NEW YORK STATE
DEPARTEMNT OF PUBLIC SERVICE

October 14, 2011

Attn: Nicole Bouchez, NYISO
Sent via E-mail: nbouchez@nyiso.com

Re: DPS Staff Comments on NYISO's Proposed Changes to Ancillary Service Mitigation Provisions

In the NYISO's presentation to the Market Issues Working Group on September 16, 2011, the NYISO proposed to remove the current bid cap of $2.52 for 10 Minute Non-Spinning Reserves throughout the State, and to remove the requirement for New York City units to offer 10 Minute Spinning Reserves at $0.(NYISO Proposal). The NYISO indicated that the purpose for these changes is to improve the convergence of day-ahead and real-time reserve prices during peak load hours, as recommended by the NYISO's Independent Market Monitoring Unit (MMU). Comments were solicited on the NYISO's Proposal by October 14, 2011.

The New York State Department of Public Service Staff (DPS Staff) hereby submits its comments on the NYISO's Proposal. DPS Staff is concerned that the NYISO's Proposal to lift the bid cap on Non-Spinning reserves and remove the $0 offer requirement for Spinning Reserves will cause generators to bid even higher in the Day-Ahead Market (DAM), result in greater price divergence between the DAM and Real-Time Market (RTM), and adversely affect consumers through unnecessary higher prices during the vast majority of the hours. We urge the NYISO to either drop this proposal or consider an alternative approach, which could achieve price convergence, but ensure proper mitigation is applied to minimize any unnecessary price impacts.

For example, the NYISO could consider estimating unit-specific reference prices based on marginal costs, and allowing for higher reference prices, where appropriate, in conjunction with tighter thresholds.

The presentation accompanying the NYISO Proposal clearly demonstrates that DAM prices are higher than RTM prices during a majority of hours (i.e., non-peak hours). By eliminating the bid caps in the DAM, it is logical to assume that generators will raise their bids in the DAM, resulting in even greater price divergence between the DAM in RTM during a majority of the time. There has not been any evidence presented to suggest that the NYISO Proposal will assist in converging DAM and RTM prices during the majority of hours (non-peak hours).

Although the NYISO's Proposal may result in greater price convergence during a small percentage of hours (i.e., peak hours), the NYISO should not pursue an approach that resolves purported inefficiencies in a few hours, yet causes adverse impacts during the vast majority of the other hours. Furthermore, the NYISO has not presented any analysis of the magnitude of any supposed inefficiencies. If the NYISO's Proposal is intended to assure generating units may recover their costs of providing reserves, then an analysis should be provided so that market participants are aware of what those costs are.

DPS Staff believes that the potential for market power issues persist, and that eliminating the bid cap for generators may give rise to the same types of inappropriate exercises of market power that required the implementation of the current bid caps in the first place. The Herfindahl-Hirschman Index (HHI) estimates provided by the NYISO show that the HHIs are still well above 2,500 during many periods, which indicates the market should be considered highly-concentrated. However, because the

HHIs were only based on generators that actually provided reserves, an analysis of the markets competitiveness should consider other bids that were provided during the relevant time periods. A focused analysis on the supply curves, based on the NYISO's estimates of marginal costs for suppliers, may provide a better indication of the possible price impacts, and the potential for inappropriate exercises of market power, particularly where the supply curves are steep.

While virtual bidding may help to converge prices, as the MMU has stated, the North American Electric Reliability Corporation's reliability standards prohibit virtual bidding in the reserve market due to reliability concerns. Notwithstanding, the MMU recommended that virtual bidding be allowed in the reserves market to help converge prices. It is unclear why the MMU does not share the NYISO's reliability concerns, or whether the MMU's recommendation to converge prices is practicable without virtual bidding for reserves. To the extent the NYISO has any other reliability concerns, it should identify what they are (e.g., whether needed suppliers are threatening to leave the ancillary services markets or reduce their supplies through various means, such as reducing ramp rates).

Given the absence of an analysis demonstrating the magnitude of the market efficiencies and purported benefits of the NYISO Proposal, and the evidence suggesting that the NYISO Proposal will actually cause greater price divergence between the DAM and RTM for a majority of the time, the NYISO should reconsider the dedication of resources to this effort compared with other priorities. Presumably, if any changes to the ancillary services mitigation provisions are made, the Market Monitoring Advisor would need to undertake continuous monitoring and analysis to determine if any uncompetitive bidding practices are evident and warrant the reinstitution of bid caps. The NYISO should consider the time and costs associated with these efforts compared to the costs of the purported inefficiencies.

Very truly yours,

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Dated: October 14, 2011
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cc: Adam Evans