Before the Board of Directors
The New York Independent System Operator

MOTION OF NEW YORK POWER AUTHORITY IN OPPOSITION TO APPEAL BY KEYSPAN-RAVENSWOOD, LLC et. al.

INTRODUCTION

The New York Power Authority ("NYPA") hereby files 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 September 29, 2006 decisions (motions 4, 6 and 7), which approved a market mitigation proposal for the In-City capacity market ("Mitigation Measures").

The Management Committee approved the Mitigation Measures in order to moderate the impact of economic withholding in the In-City capacity market. Appellants' appeals should be rejected for the following reasons. First, the In-City capacity market was not functioning in a manner consistent with economic principles, absent market manipulation. Second, the Capacity Mitigation Measures represent a reasonable response to a demonstrated problem. Third, Appellants' allegations regarding monopsony power are unsupported by the facts or the law.

For these reasons, the Board should reject the appeals and file the Capacity Mitigation Measures with FERC under Section 205 of the Federal Power Act.

ARGUMENT

I. The Capacity Market for NYC Was Not Functioning Properly

When this ISO implemented the demand curve model for the capacity market in New York, it was based on the primary economic theory that the price of a product should decrease as the supply of that product increases and vice versa. FERC approved this market design change in 2003[1] based on that theory. The demand curve was designed in the expectation that as capacity is added to the NYISO's market, the price for capacity would decrease and likewise, when there is a deficiency of capacity or an increase in load, the price for capacity should increase.

During the past year approximately 1,100 MW of new capacity was added, yet the market price of capacity did not significantly decrease. As summer 2006 approached, the NYISO was for the first time presented with substantial excess capacity in NYC and thus also had the first opportunity to observe the functioning of the demand curve in that market. Logically, the clearing price should have declined, and the fact that it did not indicates the likelihood that market power has distorted the basic operation of the NYC ICAP market.

It appears that this lack of a price response to an increase in supply was caused by economic withholding. The NYISO Services Tariff, Attachment H, Section 2.4 defines economic withholding in the energy 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."

In the capacity market, the yearly price cap has been translated into individual monthly caps for each of the three Divested Generation Owners ("DGO"). Based on the slope of the demand curve, it appears that the party 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

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

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. But, the amount that does clear will result in greater revenues to that DGO when compared to revenues it would have received at a lower demand curve clearing price where all of its capacity would clear the auction. Thus, this party has the ability to control the demand curve clearing price.

It also appears that each of the DGOs independently can be a pivotal supplier. 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, and further impacting the amount of capacity in the NYCA statewide demand curve spot auction. If the highest monthly cap supplier were to bid as a price taker, the supplier with the next highest cap would be in a position to exert market power by bidding all its capacity at its cap. A majority of the Management Committee has concluded that this has occurred.

II. The Mitigation Measures Approved by the Management Committee Effectively Resolve the Problem

A. Action is Required

The NYISO always has an obligation to seek out and mitigate any efforts at market manipulation by any segment of the market. Specifically, with respect to the capacity and economic withholding, the NYISO Market Services Tariff, Attachment H, Section 4.5. makes this clear, stating that " … 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 the Market Parties and other interested parties, shall … implement appropriate mitigation measures for installed capability markets."

The Management Committee called for the implementation of such appropriate measures by a 69.54% affirmative vote. The NYISO Board should similarly act to amend this tariff and implement the approved mitigation measures.

B. The Mitigation Measures Solve The Demonstrated Problem

The Mitigation Measures create an assessment process 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 mechanism of competitive markets. If the bid of a DGO is determined to be an exercise of market power then its bid will be mitigated to the reference price. This prevents 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, as is true today.

C. The Impact on Future Price Signals

Appellants argue that the proposal will reduce market prices at a time when the NYISO's Comprehensive Reliability Plan ("CRP') is calling for more generation[2]. This argument does not withstand scrutiny. First, the current demand curve spot markets are intended to reflect available supply in the current month – not expected available supply in some future period. Secondly, while the data shows that currently there is significant excess in-City capacity supply and that that excess will be eliminated in the future, the 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

[2] NRG, pp. 4-5.

five or more years in the future.

The design of the demand curve was to give an implicit, not an explicit signal regarding future capacity needs. Market participants know that the demand curve exists, how it is developed, and that the curve changes each year. Based on these expected demand curve changes, as well as increases is demand for electricity 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 Management Committee proposal changes this dynamic. Market participants do not need to see the Cost of New Entry ("CONE") achieved today; rather, they need an appropriate pricelevel over a substantial time period. Moreover, why should the Appellants be paid at a CONE rate when they are not entrants in the market?

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

D. The Management Committee Proposal Is Intended To Allow the Demand Curve to Function Properly

The Mitigation Measures approved by the Management Committee are intended to allow the price of capacity to move with the quantity of available supply. Their purpose is not to lower prices but to allow the current demand curve to function as intended, that is, the Mitigation Measures are intended to allow the capacity market to work according to the fundamental economic principle of supply and demand.

E. Appellants' Call For Protracted Study 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.[3] The NYISO conducted all such analyses when it adopted the demand curve. Nothing has changed since then in terms of the applicability of the market design. At that time, parties accepted that price should vary with supply. That should be true today.

III. Appellants Assertions With Respect to Monopsony Power Are Misguided

Appellants argue that the alleged market power of purchasers is not similarly mitigated, pointing specifically to Con Edison's contract with SCS Astoria but also containing veiled references to NYPA as another example of potential monopsony power. The capacity market, as designed by the NYISO and approved by the FERC, permits self-supply. New capacity that is used for self-supply competes with existing capacity. Its existence should lower market prices – this is a basic principle of supply and demand.

A. Appellants' Assertions Are Factually Deficient

The NYISO capacity market allows load-serving entities ("LSEs") to enter into bilateral contracts for the purchase of capacity. 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.

Consistent with the requirements of the NYISO Services Tariff, bilateral contracts

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

are not bid into the ICAP auction. Specifically, Section 5.11.2 of the NYISO Services Tariff requires that an LSE "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.

B. Appellants' Monopsony Power Assertions Are Unsupported

Obviously, while NYPA has a significant number of customers in New York City, it is not the only – or the largest -- buyer of capacity in the In-City market. Second, NYPA's decisions on bilateral contracts for capacity are based upon its projection of the amount of capacity necessary to meet the expected minimum required for reliability over the long term. It is well known that NYPA is competitively soliciting such capacity and in the recently released CRP, the NYISO noted that the success of market solutions was likely dependent upon the suppliers' ability to enter into bilateral contracts.

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

CONCLUSION

Accordingly, for the reasons set forth above, NYPA respectfully requests that the Board reject Appellants' appeals and affirm the Management Committee's decision to approve the Capacity Mitigation Measures; and file the Capacity Mitigation Measures as adopted with FERC pursuant to Section 205 of the FPA.

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Respectfully submitted,

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