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Contact:

Carol E. Murphy 518-356-7580 / 461-1436 (cell)

Steven C. Sullivan 518-356-7605 / 461-1368 (cell)

Ken Klapp 518-356-6253

Mirant Northeast RTO Study Flawed

- Benefits of Combining Northeast Markets Uncertain -

Guiderland, New York, October 23, 2001 – A study of a Northeast Regional Transmission Organization (RTO) was based on a number of faulty assumptions that caused questionable conclusions and mischaracterization of issues, according to a review by economic consultants at LECG, LLC.

Following the publication of study results by Energy & Environmental Analysis, Inc. (EEA) for the Mirant Corporation in the September 1, 2001 edition of *Public Utilities Fortnightly*, the New York Independent System Operator (NYISO) asked energy industry analysts at LECG, LLC to conduct a peer review of the study in an attempt to duplicate its results.

"If policymakers have been relying on the numbers in this study to inform their decisions regarding a Northeast RTO, there is reason to be seriously concerned," said Steven C. Sullivan, spokesperson for the NYISO. "While the NYISO believes there can be benefits derived from a merger of the Northeast ISOs, who those benefits accrue to, and what market design will achieve those benefits are crucial questions that must be answered before any final decisions are made to merge the ISOs."

Among the incorrect assumptions identified were:

1. The study period examined (June 2000 through December 2000) was not a representative period of prices in the New York market. The early part of this period was the first summer in which the NYISO operated and during this period all three Northeast ISOs encountered "sham" transactions by market participants that appear to have been intended to distort real-time prices. Since that time this problem has been corrected and yet the EEA study does not reflect the impact of this correction.
2. The EEA study took no account of whether interregional flows were actually constrained by transmission limits and used a very overstated measure of available transmission in assessing the potential for, and benefits of, increased real-time interchange among the Northeast RTOs. Moreover, the study took no account of binding constraints within any of the three control areas and their impact on the shape of the control area supply curves or the quantity of load within each control area that would be impacted by the estimated price changes.
3. The study inappropriately compared day-ahead prices with real-time flows.
4. The study was based on estimated New York, PJM and NEPOOL supply curves for electricity that are likely to substantially overstate the response of supply to changes in real-time prices.

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5. The study did not consider the extent to which limitations of current ISO pricing systems (such as non-LMP pricing in NEPOOL) affected the study results.

When LECG adjusted for as many of these mistakes as possible and re-ran the numbers using the EEA approach, they found significantly different results. For example, analyzing a time period after the early “gaming” problems had been cured, the price reductions from the implementation of a combined real-time market between New York and PJM would have been overwhelmingly concentrated in PJM and the impact on New York energy prices would have been minimal or even to raise them by as much as \$90 million annually.

LECG further concluded that the EEA methodology could not provide a sound basis for estimating the benefits from publicly available data.

“The situation with the numbers generated by the LECG analysis is analogous to cooking. Using the right ingredients doesn’t mean a thing if you continue to use a bad recipe,” said Sullivan. To determine the true impact of merging Northeast electricity markets, a more scientifically valid study must be undertaken.”

Sullivan said the NYISO is considering such a study and could have it completed by the end of the year.

Additionally, Sullivan pointed out that the EEA study also significantly mischaracterized critical issues. With regard to whether there would be one or two proxy buses between PJM and New York, that study stated that “New York declined to accommodate PJM’s two pricing zones because of “software problems,” and thus PJM changed to one pricing zone.”

However, in reality, New York’s single proxy bus design was based upon its concerns over potential gaming and the resulting adverse market impacts from the use of multiple buses. Had the NYISO set up an additional PJM proxy bus, the potential would have existed for suppliers to realize large financial payments from New York without delivering any energy to that market. Indeed, it was precisely this kind of gaming by PJM market participants that caused PJM to move to a single proxy bus, as PJM itself acknowledged in their presentation to their Energy Markets Committee on March 28, 2001. PJM concluded that there clearly was gaming behavior in PJM, which resulted in a \$6 million deficiency in February 2001 settlements. The recommendation to create a single proxy bus was unanimously approved by the PJM Committee, in effect validating New York’s original single proxy bus design.

“The problems raised with this study underscores the need to consider carefully and plan for how Northeast market integration will take place,” said Sullivan. “After all, we are talking about building the single largest and most complex electricity market in the world and to move the RTO process forward, we need sound analysis that we can depend upon.”

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The New York Independent System Operator (“ NYISO ”)—www.nyiso.com—is a not-for-profit corporation established in 1999 to facilitate the restructuring of New York State’s electric industry. Based in New York’s Capital Region, in addition to administering the State’s wholesale energy markets, the NYISO operates the State’s high voltage electric transmission system. Last year, the NYISO’s market volume exceeded \$5.2 billion, more than all of the other Northeast markets combined.