

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Strategic Power Management, Inc.	)	Docket No. EL00-67-000
	)	
v.	)	
	)	
New York Independent System	)	
Operator, Inc.	)	

**NEW YORK INDEPENDENT SYSTEM OPERATOR’S ANSWER TO  
COMPLAINT REQUESTING FAST TRACK PROCESSING AND  
MOTION TO CONSOLIDATE**

On March 27, 2000, the New York Independent System Operator, Inc. (NYISO) filed a Request for Suspension of Market-Based Pricing for 10-Minute Reserves and to Shorten Notice Period, Docket No. ER00-1969-000 (“March 27, 2000 filing”). In that filing, the NYISO requested immediate authority to suspend the use of market-based bids in the New York markets for 10-minute reserves until those markets could be demonstrated to be workably competitive. The NYISO made its request when it was faced with evidence of a substantial decline in the quantities offered for 10-minute reserves and a substantial increase in the resulting prices.

This lack of competitive performance in the market for 10-minute reserves increased the cost of reserves dramatically, from a total cost for December 1999 of \$6.5 million to a total cost in February 2000 of \$75 million. As a result, the NYISO requested an effective date of March 28, 2000 so that it could suspend the use of market-based bids immediately. To prevent further harm pending the Commission’s decision on that request, the NYISO advised market participants that it would suspend market-based markets for 10-minute reserves effective April 1, 2000.

On April 10, 2000, Strategic Power Management, Inc. (SPM) filed a Complaint Requesting Fast Track Processing and Motion to Consolidate. SPM states that it supports the NYISO's March 27, 2000 filing because there is a potential for substantial financial harm to market participants in the market for 10-minute reserves if cost-based bids are not imposed immediately. SPM also requests that the Commission: (1) find that the NYISO is liable to compensate SPM for losses it sustained in the ancillary services markets; (2) order the NYISO to recalculate ancillary services on a cost-basis from November 18, 1999 through December 23, 1999; (3) order the NYISO to refund to SPM certain working capital collections; (4) order the NYISO to alter its procedures for publishing charges for ancillary services and other charges; and (5) grant SPM the right to conduct discovery of the NYISO's ancillary services market data. SPM also states that it supports resolution of market prices for past periods through the Commission's alternative dispute resolution process and requests consolidation of its complaint with the other dockets relating to the New York ancillary services markets.

Pursuant to Rules 206 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.206 and 213, the NYISO hereby files its answer to SPM's complaint and motion. NYISO agrees with SPM that the appropriate market prices for past periods should be determined through the Commission's ADR process. With respect to SPM's other claims, the Complaint should be dismissed.

**ANSWER**

**1. The NYISO Acted Diligently in Responding to the Lack of a Workably Competitive Reserves Market.**

SPM states that the ancillary services market failure began in mid-January 2000 and yet the NYISO took no action until early March when the February bills were issued. SPM Complaint at 8. According to SPM, this delay violated the NYISO's Market Monitoring and Mitigation Plans and caused SPM to suffer financial harm. SPM argues that the NYISO is liable to compensate SPM for the financial harm it suffered under the theory that the NYISO engaged in conduct amounting to gross negligence or intentional misconduct. SPM Complaint at 12-13.

Interestingly, SPM's arguments are the complete opposite of the arguments made by Orion Power New York GP (Orion) in its Complaint in Docket No. EL00-60-000. Orion argued that the NYISO's actions to suspend market based rates, as opposed to the NYISO's failure to act, "could cost Market Participants thousands of dollars in lost revenues to which they are otherwise entitled" and that the Commission should find that "the NYISO's conduct violates Section 205 of the Federal Power Act and the filed rate doctrine." Orion Complaint at 6, 7. The NYISO's actions were neither grossly negligent (in not going far enough) as SPM claims nor a violation of the Federal Power Act (for going too far) as Orion claims. Those actions were a measured and lawful response to the lack of competitive performance in the market for 10-minute reserves.

As discussed in the NYISO's March 27, 2000 filing, the NYISO's request to suspend the market-based markets for 10-minute reserves was an appropriate response to the indications it found regarding market concentration and bidding behavior causing

uncompetitively high prices in the reserve markets. The NYISO acted as promptly as it could given the circumstances. First, the initial indications that the markets were not workably competitive were first noted in late January 2000, not mid-January as SPM alleges. In addition, the NYISO's Board of Directors instructed the NYISO staff to conduct a careful analysis to ensure that an appropriate determination of the cause was made and that any action taken to correct the problem was not premature. Given that the ancillary services markets had only been in operation for three months before these indications of potential market problems arose, the NYISO carefully analyzed the bidding patterns and the resulting prices in the operating reserve markets in order to determine whether intervention was warranted.<sup>1</sup> Thereafter, the NYISO contacted suppliers in an attempt to obtain their voluntary cooperation to bid into the markets.

Finally, in determining what action to take in light of the lack of a workably competitive market, the NYISO took into consideration the potential limitations of acting pursuant to its Market Mitigation Measures, which had not yet been approved by the Commission, the Temporary Extraordinary Procedures, which do not include any market mitigation measures,<sup>2</sup> and the billing provisions of Section 7 of the OATT.

SPM's argument that the NYISO unreasonably delayed in taking action is incorrect and does not consider the NYISO's responsibility to ensure that its actions are a reasonable

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<sup>1</sup> The NYISO is sensitive to the Commission's expectation that the NYISO distinguish between market outcomes that result from design flaws and those that result from scarcity or surplus conditions. *New York Independent System Operator, Inc.*, 88 FERC ¶ 61,228 at 61,755 (1999).

<sup>2</sup> See *New York Independent System Operator, Inc.*, 88 FERC, at 61,755.

response based on reliable evidence of a market problem. Moreover, the NYISO must ensure that its actions do not favor any class of market participants. Given the totality of the circumstances, and the NYISO's responsibility to protect all market participants, the NYISO's actions with respect to the March 27, 2000 filing were undertaken in a reasonable and diligent manner and do not constitute negligence or misconduct in any way.

**2. The NYISO was Only Authorized to Operate Market-Based Reserves Markets Beginning on November 18, 1999 (Day 1 of Operations).**

SPM claims that the NYISO did not have authority to operate market-based ancillary services markets until December 23, 1999, the effective date of the NYISO's revised Market Monitoring Plan. As a result, SPM argues that market-based clearing prices from November 18, 1999 (Day 1 of NYISO operations) through December 23 were improper and that the charges to SPM for ancillary services should be recast on a cost basis equal to \$2.22 per MWh, based on the prices SPM paid to its ancillary services supplier (Orange & Rockland Utility) before the NYISO began operating. SPM Complaint at 10-11. SPM's claims are misplaced.

The NYISO first submitted its Market Monitoring Plan to the Commission on July 26, 1999. In that filing the NYISO requested an effective date of September 1, 1999 to coincide with the expected date of operations at that time. On August 23, 1999, the NYISO submitted its Market Mitigation Measures to the Commission. In that filing, the NYISO requested an effective date of October 12, 1999 to coincide with the revised expected date of operations. In that filing, the NYISO stated that it was "moving as quickly as possible to commence operations." On November 23, 1999 the Commission accepted in part and rejected in part the

NYISO's Market Mitigation Measures, subject to modification.<sup>3</sup> In the November 23, 1999 order, while aware that the NYISO had recently commenced operations, the Commission did not direct the NYISO not to commence operations until the mitigation measures were refiled or that the NYISO's operations were in any way modified from those the Commission approved in its January 27 and July 29, 1999 orders.<sup>4</sup> SPM's argument that cost-based ancillary service prices should be imposed from November 18, 1999 therefore has no basis. The NYISO's only authority was to commence the operation of the New York markets on the basis of the tariffs that had been approved by the Commission, and which specified market-based bidding. Thus, the NYISO had no authority at that time to impose cost-based rates.

To the extent SPM claims that its historic payment level of \$2.22 per MWh should apply to SPM after the market distortions on January 29, 2000 (SPM Complaint at 11), instead of the amounts payable under the NYISO's cost-based billing proposal, SPM's claim should be rejected. The rate that SPM paid to its utility prior to joining the NYISO has not been shown to adequately approximate appropriate cost-based market-clearing prices for the mix of generating facilities that are currently providing ancillary services to the NYISO, as well as the other costs or charges incurred by the NYISO in providing the package of ancillary services about which SPM complains.

### **3. The NYISO's Working Capital Collection Was Not Unjust and Unreasonable.**

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<sup>3</sup> *New York Independent System Operator, Inc.*, 89 FERC ¶ 61,196 (1999).

<sup>4</sup> Order Conditionally Accepting Tariff and Market Rules, Approving Market Based Rates and Establishing Hearing and Settlement Judge Procedures, *Central Hudson Gas & Electric Corp.*, 86 FERC ¶ 61,062 (1999); Order Denying in Part and Granting in Part

(continued . . .)

SPM claims that the NYISO did not have the right to collect cash working capital in its Schedule 1 charges (Scheduling, System Control and Dispatch Services) from November 18 through December 31, 1999. SPM Complaint at 6. SPM argues that the \$15 million in cash working capital that the NYISO collected through its Schedule 1 charges in a time period of less than two months was unjust and unreasonable and the portion that SPM paid should be refunded to it. SPM states that the NYISO should finance its working capital needs through a line of credit rather than building up a reserve fund. SPM Complaint at 7. SPM's arguments should be rejected.

On November 10, 1999, the NYISO filed a proposed tariff change that explicitly included cash working capital in the NYISO's Schedule 1 charges. In its January 12, 2000 order, the Commission accepted the NYISO's proposal to change its tariff to state that it specifically includes cash working capital in the Schedule 1 charges. *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,015, at 61,037 (2000) (finding that the NYISO was not adding costs, just adding greater specificity to the existing formula). Thus, SPM is incorrect that the NYISO did not have the right to collect cash working capital through the Schedule 1 charges.

Funding the working capital account over a two month period was a prudent business decision made by the NYISO after weighing competing interests. The NYISO, as a nonprofit entity, receives payments from load serving entities for services they receive through the NYISO. The NYISO in turn is required to pay those funds to generators who supply services

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Rehearing and Clarification and Conditionally Accepting Compliance Filing, *Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138 (1999).

to the NYISO in not more than four days.<sup>5</sup> Generators that supply ancillary services to the NYISO have an interest in knowing that they will be paid on a timely basis for services rendered to the NYISO. In the absence of a cash working capital account, if a load serving entity for some reason did not pay the NYISO for services received, the NYISO would be forced to restrict the amounts it paid to generators by an equal amount. By maintaining a cash working account for these purposes, the NYISO will have the funds available to pay generators even if it does not receive funds from load serving entities in a timely fashion. The cash working capital account gives the NYISO the time to collect those funds from load serving entities without having to withhold funds to generators.

In addition, there are a number of other uncertainties that can create an imbalance in the NYISO's monthly cash flow requirements. These uncertainties include the levels of congestion charges, uplift charges and the total market dollar volume, each of which can vary from month to month. These varying charges should be recovered in the month subsequent to their actual occurrence. Payment of these charges, however, will be made to the suppliers entitled to them in the current month. This timing difference between the collection of charges and the payments due suppliers may result in a shortage of funds available to pay suppliers for the current month.

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<sup>5</sup> On November 24, 1999, the Commission accepted the NYISO's proposed tariff changes to provide a one to four day separation between receipts of payments from customers and payments by the NYISO for services. *New York Independent System Operator, Inc.*, 89 FERC ¶ 61,223 (1999). This change allowed the NYISO to obtain payments from customers before it must itself make payments to generators. *Id.* at 61,663. The four day lag could be as little as one day with an intervening three day holiday weekend.



Because the NYISO's payment processes and operating history are still relatively new, the NYISO believed that establishing a working capital account to cover market payments as soon as possible was in the best interest of all market participants. If generators could not count on being paid for their services on a timely basis, that uncertainty could undermine the success of the markets.

When the NYISO began operations in November 1999, all the former transmission-owning utilities in the state also began using the NYISO. These same entities also represented most of the load in the state. Thus the cost of funding the working capital account was spread over a relatively large number of entities. In addition, the NYISO's working capital fund will generate approximately 5% per annum in interest revenues, which will be used to reduce Schedule 1 charges to market participants. Without the cash working capital account, the ISO would have to incur additional operating expenses, including bank fees and interest, to obtain a line of credit, or risk not being able to pay generators their full amount, plus interest, in the event load serving entities failed to make payments when due.

**4. Line Item Information for Schedule 1 is Currently Being Posted and Will Continue to Be Posted.**

SPM states that the NYISO has discontinued posting detailed line item data on its website for costs relating to Schedule 1. SPM Complaint at 6. As a result, SPM claims that the NYISO made it difficult for SPM to verify its costs. SPM also claims that the NYISO has not explained how the market-based ancillary service pricing information posted on its website translates into the charges on SPM's monthly bill. SPM Complaint at 9. SPM claims that as a result it cannot determine the cost impact of hourly pricing information provided by the NYISO.

In February and March 2000, the NYISO indeed did not post on the website the same level of detail for Schedule 1 as it posted for November 1999 through January 2000. This was largely due to the fact that the Schedule 1 charges for those two months amounted to a substantial credit to Market Participants instead of a charge. In any event, SPM would always have been able to calculate its Schedule 1 costs by multiplying the posted Schedule 1 rate by the amount of its load. SPM, as a member of the NYISO, should be aware that the NYISO has recently submitted to the Billing and Accounting Working Group a proposed format to reconcile the cost components used to establish Schedule 1 charges. The Billing and Accounting Working Group is a subcommittee of the Business Issues Committee and is responsible for providing feedback on the proposed format at the April 26, 2000 meeting.

With respect to translating the hourly pricing information posted on the website to charges that appear on bills, the NYISO has acknowledged that market participants are not easily able to confirm their charges for Regulation, Reserves and Black Start services. The NYISO is currently working through the Billing and Accounting Working Group to devise an acceptable presentation of the data required to provide market participants with sufficient detail on these markets. NYISO staff has stated that in the meantime all settlements and clearing prices are subject to audit should any market participant need to check the accuracy of billing determinants and settlement data.

The NYISO has thus recognized market participants' concerns over the NYISO's billing system limitations and is making, and will continue to make, every effort to address those concerns.

**5. The NYISO Currently Has A Limited Ability to Project Schedule 1 Charges.**

SPM argues that the NYISO should project uplift charges for the calendar year so that load serving entities like SPM will have some basis for customer pricing. SPM Complaint at 7. SPM claims that the volatility thus far experienced in Schedule 1 charges makes them unjust and unreasonable. SPM requests that the Commission preclude the NYISO from varying its Schedule 1 charge by more than 10% per month without Commission approval, with a 6-month true-up of costs outside the 10% and a yearly true up for costs within the 10%.

Schedule 1 of the NYISO's OATT includes charges for the NYISO's costs of operations, including costs that are relatively easy to predict, such as costs relating to scheduling, billing and dispatching transmission service, communications, transmission system studies, engineering services, record keeping, and training. Those costs are taken from the NYISO's Board-approved annual budget. Start-up costs will also remain relatively flat over the course of a year. The Schedule 1 charge, however, also includes costs that are driven by market forces and thus far have been difficult, if not impossible, to predict, such as:

- costs associated with the differences between the amounts bid by generators that have been committed and scheduled by the NYISO to provide Energy and Ancillary Services and the actual revenues received by these generators, so-called "bid production guarantee" costs; and
- residual adjustment costs, which include congestion over or under-collections, losses adjustments, and energy residuals, positive or negative, from flows from neighboring systems.<sup>6</sup>

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<sup>6</sup> In line 3 of Table 2 (SPM Complaint at 5), SPM combines bid production guarantee and residual adjustment costs.

While the NYISO understands the importance of price certainty for Market Participants, some amount of volatility at this early stage of the NYISO operations cannot be avoided. Because the markets are new, the NYISO currently has a limited ability to predict market behavior and estimate resulting costs. Moreover, the NYISO lacks operating history data from which to project NYISO costs in the future. The NYISO fully expects that the longer the markets are in place and the more data the NYISO can accumulate on its own operating history, the NYISO will gain the ability to make reliable and less volatile cost projections. The NYISO will be moving toward providing a stable estimate of Schedule 1 charges in the future as experience permits.

**6. SPM's Complaint Should Be Dismissed in Part and Referred in Part to the Commission's ADR Process.**

As the NYISO requested in the March 27, 2000 filing, the Commission should refer the question of redress for the harm caused by the physical and economic withholding in the 10-minute reserves market to the Commission's Dispute Resolution Service for resolution in 90 days. That portion of SPM's complaint could be consolidated in that ADR process for prompt resolution.

The Commission should reject SPM's request to conduct discovery of the NYISO's ancillary services markets. SPM Complaint at 15. SPM requests data that is competitively sensitive (*e.g.*, bid data and market modeling). Moreover, responding to discovery requests for operating reserves data by individual market participants outside of the ADR process will be a significant disruption and distraction from the ADR process requested by the NYISO. Questions about what operating reserves data should be made available, and how that data should be disseminated, are common to all parties interested in the recent performance of the

operating reserves markets, and should be dealt with in the context of the proposed dispute resolution process.

### **COMMUNICATIONS**

Communications regarding this proceeding should be addressed to:

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### **COMPLIANCE WITH RULE 213**

#### **a. Disputed Factual Allegations**

- The NYISO denies that it has refused to provide or “closed the door” on providing detailed information on its Schedule 1 uplift charges. SPM Complaint at 7.
- The NYISO denies that it took no action until early March 2000. SPM Complaint at 8.
- The NYISO denies that it unreasonably “forced payment” from market participants in a manner not otherwise consistent with the NYISO’s OATT. SPM Complaint at 8-9.
- The NYISO denies that it has refused to explain how market based ancillary services charges are converted to charges on monthly bills. SPM Complaint at 9.
- The NYISO denies that its monthly charges for ancillary services cannot be verified by market participants. SPM Complaint at 9.
- The NYISO denies that it was not monitoring the market. SPM Complaint at 12.

**b. Law Upon Which Answer Relies**

- Order Approving Temporary Procedures, as Modified, *New York Independent System Operator, Inc.*, 88 FERC ¶ 61,228, at 61,755 (1999).
- Order Accepting for Filing in Part and Rejecting in Part Market Monitoring and Mitigation Plan, Subject to Modification, *New York Independent System Operator, Inc.*, 89 FERC ¶ 61,196 (1999).
- Order Conditionally Accepting Tariff and Market Rules, Approving Market Based Rates and Establishing Hearing and Settlement Judge Procedures, *Central Hudson Gas & Electric Corp.*, 86 FERC ¶ 61,062 (1999).
- Order Denying in Part and Granting in Part Rehearing and Clarification and Conditionally Accepting Compliance Filing, *Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138 (1999).
- Order Accepting Proposed Tariff Revisions for Filing, as Modified, *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,015, at 61,037 (2000).
- *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,317 (2000).

**c. Admissions and Denials of Material Allegations**

- The NYISO denies that collecting cash working capital from November 18 through December 31, 1999 created two classes of market participants. SPM Complaint at 6.
- The NYISO denies that Rate Schedule 1 of its OATT is unjust and unreasonable. SPM Complaint at 6.
- The NYISO denies the allegation that it had no right to collect cash working capital under Schedule 1 of its OATT. SPM Complaint at 6.

- The NYISO denies the implication that it must utilize a line of credit to finance working capital in order to treat market participants fairly and equitably. SPM Complaint at 7.
- The NYISO disagrees that it should be required to make long-term projections of Schedule 1 uplift charges at this early stage of its operations. SPM Complaint at 7.
- The NYISO denies the allegation that because a rate is not “stable” it is unjust and unreasonable. SPM Complaint at 7.
- The NYISO denies that it has failed to administer markets in a non-discriminatory, economically efficient manner, in violation of any State or Commission order or policy. SPM Complaint at 8, 9.
- The NYISO denies that it acted in an untimely manner. SPM Complaint at 8.
- The NYISO denies that it had no authority to operate market based ancillary service markets from November 18 to December 23, 1999. SPM Complaint at 10, 11
- The NYISO denies that the prices charged for ancillary services from November 18 through December 23, 1999 were improper. SPM Complaint at 10.
- The NYISO denies that it is liable for financial losses sustained by SPM. SPM Complaint at 12.
- The NYISO denies that it engaged in gross negligence or intentional misconduct in connection with its market monitoring function. SPM Complaint at 12-13.

**d. Defenses**

- The NYISO has fully complied with Section 205 of the Federal Power Act.
- The NYISO has not violated any state or Commission order or policy regarding its market monitoring responsibilities.

**CONCLUSION**

For the foregoing reasons, the NYISO respectfully requests that the Commission dismiss in part the April 7, 2000 Complaint of SPM and refer in part the Complaint to the Commission's ADR procedures as discussed above.

Respectfully submitted,

NEW YORK INDEPENDENT  
SYSTEM OPERATOR, INC.

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Dated: April 21, 2000



**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. this 21st day of April 2000.

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