

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

NEW YORK INDEPENDENT SYSTEM        )  
OPERATOR, INC.                            )       Docket No. EL07-39-000

**COMMENTS OF THE  
NEW YORK STATE CONSUMER PROTECTION BOARD  
ON THE COMPLIANCE FILING OF THE NEW YORK INDEPENDENT SYSTEM  
OPERATOR REGARDING THE NEW YORK CITY INSTALLED CAPACITY  
MARKET STRUCTURE**

Pursuant to the Order issued by the Federal Energy Regulatory Commission (“FERC” or “Commission”) in this proceeding on July 6, 2007,<sup>1</sup> the New York State Consumer Protection Board (“NYSCP”) submits these comments on the compliance filing made by the New York State Independent System Operator (“NYISO”) on October 4, 2007.

**I. BACKGROUND**

In a March 6, 2007 Order,<sup>2</sup> the Commission rejected a December 22, 2006, filing<sup>3</sup> by the NYISO proposing new mitigation measures for the New York City Installed Capacity (“ICAP”) market. Simultaneously, it instituted this proceeding under section 206 of the Federal Power Act “to investigate the justness and

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<sup>1</sup> New York Independent System Operator, Inc., 120 FERC ¶ 61,024 at p. 15 (2007) (“July 6 Order”).

<sup>2</sup> New York Independent System Operator, Inc., 118 FERC ¶ 61,182 (2007) (“March 6 Order”).

<sup>3</sup> 16 U.S.C. § 824d (“NYISO 2006 Filing”).

reasonableness of the NYISO's in-city ICAP market, and whether and how market rules need to be revised."<sup>4</sup>

On March 13, 2007, the Chief Administrative Law Judge appointed a settlement judge who scheduled several settlement conferences. However, after only a few settlement conferences it became apparent that the chances for reaching agreement were remote. On May 2, 2007, the Chief Administrative Law Judge informed the Commission that parties to the settlement process had reached an impasse and recommended that the settlement process be terminated.

On July 6, 2007, the Commission determined in response to a request filed by the Independent Power Producers of New York, Inc. ("IPPNY") that a single-phase paper hearing would "most efficiently and expeditiously address the issues in this case and bring about a solution of New York City's capacity market problems."<sup>5</sup> It directed the NYISO to file a fully-supported proposal for a revised in-city ICAP market, and gave the parties 45 days from the date of the filing to submit their comments. On October 4, 2007, the NYISO made the required filing.<sup>6</sup> The following are the comments of the NYSCP on that filing.

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<sup>4</sup> March 6 Order at 11.

<sup>5</sup> July 6 Order at 8.

<sup>6</sup> Compliance Filing of the New York Independent System Operator, Inc. Regarding the New York City ICAP Market Structure, October 4, 2007 ("NYISO 2007 Filing").

## II. SUMMARY OF THE NYSCPb POSITION

The NYISO's analysis clearly demonstrates that market power has been exercised in the New York City ("NYC") ICAP market, and there is the potential that it will be exercised in the future.<sup>7</sup> For the protection of consumers, the NYISO has proposed mitigation measures to apply to the three large generators serving NYC possessing market power.

The NYSCPb supports the NYISO proposal for mitigation of the financial effects of the exercise of market power that has cost customers tens of millions of dollars in unnecessary charges in each of the summers of 2006 and 2007. The NYISO supply-side mitigation proposal is well balanced. It will protect consumers from market power abuse without creating unnecessary obstacles for entry by new suppliers. We urge the Commission to adopt the NYISO's supply-side mitigation proposal without further delay.

We do not, however, support the NYISO proposal to eliminate the revenue cap from existing mitigation measures that were established by FERC when Consolidated Edison Company of New York, Inc., divested its generation assets.<sup>8</sup> The NYISO has not fully analyzed the effect its proposal would have on how suppliers operate their plants if the revenue cap is lifted, and the resulting impact on consumers.

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<sup>7</sup> NYISO's December 22, 2007 Filing in Dockets Nos. ER07-360-000 and EL07-39-000, Attachment II, Affidavit of Dr. David B. Patton, Ph.D. at ¶ 15 ("Patton 2006 Affidavit") and NYISO 2007 Filing, Attachment I, Affidavit of David B. Patton, Ph.D., October 4, 2007, ¶ 42 ("Patton 2007 Affidavit").

<sup>8</sup> NYISO 2007 Filing at 27.

The NYISO also proposes buyer-side mitigation measures. The NYSCPB opposes this proposal as well. The NYISO acknowledges that load serving entities (“LSEs”) are required to buy a quantity of ICAP that is determined by NYISO-defined demand curves, and, therefore, cannot exercise market power by withholding purchases to drive down market price.<sup>9</sup> Nevertheless, it raises the specter of new, uneconomic, LSE-financed generation entering the marketplace and artificially depressing capacity prices.<sup>10</sup> This is a completely unrealistic scenario. All large LSEs serving NYC are regulated utilities or state authorities. There is no reason to believe that regulators or responsible State officials would knowingly approve uneconomic, ratepayer or taxpayer-supported investments.

Finally, the NYISO, despite calling for mitigation measures that would have saved consumers tens of millions of dollars this summer, urges the Commission not to require refunds.<sup>11</sup> We find it difficult to comprehend why suppliers should be protected from the consequences of their continued abuse of market power, when the Commission’s March 6, 2007 Order establishing a refund effective date of May 12, 2007, clearly place them on notice that they could be held accountable for their actions.<sup>12</sup> We recommend that FERC reject this proposal and establish a proceeding to determine the appropriate level of refunds due to consumers.

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<sup>9</sup> Patton 2007 Affidavit ¶ 62.

<sup>10</sup> NYISO 2007 Filing at 28.

<sup>11</sup> Id., at 32.

<sup>12</sup> March 6 Order at 8.

### III. COMMENTS

#### **A. The Need for Market Mitigation Measures to Address Economic Withholding and the Exercise of Market Power in the New York City Capacity Market is Established.**

The NYISO's proposal for supplier mitigation is a well-balance plan that will protect consumers from the abuse of market power in the NYC ICAP market, while ensuring that suppliers are adequately compensated and that no disincentives are created that might inhibit the entry of new generators into the market. The NYSCPB strongly supports this proposal and recommends that it be adopted by the Commission.

The fact that improvements to existing supplier mitigation measures are needed is amply demonstrated in the NYISO's submission. In an affidavit submitted with the NYISO filing, Dr. Patton, the Independent Market Advisor to the NYISO, reports the results of two different analyses of market concentration in the NYC market.<sup>13</sup> The first, based on the Hirschman-Herfindahl Index ("HHI"), indicates a moderately concentrated market susceptible to abuses of market power.<sup>14</sup> The second, a pivotal supplier analysis, which Dr. Patton describes as "the most useful measure of structural competition in wholesale electricity markets," determines whether a supplier is "in effect ... a monopolist for some portion of the demand" because its resources are required to satisfy total demand for capacity.<sup>15</sup>

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<sup>13</sup> Patton 2007 Affidavit.

<sup>14</sup> Id., ¶ 26.

<sup>15</sup> Id., ¶ 28.

Based on these studies, Dr. Patton determines that all three Divested Generation Owners (“DGOs”) in NYC were pivotal suppliers during the Summer 2007 Capability Period.<sup>16</sup> Moreover, he concludes that without mitigation, it is rational for DGOs to withhold capacity to raise the auction price to its cap level,<sup>17</sup> and that it is unlikely that entry of new generators will change the pivotal status of all DGOs in the foreseeable future.<sup>18</sup>

In his affidavit supporting the NYISO’s December 22, 2006 filing, Dr. Patton reviewed the ICAP Spot Market Auction for the 2006 Summer Capability Period and concluded that the process was characterized by economic withholding to exercise market power.<sup>19</sup> As a result, the price of NYC ICAP during the 2006 Summer Capability Period exceeded \$12 per KW-month when a competitive price would have been between \$5 and \$6.<sup>20</sup>

In the NYISO’s October 4, 2007 filing, Dr. Patton reported the same analysis for the summer of 2007 and reached essentially the same conclusion that “each DGO was a pivotal supplier during the summer 2007 Capability Period”<sup>21</sup> and that “the competitive price in New York City would have been between \$5 and \$6 per

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<sup>16</sup> Id., ¶ 30.

<sup>17</sup> Id., ¶ 33.

<sup>18</sup> Id., ¶ 34.

<sup>19</sup> Patton 2006 Affidavit at ¶ 15.

<sup>20</sup> Id., at ¶ 14.

<sup>21</sup> Patton 2007 Affidavit ¶ 30.

KW-month during the 2007 Summer Capability Period.”<sup>22</sup> This indicates that consumers were charged more than twice what they should have been during the past two summers, resulting in ten of millions of dollars of unnecessary ICAP payments.

Based on its analysis showing that the NYC capacity market is highly concentrated and vulnerable to the exercise of market power, the NYISO has submitted a well-balanced mitigation proposal having four main elements that assure fairness to all market participants. First, the measures would apply only to suppliers that possess market power as determined by the pivotal supplier test.<sup>23</sup> This assures that suppliers who cannot manipulate prices are not adversely affected.

Second, the proposal ensures adequate compensation for generators by setting the reference prices for DGO bids at levels well in excess of their Going Forward Costs (“GFC”), defined as the revenue required from the capacity market needed to cover a generator’s costs, net of income, from sales of energy and ancillary services. Before each monthly Obligation Procurement Period, the NYISO would compute the clearing price based on the assumption that all qualified NYC capacity was sold and then set the reference level at the equilibrium price established by the intersection of the supply and demand curves.<sup>24</sup> Suppliers subject to mitigation would be required to offer resources in the spot capacity market

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<sup>22</sup> Id., ¶ 53.

<sup>23</sup> Id., at 26.

<sup>24</sup> Id., ¶ 54.

at or below their reference level. Higher offers would be reduced to the reference level. Because Dr. Patton calculates that the GFC for all types of generators in NYC, except oil-fired combustion turbines, are near zero, the reference price will always ensure that generators are fairly compensated in relation to their costs.<sup>25</sup>

Third, the NYISO's mitigation proposal exempts market participants owning or controlling less than 500 MW of unforced capacity, from the mitigation measures.<sup>26</sup> Again, this assures that the focus of these initiatives is on those suppliers with the ability to substantially affect the market price.

Finally, the NYISO proposal provides any generator the opportunity to justify a higher reference level through consultations with the NYISO's Market Monitoring and Performance unit and the independent Market Advisor.<sup>27</sup> Thus, any issue unique to a particular generator, or currently unforeseen, can be addressed.

The proposal is a sound, analytically supported solution to a serious market imperfection. Therefore, it should be adopted by the Commission.

**B. The Impact of Lifting Revenue Caps From the Previous Consolidated Edison Mitigation Measures as Proposed by the NYISO Has Not Been Properly Analyzed and Therefore it Should Be Rejected.**

In conjunction with the implementation of the new form of supplier mitigation, the NYISO is proposing to do away with the revenue cap included in the existing

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<sup>25</sup> Patton 2007 Affidavit ¶ 44, 51 and 54.

<sup>26</sup> NYISO 2007 Filing at 27.

<sup>27</sup> Patton 2007 Affidavit ¶ 59.

mitigation measures. The NYSCPБ opposes this element of the NYISO's proposal and urges the Commission to reject it.

In contrast with the well-documented foundation the NYISO presents for revision of the bid cap, it has offered no analysis or rationale to support the revenue cap elimination. It merely makes the irrelevant argument that "in general all participants in a market for the same product should be eligible to receive the market-clearing price."<sup>28</sup> While that may be true in a well-functioning competitive market, it is clearly not an entitlement of pivotal suppliers who deliberately abuse their market power.

When Consolidated Edison divested its generation plants, it was widely understood, and expressly recognized by the Commission, that the new owners would have market power in the NYC generation market.<sup>29</sup> To minimize the incentive for these DGOs to manipulate prices, Consolidated Edison requested that the Commission impose a cap on annual ICAP revenues. FERC approved that safeguard.

Even with the new supplier mitigation measures, there will remain opportunities for profit from price manipulation. For example, a DGO might extend a maintenance outage beyond the minimum time necessary, or prematurely decommission a unit. In either case, the reduction in available generating capacity would move the clearing price upward along the demand curve. As long as the increase in revenue from the DGO's remaining assets exceeded the lost income

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<sup>28</sup> NYISO 2007 Filing at 27.

<sup>29</sup> Id., at 4.

from the unavailable capacity, the generator's net revenues would increase. Economic withholding of capacity can exist even under a bid cap regime. A revenue cap, however, eliminates the incentive to engage in this activity. Removing the cap would not be in the public interest and therefore, given FERC's mission, should be rejected.

**C. The NYISO's Proposed Purchaser Mitigation Measures are Unnecessary and Should Not Be Adopted.**

Despite recognizing that the exercise of market power by purchasers in the NYC market "is impossible given the auction design because the quantity that the LSEs must obtain is determined by the demand curve," the NYISO, nevertheless, proposes buyer mitigation measures to protect DGOs from the danger of "uneconomic entry."<sup>30</sup> The scenario posited by the NYISO is one in which a purchaser of ICAP deliberately:

builds (or contracts for the capacity rights to) a plant that will lose money in the market, but will lower prices because it increases supply and moves the market down the demand curve.<sup>31</sup>

This is completely unrealistic. The purchaser mitigation measures are a pointless complication that should be summarily rejected by the Commission.

Large LSE's that have the financial ability to build and/or contract for large amounts of capacity are either regulated by the New York State Public Service Commission ("NYSPSC") or are State government authorities whose major

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<sup>30</sup> Patton 2007 Affidavit ¶ 62.

<sup>31</sup> Id., ¶ 63.

contracts are, by law, subject to extensive scrutiny by State officials.<sup>32</sup> It is hard to imagine any responsible regulator or other government entity sanctioning the use of ratepayer or taxpayer funds to build a generating plant or sign a major contract for capacity that is inherently uneconomic. It is difficult enough to get economic projects approved.

If the daunting approval process were not enough to thwart such a scheme, the fact that it is unlikely to work even if it is implemented should be. Even assuming an LSE were able to build its coveted uneconomic plant, it still might not be able to lower market prices because sellers could respond by retiring older generating units. Not only would this thwart the efforts of the LSE, it would leave it trapped with both high prices and the cost of its new uneconomic units. The scenario drawn by the NYISO as the basis for its buyer-side mitigation is simply unrealistic and should be rejected.

**D. The Commission Should Order the Refund of Overcharges for NYC ICAP that Have Occurred Since May 12, 2007.**

It is our understanding that comments submitted by the NYSPSC and Consolidated Edison in this proceeding will indicate that the price of NYC ICAP during the summer 2007 Capability Period persistently exceeded \$12 per kw-month. The NYISO's Independent Market Advisor concludes in his affidavit that in the absence of economic withholding by the DGOs, the competitive capacity price in the

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<sup>32</sup> See e.g. New York Public Authorities Law § 1005(6) which requires contracts for the sale of power from any project of the New York Power Authority to be at a price that covers all operation and maintenance expenses and all bond interest, amortization and reserve charges of the project providing the power; and § 1009 which requires any such contract to be submitted to the Governor, the Speaker of the Assembly, and the temporary President of the Senate, among others, and be subjected to public hearings before the Senate Finance Committee.

City during that period would have been between \$5 and \$6.<sup>33</sup> Since the May 12, 2007, refund effective date established by the Commission in its March 6 Order, New York consumers have been overcharged tens of million of dollars as a result of deliberate market power abuse.<sup>34</sup>

Despite its own findings, the NYISO in its filing is recommending that refunds not be ordered by the Commission because:

Ordering refunds and changing market outcomes after the fact may have a deleterious influence on perceptions of market credibility and regulatory uncertainty.<sup>35</sup>

The argument is flatly nonsensical. The NYC ICAP market during the Summer 2007 Capability Period had as a distinctive feature the existence of a refund effective date in this proceeding. Any rational participant in the market must have taken that factor into account, and cannot now claim to be surprised if the Commission chooses to exercise its refund authority in furtherance of its primary obligation to protect consumers from unjust and unreasonable prices.<sup>36</sup>

The NYISO's position is also rather disingenuous. Four years ago, in similar circumstances, it argued that:

sellers and buyers in a deregulated market ... expect to transact business pursuant to market-based prices; rebilling for past non-market prices would therefore be neither inequitable nor unpredictable.<sup>37</sup>

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<sup>33</sup> Patton 2007 Affidavit, ¶ 53.

<sup>34</sup> March 6 Order at 8.

<sup>35</sup> NYISO 2007 Filing at 33.

<sup>36</sup> See e.g., The Towns of Alexandria, Minnesota, et al. v. FPC, 555 F.2d 1020, 1028 (DC Cir. 1977).

<sup>37</sup> Consolidated Edison Company of New York, Inc. v. FERC, 347 F.3d 964, 969 (DC Cir. 2003).

In that case, the Court ignored the argument as having been untimely presented, and it denied the requested refunds on the grounds that market participants had not been given adequate notice that rates might be adjusted retroactively. Neither infirmity exists here. The Commission has given the required notice and the argument for refunds has been timely made.

Finally, we note that purchasers are just as entitled as sellers to a credible market in which they can have confidence. To ignore tens of millions of dollars in overcharges earned through the willful abuse of market power by entities that apparently feel they can confidently flaunt the Commission's refund authority without accountability and reprisal will seriously damage consumer confidence in the NYISO's ability to conduct its responsibilities in a manner that is fair to, and appropriate for, all market participants. It would also have a deleterious effect on their perceptions of market and regulatory credibility. Accordingly, we urge the Commission to establish a refund proceeding for the purpose of determining any amounts that should be returned to consumers because of overcharges resulting from the egregious economic withholding of capacity in the NYC ICAP market after May 12, 2007.

**CONCLUSION**

The NYSCPB requests that the NYISO's Compliance Filing be approved with the modifications we recommend herein.

Respectfully submitted,

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Chairperson and Executive Director

Douglas W. Elfner  
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Dated: November 19, 2007  
Albany, New York