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June 26, 2000

**Via Hand Delivery**

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

Re: Motion in Support of Appeal

Dear Chairman Grossi:

Pursuant to the "Procedural Rules for Appeals to the ISO Board," please find enclosed three copies of a Motion in Support of Appeal filed on behalf of Aquila Energy Marketing Corp., Morgan Stanley Capital Group Inc., Constellation Power Source and Strategic Energy, LLC. We have e-mailed a copy of the Motion in Support of Appeal to Jonathan Mayo of the ISO staff and requested that he serve it on each member of the Management Committee by e-mail today.

Very truly yours,

Peter W. Brown, Esq.

Enclosures

cc: Jonathan Mayo (via e-mail)
Ira L. Freilicher, Esquire (via e-mail)

MOTION IN SUPPORT OF APPEAL

Aquila Energy Marketing Corp. ("Aquila"), Morgan Stanley Capital Group Inc. ("MSCGI"), Constellation Power Source and Strategic Energy LLC as members of the New York Independent System Operator ("NYISO") Management Committee (collectively, the "Supporting Members"), hereby move to support the appeal filed on behalf of Citizens Power Sales, East Coast Power, LLC, Indeck Energy Services, Inc., KeySpan Ravenswood, Inc., Natural Resources Defense Council, PG&E National Energy Group and Sithe Energies, Inc. (collectively, the "Appellants") with respect to the June 5, 2000 decision of the Management Committee to request that the NYISO seek authority from the Federal Energy Regulatory Commission ("FERC") to impose bid caps on the energy and ancillary services markets until October 31, 2000. Furthermore, the Supporting Members hereby provide additional arguments for denying the Management Committee's request for bid caps.

I. BASIS OF APPEAL

The Appellants have requested that the NYISO deny the Management Committee's request because the proposed bid caps would harm the nascent competitive electricity markets in New York and would actually reduce system reliability by exacerbating supply shortages during the peak summer period. The Appellants correctly note that the NYISO itself has argued in a recent filing with FERC that bid caps are unnecessary because (1) any market flaws that might cause excessive energy prices will be corrected for the summer capability period and (2) the NYISO has sufficient means to take corrective action if market flaws arise or if market power is exercised. The Appellants also have requested that, if the NYISO grants the Management Committee's request, the NYISO not make the proposed bid caps effective unless and until the FERC approves such caps so as not to further compromise the integrity of the New York wholesale power markets during the critical summer season.

In addition, as noted in the appeal filed by Hydro Quebec Energy Services (U.S.), Inc. ("HQUS"), the proposed bid caps could cause significant financial harm to purchasers of Transmission Congestion Contracts ("TCCs"). The Supporting Members, like HQUS, participated in the recent

TCC auction and purchased TCCs. At the time of the TCC auction, the Supporting Members and other purchasers relied on the tariffs which had been filed by the NYISO with the FERC. There were no bid caps at this time, nor had any bid caps been proposed to the Management Committee. As a result, buyers of TCCs valued the contracts based on a market without bid caps. In general, the value of a TCC is based on the projected difference between the energy prices at the point of injection and the point of withdrawal specified in the TCC. The presence or absence of a bid cap is essential to the proper valuation of a TCC, because a bid cap caps the spread between the relevant energy prices, and thus limits the value of the TCC. Had bid caps been in effect at the time of the TCC auction, prices almost certainly would have been lower. Imposing bid caps at this time would significantly compromise the value of the TCCs purchased in the auction, and would chill the market in any future TCC auctions. Thus, the imposition of bid caps would seriously undermine the already difficult process of ensuring that the market has an opportunity to assign appropriate values to TCCs.

Beyond the special problems posed by imposing bid caps now after the close of the TCC auctions, there is the obvious problem of frustrating the reasonable expectations of market participants in New York who have taken forward positions in the absence of bid caps. The value of these forward positions will change materially if bid caps are imposed.

*Additional Considerations*

While the Supporting Members oppose any bid caps, the caps imposed by the California Independent System Operator ("CA ISO") and PJM Interconnection L.L.C. ("PJM") are fundamentally different than those proposed by the NYISO. The CA ISO and PJM price caps were instituted either simultaneously with,[1] or prior to the creation of, TCCs.[2] Thus, participants in the CA

[1] In the case of PJM, price caps are built directly into the market structure by being explicitly addressed in detail in the market rules that each participant signs and acknowledges when joining. See Schedule 1 to PJM Operating Agreement.

[2] In the case of CA ISO, FERC, after the California market's inception, had to order the ISO to submit a plan for, and create a TCC instrument in compliance with Order No. 888. *Pacific Gas & Electric Company et al.*, 81 F.E.R.C. ¶ 61,122 at 61,209, 61,210. FERC's original order required that the TCC instrument be sold by January 1, 1999, a date well after FERC's July 17, 1998 approval of the institution by

ISO and PJM markets were able to consider the effect of the bid caps in devising their initial market strategies and purchasing TCCs. On the other hand, the Management Committee's present proposal would unfairly amend the NYISO's rules midstream, after market participants have invested substantial amounts of time and money in taking positions to hedge risks over the summer months and in TCCs in reliance on the premise that they would be participating in an open and competitive market without artificial restrictions.

## II. SUPPORTING MEMBERS' POSITION

Like the Appellants, the Supporting Members believe that competitive markets must be allowed the opportunity to function free of arbitrary bid or price caps. Only in free and liquid markets will valid price signals be given to producers and consumers of electric power. Price signals will promote the proper level of future investment in the system, whether such investment takes the form of generator construction, transmission expansion or demand side management and conservation. The Supporting Members believe that artificial price limits implemented largely to appease the short-term political and financial interests of certain stakeholders likely will result in market distortions and decreased liquidity, to the detriment of the long-term goal of developing efficient and sustainable competitive wholesale power markets in New York.

Based on the foregoing, the Supporting Members confirm their support of the appeal filed by the Appellants and urge the NYISO Board to deny the Management Committee's request that the NYISO seek authority from FERC to impose bid caps on the energy and ancillary services markets in New York.

Respectfully submitted,

AQUILA ENERGY MARKETING CORP.
CONSTELLATION POWER SOURCE

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CA ISO of price caps. *AES Redondo Beach, L.L.C., et al.,* 84 F.E.R.C. ¶ 61,046. Note that CA ISO's price caps affect only the ancillary services markets (the only markets operated by CA ISO).

STRATEGIC ENERGY LLC

By their attorneys,

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By: ____________________________

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By its attorneys,

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Dated: June 26, 2000