NOTICE OF APPEAL

The following members of the New York Independent System Operator ("NYISO") Management Committee hereby appeal the Management Committee's June 5, 2000 decision 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: 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").

The Appellants respectfully request that the NYISO deny the Management Committee's request because the proposed bid caps will harm the nascent competitive electricity market in New York and will actually reduce system reliability by exacerbating supply shortages during the critical summer period. As the NYISO demonstrated to FERC three weeks ago in its Answer opposing New York State Electric & Gas Corporation's ("NYSEG") complaint requesting cost-based bidding or price caps on the energy markets this summer,[1] bid caps are unnecessary because any market flaws that might possibly cause excessive energy prices will be corrected for the summer capability period. In addition, the NYISO made clear in its Answer that it has sufficient means to take corrective action if market flaws arise or market power is exercised. If the NYISO grants the Management Committee's request, the Appellants request that the NYISO not make the bid caps effective unless and until the FERC approves the bid caps.

---

[1] *New York State Electric & Gas Corporation v. New York Independent System Operator Inc. et al.,* Docket No. EL00-70-000 et al., *NYISO's Answer to Complaint of New York State Electric & Gas Corporation to Suspend Market Based Rates for Energy Markets and Request for Emergency Technical Conference, as Amended, and Answer to Strategic Power Management's Supplement to Complaint Requesting Fast-Track Processing and Motion to Consolidate* (corrected version filed May 31, 2000) ("NYISO Answer").

I. THE BID CAP PROPOSAL

The bid cap proposal, as approved by the Management Committee,[2] would require that generator bids in the Day-Ahead and Real-Time energy markets be capped at $1,000 per MW/hr. Combined payments for availability and lost opportunity costs for 10-Minute and 30-Minute Reserves would also be capped at $1,000 per MW/hr. Combined payments for availability and lost opportunity costs for regulation service would be capped at $1,100 per MW/hr. In addition, the proposal provides that Bid Production Cost Guarantees ("BPCGs") will be suspended for a supplier that bids minimum generation levels, start-up costs, or minimum run times when the LBMP at the supplier's bus averages $200 per MW/hr or more per day. The total payments including BPCGs may not exceed $24,000/MW per day.

The bid cap proposal provides that internal and external bids are subject to the caps but that Emergency External Purchases are not subject to the caps. Payments for Emergency External Purchases will not set market clearing prices, however. Finally, suppliers of installed capacity to New York that are not selected in the Day-Ahead market can make non-firm energy sales but will be subject to the NYISO's recall at capped recall bids.

II. ARGUMENT

A. THE NYISO MUST DENY THE MANAGEMENT COMMITTEE'S REQUEST TO IMPOSE BID CAPS BECAUSE THE NYISO HAS ALREADY DETERMINED, AND ARGUED TO FERC, THAT THERE IS NO JUSTIFICATION TO IMPOSE ARTIFICIAL RESTRAINTS ON PRICES THIS SUMMER.

The NYISO need look no further than its Answer to NYSEG's Complaint for the reasons why it must deny the Management Committee's request to impose bid caps. The NYISO must necessarily

[2] The bid cap proposal was approved by 63 percent of the vote on the Management Committee. Each of the Appellants voted in opposition to the bid cap proposal.

disavow the statements it made to FERC three weeks ago in its Answer if it chooses to support bid caps at FERC now. At best, it would be contradictory for the NYISO to strongly oppose artificial restraints on prices one week and support them the following week when the only thing that has changed is the number of market participants calling for the restraints. Appellants urge the NYISO to proceed cautiously in considering the Management Committee's request, especially when at least one of FERC's commissioners has already questioned the ability of the NYISO to effectively administer competitive markets while considering a prior request for caps.[3]

In its Answer, the NYISO stated that NYSEG's complaint "does not provide evidence of market power or insurmountable market flaws sufficient to warrant interference with market forces, or the suppression of the price information they produce, in all of the NYISO-administered markets." NYISO Answer at 10. The NYISO provided in exhaustive detail why market flaws and market power concerns are not likely to cause high prices this summer. The NYISO stated that it "anticipates that all of the market flaws it identifies will be addressed in time to avoid serious problems this summer . . ." and that it is "confident that it will continue to fulfill its responsibility to administer efficient competitive markets that operate in accordance with the NYISO's tariffs and market design this summer." *Id*. at 9. The NYISO further stated that it "is committed to market-based pricing" but that "bid caps may be warranted . . . if the NYISO were to determine, *based on actual evidence* from its summer operations, that one of the markets it administers had failed, or been distorted by market power." *Id*. at 11 (emphasis added). The NYISO distinguished NYSEG's complaint from the NYISO's own filing in Docket No. ER00-1969-000, "where the NYISO took narrowly-tailored action in response to a specific, substantiated market power problem" in the operating reserves markets. *Id*. at 19. The NYISO stated that it "reserves the right to take similar *limited* actions, *but only if, and to the extent that, they are truly necessary* this summer." *Id*. (emphasis added).

[3] See *New York Independent System Operator, Inc, et al*., 91 FERC ¶ 61,218 (May 31, 2000) (Commissioner Hebert concurring).

Based on this standard, the NYISO must reject the Management Committee's request for bid caps because the Management Committee made no finding whatsoever of market failure or market power abuses in the energy or ancillary services market. Nor can the NYISO demonstrate any evidence of market failure or market power abuses in the markets, other than the 10-Minute non-spinning reserves market, upon which FERC has already approved bid caps.[4] Only two weeks ago, FERC rejected the NYISO's request for a bid cap on the 10-Minute spinning reserves market because the NYISO failed to provide sufficient evidence of market power abuses to support the cap.[5] Appellants question how the NYISO could request in good faith that FERC authorize it to impose a $1,000 bid cap on the 10-Minute spinning reserves market, or even the energy market, when the NYISO cannot demonstrate any new evidence of market power abuses in the markets.

It is clear that the Management Committee's decision to support the imposition of price caps was not driven by the need to protect consumers from high prices caused solely by market flaws or the exercise of market power. The Management Committee's decision was rather motivated by the threat that supply shortages in New York and the Northeast would cause high prices. It is a natural impulse to oppose high prices and it should not be surprising that consumer interests on the Management Committee supported bid caps in an effort to restrain high prices that are likely to occur because of supply shortages in New York this summer.

However tempting, the NYISO must not surrender to the intense political pressure to artificially restrain prices. In its Answer to NYSEG's Complaint, the NYISO made clear that high prices are a natural occurrence of competitive markets and do not justify the imposition of restraints on prices. In an affidavit submitted to FERC in support of the NYISO's Answer, Harvard Professor William W. Hogan recognized that:

> not everything about open markets is appealing to all the market participants. Prices can be high when supplies are scarce. There can

[4] 91 FERC ¶ 61,218, slip op at. 14

[5] 91 FERC ¶ 61,218, slip op at. 17.

> be substantial price volatility. Market participants can choose to pay for price certainty or live with the price volatility of the spot market. Some will profit from their decisions while others will regret their choices. *But these features are not evidence of market failure. These features are evidence of the intended discipline of the market and the consequence of the introduction of choice and reliance on market forces.* NYISO Answer, Affidavit of William Hogan ¶ 5 (emphasis added).

The NYISO stated that because of the heightened summer demand for energy in New York in conjunction with the delays in constructing new generation, "the interplay of supply and demand may well drive prices up." *Id*. at 10. The NYISO properly recognized that "higher prices, however, provide the proper price signals for new generation." *Id*. The NYISO further stated that it "does not believe that these price increases will threaten reliability in New York State." *Id*. Because the NYISO has already determined that there is no evidence of market flaws or market power abuses in the competitive markets and that high prices are not evidence of a market flaw, the NYISO has no basis to seek FERC authority to impose bid caps for this summer.

B. BID CAPS WILL CAUSE SIGNIFICANT HARM TO THE DEVELOPING MARKETS AND MAY ACTUALLY IMPAIR SYSTEM RELIABILITY.

The Management Committee's request to impose bid caps is a major step backwards from the NYISO's goal of introducing meaningful competition. If granted, the Management Committee's request will improve load serving entities' short term profits, while penalizing generators who reasonably expect to benefit from higher energy prices during the peak, summer season. Before the NYISO takes the drastic step of seeking authority from FERC to impose bid caps on the energy and ancillary services markets this summer, the NYISO must consider the adverse impact bid caps will have on the competitive markets in New York. During times of supply shortages, the NYISO should do everything possible to encourage generators to sell energy into New York. The bid cap proposal will in fact discourage generators from selling into the New York, increasing the risk that system reliability problems will occur this summer.

FERC's distaste for price restraints has been made evident in its recent orders with respect to other ISOs. For example, in ruling on price caps in the New England ISO, former Commissioner Bailey stated that:

> price caps on otherwise competitively-determined rates are not merely safety nets or circuit breakers, acting merely to ensure that competitive markets act as they theoretically should. To the contrary, I believe that, in general, price caps have the effect of actually undermining the operation of competitive markets, by deterring entry or inhibiting capital investments. *ISO New England, Inc*., 89 FERC ¶ 61,209 (1999).

If the NYISO's goal of encouraging the growth of competitive markets is to succeed, it must allow the natural interplay of supply and demand to determine prices without imposing artificial restraints. Bid caps will send all the wrong price signals to generators, discourage demand response and stifle innovative technology solutions. It is more than likely that New York State will be in a tight capacity situation during peak summer hours. If that circumstance develops, the bid cap proposal would (1) encourage those New York generators who have not committed to sell installed capacity to bid out-of-state, where prices will be higher and (2) discourage out-of-state generators from bidding into the New York Control Area. In addition, the Management Committee's proposal will unfairly penalize the majority of consumers that have hedged themselves against higher prices this summer. The proposal that Emergency External Purchases will not set market clearing prices will require that the costs of these purchases will be shifted from the consumers who have failed to secure adequate supply in advance to all consumers through the NYISO's general uplift charge.

While the Management Committee's $1,000 MW/hr bid cap proposal is at the same level as the bid cap on energy in PJM, generators will prefer to sell into PJM, or NEPOOL, which has no cap, because they are more likely to receive the stated energy prices than if they sold in New York. The NYISO, unlike PJM, has a reputation of reserving and reducing seemingly high prices, causing generators uncertainty over whether they will actually be paid the posted price at the time the energy was delivered to the New York market. The result will be a decrease in available resources to meet the State's peak load requirements. The longer term results, if the bid cap proposal is adopted, will be even worse. Correct price signals – negated by the bid cap proposal – will encourage the development of new generation and assure that generators are fully ready to operate at peak times. In a freely competitive market, generators will do everything possible to assure their plants are available during peak hours. Maintenance will be scheduled off-peak and all other measures will be taken to assure availability. The bid cap proposal may eliminate or at least severely blunt these incentives.

Equally disturbing is the impact on existing and proposed new generation. Suppliers of capacity and energy rely on accurate price signals in determining when, or whether, to operate and to finance and develop new generation projects. If the NYISO is allowed to interfere with market-determined prices by imposing bid caps, prices will be distorted and development of new generation will be chilled. The New York generation market is operating close to the edge of its reserve requirement and it is essential that proper price signals encourage the development of needed generation. Suppliers face uncertain risk because once bid caps are imposed, there is no guarantee that the caps will not be extended, or even tightened, in the future or applied more broadly to other aspects of the market. The solution to reducing high prices in the market is to encourage greater numbers of suppliers to enter the market, not to impose artificial restraints on prices that will drive away beneficial competition.

Generators are limited largely to two markets to recover their costs, the energy market and the capacity market. Two months ago, many generators committed to sell installed capacity ("ICAP") in the first ICAP auction. These generators, as ICAP providers, will be unfairly hampered from selling electricity outside of New York because they will be subject to the NYISO's recall at capped recall bids. Had generators known that the prices within New York would be limited during the peak summer period, their bids in the ICAP auction either would have been much greater or they would have been unwilling to commit to sell ICAP in New York. Now that generators have entered into ICAP obligations with the attendant obligation to serve New York the imposition of the bid caps will deprive them of some of the profits they expected during the peak summer season. Generators are not deep pockets willing to operate in a regime where they cannot recoup their costs. Therefore, the NYISO should reject the Management Committee's request to impose bid caps on the energy and ancillary services markets.

C. THE PROPOSED BID CAPS ARE UNNECESSARY BECAUSE THE NYISO HAS THE MEANS TO TAKE OTHER, MORE NARROWLY TAILORED, MEASURES THAT ARE LESS DAMAGING TO THE COMPETITIVE MARKET AND THAT ARE ADEQUATE TO REMEDY ANY MARKET FLAWS OR MARKET POWER ABUSES IN THE MARKET.

In its Answer to NYSEG's Complaint, the NYISO demonstrated its confidence that it has ample authority to take quick action to deal with whatever problems might arise this summer. NYISO Answer at 54. The NYISO explained that if exigent circumstances arise in the NYISO administered market, it can file proposed amendments to the ISO Tariffs or the ISO Agreements pursuant to Section 205 of the Federal Power Act. "Clearly, the NYISO could use this authority to file amendments, for immediate implementation, if problems in a specific market and/or geographic area required it." NYISO Answer at 55.

The NYISO also maintained that it was well equipped to address market power problems pursuant to its recently approved market power mitigation plan. The NYISO quoted FERC's order approving the mitigation plan which stated that the mitigation measures 'will help to remedy market power quickly and deter participants from exercising market power.' *Id*. (quoting *New York Independent System Operator, Inc., et al*., 90 FERC ¶ 61,317 (2000), slip op. at 4).

Finally, the NYISO noted that it will have authority to correct erroneously calculated prices and take other remedial action to correct market flaws pursuant to its Temporary Extraordinary Procedures ("TEP"). The NYISO filed a request at FERC, on May 26, 2000, in Docket No. ER00-2624-000, for an extension of its TEP authority and there is no reason to believe that FERC will not grant the extension. Thus, with the confidence the NYISO has in its ability to address market flaws and market power problems this summer, there is absolutely no reason why it should need to request authority to impose bid caps on the energy and ancillary services markets. The NYISO should not take any action to impose restraints on prices unless and until it finds clear evidence that market flaws or market power abuses are causing excessive prices.

D. IF THE NYISO GRANTS THE MANAGEMENT COMMITTEE'S REQUEST TO SEEK AUTHORITY FROM FERC TO IMPOSE BID CAPS, THE NYISO SHOULD NOT MAKE THE BID CAPS EFFECTIVE UNLESS AND UNTIL FERC APPROVES THE BID CAPS.

If the NYISO imposes the bid caps before FERC considers them, and FERC rejects or requires higher bid cap levels, suppliers will be unfairly prejudiced because they will have no available remedy to recover revenues lost due to the $1,000 bid caps. It will be impossible to recreate bid and market prices that would have existed had there been no bid caps. Further, the NYISO cannot impose the bid caps until at least July 5, 2000, 30 days after the Management Committee approved the bid caps and well after the peak season has begun. Section 7.11(f) of the ISO Agreement provides that "[a]ny action taken by the [Management] Committee at any meeting shall not become effective until 30 days after the Committee has acted."

<u>CONCLUSION</u>

In light of the foregoing, Appellants respectfully request that the NYISO deny the Management Committee's request that the NYISO seek authority from FERC to impose bid caps on the energy and ancillary services markets.

Respectfully submitted,

Citizens Power Sales
160 Federal Street
Boston, MA 02110
617-912-6000 (phone)
617-912-5701 (fax)

By: Alan Foster

East Coast Power, LLC
1095 Cranbury-S. River Road Suite 10
Jamesburg, NJ 08831
609-409-9403 (phone)
609-409-9404 (fax)

By: Gary S. Keevill, Vice President

Indeck Energy Services, Inc.
600 N. Buffalo Grove Road
Suite 300
Buffalo Grove, IL 60089
847-520-3212 (phone)
847-520-3235 (fax)

By: Thomas M. Campone, President

KeySpan Ravenswood, Inc.
38-54 Vernon Blvd.
Long Island City, NY 11101
516-545-5598 (phone)
516-545-5210 (fax)

By: James K. Brennan, General Manager

Natural Resources Defense Council
40 W. 20th St. 11th Floor
New York, NY 10011
212-727-4462 (phone)
212-727-1773 (fax)

By: Ashok Gupta, Senior Energy Economist

PG&E National Energy Group
7500 Old Georgetown Road
Suite 1300
Bethesda, MD 20814
301-280-6615 (phone)
301-280-6601 (fax)

By: Sarah M. Barpoulis,
Senior Vice President, Trading

Sithe Energies, Inc.
335 Madison Avenue
New York, NY 10017
212-351-0266 (phone)
212-351-0800 (fax)

By: Scott A. Weiner,
Senior Vice President, Market Structure,
Legislative and Regulatory Affairs

* The Appellants' original signatures are only attached to the Notice of Appeal filed with President William J. Museler.

Dated: June 15, 2000