

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

New York Independent System Operator, Inc.

Docket No. ER03-647-010

**RESPONSE OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.
TO COMMENTS ON THE ICAP DEMAND CURVE COMPLIANCE FILING**

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the New York Independent System Operator, Inc. ("NYISO") hereby responds to comments submitted in this proceeding by the New York Transmission Owners ("New York TOs"),¹ Multiple Intervenors,² and the City of New York.³ Each set of comments were submitted in response to the NYISO's July 17, 2007 compliance filing report on the implementation of the ICAP Demand Curves.⁴ None of the comments, however, provide any

¹ For purposes of this proceeding, the New York Transmission Owners are: Central Hudson Gas & Electric Corporation, LIPA, New York Power Authority, New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation d/b/a National Grid, and Rochester Gas and Electric Corporation. *New York Indep. Sys. Operator, Inc.*, Motion to Intervene and Comments of the New York Transmission Owners, Docket Nos. ER01-3001-018, *et al.* (Aug. 8, 2007) ("New York TO Comments"). Consolidated Edison of New York, Inc. filed separate comments. *See New York Indep. Sys. Operator, Inc.*, Motion to Intervene and Comments of Consolidated Edison Company of New York, Inc., Docket No. ER03-647-009 (Aug. 1, 2007).

² Multiple Intervenors consists of "an unincorporated association of approximately 50 large industrial, commercial and institutional energy consumers with manufacturing and other facilities located throughout New York State." *New York Indep. Sys. Operator, Inc.*, Comments of Multiple Intervenors, Docket No. ER03-647-008 (Aug. 8, 2007) ("Multiple Intervenors' Comments").

³ The New York Economic Development Corporation submitted comments on behalf of the City of New York. *New York Indep. Sys. Operator, Inc.*, Motion to Intervene and Comments of the City of New York, Docket No. ER03-647-009 (Aug. 8, 2007) ("City of New York Comments").

⁴ The Commission's rules allow parties to answer comments as a matter of right. *See* 18 C.F.R. § 385.213(a)(3). If the Commission decides to view these comments as protests, the NYISO respectfully requests permission to answer them. The Commission has allowed answers when

valid criticism of using a sloped demand curve versus a *de facto* vertical demand curve. Thus, the comments do not offer any reasonable basis to conclude that experience with the Demand Curves would justify reversing course and going back to vertical demand curves.

Some of the comments deal with offering behavior of some market participants under market power mitigation measures for certain New York City capacity that are the subject of a separate, ongoing Commission proceeding and investigation. Other comments ask for the Commission to force a response from the NYISO on the motivations behind individual investors' decisionmaking for construction of new generation, while ignoring the larger question of whether the Demand Curves provide appropriate price signals to the market as a whole. Lastly, the New York TOs filed comments, and a partial presentation prepared by their consultant, regarding Rest of State capacity that was unsold in 2006, that is at best collateral to an evaluation of the Demand Curves.

I. Sloped Demand Curves Help Mitigate Market Power

A. Market Power Mitigation Measures for New York City Capacity Are Properly Raised in the Commission's Investigation in Docket No. EL07-39

The City of New York commented that the NYISO's July 17 report offered a "benign explanation" for prices of New York City capacity in the ICAP Spot Market Auctions. As the NYISO reported, the prices for this capacity in the spot auctions are the result of offering behavior under the currently effective mitigation measures. This offering behavior is within the scope of a Commission investigation in Docket No. EL07-39 and a formal, non-public

they correct inaccurate statements and provide additional information that will assist the Commission, or are otherwise helpful in the development of the record in a proceeding. *See, e.g., New York Independent System Operator, Inc.*, 108 FERC ¶ 61,188 at P 7 (2004) (accepting NYISO answer to protests because it provided information that aided the Commission in better understanding the matters at issue in the proceeding).

investigation being conducted by the Commission's Office of Enforcement.⁵ That behavior is mentioned several times in the City of New York's comments and appears to be what its finds undesirable.⁶ These issues are not relevant to the subject of the NYISO's filing, which is a report on the historic performance of the ICAP Demand Curves under the market conditions as they existed from time to time. The City's filing properly addresses a separate set of market power mitigation issues and measures that are distinct from the ICAP Demand Curves, and thus the City's comments provide no basis for evaluating the performance of sloped as opposed to vertical demand curves.

B. Sloped Demand Curves Are Preferable to Vertical Demand Curves for Reducing Incentives to Exercise Market Power

The NYISO's July 17 Compliance Filing included an extensive discussion of withholding issues. The New York TOs filed comments about capacity located in Rest of State (the areas outside the New York City and Long Island Localities) that went unsold in 2006. The New York TOs, however, do not and could not suggest that using a vertical demand curve is preferable to the current sloped ICAP Demand Curves for reducing incentives to exercise market power; plainly, a sloped demand curve by its nature reduces the incentive for withholding. The New York TOs also do not offer any support for a conclusion that any Rest of State capacity that went unsold was the result of an effort by a market participant with market power in the Rest of State to withhold capacity for the purpose of artificially raising auction prices.

⁵ See *New York Indep. Sys. Operator, Inc.*, 120 FERC ¶ 61,024 (2007) (establishing paper hearing and referring allegations of possible market manipulation to the Office of Enforcement).

⁶ See, e.g., City of New York Comments, at 6 ("This bespeaks assiduous behavior to keep prices considerably higher than those that would prevail in a competitive market. The most logical inference to be drawn from such a persistent bidding pattern is that it has constituted an attempt to forestall the beneficial market effects that would ordinarily flow from the addition of 1000 MW of new, highly efficient generation in the City.").

One desirable aspect of using a sloped demand curve instead of a vertical demand curve is that it reduces incentives to withhold capacity. Neither the City of New York's or the New York TOs' comments provide any explanation of how reverting to a vertical demand curve would be preferable in markets facing sellers with market power. It is indisputable that a supplier benefits less by withholding capacity under a sloped demand curve than a vertical one. Using a sloped demand curve means that the supplier does not get the full benefit of withholding because its ability to raise the price is limited by the slope of the curve. That is, the effect on prices of withholding a megawatt of capacity is reduced in proportion to the slope of the demand curve. Whatever the situation with other mitigation measures, none of the comments filed challenge this reasoning or offer any justification for returning to *de facto* vertical demand curves.

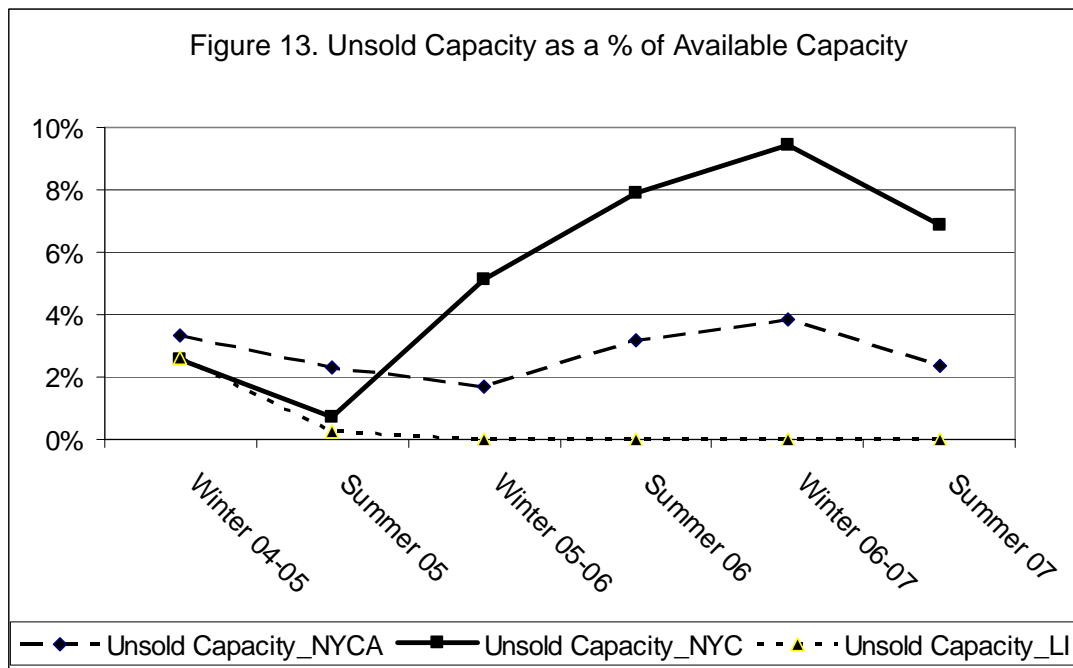
The New York TOs requested that the NYISO "assess whether physical or economic withholding of ICAP occurring in the Rest of State region has significantly affected New York's ICAP markets."⁷ The New York TOs agree with the NYISO that unsold capacity, by itself, does not necessarily mean that a market participant engaged in withholding in order to increase auction prices.⁸ Large levels of unsold capacity accompanied by significant price impact, however, could be a cause of concern.

In its July 17 Compliance Filing, the NYISO added the Rest of State capacity that went unsold with the unsold capacity in the New York City and Long Island Localities because both Localities are part of the NYCA. The following chart from that filing shows the percentage of

⁷ New York TO Comments, at 7.

⁸ New York TO Comments, at 6 ("The New York Transmission Owners agree that there are valid reasons why ICAP may go unsold, which makes it unwise to assume that the existence of unsold ICAP proves that market power has been exercised.").

available capacity that was unsold for each of the four categories of capacity – i.e. NYCA, the New York City and Long Island Localities, and imports from external control areas.⁹



As the NYISO’s report observed, “[f]or the NYCA as a whole, both the developments in New York City and the growing variability of imports contributed to the observed fluctuations in unsold capacity when measured as a percentage of available capacity.” The rise in unsold capacity in the NYCA in 2006 corresponds to an increase in the unsold capacity in the New York City Locality, which is the subject of a separately docketed investigation.¹⁰ The quantity of unsold capacity in the NYCA as a percentage of that offered did not go above four percent. After subtracting any unsold New York City and Long Island capacity, the amount of unsold Rest of State capacity is small relative to the quantity of capacity in the NYCA as a whole.

⁹ The data associated with this chart was included as Appendix B to the report.

¹⁰ See Docket No. EL07-39.

The New York TOs do not dispute these observations, but instead appear to rely on the notion that all capacity offered into the market should be sold.¹¹ Except for the specific market power mitigation measures for certain New York City capacity, however, there is no bid cap or must-offer requirement for any capacity in New York. The New York TOs' comments present no additional information that would lead to the conclusion that Rest of State capacity that went unsold was economically withheld in order to artificially increase prices under the NYCA demand curve. Moreover, even if such withholding had occurred, the TOs do not show that the Demand Curves were intended to be a complete remedy for market power, and thus do not show that such bidding behavior demonstrates that the ICAP Demand Curves did not work as designed and are not a significant improvement in the design of the New York capacity markets.

II. Sloped Demand Curves Are Preferable to Vertical Demand Curves for Providing Incentives to Construct New Generation

Multiple Intervenors' position appears to be that unless the NYISO can prove that an investor that has already built new generation in New York solely because of the sloped ICAP Demand Curves, the Commission should eliminate them altogether.¹² Eliminating the sloped ICAP Demand Curves, however, would mean returning to *de facto* vertical demand curves, and

¹¹ New York TOs Comments, at 6 (“if all of the unsold UCAP in the NYCA had been sold into the July 2006 ICAP spot market auction, the price of Rest of State UCAP would have fallen from \$3.33/kW-mo. to about \$0.58/kW-mo”). This assertion makes the assumption that all available capacity in the New York City and Long Island Localities and all capacity in Rest of State is sold. To examine the effects of potential withholding of Rest of State capacity, however, it would be necessary to remove the unsold capacity in New York City and on Long Island.

¹² Multiple Intervenors' Comments, at 5 (“Accordingly, consistent with the Commission's prior directives, the NYISO should be directed to provide a detailed analysis that demonstrates that the Demand Curves have been effective in encouraging new generation in New York. In the alternative, in the absence of such a showing by the NYISO, the Commission should conclude that the Demand Curves have been ineffective in attracting new generation.”).

Multiple Intervenors have not provided any rationale as to why vertical demand curves would provide better incentives to developers of new generation.

A fundamental difference between sloped and vertical demand curves is that a sloped curve recognizes that capacity in excess of the minimum requirement has value, while a vertical curve does not. In addition, the ICAP Demand Curves are carefully calibrated to ensure that market prices rise towards the net cost of new entry as the amount of available capacity approaches the minimum requirement. These distinctions significantly improve the incentives for a potential developer of new generation in comparison to a vertical demand curve, and are ignored by the Multiple Intervenors.

In addition, Multiple Intervenors insist that the NYISO provide an explanation of whether the “[ICAP] Demand Curves are responsible” for “generation projects that were proposed prior to the inception of the [ICAP] Demand Curves.”¹³ In fact, the report provides an extensive analysis of new generation, but also states that:

It is difficult to reach any definite conclusions regarding the effects of the ICAP Demand Curves on investment in new generation in New York mainly because, over the past several years, New York has had capacity available in excess of the minimum requirements to maintain reliability. On the other hand, the behavior of key market variables suggests that the system is geared to providing the signals necessary to provide appropriate incentives to new investment.

At the same time, it is plain from the “boom-and-bust” cycle that a vertical demand curve does not send the “signals necessary to provide appropriate incentives to new investment.” Moreover, these same price signals would be necessary for an efficient bilateral contracts market. Multiple Intervenors assert that the “need for bilateral contracts has been a long-standing mantra of many developers,” but it ignore the role of the ICAP Demand Curves in providing the appropriate capacity pricing benchmarks for the parties entering into such

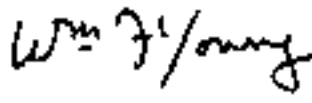
¹³ Multiple Intervenors’ Comments, at 4.

contracts. In short, the Multiple Intervenors' comments do not provide a basis for rejecting the evaluation of the ICAP Demand Curves provided in the NYISO's report.

III. Conclusion

For the foregoing reasons, the NYISO respectfully requests that the Commission accept the NYISO's compliance filing on the implementation of the ICAP Demand Curves.

Respectfully submitted,



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Dated: September 7, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document on the official service lists compiled by the Secretary in this proceeding in accordance with 18 C.F.R. § 285.2010 (2006).

Dated at Washington, DC this 7th day of September, 2007.

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