STATE OF NEW YORK
EXECUTIVE DEPARTMENT
STATE CONSUMER PROTECTION BOARD

George E. Pataki
Governor

C. Adrienne Rhodes
Chairman and Executive Director

May 9, 2001

Richard J. Grossi
Chairman, New York Independent
System Operator Board of Directors
C/O William J. Museler
President and CEO
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, NY 12303

HAND DELIVERED

Re: Motion in Opposition to Notices of Appeal to the NYISO Board of Directors Regarding the Management Committee's April 18, 2001 Approval of Penalties and Public Disclosure for Conduct That Results in the Application of Market Mitigation.

Dear Chairman Grossi:

Pursuant to the "Procedural Rules for Appeals to the ISO Board," enclosed are three original copies of a Motion in Opposition to Notices of Appeal of the Management Committee's April 18, 2001 decision regarding penalties and public disclosure.

The New York State Consumer Protection Board (CPB) submits this Motion in Opposition on behalf of itself and the following members of the NYISO's Management Committee, each of whom have authorized the CPB to file this Motion on their behalf: The New York State Department of Public Service, the New York Energy Buyers Forum, New York University, New York Presbyterian Hospital, Columbia University, Mt. Sinai Medical Hospital, Beth Israel Hospital, and the Association for Energy Affordability, Inc. A copy of the Motion in Opposition has been e-mailed to the NYISO's staff for service to all members of the NYISO Management Committee.

Very truly yours,

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Tariq N. Niazi
Chief Economist

cc: Debbie Doyle, via e-mail

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Motion in Opposition

In accordance with Section 2.02 of the *Procedural Rules for Appeals to the ISO Board*, the New York State Consumer Protection Board (CPB), the New York State Department of Public Service, the New York Energy Buyers Forum, New York University, New York Presbyterian Hospital, Columbia University, Mt. Sinai Medical Hospital, Beth Israel Hospital, and the Association for Energy Affordability, Inc., jointly submit this Motion in Opposition regarding the jointly filed Notice of Appeal of Aquila Marketing Corporation and Morgan Stanley Capital Group, Inc. and the Independent Power Producer's filing on behalf of its members (collectively, the Appellants) to the New York Independent System Operator (NYISO) Board of Directors (Board) on the Penalty and Public Disclosure proposal. That proposal, approved by the Management Committee on April 18, 2001, requested that the NYISO Board concur in a joint §205 filing to the Federal Energy Regulatory Commission (FERC) to amend the Market Mitigation Plan (MMP) to include penalties and public disclosure for conduct that results in the application of market mitigation measures. We request that the NYISO Board of Directors reject those Appeals and approve the Management Committee's decision expeditiously.

Summary

The CPB sponsored a motion to amend the MMP to include penalties and public disclosure for conduct by power suppliers that results in the application of market mitigation. That proposal reflects compromises by all sectors, and is a reasonable and balanced measure to help prevent unreasonable price increases while furthering the development of a competitive market. It was approved by the Management Committee on April 18, 2001.

Currently, the NYISO's market mitigation authority is prospective only. The NYISO cannot retroactively correct prices that result in the application of market mitigation or assess financial penalties on the market participant to eliminate the profit from such conduct.[1] This loophole in the NYISO's market mitigation authority allows a market participant to engage in conduct that warrants market mitigation and receive the full benefit of that conduct unless and until its behavior is detected and mitigated. The objective of the penalty and public disclosure proposal is to provide a deterrent to such conduct. As such, it is a key component of a comprehensive market monitoring and mitigation plan that, if implemented as intended, will help ensure just and reasonable prices in New York's wholesale electric markets. Such a measure is necessary to restore consumer confidence in the restructured electric industry.

[1] An exception is physical withholding, where the NYISO has the authority to impose a financial obligation on the entity involved (Section 4.3 of the April 18, 2000 ISO Compliance Filing, Docket Nos. ER97-1523-020…et al.).

Argument

The arguments raised by the Appellants in their Appeals regarding this proposal are not new and have been thoroughly discussed and addressed by the Business Issues Committee, the Management Committee and working groups. The penalty proposal was initially presented at the Scheduling and Pricing Working Group on March 30, 2001. It was also discussed at special meetings of the Business Issues Committee on April 3, 2001 and April 16, 2001. Additionally, the proposal was discussed among members of the Penalties and Public Disclosure Task Force, which was specifically established to consider this issue. The CPB, the Department of Public Service (DPS) and various market participants also met with several generators outside of the formal NYISO structure to address their concerns. As a result of these and other meetings, the initial proposal was modified on numerous occasions to accommodate the appropriate objections and concerns of various market participants and the NYISO staff.

The penalties and public disclosure proposal ultimately approved by the Management Committee on April 18, 2001 reflects the compromises reached at these meetings. The numerous changes from the initial proposal presented to the Scheduling and Pricing Working Group on March 30, 2001 are a testament to the collaborative, open, and fair manner in which this proposal was developed, and the balanced resolution that was achieved.

The NYISO Board of Directors should give substantial weight to the fact that the decision of the Management Committee was reached following procedures approved by market participants and the FERC, including full discussion of the issues and compromises at the committee and working group levels. The motion on penalties and public disclosure was approved by 60.66% of the Management Committee and received overwhelming support from three sectors (End-Use, Transmission Owners, and Public Power and Environmental) and some support from other sectors. The outcome of this process should not be set aside in favor of contentions that were fully considered.

Several points raised by the Appellants repeat arguments already considered at the Committee and working group levels. Therefore, to assist the Board in considering these issues, we address only the Appellant's main concerns.

THE APPELLANTS' CLAIM THAT THE PENALTY PROGRAM IMPOSES DRACONIAN PENALTIES IN AN OVERLY BROAD MANNER IS WITHOUT MERIT.

The Appellants claim that the penalties approved by the Management Committee are draconian and overly broad.[2] This claim is without merit. In contrast, the proposed penalties are a measured response to deter conduct that can result in hundreds of millions of dollars in overpayments by consumers. A key feature of the penalty program is that penalties would be imposed only if a market participant engages in conduct that results in mitigation. Therefore, this proposal is a precise and focused measure that would not interfere with the development of a well-functioning competitive market. Indeed, it would encourage the development of such a market.

Moreover, mitigation occurs only after approval by the Market Monitoring Unit (MMU) of the NYISO. As part of its fact-finding efforts regarding the appropriateness of mitigation, the MMU provides market participants full opportunity to explain questionable bidding behavior. And far from being draconian, the penalties under this proposal are calibrated to increase gradually in response to repeated inappropriate conduct by the same entity. Finally, the NYISO has the discretion to waive these penalties.

The structure and magnitude of penalties in the proposal approved by the Management Committee reflects input from other market participants and the NYISO staff. The initial proposal called for penalizing the entire fleet, including all spot-market and bilateral transactions, of the entity engaged in conduct that

[2] Notice of Appeal of the Independent Power Producers of New York (Notice of Appeal of IPPNY)), May 2, 2001, at 1-2; Notice of Appeal of Aquila Energy Marketing Corp. and Morgan Stanley Capital Group, Inc. (Aquila Appeal), at 1.

was mitigated. That proposal was first modified to exclude long-term bilateral transactions and finally to only include the megawatts that were mitigated. The provision to constrain generators to their reference bid curve for six months after the third offense was also the result of compromise.

THE APPELLANTS' CLAIM THAT THERE IS NO RISK OF MARKET POWER IS FALSE.

The Appellants further claim that the NYISO Market Power Advisor found that higher electricity prices in New York were caused by increases in natural gas and oil prices, not market power.[3] However, the Market Power Advisor's analysis covered the summer of 2000 -- one of the coolest on record. Accordingly, peak demand conditions did not exist for a prolonged period of time. The Appellants fail to mention that the Market Power Advisor cautioned that market power is a concern in such peak demand situations:

> The following supply curve (referring to the Supply Curve for Day-Ahead Energy in New York) is similar to the supply curve in most electric markets – flat over the vast majority of output levels and very steep at peak levels.
>
> This supply characteristic illustrates why market power is a concern during the "super-peak" and when transmission constraints are binding – when prices are the most sensitive to changes in supply.[4] (Emphasis added)

The conditions under which market power is a concern may be even more apparent in a summer with normal or above normal temperatures.

CONTRARY TO THE APPELLANTS' CONTENTIONS, THE PENALTY PROPOSAL WILL NOT HARM THE COMPETITIVE MARKET.

Under the penalty proposal approved by the Management Committee, the NYISO could penalize inappropriate conduct that occurred 14 days prior to

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[3] Notice of Appeal of IPPNY, at 3-4; Aquila Appeal at 2, 4-5.

[4] NYISO, Annual Assessment of the New York Electric Markets 2000, April 17, 2001, at 17.

mitigation for physical withholding and 5 days prior to mitigation for other behavior. The Appellants claim that this provision will create uncertainty and discourage suppliers from selling energy and investing in new generation in New York.[5] This claim is inconsistent with the Appellants previous position, and is also incorrect.

The generators have previously argued that penalties for inappropriate conduct are preferable to other broader measures such as price correction. When "Expanded Price Correction Authority" was being considered at the committee level, the generators stated that penalties were preferable since they are targeted to the perpetrators rather than applied broadly to the entire market. However, now that penalties are being considered, generators are retreating further and apparently seek to avoid any responsibility for inappropriate conduct.

The purpose of applying penalties 14 days prior to mitigation for physical withholding and 5 days for other mitigation actions is to allow sufficient time for the NYISO's MMU to complete its data gathering and investigation. The 14-day and 5-day time periods reflect compromises, since investigations often take longer to complete. Contrary to the Appellants' claims, penalties will not create any uncertainty for generators that do not engage in conduct that results in market mitigation. Further, there is no merit to the claim that some generators may not be aware that they are engaging in conduct that can be mitigated, since the NYISO informs generators about their conduct and provides them an opportunity to change their bids before actual mitigation.[6] As for those who engage in conduct that results in market mitigation, such conduct should be penalized, since higher prices that result from market power can cost consumers hundreds of millions of dollars.

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[5] Id. at 5; Aquila Appeal at 1-2, 6-7.

[6] It should also be noted, that penalties will not apply for mitigation that occurs through the use of the NYISO's Automatic Mitigation Procedure (AMP).

THE APPELLANTS' CLAIM THAT PENALTIES VIOLATE DUE PROCESS AND RESTRICT THE GENERATORS' RIGHT TO APPEAL IS INCORRECT.

The Appellants claim that the proposal approved by the Management Committee is overly broad since it would penalize both the generation owner and its affiliates after the third violation by either entity.[7] This provision is required because actions by generation owners and their affiliates are coordinated since they are conducted by entities under the same management structure. To treat actions by these entities separately would undermine the application of the penalties and create opportunities for abuse. Further, this same principle is recognized in the affiliate rules that are part of the NYISO's committee governing structure, under which the parent company and/or affiliate are permitted to vote in only one sector.

The Appellants are also critical of the Alternative Dispute Resolution (ADR) provision of the penalties and public disclosure process. This is surprising since they previously advocated the ADR as an intermediate step between the NYISO's decision to mitigate and the market participants' appeal to FERC.

The Appellants are also critical of the imposition of penalties after the ADR process and before the FERC appeal process is exhausted. Overcharges that have been confirmed by the NYISO and the ADR process should result in penalties to protect consumers that have already paid bills reflecting such overcharges. Further, the vast majority of consumers are price takers and can do little to respond to unwarranted price increases. In contrast to the Appellants' view, the penalty proposal approved by the Management Committee appropriately balances the interests of consumers and generators.

[7] Id. at 6-7. Aquila Appeal at 3.

THE APPELLANTS' CHARGE THAT THE PENALTY PROPOSAL DISCRIMINATES AGAINST GENERATORS BECAUSE PENALTIES DO NOT APPLY TO LOADS AND TRANSMISSION OWNERS IS FALSE.

The generators argue that the penalty proposal should not be adopted because penalties would not be applicable to loads and transmission owners.[8] We were willing to consider well-structured proposals that apply penalties to any market participant that exercises market power. However, no market participant offered a proposal detailing how penalties applicable to loads and transmission owners would work, the circumstances under which they would be applied, and how they would be calculated. It was not until the Management Committee meeting on April 18, 2001 that an unfriendly motion, proposing penalties applicable to loads was introduced. No details were offered, other than that these penalties would mimic the penalties proposed for generators. The absence of a properly developed proposal applicable to loads for consideration by the market participants does not warrant delay in approving the Management Committee's decision to apply penalties to address market power by the suppliers of electricity.

THE APPELLANTS' CLAIM THAT THE PENALTY PROPOSAL INTRUDES ON FERC'S AUTHORITY TO GRANT AND REVOKE MARKET-BASED RATE AUTHORITY IS ERRONEOUS.

Contrary to the Appellants' claim, the penalty and public disclosure proposal approved by the Management Committee does not revoke the generators' market-based rate authority. It merely penalizes generators by lowering their bids to their reference bid curves after the third violation, as a measure to reduce the impact of their conduct on the market. Further, once approved by the NYISO Board, the penalty and public disclosure proposal will be sent to FERC for its approval. Contrary to the Appellants' contention[9], FERC will make the decision whether to grant this authority to the NYISO.

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[8] Id, at 7-8; Aquila Appeal at 8-9.

[9] Id. at 8-9.

THE CLAIM THAT THE PENALTY PROPOSAL GIVES TOO MUCH DISCRETION TO THE NYISO IS WITHOUT MERIT.

The Aquila appeal claims that the penalty and public disclosure proposal approved by the Management Committee gives too much discretion to the NYISO.[10] The original motion sponsored by the CPB gave limited discretion to the NYISO for the first offense for both penalties and public disclosure. The broader discretion that became part of the final motion approved by the Management Committee was an unfriendly amendment favored by over 70% of the committee, including almost all generators and other suppliers. During most of the committee proceedings, generators and other suppliers advocated the need for NYISO discretion. Now that it is part of the motion, over our objections, those same parties claim that it is a weakness of the proposal.

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[10] Aquila Appeal at 7-8.

Conclusion

The New York State Consumer Protection Board, the New York State Department of Public Service, the New York Energy Buyers Forum, New York University, New York Presbyterian Hospital, Columbia University, Mt. Sinai Medical Hospital, Beth Israel Hospital, and the Association for Energy Affordability, Inc., urge the NYISO Board of Directors to deny the Appeals, and ratify the April 18, 2001 decision of the Management Committee to amend the Market Mitigation Plan to include penalties and public disclosure for conduct that results in the application of market mitigation. We also request that the Board direct the NYISO counsel to seek FERC approval immediately.

Sincerely,

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C. Adrienne Rhodes, Chairman and Executive Director
Douglas W. Elfner, Director of Utility Intervention and Strategic Programs
Tariq N. Niazi, Chief Economist

Albany, New York
May 9, 2001