

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

New York Independent System Operator, Inc.)

Docket No. ER09-1682-000

**MOTION FOR LEAVE TO RESPOND, AND RESPONSE, AND REQUEST FOR
CONFIDENTIAL TREATMENT AND EXEMPTION FROM FREEDOM OF
INFORMATION ACT DISCLOSURE OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.**

**THERE IS NO PRIVILEGED OR CONFIDENTIAL INFORMATION IN THIS
PLEADING. CONFIDENTIAL VERSIONS OF ATTACHMENTS B AND C HERETO
ARE SUBMITTED IN A SEPARATE ENVELOPE THAT IS CLEARLY MARKED
“CONTAINS PRIVILEGED INFORMATION—DO NOT RELEASE”**

Pursuant to Rule 212 and 213 of the Federal Energy Regulatory Commission’s (“FERC” or “Commission”) Rules of Practice and Procedure,¹ the New York Independent System Operator, Inc. (“NYISO”) respectfully requests leave to submit the following response (“Response”) to the comments and protests filed in this docket on September 25, 2009 by TransCanada Power Marketing Ltd. and TC Ravenswood LLC (“TransCanada”), PSEG Energy Resources & Trade LLC and PSEG Power New York LLC (the “PSEG Companies”), Attachment E Supplier,² Electric Power Supply Association (“EPSA”), an unidentified generation owner (“Generation Owner”), AES Eastern Energy, L.P. (“AES”), and Independent Power Producers of New York, Inc. (“IPPNY”) (collectively, the “Generator Protests”). The Generator Protests were submitted in response to the NYISO’s *Filing Requesting Authority to Prospectively Apply New Mitigation Rules to Three Specifically Identified Generators, Requesting Limited Waivers of the NYISO’s Tariff and of the Commission’s Regulations, Seeking*

¹ 18 C.F.R. §§ 385.212 and 385.213.

² According to the NYISO’s records, the Market Party filing as the “Attachment E Supplier” was, in fact, the subject of Privileged and Confidential Attachment C to the NYISO’s September 4 Filing, not Attachment E. To avoid confusion, this Market Party and the generator it owns will be referred to as the “Attachment E Supplier” in this submission.

Expedited Commission Action, and Requesting Shortened Notice and Comment Periods that was submitted in the above-captioned Docket on September 4, 2009 (“September 4 Filing”).

In Section II of this Response, the NYISO identifies certain Attachments hereto that contain privileged, confidential and commercially sensitive information specific to individual Market Participants³ that the NYISO is required to safeguard under its Tariffs. The NYISO requests confidential treatment, and exemption from Freedom of Information Act (“FOIA”) disclosure, for that information. The NYISO does not request privileged treatment, or an exemption from FOIA disclosure, for any of the information contained in the body of this Response.

I. Motion for Leave to Respond

Some of the Generator Protests in this docket were submitted as “comments,” while others were called “protests.”⁴ The NYISO recognizes that the Commission generally discourages responses to protests but allows responses to comments.⁵ The NYISO respectfully

³ Unless otherwise specified, capitalized terms have the meanings specified in the NYISO’s Market Administration and Control Area Services Tariff (“Services Tariff”) or in Attachment H thereto.

⁴ See “Comments of TransCanada Power Marketing Ltd. and TC Ravenswood LLC under ER09-1682,” Docket No. ER09-1682-000 (Sept. 25, 2009); “Motion to Intervene of the PSEG Companies under ER09-1682,” Docket No. ER09-1682-000 (Sept. 25, 2009); “Attachment E Supplier submits Protest and Request for Confidential Treatment of the Attachment E Supplier et al under ER09-1682,” Docket No. ER09-1682-000 (Sept. 25, 2009); “Comments of the Electric Power Supply Association under ER09-1682,” Docket No. ER09-1682-000 (Sept. 25, 2009); “Generation Owner’s Motion to Intervene and Protest in Docket No. ER09-1682,” Docket No. ER09-1682-000 (Sept. 25, 2009); “Motion to Intervene and Comments of AES Eastern Energy, L.P. under ER09-1682,” Docket No. ER09-1682-000 (Sept. 25, 2009); “Motion to Intervene and Comments of Independent Power Producers of New York, Inc. under ER09-1682,” Docket No. ER09-1682-000 (Sept. 25, 2009).

⁵ 18 C.F.R. § 385.213(a)(2) and (3).

requests leave to respond to the protests, including any of the comments that the Commission determines also constitute a protest. For the reasons explained below, the Generator Protests do not show that the NYISO's new mitigation rules are not correct in principle, or that the application of the measures to the three Generators specifically identified in the NYISO's September 4, 2009 Filing in this docket would be unjust or unreasonable. The Commission has previously allowed responsive pleadings when they correct inaccurate statements,⁶ help to clarify complex issues, provide additional information that will assist the Commission, or are otherwise helpful in the development of the record in a proceeding.⁷ This filing is limited to points that satisfy the Commission's stated objectives. Thus, the NYISO submits that good cause exists to permit this response, to the extent permission is required.

II. List of Documents Submitted with This Response and Request for Confidential Treatment and Exemption from Freedom of Information Act Disclosure

The documents being submitted are:

1. This Response;
2. Supplemental Affidavit of Dr. David B. Patton, the NYISO's independent Market Advisor ("Patton Supplemental Affidavit"), Attachment A to this Response;

⁶ *S. Minn. Mun. Power Agency v. N. States Power Co.*, 57 FERC ¶ 61,136 at 61,494 (1991).

⁷ *See, e.g., N.Y. Indep. Sys. Operator, Inc.*, 108 FERC ¶ 61,188 at P 7 (2004) (accepting NYISO answer to protests because it provided information that aided the Commission in better understanding the matters at issue in the proceeding); *Morgan Stanley Capital Group, Inc. v. N.Y. Indep. Sys. Operator, Inc.*, 93 FERC ¶ 61,017 at 61,013 (2000) (accepting an answer that was "helpful in the development of the record . . .").

3. Supplemental Affidavit of Mr. Joshua A. Boles, the Supervisor of Monitoring, Analysis and Reporting for the NYISO (“Boles Supplemental Affidavit”), Attachment B to this Response; and
4. Affidavit of Mr. Ricardo T. Gonzales, the NYISO’s Vice President of Operations (“Gonzales Affidavit”), Attachment C to this Response.

Attachments B and C to this Response contain confidential, proprietary and commercially sensitive information. The confidential portions of the Attachments for which the NYISO requests privileged treatment and an exemption from FOIA disclosure each contain commercially sensitive information, including: (a) the identity of a specific Generators that the NYISO proposes to apply Rate Schedule M-1 to, (b) descriptions and analyses by the NYISO’s MMP of the conduct of the specified Generator that gives rise to this filing, (c) a description of the evidence and arguments presented by the Market Parties in support of claims that their Bids did not violate Sections 1(b) and 3.2.3 of the MMM, (d) the bidding strategies of the subject Generators and the impact that the Bids submitted for each Generator had on the guarantee payments to that Generator, and (e) costs and operating data relating to the subject Generators.

Disclosure of this information could cause commercial harm to each entity to which it relates, and could harm the markets administered by the NYISO. For the reasons set forth in Section VIII of the NYISO’s September 4 Filing and in accordance with Sections 388.107 and 388.112 of the Commission’s Regulations,⁸ Article 6 of the NYISO Market Administration and Control Services Tariff, and Sections 1.0(4) and 4.0 of the NYISO’s Code of Conduct, the NYISO requests Privileged and Confidential treatment of the confidential versions of Attachments B and C to this Response. The NYISO also requests that the identified Attachments

⁸ 18 C.F.R. §§ 388.107, 388.112 (2009).

be exempted from public disclosure under the Freedom of Information Act (“FOIA”), 5 U.S.C. § 552, for the reasons explained in Section VII of the NYISO’s September 4 Filing.⁹

In accordance with the Commission’s regulations, “public” versions of Attachments B and C hereto, from which all privileged and confidential material has been redacted, are submitted with this Response. The NYISO is separately submitting the versions of Attachments B and C that contain Privileged and Confidential Market Participant specific information, clearly labeled “CONTAINS PRIVILEGED INFORMATION—DO NOT RELEASE.” In addition, the NYISO has provided to each of the Suppliers that is responsible for one or more of the generators that the NYISO proposes to apply Rate Schedule M-1 to versions of Attachments B and C that include the confidential information that is pertinent to their generator(s).

III. Response

A. NYISO’s Failure to Specifically Address a Particular Argument or Statement Does Not Indicate Agreement Therewith

The Generator Protests contain numerous arguments, some of which are advanced in several different ways, and a range of factual assertions, with which the NYISO does not, or does not fully, agree. The NYISO has focused this Response on the issues of the most importance to the Commission’s review of the September 4 Filing, and the time available for this filing does not permit the NYISO to address every subtle shading of an argument, or partial or complete misstatement, contained in the Generator Protests. In addition, the NYISO has made every effort to keep privileged and confidential market Participant-specific information out of this filing, so that the Commission can issue a decision in this Docket that does not require the disclosure of

⁹ The information provided by the NYISO for which the NYISO claims an exemption from FOIA disclosure are designated “Contains Privileged Information - Do Not Release.”

protected information. Consistent with the Commission's directives to entities that seek permission to respond to protests, the NYISO has limited this Response to correcting the inaccurate statements, clarifying the complex issues, and providing the additional information that the NYISO believes will best assist the Commission to reach an appropriate decision in this proceeding. The NYISO's failure to respond to a particular nuance or version of an argument, or to a specific factual assertion, should not be interpreted as indicating the NYISO necessarily accepts the argument or agrees with the assertion.

B. The Bids Submitted by Generation Owner and the Attachment E Supplier when their Generators were Committed for Reliability were not Consistent with Bids under Competitive Market Conditions

Generation Owner and Attachment E Supplier repeatedly assert that the bids they submitted when their Generators were called on for reliability were consistent with bids under competitive conditions because any increment over variable operating costs in those bids was simply intended to recover the relevant Generator's fixed costs.¹⁰ These assertions fly in the face of the Commission's long standing recognition that competitive bids should reflect only the Generator's variable operating costs. From the inception of the NYISO, the Commission has recognized that its markets use “a pricing methodology under which the price of Energy at each location into the NYS Transmission System is equivalent to the cost to supply the next increment of Load at that location (*i.e.*, the short run marginal cost).”¹¹ It necessarily follows that

¹⁰ See, e.g., Privileged and Confidential Affidavit provided as Attachment C to the Protest submitted by Attachment E Supplier (“Attachment C Affidavit”), ¶ 40, Generation Owner at 25-26.

¹¹ *NRG Power Marketing, Inc. v. N.Y. Indep. Sys. Operator, Inc.*, 91 FERC ¶ 61,346 at p. 62,165 (2000) (quoting §1.17e of the NYISO's Open Access Transmission Tariff).

competitive bids should reflect each generator's marginal cost, so that the market-clearing price is set at the marginal cost of the marginal unit.

Similarly, in an order ruling on the proper mitigation of certain Generators that were erroneously committed but correctly subject to guarantee payment mitigation once committed, the Commission found that "no further compensation is necessary for these generators," because the mitigated generators "received their reference bids, which are intended to reflect the generators' actual cost of operation;" and since the mitigated Generators were paid at the level of their reference bids, they were "appropriately--and adequately--compensated pursuant to the terms and conditions of the NYISO Services Tariff."¹²

These holdings are consistent with the Commission's policies in other markets comparable to those in New York. In an order issued on October 2, 2009 in Docket No. ER09-1546-000, the Commission found that mitigated payments to Generators committed for reliability in New England should not include a fixed-costs component.¹³ Dr. Patton states that the ISO-NE and NYISO proposals "address[] the same concerns," and "the proposals themselves are virtually identical."¹⁴

The exclusion of fixed costs recovery from market power mitigation was unequivocally endorsed by Dr. Patton in the affidavit he submitted in support of the NYISO's September 4 filing:

¹² *N.Y. Indep. Sys. Operator, Inc.*, 115 FERC ¶ 61,021 at P 22 (2006). See also *N.Y. Indep. Sys. Operator, Inc.*, 103 FERC ¶ 61,291 at n.8 (2003) (finding that: "A reference price is a proxy for [the] marginal costs of a resource.").

¹³ *ISO New England, Inc. and New England Power Pool*, 129 FERC ¶ 61,008 at P 4, 19 (2009); Patton Supplemental Affidavit, ¶ 27.

¹⁴ Patton Supplemental Affidavit ¶ 24.

As a preliminary matter, suppliers in a competitive market would not include fixed costs in their offers. When suppliers do not have market power (cannot influence prices or payments by raising their offers) in a market with a uniform clearing price, they will maximize their profits by submitting offers priced at their short-run marginal costs. Offers priced above this level can only reduce the number of hours that the unit will be dispatched and lower its profits. Hence, the offers identified by the NYISO in this filing are inconsistent with what would be expected in a competitive market because they are priced substantially above the suppliers' short-run marginal costs.¹⁵

In response to the arguments advanced in the Generator Protests, in his Supplemental Affidavit Dr. Patton further explains why Generators in a competitive market are expected to submit offers that reflect their marginal operating costs.¹⁶ Dr. Patton points out that the Attachment C Affidavit to Attachment E Supplier's protest "does not distinguish clearly between competitive conditions and market power, or between short-run and long-run considerations."¹⁷ Dr. Patton further explains that bidding at marginal cost is the profit-maximizing strategy in a competitive market, and thus is the expected bidding strategy because it is in a generator's self-interest in the absence of market power.¹⁸

The Generator Protests do not and cannot show that recovery of a fixed cost component as part of a market power mitigation measure should be permitted for energy markets in New York. Recovery of fixed costs as a component of a Generator's Minimum Generation, Start-up or Incremental Energy Bids is not consistent with the NYISO's market.

¹⁵ Patton Initial Affidavit, ¶ 34.

¹⁶ *Id.*, ¶¶ 5-9.

¹⁷ *Id.*, ¶ 5.

¹⁸ *Id.*, ¶¶ 7-9.

C. Generators are not Guaranteed Recovery of Fixed Costs in the NYISO Energy Markets; Even in Capacity Markets, Competitive Bids would be Based on Going-Forward Costs, not Fixed Costs

Competitive bids in the New York energy markets are expected to be at the level of a Generator's variable operating costs. It follows that a Generator would have an opportunity, but not a guarantee, to recover its fixed costs in the energy markets, to the extent it operates as an inframarginal unit when the clearing price is above its marginal costs. A Generator would have an additional opportunity to recover its fixed costs by participating in the New York Capacity markets.¹⁹ Even in Capacity markets, however, the measure of a competitive bid is a Generator's going-forward costs, not its fixed costs as suggested in the Generator Protests.²⁰ This is expressly recognized in the Services Tariff, which permits Generators in the portfolio of a pivotal Supplier in the New York City Capacity market to submit Capacity bids up to the level of the Generator's going-forward costs without exceeding the Capacity mitigation thresholds.²¹

None of the Generator Protests discusses going-forward costs or provides any analysis showing that the relevant Generators have not been able to recover their going-forward costs in

¹⁹ See, e.g., *ISO New England*, 129 FERC ¶ 61,008 at P 19.

²⁰ Generation Owner at 7, 17-18, and supporting affidavit, ¶¶ 7-9.

²¹ Services Tariff, Attachment H §§ 2.1 and 4.5(b) & (c); see also *N.Y. Indep. Sys. Operator, Inc.*, 124 FERC ¶ 61,301 (2008) (holding, with respect to the New York City Capacity market, that: "Because some generators have market power, their bids are mitigated to their going-forward costs as a way to approximate their competitive bids;" and also holding that "the relevant costs in the calculation of going-forward costs are those costs that can be avoided if a unit is mothballed."); see also Patton Initial Affidavit, ¶¶ 35-36. As specified in Attachment H, "going-forward costs" are the marginal costs of providing Capacity, that is, the net costs that a Generator would not incur if it went out of operation for a year or more (*i.e.*, were mothballed), or permanently retired. Going-forward costs may include maintenance costs incurred to keep the generator in service, labor costs necessary to keep the plant available, and expected profits from converting the facility to an alternative purpose that would be foregone by keeping the generator in service. Going-forward costs do not include sunk costs such as past expenditures and/or

the energy, ancillary services or Capacity markets. Thus, the Generator Protests provide no basis on which the Commission could conclude that any of the three Generators that the NYISO proposes to mitigate is not recovering the costs it should expect to recover in competitive energy and Capacity markets. As Dr. Patton states, “[n]one of the suppliers in question have presented data showing that the current energy, ancillary services, and capacity markets do not cover the going-forward costs of the resources in question.”²²

The Generator Protests do not make any effort to place their cost recovery issues in the context of the current economic climate. To the extent that some Generators are not achieving their hoped-for levels of profitability in the current difficult economic conditions, with low demand and low LBMPs, that is not a basis for changing the design of the New York markets or for rejecting the NYISO’s proposed Rate Schedule M-1.

D. Permitting Generators to Exercise Market Power Is Not an Appropriate Method of Providing Generators that are Needed for Reliability an Opportunity to Recover Going-Forward Costs

In addition to the economic and policy considerations against recovery of fixed costs in market power mitigation measures discussed above, attempting to “fine tune” reference levels and mitigation thresholds to permit Generators that are needed for reliability to recover their going-forward costs would be an impractical and imprecise cost recovery method, because it would almost always result in either over-recovery or under-recovery. For example, suppose that a Generator required for reliability could demonstrate unrecovered going-forward costs and was anticipated to be needed for reliability, and thus pivotal, on 10 days each year. If a premium

financing costs that could not be avoided by taking the generator out of service. *See* Patton Supplemental Affidavit. ¶ 15.

²² Patton Supplemental Affidavit, ¶ 15.

(in \$/MWh) for going-forward cost recovery were added to its reference level based on the assumption of 10 days of commitment as a pivotal supplier, the Generator would under-recover if it turned out to be pivotal on fewer than 10 days, and would over-recover if it were pivotal on more than 10 days. By contrast, as the Commission has recognized in ruling on a similar mitigation situation in New England, “the frequency with which a resource is dispatched out-of-merit is irrelevant when proposing mitigation rules that are designed to prevent the exercise of market power in all circumstances. If bids are offered competitively, market participants will remain unaffected by the proposed mitigation framework.”²³

E. The NYISO Tariff Provides a Remedy if There is an “Imminent Threat” to Reliability Because a Generator Intends to Cease Operations Absent Additional Legitimate Cost Recovery

As Dr. Patton acknowledged in his affidavit in support of the September 4 Filing, notwithstanding the various sources of revenue available to Generators in the competitive energy, ancillary services and capacity markets, “it is possible that a unit needed for reliability will not receive adequate revenues to remain in operation.”²⁴ Even if this were the case -- and the Generator Protests have not shown that it is²⁵ -- Dr. Patton shows that it would be “highly undesirable” to use inflated market power mitigation reference levels as a means to recover those costs.²⁶ Instead, in “cases where a supplier is providing necessary reliability services to the system that are not priced in the market, and is not recovering its fixed costs, the Commission has generally relied on contractual solutions that are customized and appropriate for the specific

²³ *ISO New England*, 129 FERC ¶ 61,008 at P 18.

²⁴ Patton Initial Affidavit, ¶ 38.

²⁵ Patton Supplemental Affidavit, ¶ 15.

²⁶ Patton Initial Affidavit, ¶ 39-41.

resource in question.”²⁷ In New York, this result can be achieved through Attachment Y to the NYISO's OATT.

Section 8.9 of Attachment Y authorizes the NYISO Board, in consultation with the New York Department of Public Service (“DPS”), to identify “an imminent threat to the reliability of the New York power system,”²⁸ and in that event to require the appropriate Transmission Owner or Owners to propose an appropriate “Gap Solution” outside the normal reliability planning cycle.²⁹ Other entities, which could include the Generators identified in the September 4 Filing, can also submit proposed Gap Solutions. If the operation of one of the subject generators is needed to prevent an imminent threat to the reliability of the New York State Bulk Power Transmission Facilities, and if such a Generator would cease operations because it is not able to recover its legitimate going-forward costs, then the predicate for the use of an Attachment Y Section 8.9 Gap Solution would be met. Section 13.6 of Attachment Y provides for the recovery of the costs of a Gap Solutions that are not transmission projects; such as the funding of a reliability must-run arrangement with a given Generator in appropriate circumstances. Hence, there is no need to permit Generators to exercise market power in the energy, ancillary services, or Capacity markets in order to make necessary cost recovery payments to Generators that are

²⁷ *Id.*, ¶ 42.

²⁸ The NYISO’s planning responsibilities under Attachment Y to its OATT extend to the “New York State Bulk Power Transmission Facilities,” as that term is defined in Sections 1.1 and 2.0 of Attachment Y.

²⁹ A “Gap Solution” is defined in § 2.0 of Attachment Y as: “A solution to a Reliability Need that is designed to be temporary and to strive to be compatible with permanent market-based proposals. A permanent regulated solution, if appropriate, may proceed in parallel with a Gap Solution.” Section 8.9(a) of Attachment Y provides that Gap Solutions “may include generation, transmission or demand side resources.”

genuinely needed for the reliability of the bulk power system and that are not able to recover their legitimate going-forward costs.³⁰

None of the Generator Protests address the availability of Gap Solutions under Attachment Y. Consequently, the Generator Protests do not show that the NYISO must be directed to submit a compliance filing allowing for reliability must-run payments, or that not providing for the recovery of fixed costs makes the NYISO's proposal unreasonable.³¹

F. Modeling a New Constraint that Can Only be Solved by One Supplier Would Expand the Effects of that Supplier's Exercise of Market Power

IPPNY and several of the other Generator Protests argue that modeling the reliability concerns that required the commitment of the three Generators will address the Generators' cost recovery concerns by sending an appropriate price signal to the market. There are two problems with this suggestion. First, modeling the relevant constraints would not cure the market power problem, but only shift its effects from guarantee payments to energy prices.³² Second, as the NYISO explained in the September 4 Filing and as Dr. Patton explains in his Supplemental Affidavit, adding new constraints to the NYISO's market model that can only be solved by a single supplier will expand the potential market impact of that Supplier's ability to exercise market power.³³ Instead of limiting the impact to the guarantee payment made to a single

³⁰ Generators whose continued operation is needed to provide reliable service to loads on facilities that are not New York State Bulk Power Transmission Facilities would need to seek any necessary cost recovery payments directly from the local Transmission Owner. The reliability commitment of such a generator would be at the request of the local Transmission Owner.

³¹ See, e.g., Attachment E Supplier at 31; Attachment C Affidavit, ¶¶ 35 and 36.

³² Patton Supplemental Affidavit, ¶ 16; September 4 Filing at 8..

³³ *Id.*.

Generator, the Supplier's non-competitive bids would set an artificially high LBMP that could affect a far broader segment of the market. In other words, permitting a Supplier that possesses market power to set price will not solve the underlying market power problem; it will only serve to expand the problem's scope.

As Dr. Patton explains in his Supplemental Affidavit, in order to send appropriate price signals to the market, the modeling of a new reliability constraint that that can only be addressed via the commitment of a pivotal Suppliers generator(s) would need to be accompanied by appropriate mitigation measures.³⁴ The NYISO would support IPPNY's proposal if there are mechanisms in place to require a pivotal Supplier to submit competitive bids that reflected its Generators' marginal costs. The NYISO expects to discuss this proposal further in its stakeholder governance process.

G. The NYISO has Provided Appropriate Support for the Mitigation Thresholds Proposed in Rate Schedule M-1

The Generator Protests assert that the NYISO has not provided adequate cost support or an adequate economic rationale for the proposed "greater of 10% or \$10/MWh" mitigation thresholds proposed in Rate Schedule M-1.³⁵ Contrary to the Generators' assertions, the thresholds are not intended as a vehicle to permit Generators to recover their fixed or going-forward costs. Any such use of the thresholds would be inappropriate for all the reasons explained above. Rather, as explained by Dr. Patton and Mr. Boles, the thresholds are appropriate to provide some flexibility in bidding to account for the potential uncertainties in determining reference prices, particularly changes in fuel prices, thereby avoiding over

³⁴ Patton Supplemental Affidavit, ¶ 16.

³⁵ See, e.g., Attachment E Supplier at 25, 26.

mitigation of guarantee payments.³⁶ Dr. Patton also points out that the 10% threshold in Rate Schedule M-1 rests on the same basis as the 10% threshold recently approved by the Commission for use in comparable circumstances in New England.³⁷ The Generator Protests argue that the thresholds should be looser to permit additional fixed cost recovery, but do not show that the proposed thresholds are not at appropriate levels for the purposes for which they were intended.

Dr. Patton has explained that setting thresholds in Rate Schedule M-1 that are significantly lower than the default mitigation thresholds “is analogous to the situation in the New York City load pockets where much lower conduct and impact thresholds are applied to address local market power.”³⁸ The Commission approved the New York City thresholds on the basis of analysis by Dr. Patton similar to that provided with the September 4 Filing.³⁹ In that proceeding, the Commission agreed with NYISO that the proposed “threshold reasonably balances the need for flexibility for generators bidding in constrained areas to reflect legitimate changes in marginal costs and the need to prevent undue exposure of the market to locational market power.”⁴⁰ In doing so, the Commission noted the NYISO's explanation that the proposed threshold level “is between levels that are impractically low and thus likely to mitigate

³⁶ Patton Initial Affidavit, ¶¶ 15-20; Patton Supplemental Affidavit, ¶ 24 and 27; Boles Supplemental Affidavit, ¶¶ 4-6.

³⁷ Patton Supplemental Affidavit, ¶ 27.

³⁸ Patton Initial Affidavit, ¶ 15.

³⁹ See *N.Y. Indep. Sys. Operator, Inc.* 99 FERC ¶ 61,246 at p. 62,047-48 (2002).

⁴⁰ *Id.* at p. 62,048.

unjustifiably (mitigate instances of legitimate conduct) and levels that would permit sustained price increases resulting from the presence of locational market power.”⁴¹

The Attachment E Supplier asserts that the Commission’s rejection of a March 2007 filing by the NYISO of a form of mitigation for the In-City ICAP market supports its claim that the NYISO has not provided adequate “cost support” or “economic justification” for its proposed Rate Schedule M-1.⁴² This assertion is completely misplaced. First, the NYISO itself acknowledged that the proposed reference price at issue in the In-City ICAP proceeding was not based on a cost analysis, but was instead a negotiated compromise.⁴³ Second, the September 4 Filing does not address how reference levels are determined. Rather, it proposes to re-set the threshold above a Generator’s reference level at which mitigation will be applied.

A cost of service justification would be appropriate for determination of the reference levels on which mitigation is based. Reference levels are determined on a case-by-case basis under the NYISO’s existing tariff provisions.⁴⁴ The setting of reference levels, however, is not at issue in this filing. The issue here is mitigation thresholds, which serve a different purpose. The NYISO has provided both an economic justification of,⁴⁵ and cost support for certain aspects of,⁴⁶ its proposed Rate Schedule M-1.

⁴¹ *Id.* at p. 62,047.

⁴² Attachment E Supplier at 26, *citing N.Y. Indep. Sys. Operator, Inc.* 118 FERC ¶ 61,182 at PP 13-14, 17; *see also* Generation Owner at 11.

⁴³ *N.Y. Indep. Sys. Operator, Inc.*, 118 FERC ¶ 61,182 at P 15.

⁴⁴ Services Tariff, Attachment H § 3.1.4.

⁴⁵ *See, e.g.*, Dr. Patton’s Initial and Supplemental Affidavits.

⁴⁶ *See, e.g.*, Boles Supplemental Affidavit, ¶¶ 4-6.

H. The NYISO's Calculation of Impact Pursuant to Section 3.2.3(2) of its Market Mitigation Measures was Performed Correctly

Attachment E Supplier and Generation Owner argue that the NYISO's method of determining whether the bids they submitted on behalf of their Generators exceeded the 100% guarantee payment impact mandatory filing threshold specified in Section 3.2.3(2) of the Market Mitigation Measures ("MMM") was not the appropriate method of performing this test because it can produce anomalous results in some circumstances.⁴⁷

The NYISO used the same method it uses on a daily basis to test for real-time guarantee payment ("RTGP") impact under Section 3.2.1(2) of its MMM to determine if the bids submitted on behalf of the three Generators exceeded the "increase of 100 percent in guarantee payments" threshold set forth in Section 3.2.3(2) of the MMM.⁴⁸ The method that the NYISO used to calculate guarantee payment impact in this case is consistent with the calculation method it described on page 4 of its August 31, 2007 RTGP mitigation filing in Docket No. ER07-1334-000 ("August 31, 2007 Filing"):

Under the MMM, competitive "reference levels" [footnote omitted] are established for each generator's Incremental Energy, Minimum Generation and Start-Up Bids. Bids that exceed the relevant reference level by the conduct thresholds specified in Section 3.1.2 of the MMM fail the conduct test and are eligible for guarantee payment mitigation if they would also result in a real-time BPCG payment to the generator that is 50% (in New York City) or 200% (in the rest of New York State) greater than the "reference" BPCG payment that would be available for the operating day if all conduct-falling Bids were replaced with reference levels (the "RTGP Impact Test"). [footnote omitted] Stated another way, the RTGP Impact Test compares (i) the BPCG payment that a generator would receive if its Bids that fail the conduct test were replaced with reference levels (the "Reference BPCG"), to (ii) the BPCG payment that the generator would receive if the generator were compensated based on the offers the NYISO

⁴⁷ See, e.g., Attachment C to the Attachment E Supplier's Protest ¶¶ 20 through 31. The MMM are set forth in Attachment H to the Services Tariff.

⁴⁸ Boles Supplemental Affidavit, ¶ 12.

used to run its Real-Time Market (the “Initial BPCG”). If the comparison of the Initial BPCG to the Reference BPCG indicates that the generator's offers increased its BPCG payment by more than 50% (in New York City) or by more than 200% (in the rest of New York State), then all of the generator's conduct-failing Bids are mitigated for the entire operating day and a revised BPCG payment (which can never be less than \$0) is calculated based on the mitigated offers.

Before the NYISO submitted the August 31, 2007 Filing, the NYISO explained the method it intended to use to calculate guarantee payment impact to its stakeholders. Both the NYISO’s presentation to the Business Issues Committee⁴⁹ and its presentation to the Management Committee⁵⁰ included slides illustrating how guarantee payment impact would be calculated.

The vast majority of the Generation sector entities that submitted protests in this Docket participated in the stakeholder process that resulted in Management Committee approval of the NYISO’s August 31, 2007 Filing. The concerns that Attachment E Supplier and Generation Owner raise in this proceeding regarding the appropriate method of calculating guarantee payment impact were also raised in the stakeholder process that ultimately resulted in the August 31, 2007 Filing. Although the concerns were identified as a potential area for future improvement⁵¹ in the stakeholder discussions, seventy-two percent of the NYISO’s Management

⁴⁹ The NYISO’s April 20, 2007 presentation to its Business Issues Committee can be found on the NYISO’s web site at the following location:

http://www.nyiso.com/public/webdocs/committees/bic/meeting_materials/2007-04-20/BIC_agenda_05_Realttime_Guarantee_Payment_042007.pdf

⁵⁰ The NYISO’s April 30, 2007 presentation to its Management Committee can be found on the NYISO’s web site at the following location:

http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2007-04-30/mc_agenda_06_presentation_re_gp_proposal.pdf

⁵¹ Possible improvements that were discussed included not applying guarantee payment mitigation if a generator’s guarantee payment would change by \$500 or less as a result of the

Committee voted to move forward using the RTGP calculation method described above. In the end, seventy-two percent of the NYISO's stakeholders voted in favor of the NYISO's proposal at the Management Committee.⁵² The Commission accepted the proposed Tariff revisions that accompanied the NYISO's filing in an order issued on October 30, 2007.⁵³

In addition, as explained in the Supplemental Affidavit of Joshua A. Boles, the impact calculations that resulted in the NYISO's filing in this proceeding identified substantial daily guarantee payment impacts of thousands of dollars per Generator, per commitment day.⁵⁴ Hence, the theoretical concern that the NYISO could mathematically calculate an inappropriate guarantee payment impact when the LBMP is, to use the extreme example in the Protests, \$49.99/MWh, the generator's (minimum generation) reference level is \$50/MWh and the generator's (minimum generation) bid is \$51/MWh,⁵⁵ while technically correct, is not relevant to the facts presented here. Had the scenario posited by Attachment E Supplier and Generator Owner occurred, the NYISO would have exercised its authority under Section 3.2.3 of the MMM

mitigation. Prior to the initiation of this proceeding, the NYISO's stakeholders had not asked the NYISO to prioritize developing a solution to the guarantee payment impact test calculation concern identified by the Attachment E Supplier or Generation Owner. The NYISO presumes its generation sector stakeholders did not show sustained interest in addressing this calculation concern because, relatively speaking, it is a concern that is of relatively small financial importance to them.

⁵² See NYISO August 31, 2007 filing in Docket No. ER07-1334-000, at 15.

⁵³ *N.Y. Indep. Sys. Operator, Inc.* 121 FERC ¶ 61,112 (2007).

⁵⁴ Boles Supplemental Affidavit, ¶¶ 13-16.

⁵⁵ Resulting in potential mitigation of \$1.01/MWh.

to determine that the guarantee payments received were “due to legitimate competitive forces or incentives,” which would have obviated the need for the NYISO’s September 4 Filing.⁵⁶

I. Attachment E Supplier’s Proposed Alternative Method of Calculating Guarantee Payment Impact Under Section 3.2.3(2) of the Market Mitigation Measures is Either a Conduct Test or a Total Revenue Impact Test; It is Not a Guarantee Payment Impact Test

In its protest, Attachment E Supplier suggests that the guarantee payment impact test set forth in Section 3.2.3(2) of the MMM should not be calculated the same way as the RTGP impact test. Rather, Attachment E Supplier argues that for purposes of Section 3.2.3(2) of the MMM, guarantee payment impact should instead be calculated by comparing the accepted portions⁵⁷ of a Generator’s bid to the corresponding reference levels to determine if the Generator’s bid resulted in a guarantee payment impact. Hence, if a Generator with a \$40/MWh (minimum generation) reference level has a \$120/MWh (minimum generation) bid accepted, the resulting impact would be a 200% increase to the Generator’s guarantee payment under the Attachment E Supplier’s proposal.

As Dr. Patton and Mr. Boles explain in their Supplemental Affidavits,⁵⁸ the alternative method for determining when mitigation should be imposed proposed by Attachment E Supplier ignores the LBMP revenues that the Generator receives, so it would not accurately test the impact that a Market Party’s bidding behavior had on the guarantee payment that its Generator

⁵⁶ See Boles Supplemental Affidavit, ¶ 17.

⁵⁷ Attachment E Supplier’s filing did not thoroughly explain the details of its proposed MMM Section 3.2.3(2) impact calculation method. The NYISO assumes that the proposed test is intended to be performed after-the-fact and to compare a generator’s accepted bids to the corresponding reference levels.

⁵⁸ Patton Supplemental Affidavit, ¶¶ 18 and 19; Boles Supplemental Affidavit, ¶ 12.

receives. Rather, Attachment E Supplier's proposed test compares a Generator's bids to its reference levels. The proposed test is either a conduct test (as Mr. Boles suggests) or a total revenue impact test (as Dr. Patton suggests). In either case, it is *not* a guarantee payment impact test.⁵⁹ The relevant provisions of Section 3.2.3(2) of the MMM expressly state that the NYISO is to determine the extent to which a Market Party's bidding behavior increased its guarantee payment, not to perform a conduct test,⁶⁰ or to determine the extent to which a Market Party's total revenues were enhanced by its bidding behavior.⁶¹

J. The NYISO's MMM Section 3.2.3(2) Guarantee Payment Impact Test is not Deficient Simply Because Generators Assertedly May Not Know in Advance if their Bids will Result in a Determination of Impact

Attachment E Supplier and Generation Owner argue that the NYISO's method of calculating guarantee payment impact under Section 3.2.3(2) of its MMM is impermissible because at the time a Supplier submits its bid, the Supplier cannot know whether its bid will exceed the mandatory filing threshold and trigger the NYISO's submission of a proposed mitigation measure to the Commission pursuant to Section 205 of the Federal Power Act.⁶² Generation Owner's pleading argues that Section 3.2.3(2) should be applied on the basis of a

⁵⁹ While the NYISO proposes to employ a new conduct test that is similar in nature to Attachment E Supplier's proposed "impact" test in its Rate Schedule M-1, the NYISO explained on pages 10 and 11 of its September 4 Filing and in paragraphs 25-30 of Dr. Patton's Initial Affidavit that proposed Rate Schedule M-1 is different from the NYISO's existing mitigation measures because it incorporates an assumption that when the three identified generators are committed for reliability and are pivotal, they will (unless mitigated) be able to recover the full amount of their bids. The September 4 Filing requests the Commission's permission to implement its proposed new mitigation measure.

⁶⁰ See Boles Supplemental Affidavit, ¶ 12.

⁶¹ See Patton Supplemental Affidavit, ¶ 18 and 19.

⁶² Attachment E Supplier at 15-17; Generation Owner at 14 and 16.

Supplier's bidding conduct, not the impact on its guarantee payments, and in effect suggests that a "right" to bidding certainty entitles Suppliers to exercise market power, so long as their offers do not exceed the default conduct or impact thresholds specified in the NYISO's mitigation measures.

The NYISO vigorously disagrees with both assertions. First, as pointed out above, the language of Section 3.2.3(2) explicitly requires the NYISO to perform a guarantee payment impact test. Second, Suppliers that bid a Generator into the NYISO's markets can know with certainty that they will not be mitigated by bidding the Generator's marginal cost. The very purpose of the MMM Section 1(b) and 3.2.3 monitoring requirements is to identify Generators that are able to exercise market power in a targeted manner that does not exceed the otherwise applicable mitigation thresholds set forth in the NYISO's MMM. The purpose of the mitigation thresholds is not to permit a Supplier to receive compensation in excess of the compensation it would receive if it bid competitively. Moreover, in its Order accepting the NYISO's proposed MMM in 2000, the Commission made clear that the NYISO "may make a section 205 filing any time it believes conduct in a particular circumstance warrants it, even when the thresholds are not met."⁶³ By definition, a mitigation measure that is designed to catch Market Parties that are attempting to "fly under the radar" by bidding just under an existing mitigation threshold cannot, and should not, be subject to any set or defined minimum criteria (other than the generator's reference level). Suppliers that want certainty should submit bids at competitive levels, and use the consultation process, as necessary, to ensure their Generators' reference levels are accurate.⁶⁴

⁶³ *N.Y. Indep. Sys. Operator, Inc.*, 90 FERC ¶ 61,317 at p. 62,053 (2000).

⁶⁴ In addition, in the NYISO's proposed Rate Schedule M-1 the three generators are provided the additional assurance of the 10% or \$10 thresholds before mitigation will be applied.

K. The NYISO's Obligation to Inform Generators of the Reliability Need they are Being Committed to Address

Generation Owner and Attachment E Supplier argue that the NYISO is obligated to inform them of the reason(s) their generators are being committed for reliability. The NYISO agrees. However, they are not entitled to more information than the NYISO provides to the rest of the market.

As Ricardo T. Gonzales, the NYISO's Vice President of Operations, explains in his attached affidavit,⁶⁵ Section 4.0 of the NYISO's Code of Conduct (Att. F to the OATT) provides:

The ISO shall disclose data that is not Confidential Information, and information required to be disclosed by FERC, by posting the information on the OASIS. If an ISO Employee improperly discloses TSI to any Market Participant, the ISO shall immediately post the information on the OASIS and notify the Commission.

The NYISO interprets this requirement, along with the requirement in Section 2.0 of its Code of Conduct that it administer the OATT and Services Tariff fairly and impartially, as requiring the NYISO not to give a particular market party preferential access to market data. This is one of the reasons that the NYISO publicly posts all reliability commitments on its web site at http://www.nyiso.com/public/market_data/reports/operational_announcements.jsp.

L. Other Suppliers' Resources Cannot Address the Reliability Concern that its Generator(s) Are Being Committed to Address

In paragraphs 4 through 8 of his attached Affidavit, Ricardo T. Gonzales, the NYISO's Vice President of Operations, responds to Attachment E Supplier's claims that its Generator(s) should not be subject to Rate Schedule M-1 because the Attachment E Supplier is not the only Supplier that can, or that has been designated to, solve the reliability need for which its

⁶⁵ Gonzales Affidavit, ¶ 3.

generator(s) were committed or dispatched. In his Affidavit Mr. Gonzales explains that there are circumstances under which Attachment E Supplier's Generator(s) are the only resource(s) that are able to address an identified reliability need.⁶⁶

M. The NYISO's Requested Waivers are Appropriate

The Generation Owner asserts that the NYISO has not presented any evidence to suggest that the reliability problems that occurred during the hottest months of the year will occur again before next summer, and thus asserts that the requested waiver of the six month effective period for mitigation measures should not be granted.⁶⁷ The Generation Owner admits, however, that relevant reliability commitments occurred last winter, and provides no analysis establishing that the same cannot be expected this winter.⁶⁸ Mr. Boles confirms that reliability commitments of the relevant Generators during the winter months are likely.⁶⁹

The Generator Owner also does not show that the NYISO's waiver request does not meet the criteria in the Commission's Guidance order.⁷⁰ First, Generation Owner's protest asserts that there is no adverse impact on the market because the conduct at issue does not meet the existing mitigation thresholds.⁷¹ This assertion simply ignores the fact that the existing mitigation thresholds are not the only criteria in the MMM for identifying a significant adverse market

⁶⁶ *Id.*, ¶ 8.

⁶⁷ Generation Owner at 32.

⁶⁸ *Id.* at 8.

⁶⁹ Boles Supplemental Affidavit, ¶ 11.

⁷⁰ *See. e.g.*, Generation Owner at 32 *et seq.*

⁷¹ *Id.* at 33.

impact. The MMM include the market impact threshold specified in §§ 1 (b) and 3.2.3. Those are the thresholds that required the NYISO to submit its September 4 Filing.

Second, Generation Owner's protest asserts that the need for the NYISO to take action was not unanticipated because the conduct at issue is within the existing thresholds and Generation Owner has not changed its bidding behavior.⁷² Again, the issue in this filing is not whether the existing thresholds for rest-of-state mitigation are met, but whether significant adverse market impacts are occurring that require a filing under Sections 1(b) and 3.2.3 of the MMM.

Finally, Generation Owner's protest claims that there is no evidence that prompt action is needed because its generator has been selected to operate under almost identical bids in the past without triggering mitigation.⁷³ Generation Owner's apparent belief that it is entitled to some sort of detrimental reliance on past bidding behavior is utterly without merit. The mitigation measure in Rate Schedule M-1 would only apply prospectively, and past bids will have no bearing on whether future bids should be mitigated. Once the schedule becomes effective, the three Generators will be on notice that they are subject to mitigation, and can formulate their bids accordingly. They can avoid mitigation by bidding competitively.

As the NYISO explained in its September 4 Filing, the NYISO hopes to be able to complete the stakeholder process to develop a new mitigation measure within six months. Automation of the new mitigation solution will, however, of necessity require longer than six months to complete. Limiting the NYISO's authority to apply Rate Schedule M-1 to the three

⁷² *Id.*.

⁷³ *Id.* at 34.

identified Generators to a six-month period will not provide the NYISO sufficient time to develop, code and test the additional software capability that will be necessary to implement the new mitigation measures it develops with its Market Participants. In the meantime, the requested mitigation measure will only require the relevant Generators to bid as if they were facing competitive market conditions. Accordingly, the NYISO respectfully submits that the requested waiver is appropriate.

N. The Stakeholder Process for Determining a Permanent Mitigation Measure

The Generation Owner contends that the stakeholder process for consideration of tariff changes to incorporate a mitigation measure for Generators that are committed for reliability outside New York City should be provided an economic analysis of the alternatives for addressing each reliability concern that requires a Generator to be committed. IPPNY contends that the NYISO should be required, in the stakeholder process, to develop comprehensive market rules to ensure that Generators are appropriately compensated when called upon to meet reliability needs.⁷⁴

The NYISO is of course committed to providing appropriate economic analysis as necessary to support stakeholder consideration of issues that come before them. However, the NYISO's proposed tariff revision will not be directed at a specific reliability concern, but rather the general solution for the market power that can arise when Generators must be committed for reliability, including future reliability concerns that are not yet known. In the meantime, the analysis submitted with the September 4 Filing and this Response shows that mitigation of

⁷⁴ *Id.* at 30-31; IPPNY at 7.

Generation Owner's identified Generation is warranted. No further direction from the Commission on this is warranted.

The NYISO agrees with IPPNY that any new mitigation rules should provide appropriate compensation to Generators. The NYISO's view of "appropriate compensation" would differ from IPPNYs, however, if IPPNY proposes that market power mitigation measures should provide for the recovery of fixed costs. The NYISO has invited its stakeholder governance participants to present proposed compensation procedures for discussion in its Market Issues Working Group. However, as explained above, IPPNY has not shown that there is a need for additional procedures to supplement the Gap Solution process that is already available in Attachment Y to the NYISO's OATT.

O. The Rate Schedule M-1 Consultation Process

The Generator Protests contend that the existing time frames for real-time guarantee payment mitigation in Section 3.3.3.1 of the MMM should be adopted in Rate Schedule M-1.⁷⁵

Upon consideration of these comments, the NYISO agrees that this proposed modification of Rate Schedule M-1 is appropriate, with the exception that the NYISO requires at least 10 business days to identify Bids that appear to violate the mitigation thresholds. The NYISO is otherwise willing to agree to use all of the other consultation deadlines set forth in Section 3.3.3.1 of the MMM, and to change its proposed Rate Schedule M-1 to reflect this requirement in a compliance filing.

The NYISO requires 10 business days to identify Bids that appear to violate the mitigation thresholds because Rate Schedule M-1 is being implemented manually by the NYISO

⁷⁵ IPPNY at 8-9; *see also* EPSA at 4.

staff. As a result, it is not possible for the NYISO to identify possible mitigation under Rate Schedule M-1, notify the affected Market Party, and reflect the proposed mitigation in the Market Party's settlement results as quickly as the partially automated Real-Time Guarantee Payment Mitigation procedure contemplated by Section 3.3.3.1. With this exception, the NYISO believes the use of the timelines in Section 3.3.3.1 would be appropriate.

IV. Conclusion

WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission accept this response to the intervenors' comments and protests and accept the new mitigation rules proposed by the NYISO in this docket for the three specifically identified Generators for filing, subject only to the modification agreed to by the NYISO in Section III(O) of this filing.

Respectfully submitted,

/s/ Alex M. Schnell
Robert E. Fernandez, General Counsel
Alex M. Schnell
New York Independent System Operator, Inc.

William F. Young
Hunton & Williams LLP
Counsel to the New York Independent System Operator,
Inc.

Dated: October 13, 2009

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 Rules of Practice and Procedure, 18 C.F.R. § 385.2010.

Dated at Washington, D.C. this 13th day of October, 2009.

/s/ William F. Young
William F. Young
Hunton & Williams LLP
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Washington, DC 20006
Tel: (202) 955-1500
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E-mail: byoung@hunton.com

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

New York Independent System Operator, Inc. Docket No. ER09-1682-000

AFFIDAVIT OF RICARDO T. GONZALES

I. Qualifications and Purpose

1. My name is Ricardo T. Gonzales. I am the Vice President of Operations for the New York Independent System Operator, Inc. (“NYISO”). My responsibilities include the reliable operation of the New York Control Area transmission system, in compliance with all applicable NERC, NPCC, and NYSRC reliability rules and standards, the operation of the ISO Day-Ahead and Real-Time wholesale Energy Markets and validating the Energy Markets’ prices, and the operation of the NYISO Transmission Congestion Contract and Installed Capacity Markets, and other NYISO administered markets.

2. The purpose of this affidavit is to respond to a number of protests that challenge certain aspects of the reliability commitments of the identified generators.

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II. Response to Protests

3. In its protest the Attachment E Supplier complained that it was not informed of the nature or extent the reliability commitment need its generator was being committed to address. As detailed in its Code of Conduct, the NYISO is not permitted to disclose Confidential Information to a single market participant, in this case Transmission System Information (TSI), which has not yet been posted on the OASIS or in some other public forum. In order to provide transparency of the North Country reliability need,

4.

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5.

6.

7.

the

Attachment E Supplier argues in its protest that the NYISO's proposed Rate Schedule M-1, by its terms, does not apply to its generator because there are other suppliers, including demand response, that can

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fully address the reliability need that the generator is being committed to address. I do not agree.

8. There are no demand-side resources that are capable of solving the reliability requirement that the Attachment E Supplier's generator is being committed to address.

9. Further, affiant sayeth not.

ATTESTATION

I am the witness identified in the foregoing Affidavit of Ricardo T. Gonzales (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.

Ricardo T. Gonzales

Ricardo T. Gonzales
Vice President, Operations
New York Independent System Operator, Inc.

October 13, 2009

Subscribed and sworn to before me
this 13th day of October, 2009

Diane Lemner

Notary Public

My commission expires: 9/29/2013

DIANE LEMNER
Notary Public, State of New York
Saratoga Co. #01LE5085930
Commission Expires Sept. 29, 2013

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

New York Independent System Operator, Inc.

Docket No. ER09-1682-000

SUPPLEMENTAL AFFIDAVIT OF JOSHUA A. BOLES

I. Qualifications and Purpose

1. My name is Joshua A. Boles. I currently serve as the Supervisor of Monitoring, Analysis, and Reporting for the Market Monitoring Department (“MMP”)¹ of the New York Independent System Operator, Inc. (“NYISO”). My responsibilities include supporting the Manager of Market Monitoring in administering the NYISO’s Market Mitigation Measures (“MMM”), which are set forth in Attachment H to the NYISO’s Market Administration and Control Area Services Tariff. I hold a M.A. in Applied Economics and a B.A. in Economics from the State University of New York at Buffalo. I am the same Joshua A. Boles who submitted an affidavit in support of the NYISO’s September 4, 2009 filing in the above docket.
2. This affidavit is submitted in response to the protests received from the suppliers whose offering behavior was addressed and whose generators were

¹ The NYISO’s May 15, 2009 compliance filing in Docket No. ER09-1142-000 proposes to modify the duties assigned to the NYISO’s Market Monitoring and Performance Department, and to change the name of that department to the Market Mitigation and Analysis Department.

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identified in attachments C, D, or E to the NYISO's September 4, 2009 filing in Docket No. ER09-1682-000.

3. In this testimony I: (1) provide analysis to support the "greater of 10% or \$10/MW increase in guarantee payments" incremental energy and minimum generation mitigation thresholds proposed in Rate Schedule M-1; (2) explain why the guarantee payment impact test that the NYISO performed to determine if the Bids submitted on behalf of the three generators is the appropriate test to apply; and (3) explain why the NYISO is proposing to Apply Rate Schedule M-1 to the

II. Analysis Supporting the Proposed Rate Schedule M-1 "Greater of 10% or \$10" Mitigation Thresholds

4. Protests submitted by the "Attachment E Supplier" and "Generation Owner" in Docket No. ER09-1682-000 argue that the NYISO failed to provide economic analysis or cost support for its proposed "greater of 10% or \$10/MWh" incremental energy and minimum generation mitigation thresholds.
5. Dr. Patton's Initial and Supplemental Affidavits explain the basis for the thresholds in Rate Schedule M-1, and respond to the protesters' arguments that they should be permitted to incorporate fixed costs into their offers. Set

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forth below is additional support, consistent with Dr. Patton’s analysis, for the NYISO’s proposed “greater of 10% or \$10/MWh” threshold for the mitigation of Incremental Energy Bids² and Minimum Generation Bids. The discussion below refutes the unsubstantiated assertions of the Attachment E Supplier and the Generation Owner that the thresholds do not provide a just and reasonable bandwidth for the suppliers to recover their respective marginal operating costs, and shows that there is only a very limited chance that a supplier that bids competitively could be over mitigated.³

6. In calculating the likelihood of over-mitigation, the NYISO examined day-over-day changes in Transco Z6 NY spot natural gas costs for the time period May 11, 2007 through October 7, 2009. The NYISO found that the daily price changes reflected spot natural gas price increases in excess of 10% on less than one day in twenty. The observed spot gas price increases would have increased the reference levels of a generator with a heat rate of _____ of the market days studied. Such increases would have increased the reference levels of a generator with a heat rate of _____ of the

² Capitalized terms that are not defined herein have the meaning ascribed to them in the NYISO’s Market Administration and Control Area Services Tariff, or the meaning ascribed to them in the MMM.

³ Over-mitigation due to inaccurate reference levels can be addressed via consultation with MMP in accordance with Rate Schedule M-1 if and when the greater of 10% or \$10/MWh threshold proves inadequate to address variation in a generator’s marginal operating costs. In the NYISO’s Response to Protests that this Affidavit supports, the NYISO agrees with IPPNY’s suggestion that the NYISO should (with one exception that is noted in the NYISO’s Response) use the process and timelines for consultation that are set forth in Section 3.3.3.1 of the MMM.

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market days studied. The observed spot gas price increases would have increased the reference levels of a generator with a heat rate of

of the market

days studied. Such increases would have increased the reference levels of a generator with a heat rate of of the market days studied. These heat rates provide a reasonable approximation for purposes of analyzing the thresholds in Rate Schedule M-1. The results of this test of day-over-day changes in spot natural gas costs is consistent with the results of a similar test that was the basis for the Commission's acceptance of a similar conduct threshold provision in New England.⁴

III. NYISO Proposal to Mitigate Generation Owner's Generation

7. In an affidavit filed on behalf of the Generation Owner

⁴ *ISO New England and New England Power Pool*, 129 FERC ¶ 61,008 at P 27 (2009) (stating that: "Filing Parties have justified the 10% threshold by explaining that this threshold was determined to reflect a reasonable bound of measurement error based on the Internal Market Monitor's analysis of inter-day fuel price creations.").

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8. Generation Owner further argues that: (1) there were no adverse impacts to the market because Generation Owner's bidding behavior did not exceed the existing mitigation thresholds; (2) the conduct was not unanticipated because it was within the existing mitigation thresholds
- ; and (3) there is no evidence that expedited Commission action is needed because

As explained below I disagree with these arguments.

9.

10. The issue here is not whether the existing thresholds for mitigation outside the New York City Constrained Area were exceeded. Rather, the issue is whether
- (a) Generation Owner engaged in conduct that departed significantly from conduct that would be expected under competitive market conditions, and
- (b) that conduct had a significant impact on guarantee payments. As explained in my prior affidavit

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The entities that are responsible for paying the guarantee payment were adversely affected by this bidding behavior.

11. Consistent with my prior affidavit, it is not possible to predict whether and to what extent the Generation Owner's generation will be committed for reliability and have the opportunity to continue to exercise market power.

⁵ Based on this information the NYISO still believes expedited Commission action is warranted to protect the entities that are responsible for paying for the guarantee payments in the event that these generators are needed for reliability in the near term.

IV Impact Test

12. The Attachment E Supplier and Generation Owner's protests question the validity of the impact test that was described in my previous affidavits. The impact test that was calculated is consistent with the FERC-accepted Real Time Guarantee Payment ("RTGP") Impact Test. I calculated the impact on guarantee payments by comparing the original Bid Production Cost Guarantee ("BPCG") payment based on the bids submitted by the generators with the BPCG payment based on the applicable references of the generators. This is the same methodology that has been consistently used by the NYISO to

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determine guarantee payment impact since the inception of the Market Mitigation Measures, and has been the subject of extensive stakeholder discussions and approval and prior Commission proceedings. A calculation based on a generator's bids rather than its guarantee payments would be a conduct test rather than an impact test. Section 3.2.3(2) of Attachment H explicitly requires an impact test.

13. The Attachment E Supplier and Generation Owner argue that the impact test that the NYISO performed produces unreasonable results as the LBMP approaches the generator's reference level, and posits that a generator could be adversely affected by an inappropriate determination of impact under these circumstances.
14. Although the concerns raised in the protest may identify a potential enhancement to the current guarantee payment impact test methodology, the argument is purely academic when one considers the facts that the NYISO has presented in this proceeding.
15. First, the evidence contained in my Initial Affidavits shows that the level of payments received in excess of marginal costs by these suppliers supports the NYISO's determination of impact. The Generation Owner received, _____ and the Attachment E Supplier received, _____ in guarantee payments above the payments they would have received at the applicable reference level each time the generators were committed in 2009.

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16. The following information also refutes the unsubstantiated claims that as a result of the LBMP approaching the reference level the results of the impact test are unreasonable. During the time period the
committed for reliability the average hourly real time zonal
LBMP was

The

average hourly real time zonal LBMP was

Based on these facts, the NYISO's impact calculation in this case is not subject to the concerns raised by the protesters.

17. Second, prior to making a determination that sections 1(b) and 3.2.3 of the MMM were violated and a filing was necessary, the NYISO is required to determine if the behavior was inconsistent with competitive market outcomes. A bid that was only a minimal amount above a generator's reference level would not be found to be inconsistent with competitive market outcomes. That was not the case here.

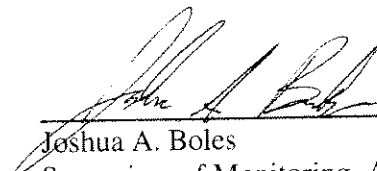
V. Conclusion

18. For the foregoing reasons, the Commission should reject the objections made by the protestors in this case and approve the mitigation rule changes proposed in this docket.

Further affiant sayeth not.

ATTESTATION

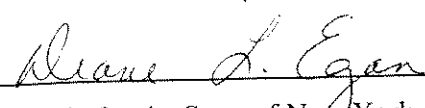
I am the witness identified in the foregoing Affidavit of Joshua A. Boles dated October 13, 2009 (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.



Joshua A. Boles
Supervisor of Monitoring, Analysis, and
Reporting
New York Independent System Operator, Inc.

October 13, 2009

Subscribed and sworn to before me
This 13th day of October, 2009



Notary Public for the State of New York

DIANE L. EGAN
Notary Public, State of New York
Qualified in Schenectady County
No. 4924890
Commission Expires March 21, 20 10

My commission expires: March 21, 2010

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

New York Independent System Operator, Inc) Docket No. ER09-1682-000

Supplemental Affidavit of David B. Patton, Ph.D.

I. Purpose and Summary

1. My name is David B. Patton. I am an economist and President of Potomac Economics. Our offices are located at 9990 Fairfax Boulevard, Fairfax, Virginia 22030. Potomac Economics is a firm specializing in expert economic analysis and monitoring of wholesale electricity markets.

2. I filed an affidavit previously in this case explaining the need for and benefits of the proposed mitigation measure that would apply to specific units that have frequently been committed out-of-market (“OOM”) to address reliability issues.¹ When a resource is committed out-of-market, it receives a payment equal to the

¹ My out-of-market (OOM) term broadly encompasses commitments like the NYISO’s Day-Ahead Reliability Unit (“DARU”) commitments and Supplemental Resource Evaluations (“SRE’s”) commitments. It also covers additional OOM dispatch of OOM committed generators.

difference between its offered cost and wholesale market LBMP. I will refer to this as a “BPCG payment.”

3. When a large share of a generator’s commitments is made for reliability, the supplier may have an incentive to offer above its marginal costs in order to increase its BPCG payments. The proposed mitigation rule is intended to reduce the incentive and ability for participants to exercise market power by raising their offers when they face no competition to resolve a local reliability issue.
4. The purpose of this affidavit is to respond to a variety of protests that challenge the basis for the mitigation measure or the conclusions that were drawn regarding the conduct of the identified generators.

II. Response to Protests

A. Generator Offers Expected Under Competitive Conditions

5. In an affidavit filed on behalf of Attachment E Supplier, their consultant argues that the NYISO did not show that the generators’ offers departed from competitive expectations.² However, these arguments do not distinguish clearly between competitive conditions and market power, or between short-run and long-run considerations.
6. The objective of any rational business is to maximize its profits. When a supplier does not have market power, its offer will not substantially affect the market’s

² See Attachment C to the “Attachment E Supplier’s” protest at ¶¶ 33-40.

- clearing prices or its payments. Hence, its offer will simply determine when its resource will be committed and dispatched. A profit-maximizing supplier will seek to be dispatched any time the market revenue exceeds its production costs.
7. Generation Owner argues that if a generator's costs are generally higher than the LBMP, the expected profit-maximizing strategy is to offer at its marginal cost plus the maximum mark-up allowed under the current mitigation measures. Generation Owner's argument is correct for a supplier with market power, but demonstrably incorrect under competitive conditions.
8. Assume a resource has marginal cost of \$50 per MWh and average fixed costs of \$20 per MWh. In a competitive single clearing price market, a profit-maximizing supplier will never offer its resource at \$70 per MWh. By offering at \$70 per MWh, it will receive the difference between the price and its marginal cost in all hours when the price is greater than \$70 per MWh. However, if it were to offer at \$50 per MWh, it would receive the same amount of profit in the hours when the price exceeds \$70 per MWh *plus* the margin between the price and its marginal costs in hours when the price is between \$50 and \$70 per MWh. For example, if the price in an hour is \$60, the supplier that offers at \$70 per MWh will earn no profit while the supplier offering at \$50 will earn \$10 MWh. The latter strategy is clearly the profit-maximizing strategy for a supplier facing competition and is, therefore, the offers that one would expect under competitive conditions.
9. The consultant for Attachment E Supplier acknowledges this when the consultant indicates "I agree that in a purely competitive scenario, an entity has the incentive

to lower its bid to the degree possible so that it is chosen to run as an inframarginal generator. . .”³ The consultant then argues that the situation is different here because the market is not competitive and there are not many other suppliers that can set the price above competitive offer of the resource in question. This argument does nothing to alter the competitive expectations of a supplier when it determines its offer price. The fact that the particular conditions that the proposed mitigation measure addresses are significantly different from normal competitive conditions is precisely why the mitigation measure is proposed.

B. Incorporating Fixed Costs into a Supplier’s Offer

10. The consultant for Attachment E Supplier and I agree that a supplier that is needed for reliability should have an opportunity to recover its fixed costs of remaining in operation. However, Attachment E Supplier argues one reasonable means to accomplish this is to employ mitigation measures that allow generators to raise their offers as a means to recover fixed costs.⁴ The consultant then attempts to support this approach by citing a 2002 Order from the Commission that established “Peaking Unit Safe Harbor” or “PUSH” thresholds, which allowed certain generators in chronically constrained areas to raise their offer prices.⁵

³ Attachment C to the “Attachment E Supplier’s” protest at ¶ 38.

⁴ *Id.*

⁵ *Id.* at 39; *New England Power Pool and ISO New England, Inc.*, 100 FERC ¶ 61,287 (2002),.

11. The PUSH thresholds case is not applicable here for a number of reasons. The Commission's objective in that case was to allow clearing prices to rise in the constrained areas to reflect local reliability needs in those areas that were not fully priced due to the lack of locational operating reserves markets and locational capacity markets. Allowing higher offers from the New York generators in this case will not increase energy prices and produce economic signals that reflect the reliability needs of their respective areas, they will simply result in higher guarantee payments made directly to the suppliers. Hence, it would not alter the economic signals that are received by other new and existing suppliers. Additionally, the New York ISO *does* currently have locational requirements in both its operating reserves and capacity markets. When ISO-New England implemented locational requirements in these markets, they discontinued the use of the PUSH thresholds. Furthermore, both the internal and external market monitors in New England found that the PUSH thresholds were not effective in achieving the Commission's objectives.⁶
12. In Section III below, I explain that ISO-New England recently filed a mitigation measure that is very similar to the measure proposed by the New York ISO to address the same competitive issue. The measure proposed by ISO-New England was conditionally approved by the Commission on October 2, 2009.

⁶ See *A Review of PUSH Implementation and Results*, ISO-NE, December 2003. See also *2004 Assessment of the Electricity Markets in New England*, Potomac Economics, June 2005.

13. Therefore, while I do *not* disagree with arguments by Generation Owner and Attachment E Supplier that resources needed for reliability should have an opportunity to recover their fixed costs, I strongly disagree that recovering such costs by exercising a prescribed amount of market power is a reasonable approach. My prior affidavit provided a number of reasons why such an approach is not reasonable.
14. Many of the protests argue that if such costs are not recovered through the market, some form of contractual backstop (*e.g.*, a reliability agreement) would be needed. I agree. The Attachment E Supplier's consultant asserts that the NYISO does not have Tariff provisions that would allow for such agreements. The NYISO disagrees, arguing that Attachment Y to its Open Access Transmission Tariff would facilitate such agreements. Regardless, relying on some form of process to establish reliability agreements is preferable to rejecting the proposed mitigation measure.
15. None of the suppliers in question have presented data showing that the current energy, ancillary services, and capacity market do not cover the going-forward fixed costs of the resources in question.⁷ Given the net revenues available to

⁷ Going-forward costs include costs that could be avoided by taking a generator out-of-service for an extended period or by retiring a generator permanently. Going-forward costs may include maintenance costs incurred to keep the generator in service, labor costs necessary to keep the plant available, and/or expected profits from converting the facility to an alternative purpose that would be foregone by keeping the generator in service. Going-forward costs do not include sunk costs such as past expenditures or investments, and/or financing costs that could not be avoided by taking the generator out of service.

relatively high-cost units from the energy and capacity markets, I believe it is not unlikely that the markets would cover these resources' fixed going-forward costs with no reliability agreement. At best, the arguments regarding fixed cost recovery are theoretical at this point.

C. Modeling the Reliability Constraint

16. A number of the protests argue that the best way to resolve the problem of fixed cost recovery is to model the constraints so that they can be reflected in the clearing prices.⁸ Contrary to their assertion, modeling a reliability constraint that only one supplier can satisfy would not address the fixed cost issue. It would simply shift the market power rent from the guarantee payment to the energy payment. The market power mitigation measure would still be needed and would engender comparable fixed cost recovery concerns because the generator's Incremental Energy Bid would need to be mitigated to a competitive level that reflects the generator's marginal cost of producing energy.

17. Additionally, even if a transmission constraint is priced, the lumpiness of generation may still prevent the clearing price from reflecting the need for the generator. For example, if 30 MW of generation is needed to resolve a transmission constraint, and the only available generator has a minimum

⁸ See IPPNY at 6, EPSA at 4, and AES at 5.

generation level of 45 MW, the generator will be dispatched at minimum and the LBMP will not reflect the cost of dispatching the generator.

D. Application of the Impact Test

18. A consultant for the Attachment E Supplier argues that the NYISO applied the impact test for guarantee payments incorrectly. The consultant argues extensively that changes in the underlying LBMP can significantly change the estimated impact of a participant's conduct on its guarantee payment. The consultant argues that a more reasonable approach would be to apply the conduct test to the participants total payments (i.e., not to subtract the LBMP revenue). That is, the consultant claims that Sec. 3.2.3(2) of Attachment H of the Services Tariff should be interpreted to require testing of "the revenues that the generator received as a result of its offer compared to the revenues it would have received at its reference price."⁹ The Attachment E Supplier makes this same argument, apparently focusing on the difference between a generator's reference price and its offer rather than the revenues produced by each, but this produces the same result as proposed by the consultant.¹⁰ Since the offer and reference price would be multiplied by the same number of MW of output to determine the gross revenue levels produced by each, the percentage increase is the same for the difference between the offer and reference price or the total revenues each would produce. Either approach amounts to only testing the impact of the generator's conduct on

⁹ Attachment C to Attachment E Supplier protest, at ¶31.

¹⁰ Attachment E Supplier at 15.

its total revenues, rather than the impact of its conduct on its guarantee payments.

This type of impact test is only slightly different than a conduct test.¹¹

19. While the consultant claims that the approach discussed in the preceding paragraph is a “reasonable interpretation” of the Tariff, the argument cannot be reconciled with the plain language of the Tariff, which clearly indicates that the impact is related to the change in the *guarantee payment*. It requires a relatively tortured interpretation of the Tariff to argue that performing the impact test based on the total revenue is consistent with the Tariff. Furthermore, since the impact on energy prices is separately tested, it is appropriate in this context to measure only the change in the guarantee payment to the participant. This impact measures the true change in the costs to New York’s consumers and the payments to the generator. Section 3.2.3(2) by its terms specifies an impact test, not a conduct test.

20. The reason why the impact results vary as substantially as they do in the examples provided by the Attachment E Supplier in ¶¶ 26-31 of Attachment C to its protest is that it is measured in percentage terms only. Therefore, a small increase in a small number can result in a large percentage increase, which seems counterintuitive to Attachment E Supplier’s consultant. In reality, this is a criticism of the impact threshold (i.e., that fact that only a percentage threshold is

¹¹ A conduct test is performed on the entire offer curve, while this test is performed up to the level actually committed and dispatched by the NYISO.

used in §3.2.3(c) rather than a combination of a percentage change and/or absolute dollar change). Attachment E Supplier's criticism does not apply to the conduct at issue in this case because the impact test was correctly performed, the guarantee payments were sizable and there was a significant difference between the LBMP and the generator's reference level, as shown in the Supplemental Affidavit of Joshua A. Boles.

III. Mitigating Similar Local Market Power Issues in New England

21. On August 5, 2009, ISO New England filed proposed changes to its market power mitigation measures to address the exercise of market power by a supplier with a resource that must be committed to satisfy a local reliability need of the system.¹² As described below, ISO New England's proposed measure is very similar to the measure proposed by the New York ISO, and it was conditionally approved on October 2 by the Commission.¹³ Given the similarities in the proposals and the issues in the two cases, the same determination is warranted in this proceeding.

A. The ISO New England and NYISO Proposals

¹² *ISO New England Inc. and New England Power Pool*, ISO New England Inc. and New England Power Pool, Market Rule 1 Revisions Relating to Mitigation of Supply Offers for Resources Committed to Satisfy Reliability Needs, Docket No. ER09-1546-000 (Aug. 5, 2009).

¹³ *ISO New England Inc. and New England Power Pool*, Order Conditionally Accepting Market Rule 1 Revisions, 129 FERC ¶ 61,008 (2009). (Hereinafter "ISO-NE Order").

22. The mitigation measure proposed by the New York ISO are similar to provisions approved by the Commission for use in ISO New England. Both measures address local market power issues associated with generators committed for local reliability. Hence, the proposals address the same issue in the two markets.
23. The NYISO proposal is arguably more necessary because the current conduct threshold applied to these New York generators is less stringent than the conduct threshold that had previously applied to the New England generators.¹⁴ However, the scope of the NYISO current proposal, which would apply to just three generators until a more general tariff revision is filed and approved, is much narrower than the ISO-NE measure, which applies to all generators committed for reliability.
24. In addition to addressing the same concern, the proposals themselves are virtually identical. Both ISOs employ a conduct and impact mitigation framework. Both NYISO and ISO New England would apply a 10 percent conduct threshold standard to offer components related to the commitment of a generator (i.e., start-up cost and cost of operating at the minimum generation level). The most significant difference between the NYISO's proposed conduct threshold and the

¹⁴ In the NYISO the conduct threshold that applies to generators located outside the New York City Constrained Area is currently an increase of (the lesser of) \$100/MWh or 300 percent over a generator's reference level, while the conduct threshold previously applied to New England generators committed for local reliability was an increase of (the lesser of) \$25/MWh or 50 percent over the generator's reference level.

ISO-NE's is that the NYISO proposal would use the *greater* of 10 percent or \$10/MWh as the threshold for testing Minimum Generation and Incremental Energy Bids. The ISO New England proposal would use the lesser of 10 percent or \$80/MW-day. Hence, the New York ISO proposal is less stringent than the ISO-NE measure.¹⁵

25. Finally, both New York and New England's proposals recognize that an impact test is not necessary because increases in offers submitted on behalf of generators committed out-of-market for local reliability that are eligible to receive a guarantee payment will directly impact the generator's compensation.
26. In conditionally approving the ISO-NE measure, the Commission noted that the ISO-NE "justified the 10 percent threshold by explaining that this threshold was determined to reflect a reasonable bound of measurement error based on the Internal Market Monitor's analysis of inter-day fuel price variations." The 10 percent threshold is also likely to be appropriate in New York where most fuel prices fluctuations are highly correlated with prices in New England and driven by similar factors.
27. Furthermore, in its Order on ISO New England's proposal the Commission rejected a contention that generators should be allowed to exercise market power

¹⁵ The Commission conditionally approved the ISO New England proposal, but required a compliance filing to provide more justification for the \$80/MW-day portion of the conduct threshold. See ISO-NE Order at p. 19.

in order to recover their fixed costs in an ISO with locational markets for energy, operating reserves, and capacity. The Commission indicated that “[concerns related to fixed cost recovery] are more appropriately addressed in another proceeding or in ISO-NE’s stakeholder process.”¹⁶

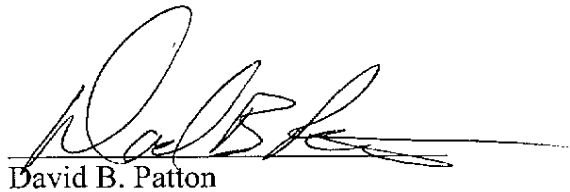
IV. Conclusion

28. For the foregoing reasons, the Commission should reject the objections made by the protestors in these case and approve the mitigation rule changes proposed by the NYISO.
29. This concludes my affidavit.

¹⁶ See ISO-NE Order at p. 25.

ATTESTATION

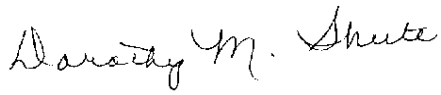
I am the witness identified in the foregoing Affidavit of David B. Patton, Ph.D. dated October 13, 2009 (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.



David B. Patton

October 13, 2009

Subscribed and sworn to before me
this 13th day of October, 2009



Notary Public

DOROTHY M. SHUTE
Notary Public, State of Indiana
My County of Residence: Hendricks
My Commission Expires May 8, 2017

My commission expires: _____