

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

Market-Based Rates for Wholesale Sales of) Docket No. RM04-7-000
Electric Energy, Capacity and Ancillary
Services by Public Utilities

**REQUEST FOR CLARIFICATION OR, IN THE ALTERNATIVE, REHEARING OF
THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.**

Pursuant to Rule 713 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2006), the New York Independent System Operator, Inc. (“NYISO”) hereby seeks clarification or, in the alternative, rehearing of one aspect of Order No. 697, the Commission’s final rule codifying its policies for market-based rate authorizations.¹ Order No. 697 establishes that if a seller is found to have market power, it can propose mitigation measures, including the Commission’s default “cost plus 10 percent” mitigation for short term sales (less than one week),² subject to the Commission’s approval.

The Order refers to³ but does not address concerns raised in the NYISO’s August 7, 2006 “Comments” addressing the application of cost-based mitigation for short-term sales in bid-based Locational Based Marginal Price (“LBMP”) markets in which all sellers receive the market clearing price.⁴ In particular, the NYISO explained:

[T]he NYISO’s conduct and impact mitigation is based on limiting a seller’s bids, while that seller remains eligible to receive the market-clearing price if its mitigated bid is infra-marginal. Imposing a price cap to limit an individual seller’s revenues to a cost basis would be fundamentally inconsistent with the well-established pricing and settlement processes in New York, would distort efficient responses to market price signals and would require the NYISO to make

¹ *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 119 FERC ¶ 61,295 (June 21, 2007).

² *Id.* at PP 620-631.

³ *See id.* at P 781, n.907 and P 798, n.928.

⁴ *See* Comments of the New York Independent System Operator, Inc., Docket No. RM04-7-000 at 7 (Aug. 7, 2006).

significant, time consuming and expensive revisions to its software to keep track of transactions entered into by entities that would be subject to Commission-imposed revenue caps. Comments at p. 7.

Order No. 697 is not clear on whether a cost-based default bid for short-term sales is intended to function as a revenue cap as well as a bid cap in Locational Based Marginal Price (“LBMP”) markets where all accepted offers receive the market clearing price, such as in New York. As discussed further below, the imposition of default mitigation in the form of revenue caps rather than bid caps in bid-based, uniform market-clearing price auctions with Commission-approved mitigation measures would be fundamentally inconsistent with the Commission-approved design of the NYISO’s markets, and would not be necessary to achieve the objectives of Order No. 697. The NYISO respectfully requests that the Commission clarify that it did not intend for its default mitigation measure to impose a revenue cap in LBMP markets where all accepted offers receive the market clearing price. If that is not the case, the Commission should grant rehearing. The imposition of default market power mitigation in the form of revenue caps rather than bid caps would be incompatible with the principles underlying uniform clearing-price auctions, and this conflict would be arbitrary and capricious, and not based on substantial evidence.

In addition, anticipation of a possible need to implement mandatory revenue caps would present a significant practical quandary for the NYISO. Given the number of tariff compliance projects and projects that are designed to improve the NYISO’s markets that are currently pending in its software development queue, expending the NYISO’s limited resources to develop and deploy a significant new software project that might be needed to permit a theoretical Market Participant to employ the default mitigation measures set forth in Order No. 697 would not be efficient, nor justified. On the other hand, unless the NYISO develops this software in

advance, the NYISO would not be able to immediately apply a “default” mitigation method to Market Participant revenues in its markets if and when necessary. These adverse consequences would likewise be arbitrary and capricious, and not supported by substantial evidence.

For the foregoing reasons, the NYISO requests that the Commission clarify that, in bid-based, uniform clearing-price auction markets where all accepted offers receive the market clearing price for their accepted offers, cost-based mitigation will limit a mitigated entity’s permissible maximum bid, but will not constrain the mitigated entity from receiving the market clearing price if it is not the marginal seller.

Alternatively, the NYISO seeks rehearing of this issue, which was not addressed in Order No. 697.

I. Communications

Communications regarding this pleading should be addressed to:

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II. Specification of Errors/Statement of Issues

In accordance with Rule 713(c), 18 C.F.R. § 385.713(c), the NYISO submits the following specifications of error and statement of the issues:

1. If the Commission intended to adopt a default mitigation measure that would be inconsistent with its previously approved market design and mitigation measures for the

NYISO's bid-based, uniform clearing-price auction markets, and that would impose unreasonable and unnecessary costs on Regional Transmission Organizations ("RTOs") or Independent System Operators ("ISOs") such as the NYISO, then its action was arbitrary, capricious, and not based on substantial evidence. The Commission has repeatedly endorsed the NYISO's LBMP market design, including its conduct and impact mitigation measures for market power,⁵ and there is no policy or evidentiary basis provided in Order No. 697 for putting in place measures that conflict with previously accepted market design and mitigation measures.

2. The Commission erred in failing to address the NYISO's argument regarding the imposition of default cost-based mitigation as bid caps, rather than revenue caps, in bid-based, uniform clearing-price auction markets with Commission-approved mitigation measures such as those administered by the NYISO. Courts have held that an agency's failure to address issues raised by parties is arbitrary and capricious.⁶

III. Request for Clarification

The NYISO requests that the Commission clarify that a default cost-based mitigation measure for market power would apply as a bid cap rather than a revenue cap in bid-based, uniform clearing-price auctions with Commission-approved mitigation measures such as the markets administered by the NYISO. The NYISO's Comments explained that its existing, Commission-approved conduct and impact mitigation measures are based on limiting sellers'

⁵ See, e.g., *New York Independent System Operator, Inc., et al.*, 89 FERC ¶ 61,196 (1999), *order on compliance and reh'g*, 90 FERC ¶ 61,317, *clarified*, 91 FERC ¶ 61,154 (2000) (orders addressing the NYISO's proposed Market Mitigation Measures); *New York Independent System Operator, Inc., et al.*, 99 FERC ¶ 61,246 (2002) (order on the NYISO's comprehensive mitigation measures filing). *Accord Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 at P 257, *order on reh'g*, 109 FERC ¶ 61,157 (2004) ("We find that the conduct and impact approach with its associated thresholds is an appropriate approach to mitigation in the Midwest ISO's market. The conduct and impact approach allows for a lighter handed approach to mitigation, in which the market is allowed to function as is, except when problems are detected.").

⁶ See, e.g., *Canadian Ass'n of Petroleum Manufacturers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001); *PPL Wallingford Energy LLC v. FERC*, 419 F.3d 1194, 1199 and n.2 (D.C. Cir. 2005).

bids, but mitigated sellers are still eligible to receive the market clearing price, which may exceed their bids if another bidder is the marginal seller.

Under the NYISO's market design, the marginal, price-setting bid will either be a bid submitted by an entity that has not been determined to possess market power (subject to Commission-accepted conduct and impact testing), or a bid that has been mitigated in accordance with either the NYISO's Commission-accepted Market Mitigation Measures ("MMM")⁷ or the Order No. 697 bid cap. Thus, the market clearing price will either be a competitive price, or it will be a mitigated price. If the clearing price is set by a marginal seller that is not subject to a bid cap, then that indicates that there are competitive alternatives in the region and that further intervention to limit clearing prices is not warranted. If the clearing price is a mitigated price, that price may be higher than the mitigated offer of an inframarginal seller, but that is a natural and appropriate consequence of using uniform clearing-price auctions. As the Commission stated in Order No. 697: "Commission-approved RTOs and ISOs run real-time energy markets under Commission-approved tariffs. These single price auction markets set clearing prices on economic dispatch principles, to which various safeguards have been added to protect against anomalous bidding."⁸

In addition, if the Commission's default cost-based mitigation is interpreted to impose a revenue cap as well as a bid cap, the NYISO would not presently be able to prevent that seller from receiving the market clearing price for its accepted offers. Moreover, the NYISO has no procedures in place for redistributing the mitigated seller's forfeited revenues (the difference

⁷ The NYISO's MMM are set forth in Attachment H to its Market Administration and Control Area Services Tariff.

⁸ Order No. 697 at P 963. The Commission noted in its footnote to this statement that: "In response to State AGs and Advocates' argument about the rate of return for a seller receiving a market clearing price for power sold in an auction process, the issue does not concern whether a particular seller should have market-based rate authority, and it is more appropriately addressed in the context of an RTO/ISO proceeding rather than in this rulemaking proceeding." *Id.* at n.1108.

between the market clearing price and the compensation allowed under the revenue cap), nor does it have rules in place to address the interaction between the Commission's potential cost-based mitigation of generator revenues and mitigation applied by the NYISO pursuant to its MMM.

In order to be in a position to be capable of implementing a default mitigation methodology as a revenue rather than a bid cap, the NYISO would also have to revise its tariffs to address compensation to sellers that are subject to revenue caps. The necessary tariff revisions would include provisions addressing how the unpaid amounts are to be "credited back" to the rest of the market. The NYISO would also have to make significant, resource-intensive software revisions to enable its systems to (a) keep track of transactions entered into by sellers that would be subject to Commission-imposed revenue caps, and (b) ensure that they do not receive revenues in excess of the cap based on the market clearing price.

These considerations are significant, and the NYISO does not believe that the Commission intended to create substantial disruptions in the design of organized electricity markets. Consequently, the NYISO asks the Commission to clarify that, in bid-based, uniform clearing-price auction markets in which all accepted offers receive the market-clearing price, cost-based mitigation imposed pursuant to Order No. 697 would limit the maximum permissible bid that may be submitted by the mitigated seller, but would not limit such a seller's ability to receive the market clearing price if it is not the marginal seller.

IV. Alternative Request for Rehearing

If the Commission does not grant the NYISO's request for clarification, as described above, the NYISO seeks rehearing of these issues. As the Commission stated in Order No. 697, "for sellers in RTO/ISO organized markets, Commission-approved tariffs contain specific

market rules designed to prevent or mitigate exercises of market power.”⁹ Thus, “for sellers in RTO/ISO organized markets, the Commission has in place market rules to help mitigate the exercise of market power, price caps where appropriate, and RTO/ISO market monitors to help oversee market behavior and conditions.”¹⁰ There is no evidentiary or policy basis in the record of this proceeding that would justify the imposition of default mitigation in the form of a revenue cap, rather than a bid cap, in order to achieve the objectives of Order No. 697 in markets such as those administered by the NYISO. To the contrary, the use of bid caps with mitigated sellers receiving the clearing price even if they are infra-marginal would be fully consistent with time-tested and Commission-accepted procedures in New York. Accordingly, it would arbitrary and capricious, and not the result of substantial evidence, for default mitigation under Order No. 697 to be applied in a manner fundamentally inconsistent with the Commission-accepted design of the NYISO’s markets. Moreover, as explained in the NYISO’s Comments, such an implementation of Order No. 697 would impose an undue, unjustified burden and expense on the NYISO, and ultimately on the ratepayers in New York.

Furthermore, while Order No. 697 expressly references other matters raised in the NYISO’s Comments, it failed to address the NYISO’s argument concerning the problems associated with imposing revenue caps rather than bid caps on mitigated sellers in the NYISO’s markets.¹¹ Courts have found that an agency’s failure to meaningfully respond to issues raised

⁹ Order No. 697 at P 952.

¹⁰ *Id.* at P 955.

¹¹ The NYISO notes that footnote 907 references the NYISO’s comment that “sellers should be free to respond to market price signals in all markets in which they are eligible to sell.” Comments at 10. However, that discussion was in the context of whether sellers should be able to sell at market-based rates in areas where they do not possess market power. Thus, while some of the underlying themes are present in both arguments, Order No. 697 only acknowledges the NYISO’s comments regarding a seller’s relationship among different balancing authority areas. In addition, Order No. 697 references (at P 798) the NYISO’s comment regarding the relationship of clearing price auctions to exports to neighboring markets. Similar to the discussion above, this is a separate point. Finally, Order No. 697 (at P 1066) notes similar comments made by the NYISO in the context of ancillary services markets.

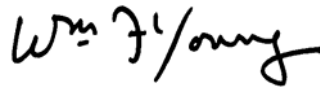
by parties is arbitrary and capricious.¹² In addition, the Commission's failure to respond to the NYISO's Comments on these issues creates uncertainty for not only the NYISO, but for all Market Participants including mitigated sellers.

V. Conclusion

WHEREFORE, for the foregoing reasons, the New York Independent System Operator, Inc. respectfully requests that the Commission grant the clarification or, in the alternative, rehearing requested herein.

Respectfully submitted,

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See Comments at 10. Again, this is a different argument from the one advanced by the NYISO regarding the imposition of revenue caps.

¹² *See, e.g., Canadian Ass'n of Petroleum Manufacturers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001) (stating that failure to meaningfully respond to a party's arguments rendered the Commission's decision arbitrary and capricious and "[u]nless the Commission answers objections that on their face seem legitimate, its decision can hardly be classified as reasoned."). *See also PPL Wallingford Energy LLC v. FERC*, 419 F.3d 1194, 1199 and n.2 (D.C. Cir. 2005) (failure to meaningfully respond to arguments is sufficient to vacate a Commission order).

CERTIFICATE OF SERVICE

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

Dated at Washington, DC, this 23rd day of July, 2007.

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