



Office of United States Senator

CHARLES E. SCHUMER

SENATOR FOR NEW YORK STATE

Albany
Room 420
Leo O'Brien Building
Albany NY 12207
(518) 431-4070
(518) 431-4076/fax

Binghamton
Room B6
Federal Office Building
Binghamton NY 13901
(607) 772-8109
(607) 772-8124/fax

Buffalo
Room 620
111 West Huron Street
Buffalo NY 14202
(716) 846-4111
(716) 846-4113/fax

Hudson Valley
Suite 100
One Park Place
Peekskill NY 10566
(914) 734-1532
(914) 734-1673/fax

Long Island
Two Greenway
145 Pine Lawn Road
Melville NY 11747
(631) 753-0978
(631) 753-0994/fax

New York
Suite 1702
757 Third Avenue
New York NY 10017
(212) 486-4430
(212) 486-7693/fax

Rochester
Room 3040
100 State Street
Rochester NY 14614
(716) 263-5866
(716) 263-3173/fax

Syracuse
Room 841
100 South Clinton Street
Syracuse NY 13261
(315) 423-5471
(315) 423-5185/fax

Washington
313 Hart Senate
Office Building
Washington DC 20510
(202) 224-6542
(202) 228-3027/fax

FAX TRANSMISSION

TO: Chairman Kellner

OF: FERC

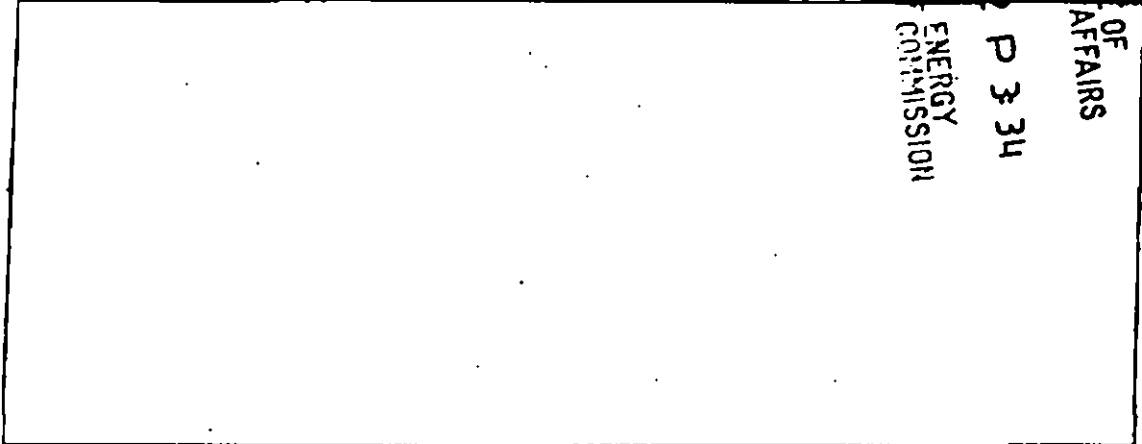
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OFFICE OF
EXTERNAL AFFAIRS
2008 AUG 12 P 3:34
FEDERAL ENERGY
REGULATOR COMMISSION

CHARLES E. SCHUMER
NEW YORK

COMMITTEES:

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RULES

United States Senate

WASHINGTON, DC 20510
August 12, 2008

Chairman Joseph T. Kelliher

Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

Dear Chairman Kelliher,

I am writing to request that the Federal Energy Regulatory Commission (FERC) immediately and permanently close a loophole through which a group of buyers and sellers of power in New York State's energy markets have profited handsomely, while passing on costs to consumers and municipalities. It is critical that FERC quickly take a close, hard look at these trading practices to determine how they were achieved and whether any unwarranted, deceptive, or even criminal action was involved.

While the New York Independent System Operator (NYISO) has yet to determine the exact costs of these trading practices, some estimate that increased congestion and "uplift" fees have cost consumers as much as \$125 million in April and May of this year alone, and as much as \$240-290 million overall. Furthermore, it appears that this practice may have played at least a part in New Yorkers spiking utility bills, as well as the record bills faced by many municipal electric utilities. Given the magnitude of economic impact these trading practices appear to have caused, it is imperative that FERC determine the extent to which they are to blame and if monetary recompense can or should be exacted from the parties involved.

According to a July 21st filing with FERC by the NYISO, beginning in January of this year one or a group of market participants began to schedule circuitous and inefficient routes for transmission between states. Direct transactions between two points – principally from New York to either Pennsylvania or New Jersey – were "sent" on a roundabout course that purportedly would travel around Lake Erie, transporting power through Ontario, Michigan and Ohio and then back to the intended destination.

This practice of scheduling power on circuitous routes around Lake Erie was not merely deceptive, but also costly to New York and in defiance of the basic laws of physics. The economic motive for this practice appears to be evading fees associated with sending power over congested, direct lines between New York and New Jersey for which there is a more costly transaction fee.

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<http://schumer.senate.gov>

However, while traders claiming one alleged and circuitous course for transmission, the electricity was actually traveling on the most direct path between two points, via the already congested portal that should require the payment of a transaction fee. The NYISO operations department determined that 80% of the power flow originating in New York and terminating in the PJM service territory (comprising all or portions of 17 States including Pennsylvania and New Jersey) traveled over the direct interface connection between New York and New Jersey, regardless of how individuals scheduled its path.

This means that the certain market participants were sending their power through the most expensive and congested corridors, but not paying the fees like everyone else. This mechanism did not just allow them to avoid paying higher fees, but also meant the power they were selling was garnering a higher price, because, as market participants increased the volume of power flow on the congested interfaces, the price for power would rise, further adding to the profits of the sellers.

While profiting a few handsomely, the unannounced power flowing over this portion of the transmission grid had several serious impacts on New York ratepayers.

Uplift Charges: The scheduling over circuitous paths increase unexpected congestion on transmission lines the cost of which is not attributable to a particular market participant. Then, in the Day-Ahead Market, the NYISO was forced to increase congestion charges to all users of the interface. That creates "uplift" in prices for all customers, the burden of which is passed onto to residential on commercial users.

Congestion Rent Shortfalls: The NYISO issues Transmission Congestion Contracts (TCC) with owners of transmission that rely on fully utilizing their capacity. These contracts can provide a benefit to consumers because, when capacity is maximized, the transmission owners pay a credit back to their customers under an arrangement with NYISO. However, if they cannot collect rents from all those who are using the lines — because some are piggybacking for free — a diminished credit is given. DC Energy, a party to this case with FERC estimates that congestion rent shortfalls has cost consumers on the order of \$40 million since the beginning of 2008.

Costly Generation: With congestion clogging up transmission lines, utilities cannot rely on buying cheap power and must ramp up costly generation. In these instances, the NYISO pays a premium to generators to hastily supply power when it cannot be brought in through transmission. This expensive fix is, again, passed on directly to the consumer.

The NYISO's filings with FERC give a snapshot of just how lucrative this practice was to the traders, and costly to consumers. The NYISO has calculated that on May 26, 2008 over 2000 MegaWatts (MW) were scheduled on the circuitous Lake Erie route: traveling to western New York before entering Ontario, then the

Midwest Independent System Operator via Michigan and Ohio and then back to PJM in New Jersey or Pennsylvania. According to their analysis, on this day alone, \$800,000 in uplift and congestion fees was attributable to this trading practice.

As mentioned earlier, it is my understanding that the NYISO is still working to determine the cumulative cost of these trading practices. However, the snapshot of its cost on a single day shows the magnitude of its impact. Estimates on the cost of deceptive circuitous scheduling cover a wide range, but are all unacceptably high. DC Energy calculates circuitous scheduling cost New York \$240 million. Suez believes the cost was \$125 million in April and May alone. Others have put the cost as high as \$290 million. If the practice existed before January 2008, it could be even higher than these estimates.

These costs hit us right at home. In upstate New York, small cities like Plattsburgh, Rouses Point and Tupper Lake have been hit with exorbitant uplift fees from NYISO, hundreds of thousands of dollars in excess of what they usually pay.

While the relation between these trading practices and the dramatic rise in energy bills has not been fully demonstrated, when the NYISO shut down 8 circuitous scheduling paths on July 21, 2008 it is my understanding that they noted a precipitous decrease in congestion costs in the first week alone.

Scheduling energy along circuitous paths appears to have spiked between April and June 2008, but it is entirely unclear if it persisted earlier, but on a more limited basis. These practices raise a host of questions that FERC must answer. It is absolutely critical that FERC determine exactly who has been engaging in these practices; for how long have they have been occurring; and how much it has cost New York consumers and municipalities. Increases in cost of living – especially spiking energy prices – are buffeting consumers on all sides; the bottom line is that New York's energy consumers need FERC to be the cop on the beat to make sure they are not being ripped off by rogue energy traders involved in deceptive practices.

Furthermore, FERC should not limit the scope of their inquiry. It must investigate whether scheduling practices are the sole reason for substantially increased transmission charge; if it is a partial reason; or if there are other practices contributing, as well.

In the NYISO's filing they identified 8 circuitous routes that they would have curtailed scheduling on and are asking for FERC to permanently shut them down. NYISO has preemptively taken this step, but needs FERC to take action for final approval. I would ask that you not only heed their request but proactively look to identify other paths that traders might attempt to use in the future to game the markets.

Finally, by some accounts, it appears that a handful of market participants found a legal method to exploit the market. In response NYISO has sought to eliminate this

mechanism. However, it remains unclear whether these traders acted within the four corners of the law. Given the magnitude of the impact they had on New York ratepayers I believe a full and thorough investigation is called for.

Thank you for your consideration of this matter. I hope that the Commission acts quickly on permanently closing these harmful and deceptive circuitous paths and seeks to identify is any malfeasance was involved in the trading practice that resulted in massive costs borne by New York consumers and municipalities.

Sincerely,



Charles E. Schumer

U.S. Senator