

and ancillary service markets to the point that a short-term safety net is the only prudent course to avert a potential disaster this summer. In its Complaint, NYSEG urged the Federal Energy Regulatory Commission (Commission) to create a safety net to help New York through the Summer Capability Period by adopting cost-based bidding, or in the alternative price caps, and/or establishment of a refund effective date.

On May 10, 2000 NYSEG amended its Complaint to withdraw the request for cost-based bidding and price caps and agreed to support a joint proposal of seven of the eight Members of the Transmission Owners Committee of the Energy Association of New York State, formerly known as the Member Systems of the New York Power Pool.² The joint proposal asks the Commission to require a new remedy involving implementation of a series of price screens applied to the NYISO Day-Ahead Market (DAM), Real-Time Market (RTM), and the three operating reserves and regulation markets. Where Locational Based Marginal Prices (LBMP) or clearing prices exceed the price screens, the prices would stand so long as the NYISO determines that the prices are the result of properly-functioning, competitive markets.

Although dozens of parties have sought to intervene and/or protest in this matter, only a handful have made substantive comments on the Complaint. Many of the comments or protests are centered on NYSEG s original remedies of cost-based bidding or price caps. Since NYSEG has withdrawn those remedies from its Complaint, NYSEG will not address those issues in this answer and will focus instead on correcting any misstatements regarding NYSEG s Complaint. Additionally, because the Commission established May 25, 2000 as the intervention deadline, NYSEG reserves the right to answer additional motions not addressed in this answer with a subsequent answer. In this Answer, NYSEG responds to the motions it received as of May 22, 2000.³

² Central Hudson Gas & Electric Corporation; Consolidated Edison Company of New York, Inc./Orange and Rockland Utilities; LIPA; Niagara Mohawk Power Corporation; and Rochester Gas and Electric Corporation. NYPA intervened separately and takes no position on the price screen proposal.

³ The motions, protests and letters submitted as of May 22 are: Independent Power Producers of New York, Inc., Southern Energy NY-Gen, L.L.C., Southern Energy Lovett, L.L.C., and Southern Energy Bowline, L.L.C., Indeck Companies, New York Power Authority, 1st Rochdale Cooperative Group, Ltd. and Coordinated Housing Services, Advantage Energy Inc., Dynegy Power Marketing, Inc., Energetix, Inc., Strategic Power Management, Inc., TransCanada Power Marketing Ltd., Williams Energy Marketing & Trading Co., National Energy Marketers Association, Niagara Mohawk Energy Marketing, Inc., Sithe Power Marketing, L.P. and AES NY, L.L.C, Select Energy Inc., PECO Energy Company, Member Systems, International Wire Group, Inc., Parker Hannifin Corporation, Goulds Pumps ITT Industries, Owners Committee on Electric Rates Inc., Pace Energy Project, Hammond & Irving, Inc., City of New York, Public

EXECUTIVE SUMMARY

In its motion, Indeck argues that NYSEG has failed to demonstrate that the NYISO markets are not functioning acceptably. From this Indeck concludes that no safety net is needed. Indeck, however, does not refute any of the facts raised in NYSEG's Complaint and affidavits. Moreover, in the short time since NYSEG's Complaint, NYISO market participants have witnessed numerous events that compel an even greater sense of urgency for immediate action to create a temporary safety net for the summer capability period while the NYISO corrects the Market Flaws that give rise to irrational prices and erroneous price signals. For example, on May 24, 2000, real-time prices in the Capital zone went from -\$1,141.38 to \$1,229.14 in a span of seven minutes. Three weeks ago, prices in the Hour-Ahead Market went from less than -\$60,000 (yes, negative sixty-thousand dollars) to approximately positive \$60,000 in one hour. Real Time Market energy prices cleared at more than \$3,000 only to be corrected days later down to less than \$400. Separately, the NYISO concluded that some of the patches or short-term corrections to Market Flaws were being gamed and had to be discontinued. Also, since NYSEG filed the Complaint, the NYISO appears to have concluded that the congestion components of the prices at all of the external proxy buses are not correct. This has an impact on dispatch and scheduling decisions and will harm market participants and produce inefficient results.

The consequences of Market Flaws that NYSEG identified are cropping up in both expected and unexpected areas. The attempts to fix the flaws have met with mixed results, attesting to NYSEG's contention that even where flaws are identified, the ability to fix, test, implement remedial measures and reestablish market confidence is virtually impossible in the few remaining days before the summer peak season begins. Lastly, events over which the NYISO and market participants exert no control, the actions of neighboring ISOs to discontinue inter-control area transactions, threaten to undercut many of the efforts made to date to mend the current NYISO energy markets.

The Balancing Market Evaluation (BME), also known as the Hour-Ahead Market (HAM), remains a system plagued by flaws that are distorting NYISO markets in many areas. On May 8, for instance, the BME forecast a real-time LBMP of negative \$68,307.30 in the Capital Zone, then within one hour, forecast an LBMP real-time price of +\$58,887.79. This

represents a change in forecast price of \$127,195.09/MW in just one hour. The BME is not used for settlement, but is used in making transaction scheduling, NYISO LBMP market and curtailment decisions. The BME has been a constant source of irrational price predictions and consequent Market Flaws in several areas, which have confounded market participants and the NYISO alike.

The practical impacts of a BME that bears so little correlation to the RTM prices are manifold. First, the BME curtails bilateral transactions when the BME price prediction is less than the decremental bids associated with the bilateral transactions. When the RTM prices end up being much higher than the BME predictions, the customers whose bilateral transactions were cut end up having to pay the much higher RTM prices because the NYISO cut their bilateral transactions with much lower prices. Second, when suppliers offer economic energy to the NYISO for use in the HAM, the NYISO rejects these offers whenever they exceed the BME forecast price. Obviously with a BME predicting next hour prices as low as negative \$60,000.00, there are likely to be substantial foregone economic savings associated with the BME. Other impacts are subtle but cut to the heart of the new market structure by degrading reliability and confidence in the NYISO energy market system. This occurs when the BME no longer serves as a source of credible price signals, for instance when the BME price prediction swings sharply from one price to another. In these instances, which are numerous, generators and consumers alike are unable to either plan or react adequately, and must simply hope that real-time prices will fall into a reasonable zone or be corrected, reliance upon which introduces a different set of problems, as illustrated by the actions of ISO New England.

ISO New England recently posted a letter to its market participants warning that ISO New England anticipates that it will not be able to rely on inter-control area energy transactions with the NYISO during pre-emergency and emergency periods because of the NYISO's volatile and unpredictable operations and pricing. As noted in NYSEG's Complaint, PJM OI had previously warned the NYISO that NYISO's radical transaction cuts may force PJM to discontinue transactions with the New York Control Area. New York has been warned by ISOs on both flanks that inter-control area energy transactions are in jeopardy.

The NYISO's attempts to fix identified flaws have been mixed. Examples of fixes to Market Flaws resulting in Emergency Corrective Actions or withdrawal and reapplication of the fix are detailed in this Answer. These too demonstrate that an illusory and overly optimistic forecast of when the Market Flaws will be implemented is not a basis for inaction by the

Commission.

It is increasingly urgent that the Commission act soon to provide New York market participants a safety net during the summer capability period. Events since the NYSEG Complaint serve only to emphasize that point. NYSEG strongly urges the Commission not to wait and see how irrational the markets in New York can become.

Lastly, one motion contends that FERC does not have the authority to grant the relief sought by NYSEG and other market participants because FPA section 206 requires the establishment of a refund effective date at least 60 days after a complaint is filed. This same protest also confusedly protests a refund effective date. These specious arguments are dispatched at the end of this Answer, as is an unfounded and offensive allegation that NYSEG is attempting to manipulate the NYISO energy markets by exercising its right to petition this Commission for action.

THE EXISTING MARKET FLAWS NECESSITATE A SUMMER CAPABILITY PERIOD SAFETY NET

Of the substantive motions to date, not one disputes NYSEG's contention that Market Flaws exist, and that these Market Flaws are impeding the operation of the NYISO-administered markets. For instance, despite disagreeing with NYSEG's proposed remedy of cost-based bidding, PECO Energy Company (PECO) corroborates the Market Flaws described in NYSEG's complaint and then goes on to add to the list. Among the more prominent flaws cited by PECO are the following: ramping inconsistencies between neighboring control areas; external generators' power flows into the New York Control Area (NYCA) being curtailed through improperly prioritized computer software runs; the NYISO's BME curtailing bilateral transactions based on inaccurate forecasting of the RTM; the BME failing to provide meaningful price signals it was intended to provide, and even requiring market participants to modify their behavior to their own disadvantage; reliability degrading block bidding of internal generators; and numerous problems in the ancillary markets, among other problems.

Similarly, the National Energy Marketers Association (NEM) disagrees with the proposal for cost-based bidding, but acknowledges the existence of Market Flaws and the need to mitigate them. NEM recognizes the need to mitigate the adverse financial consequences of the Market Flaws alleged by NYSEG, many of which NEM members have

reported experiencing as well; however, NEM does not endorse the cost-based bidding system proposed by NYSEG.⁴

Pace Energy Project, a member of the NYISO Management Committee, also disfavors the cost-based bidding approach, but suggests that remaining uncorrected Market Flaws justify a summer-season time-out.⁵

The Indeck Companies⁶ seek to have it both ways on the Market Flaws issue. Initially, Indeck argued that an extension to file an intervention and protest was necessary given that the NYSEG Complaint is lengthy, containing more than 90 pages, and includes three supporting affidavits that are loaded with highly technical factual assertions, which require careful analysis by specialists.⁷ Then in its Intervention, Indeck states that the Complaint provides no facts to show that the NYISO has acted unreasonably or that any of its tariffs are unjust or discriminatory. At no point does NYSEG even come close to satisfying its burden of proof or even its burden of going forward.⁸ This latter assertion is utterly false. The heart of the NYSEG Complaint and the affidavits established without doubt that the NYISO-administered markets are plagued by extra tariff pricing rules, software flaws that lead to irrational and counterintuitive results contrary to a properly functioning competitive market, insufficient price signals resulting from incorrect implementation of the market design and tariffs, and untimely or nonexistent communications between the NYISO and market participants that exacerbate the identified Market Flaws.

Other intervenors are more consistent. Several wholeheartedly agree that the Market Flaws identified in the NYSEG Complaint pose a significant risk to themselves and the future of retail competition in New York. Motions and Letters in support of the NYSEG request for a summer capability period safety net were received from energy service companies and high-load retail users,⁹ among others.

⁴ Motion to Intervene and Comments of National Energy Marketers Association, May 5, 2000, at 3.

⁵ Motion for Intervention and Protest by Pace Energy Project, May 12, 2000, at 4.

⁶ Indeck Energy Services, Inc., Indeck-Olean L.P., Indeck-Ilion L.P., Indeck-Oswego L.P., and Indeck-Yerkes L.P. See Motion for Extension of Time to File Intervention and Protest and Request for Expedited Consideration (Indeck Motion for Extension of Time), April 28, 2000, and Motion to Intervene and Protest (Motion to Intervene), May 12, 2000.

⁷ Indeck Motion for Extension of Time, at 3.

⁸ Indeck Motion to Intervene, at 9-10.

⁹ Companies expressing strong support for NYSEG=s call for a safety net include, among others,

At least two other interventions represent retail purchasers of electricity, and both strongly urge the Commission to adopt some form of safety net for the summer capability period.¹⁰ The Owners Committee on Electric Rates, Inc., (OCER) a nonprofit organization representing large commercial electric consumers in New York City pointedly worries about the future of a competitive electric industry in New York. The uncertainty of pricing in New York this summer has already led a number of retail providers to withdraw from serving residential and small business customers. Even large customers, many of whom are OCER members, have been advised by their retail providers that retail service will not be continued for some accounts due to the lack of competitive options. Consumers, large and small, who experience unreasonably high electric bills this summer will not care whether blame should be placed with the utility, the NYISO or their retail providers. They will point to the experience as confirmation of their fears as to [the] wisdom of abandoning the regulated system in favor of electric competition.

NYSEG detailed the many Market Flaws for which documentation was available at the time of its initial filing. Other Intervenors have since noted other Market Flaws.¹¹ NYSEG reiterates its contention that the Market Flaws identified to date by NYSEG and others can lead the Commission to only one conclusion: unless a safety net is created to protect consumers and market participants, irrationally high energy prices and wild volatility could set back the nascent competitive markets in New York for years through the loss of the retail access programs, substantial financial harm to many market participants in all sectors of the energy markets, and exorbitant cost increases to both large and small energy consumers. With the continuing existence of Market Flaws, prices in New York will not be the result of a properly functioning competitive market or the result of cost-based rates, and thus can not be said to be just and reasonable.

Although the many generators serving New York seemingly speak with one voice opposing any change to the status quo, the Commission should recognize that even some external generators will be burned in the absence of a safety net and possibly leave the New

Advantage Energy, Inc., Hammond & Irving Inc., Strategic Power Management, Inc., International Wire Group, Inc., Parker Hannifin Corporation, and ITT Gould Pumps.

¹⁰ See Motion to Intervene in Support of the Complaint of New York State Electric & Gas Corporation to Suspend Market Based Rates for Energy Markets and Request for Emergency Technical Conference of Owners Committee on Electric Rates, May 12, 2000, and Motion to Intervene and Request for Relief of the City of New York, May 12, 2000.

¹¹ See, e.g. Motion to Intervene of Strategic Power Management; Motion to Intervene and Protest of

York markets as a result, thereby exacerbating the artificial scarcity caused by the Market Flaws described in the Complaint. It is not difficult to forecast that some generators who bid into and are accepted in the Day-Ahead Market will be forced to replace energy from tripped units at Real-Time Market prices that could reach tens of thousands of dollars per MWH. Many generators may be anticipating that exorbitant income from generation produced will outweigh exorbitant costs related to purchasing replacement energy for tripped units. It is nonetheless a game of chance, where tripping on the wrong day could wipe out months of moderate but steady income.

In its initial filing, NYSEG cited several flaws that hinged on the faulty operation of the BME. These included (1) curtailed bilateral transactions where the purchaser had its existing agreement displaced because the BME forecast a Real-Time price below the purchaser's mandatory decremental bid, but for various reasons the purchaser was forced to pay far more in the Real-Time market because the BME was grossly off the mark; (2) rejected energy bids hour ahead that were more economic than the resources dispatched in the RTM; (3) extreme price volatility which negates credible market signals among other things; and (4) such resultant uncertainty that the PJM has threatened to discontinue day-ahead transactions with the NYISO rather than continue to be subject to the NYISO's unpredictable curtailment of scheduled transactions.

Since NYSEG's Complaint, the BME has continued to confound market participants. Credible price signals are still largely nonexistent, the NYISO continues to address the issue of improperly curtailed bilateral agreements (although a fix has been attempted, withdrawn and re-implemented for external generators who bid into the DAM), convergence and price volatility remain far astray of acceptable norms, and now the only other ISO in the East, ISO New England, anticipates that it will be unable to rely on inter-control area transactions during emergencies and anticipated emergencies because real-time prices in New York are unavailable until well after the fact.

NYSEG had earlier noted in its Complaint that PJM warned it may discontinue day-ahead transactions with the NYISO because of short-notice curtailments.¹² Now, ISO New England has concluded that it does not expect to transact with the NYISO during periods of

PECO Energy Company, May 11, 2000.

¹² By letter of May 22, 2000, PJM indicated that it was encouraged by the NYISO's decision to correct the software to solve the issue of short-notice curtailments, as are we. Time is too short at this juncture to delay implementation of fixes for which a solution has been identified.

pre-emergency and emergency conditions because real-time prices in New York are not available on a timely basis. In a May 17, 2000 letter to market participants, ISO New England President and CEO Philip Pellegrino stated [t]he ISO must very reluctantly and regrettably withdraw its support for adoption of a resolution related to Option 2 to implement Emergency Energy Transactions [because of] extenuating circumstances concerning the operation of the New York wholesale power markets that militate against adoption of the proposal at this time. Option 2 was a proposal that would allow emergency transactions to set the ISO New England's Energy Clearing Price.

Pellegrino continued:

Events of recent days indicate that there is an extraordinary degree of price uncertainty related to transactions between New York and New England, which is typically the source of most New England emergency purchases. The price uncertainty is likely to preclude any reasonable or accurate estimate of the purchase price of an inter-control area transaction. The NYISO has indicated that it is unable to provide a real-time estimate of the price. These price estimates were an essential component of the proposed NEPOOL Market Rule changes. Without accurate price estimates the proposal to allow Participant energy and emergency transactions to set the clearing price is unworkable.

As an example, on May 8, 2000, ISO New England purchased emergency energy from New York up to a maximum of 342 MW, during 3 hours in the morning and 2 hours in the evening. During these hours, the integrated hourly real-time prices posted on the New York ISO website (NEPEX bus) ranged from a low of approximately \$77 per MW to a high of approximately \$1,453 per MW. In other hours when the ISO was not purchasing emergency [energy] from New York, the New York integrated hourly price was as high as \$3,387 per MW.

Final pricing is not available until five days after the fact. It is also noteworthy that the New York ISO has price correction authority. When the final prices for May 8 became available, they were reduced to a range of approximately \$78 per MW to approximately \$249 per MW. The \$3,387 price was reduced to \$331 per MW. This price uncertainty results from inconsistencies between New York's Balancing Market dispatch and its real-time dispatch. There are also problems related to the dispatch of their gas turbines that cause incorrect dispatch and prices.

Since many of the external energy transactions from Participants are also similarly sourced in or through New York, it will be difficult, if not impossible for the seller to determine a delivered price to New England in real time. Hence, we expect that sellers will protect themselves financially by either refusing to bid or by submitting bids with very high prices.

The PJM and ISO New England alarms regarding inter-control area energy transactions

is serious evidence corroborating the extent of the NYISO problems. If inter-control area energy transactions are artificially impeded by uncertainty due to market flaws, the resultant artificial scarcity raises very troubling market power concerns. It is essential that New York institute a safety net as soon as possible to check these market distortions.

As noted earlier, in a single hour, the projected real-time price in the Capital Zone of the New York energy market went from -\$68,307.30 to \$58,887.79. In a one-hour span, the price for energy in New York moved more than \$125,000/MW. Price movements of this magnitude are outside the scope of reasonable expectations. The repercussions of a malfunctioning BME crop up in many areas. In the area of bilateral agreements, when the BME price prediction is negative, any positive bid amount is curtailed by the BME. For instance, when the BME price was -\$68,307.30, low-cost energy bids from inexpensive sources are not accepted and bilateral transactions with higher decremental bids are curtailed. When the real-time price is positive, as rationality dictates, the computer software modeling in the Real-Time Market (RTM) nevertheless presumes a functionally rational BME, and the BME s curtailment damage can not be undone. Prices well above the competitive level are paid because available low-cost resources are first swept aside, then ignored. This single scenario is repeated over and over in the current NYISO energy markets. Even more often, an absurdly low, albeit positive, BME price prediction sweeps away the reasonable energy bids, only to have the markets in real-time scramble to find available energy, consistently at higher than necessary prices.

The BME was also intended to function in part as a provider of price signals. When the BME predicts real-time prices to be negative or extremely low, it effectively drives available but uncommitted generation out of the RTM. It also signals no further generation is needed, thus units that are up and running prepare to shut down upon completion of their commitment. When prices reverse and hit highs of \$50,000 and more, just the opposite operation signal is sent to generators. Now the scramble is on to lock in such prices and ramp up as quickly as possible. Conversely, load serving entities and energy users are confronted with similar diametrically opposed price signals within a span of one hour. Though very limited, those loads that would respond to hour-ahead price signals are left clueless. Price signals are detached from reality and appear nonsensical, and over time lose any credibility. Free markets can operate adequately under a wide variety of circumstances and variables; inadequate or nonexistent price signals, however, are a sure formula for inefficiency. Free markets can not operate as intended in the

absence of credible price signals. The NYISO's BME is clearly broken and must be overhauled or discarded. Undeniably, market participants are not receiving proper price signals, which are a fundamental requirement of a market-based system.

Indeck and PECO note, as NYSEG did in the Complaint, that the NYISO is working to correct the Market Flaws. Unlike the other two, given the enormity of the task involved, NYSEG does not think it reasonable to bank on sufficient corrective action soon enough to handle the strains of summer. Even where the NYISO identifies a problem, studies it and introduces a fix, there is no guarantee that the fix will (1) adequately resolve the initial problem or (2) avoid creating derivative problems potentially as troubling as the original problem. The issue of energy imports from neighboring control areas is a clear example of a NYISO fix gone awry.

In its Complaint, NYSEG's uncontroverted data indicating that external generators were not participating in the New York energy markets to the extent previously was posited as the result in part of faulty software in the DAM and BME setting prices at less than the generator's bid price. NYSEG detailed the process by which external and internal generators were supplying energy to the neighboring control area and subsequently being charged for the transaction when the real-time price surfaced many days later. See Complaint pages 9-12.

In response to this irrational and unfair circumstance, the NYISO unilaterally extended the Bid Production Cost Guarantee (BPCG) to external generators to make them whole in an instance where their costs exceeded their income from such transactions. The extra-tariff nature of this unilateral policy adoption aside, the fix is far from perfect. In fact, on May 12, 2000, the NYISO concluded that external generators were exploiting the BPCG, and called for the immediate posting of an Extraordinary Corrective Action. NYISO President Bill Museler informed market participants in an open letter that [t]his Market Design Flaw must be corrected because of the significant impact that Market Participants exploiting this Market Design Flaw have caused on prices in the last few days. These prices are not prices based on supply and demand levels determined by efficient competition in periods of relative scarcity. I have further determined, based on consultations with ISO Staff, that (ii) corrective measures are required immediately and must take effect before the ISO can begin or complete consultation and cooperation with the Market Participants, and jurisdictional agencies as necessary, to develop an appropriate rule or rule change in accordance with the ISO Agreement.

In a second instance of a fix gone awry, the NYISO on May 22 attempted a Business Issues Committee-approved software fix to the problem of curtailed bilateral transactions involving external generators. In this common occurrence, the BME wrongly predicts a low real-time price for energy relative to the decremental bid, and therefore curtails the existing bilateral transaction in favor of the BME-predicted real-time LBMP price. Under this circumstance, the party to the bilateral should pay no more in real-time than its decremental bid, and most often less because the decremental bid, when employed, should be the new ceiling price of the real-time LBMP for that transaction. Instead, when settlement occurs several days later, the actual real-time price is well above the decremental bid (and the pre-existing bilateral agreement price). See NYSEG Complaint at 10.

The NYISO sought to remedy this common occurrence by effectively bypassing the problematic step, having the price cycled through the BME, by preprogramming the NYISO computers to automatically add or subtract twenty thousand dollars to the bid amount in order to take the bid outside the region normally allowed for bids. Because input limitations allow decremental bids of only six digits, including cents, the highest and lowest bids that a market participant can enter are \$9,999.99 and -\$9,999.99 respectively. By adding or subtracting twenty thousand dollars to the bid amount, the NYISO gives the bids qualifying for such treatment an absolute priority over any nonqualifying bids limited to six digits.

For an unknown reason, the original fix did not work as anticipated. Within hours of implementing the software change, the fix was removed because transactions were still wrongly being cut by the BME. A second attempt was made on May 23. Presumably this time the patch will rectify one of the many flaws identified in NYSEG's Complaint. Assuming the patch works and does not give rise to other unintended consequences, there remains a barrier to efficient operation. External suppliers and LSEs must regain confidence in the system. This may take time the New York market participants do not have.

Apparently unmindful of these experiences, the NYISO continues to insist on an optimistic schedule for resolving and implementing market flaw fixes prior to the summer peak season. The schedule does not allow for setbacks or wrong implementation choices. Interestingly, in a cover note to NYISO Technical Bulletin #40, which explains the software modification that adds or subtracts twenty thousand dollars and how it applies, the NYISO stated that the fix was being implemented on May 22 because [i]mplementing this change today is required to allow meeting the June 1st deadline for other NYISO project list software

modifications. Whether the apparent one-day delay will impact the other scheduled project software modifications is unclear.

While NYSEG and other market participants continue to offer their services and participation in the committee process to fix the highest priority problems in the shortest time possible, it is nothing short of foolhardy to believe that the New York energy markets will be capable of generating prices that are based on supply and demand levels determined by efficient competition. They have not occurred so far -- during the low-load periods. The NYISO structure as it currently exists simply is not capable of facilitating the invisible hand of free markets without stubbing a finger or two in the process.

NYSEG does not wish to belittle the efforts of the NYISO, which is currently working on correcting some of the Market Flaws. The point is that even under the best conditions guided by the best of intentions, the current market-based energy and ancillary services markets are incapable of withstanding the extreme summer demands. Even a slew of hurried fixes will not change that fundamental fact. To fully restore confidence in the New York energy markets will take longer than the few remaining weeks before the peak summer season is upon us.

INDECK S REQUEST THAT FERC DISMISS THE COMPLAINT BECAUSE THE NYISO COMMITTEES SHOULD HANDLE NYSEG S ISSUES IS MISGUIDED

The Commission has authority to order remedies. Indeck argues that the Commission must wait 60 days to do so at the same time it argues that NYSEG should not have gone to FERC until it exhausted the committee process.¹³ Under this theory, market flaws could be the subject of committee debate and alternative dispute resolution for four to six months. See NYSEG Complaint at 34.

NYSEG filed its Complaint with the Commission because the remaining time before the beginning of the summer capability period was rapidly dwindling and there was, and remains, no rational reason to conclude that the NYISO could adequately deal with the identified Market Flaws in the short time available. More importantly, committees don t develop, test and implement software changes. Nonetheless, NYSEG has pursued the committee process at every step available and has participated in most of the major committees, subcommittee and working group meetings.

Notwithstanding these efforts, NYSEG and the committees ran out of time. A few key examples are in order.

At a meeting on February 3, 2000, the Management Committee discussed a relatively simple and easy-to-implement fix to resolving the unnecessary curtailments of external transactions scheduled in the DAM - the treatment of external firm transactions as must run. The curtailment problem and the must run fix was originally identified by the Scheduling and Pricing Working Group back in January. By mid-March, the problem was still unresolved when PJM drafted a letter of complaint to the NYISO and threatened to take independent action to protect the operations of its system including withholding the pre-scheduling of transactions with the NYCA. Despite the PJM pressure, it took until May 22, 2000, for a fix to be instituted.¹

In sum, the NYISO and the committees took more than four months to implement the proposed fix to a problem that was serious enough to motivate a neighboring control area operator to threaten to take drastic isolating measures to protect its system.

¹³ See Indeck Motion to Intervene, at 14, 17-20.

¹⁴ As described earlier, this fix was withdrawn and a modified fix installed on May 23. According to the NYISO, the latter fix is working properly.

NYPA raised the issue of limiting generator output to Dependable Maximum Net Capability (DMNC) in a letter dated December 13, 1999. The NYISO Operating Committee addressed the issue in January 2000 and it required the Business Issues Committee involvement. During a January 12, 1999, meeting of the Scheduling & Pricing Working Group, the working group members decided that limiting a generator s energy bids in the DAM to that generator s DMNC level was unnecessarily restrictive. The Operating Committee approved a measure on April 19 (four months later) that declared there are no reliability impacts on generators exceeding their DMNCs with certain qualifiers. Notwithstanding the Operating Committee approval in April, the ISO did not actually implement the measure until mid-May (Technical Bulletin #46 issued May 23, 2000). Note that this is a result of the By-Laws that state in section 4.11: Any action taken by the Operating Committee at any meeting shall not become effective until 30 days after the Operating Committee has acted. As in the earlier example, this relatively simple change took over five months to implement through the committee process.

3. Again, during the January 12, 2000 meeting, the Scheduling & Pricing Working Group concluded that serious problems were being caused by the lack of correlation between the BME results and the RTM. More than four months later, the BME is still the apparent cause of many NYISO problems, including lack of convergence between BME predicted prices and RTM prices, exceedingly high volatility which negates price signals, and the curtailment of bilateral and external generation transactions, as discussed in other sections of this Answer. Finally, on May 23, 2000, the NYISO issued a report¹ concluding that the price differences between BME and SCD [Security Constrained Dispatch, or software applicable to the RTM] have market and reliability consequences. The report states that there are no short-term solutions to the basic functional and structural differences between BME and SCD.

¹⁵ Initial Report on Price Differentials Between Balance Market Evaluation and Real-Time, dated May 23, 2000.

The overall problem lies not in NYSEG's lack of involvement in the committees, but rather in the nature of the Market Flaws. Were there only one or two finite problems, or long-term policy issues at stake, then the committee processes could address most situations. In the instant case, the problems are far too large and the impacts far too immediate and severe to wait for the committees. In any event, NYSEG did not sit idly by in the committee meetings. Prior to filing the Complaint, NYSEG representatives, on many occasions, raised these problems during committee meetings and with the ISO's senior level staff, including its CEO, and its directors.¹⁶ On January 24, 2000, and February 25, 2000 NYSEG sent letters to the ISO describing major market flaws or failures requiring immediate attention by the NYISO.

Dissatisfied with the NYISO's lack of action in correcting the Market Flaws identified by NYSEG, and the continuing regularity of Market Flaws distorting the New York energy markets, NYSEG addressed a March 17, 2000 letter to the NYISO Board of Directors, with copies to the NY Public Service Commission, reiterating the many Market Flaws plainly visible to NYSEG and other market participants. In the March 17 letter, NYSEG President and Chief Operating Officer Michael German stated, "[w]e have written to and had many other communications with ISO Staff about significant problems with NYISO operations. Notwithstanding the NYISO's efforts, we see inadequate changes in the performance of markets. It has reached the point where we no longer have confidence in the ability of the NYISO to manage the transmission grid and electricity markets. This is particularly troubling as we approach the most vulnerable period, the summer peak season.

NYSEG seeks the Commission's intervention only after exhausting every reasonable opportunity available in and outside the committees. NYSEG recognizes that the NYISO markets are new, the market mechanisms are complicated, and NYISO staff is advancing on the learning curve. Given sufficient time, the NYISO could resolve the problems experienced over the last six months. Unfortunately, summer is upon us and no customer in New York can afford the luxury of awaiting committee resolution of these significant problems.

¹⁶ NYSEG's correspondence is attached to this filing.

The underlying impetus in all of NYSEG's actions is to improve and preserve the future for competitive electric markets in New York. If this requires a temporary time-out or other short-term fix, this approach is far more desirable than a chaotic summer of extreme price volatility and financial damages to many market participants, including the new competitive retail suppliers.¹⁷ The NYISO committee process necessarily involves stakeholders, and is designed to work in a deliberate, contemplative fashion. NYSEG has worked with that process and not achieved results necessary to sufficiently diminish the likelihood of a chaotic summer capability period. Today, time is of the essence. NYSEG has been addressing the many Market Flaws since January and thus far has little to show for its efforts. The Commission should act immediately to do what is necessary to ensure a safety net for the summer months; in the absence of Commission action, the future of electric competition in New York truly is in jeopardy.

THE COMMISSION HAS THE AUTHORITY AND RESPONSIBILITY TO GRANT THE RELIEF REQUESTED BY NYSEG

Contrary to the assertions of Indeck and others, the Commission possesses the authority to grant the relief requested by NYSEG. The FPA empowers the Commission to take whatever actions are necessary to ensure that the provisions of the FPA are carried out. 16 U.S.C. 825h. The Commission's regulatory powers are, to be sure, broad, viz., to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules and regulations as it may find necessary or appropriate to carry out the provisions of this chapter. Kokayko v. FERC, 873 F.2d 419 (1989). Included among the provisions of the FPA, is the requirement that rates under the Commission's jurisdiction must be just and reasonable. In the instant case, the Commission has already made the determination that the NYISO's tariff is just and reasonable; however, because of market anomalies, the approved NYISO tariff cannot be followed. Remedial action is required. As long as these market anomalies exist, the NYISO cannot follow the approved tariff. Particularly in view of the upcoming peak summer season, NYSEG's complaint requests that the Commission exercise the necessary actions to stem the assessment of unjust and unreasonable rates that have resulted from a flawed system. NYSEG requests the institution of a safety net, such as price screens and a refund effective date, while the NYISO and market participants work together to address the Market Flaws.

¹⁷ See Motion to Intervene by Strategic Power Management, Inc., May 4, 2000.

The Commission's authority to order a remedy here does not run afoul of the filed rate doctrine. Invoking the filed rate doctrine presupposes that rates are being applied as filed. They are not. An abundance of evidence supporting the deviations from the tariff is found in the affidavits affixed to NYSEG's Complaint. The evidence presented illustrates that there is a confluence of severe implementation problems to date, including extra-tariff pricing rules, software problems and communications problems (collectively "Market Flaws") [that] have strained the NYISO market to the point that short-term safety net is the only prudent course to avert potential disaster this summer. NYSEG Complaint at 2. The Commission's expectations that a system of market-based rates could successfully co-exist with the NYISO tariff has not materialized.

Because the enforcement of filed rate schedules is a matter distinctly within the Commission's statutory mandate, see 16 U.S.C. ' 824d; 18 C.F.R. ' 35.1(e); *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-252 (articulating filed rate doctrine), the Commission has an independent regulatory duty to remedy a utility's violation of its filed rate schedule.

Duke Power v. FERC, 864 F.2d 823 (D.C. Cir. 1989). In the face of unjust and unreasonable rates under the current market-based rate regime, the FPA commands the Commission to act to ameliorate this untenable situation.

Moreover, claiming that the filed rate doctrine precludes remedial action in the face of economic damage being encountered in the market would amount to placing form over substance. The NYISO cannot follow the Commission-approved tariff as the Commission intended. The Commission reasonably assumed that the NYISO would optimize the DAM and RTM, that dispatch and curtailment decisions would be non-discriminatory based on economics. NYSEG has proved this is far from the case. The tariff is approved, but in key areas ineffective. Commission inaction in the wake of unjust and unreasonable rates is not allowed. The Commission cannot sit by and await the outcome of another proceeding wherein the NYISO tariff would be amended.

NYSEG's complaint provides evidence of the imperfections of the NYISO-administered markets. Its complaint is lodged against the NYISO, not the entities participating in the New York energy market with approved market-based rates. NYSEG is not attempting to use the filing to unlawfully abrogate the filed rates of suppliers. Indeck Protest at 4. Prior to NYISO operations on November 18, 2000, most suppliers had one option in New York bilateral transactions at market-based rates. Under any remedy proposed by NYSEG, suppliers would still have that option. The infirmities in the market are distinctly under the NYISO tariffs, software, and operations NOT under a supplier's bilateral market-based tariff. The claim that NYSEG should have filed a complaint against each supplier does not withstand scrutiny. Hence the relief requested by NYSEG does not require a series of complaints filed against the individual market participants. See Indeck Motion to Intervene at 14. NYSEG's complaint is plainly addressed at the NYISO rates and charges, not the market participants with filed market-based tariffs.

Moreover, the relief requested by NYSEG does not impede the ability of those market participants to transact in the New York energy markets. Such relief would not be financially ruinous for generators nor result in inadequate electricity supplies this summer. See Indeck Protest at 4. Bilateral arrangements continue to remain an option during the summer peak period and thereafter. The relief requested by NYSEG does not close the door on the ability of market participants to partake of the energy market.

A REFUND EFFECTIVE DATE UNDER SECTION 206 IS NECESSARY

Indeck, PECO and some of the other intervenors argue that the Commission should not establish a refund effective date. The intervenors fail to refute any of the evidence NYSEG has presented. Most of the interventions corroborate NYSEG's evidence and identification of the Market Flaws. Under these circumstances, the prices produced in the NYISO-administered markets cannot be said to be the result of a properly functioning competitive market or the result of cost-based rates. Consequently, NYSEG has established the burden of showing that the rates are not just and reasonable. The Commission does not have the authority to suspend the just and reasonable standard. Accordingly, a refund effective date is necessary.

NYSEG's complaint also seeks a refund of charges impermissibly charged by the NYISO since ISO startup in November 1999. The Commission may order refunds where filed rates are not followed. See e.g., Carolina Power & Light Company, 17 FERC & 61,118, 61,238 (1981) (We find that CP&L improperly increased its rates as early as May 1977, and that the company should refund to its wholesale customers, with interest, amounts illegally charged under its fuel adjustment clause for service between the time of its nuclear fuel accounting change and December 29, 1977.) The Commission has an independent regulatory duty to remedy a utility's violation of its filed rate schedule. Duke Power Co. v. FERC, 864 F.2d 823 (D.C. Cir. 1989). Erroneous changes due to software flaws and other implementation problems similarly should be subject to refunds. As charges have impermissibly been assessed since the commencement of ISO operations, Commission precedent dictates that the refund be effective as of the date the Commission-approved ISO tariff went into effect.

**INDECK'S ASSERTION THAT NYSEG IS
UNPREPARED FOR THE SUMMER CAPABILITY
PERIOD IS UNFOUNDED AND LUDICROUS**

Indeck's Motion to Intervene includes a section speculating that the underlying reason for the NYSEG Complaint is NYSEG's last-minute attempt to manipulate the bilateral energy markets because, according to Indeck, NYSEG has failed to properly plan for the summer capability period. Indeck states that NYSEG's failure to follow industry planning norms, coupled with its seemingly rushed Complaint filing, suggests that the Company may be using the regulatory process to mask its own planning failures.¹⁸

¹⁸ Indeck Motion to Intervene at 23. Notably, Indeck again attempts to belittle the NYSEG Complaint by calling it a seemingly rushed Complaint filing. Earlier in this Answer, we point out that Indeck's first response to the Complaint was that it is lengthy, containing more than 90 pages, and includes three supporting affidavits that are loaded with highly technical factual assertions, which require careful analysis by specialists. See Indeck Motion for Extension of Time, at 3 (emphasis added). This degree of hypocritical theatrics would be humorous were the substantive issues that NYSEG addresses of lesser import.

Indeck offers absolutely no support for its speculation that NYSEG filed the Complaint because NYSEG was not prepared for this Summer. Indeck's bald claim is unsupportable for several reasons. First, NYSEG is substantially hedged this Summer. Second, Indeck's claim is not relevant to the central issue presented in the Complaint -- current NYISO rates under NYISO tariffs are not just and reasonable because they are neither the result of properly functioning competitive markets nor cost-based. The uncontroverted infirmities in the NYISO markets may not be allowed to persist. By attempting to shift the focus on to "preparedness," Indeck seeks to avoid the merits of the Market Flaws. Third, the utilities in New York are subject to exogenous factors completely beyond their control. For example, energy service companies serving retail access customers generally have the right to turn retail load back to the traditional utility suppliers on such short notice that there will be no time to secure bilateral contracts in advance of the Summer to serve these customers. Finally, the survival of retail competition in New York is jeopardized by the Market Flaws. Software flaws that produce extremely volatile and irrational prices require constant administrative recalculation. The manner in which this critical function is performed will have a substantial impact on energy services companies and retail competition in New York. Indeck's diversionary tactic to avoid the serious issues and to shift focus to NYSEG's preparedness must fail for all of these reasons.

CONCLUSIONS

NYSEG supports the implementation of price screens as described in the Member Systems intervention in this docket. Additionally, NYSEG has satisfied the burden to establish a refund effective date. There are sufficient price excursions that review is needed to determine whether the NYISO has identified and properly corrected prices associated with the Market Flaws. Refunds of any overcharges associated with the Market Flaws are appropriate. To the extent the NYISO failed to satisfy its obligations under its tariffs or failed to reasonably implement the Temporary Extraordinary Procedures, the Commission has the authority to require refunds for services since NYISO startup.

Wherefore for the foregoing reasons, NYSEG respectfully requests that the Commission:

Require an interim emergency safety net to satisfy the Commission's statutory duty to replace irrational, unjust and unreasonable rates with just and reasonable rates.

NYSEG and the Member Systems' price screen proposal, combined with vigilant review and use of the NYISO's Temporary Extraordinary Procedures are one vehicle to achieve this result.

Establish the earliest possible refund effective date applicable to prices and changes in the NYISO LBMP energy and ancillary services markets.

Establish an investigation and further procedures to resolve the issues raised in the Complaint, to the extent that they are not resolved through the procedures outlined in item 1 above.

Direct the NYISO to refund over-charges to the extent prices were the result of Market Flaws or are otherwise subject to correction.

Grant any necessary waivers to effect any of the foregoing.

Grant such other relief as the Commission deems just and reasonable or in the public interest.

Respectfully submitted,

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