STATE OF NEW YORK
EXECUTIVE DEPARTMENT
STATE CONSUMER PROTECTION BOARD

George E. Pataki
Governor

Debra Martinez
Chairwoman and Executive Director

June 26, 2000

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 Carmam Road
Schenectady, NY 12303

Re: Motion in Opposition to Notices of Appeal to the NYISO Board of Directors Regarding the Management Committee's June 5, 2000 Decision to Impose Bid Caps in NYISO Administered Markets.

Dear Chairman Grossi:

In accordance with the Procedural Rules for Appeals to the ISO Board, the New York State Consumer Protection Board ("CPB") respectfully submits this Motion in Opposition to the Notices of Appeal of a June 5, 2000 decision by the New York Independent System Operator's ("NYISO's") Management Committee. We respond to the three appeals that have been noticed to date regarding the Management Committee's decision to impose bid caps of $1,000 per megawatt hour ("MWh") on energy and

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ancillary markets -- those filed by: 1) Hydro Quebec Energy Services (U.S.) Inc.; 2) Citizen Power Sales et al.;[1] and 3) Orion Power New York ("Appellants").

Summary

The CPB requests that the NYISO Board of Directors deny the Notices of Appeal and approve the Management Committee's June 5, 2000 decision to impose bid caps for the New York market. The CPB sponsored the motion to impose temporary bid caps as a measure to reduce uncertainty, foster consumer confidence and avoid the potential of unwarranted price increases this summer.

The arguments raised by the Appellants are not new and were thoroughly discussed by the Management Committee. A special working group was established at the May 24, 2000 Management Committee meeting where the bid cap proposal was first raised, to address the concerns of the opponents regarding bid caps. This "Bid Cap Working Group" met on two occasions and discussed fully all issues raised by the Appellants.

Subsequently, the NYISO's Management Committee discussed the bid cap issues at length. The bid cap motion approved by the Management Committee on June 5, 2000 reflected several of the suggestions made by opponents of bid caps. The motion received overwhelming support from three sectors, including support from all sectors, and was approved by 63.15% of the Management Committee. Overall, all parties were given an opportunity to fully express their views on the bid cap issues through a process that fully

[1] Citizen Power Sales was joined by East Coast Power, LLC, Indeck Energy Services, Inc., KeySpan Ravenswood, Inc., Natural Resources Defense Council, PG&E National Energy Group and Sithe Energies, Inc.

complied with procedures established by market participants and approved by the Federal Energy Regulatory Commission ("FERC"). The outcome of that process should not be set aside in favor of contentions that have been fully debated and rejected.

The CPB recommends that the NYISO establish a temporary cap on energy bids similar to the one approved for the Pennsylvania, New Jersey and Maryland ("PJM") ISO. We regard the imposition of a price cap as a short-term measure to allow time for reducing uncertainty, fostering consumer confidence, and avoiding the potential of unwarranted price increases this summer. The NYISO started operations on November 18, 1999, and is still going through a period of transition evidenced by the number and type of problems it is encountering. The CPB continues to support restructuring of the electric utility industry and the move to competition since competitive markets deliver lower rates and better service to customers. High rates, however, are not necessarily the result of a well-functioning market and would diminish confidence in a competitive market.

The CPB believes that a bid cap of $1,000 per MWh is well above the cost of generation and should not disrupt the normal working of the competitive market. This approach will serve as a "safety net" if prices increase substantially as a result of market power, market design, or implementation flaws. Such action is required to avoid extraordinary price increases, such as those that occurred in the 10-minute spinning reserve market where the value of transactions increased from $6.5 million in December 1999 to $75.0 million in February 2000.[2] An increase of that magnitude in the energy

[2] Request of New York Independent System Operator, Inc. for Suspension of Market-Based Pricing for 10-Minute Reserves and to Shorten Notice Period, March 27, 2000, at 8.

market, even for a very short period, would have a substantial negative impact on consumers.

Argument

Each point raised by Appellants has been addressed by the Bid Cap Working Group and/or the Management Committee. Therefore, the CPB does not respond to each claim made by the Appellants.

I. THE APPELLANTS' CLAIM THAT BID CAPS WOULD HARM COMPETITION AND MAY IMPAIR SYSTEM RELIABILITY IS WITHOUT MERIT.

The Appellants claim that bid caps would harm competition in both the short and long-term. They claim that such caps would encourage non-installed capacity ("ICAP") generators to bid out-of-state and discourage out-of-state generators from bidding into the New York Control Area, [3] thereby threatening system reliability. Both claims are without merit.

New York State generators have committed to provide enough ICAP to meet New York's needs during peak conditions. These generators are required to bid in the Day Ahead Market and are subject to recall if not selected in that market. In addition, New York generators that are not committed to sell ICAP would not have an incentive to divert power to the PJM Control Area instead of New York since the PJM ISO also has a $1000 per MWh bid cap.

The Appellants' claim that out-of-state generators would be discouraged from selling into the New York Control Area ignores the fact that the bid cap proposal specifically provides

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[3] Notice of Appeal of Citizens Power Sales et al., at 7.

that external purchases during emergencies would not be subject to bid caps. In other words, in tight capacity situations during peak summer hours when demand for out-of-state generation is the highest, New York State will not be disadvantaged since market prices will be offered to external generators.

The Appellants also maintain that bid caps would adversely impact existing and proposed new generation.[4] Once again, the Appellants are raising the specter of doom without any basis. First, bid caps are a temporary measure that would expire on October 31, 2000. Surely, investors are making decisions regarding generation siting issues based on expectations of conditions that will prevail when the plant is in place, and not on circumstances that will expire in five months. Second, we believe that bid caps set at a level sufficiently above the cost of generation will not interfere with the development of a competitive generation market in New York State, as shown by the PJM ISO experience. In that situation, a queue for generation interconnection projects exists and exceeds 40,000 megawatts. This fact demonstrates that a price cap of this nature has not adversely affected the generation of electricity, contrary to Appellants' claims.

II. THE MANAGEMENT COMMITTEES' DECISION ON BID CAPS WILL PROTECT CONSUMERS FROM MARKET DESIGN FLAWS AND MARKET POWER.

Appellants claim that the Management Committee's decision to adopt bid caps was not motivated by an interest in protecting consumers from high prices as a result of market design flaws or market power.[5] In support of their claims, Appellants contend that any decision by the NYISO to approve bid caps would contradict the position the NYISO took several weeks

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4 Id., at 7-8.

5 Id., at 4-5.

ago in responding to a Complaint filed by New York State Electric and Gas ("NYSEG").[6] Clearly, the Appellants misunderstood the NYISO's position. In its response to Complaint, the NYISO took the position that the suspension of energy markets and the imposition of cost-based rates was not needed. However, that does not lead to the conclusion that extraordinarily high energy prices would not be problematic and that any eventuality could be addressed.

The CPB emphasizes that bid caps are being recommended as a temporary measure for this summer to maintain consumer confidence and afford the NYISO additional time to resolve the large number of outstanding issues. The NYISO must have adequate time to test and properly implement corrective measures to ensure that such remedies are working properly and do not generate other unintended issues.

The approaching summer season is critical since it will set a precedent in the NYISO market. It is the first time that the new market-based system will be tested under peak summer conditions. Last summer, New York State experienced its all-time peak electricity demand. Industry representatives predict that peak demand this summer is expected to be

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[6] New York Independent System Operator, Inc., Docket Nos. EL00-70-000 and EL00-67-000 (Unconsolidated) Re: Corrected Answer of NYSEG, May 31, 2000.

approximately the same as last year.[7] In these circumstances, action is required to protect consumers from high prices due to market design flaws or market power. As demonstrated recently in the operating reserves market, the NYISO's Temporary Extraordinary Procedures ("TEP") authority was not sufficient to prevent a 60-fold increase in prices. Accordingly, additional measures are required in the energy market, where the consequences of substantial price increases will be far more severe.

III. THE MOTION APPROVED BY THE MANAGEMENT COMMITTEE WOULD HELP ELIMINATE SUBSTANTIAL PRICE INCREASES AND VOLATILITY.

The Appellants attempt to trivialize price increases and volatility as natural consequences of markets forces.[8] However, in so doing, they ignore the resulting damage to consumer confidence. We are concerned that a substantial increase in prices could occur this summer unless a bid cap is imposed. Customers that expected competition to lower rates may lose faith in a market-based system if rates increase dramatically in the first summer of operation under this new regime. Similarly, Energy Service Companies ("ESCOs") which are new to the market and without traditional advantages may find it difficult to stay in business when faced with large price increases that they cannot pass through to customers.

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[7] According to the Northeast Power Coordinating Council, the forecast peak demand for the New York Control Area is 30,200 MW. The net available resources at peak, after allowing for unplanned outages (based on historical averages) will be 30,825 MW. Although this is enough to meet peak demand, it will not be sufficient to meet the New York Control Area reserve requirement during this period. A negative reserve margin of approximately 1,175 MW is expected during the peak period. Northeast Power Coordinating Council, Reliability Assessment for Summer 2000, May 17, 2000, at 32.

[8] Id., at 5.

Customers and other market participants are expecting that competition and restructuring would lead to lower prices. Significant price increases would create the wrong perception about competition in the minds of customers. Consumer confidence about this new market could be shattered by these events and take years to rectify. Once consumers endure an overall bad experience with this market, it will be difficult to erase.

IV. PRICE BIDS WILL NOT HARM MARKET PARTICIPANTS THAT SOLD ICAP AND PURCHASED TCCS.

Hydro Quebec Energy Services (U.S.) Inc., claims that bid caps would cause significant harm to bidders who purchased Transmission Congestion Contracts (TCCs) and sold ICAP in auctions conducted by the NYISO.[9] It contends that buyers and sellers of TCC and ICAP based their decisions in those auctions on expectations of markets without bid caps and that the imposition of bid caps after the ICAP and TCC auctions have been completed would undermine those decisions.

That contention is without merit. First, $1,000 per MWh is well above any reasonable expectation of the future price of energy. On most days, wholesale energy prices range from $10 to $50 per MWh and forward energy prices are approximately $100/MWh. Given these prices, there is no rational basis for any entity to base its bidding strategy in the ICAP and TCC auctions on expectations of prices over $1,000 per MWh. Second, there is no basis to assume that energy markets are without risk. A temporary price cap in New York's nascent energy market should not be a surprise to market participants. The PJM market, in which most Appellants also participate, has a bid cap similar

[9] Appeal of Hydro Quebec Energy Services Inc., at 1-2.

to that being proposed for the NYISO.

Conclusion

For the reasons explained herein, we urge the NYISO Board of Directors to deny the Notice of Appeals and instead ratify the June 5, 2000 decision of the Management Committee to impose bid caps on NYISO administered energy and ancillary services markets. We also request that the Board direct the NYISO Counsel to immediately seek FERC approval of the bid cap decision.

Sincerely,

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Debra Martinez, Chairwoman and Executive Director
Christopher Hannifin, General Counsel
Tariq N. Niazi, Chief Economist