UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	Docket No. ER00-3038-000
New York State Electric & Gas Corporation v. New York Independent System Operator, Inc.	Docket Nos. EL000-70-000 and EL00-70-001

(Issued July , 2000)

HÉBERT, Commissioner *dissenting*:

Like a moth to a flame, FERC again falls under the spell of price caps. Like a flame that, in the end, consumes everything in its wake, price caps and their cousins, bid caps, will undermine competition, something we all want and the American people deserve. Unlike a moth, that acts under an irresistible impulse, we humans exercise judgment and should place long term goals ahead of expediency. I would reject the bid caps for New York. I see no need for them and I think they will cause particular harm in this market.

Not only does the order rely on faulty economics and false analogy to impose the caps, the majority imposes more stringent ones than the New York Independent System Operator, Inc. (ISO) itself requested. The caps also have the practical effect of protecting those utilities that sold their generating plants, gambled on the spot market to find supplies for their customers and lost. Today's order punishes those market participants that made proper arrangements. These entities now stand to lose money, not because they misjudged the market, but because of interference by a regulatory agency that arbitrarily changed the rules in midstream. The bid caps the majority imposes also will tighten the market for this and following summers. I dissent.

Can't Anyone Here Play This Game?

Beneath lofty sentiments often lurk grisly facts. For example, the eloquent tributes to baseball from the pens of great writers, such as the late A. Bartlett (Bart) Giamatti, can mask the reality of ineptitude. Casey Stengel, on watching his expansion Mets of 1962, with their collection of cast-offs and amateurs, exposed the dark side when he exclaimed in exasperation, "Can't anyone here play this game?"

Beneath the noble policy pronouncements of this order lies a more disturbing picture. The miscalculation of some Member Systems, including New York State Electric & Gas Corporation (NYSEG), and the slap-dash justification the ISO uses in arriving at the bid caps, underscore that the mind set of regulation in a context of not-for-profit status can bring strange results, indeed.

The free market has its share of incompetence, but the government does not rush in, as the majority does today, to apply a policy of protectionism in the guise of a "safety net." Today's decision to impose caps lower than those the ISO requested further exacerbates the anomalous consequences of the policy the majority embraces. It will dry up supplies necessary for meeting demand during hot weather. As one example, owners of mobile peaking units will move them out of the New York market. Others, as had occurred in California, will hesitate to make the investments necessary to expand supplies for the next and following summers.

a. NYSEG and Other Member Systems

One of the protests in a related docket puts its finger on the heart of this case. FERC rushes in to cover utilities' mistakes that created exposed positions in the market. Despite the recitation in today's order, we do not deal with "market design flaws" in the straightforward meaning of that term. A review of the record here and the compliance filing in Docket No. ER00-1969 (involving the reserve market) indicates that the ISO has repaired all but one software problem. Even though experts consider some of the repairs "patches," temporary measures for this summer suffice to negate the need for bid caps. The one remaining problem involves the inability to use 600 megawatts of the Intertie with Hydro Quebec. The 600 MW constitutes a drop in the ocean of the 24,000 MW capacity of the New York market.

NYSEG's complaint and later pleadings (such as the Answer to the New York ISO's Motion to Intervene in Docket No. EL00-70) place great emphasis on the threat of the New England ISO and the PJM ISO to curtail exports to New York. According to NYSEG, this shows the breakdown in the market in New York. That may have been true at one time, but no longer. At today's meeting, we approved an agreement between PJM and the New York ISO for exports between the two markets. *New York Independent System Operator, Inc.*, 92 FERC ¶ 61, (2000). The threat from New England has faded as well.

Indeed, the majority admits that the ISO has "made progress" in addressing problems with the "design flaws." Slip op. at 14. The majority expresses its "concern[s]" that it "cannot be assured that . . . these corrections may not have unintended

consequences." *Id*. By placing the onus on opponents to prove a negative, the majority turns on its head the burden of proof and, despite its rhetoric, makes it hard to let go of regulation.

Even if the New York market still needs more structure in place to operate through the summer, the period for which the majority approves these "temporary" bid caps, I consider today's order bad policy. As I wrote in my concurrence to the order on reserve markets, if the remaining flaws rise to the level of undermining a competitive market, we should then substitute a form of cost-based rates and institute a proceeding against the ISO. *New York Independent System Operator, Inc.*, 91 FERC ¶ 61, 218 at p. (2000) (Hébert, Commissioner concurring). That, at least, has the advantage of dealing with the problem at its source.

Rather, the Member Systems' requests for bid caps result from a desire to have FERC offer a bail out for bad business decisions. The utilities in New York are divesting their generation, but, as load serving entities, must still sell to consumers in their service territories. These divesting utilities could have signed contracts for the capacity they needed. Some in New York and in other markets have done that. (For example, the Sierra Pacific-Nevada Power-Portland General Electric merger, on which we voted today, has in it issues arising from buyback contracts, under which the Nevada utilities did just that.)

The Member Systems could have protected themselves in other ways. They could have purchased hedging instruments, for example. Instead, NYSEG, in particular, relied on the spot market. The price in the spot market rose above the level these utilities calculated. The obligation to serve customers under rate freezes remained, however. The state of the spot market left company shareholders in the lurch.

In short, "[s]everal . . . utilities, including NYSEG . . . agreed to a price freeze for retail customers but failed to enter into transition contracts or otherwise properly hedge their positions for this summer against higher electricity prices." Motion of Merrill Lynch Capital Services, Inc. for Leave to Intervene and Protest (Docket No. ER00-2464) at 2. NYSEG does not dispute the fact that, on divestiture, it failed to sign contracts and remained vulnerable in the spot market. As NYSEG states, "It is *nearly fully* hedged." Second Answer of NYSEG (Docket No. EL00-70) at 2 (Emphasis added).

I understand that, in these circumstances, asking for a bail out serves NYSEG's and other Member Systems' self interest. Granting the bail out, however, as the majority does today, ill serves the public interest.

b. The New York Parties

At least NYSEG and the Member Systems have a business reason, though an illegitimate one, for supporting the bid caps. The grid's governing authorities have none at all. The ISO initially opposed them, in favor of market screens. Then, the ISO filed for a higher level than the majority approves today. In approving the $1000 bid cap, the majority rejects the consensus of the ISO. Ironically, the same majority argues that ISO's, non-profit entities, offer benefits because of the very consensus the stakeholder process offers but my colleagues override here. The majority, instead, favors the views of the New York Public Service Commission.

Its pleading begins by admitting that the ISO "has addressed most of the implementation flaws that have been identified to date." Notice of Intervention, Comments and Request for Expedited Relief of the New York Public Service Commission (Docket No. EL00-70) at 1. Nevertheless, the state supports bid caps because "there still *may* be *undetected* or uncorrected problems." *Id.* (Emphasis added). By definition, in any market there always "may be undetected problems." Following that logic, regulation would endure in perpetuity.

The Notice of Intervention goes on to argue that, while the laws of supply and demand may raise prices, "there is also the *possibility* that prices may be extremely high this summer . . . for reasons not at all related to" competition. *Id.* (Emphasis added). I admire the candor in admitting that we should enact price controls to guard against, not proven behavior, but the possibility of manipulation, however remote. That tells me the wish for bid caps in this market flows from a fear of deregulation. We at FERC must stand up to timidity.

Finally, the New York Commission argues that bid caps bring certainty. Notice of Intervention at 3. So does price fixing, yet the gross inefficiency that creates outweighs any alleged benefits. Here, too, the so-called certainty comes at too high a price. Moreover, approving bid caps has the opposite effect.

As several parties, including the Member Systems in their Answer in Docket No. ER00-3038-000 call to our attention, we impose the bid caps after the market participants took positions on future prices, to the extent of spending considerable amounts of money in the hedging market to buy transmission congestion contracts. Those entities that assumed high prices will lose, not because of the operations of the market, but because of FERC's interference. I disagree with the Member Systems that entities should have anticipated that, that we would arbitrarily impose bid caps to distort the market.

Nevertheless, all would agree that this order introduces uncertainty from this day forward.

In the end, the comments of the Chairman of the New York ISO best characterize the flimsy support for and arbitrary nature of today's action. In an interview, he said that, though "philosophically" he opposes bid caps, "the state energy auction needs a 'safety net' . . . because the . . . market still is 'a bit wobbly.'" Grid Operators Diverge Widely on Price Caps, *Wall Street Journal*, July 3, 2000 at 1. Economists say that all markets lack perfection. When asked how he came up with the particular amount, he answered that "it's hard to know what price is fair but that it is important to pick a number and stick with it." *Id.*

We policy makers ought to do better than that. Competition means moving away from trying to find fair prices. It means moving toward letting buyers and sellers set efficient prices. The market, not regulators, determine the outcome. Regulators call the balls and strikes. "Can't anyone here play this game?"

Get Me Through The Summer

As I indicated earlier, the majority acknowledges that the ISO has, for all practical purposes, fixed the problems NYSEG identified. The order brushes that aside, because "may of the fixes are short-term." Slip op. at 15. Since the majority claims to apply "temporary" bid caps for this summer only, the ISO applied a sufficient remedy. Without evidence of need, we should reject the bid caps. Moreover, we should replace the attitude "get me through the summer" with a long-term outlook. As we acknowledge with great fanfare in the Order Directing Staff Investigation of the markets, that I discuss in my dissent in *NSTAR Servies Co. v. ISO New England, Inc.*, 92 FERC ¶ 61, (2000), bid caps represent bad long-term policy.

The majority gives two reasons for imposing the bid caps. The order proclaims a "concern[ ] about the lack of demand-side responsiveness" in the New York market. Slip op. at 14. The order also states that, PJM has used the same bid cap, without apparent ill effect. Slip op. at 16. I find the first bad economics and the second illogical.

Prices come down through increases in supply, as well as reductions in demand. Seeing an opportunity to make money, owners of mobile peaking units will direct their assets over road, rail and barge to serve the New York market. Entrepreneurs now in business will approach owners of buildings with backup generators to aggregate capacity for customers in need. The entrepreneurs need only make arrangements for moving the energy. Opportunities for profit will induce other steps. Bid caps squelch innovation, in the short and long term.

Moreover, the pressure of shareholders enduring losses spurs management to institute demand side measures. A week ago Monday, the lead story on page 1 of the *New York Times* described demand side measures that Wisconsin Electric Power Company instituted when spot prices rose. In a matter of weeks, the utility compiled a list of top uses from which it would request reductions. The article told of a lignite quarry that agreed, for a payment, to close for the day. Deprived of the crutch of bid caps, the Member Systems would follow that example. They could have for this summer.

The story also mentioned a "Kilowatcher's Club," like that in Maryland, under which, for a credit on the monthly bill, consumers agree to allow the power company to shut off their air conditioners for different periods of time on hot days. The article also mentioned that residential customers of Wisconsin Electric Company take advantage of time-of-day rates that make it profitable to run appliances on nights and weekends. Instead of advocating price controls, NYSEG and the State should have instituted that reform for this summer, even if on an emergency basis. On their own, the Member Systems can broadcast appeals for conservation and State and local government can dismiss non-emergency employees for the day.

If the majority needs further proof of demand side response to prices, it can find the evidence in the record here. The Electric Power Supply Association, the trade association of generators and marketers calls the argument about the lack of demand side response "misleading," given the possibility for hedging and bilateral arrangements with suppliers, as well as conservation. Motion for Leave to Intervene at 4-6. Individual marketers call to our attention that consumers in New York City and its suburbs (and customers of Central Hudson Gas & Electric Corporation) do see on their bills increases in the price of electricity. Motion to Intervene and Protest of Merrill Lynch Capital Services, Inc.(Docket No. ER00-3038-000) at 8-9.

I note, however, that the majority breezed by the presence of demand-side "responsiveness" in New England to impose $1000 bid caps there. (See my dissent in *NSTAR Services, Company v. New England Power Pool, et al.*, 92 FERC ¶ 61, at p. (2000) (Hébert, Commissioner *dissenting*)). The real reason for the bid caps comes from the fact PJM has them and allegedly "they do[ ] not appear to have discouraged generators from participating in the PJM Market nor from adding capacity [there]." Slip op. at 16. Before making PJM the poster child for other markets, let us look at the record.

Nobody knows the impact of price controls in PJM. I agree that capacity will still enter a market with $1000 bid caps. Will enough come in, however? Without knowing

how much capacity PJM needs, we cannot extrapolate to New York. While the $1000 – which, for all we know, resulted from the capability of now three-year old software to handle three digits at most -- may mean nothing in PJM, it does in New York. Indeed, the New York ISO pegged $1,300 as the highest price the market ever reached under the new arrangement. For that reason, the ISO requested the higher figure. For the sake of consistency, I would eliminate the PJM cap, instead of transplanting it to a completely different environment in New York.

Moreover, like the magician's claim that his spells keep elephants from the endangering North America, the conclusion that PJM's caps caused no harm does not flow from the premise. Until three weeks ago, generators that needed to recover more than the bid cap, for example peak units, could specify minimum run times to make up the difference. Referring to this economically rational course as "gaming," the majority, over my dissent, allowed PJM to amend its rules to eliminate that possibility. *PJM Interconnection, LLC*, 92 FERC ¶ 61, (2000). With that "safety net" for recovering high costs gone, generators may stay out of PJM in greater numbers.

In the same vein, I remain highly skeptical about the "offsetting factors" the majority relies on as lessening the consequences of the bid caps. Slip op. at 16. I consider relying on these factors akin to whistling past a graveyard. The ISO may have rules under which it must acquire adequate capacity and generators must offer it. If, however, the bid caps curtail investment in high-cost peaking units, a shortage will result, despite all the requirements in the world. If the ISO may pay more than the bid cap for power outside New York, today's decision leads to the perversely inefficient result. We condone penalizing nearby generators in favor of the more remote. Some congestion management policy we have enacted. The majority should look before leaping to adopt bid caps as benign.

Conclusion

Whether or not my colleagues call the bid caps in New York "temporary," the truth remains that the ugly facts underlying today's action belie our lofty sentiments. The "Talking Points" column in the June 2000 issue of our internal newsletter, *FERC Insider*, contained the following observations:

> Yet, as we all know change is continuing in the industry and the Commission must "roll with the punches."
> * * *

> [T]he Commission and its staff will play a key role in shaping a dynamic market environment that will be a beacon of openness and free enterprise. This is a very lofty goal that will challenge us all to excel.

Eagerly I await the time when this Commission actually lives up to that charge. Under the circumstances prevailing in those markets, this order and its companion, imposing bid caps on New England, lean into the punch, shape an environment of price controls and stand as a beacon of corporate welfare for utilities that made bad business decisions. Bowing to a fear of competition, the Commission stifles the market with a heavy hand. The words of Casey Stengel, not the eloquence of Bart Giamatti, rule this day.

I respectfully dissent.

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Curt L. Hébert, Jr.
Commissioner