

June 19, 2000

Richard J. Grossi
Chairman, Board of Directors
New York Independent System Operator
3890 Carman Road
Schenectady, NY 12303

RE: ***MEUA Motion in Opposition to Appeals of Management Committee's June 5, 2000 Decision to Establish Bid Caps in Energy and Ancillary Services Markets***

Dear Chairman Grossi:

In accordance with the Procedural Rules for Appeal to the ISO Board of Directors, the Municipal Electric Utilities Association of New York State (MEUA), acting through its Members on the ISO Management Committee, respectfully submits this Motion in Opposition to the three appeals noticed to date of the Management Committee's decision on June 5, 2000, to establish bid caps of \$1,000 per MWh for the energy and ancillary services markets. The three appeals noticed to date are by: (i) Coastal Power Sales, *et al.*, (ii) Orion Power New York, and (iii) Hydro Quebec Energy Services (U.S.), Inc. (collectively, Appellants).

The identities of the Parties filing this Motion in Opposition are the MEUA Members on the Management Committee: Bath Electric Gas & Water Systems, Town of Massena Electric Department, Village of Fairport Municipal Commission, Village of Freeport, Village of Rockville Centre, and the Village of Westfield.

SUMMARY

The Appellants raise no new issues. All of the arguments raised by the Appellants were carefully considered by the Management Committee at its meetings on May 24 and June 5. Based on the information presented at those meetings and in private discussions among the Parties, 63 percent of the Management Committee voted to establish the \$1,000 per MWh bid caps in the energy and ancillary service markets (\$1,100 per MWh in the market for Regulation Service).

The Governance Committee of the ISO Board of Directors, and the ISO Board generally, should respect the compromise achieved by the Management Committee. While the Appellants take the position that the bid caps are too low, other Parties, including MEUA, believe that the bid caps are much too high. The consequences of raising the bid caps to a higher level (or of having no bid caps in the energy market) would cost consumers tens or even hundreds of millions of dollars this summer.

A factual predicate for the establishment of these bid caps was the dramatic run-up in the price of operating reserves this past winter. The Federal Energy Regulatory Commission (FERC) has already approved the ISO's use of a cost-based bid cap in the non-spinning reserve market, at a level far below that proposed by the Management Committee for the markets. The consequences of having a similar uncontrolled run-up in prices this summer could be catastrophic to the development of competitive markets.

Because prices for wholesale energy are currently in the range of \$15 to \$50 per MWh, a bid cap of \$1,000 per MWh offers only minimal protection to consumers. The \$1,000 per MWh bid caps allow substantial, not to say excessive, profit-taking. In a situation where demand is inelastic, the establishment of these bid caps allows pricing that is only slightly below the level of grossly obscene.

Nonetheless, MEUA supports the establishment of the bid caps approved by the Management Committee as a step in the right direction. MEUA urges the ISO Board to ratify the decision of the Management Committee, deny the appeals, and direct ISO counsel to make the appropriate filings as soon as possible.

ARGUMENT

The Appellants have raised no new issues which would cause the ISO Board to reconsider its previous commitment to approve bid caps if that was the course of action adopted by the Management Committee. The arguments raised by the Appellants were carefully considered by the Parties at the Management Committee meetings of May 24 and June 5, and in private discussions among the Parties. MEUA urges the ISO Board to respect the compromise reached by the Management Committee and deny the appeals.

While it is not necessary to offer a comprehensive rebuttal to each point raised by the Appellants, MEUA believes the following discussion may be helpful to the ISO Board.

1. *The ISO Board must support the action of the Management Committee as a reasonable compromise and a step in the right direction.*

The Management Committee met on May 24 and again on June 5 in an attempt to fashion a compromise of the issues raised in the complaints of New York State Electric & Gas Corporation (NYSEG) and Strategic Power Management, Inc. (SPM). Based on the information presented at those meetings and in private discussions among the Parties, 63 percent of the Management Committee voted to establish the \$1,000 per MWh bid caps in the energy and ancillary service markets (\$1,100 per MWh in the market for Regulation Service).

Appellants argue (in, *e.g.*, Appeal of Coast Power Sales, *et al.*, at 2-5) that the bid cap proposal contradicts arguments made by the ISO to FERC in response to the NYSEG /SPM requests for action. The answer to this argument is found in the FERC s May 31, 2000 Order on the excessive prices in the operating reserve markets. The Commission there faulted the ISO for not exercising market mitigation measures in a timely fashion. FERC ordered the ISO to implement cost-based bid caps in the non-spinning operating reserve market, effective March 28, 2000.

The \$1,000 per MWh bid cap established by the Management Committee is far above the level approved by FERC for the non-spinning operating reserve market. While Appellants take the position that the bid caps are too low, other Parties, including MEUA, believe that the bid caps are much too high. The consequences of raising the bid caps to a higher level (or of having no bid caps in the energy market) would cost consumers tens or even hundreds of millions of dollars this summer. The Governance Committee of the ISO Board of Directors, and the ISO Board generally, should respect the compromise achieved by the Management Committee.

2. *The establishment of bid caps is reasonable under the circumstances, and the Appellants have not demonstrated that there will be harm to the markets.*

The Appellants argue (*e.g.*, Appeal of Hydro Quebec at 7-8), that the Management Committee has not presented evidence to support the establishment of bid caps. This misapprehends the role of the Management Committee, which is a policy making body, not an advocate in a legal proceeding.

The main factual predicate for the establishment of these bid caps was the dramatic run-up in the price of operating reserves this past winter. The conditions which allowed the price of operating reserves to increase by 650 percent are all the demonstration one needs to conclude that the other markets may not be workably competitive. This is the factual underpinning of FERC s May 31 order, wherein it approved the ISO s use of a cost-based bid cap in the non-spinning reserve market. This cost-based level, \$2.53 per MWh, is far below the bid cap established by the Management Committee for the markets.

The Appellants which have put forth no facts demonstrating harm to the marketplace. All they can offer is speculation and empty theory. They have a laundry list of complaints, but it is only a list. They say energy will flee New York (ignoring that ICAP

suppliers must bid in New York). They say new generation will not be built (ignoring the fact that no one has pulled its project out of the interconnection study queue). Imaginatively, Hydro Quebec claims (at 2-4) that bidders in the ICAP and TCC auctions will be unfairly treated because they have already acquired rights in those auctions. But, any entity which staked its profitability to the likelihood that prices would be over \$1,000 per MWh for sustained periods ought to reexamine its bidding strategy.

Where prices for wholesale energy are currently in the range of \$15 to \$50 per MWh, a bid cap of \$1,000 per MWh offers only minimal protection to consumers. The \$1,000 per MWh bid caps allow substantial, not to say excessive, profit-taking. In a situation where demand is inelastic, the establishment of these bid caps allows pricing that is only slightly below the level of grossly obscene.

3. *The Appellants fail to recognize that without consumer protection from price spikes, the future development of competitive markets may be in doubt.*

Appellants claim the Management Committee decision was not based solely on the desire to protect consumers from market design flaws or the exercise of market power; it was rather motivated by the threat that supply shortages ... would cause high prices. *See* Appeal of Coastal Power Sales, *et al.*, at 4. The Appellants then quote Dr. William W. Hogan to the effect that substantial price volatility is to be expected and is the consequence of the reliance on market forces. *Id.* at 5. Appellants fail to recognize that without consumer protection from price spikes, the future development of competitive markets may be in doubt.

As entities poised to profit handsomely from their absence, the Appellants are not in favor of even the minimal consumer protection offered by the compromise bid caps established by the Management Committee. The Appellants fail to recognize that consumers pay the prices caused by scarcity and other factors, and that consumers vote. Others in favor of competitive markets, will realize that a summer of high prices could melt the current political resolve in favor of introducing market forces.

From long experience as transmission dependent utilities, MEUA's Members have been concerned about the exercise of market power and market design flaws in a restructured electricity marketplace. Until a workably competitive market is demonstrated to be able to function, MEUA's position (for years) has been that prices paid above the suppliers long run marginal costs are the result of market flaws and/or excessive market power.

Without waiving its rights to continue to take the position that a marginal cost bid cap is appropriate, MEUA states that it supports the establishment of the compromise bid caps approved by the Management Committee. MEUA urges the ISO Board to ratify the decision of the Management Committee and deny the appeals. The ISO Board should direct ISO counsel to

make the appropriate filings as soon as possible, and request an effective date contemporaneous with the filing date.

Sincerely,

Thomas L. Rudebusch
Attorney for the Municipal Electric
Utilities Association of New York State

cc: Robert A. Mullane - MEUA
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