UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York State Electric & Gas Corporation	)	Docket No. EL00-63-000
	)	
v.	)	
	)	
New York Independent System	)	
Operator, Inc.	)	

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.'S ANSWER TO COMPLAINT, MOTION TO CONSOLIDATE, AND CONDITIONAL REQUEST FOR EXPEDITED COMPLAINT PROCEDURE

Pursuant to Rules 206 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.206 and 213, the New York Independent System Operator, Inc. (NYISO) hereby files its answer to New York State Electric & Gas Corporation's (NYSEG) Complaint, Motion to Consolidate, and Conditional Request for Expedited Complaint Procedure, filed on March 31, 2000.

On March 27, 2000, 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. Consequently, the NYISO requested an effective date of March 28, 2000 so that it could suspend the use of market-based bids immediately.

In its Complaint, NYSEG seeks to correct alleged tariff and implementation flaws associated with the operating reserves markets and to compel the NYISO to use its Temporary Extraordinary Procedures (TEPs) to provide retroactive relief for "Transitional Abnormalities" and "Market Design Flaws," as defined in the TEPs, which NYSEG alleges caused the abnormally high prices in the 10-minute reserve markets. NYSEG also seeks prospective relief to correct market implementation flaws in those markets.

The NYISO agrees that NYSEG's Complaint should be consolidated with the NYISO's March 27, 2000 filing and resolved through the alternative dispute resolution process requested in that filing. NYSEG asserts a need for redress for any "erroneously" high prices for 10-minute reserves from the start-up date of the NYISO. NYSEG Complaint at 17. The NYISO has already requested that the Commission refer the question of whether such relief is appropriate for the time period from January 29 to the effective date of the revised reserve markets to the Commission's Dispute Resolution Service for a settlement proceeding involving all buyers and sellers of 10-minute reserves.

The so-called Market Design Flaws that NYSEG asserts contributed to the abnormal prices in the 10-minute reserves markets are in fact software design issues that, in most instances, are currently under review in the NYISO committee process. In any event, these potential software changes will not eliminate the problems in the reserves markets, which arose from a significant level of market concentration and related bidding behavior.[1]

[1] Ironically, all or substantially all of the software defects complained of in the NYSEG Complaint were contained in the system created, and then turned over to the NYISO, by NYSEG and its fellow transmission owners at the time the NYISO commenced operations.

ANSWER

A. The NYISO Supports Resolving the Question of Billing Adjustments Through the Settlement Process.

NYSEG seeks retroactive relief on an expedited basis under the framework of the NYISO tariffs and the TEPs. NYSEG states that the NYISO has the authority under the TEPs to take Extraordinary Corrective Action to issue rebills to reverse erroneously high charges retroactive to the start-up date of the NYISO. NYSEG Complaint at 10-11.

As discussed in the NYISO's March 27, 2000 filing, the Commission has the authority to order retroactive relief should that become necessary, whether under the TEPs, the Section 205 authority invoked in the March 27, 2000 filing, the filed rate doctrine or the NYISO's tariffs.[2] At present, however, it is not necessary to resolve this issue. Instead, the Commission should allow the question of the appropriate redress to be mediated under the procedures of its Dispute Resolution Service. *See NYISO's March 27, 2000 Request for Suspension of Market-Based Pricing for 10-Minute Reserves*, at 12-13.

[2] As stated in the March 27, 2000 filing, the Commission could order an effective date of January 29, 2000 for implementing the NYISO's request to redetermine the market prices for 10-minute reserves. In addition, the Commission has authority to grant relief without ordering a retroactive effective date. *See, e.g., Washington Water Power Co.*, 83 FERC ¶ 61,282 (1998) (requiring a refund of profits in connection with transactions undertaken in violation of utility's market-based rate order and affiliate conduct requirements); *see also* Section 7.2.A of the NYISO's Open Access Transmission Tariff (OATT) and Section 7.4 of its Market Administration and Control Area Services Tariff (Services Tariff); NYSEG Complaint at 3, n. 3.

B. Software Changes Regarding the Use of the Blenheim-Gilboa Plant to Supply 10-Minute Reserves are Underway.

According to NYSEG, certain operating procedures relating to the operation and use of the Blenheim-Gilboa Hydro facility were lost upon the transition to the NYISO. NYSEG states the New York Power Pool (NYPP) "recognized Blenheim-Gilboa as a source of operating reserves" but that the NYISO's software programs failed to include Blenheim-Gilboa "as a 1000 MW source of Spinning Reserves." NYSEG Complaint at 12. In addition, as NYSEG points out, the NYISO's software treats the facility as a single unit instead of four 250 MW units. This means that the four Blenheim-Gilboa units cannot be modeled separately for purposes of scheduling operating reserves. One consequence of this is that if one of the Blenheim-Gilboa units is operating for energy, the remainder of that operating unit and all of the rest of the facility's capacity can only be recognized as spinning reserves. At the same time, however, if the other units at Blenheim-Gilboa are not being operated for energy, the NYISO software does not recognize these non-operating, unsynchronized units as capable of providing spinning (as opposed to non-spinning) reserves. As a result, as NYSEG asserts, the NYISO has had to call on substantial amounts of other reserves, which contributed to the operating reserve crisis. NYSEG Complaint at 12-13.

Thus, NYSEG is correct that the NYISO's software to date does not recognize an ability on the part of Blenheim-Gilboa to provide operating reserves at the levels that NYSEG asserts could be provided by Blenheim-Gilboa. Moreover, to the extent that the NYISO software design could be changed to recognize significant operating reserves from Blenheim-Gilboa, the NYISO does not disagree that this situation could be characterized as a Market

Design Flaw. The operational limitations affecting the Blenheim-Gilboa unit are, however, the result of the Blenheim-Gilboa modeling decisions detailed in the "B-G Scheduling Agreement with NYISO Operation" document developed and signed by the Blenheim-Gilboa joint project contractors, of which NYSEG is a member. For the reasons described above, the decision to model the Blenheim-Gilboa plant as a single dispatch unit inherently restricts its ability to participate in both the 10-minute spinning and non-spinning reserve markets and to be scheduled for energy at feasible operating levels. The NYISO has been investigating various means to better utilize the Blenheim-Gilboa plant, and, on March 24, 2000, entered into an operating agreement with its contractors to allow the scheduling of an additional 250 MW of spinning reserves. The contractors have also agreed to model the Blenheim-Gilboa plant as four individual units, which will allow the Blenheim-Gilboa plant to purse bidding strategies, that, within the constraints of a competitive market, could result in operating schedules similar to those realized under NYPP Operation, by June 1, 2000. These changes, however, required discussion and agreement with the Blenheim-Gilboa contracting parties, and could not have been quickly or unilaterally implemented in response to the sudden non-competitive performance of the 10-minute NSR market. Similarly, although the NYISO is considering whether additional changes can be made in order to permit the Blenheim-Gilboa plant to adopt more flexible bidding strategies, the NYISO will need additional time, and the agreement of other parties, to implement such changes.

C. The NYISO's Market Design Objective is to Minimize Bid Costs Across All of the New York Markets.

According to NYSEG, at times when bids for 10-minute spinning reserves are lower than bids for 10-minute NSR, the NYISO schedules more of the superior quality spinning reserves, in accordance with the NYISO tariff. At the same time, however, NYSEG alleges that the NYISO uses the higher market clearing price of the 10-minute NSR to establish payments and charges for suppliers of both 10-minute spinning reserves and 10-minute NSR. NYSEG claims that this practice is contrary to the NYISO Services Tariff and the Commission's January 27, 1999 order, *Central Hudson Gas & Electric Corp.,* 86 FERC ¶ 61,062 (1999).

In its January 27, 1999 order, the Commission stated that it would require tariff modifications to permit the NYISO to purchase a "higher quality" category of reserves (such as spinning reserves) and purchase correspondingly less of a "lower quality" category of reserves (10-minute NSR) when doing would lower the NYISO's total cost. According to the Commission, this procurement method is known as "cascading." 86 FERC ¶ 61,062, at 61,227. In response, the Member Systems of the NYPP pointed out that their proposed "simultaneous clearing" mechanism achieved the same effect as cascading and argued that it was more efficient. In July 1999, the Commission accepted the Member Systems' simultaneous clearing market design, finding that it achieved the same result as cascading.[3] *Central Hudson Gas & Electric Corp.,* 88 FERC ¶ 61,138, at 61,399.

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[3] As described in the July 1999 order, the Member Systems did not intend to implement in New York a cascading model for reserve pricing like the California ISO's

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The NYISO's Services Tariff reflects the requirements of the Commission's January and July 1999 orders. Tariff Sheets 51-52 of the NYISO Services Tariff state:

> The ISO will select the least cost mix of Ancillary Services and Energy Suppliers. The ISO may substitute higher quality Ancillary Services (i.e., shorter response time) for lower quality Ancillary Services when doing so would result in an overall least cost solution. For example, 10-Minute Non-Synchronized Reserve may be substituted for 30-Minute Reserve if doing so would reduce the total cost of providing Energy and Ancillary Services.

Despite NYSEG's arguments to the contrary, the NYISO software design will produce the least cost mix of Ancillary Services. Specifically, the NYISO software substitutes higher quality reserves in place of lower quality reserves, when doing so would lower the total bid costs (*i.e.*, when the marginal bid for the higher quality reserve is lower than the marginal bid for the lower quality reserve). Thus, the NYISO's software will always schedule low cost reserves on operating units instead of higher cost reserves on off-line units. As this substitution is made and a larger quantity of the 10-minute spinning reserves are accepted, the marginal bid cost of 10-minute spinning rises. Likewise, as the quantity of accepted bids for 10-minute NSR on non-synchronized units falls, the marginal bid cost of the 10-minute NSR will decrease. This substitution will continue until the marginal bid cost of 10-minute spinning reserves and 10-minute NSR converges or the supply of 10-minute spinning reserves is exhausted. This system guarantees that the total bid cost for all reserves will be minimized.

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model. The California ISO purchases ancillary services in a sequential fashion, starting first with the service with the shortest response time (regulation services). The concept of cascading was intended to ensure that the unaccepted bids for one market spill over into the bids available for the next product. In the New York model, the NYISO makes a simultaneous determination of the least cost schedule that will satisfy the requirements for all

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Consequently, the NYISO's price calculation for reserves that sets the price for higher quality reserves at the level of the lower quality reserves is not inconsistent with the Services Tariff. The Services Tariff defines 10-minute NSR as "Operating Reserves provided by generation facilities that can be started, synchronized and loaded within ten (10) minutes." This definition can be met by either spinning or nonspinning reserves. Thus, the NYISO's Security Constrained Unit Commitment (SCUC) program[4] does not distinguish operationally between reserves that are on units that are spinning or units that are not spinning but can start up quickly, except to the extent that a portion (currently, 600 MW) of the operating reserve requirement must be met by spinning reserves. Once this requirement is met, however, the two types of reserves are substitutes, and the substitution of the two services (described above) causes the prices of the two to converge as fewer 10-minute NSR bids are accepted and more 10-minute spinning reserve bids are accepted.

In addition, the NYISO's market design is consistent with the economic theory underlying the approach of paying all suppliers the market clearing price. When the marginal bid for 10-minute NSR exceeds the marginal bid for spinning reserves, the value to the NYISO of both categories of reserves is equal to the price of the 10-minute NSR if there are not sufficient spinning reserves being offered to meet the full operating reserves requirement, so that some 10-minute NSR must be scheduled. In that situation, if 10-minute spinning

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ancillary services and energy. In this model, all bids are in a single pool to be considered by the NYISO at one time.

[4] The Security Constrained Unit Commitment program administers the NYISO's Day-Ahead Market.

reserve suppliers supplied 1 MW less of spinning reserves, the NYISO would have to increase its purchases of 10-minute NSR by 1 MW, at a cost of the marginal 10-minute NSR supplier's bid. Conversely, if 1 additional MW of spinning reserves was offered at an economic price, the NYISO would forego the purchase of 1 MW of 10-minute NSR at the higher 10-minute NSR price. Therefore, the marginal value to the NYISO of 10-minute spinning in both cases is equal to the price of 10-minute NSR.

This methodology provides the correct economic incentives to market participants. Setting market clearing prices at the level of the marginal unit, whether spinning or nonspinning, serves to encourage competitive suppliers to offer more lower-cost reserves into the market and to undercut potential exercises of market power.

D. The Provision of the NYISO's OATT Allocating Costs Incurred to Meet Local Reliability Rules is Not Applicable to the State-Wide 10-Minute Reserve Requirements.

NYSEG acknowledges the reliability requirement that 1200 MW of the 10-minute reserves must be purchased east of New York's Central-East constraint. According to NYSEG, Schedule 1 of the OATT (Second Revised Sheet No. 144) provides that costs incurred to meet local reliability requirements should be recovered from customers in the Load Zone where the local reliability requirement applies. NYSEG argues that the higher costs for 10-minute reserves caused by the requirement that 1200 MW be purchased east of Central-East should thus be paid by load located east of Central-East and not by load across the rest of the state.

The NYISO's OATT, Schedule 1 (Second Revised Sheet No. 144), states:

> Where the costs are incurred to compensate generating facilities for satisfying Local Reliability Rules, the associated charge shall apply only to Transmission Customers serving Load in the Load Zone(s) where the rule is applied.

This provision, however, applies only to Local Reliability Rules; the requirement to have 1200 MW of operating reserves east of Central-East is a state-wide reliability rule.[5]

Thus, the above-quoted provision does not require that 10-minute reserve requirement costs incurred because of the Central-East constraint be borne solely by load located East of the Central-East constraint. The total New York Control Area (NYCA) Eastern and Western reserve requirements are based on Section 4.9 of the New York State Reliability Council (NYSRC) Reliability Rules for Planning and Operating the New York State Power System, filed with the Commission in Docket No. ER97-1523 on October 18, 1999. Implementation of Section 4.9 is described in NYPP Operating Policy 2 –23 (Attachment A hereto). For the Central-East interface, Eastern NYCA reserves are activated to restore the Central-East loadings to within limits. Although this results in a requirement to use reserves in Eastern New York, it is based on NYSRC Rules, and does not constitute a Local Reliability Rule. Nonetheless, the NYISO, because of the locational effect of this requirement is, through its committees, reviewing whether this costing arrangement should be revised.[6]

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[5] If NYSEG were correct that the 1200 MW requirement was a Local Reliability Rule, the whole state should not be bearing the costs of this requirement.

[6] Similarly, while the locational requirement on Long Island is not characterized as a Local Reliability Rule, NYSEG Complaint at 16, this issue is also under review by the NYISO committees.

E. Software Limitations Preclude the NYISO from Accepting Bids from Resources West of the Central-East Constraint in the Day-Ahead Market.

NYSEG states that the NYISO "appears" to reject more economic bids from resources located west of the Central-East constraint when there are no transmission constraints in the Day-Ahead Market. NYSEG claims that if the total cost of energy and ancillary services would be lowered if the NYISO accepted some reserves from the west, the NYISO should accept such bids. According to NYSEG, the "optimization of bids across energy and Ancillary Services is one of the NYISO's objectives." NYSEG Complaint at ¶ 29.

For the NYISO Day- and Hour-Ahead Markets, the optimization of both the LBMP energy and ancillary reserves markets is achieved simultaneously to minimize bid costs. Under NYPP Operating Policy 2-23, the NYISO determines the total NYCA Eastern and Western reserve requirements, as discussed in Section D. These requirements are employed as fixed requirements in both the Day- and Hour-Ahead Markets. In the Real-Time Market, the same level of locational reserves are assigned to specific Eastern and Western NYCA generating units in order to meet the locational requirements.

The NYISO's adoption of fixed locational reserve requirements was primarily based on the Member Systems' assumption that the cost of reserves would be less than the cost of energy. By maintaining the fixed NYCA Eastern reserves, a greater transmission capability across the Central-East interface could be made available for energy, thereby reducing a major source of potential LBMP congestion within the NYCA.

Thus, at present, the system is operating as it was initially proposed by the Member Systems and is consistent with reliability constraints. If the NYISO is ultimately able to develop a better representation of the reliability constraints associated with locational reserves, its software could be improved to reflect this better representation of the constraints.

COMMUNICATIONS

Communications regarding this proceeding should be addressed to:

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COMPLIANCE WITH RULE 213

a. Disputed Factual Allegations

- The NYISO denies the allegations in Paragraph 22 regarding the historical operation of the Blenheim-Gilboa facility. Specifically, to the extent implied by the language on page 11-12, the NYISO disagrees that 1) the NYPP had the ability to call upon all the units as operating reserves at one time under any circumstances; and 2) that the NYISO modeled its software programs incorrectly.
- The NYISO disputes the implication in paragraph 23 that the Blenheim-Gilboa facility is capable of being factored in as a 1000 MW source of Spinning Reserves under any circumstances.
- The NYISO also disagrees that it is the failure of the software as implemented that resulted in the need to call on other reserves. NYSEG Complaint at ¶ 23.

- The NYISO denies that it failed to follow NYPP Operating Procedure 2-23 (NYSRC Rule 4.1.2.A). NYSEG Complaint at 12, ¶ 23.
- The NYISO denies that the NYISO's implementation of the software is flawed. NYSEG Complaint at 12.
- The NYISO denies that it improperly precluded the Blenheim-Gilboa facility from providing operating reserves. NYSEG Complaint at 13.
- The NYISO denies that it has implemented the tariff to allow Local Reliability Rules to set the market clearing price. NYSEG Complaint at ¶ 28.
- The NYISO denies the implication that it improperly rejects bids from resources west of Total East. NYSEG Complaint at ¶ 29.
- The NYISO denies that the March 27, 2000 filing was premised on the effects of a locational requirement on Long Island. NYSEG Complaint at ¶ 31.

b. Law Upon Which Answer Relies

- *Central Hudson Gas & Electric Corp.*, 86 FERC ¶ 61,062, at 61,227 (1999).
- *Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138, at 61,399 (1999).

c. Admissions and Denials of Material Allegations

- The NYISO denies that it has deviated from the of its OATT and that its implementation of its Tariffs is inconsistent with the filed rate. NYSEG Complaint at ¶ 25, 26.
- The NYISO disputes the allegation that the NYISO Tariffs have been implemented in a manner leading to Market Design Flaws. NYSEG Complaint at 10.

d. Defenses

- The NYISO has fully complied with its tariffs, applicable reliability requirements and Section 205 of the Federal Power Act.

CONCLUSION

For the foregoing reasons, the Commission should consolidate NYSEG's Complaint with the NYISO's March 27, 2000 filing for resolution through an alternative dispute resolution process.

Respectfully submitted,

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

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April 13, 2000

Attachment A

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 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 2010 (1999).

Dated at Washington, D.C. this 13th day of April, 2000.

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