

Motion in Opposition To Petitioners' Notices of Appeal

New York State Electric & Gas Corporation (“NYSEG”), Empire Natural Gas Corporation and NYSEG Solutions, Inc. (collectively “Movants”) submit this Motion pursuant to sections 1.03 and 4.01 of the New York Independent System Operator’s (“NYISO”) Procedural Rules for Appeals to the ISO Board in Opposition to the three Notices of Appeal submitted by Petitioners.¹

Movants request that the Board of Directors (“Board”) reject the Petitioners’ attempt to overturn the Management Committee’s vote to adopt a \$1,000 bid cap for the energy and specified ancillary services markets.² Absent a safety net, energy prices that are not the product of a properly functioning competitive market could reach extraordinary levels this summer due to a variety of market and implementation flaws, harming the nascent competitive retail energy markets, market participants and consumers. In the NYSEG Complaint and two Answers and filings by market participants in *NYSEG v. NYISO*, FERC Docket No. EL00-70-000 (the “FERC Proceeding”), market participants have identified and discussed the impact of the existing market flaws and the necessity for a safety net. Copies of the NYSEG Answers are attached.

In addition, Movants demonstrate here that the Petitioners’ reliance on the NYISO’s ability to correct the many market flaws prior to the summer peak season has been misplaced. Despite added staffing and a concerted effort, the NYISO does not have sufficient time to design, test and implement fixes addressing the multiple market flaws to ensure proper market performance during the Summer peak load period. Petitioners’ supporting arguments, for instance that bid caps will cause significant harm to the developing markets in New York, are

¹ Citizens Power Sales, East Coast Power, LLC, Indeck Energy Services, Inc., KeySpan Ravenswood, Inc., Natural Resources Defense Council, PG&E National Energy Group, Sithé Energies, Inc., Orion Power New York L.P., and Hydro Quebec Energy Services (U.S.) Inc.

² NYSEG also joined a Member Systems Motion in Opposition and submits this separate Motion to more fully elaborate on issues NYSEG has advanced in the related FERC Proceeding.

entirely without merit. Given the erratic pricing in the NYISO coordinated central markets, it is doubtful that any market participant is basing long term resource commitment decisions on the price signals emanating from those markets, including the day-ahead and real-time energy markets that would be subject to the \$1000 bid cap. Moreover, the market participants' bids on Transmission Congestion Contracts ("TCC") and resulting clearing prices demonstrate that market participants are not bidding with an expectation that prices will exceed or often equal to \$1,000 per MWH.

If the markets were functioning properly and were not subject to numerous software flaws and implementation problems, then high prices would be a sign of genuine scarcity and the product of competitive market forces. Such prices would send efficient long term investment signals and would focus the debate on whether absent appreciable demand response and with regulatory barriers to entry, some cap is appropriate. This hypothetical state of affairs is manifestly not the current situation. Prices today are not the product of a well-functioning market, but rather the product of a market system malfunctioning because of numerous severe market flaws. Some mechanism is needed immediately to protect customers from the inequitable effects of the malfunctioning market.

The Board should recognize that the Petitioners will oppose anything that limits their upside potential, regardless of whether the pressure for high prices is caused by genuine competitive forces or price-distorting market flaws. Movants and other market participants have proposed several types of safety net for the summer capability period, including price screens and a stronger application of the existing Temporary Extraordinary Procedures ("TEP"). The NYISO Staff contended that price screens would not be available in time for the summer, and thus opposed that proposal. Petitioners have opposed every measure presented so far, and it is no surprise that they oppose even a \$1,000 bid cap.

The Board is faced with a serious question: should the Board disregard a near two-thirds majority of the Management Committee and block temporary protection against erroneous prices resulting from market flaws and implementation problems acknowledged by the vast majority of

the market?³ Doubtless there will be times when the Board should over-ride the Management Committee. This is not one of them. In order for the Board to reject the Management Committee's vote, it must be certain that the market flaws are incapable of producing substantial and significantly erroneous prices or price signals. Movants contend that it would not be reasonable for the Board to reach a sufficient level of certainty to over-ride the Management Committee. At its May NYISO Board Liaison Committee Meeting, the Board urged the Management Committee to decide what to do to address exigent market circumstances and indicated that the Committee's response was a test of the Committee's ability to address this and other critical matters The Committee did. The Board should not now reject that result. As discussed below, and in more detail in the attached Answers, extremely ambitious schedules to correct the market flaws have not been attainable. The Board is on fully rational and responsible ground in affirming the Management Committee vote. If the Board does not, we believe retail competition will wilt away and enormous wealth transfers from customers to suppliers will come at the hands of market flaws, not from the invisible hand of competition. In order to stave off these results, the Board must direct the NYISO: (a) to act to make the bid caps effective this week, and (b) to do everything possible to use the TEPs to avoid erroneous and damaging results beneath the bid cap radar screens.

I. Neither The Petitioners Nor The NYISO Have Credibly Rebutted The Existence Of Severe Market Flaws

In the FERC Proceeding, market participants described the following market flaws: (a) wrongly curtailed bilateral transactions caused by a software evaluation phase that contains

³ NYSEG just received the NYISO's June 23 motion in the FERC proceeding. There the NYISO indicates the market did not support NYSEG's FERC complaint. The Answers and the NYISO response speak for themselves as do the recent interventions in *Niagara Mohawk Energy Marketing v. NYISO*, FERC Docket No. EL00-82-000 ("NMEM Docket"). There, PPL Electric Utilities said: "This irrational outcome is indicative of the software problems that have plagued the NY ISO-administered markets and have in many cases made it impossible for market participants to know in advance what their prices will be with a reasonable degree of predictability." An Enron filing in the same docket states: "... that the flawed SCUC software and the NYISO's lackadaisical attitude about fixing it present a problem larger than the immediate economic injury to NMEM and other market participants." See motions to intervene at 3. Southern Energy also claims in its intervention that the NYISO is violating its tariff and FERC Order Nos. 888 and 2000.

significant flaws; (b) misapplied rules to fixed-block generation causing unnecessarily high energy prices; (c) tariff violating supra-competitive payments to generators through misapplied lost opportunity payments; (d) delayed and inaccurate load data information which prevents final billing to load serving entities (“LSEs”); (e) explicit warnings from neighboring ISOs that inter-control area transactions may not be relied on this summer; (f) the severity and importance of inefficiencies significantly reducing energy imports into the New York Control Area (“NYCA”); (g) the extension of Bid Production Cost Guarantees (“BPCG”) to external generators; (h) odd congestion patterns not seen prior to the NYISO’s taking control of the NYCA energy markets; (i) unreasonably volatile energy prices; and (j) failure to recognize available resources. In the NMEM Docket, parties complain about failed exports, erroneous curtailments and tariff violations. Many of these flaws are beyond reasonable dispute. Moreover, the NYISO Staff does not correct erroneous prices resulting from some of these flaws.

Petitioners’ oft-repeated claim that these flaws will be fixed prior to the summer peak season have been proven wrong. In just one example, the flaw of wrongly curtailed bilateral transactions, the NYISO has instituted two fixes and problems still remain. The NYISO attempted to resolve the unnecessary curtailments of external transactions scheduled in the Day-Ahead Market (“DAM”) by treating the transactions as “must run.” The curtailment problem and the “must run” fix was originally identified by the NYISO’s Scheduling and Pricing Working Group back in January. On May 22, the fix was instituted and nearly immediately withdrawn because the NYISO continued to erroneously curtail transactions. A second fix was instituted by the NYISO the next day, on May 23. It now appears that the fix is creating unanticipated problems, such as continuing to curtail must run transactions and making even more volatile the extremely problematic Balancing Market Evaluation (“BME”). Although the causes of the problem appear to have shifted, the result is the same: energy imports from and exports to other control areas are highly unpredictable even when available transmission capability is more than sufficient to handle scheduled transactions.

This flaw alone is the basis for the separate NMEM Complaint filed against the NYISO on June 12, 2000. Moreover, with imports not functioning properly, artificial scarcity will occur, causing higher prices due to the unavailability of vibrant competition from external suppliers.

Movants and several intervenors in the FERC Proceeding and the NMEM docket, find the NYISO'S conclusion that the market is plodding along well enough troubling.⁴ Time and time again economic transactions are cut, harming the participants, only to be replaced with RTM energy at much higher prices. These RTM transactions that should not be occurring are causing higher LBMPs and causing erroneous wealth transfers from customers to generators. This situation is untenable.

There are numerous other flaws for which a fix has not even been determined yet, let alone tested and implemented. Despite the optimism of Petitioners and the NYISO, the market flaws identified in the FERC Proceeding and the NMEM Docket have not been fixed prior to the summer peak season, which is upon us today.

II. Petitioners Supporting Arguments Do Not Withstand Scrutiny

A. Petitioners Argue That The NYISO Cannot Change Its Position Since Its May 25 Answer In The FERC Proceeding

Petitioners suggest that the NYISO is locked into its May 25 Answer in the FERC Proceeding and may not consider deviating from the positions espoused in that filing. The Petitioners state:

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.

⁴ While some of the supplier/intervenors question whether the NYISO should be permitted to exist as a stand alone organization (Enron Intervention in the NMEM Docket at 4), NYSEG continues to support the fundamental design of the NYISO, but must take issue with the NYISO's assessment that markets and operations are good enough to withstand the strains of sustained high demand periods.

First, in the FERC Proceeding, the NYISO argued against cost-based bidding, and was not focused on the specific Management Committee resolution. Second, Petitioners conveniently forget to cite the Answers attached to this Motion demonstrating the shortcomings in the NYISO's Answer. Third, as discussed below, subsequent events corroborate severe market flaws and the need for emergency corrective action.

Movants believe that the overall framework of the NYISO is sound. Movants are equally firm in their conviction that the current market flaws and the inherent stresses of the first summer capability period on the new system will lead to chaotic events this summer, and thereby jeopardize the very existence of competitive markets in the state for several years.

Events since the NYISO's May 25 Answer filed in the FERC Proceeding further bolster the contention that the markets are not ready for the summer peak season. The lack of a fix to external transaction curtailments, as noted above, portends ill for other first-round fixes. The BME's performance has been a recognized problem area. These and many other serious market problems are described in the attached answers. Furthermore, since the NYISO Answer, the Management Committee and market participants generally have had greater opportunity to debate the issue of bid caps, and have since voted to adopt them.

B. Petitioners Argue That Bid Caps Will Cause Significant Harm To Competition

The Petitioners make a two-pronged attack on bid caps. First, Petitioners argue that bid caps may cause shortages of energy this summer because limiting prices to \$1,000/MWH may not be enough incentive for generators to keep their plants ready and able to run. There is not a single generator in the state that will not jump at the opportunity to sell at a price of \$1,000/MWH, or, if there is, it is the needle in the haystack and is destined for retirement. This price is so far above even the highest incremental cost that to suggest that generators may lack incentive to run at this price is preposterous. If bids hit \$1,000/MWH, all available generation will be running; if there is a shortage it will assuredly not be because the price wasn't allowed to rise high enough. Moreover, were the NYISO to experience shortages, it would recall export transactions from all Installed Capacity suppliers, whose capacity, taken with the remainder of

Installed Capacity suppliers providing energy to internal New York loads, exceeds peak load by eighteen percent.

Second, the Petitioners argue that bid caps, and the NYISO's preponderance to reserve and reduce "seemingly high prices,"⁵ could harm the development of new generation in the state. Movants agree that in a well functioning market, price reservations and corrections delay market signals and are akin to running an exchange by ex post roulette wheels. The reservations and corrections, however, are critically needed due to market flaws that otherwise cause erroneously high (and sometimes low) prices. The NYISO purposefully reserves and corrects erroneous prices because market flaws are leading to prices that are produced due to market flaws. The NYISO should be correcting more prices than it does already because it does not correct prices associated with certain market flaws, such as the impacts on LBMPs resulting from BME's curtailment and rejection of efficient transactions.

More important is the argument that bid caps will ward off future generation and lead to energy shortfalls in the future. This argument rests on two closely related suppositions which clearly are false given the existence of severe market flaws in the current energy markets. The first supposition suggests that generators will not be given proper price signals by the artificial barrier of a \$1,000 bid cap. Today, there are at best extremely weak price signals being generated in the NYISO-administered energy markets. As detailed in the FERC Proceedings, timely price signals are largely nonexistent, and are in any event inflated by distortions caused by the market flaws. Price signals are lacking because the flow of information is in some instances nonexistent. For example, LSEs are still awaiting load data from last year. Without this, they cannot know what business they conducted. Other instances of price signal weakness stems from the recurrent, but necessary, reservation and recalculation of unreasonably high energy prices, which are necessitated by the current market flaws.

If generators are planning new generation based on the experience of high prices which accompany the numerous market flaws, then their investors and lenders are investing foolishly because when the flaws are worked out of the system, more rational prices will become the norm.

⁵ See Citizens Power Sales et al Notice of Appeal at 7.

Thus, by capping bid prices at \$1,000, the NYISO is not distorting price signals to future generation, but if anything is rightly tempering future expectations, which should be arrived at without the many distortions caused by the current market flaws.

The related supposition relies on the belief that the market today is a properly functioning competitive market. This simply is not the case. The NYISO itself interferes with the competitive forces on a daily basis by wrongly curtailing economically rational negotiated bilateral transactions only to replace them with higher priced Real-Time Market (“RTM”) energy. There are a number of NYISO-imposed rules that further distort truly competitive economic forces, including the imposition of Fixed-Block bidding of certain resources, which leads to unnecessarily high Locational Based Marginal Prices (“LBMP”) in affected zones, and rejection of Hour-Ahead Market (“HAM”) bids even where these bids are more economic than the energy prices in the RTM. Furthermore, as discussed above, the system today suffers from an almost total absence of timely and accurate price signals. One additional essential ingredient to a properly functioning competitive market is the existence of timely and accurate price signals; absent reliable price signals, the system is not truly a competitive market, as is the case today in New York. With shaken export/import transactions, market responsiveness is lacking.

Irrespective of the proposed bid caps’ effect on the NYISO-administered energy markets, Petitioners avoid the fact that bilateral transactions were a key component in the energy system prior to November 18, 1999, and remain today. The bid caps do not apply to bilateral transactions.

C. Petitioners Argue That The NYISO Has Sufficient Other Means To Address Market Flaws

Petitioners also argue that the NYISO has the ability 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. The currently expired Temporary Extraordinary Procedures and market power mitigation plan, however, are insufficient protection against erroneous high prices this summer. For one, the NYISO’s Market Mitigation

Unit is currently in the process of hiring more staff. With the strains of summer conditions, it is unlikely that the MMU will be sufficiently staffed this summer to investigate frequent price anomalies or to deploy additional price screens. Moreover, experience dictates that even where the NYISO has tools at its disposal, extreme damage can occur in the period between suspicious activity and corrective action. In the case of operating reserves, even when there was clear evidence that market power was being exercised and prices were skyrocketing, it took two months to get prospective relief through a NYISO filing with FERC. Two months of erroneous market outcomes in the energy markets this summer could make the operating reserves problem look like petty cash, devastate new market entrants and set back retail competition in the state for years to come. There is also no assurance that the NYISO will use the tools at its disposal. Despite clear evidence that the BME is causing the NYISO to reject or curtail rational economic transactions, the NYISO does not correct for the BME's erroneous impacts on LBMPs.

Contrary to the claims of the Petitioners, the existing tools are not sufficient in order to prevent huge injustices from occurring.

D. Petitioners Argue That Imposing Bid Caps Would Cause Harm To Market Participants Who Sold Installed Capacity ("ICAP") And Purchased Transmission Congestion Contracts ("TCC")

Hydro Quebec Energy Services (U.S.) Inc. ("HQUS") argues that imposing bid caps "would cause significant financial harm to sellers of ICAP and purchasers of TCCs, who at the time of these auctions relied on the OATT and Services Tariff ... [B]uyers and sellers of TCC and ICAP valued these assets based on a market without bid caps. To impose bid caps would severely undermine the elaborate and painstaking process of ensuring the market had an opportunity to value appropriately the TCCs and ICAP."

This argument does not overcome the simple fact that suppliers are not entitled to erroneously high energy prices that are the product of market flaws.

A number of bid cap supporters hold TCCs. For example, NYSEG holds more than several hundred MW of TCCs, and it supports the bid cap. There is no solid calculation in the HQUS Motion to indicate that a \$1,000 bid cap would have a significant economic impact on

TCC holders. Almost certainly a \$1,000 bid cap is sufficiently high to include the energy price plus applicable TCC congestion rents without breaching the bid limit. A quick calculation bears this out. Even supposing the highest price paid for a six-month TCC right, if the bid cap of \$1,000 is reached, \$250 of which is attributable to energy and \$750 attributable to congestion, the TCC holder could recoup its TCC costs in just 71 hours, or in less than the equivalent of one week of on peak hours (5 days x 16 hours per day). This is true even though the TCC right lasts the entire summer capability period, or 4,380 hours. Viewed another way, TCC owners need to see congestion prices at this level for only 1.6 percent of the total hours during the summer capability period. If the purchaser bought a 24-month TCC, the recoupment period for the most expensive TCC is 146 hours over the 24-month period.

Quite clearly, the market for TCCs did not anticipate energy prices often exceeding \$1,000, otherwise the bids for TCCs would have been far higher, given the huge potential return that TCCs would offer the holder if prices were above \$1,000.

The argument regarding ICAP is equally spurious. In a competitive market, each potential ICAP supplier would have bid at the highest possible level seeking to win the contracts irrespective of whether an energy bid cap existed or not. There is no indication that an energy bid cap would have altered the results achieved in the ICAP auctions to date. Even were this argument valid, it does not justify abandoning the Management Committee's bid cap vote. Petitioner's argument is premised on their being able to obtain energy prices in excess of the bid cap, which they claim they could do outside New York. The bid cap would prevent them from selling energy outside New York at a price in excess of \$1,000 because if New York needed their energy, it would recall the energy under certain circumstances. At most, this argument would suggest that the Board consider altering the bid cap to exempt recall energy from the bid cap, so long as it additionally would not set LBMPs. It is wholly unnecessary to abandon the bid cap proposal in the face of a relatively small exception.

III. Under Present And Exigent Circumstances The Board Should Effect Bid Caps Immediately

Movants wish to clarify one issue presented by the Petitioners regarding the effective date of a bid cap. The Petitioners are correct in stating that under ordinary circumstances Management Committee actions cannot become effective until 30 days after the Committee has acted. Here, however, the Board is fully empowered to file with the Commission under Section 205 of the Federal Power Act in the event of exigent circumstances, and thereby set an effective date prior to the conclusion of 30 days since the Management Committee vote of June 5.⁶ Circumstances witnessed to date, amply detailed in the FERC Proceedings, warrant Board action under the exigent circumstances language in the NYISO Agreement.

⁶ It bears mention that when all parties left the Management Committee meeting on May 24, 2000, they thought the Committee had approved bid caps. It was only the next day that the NYISO Staff informed the

IV. Conclusion

For the reasons stated above, Movants strongly urge the Board (a) to reject Petitioners attempts to overturn the Management Committee's vote to adopt a \$1,000 bid cap for the energy and ancillary services markets during the remainder of the summer capability period and (b) to facilitate in every way possible the use of the existing TEPs to avoid erroneous and damaging results that may continue beneath the bid cap price screen.

Respectfully submitted,

Stuart A. Caplan, Esq.
Adam H. Bartsch, Esq.
Huber Lawrence & Abell
605 Third Ave. 27th Floor
New York, NY 10158
Attorneys for New York State Electric &
Gas Corporation

Carl Taylor
President
NYSEG Solutions, Inc.
2 Court Street
Binghamton, NY 13901

Marcel Barrows
President
Empire Natural Gas Corporation
173 Airport Road
Greene, NY 13778

market that it had slightly miscounted the vote. The parties were deprived of the opportunity to have further discussions on the spot to alter the motion or to propose other safety nets.