted that NRG did not oppose and, in fact, abstained in the vote on the Mitigation Measures.

² NRG, pp. 2-3; Hieronymus Paper, pp. 5-8; IPPNY, p.8.

³ Hieronymus Paper, p. 6.

⁴ NRG, p.3.

⁵ Testimony of William H. Hieronymus on behalf of Con Edison in Docket ER98-3169 (June 1, 1998).

existing generators for their investments. Rather a capacity market exists to provide an economically efficient vehicle for purchasers to acquire installed capacity resources. *See Sithe New England Holdings v. Federal Energy Regulatory Commission*, 308 F.3d 71 (1st Cir. 2002).

Thus, there was no reasonable expectation that the cap would have continued indefinitely or that a DGO would have a vested right in a specified revenue stream.

II. Capacity Prices Should Have Decreased In 2006

It is fundamental economic theory that the price of a commodity should decrease as the supply of that commodity increases. This theory is one of the principal premises behind the demand curve market design that was implemented by the NYISO and approved by FERC in 2003.⁶ Specifically, the demand curve was designed with the expectation that as capacity is added to the NYISO's market, the price for capacity would decrease (i.e., slide down along the demand curve to a lower level) and correspondingly, when there is a shortage of capacity or an increase in load, the price for capacity should increase (or slide up the demand curve to a higher level).⁷ This was expected by FERC, which indicated that the "demand price would gradually fall for amounts of capacity beyond 118 percent of peak load."⁸

During the past year approximately 1,000 MW of new capacity was added, yet the price of capacity remained stuck at the KeySpan price cap level. Appellants argue that prices should not have decreased with this additional capacity.⁹ The period leading up to

⁶ *New York Independent System Operator, Inc.*, Order Conditionally Accepting for Filing Tariff Revisions, 103 FERC ¶61,201 (2003) (the "Demand Curve Order").

⁷ Although the In-City price caps for capacity were in place at the time the demand curve came into being, the workings of the demand curve (including the obligation of load to purchase all capacity offered for sale) sufficiently changed the market so as to bring about the need for additional mitigation.

⁸ *Demand Curve Order* at P 5.

⁹ NRG, p.3; KeySpan, pp.-2-3; IPPNY, p.6.

summer 2006 was to be the first such period with significant excess. Many parties, including respected industry analysts, expected prices to decline. In its April 13, 2006 publication “iOn Power Weekly,” Merrill Lynch stated that the:

Initial auction for New York City (NYC) summer capacity produced higher prices than we had expected. We had expected the addition of 1,100 [SIC] MW of new generating capacity this year to result in prices clearing well below the “caps” that the four price-mitigated in-city generators are subject to.¹⁰

Further, Citigroup’s April 9, 2006 “Industry Note” stated:

New York City summer 2006 results price well above our expectations. The May 2006 summer strip priced at \$12.35/KW-month, roughly equivalent to 2005’s summer strip price and close to the maximum limit price. This, when combined with a Winter 2005/06 average price of \$6.50/KW-month, suggests the 2006 New York City capacity market price will be approximately \$113/KW-yr. We had been expecting 1) the completion of the Astoria and Charles Poletti plants in New York City and 2) the NYSRC reliability rule change to negatively impact year over year summer prices down from \$112/KW-yr in 2005 to an approximate level of \$85/KW-yr.¹¹

Appellants, however, appear to believe that the basic principles of supply and demand are not supposed to work for the NYISO’s capacity market.

III. Economic Withholding Has Kept Capacity Prices Artificially High

It appears that this lack of a price response to an increase in supply was caused by the exercise of market power through economic withholding. Specifically, economic withholding is “submitting supply bids at inflated prices to ensure that the bids were not accepted.” *U.S. v. Reliant*, 420 F. Supp. 1043, 1046 (N.D.Ca. 2006). The NYISO Services Tariff, Attachment H, Section 2.4 defines economic withholding in the energy

¹⁰ See page 1 of the attached April 13, 2006 Merrill Lynch “iOn Power Weekly.”

¹¹ See page 1 of the attached April 9, 2006 Citigroup Industry Note.

market as “submitting bids for an Electric Facility that are unjustifiably high so that (i) the Electric Facility is not or will not be dispatched or scheduled, or (ii) the bids will set a market clearing price.”¹² Further, “there is universal agreement that monopoly power is the power to exclude competition or control prices.” *U.S. v. Syufy*, 903 F.2d. 659, 664 (9th Cir. 1990).

In the capacity market, the yearly price cap has been translated into individual monthly caps for each of the three DGOs. Based on the slope of the demand curve, it appears that the supplier with the highest monthly cap can receive an increase in revenue by bidding its full amount of capacity at a price it knows beforehand will set the demand curve clearing price at its cap because it knows beforehand that part of its bid must be taken. At that same clearing price, that party also knows beforehand that not all of its capacity will clear the auction. However, despite the fact that not all of its capacity is selected, the DGO will receive greater revenues when compared to revenues it would have received at a lower demand curve clearing price if all of its capacity clears the auction. Thus, this party has the ability to control the demand curve clearing price and increase its net revenues through the exercise of market power.

The Mitigation Measures will apply to all DGOs. This is because it appears that each of the DGOs independently can be a pivotal supplier. Since each DGO has a slightly different price cap, only the supplier with the highest monthly cap can bid into the demand curve market in a way that forces the market to clear at its price cap thereby forcing an amount of excess capacity above the minimum requirement to be purchased. If the supplier with the highest monthly price cap were to be mitigated, the supplier with

¹² Part of the DGO capacity bid in at the price cap is not sold, but, under the demand curve rules the rest of the capacity from that unit is used to set the demand curve clearing price.

the next highest cap would be in a position to exert market power by bidding all its capacity at its cap. A review of recent auction results shows that capacity clears at the KeySpan price cap.

KeySpan has a demonstrated incentive to keep capacity prices high. Under its January 18, 2006 master swap agreement with Morgan Stanley, KeySpan receives a payment from Morgan Stanley if the price of capacity is greater than \$7.57/kW-month. That payment is equal to the difference between the price of capacity in the auction and \$7.57/kW-month. Thus, if capacity clears at its price cap, KeySpan receives a double benefit. In its review of this swap agreement, Cylon Securities states that “[w]hile KSE may be correct that variable NYC generation capacity prices will remain high, we are dubious about the benefits of this tangential move into speculative financial contracts. Management may have felt more comfortable entering into this agreement because of the recent success the company had locking in very profitable hedges for the company’s Ravenswood plant.”¹³

IV. The Mitigation Measures Solve The Problem Without Causing Adverse Effects On the Market

A. The NYISO Needs To Act

The NYISO has an obligation to act to mitigate the opportunity for parties to artificially raise capacity prices by economically withholding. The NYISO Market Services Tariff, Attachment H, Section 4.5.a states:

If and to the extent that sufficient installed capability is not under a contractual obligation to be available to serve load in New York and if physical or economic withholding of installed capability would be likely to result in a material change in the price for installed capability in all or some portion of New York, the ISO, in consideration of the comments of

¹³ Cylon Securities, January 26, 2006 US Research Comments on KeySpan Corporation, p.1. See attached.

the Market Parties and other interested parties, shall amend this Addendum, in accordance with the procedures and requirements for amending the Plan, to implement appropriate mitigation measures for installed capability markets.

The MC recognized that obligation and fulfilled it by passing the Mitigation Measures by a 69.54% affirmative vote. The NYISO Board must similarly act to amend this tariff and implement the approved mitigation measures.

IPPNY's argument that the Board cannot act without the prior recommendation of the Market Monitor ("MM") is misleading.¹⁴ Contrary to IPPNY's view, Section 8.1 of the Market Monitoring Plan ("MMP") does not prohibit the NYISO from making FERC filings with respect to the MMP that are not initiated by the MM. Rather, the MMP directs the NYISO to file with FERC those recommendations that were developed by the MM in consultation with the NYISO CEO and approved by the Board. It does not limit the NYISO ability to make other filings with the FERC with respect to the MMP. For example, Section 8.3 of the MMP states the "NY ISO, as directed and as authorized by the Chief Executive Officer, shall implement the mitigation measures developed as specified above and such other mitigation measures as may be authorized or required by the FERC as a result of filings or other submission by Market Parties or other interested parties or otherwise." That being said, modifications to the NYISO tariffs are governed by Article 19 of the ISO Agreement, not the provisions of the MMP or the rest of the Services Tariff. Article 19 describes the process to be used to amend the ISO Agreement and the NYISO's tariffs. With certain exceptions inapplicable here, FPA Section 205 filings must be approved by the Board and 58% of the Management Committee. Article 19 does not vest the MM with any authority over modifications to any of the NYISO

¹⁴ IPPNY, p. 9.

tariffs and agreements.

B. The Mitigation Measures Solve The Demonstrated Problem

The Mitigation Measures establish a conduct and impact test that compares the capacity bid of an In-City generator, in the demand curve spot auction, with that of its reference bid to determine if the bid of such generator is inconsistent with the workings of competitive markets. If a DGO bid is the product of the exercise of market power then its bid will be mitigated to the reference price. This will keep that DGO from setting the clearing price for capacity. It will not, in and of itself, reduce the revenues paid to DGOs. They will still get paid the demand curve clearing price provided it is no higher than the DGO's individual price cap, just as is the case today.

To the extent that DGOs can bid in such a way as to impede the intended operation of the Demand Curve and, thereby, artificially set the market clearing price and raise capacity prices statewide, immediate action by the NYISO is needed. The Mitigation Measures would do nothing more than provide for DGO capacity to be bid into the demand curve auction in a way that would allow the demand curve to set the market-clearing price outside of the influence of economic withholding. At bottom, what all Appellants are complaining about is their inability under the Mitigation Measures to use economic withholding to set the clearing price.

C. The Demand Curve Is A Spot Market Not A Forward Market

Appellants argue that the proposal will reduce market prices just when the NYISO's Comprehensive Reliability Plan ("CRP") is calling for more generation.¹⁵ While this argument sounds appealing, it is factually wrong and misleading. To begin with, the current demand curve spot markets are intended to reflect available supply in

¹⁵ NRG, pp. 4-5.

the current month – not expected available supply in some future period. A review of the data shows that currently there is significant excess in-City capacity, which will be used up in coming years. The identified need for new capacity that was identified in the NYISO’s CRP is for the year 2011 and beyond, not for 2006 or 2007. Thus, claims that the market price is too low, given identified needs, clearly mixes the existing monthly market design with a potential need five or more years in the future.

The demand curve was designed this way. Its signal for future needs was not supposed to be explicit, but rather implicit. Market participants know that the demand curve exists, how it is developed, and that the curve prices change each year. Based on these expected demand curve changes, as well as increases in demand for electricity, generator retirements and other market forces, market participants can determine for themselves expected future capacity market prices, and as a result, determine when, or whether, to add new capacity. Nothing in the current proposal changes this dynamic. Market participants do not need to see the Cost of New Entry (“CONE”) achieved at times when there is a capacity surplus. Rather, they need an appropriate level of price over a period of time. Contrary to Appellants’ allegations, the CONE is not needed for an extended period of time, especially in light of the fact that the demand curve prices tend to shift upward over time, thus providing an opportunity for continuously increasing revenues at any amount of supply in the market. Further, Appellants’ argument that they expect to get paid at CONE is off base. They are not new entrants; rather, they are incumbent suppliers.

Accordingly, arguments that the Mitigation Measures send the wrong price signal when capacity is short is disingenuous. It is a misleading interpretation of the intention

of the demand curve, akin to spreading doom and gloom where none exists.

D. The Proposal Would Allow Demand Curve To Follow The Normal Workings Of Supply And Demand

The Mitigation Measures would allow the price of capacity to move with the quantity of available supply. Depending upon the circumstances, the Mitigation Measures would allow the market price to rise and fall in response to supply and demand. The Mitigation Measures would remove the glue on the demand curve that has kept the price stuck on the Keyspan price cap price regardless of the amount of capacity in the region. As such, the proposal does not adversely impact the future price signal.

Appellants take issue with the \$82 reference price. In doing so Appellants fail to recognize that the \$82 reference price is not the price that they would get paid for capacity but, rather, it is a mitigated bid. Generators would still get paid the clearing price as determined by the intersection of the supply bids and the demand curve.¹⁶ At an \$82/kW-year reference price, non-DGOs that lack market power will be able to set the clearing price. And, as recognized by the supporters of the demand curve and FERC, all points on the demand curve represent a just and reasonable price for the associated volume.¹⁷

E. Appellants' Call For Analysis Paralysis Should Be Rejected

Appellants argue that the proposal was not adequately studied by the NYISO, and that the NYISO itself claims it needs more time to assess total market impacts.¹⁸ The Mitigation Measures are only intended to let the demand curve work as designed.

¹⁶ DGOs will receive the demand curve price except to the extent that it exceeds their price caps, in which case they will be paid at the price cap level.

¹⁷ At an \$82/kW-month reference price approximately 450 MW of additional capacity would clear in the auction. This amount is roughly equal to the size of one of the new generating units that recently came into service.

¹⁸ NRG, pp. 6-8; ECS, p. 1; IPPNY, pp. 2-5; KeySpan, p. 14.

Presumably the NYISO conducted all such analyses when supporting the adoption of the demand curve. Nothing has changed since then in terms of the application of the market design. At that time, parties recognized that price would vary with supply. The same is true now. As a result, this argument is merely a stall tactic to allow generators to maintain existing inflated revenue streams. All generators benefit from delay since the result of delay is continued artificially higher capacity prices both In-City, and because of the market design, in the Rest of State capacity market as well.

Generators have no vested entitlement nor a contractual right to capacity revenues priced at the price cap. In fact they do not have an entitlement to any particular price for capacity. The market price was intended to fluctuate and their revenues were intended to fluctuate. Thus, there is no equitable reason to keep capacity prices artificially high. Market participants should not have to wait, as Appellants argue, until the demand curve is reset in May 2008 or until a new capacity market may be developed in order to realize spot market capacity prices that are the result of the normal workings of supply and demand and not the result of the exercise of market power in the current month-to-month market. Given the concentration of capacity in the hands of the DGOs it is impossible in the foreseeable future to expect that the NYC demand curve market would become competitive and not need the mitigation measures approved by the MC at times when surplus capacity exists.

V. Appellants Assertions With Respect to Monopsony Power Are Misguided

Appellants argue that the alleged market power of purchasers is not similarly mitigated, pointing to Con Edison's contract with Astoria Energy LLC ("SCS").¹⁹ These allegations are factually deficient. They boil down to dissatisfaction with the fact that the

¹⁹ KeySpan, p. 3; Hieronymus paper, pp. 23-26; IPPNY, pp 6-7; NRG, pp. 1, 5-6.

capacity market, as designed by the NYISO and approved by the FERC, permits self-supply. This feature is pro-competitive, and the DGOs arguments against it have already been rejected. New capacity that is used for self-supply competes with existing capacity. Its entry into the market should lower market prices – this is a basic principle of supply and demand. Efforts to withhold capacity and exercise market power is an attempt to insulate certain DGO’s from the effects of this competition and improperly transfer income from consumers to the DGOs. In the end, a review of the relevant facts and law demonstrate that allegations concerning monopsony power are a red herring designed to deflect attention from the real issue in this case: the clear exercise of market power of certain DGOs.

A. Appellants’ Assertions Are Factually Deficient

As Appellants are well aware, the NYISO capacity market allows load-serving entities (“LSEs”) to enter into bilateral contracts for the purchase of capacity. In its order approving the demand curve FERC stated that the “Commission does not regard the ICAP Demand Curve proposal as a measure that would preclude parties from entering into bilateral contracts or increasing demand responsiveness.”²⁰ Bilateral contracts by LSEs are not only allowed under the design of the NYISO capacity market, they were expected to continue and they serve a legitimate purpose. Section 5.11.2 of the NYISO Services Tariff provides that:

Each LSE must procure Unforced Capacity in an amount equal to its LSE Unforced Capacity Obligation from any Installed Capacity Supplier through Bilateral Transactions with purchases in ISO-administered Installed Capacity auctions, by self-supply from qualified resources, or by a combination of these methods.

²⁰ *Demand Curve Order*, P 75.

Appellants incorrectly argue that Con Edison “bids” its SCS capacity into the demand curve spot auction at an artificially low price and that this act of bidding constitutes the exercise of monopsony power.²¹ This assertion is erroneous. Consistent with the requirements of the NYISO Services Tariff, buyers do not bid bilateral contracts into the ICAP auction. Rather, Section 5.11.2 of the NYISO Services Tariff requires that a buyer “must certify the amount of Unforced Capacity it has or has obtained prior to the beginning of each Obligation Procurement Period by submitting completed Installed Capacity certification forms to the ISO by the date specified in the ISO Procedures.” That date is prior to the conduct of the auction. Consistent with its procedures, the NYISO includes these capacity volumes in the auction as self-certified capacity. Since the demand curve is supposed reflect all volumes, the NYISO counts the volumes associated with bilateral contracts in the auction without a price. Bilateral contracts settle outside of the auction thus there is no need to reflect a price for these contracts. Accordingly, Con Edison complies with the NYISO tariff process and does not bid the SCS Astoria contract into the auction.²²

Further, the NYISO’s treatment of bilateral capacity contracts in the auction is appropriate. By including the contract in the auction at the left side of the demand curve, the NYISO ensures that LSEs do not pay twice for the same capacity. The NYISO’s actions also ensure that all capacity is accounted for in determining the capacity clearing price. Finally, it is inappropriate to compare prices derived from a long-term contract with those produced in a monthly auction.

²¹ Hieronymus paper, pp. 23-26.

²² With respect to any reduction in the output of KeySpan, that is due entirely to decisions by KeySpan. It could have sold more capacity in the auction by lowering its bid. But, it chose not to. In fact, it has an incentive not to.

KeySpan incorrectly asserts that the price Con Edison pays SCS for capacity is \$184/kW-year.²³ Using creative accounting, KeySpan assumed that SCS would not run at its minimum output and thus added certain guaranteed energy payments to the stated SCS capacity price in order to arrive at its fictional \$184 number. But, as a new and very efficient plant, SCS is expected to run beyond its minimum run times. Since the plant will meet its minimum run times and more, Con Edison expects to receive a significant level of energy-related discounts over a ten-year period. In fact, correctly applying Keyspan's methodology, the energy portion of the agreement provides additional benefits to Con Edison's customers, netting the energy benefits contained in the contract with the capacity payments shows that Con Edison receives capacity at prices below even the proposed mitigated level.

KeySpan's argument demonstrates the fallacy of trying to determine a short-term monthly capacity charge based on a ten-year agreement for energy and capacity that contains discounts.²⁴ Further, like all contracts, the SCS contract includes terms and conditions that are part of an overall deal and beneficial to both parties. Contracts provisions cannot be cherry-picked; they are part of an overall package, any one provision of which might be particularly unattractive to an individual reviewer even if the entire package is seen as beneficial – or vice versa.

KeySpan also incorrectly asserts that 500 MW of capacity from SCS was not available in New York City in May and June of this year, citing to a May 11, 2006 filing by Con Edison. What KeySpan neglects to mention is that subsequent to that filing, SCS received the go ahead from the NYISO to be considered a capacity provider. As such, it

²³ KeySpan, p. 2.

²⁴ On the other hand, bids into the demand curve auction consist of monthly bids of capacity at a monthly price.

has provided, and was paid for providing, 500 MW of UCAP since May 1, 2006.

B. Appellants' Monopsony Power Assertions Are Unsupported

Monopsony power is a situation in which a single buyer exercises market power by limiting its purchases to reduce market prices in order to profit from that action. *See U.S. v. Syufy*, 903 F.2d. 659, 663 (9th Cir. 1990). Market power “is the power to exclude competition or control prices.” *Syufy*, 903 F.2d. at 664. With respect to Con Edison’s activities in the demand curve auction, none of these elements have been met.

First, although Con Edison may have a significant number of retail customers in New York City, it is not the only buyer of capacity in the In-City market. As the court in *Syufy* recognized, “[a] high market share, though it may ordinarily raise an inference of monopoly power, will not do so in a market with low entry barriers or other evidence of a defendant’s inability to control prices or exclude competitors.” *Syufy*, 903 F.2d. at 664. There are no significant barriers to entry into the capacity market for buyers. Through its retail access program, Con Edison encourages new entry by buyers (i.e., LSEs) into the market. These LSEs automatically become buyers in the NYISO’s capacity markets. With respect to the entry of new generators into the market, Con Edison aided in that by entering into a contract with SCS. Further, Con Edison could not keep generators out of the market: all generator interconnections are governed by the NYISO’s tariff. Con Edison does not exclude competition; it furthers it.

Second, given the structure of the demand curve auction, LSEs do not get to choose how much capacity they must purchase in the auction nor the price of such capacity. Accordingly, Con Edison neither controls the amount of capacity it must purchase nor the market clearing price of such capacity. The capacity clearing price is set

at the intersection of the supply bids, which are controlled by the generators, and the demand curve, which is administratively set. Recent history has shown that the demand curve clears at the KeySpan price cap. Thus, Con Edison obviously does not control the clearing price of capacity.

Accordingly, Appellants arguments with respect to monopsony power are misguided, unsupported and counter to the relevant law and facts.

CONCLUSION

Accordingly, for the reasons set forth above, the Companies respectfully request that: (1) the Board reject Appellants' appeals and affirm the MC's decision to approve the Mitigation Measures; and (2) the Board file the Mitigation Measures as adopted with FERC pursuant to Section 205 of the FPA. In addition, the Companies respectfully request an opportunity to participate in oral argument.

Dated: October 23, 2006

Respectfully submitted,
Consolidated Edison Company
of New York, Inc. and
Orange and Rockland Utilities, Inc.
By: /s/ Neil H. Butterklee
Neil H. Butterklee, Esq.
Associate Counsel
Consolidated Edison Company of New York, Inc.
4 Irving Place, Room 1815-S
New York, N.Y. 10003
Telephone: (212) 460-1089
Fax: (212) 677-5850
butterkleen@coned.com

ATTACHMENT "A"

Evolving legislative developments in Maryland, Virginia

Industry Overview

Equity | United States | Electric Utilities

13 April 2006


Merrill Lynch

Steve Fleishman Research Analyst MLPF&S	+1 212 449 0926
Erica Piserchia Research Analyst MLPF&S	+1 212 449 1887
Jonathan Arnold Research Analyst MLPF&S	+1 212 449 4673

Maryland legislature update

The state legislature adjourned its regular session on April 10 without reaching a deal to mitigate a 72% increase in power prices at Baltimore Gas and Electric. Because the bills giving merger oversight to the legislature and reform of the PSC were vetoed but not overridden by the legislature, there currently is no restriction on either the upcoming rate increase or on the merger. **Importantly, although the situation continues to evolve, these developments have not resulted in the establishment of unfavorable precedent concerning stranded costs.**

Reasonable legislative development in Virginia

Governor Timothy Kaine has announced that he will submit a substitute bill in place of energy legislation (SB262) passed by the 2006 General Assembly. The new bill proposes a return to "a more accurate method of determining energy costs in utility fuel rate hearings". Specifically, we understand that this would involve a return to annual utility fuel cost adjustments and deferral accounting. Going back to the traditional utility fuel recovery method could have strategic implications for **Dominion** - potentially even weakening the case for an integrated business model that includes both E&P production and power generation under one roof.

NYC capacity auction produced higher than expected prices

Initial auction for New York City (NYC) summer capacity produced higher prices than we had expected. We had expected the addition of 1,100 Mw of new generating capacity this year to result in prices clearing well below the "caps" that the four price-mitigated in-city generators are subject to. Instead, the clearing price for the six-month "strip" auction (May-October) was \$12.35 per Kw-month, which was only 2% below the average price cap. The results also reinforce our view that Reliant Energy sold its NYC plants at much too low a price last fall, one that we believe discounted a decline in capacity prices of as much as 50%.

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Company notes issued last week include AES.

Brief comments on upcoming events are included for AEP, CNP, EIX, EXC, PNW and XEL.

Table 1: Weekly Performance - as of 4/7/06

Group	% Change		P/E		EV/EBITDA		Current Yield
	This Wk.	YTD 2006	2006E	2007E	2006E	2007E	
Less Regulated	-0.1%	-3.3%	13.8x	12.2x	7.8x	7.2x	3.4%
Mostly Regulated	-1.0%	-0.7%	14.7x	13.6x	8.2x	7.9x	4.1%
IPP/Merchant	3.8%	3.2%	13.0x	10.6x	16.8x	5.9x	0.0%
Indices:							
S&P 500	0.1%	3.9%					
S&P Electrics	-1.4%	-3.2%					
Dow Jones Utilities	-0.2%	-4.2%					

Source: Reuters and ML estimates

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Refer to important disclosures on page 12 to 13. Analyst Certification on page 11. Price Objective Basis/Risk on page 11.

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State Legislative Update: MD, VA, PA

Maryland: The state legislature adjourned its regular session on April 10 without reaching a deal to mitigate a 72% increase in power prices at **Baltimore Gas and Electric**. A tentative deal appeared to have been reached through the mitigation of a significant amount of the rate increase (about \$600M) through deferrals. However, the governor, BG&E, and key legislators disagreed over whether to require the nomination of an entirely new set of regulators at the MD PSC, and the session closed without a vote by the Senate. Because the bills giving merger oversight to the legislature and reform of the PSC were vetoed but not overridden by the legislature, there currently is no restriction on either the upcoming rate increase or on the merger.

Most importantly, although the situation continues to evolve, these developments have not resulted in the establishment of unfavorable precedent concerning stranded costs.

Reasonable legislative development in Virginia

Virginia: Governor Timothy Kaine has announced that he will submit a substitute bill in place of energy legislation (SB262) passed by the 2006 General Assembly. The new bill would be voted on at a one-day session next week (April 19) and the original sponsor (Senator Frank Wagner) has indicated his support for Governor Kaine's version. The main focus of the new bill is offshore E&P drilling limitations, but it also proposes a return to "a more accurate method of determining energy costs in utility fuel rate hearings". Specifically, we understand that this would involve a return to annual utility fuel cost adjustments and deferral accounting. In addition, the SCC would be given the option to defer up to 40% of the increase expected at **Dominion's** next scheduled reset (July 2007). These measures would change current arrangements for Dominion Virginia Power (DVP) which currently operates under frozen fuel rates with only one reset opportunity (in July 2007) between now and the end of 2010. There have been some concerns expressed regarding a recent State Corporation Commission (SCC) instruction that DVP should submit its initial July 2007 fuel costs a full year in advance. The SCC statement referenced concern with the uncertainty of estimating forward energy costs over a 42-month period and it seems the governor's proposal is responding to similar concerns. From Dominion's perspective we view this development as reasonable, as it would reduce the uncertainty around energy cost recovery in the 2007-2010 period. Going back to the traditional utility fuel recovery method could also have strategic implications - potentially even weakening the case for an integrated business model that includes both E&P production and power generation under one roof.

Pennsylvania regulators have established a modified supply auction for Pike County Light & Power

Pennsylvania: On April 6, the Pennsylvania Public Utilities Commission voted to initiate a new competitive retail aggregation bidding process for wholesale power at Pike County Light & Power (a subsidiary of **Con Edison**). Previously, an auction for default service led to extremely high prices. The PA regulators determined that the high prices were a result of the very high gas market prices, along with very few bidders and no competitive retail supplier presence. Consequently, the regulators have initially decided to establish a modified auction to address the flaws in the previous auction. The PAPUC expects to run the auction and determine a winner on April 20, with rates going into effect in May. We believe that this is a positive sign that regulators in Pennsylvania remain committed to the markets despite the near-term run up in energy costs.

For a review of **FirstEnergy's** transition rate filing, please see Recent Developments on page 5.

Initial NYC Summer Capacity Prices Higher Than Expected

The following is excerpted from our April 4th Comment on IPPs concerning the outcome of New York City's recent summer capacity auction.

Initial auction for New York City (NYC) summer capacity produced higher prices than we had expected. We had expected the addition of 1,100 Mw of new generating capacity this year to result in prices clearing well below the "caps" that the four price-mitigated in-city generators are subject to, even though load growth, adjustments to reserve capacity amounts and an increase in the in-city or locational generation requirement to 83% from 80% would partly offset the negative impact of additional supply. Instead, the clearing price for the six-month "strip" auction (May-October) was \$12.35 per Kw-month, which was only 2% below the average price cap.

Capacity prices YTD are down only slightly from 2005. Because the New York ISO reshaped the relationship of summer and winter prices this year (summer was increased and winter decreased), it is not possible to directly compare the initial summer 2006 price with that of 2005. However, on a YTD basis, we would note that the market has been clearing essentially in line with the caps whereas last year the market on average cleared slightly above the caps – overall implying a very modest year-over-year reduction.

Monthly auctions also bear close watching. Generators do not sell all their capacity through the six-month strip auction, and thus the capacity prices they realize will also depend on the prices and relative amounts sold in the monthly auctions held in May-October. Prices for the remaining months will in part depend on whether the second plant under construction in NYC (SCS Astoria Energy) enters service on schedule in June.

Implications for other companies. This development is also positive for **KeySpan**. The results also reinforce our view that **Reliant Energy** sold its NYC plants at much too low a price last fall, one that we believe discounted a decline in capacity prices of as much as 50%.

Events this Week

AEP: Opening briefs due April 11 in VA E&R case

American Electric Power: Opening briefs are due Tuesday (April 11) in AEP's Virginia Environmental and Reliability (E&R) case. The company is seeking \$21.1M (10.85% allowed ROE) and the Staff has recommended an increase of \$19.6M (9.8% ROE).

CNP: Hearings in MN gas case begin this week

CenterPoint Energy: Hearings in CNP's Minnesota gas rate case are scheduled to begin on Tuesday (April 11) and may run through the end of the week. Company is seeking a \$40.9M increase (based on an 11.25% allowed ROE) and Staff has recommended a \$27.3M increase (9.98% ROE).

CNP: To file electric rate case in TX this week (in response to show-cause order)

In addition, CNP must file a general rate case in Texas by Friday, April 14 in response to a show-cause order by the Public Utility Commission of Texas regarding the company's earned ROE. We note that each 100bp change in allowed ROE (from 11.25% currently) is equivalent to approximately \$20-\$25M of annual revenues, and that a reduction in CNP's equity ratio to 40% from 50% currently would hurt revenues another \$30-\$35M.

Edison International: Final oral arguments before the California Public Utilities Commission (CPUC) in SCE's 2006 general rate case (GRC) are scheduled for April 4. This session had been set for March 6, but was later pushed back into this month. Once the final arguments have been heard the commission will decide the case, although timing remains uncertain. The case may be taken up as early as the April 13 open meeting, but the next meeting (April 27) seems a more likely date in our view. With a memorandum account in place, once the decision comes it will still be retroactive to mid-January. SCE's updated request was for a rate increase of \$324.9M in 2006 and subsequent increases of \$108.5M in 2007 and \$113M in 2008. The request was predicated on a 2006 average rate base of \$9.3B, equity of 48% and ROE of 11.4%. The ALJ recommendation is for a rate increase of \$60.7M in 2006, \$67.8M in 2007 and \$105.3M in 2008. This incorporates a starting rate base of \$9.1B, with equity (48%) and ROE (11.6%) consistent with the CPUC's decision in the cost of capital proceeding from December. At this stage there has been no alternate decision proposed, but one could be offered at any time ahead of the vote. Even with no alternate decision, the CPUC still has the option to adopt the company's request in full. In terms of sensitivity, Edison has indicated that the ALJ recommendation would reduce effective rate base by 2-3% over the 2006-2008 time frame (about \$0.05/share of earnings power).

Exelon Corp.: Regarding the ComEd delivery rate case, hearings were mostly completed last week, but one extra day has been scheduled for April 13. Thereafter, the next key date on the schedule is the ALJ recommendation (June 8) with a decision from the ICC expected in late July. In terms of context, ComEd filed for a \$317M (20%) increase in its delivery rates premised on an 11% ROE, 54% equity ratio and rate base of \$6.2B. The AG has recommended a rate reduction of \$115M based on a 7.75% ROE, 30% equity ratio and \$5.2B rate base. Staff of the ICC has proposed a \$38M rate reduction, incorporating ROE of 10.2%, equity of 37% and \$5.2B of rate base.

During March ComEd formally laid out the details of its procurement cost cap and deferral scheme (Customer Safety Net Plan). This was done as part of the company's surrebuttal testimony in the delivery case, but later withdrawn following objections from other parties. ComEd has indicated that it intends to refile the Plan under a separate docket.

Pinnacle West Capital: Arizona Corporation Commission (ACC) hearings on APS's emergency interim rate application ran from March 20 through March 29. As a reminder, the emergency application is for \$299M and represents the fuel component of the ongoing general rate case. In addition to APS's requested early adjustment of base fuel rates, the hearings covered a wide range of other options including raising the current cap on the PSA adjustor and other temporary surcharges. The ALJ has requested closing briefs from all intervenors by **April 10** and is targeting (not guaranteeing) a recommendation by April 22. Parties have agreed to shorten the normal two week timeframe for filing exceptions to just two business days so the ACC could make a decision as early as late April. The next ACC open meeting is May 2-3, but a special open meeting could also be sooner than this.

Texas: Public hearing held last Friday on PTB and POLR proposals; reply comments due Wednesday

Texas regulatory and legislative developments: Reply comments on the Price-to-Beat (PTB) and Provider of Last Resort (POLR) proposals are due on Wednesday, April 12. At the public hearing last Friday (April 7), there were no comments on the proposals themselves. Consumer groups were permitted to express their views in the afternoon session.

Recent Developments

AEP: Received approval to recover preconstruction costs for OH IGCC project

American Electric Power: On April 10, the Public Utilities Commission of Ohio (PUCO) determined that AEP would incur costs associated with its proposed IGCC plant in meeting its provider of last resort (POLR) obligation and thus it would be reasonable to recover these costs through a POLR recovery mechanism. The PUCO approved recovery of preconstruction costs (Phase I costs), which are expected to total \$23.7M, through a bypassable generation surcharge to customers. AEP is required to return to the Commission for final approval when the front-end engineering and design (FEED) study results are completed in October. This study is expected to produce a firm cost estimate for the project. We view the Commission ruling as positive and in line with expectations. It allows AEP to recover the preconstruction costs (basically insulating the company from the risk of not proceeding and having to write off these costs), but we do not view it as complete assurance that the project will definitely go forward. We also expect this ruling to be challenged either now or at the time of a subsequent Commission decision, on the basis that the law does not permit regulators to assure cost recovery for generation investments.

AEP: Filed rebuttal testimony in WV rate case; hearings set for next week

AEP filed rebuttal testimony in its West Virginia rate case on April 7. In its rebuttal, AEP proposed combining the first two base rate increases into one \$17.8M increase along with a \$56M increase related to the reinstatement of the Expanded Net Energy Clause (ENEC) and an \$18.8M annualized increase for the new Wyoming-Jackson Ferry transmission line. AEP's filing is based on an 11.5% allowed ROE. As discussed in our April Calendar of Events note, the Staff recommendation is considerably more stringent, calling for a base rate reduction and an allowed ROE of only 9.6%. The Staff does support reinstatement of the ENEC (\$52.6M) and revenues for the new transmission line (\$15.7M), however. Hearings are scheduled for April 18-21 and briefs are due April 27.

FE: Filed transition rate proposals in Pennsylvania

FirstEnergy: On April 10, FirstEnergy subsidiaries Metropolitan Edison and Pennsylvania Electric filed transition rate proposals with the Pennsylvania Public Utilities Commission (PAPUC). Briefly, the rate proposals called for transmission and distribution rate relief, as well as changes to the recovery of certain stranded costs. The filings also ask the PUC to remove existing generation rate caps (currently scheduled to expire in 2010) and to replace these caps with a request for proposal (RFP) process that is anticipated to result in higher generation rates that will step up over time through the end of 2010.

This last request is being made in light of the fact that FE's non-regulated supply affiliate, FirstEnergy Solutions (FES), recently modified its supply contract with the PA utilities. Under prior terms of the contract, FES supplied power to the PA utilities at the capped generation rate (~\$42/MWh), but has had to procure that power off the market at much higher prices. As a result, FES has been shouldering losses from the contract. FES recently changed the terms of this contract, such that FES will continue to provide power at the capped rate, but in declining amounts through 2010 (32% in 2007 declining to 5% in 2010).

The company expects that a final order regarding the filings is likely to come in Q1 2007.

We are currently evaluating the financial impact that these proposals would have on FE. That said, the filings appear consistent with our prior comments, in which we have noted that T, D and/or G rate relief in Pennsylvania could be additive to earnings in the 2007-2010 timeframe.

XEL: Filed rebuttal testimony in MN electric rate case; hearings set for later this month

Xcel Energy: XEL filed rebuttal testimony in its Minnesota electric rate case on March 30. It proposed no change to the allowed ROE (11%) but did reduce its revenue requirement from \$168M to \$155.6M. Most of the change relates to a reduction in the proposed nuclear decommissioning accrual from \$45.8M to \$32.0M, with another \$1M of the difference attributable to a reduction of XEL's end-of-life nuclear fuel accrual. These adjustments should have no impact on XEL's earnings or cash flow. Hearings in the case are scheduled for April 20-28.

Spark Spread Watch

Calendar year 2007 spark spreads fell in the West but were unchanged slightly. Natural gas prices rose only 0.5% last week but western power prices declined about 1% on average.

Calendar year 2008 spark spreads were about unchanged in all regions by NY Zone-J, where spark spreads fell. Natural gas prices rose nearly 1% while forward power prices were flat to slightly higher.

Summer 2006 spark spreads rose slightly in all regions except PJM, Mass Hub, Entergy and Mid-C. Natural gas prices fell 5.5% last week, causing forward power prices to decline.

Table 2: Forward Implied Spark Spreads for 4/7/06 (\$/MWh)

	Calendar Year 2007				Calendar Year 2008				Summer 2006			
	Range	Peak Date	Median	Current	Range	Peak date	Median	Current	Range	Peak date	Median	Current
East												
Mass Hub	\$27-11	11/15/2005	\$18	\$20	\$23-16	12/30/2005	\$19	\$19	\$42-22	6/24/2005	\$31	\$28
PJM West	\$9-2	7/13/2005	\$7	\$8	\$9-3	1/10/2006	\$7	\$8	\$32-20	6/24/2005	\$27	\$26
N.Y. Zone-J	\$53-34	11/14/2005	\$40	\$36	\$42-36	1/24/2006	\$38	\$36	\$72-49	12/25/2110	\$63	\$53
Midwest												
Cinergy, into	\$2-(12)	1/10/2005	\$(4)	\$(8)	\$(5)-(9)	3/6/2006	\$(7)	\$(6)	\$15-7	7/25/2005	\$11	\$12
NI Hub	\$7-(11)	1/10/2005	\$1	\$(4)	\$(0)-(6)	4/3/2006	\$(4)	\$(0)	\$20-7	11/1/2005	\$13	\$16
South Central												
Entergy, into	\$7-2	7/11/2005	\$5	\$5	\$6-3	12/30/2005	\$4	\$4	\$22-13	2/8/2006	\$16	\$17
ERCOT	\$19-6	7/11/2005	\$13	\$12	\$17-12	12/23/2005	\$13	\$13	\$41-24	2/8/2006	\$37	\$30
West												
Mid-C	\$19-4	3/8/2005	\$15	\$4	\$9-3	12/30/2005	\$6	\$5	\$25-3	3/31/2006	\$18	\$3
Palo Verde	\$25-11	7/12/2005	\$21	\$11	\$17-11	1/26/2006	\$14	\$12	\$40-19	3/27/2006	\$32	\$21
NP15	\$28-15	7/11/2005	\$24	\$15	\$20-14	12/23/2005	\$16	\$15	\$40-18	3/27/2006	\$32	\$19
SP15	\$32-18	7/11/2005	\$28	\$19	\$23-18	12/28/2005	\$20	\$18	\$45-23	3/27/2006	\$38	\$24

Source: Reuters and ML estimates

Table 3: Forward Power and Gas Prices for 4/7/06 (\$/MWh)

	CY 2007	% Change This Week	% Change YTD	CY 2008	% Change This Week	% Change YTD	Summer 2006	% Change This Week	% Change 6/30/2005
East									
Mass Hub	\$98.65	0.5%	-6.5%	\$94.50	0.7%	-4.2%	\$88.65	-4.6%	-25.4%
PJM West	\$82.80	0.9%	-4.1%	\$79.95	2.9%	1.2%	\$82.45	-4.1%	-25.2%
N.Y. Zone-J	\$117.30	0.0%	-7.5%	\$113.90	0.0%	-4.5%	\$115.45	-2.6%	-24.6%
Midwest									
Cinergy, into	\$66.55	1.2%	-5.5%	\$65.55	2.8%	-1.1%	\$68.75	-2.6%	-26.3%
NI Hub	\$65.15	2.8%	4.1%	\$65.70	5.6%	3.1%	\$67.15	-3.2%	-24.3%
South Central									
Entergy, into	\$77.20	0.5%	-7.2%	\$72.80	1.0%	-4.6%	\$71.75	-5.8%	-23.3%
ERCOT	\$78.20	-0.4%	-10.3%	\$75.55	0.9%	-5.9%	\$77.95	-3.1%	-29.0%
West									
Mid-C	\$65.15	-0.5%	-12.3%	\$62.95	1.0%	0.0%	\$47.00	-6.9%	-43.7%
Palo Verde	\$74.15	-0.9%	-12.3%	\$71.40	1.2%	-4.7%	\$66.25	-2.2%	-34.2%
NP15	\$80.80	-0.7%	-12.1%	\$76.95	1.1%	-7.5%	\$67.50	-2.9%	-35.3%
SP15	\$81.65	-0.7%	-12.6%	\$78.00	1.0%	-7.1%	\$69.50	-2.8%	-34.3%
NYMEX Gas Futures	\$9.65	0.5%	-5.9%	\$9.21	0.9%	-1.7%	\$7.33	-5.5%	-29.6%

Source: Reuters and ML estimates

Research Highlights

AES - 2006 outlook: Spending money to make money (4/5)

Filed 2005 10-K and completed 2003/2004 restatements. AES reported 2005 results and filed its 10-K yesterday, only one day after a delay caused by the need to restate 2003 and 2004 financials (see our April 3rd note). Restatements were minor, increasing 2004 earnings \$6M (\$0.01/sh) and reducing 2003 earnings \$17M (\$0.03); there was no impact on 2005 EPS or on cash flow.

Q4 EPS beat our estimate on a lower effective tax rate. EPS of \$0.27 including a \$0.01 foreign currency transaction loss were \$0.10 better than our estimate, largely due to a lower effective tax rate in Q4 (23%), which pulled the rate for the year down to 32% from our expectation of 36%. Full-year EPS were \$0.95, including \$0.04 of foreign currency transaction gains.

2006 guidance: flat EPS, slightly below expectations. AES provided its initial outlook for 2006, projecting \$0.95 on an adjusted EPS basis and \$0.90 on a GAAP basis. The EPS forecast is below our \$1.00 estimate, in part because of higher development costs and a lower level of interest cost savings as management pursues its growth strategy and devotes less free cash flow to parent debt retirement (AES quantified this as an \$0.08 drag vs. 2005). Successful development projects would produce earnings over long run.

2006 guidance: free cash flow slightly better than expected. AES projected maintenance capex of \$800-\$900M, about \$200M higher than our forecast, mostly because of required environmental capex. Despite the increased maintenance capex, AES is forecasting 2006 free cash flow (FCF) of \$1.3-\$1.5B, which is slightly higher than our \$1.37B projection. AES also raised its 2008 operating cash flow goal to a level that would imply FCF of about \$1.8-\$1.9B.

2006 guidance: subsidiary distributions about as expected. AES forecast \$1.0B of subsidiary distributions to the parent in 2006, up slightly from \$993M in 2005. IPALCO and contract generation businesses are expected to account for 54% of the total vs. 68% in 2005, with the difference made up by higher distributions from the NY plants and various Latin American businesses.

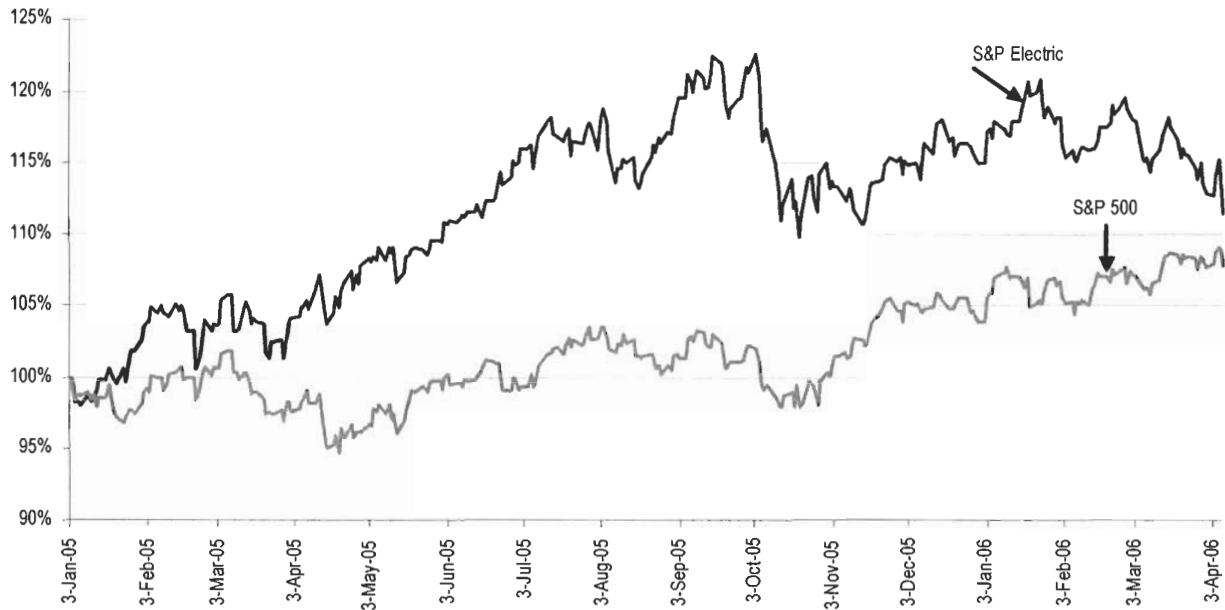
Still reviewing our 2006 financial projections. We will revisit our \$1.00 EPS and \$2.05 FCF projections for 2006 as necessary.

Table 2: Companies mentioned

Company	Ticker	Rating	Price
AES Corporation	AES	C-2-9	16.40
American Electric Power	AEP	B-2-7	33.06
CenterPoint Energy	CNP	Not rated	11.73
Dominion	D	B-1-7	71.50
Edison Intl	EIX	B-2-7	39.34
Exelon Corp.	EXC	B-1-7	51.76
FirstEnergy	FE	B-1-7	49.14
KeySpan Corp.	KSE	Not rated	40.19
Pinnacle West	PNW	B-2-7	39.35
Reliant Energy	RRI	C-2-9	11.03
Xcel Energy	XEL	B-2-7	17.89

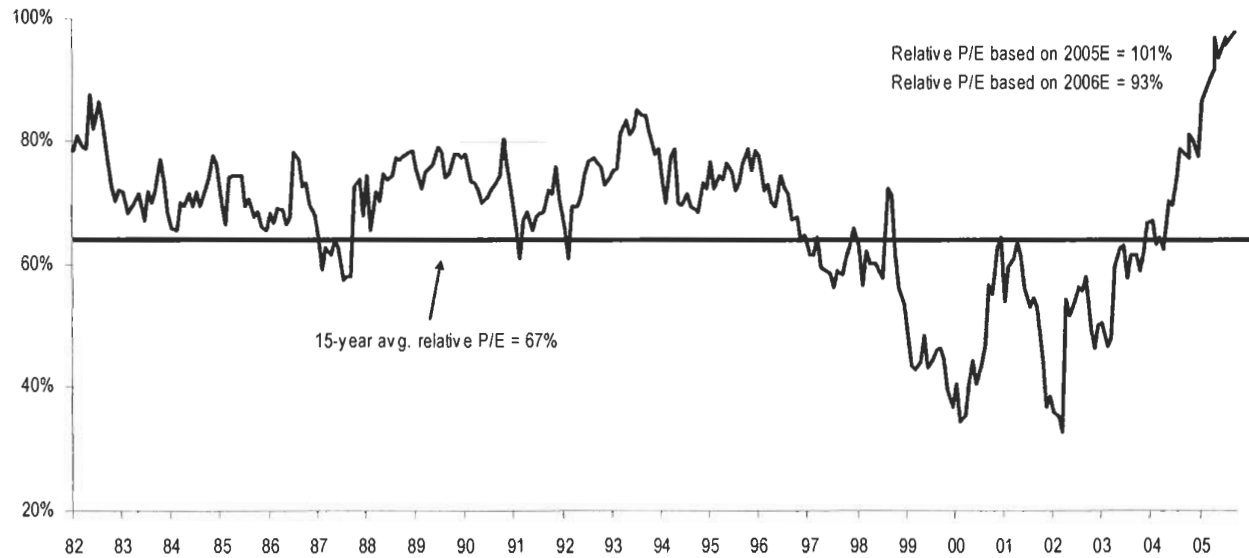
Source: Reuters pricing data, ML estimates

Chart 1: S&P 500 vs. S&P Electric – Percentage Change in Price (January 1, 2005 – April 7, 2006)



Source: Bloomberg; ML calculations

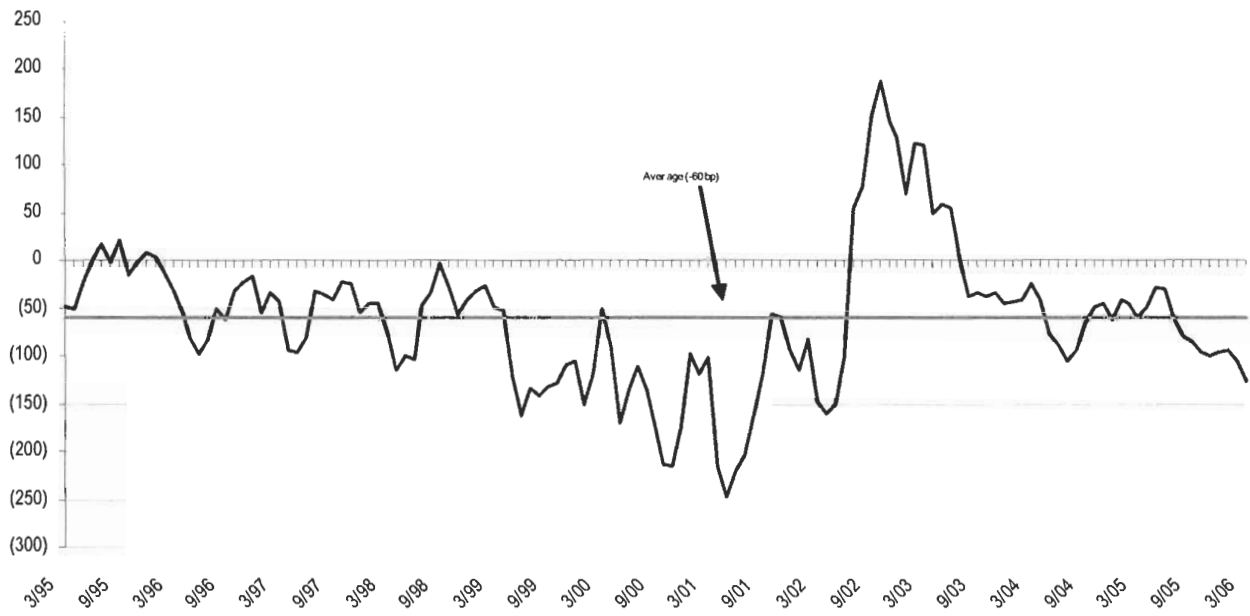
Chart 2: Relative P/E Multiple of the S&P Electrics to the S&P 500 (January 1977 through Forecasted 2006)



Note: S&P Electrics P/E calculated using I/B/E/S rolling full-year forward earnings estimates. Average is market cap weighted. Companies included in the sample are PEG and DUK.

Source: Bloomberg; ML calculations

Chart 3: S&P Utility Index Dividend Yield vs. U.S. Treasury Yield



Source: FactSet; ML calculations

Price Objective Basis & Risk

Dominion Resources

Our price target of \$86 is based on 11.5x our 2008E of \$7.50, a modest discount to peers. We believe improved execution on near-term numbers (absent hits from Katrina and Rita) will allow investors to focus on the potential long-term earnings upside. Moreover, there are a number of opportunities for D to better maximize the value of its mix of businesses and we sense management's enhanced ROIC focus may lead to some restructuring moves. Risks to our price objective are nuclear operations; E&P cost pressures and production growth risks; and managing fuel risk under frozen rates in Virginia.

Exelon Corp.

Our price objective of \$64 for EXC looks forward to 2007 earnings potential in the \$4.75 range and applies a P/E multiple of 13.5x (modest discount to average forward utility multiple). We believe this range of earnings potential is relatively conservative given current forward commodity prices and assuming a transition to the proposed auction-based utility procurement in Illinois. Likewise, we believe a discount remains appropriate given the commodity earnings component and remaining political risks around the Illinois auction process. Risks to our target are nuclear operations; regulatory approvals for the PSEG merger; outcomes of new rate plans in Illinois and PA; and longer-term earnings sensitivity to commodity pricing.

FirstEnergy Corp.

Our \$55 price objective represents 12.5% upside potential. At a 13.8x multiple of our 2007E EPS, our PO represents a 4% premium to peers, and reflects significant long-term earnings drivers and share buybacks. FE's Ohio rate plan also limits exposure to declining commodity prices through 2008. Risks to our price objective are nuclear operations, PA rate cases, and OH market structure in 2009. Solid 3.7% yield should grow 5% per year.

Analyst Certification

I, Steve Fleishman, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Note To Readers

Merrill Lynch is currently mandated as financial advisor to Exelon Corp.

Important Disclosures

Investment Rating Distribution: Energy Group(as of 31 Mar 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	65	40.63%	Buy	26	40.00%
Neutral	84	52.50%	Neutral	24	28.57%
Sell	11	6.88%	Sell	0	0.00%

Investment Rating Distribution: Utilities Group(as of 31 Mar 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	44	36.97%	Buy	22	50.00%
Neutral	65	54.62%	Neutral	32	49.23%
Sell	10	8.40%	Sell	3	30.00%

Investment Rating Distribution: Global Group(as of 31 Mar 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1145	40.29%	Buy	393	34.32%
Neutral	1474	51.86%	Neutral	430	29.17%
Sell	223	7.85%	Sell	44	19.73%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium, and C - High. **INVESTMENT RATINGS**, indicators of expected total return (price appreciation plus yield) within the 12-month period from the date of the initial rating, are: 1 - Buy (10% or more for Low and Medium Volatility Risk Securities - 20% or more for High Volatility Risk securities); 2 - Neutral (0-10% for Low and Medium Volatility Risk securities - 0-20% for High Volatility Risk securities); 3 - Sell (negative return); and 6 - No Rating. **INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure); 8 - same/lower (dividend not considered to be secure); and 9 - pays no cash dividend.

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ATTACHMENT "B"

Energy Merchants

Capacity Markets Update: NY Prices Rise; California Debates Plans

April 9, 2006

Brian Chin, CPA

+1-212-816-2861
brian.chin@citigroup.com

Greg Gordon, CFA

+1-212-816-2802
greg.gordon@citigroup.com

Humberto Medina, CFA

+1-212-816-3366

SUMMARY

- On 4/3/06 New York's capacity market auctions for May 2006 priced well above our expectations. We estimate higher capacity market results, if reflective of Summer 2006 prices, could be EBITDA accretive to our estimates and management guidance for NRG Energy by approximately \$24 million.
- Tight NY capacity markets in 2006 portend high capacity market revenues in future periods; auction results for Jun-Oct will be closely watched.
- Separately, our recent discussions with California regulatory officials and review of power procurement proposals suggest California is moving closer towards a capacity market similar to New York's and the RPM/LICAP proposals. We continue to believe California will not likely implement a capacity market because spiking energy prices may preclude capacity market passthroughs in the political arena. Nevertheless, we now believe a more formal proposal may be fleshed out sometime in 2007-08 for FERC approval.

United States

OPINION

New York capacity markets show tightening supply/demand balance. On 4/3/06 New York City's May 2006 capacity markets auction results were priced well above expectations. May results are typically the first "summer" results of the year, so these auction results may portend overall Summer 2006 results significantly higher than we expected.

New York City summer 2006 results price well above our expectations. The May 2006 summer strip priced at \$12.35/KW-month, roughly equivalent to 2005's summer strip price and close to the maximum limit price. This, when combined with a Winter 2005/06 average price of \$6.50/KW-month, suggests the 2006 New York City capacity market price will be approximately \$113/KW-yr. We had been expecting 1) the completion of the Astoria and Charles Poletti plants in New York City and 2) the NYSRC reliability rule change to negatively impact year over year summer prices down from \$112/KW-yr in 2005 to an approximate level of \$85/KW-yr.

Rest of New York state also prices higher. New York's Rest of State May 2006 Auction also came in above expectations. The summer strip priced at \$1.44/KW-month, which is above the Summer 2005 average strip of \$1.15/KW-month. At this price and a Winter 2005/06 average price of \$0.72/KW-month, Rest of State results suggest an annual level of \$13/KW-yr. We had been expecting an annual level of \$6/KW-yr down from \$10/KW-yr in 2005 due to the NYSRC's reliability rule change.

NRG Energy has largest exposure to New York capacity market results. NRG Energy (NRG - IH) owns 1,550 MW in New York City and 3,050 MW in Rest of State. We estimate the potential impact of the auction as a positive \$24 million in EBITDA to our current estimates. Our conversations with management indicate current 2006 guidance does

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not account for the high auction results. We have not adjusted our earnings estimates since June-October 2006 auctions remain pending (results are posted on the last work day of the second-to-last month prior to delivery date.)

Figure 1. NY Capacity Market Analysis

	In-City	Rest of State	Net impact
Per 2Q05 Presentation	1,550	3,050	
x 90% Availability	90%	90%	
x 90% Summer vs Nameplate	90%	90%	
x 90% Mitigating Auction rules	90%	90%	
= Unforced Capacity	1,130	2,223	
x Auction Results vs Expectations (\$113 - \$83 for NYC) and (\$13 - \$6 for ROS) /KW-yr	\$28.00	\$7.00	
= Unhedged Capacity Revenue Impact on EBITDA \$/millions	32	16	
x Estimated already contracted through bilateral agreements prior to May 2006 Auction	50%	50%	
= Hedged Capacity Revenues Impact on EBITDA \$/millions	16	8	24

Source: Citigroup

Other merchants with New York capacity exposure include Dynegy (DYN – 2H) and Mirant (MIR – 1H), with 2,750 megawatts and 1,677 megawatts, respectively, (all are in Rest of State) although we estimate their EBITDA impact to be minimal (low single-digits.)

CALIFORNIA DEBATES MULTIPLE POWER MARKET PROPOSALS

In March 2006 California hosted a Long Term Power Procurement workshop to discuss several options for creating long term power contracts. On 4/3/06 we met with CPUC Staff to understand where California currently stands in its capacity markets debate. Based on our review of submissions, whitepaper reviews and discussions with Staff, we hold the following views at this time:

- Staff and commissioners generally back capacity market development. The California August 2005 whitepaper on capacity markets, located at <http://www.cpuc.ca.gov/published/REPORT/48884.htm>, was favorable towards capacity markets development.
- There are several capacity markets and long term procurement options being debated. One proposal, known as the Consortium proposal, we see as the front runner. This proposal aims to establish a centralized entity for each major California subregion to act as a buyer for long term power contracts. The proposal does not include a formal capacity market, but does not preclude one. The Consortium proposal is at http://www.cpuc.ca.gov/Static/hottopics/1energy/jointproposalofsce_pge_nrg_aes_turn.ppt and a related powerpoint description is located at http://www.cpuc.ca.gov/Static/hottopics/1energy/3_14_2006workshoppresentation.ppt. The Consortium proposal includes Edison International (EIX – 2M), Pacific Gas & Electric (PCG – 1L), AES Corporation (AES – 1H), NRG Energy, and TURN (a consumer advocacy group). See our summary of proposals below at Figure 2.
- There appears to be no major political opposition yet to capacity markets, although this is likely because the issue has not popped up on political radars yet.
- California is generally aligning itself with the Regional Greenhouse Gas Initiative states in Northeast with regards to climate change. We expect SO₂, NO_x, mercury and carbon dioxide standards evolving in the Northeast will largely drive California policy.
- The California Public Utilities Commission and California Independent Systems Operator are monitoring what happens with the Reliability Pricing Model (RPM) and Locational Installed Capacity (LICAP) settlement. Possible LICAP/RPM approval could provide a regulatory tailwind for capacity markets traction in California. As we have

discussed in our 3/8/06 note *New England Settlement Awaiting FERC OK* <https://www.citigroupgeo.com/pdf/SBD81280.pdf>, FERC could approve the LICAP settlement by mid-year. We believe key beneficiaries of the agreement could include: International Power (IPR-1M) covered by Peter Atherton, FPL Group (FPL-1M), NRG Energy (NRG-1H), Dominion Resources (D-1M), and Mirant (MIR-1H).

- We continue to believe it is unlikely California will ultimately implement a fully centralized capacity market. California summer peak reserve margins in Southern California are currently estimated in the low double digits according to the California Energy Commission, suggesting that spiking power prices may only be two to three years away. If power prices begin to spike above already-high levels set by high natural gas prices, we believe an additional capacity market charge would be difficult to politically approve. Other capacity market proposals have historically taken 2-3 years to approve, suggesting California's current initial talks are too late for implementation. For investors, we believe actual California implementation of a capacity market would be an unexpected positive.

A timeline of events and weblinks leading up to the current California capacity markets discussion can be found at <http://www.cpuc.ca.gov/Static/hottopics/1energy/r0404003.htm>.

Proposals for Long Term Power Procurement can be found at http://www.cpuc.ca.gov/Static/hottopics/1energy/_march14_2006workshopmaterialr0602013.htm. We summarize key proposal differences and comments in the following table.

Figure 2. California Power Procurement Proposals' Key Points

Entity	Long Term Power Plan Proposal
SCE/ NRG/ PG&E/ TURN/ AES (The "Consortium")	<ul style="list-style-type: none"> • Essentially passthrough wholesale generation costs/profits to regulated customers. Wholesale profits determined by formula. • <i>Does not include, but does not preclude, a capacity market.</i> • Designate central entity per LSE region to procure resources. • Allocate <i>net costs</i> (defined as fixed and variable costs less market value of energy and ancillary services) via "12 monthly coincident peak method". • Defines market value of energy based on simple heat rate formula. • CPUC has authority to review allocation of costs.
PG&E	<ul style="list-style-type: none"> • Adds modifications to the joint proposal. • Designates the IOUs be the central entity to procure resources. • No distinction between contract and utility owned generation. • LSEs wanting to opt out must first demonstrate multi-year resource adequacy.
Sempra	<ul style="list-style-type: none"> • Implement a central capacity market. • Central capacity market, with two stage auctions, four years prior to compliance. • One year contracts, and ten year contracts for new build. • Capacity charges in auction paid for by higher transmission rates. • LSE procure own capacity and can bid this capacity into capacity markets, or could use central capacity market to pay for capacity. • CAISO procures any capacity shortfall, preventing load migration risk and preventing need to forecast demand by LSE.
Constellation	<ul style="list-style-type: none"> • Implement capacity market with five year interim contracts. • Current hybrid market structure favors regulated generation investment only. • Proposes five year terms for interim contracts. • Limit additional investment backed by regulatory guarantee.
Western Power Trading Forum	<ul style="list-style-type: none"> • Implement a capacity market. • Existing regulatory rules are sufficient to incite investment in California, with the exception of a capacity market.
Goldman Sachs	<ul style="list-style-type: none"> • Implement backstop capacity revenue/charge for fixed cost recovery, investing company takes risk of variable cost recovery and profits.
Calpine	<ul style="list-style-type: none"> • Do not exclude existing generation from participating in long term IOU resource solicitations.

Source: Citigroup

Companies mentioned in this report: AES Corporation (AES-\$16.43; 1H) Dominion (D-\$70.96; 1M), Dynegy Incorporated (DYN-\$4.83; 2S), Edison International (ELX-\$40.30; 2M), Gas & Electric (PCG-\$39.20; 1L) FPL Energy (FPL-\$40.12; 1M), Mirant Corporation (MIR-\$24.46; 1H), NRG Energy, Incorporated (NRG-\$47.82; 1H), International Power (IPR-\$50.56; 1M)

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APPENDIX A-1

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ATTACHMENT "C"

Craig K. Shere, CFA, CFP
212 408 5853
craig.shere@us.calyon.com

Lance Ettus, CFA
212 408 5830
lance.ettus@us.calyon.com

Price: \$35.89
12-Month Price Target: \$35.25
52 Week Range: \$41.03 – \$32.66
Shares Outstanding (Mil.): 174
Float (Mil.): 156
Est. 3-5 Year Ind. Growth Rate: 4%
Book Value (Mil.): \$4,388
Market Cap (Mil.): \$6,245
Long-term Debt (Mil.): \$3,915
Net Debt/Cap: 47.0%
Avg. Daily Vol (000s): 895
Ann. Div.: \$1.86
Yield: 5.2%
Balance Sheet Date: 09/30/2005
Cash (Mil.): \$84
Book Value/Share: \$25.04
Cash (Mil.): \$84

EPS Diluted	2004A	2005E	2006E	2007E
Q1	\$1.53A	\$1.49A	\$1.45	NE
Q2	\$0.27A	\$0.11A	\$0.15	NE
Q3	\$0.01A	\$0.13A	\$0.20	NE
Q4	\$0.85A	\$0.64	\$0.70	NE
FY	\$2.66A	\$2.37	\$2.50	\$2.50
P/E	13.5x	15.1x	14.4x	14.4x

Quarters may not total due to rounding. NA-Note Available.



KeySpan Corporation

KSE - NYSE

KSE: Correction Regarding Derivative Contract Terms

NEUTRAL

Industry Update

- Our note yesterday highlighting KSE's new, speculative derivative NYC capacity contract with Morgan Stanley inadvertently reversed the contract terms. A corrected note with the changes italicized is below. We reiterate all comments, however, regarding the contract being an unnecessary, speculative increase in KSE's exposure to the NYC variable capacity markets.
- KeySpan filed an 8K stating it had entered into a three-year NY ISO derivative capacity contract. The fixed-for-floating swap agreement for 1.8 million KW requires Keyspan to make monthly payments to Morgan Stanley in an amount equal to the degree that a \$7.57/KW-month fixed capacity price exceeds the monthly unforced NYISO capacity price (Morgan Stanley pays KSE when floating exceeds fixed). In 2004, KSE's average capacity payments from its 2,450 MW NYC Ravenswood plant were \$8.17 per KW-month.
- We view the derivative agreement as a speculative investment. The swap effectively makes KSE long another 1,800 MW in the NY ISO capacity markets. While KSE may be correct that variable NYC generation capacity prices will remain high, we are dubious about the benefits of this tangential move into speculative financial contracts. Management may have felt more comfortable entering into this agreement because of the recent success the company had locking in very profitable hedges for the company's Ravenswood plant, in our opinion.
- We note the stark contrast between market forecasts underlying this derivative investment and Reliant Energy's decision to sell its 2,100 MW of NYC generation in October 2005. If KSE is correct in its analysis, the RRI October 2005 plant sale announcement will turn out to have been at an excessively cheap valuation.
- The contract exposes KSE to roughly a \$0.04 increase / decrease in cash EPS for every \$0.50 increase / decrease in monthly NY ISO capacity prices. It is possible that the contract may be accounted for on a mark-to-market basis for GAAP EPS. KSE should benefit (within limits) from forced outages that may occur in NY city power generation.
- Management reiterated 2006 EPS guidance of \$2.40 to \$2.50.

See important disclosures on pages 2 - 3 of this report.

January 26, 2006

IMPORTANT DISCLOSURES

Analyst Certification

I, Craig Shere, CFA, CFP, hereby certify that the views expressed in this research report accurately reflect my own personal views about the securities and/or the issuers and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report.

Coverage of KeySpan Corporation was transferred to Craig Shere on October 12, 2004. Effective April 22, 2003, Calyon Securities (USA) Inc. changed the Hold rating to Neutral.

Calyon Securities (USA) Inc. receives or has received compensation from KeySpan Corporation for non-investment banking services (i.e., brokerage services) in the past 12 months.



Valuation Methodology

14.1x 2007E EPS.

Risk to Target

Rising interest rates, cost-effective risk management to hedge primary markets of New York, Long Island and New England.

RATING RECOMMENDATIONS (based on anticipated returns over a 12-month period): BUY, above 20%; ADD, 10%-20%; NEUTRAL, +/-10%; REDUCE, negative return, but by less than 20%; SELL, negative return of more than 20%. **OVERALL RATING DISTRIBUTION** for Calyon Securities (USA) Inc., Equity Universe: BUY - 51.3%, HOLD - 41.0%, SELL - 6.8%, Restricted - 0.9%. Data as of September 30, 2005. **INVESTMENT BANKING CLIENTS** as a % of rating category: BUY - 18.3%, HOLD - 16.7%, SELL - 12.5%, Restricted - 100%. Data for 12-month period ending December 30, 2005. **FOR A HISTORY** of the recommendations and price targets for companies mentioned in this report, please write to: Calyon Securities (USA) Inc., Compliance Department, 1301 Avenue of the Americas, 15th Floor, New York, New York 10019-6022.

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