UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	))	**Docket Nos. ER00-3591-000 and ER00-3591-001**

NEW YORK INDEPENDENT SYSTEM OPERATOR'S INC.'S REQUEST FOR LEAVE TO ANSWER AND ANSWER TO COMMENTS AND PROTESTS

Pursuant to Rules 212 and 213(a)(2) of the Commission's Rules of Practice and Procedure,[1] the New York Independent System Operator, Inc. ("NYISO") hereby respectfully requests permission to submit an answer to, and answers, certain pleadings that have been filed in response to its September 1, 2000, as corrected September 8, 2000, combined compliance filing and report in this proceeding ("Report"). The NYISO is making this filing for the limited purpose of: (i) addressing new issues that were introduced for the first time by certain comments and protests; (ii) attempting to clarify certain factual matters; and (iii) correcting inaccurate or misleading statements made by some parties.

I. Procedural Matters

A. Request for Leave to Answer

The NYISO recognizes that the Commission generally discourages parties from filing answers to protests, answers and to comments that are tantamount to protests. The Commission has, however, allowed such answers when they help to clarify complex issues, provide additional information that will

1 18 C.F.R. §§ 212, 213(a)(2) (2000).

New York Independent System Operator, Inc., 91 FERC ¶ 61,218 at 61,797 (allowing an answer deemed "useful in addressing the issues arising in these proceedings . . . .) (2000); *Central Hudson Gas & Electric Corp*., 88 FERC ¶ 61,137, 61,381 (1999) (accepting prohibited pleadings because they helped to clarify the issues and because of the complex nature of the proceeding).

[3] Insofar as the Commission prohibits parties from answering protests, answers and certain comments absent a waiver, the NYISO is unsure whether the Commission's normal filing deadlines apply to this pleading.

[4] For example, the NRG Companies, Morgan Stanley Capital Group, Inc., Keyspan-Ravenswood, Inc., Aquila Energy Marketing Corporation and the Indeck Companies have all asked the Commission to reject ConEd's filing.

time to review and answer properly. The time required to develop an answer was also extended because of NYISO staff's and consultants' are heavily burdened by work on other projects, which has most recently included preparing a comprehensive response to an investigation by the New York State Public Service Commission, as well as the Commission's own wholesale power markets investigation. The NYISO therefore respectfully asks that the Commission grant it permission to answer out-of-time, to the extent necessary. Because the scope of this answer has been limited in the manner described above, the NYISO does not believe that granting this request will unfairly prejudice any other party to this proceeding.

B. Alternative Request for Leave to Answer Certain Pleadings

The pleadings submitted by the Consolidated Edison Company of New York, Inc. ("ConEd") along with Orange and Rockland Utilities, Inc. ("O&R")[5] and Enron Power Marketing, Inc. ("EPMI") make numerous new allegations and include requests for relief that were not previously before the Commission. Consequently, simple fairness dictates that the NYISO be permitted to respond. Indeed, these pleadings contain so much new material that they are arguably *de facto* complaints, which the NYISO should be entitled to answer.[6] ConEd has gone so far as to ask the Commission to treat its filing as a complaint "[t]o the extent necessary."[7] Thus, at a minimum, the Commission should accept

5 For convenience, throughout the remainder of this answer, the NYISO refers to ConEd and O&R's *Motion to Intervene, Answer and Comments* as the "ConEd" filing.

6 *See, e.g., Great Lakes Gas Transmission Limited Partnership,* 62 FERC ¶ 61,225 (1993) (allowing a party to answer a pleading that was styled a protest when the Commission determined that the filing was in fact a complaint).

7 ConEd at 21, n. 7.

the portions of this answer that address issues introduced for the first time in ConEd's and EPMI's *de facto* complaints.

In addition, on September 27, the Members of the Transmission Owners Committee of the State of New York ("Member Systems") filed a *Motion to Intervene and Comments* requesting that the NYISO continue to work with its committees to complete the correction of remaining market flaws. Unexpectedly, a mere two weeks later, the Member Systems, with the exception of the Power Authority of the State of New York ("NYPA"), filed a markedly different pleading, designated an "answer" offering "limited support" to EPMI's request for a technical conference ("October 13 filing"). In their second filing, the Member Systems ask the Commission to bypass the NYISO's governance procedures and compel the NYISO to immediately develop a completely new "implementation plan" for addressing remaining market flaws that would exclude projects the Member Systems consider unimportant. This request constitutes a fundamental attack on the NYISO's governance procedures that was not previously before the Commission. Accordingly, the NYISO requests leave to answer it herein.

C. Alternative Request that Certain Pleadings Be Rejected or Re-Docketed

The NYISO believes that the Commission has discretion to reject the portions of EPMI's and ConEd's pleadings that introduce new material for a number of reasons, including their failure to comply with: (i) the evidentiary requirements of the Commission's complaint rules;[8] (ii) Commission precedent

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[8] For example, the Commission's complaint rules require that allegations be substantiated with evidence. *See* 18 C.F.R. § 385.206. ConEd and EPMI's pleadings frequently fall short of this standard.

prohibiting parties from combining complaints with other filings,[9] and/or (iii) Commission precedent restricting the scope of compliance proceedings.[10] Because there is currently no emergency in the NYISO-administered markets that would justify departing from the Commission's normal procedural rules, the NYISO believes that it would be appropriate for the Commission to reject these filings and require that they be re-filed properly. In the alternative, given the lack of proper notice and general procedural irregularity of EPMI's and ConEd's *de facto* complaints, the Commission should re-docket and notice them as complaints. Finally, in the event that the Commission decides to grant requests for relief made for the first time in these pleadings, it should permit the NYISO, and other market participants, to more fully develop their arguments on rehearing.

In addition, the NYISO respectfully reminds the Commission that the Member Systems' October 13 filing is the third pleading submitted in this proceeding by, or on behalf of, four of the Member Systems, *i.e.,* ConEd, O&R, RG&E and NYSEG, and the fourth filing submitted by, or on behalf of, LIPA. The NYISO believes that this is excessive. In addition, the Member Systems did not seek leave to answer EPMI's filing, which is contrary to Rule 213(a)(2) of the

Practice and Procedure.[11] Because there is no need for further Commission intervention in the NYISO-

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9 *See, e.g., Louisiana Power and Light Co.,* 50 FERC ¶ 61,040 (1990) (prohibiting the filing of complaints as part of protests and/or interventions).

10 *See, e.g., PJM Interconnection, L.L.C.*, 87 FERC ¶ 61,054 at 61,218 (1999) ("It is well-established Commission policy to limit the scope of compliance filing proceedings to the compliance filing itself.").

11 Rule 213(a)(2) prohibits parties from answering protests without the Commission's permission. Although Rule 213(a)(2) does not expressly prohibit answers to comments, the Commission has previously prohibited answers to comments that are tantamount to protests. *See, e.g., CP National Corp.,* 48 FERC ¶ 61,329 at 62,081, n. 11 (1989). Because EPMI's "comments" disagree so fundamentally with the conclusions of the Report and call for drastic Commission action, the NYISO

(continued . . .)

administered markets at this time, the NYISO asks that the Commission apply its ordinary procedural rules and reject the October 13 filing.

II. Answer

A. There Is No Crisis in the NYISO-Administered Markets That Would Justify Bypassing the NYISO's Governance Institutions and Taking Hasty Action In Response to Unsubstantiated Claims by Self-Interested Market Participants

1. Certain Comments and Protests Have Exaggerated the Severity and Extent of Problems in the NYISO-Administered Markets

EPMI, ConEd, the New York State Electric and Gas Corporation ("NYSEG"), and the City of New York ("City"), claim that the NYISO-administered markets continue to suffer from serious market flaws. They assert that the NYISO falsely painted too "rosy" a picture of its markets' performance in the Report.[12] As was noted above, the remainder of the Member Systems, with the exception of the Power Authority of the State of New York ("NYPA"), are late converts to this point of view.

The NYISO fundamentally disagrees with these overly negative assessment of market conditions in New York. Of course, the NYISO does not believe, and has never claimed, that its markets have been unqualified successes. As the NYISO explained in the Report, it fully recognizes that prices in the markets it administers reflected unusually mild summer temperatures.[13] Likewise, the NYISO understands that its "efforts to improve its markets are by no means complete, and that

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submits that they are tantamount to a protest. The Member Systems should therefore have sought leave from the Commission to answer EPMI's comments, as the NYISO has done.

12 EPMI at 1.

13 Report at 2.

participants in the NYISO-administered markets are still adversely affected by market flaws."[14] The NYISO is sympathetic to the concerns and frustrations of all market participants, including those who have attacked the Report's conclusions. Indeed, the NYISO believes that some of their concerns warrant careful review, and, in some cases, may merit rapid action, by NYISO staff and the NYISO's governance institutions. The NYISO also appreciates the importance of the NYISO-administered markets to New York's economy and consumers. Finally, with respect to ConEd's pleading, the NYISO is aware of the intense political pressure directed against ConEd because of high summer prices in New York City, and understands the company's desire to protect both its customers from possible harm and itself from new attacks.

Nevertheless, the NYISO stands by its determination that its markets are workably competitive under most conditions.[15] Although there are many desirable improvements yet to be implemented, such as fixing problems associated with the NYISO's Balancing Market Evaluation ("BME"), establishing demand-side response mechanisms and creating an alternative "market protective mechanism,"[16] the NYISO's market design is fundamentally sound. The NYISO expects that the market design will serve as the foundation for a fully successful competitive marketplace in the near future. The NYISO has already made substantial market improvements and has progressed further on several important fronts,

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14 *Id*.

15 Moreover, the NYISO either already has, or is developing, the tools it needs to protect consumers during those periods when its markets cease to be workably competitive.

16 Acting at the direction of its independent Board of Directors, the NYISO recently announced that it intends to create a market protective mechanism, such as a market power "circuit breaker," as a superior alternative to bid caps. *See* Section 206 Filing of the New York Independent System Operator, Inc., Docket No. ER01-181-000 (October 20, 2000, as corrected October 24, 2000).

including the BME- Security Constrained Dispatch ("SCD")[17] interface issues, in the short time since the Report was filed. In addition, the NYISO has already established, or recently proposed, a number of consumer safeguards that will protect against unexpected problems during the time required to complete its improvements. In short, there is no emergency in the NYISO-administered markets and no need for the precipitous action some parties have requested.

In further support of its position, the NYISO has appended, as Attachment I to this answer, a copy of the *Preliminary Market Assessment of the New York Electric Markets ("Preliminary Assessment*"). The *Preliminary Assessment* was prepared by Dr. David B. Patton, the NYISO's independent market power advisor.[18] Although the *Preliminary Assessment* focuses on the Day-Ahead Market, and contains findings that may be revised when Dr. Patton issues a more comprehensive year-end report, the NYISO believes that this report will assist the Commission's review of certain allegations concerning the state of the NYISO-administered markets.

Dr. Patton concludes that "electric markets in New York have been competitive under most

[19] and that increased electricity prices were not caused "by the New York ISO's market design or operation."[20] To the contrary, Dr. Patton's analysis demonstrates that

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17 SCD is a computerized algorithm that performs the NYISO's real time dispatch by evaluating the New York Control Area contingency set against the system conditions expected for the next 5 minutes, or a shorter period under certain circumstances. SCD's results are a key input in the calculation of real-time market-clearing prices.

18 The *Preliminary Assessment* was not complete at the time the Report was filed. Therefore, the NYISO respectfully requests that the Commission permit it to submit the Report now.

19 *Preliminary Assessment* at 37.

20 *Preliminary Assessment* at 7.

price increases in New York, including New York City, were closely correlated to increases in fuel prices and the forced outage of a nuclear generating unit. Dr. Patton also explains that there is little evidence of economic withholding in the NYISO-administered markets, although he adds that the NYISO has identified other kinds of manipulative bidding behavior which have been mitigated prospectively.[21]

Dr. Patton's analysis supports the NYISO's assessment that the NYISO-administered markets have been, are, and will continue to be workably competitive under most conditions. The NYISO markets therefore do not require urgent intervention, as ConEd and the Member Systems claim, or the radical overhaul that EPMI seeks. Looking ahead, the NYISO's implementation of well-designed additional improvements, such as demand-side response measures, and its plan to develop a market protective mechanism, will reduce the frequency with which the NYISO-administered markets cease to be workably competitive and protect consumers when they do. Other improvements will ensure that opportunities to manipulate the market, which have already been substantially reduced, are further diminished. The NYISO's implementation of these improvements is already underway and should not be disrupted.

2. Proposals that the NYISO Modify Its Rules, Software or Market Design Should Be Considered by the NYISO's Independent Governance Institutions, Not Imposed on Behalf of a Single Market Participant or a Single Class of Market Participants

Because there is no emergency in the NYISO-administered markets, the Commission should not allow individual market participants, or any market participant class, to circumvent the NYISO's

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21 *Preliminary Assessment* at 37. Dr. Patton also explained that the NYISO lacks retroactive mitigation authority and thus cannot refund charges caused by manipulative bids.

Commission-approved governance institutions[22] and impose new market rules or structures on the NYISO. The Commission has frequently emphasized that ISO governance mechanisms should be respected and allowed to find consensual solutions "whenever possible."[23] Unilateral attempts to override these independent governance institutions have often been rejected.[24] The Commission should follow its precedent and not allow EPMI, ConEd, the Member Systems, Morgan Stanley Capital Group, Inc. ("Morgan Stanley"), or others, to force their own preferences either on the NYISO or other market participants.

The NYISO does not consider its existing governance institutions to be perfect,[25] but it believes that they generally provide a viable means of: (i) ensuring that complex market rule changes are properly

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22 The Commission approved the NYISO's governance institutions in *Central Hudson Gas & Electric Corp., et al.,*88 FERC ¶ 61,229 (1999).

23 *See, e.g., New York Independent System Operator, Inc.*, 90 FERC ¶ 61,319 (2000) (rejecting alternative ICAP recall bid proposal that a single party attempted to propose even though another system had been endorsed by the NYISO Committees.) *See also USGen New England, Inc.*, 90 FERC ¶ 61,323 (2000) (rejecting unilateral contract for system restoration services); *New England Power Pool,* 90 FERC ¶ 61,168 (2000) (expressing preference for consensus CMS/MSS proposal in New England); *Sithe New England Holdings, LLC and Sithe New Boston, LLC v New England Power Pool, and ISO New England, Inc.,* 86 FERC ¶ 61,283 (1999), *reh'g denied,* 88 FERC ¶ 61,080 (1999) (rejecting a market participant's attempted unilateral revision of a complex arrangement developed by an ISO); *PJM Interconnection, L.L.C.,* 84 FERC ¶ 61,212 at 62,035 (1998) ("[W]e emphasize that in accepting PJM's proposed revisions . . . we deferred to the judgment of the PJM ISO and its Board concerning a regional solution to an identified regional problem based on what we understand is a broad, if not unanimous, consensus.").

24 *See, e.g.,* 87 FERC ¶ 61,054 at 61,220 (1999) ("We believe as a general proposition that full and open discussion of among interested parties often leads to better and more reasonable decisions. We intend for ISOs . . . to be a forum in the first instance for stakeholders to work out their differences, wherever possible, so that they need not come to the Commission.").

25 The NYISO will address the operation of its governance structure in the status report it is required to file on December 1, 2000. *See* 88 FERC ¶ 61,229 at 61,760 (1999).

vetted; (ii) reconciling market participants' conflicting concerns; and (iii) arriving at consensus decisions. Of particular relevance to this proceeding, the NYISO employs a project management process pursuant to which the NYISO determines the priority of the various market corrections and market enhancements that compete for its resources in a reasoned, orderly manner. Pursuant to this process, the NYISO staff has developed a list of project priorities incorporating input from its market participant committees.[26] The NYISO is currently refining this list to ensure that its staff's attention is properly focused on the projects that the NYISO, and the market participants, consider to be the most important. In addition, senior NYISO staff recently met with the chairs and vice-chairs of the three market participant committees and agreed on certain enhancements that will make the project management process better.[27]

The NYISO respectfully submits that permitting it to continue to set its own priorities through its governance procedures is vastly superior to imposing priorities on the NYISO through administrative litigation, as certain parties in this proceeding propose. It is better to allow the NYISO and market participants, who are more familiar with the details of relevant issues, to balance the competing concerns of different entities. The alternative would be for the Commission itself to choose among the competing interests of, by way of example, EPMI and Morgan Stanley, which would have the NYISO make the implementation of virtual bidding and other "liquidity" measures a top priority,[28] against those of entities

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[26] The current version of this list is posted on the NYISO's website.

[27] In particular, it was agreed that the NYISO's resource allocation and budgeting systems needed to be better integrated into the prioritization process, and that it was necessary to establish a single centralized priority assignment system rather than allowing individual committees to set potentially inconsistent priorities.

[28] *See* EPMI at 6-15, Morgan Stanley at 3-7.

like ConEd and the other Member Systems, which would impose a moratorium on virtual bidding and all other market enhancements they think non-essential.[29]

In short, because there is no emergency in the NYISO-administered markets, the Commission should defer to the NYISO's governance institutions and allow them to make factually-intensive project priority decisions. To do otherwise would subvert the NYISO's governance and penalize market participants that have adhered to Commission precedent by working through them. Allowing individual market participants, or single classes, to set the NYISO's agenda would send a message to participants in all ISOs, and future RTOs, that they need not respect Commission-approved governance institutions. Even worse, it would fundamentally undermine the NYISO's independence by permitting market participants to disregard its decisions.[30]

The NYISO is especially disturbed by Member Systems' October 13 filing, which asks that the

-approved project list be discarded and a new one created that would more closely reflect the Member Systems' priorities. This request is totally inconsistent with the position the Member Systems have taken in earlier Commission proceedings[31] and at NYISO committee meetings. The Member Systems have repeatedly insisted that all NYISO-related decisions must be

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29 *See* ConEd at 11, Member Systems at 4-5.

30 The Commission has often stated that "the principle of independence is the bedrock upon which [an] ISO must built" and emphasized that this principle is equally valid where RTOs are concerned. *See, e.g., Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 at 31,061 (1999).

31 *See, e.g., Motion to Intervene and Comments of Member Systems*, Docket No. EL00-90-000 at 5 (July 17, 2000) ("The Commission should defer to the Commission-approved NYISO governance structure and should allow this issue to be addressed by market participants in the context of all other related issues. Permitting an end-run around that process is neither necessary nor appropriate at this juncture.").

made by market participants through the committees. They have repeatedly questioned the NYISO staff's authority to take independent action, no matter how trivial (or urgently necessary), without strictly following governance procedures. The NYISO has done everything it reasonably can to accommodate the Member Systems concerns, including dedicating time and resources to abstruse governance discussions, which would have probably have been better utilized working on substantive issues.

Frankly, given the Member Systems' unwavering insistence that the NYISO respect and defer to market participants they should not be permitted to have it both ways. If they genuinely want participatory governance, they must be willing to accept the decisions, and project priorities, established by the governance process.

3. There Is No Need for the Commission to Hold a Technical Conference In This Proceeding

EPMI and the Member Systems have requested that the Commission hold technical conferences. EPMI's objective is to compel the NYISO to give projects that it supports a higher priority and to revise drastically certain fundamental features of the NYISO's market design and rules. By contrast, the Member Systems would retain the existing market structure but would still force the NYISO to abandon the project list that it previously developed with its market participants and create a new list more to the Member Systems' liking. The two proposals appear to be mutually exclusive insofar as the Member Systems would presumably have the NYISO cease work on the very projects EPMI would put on a fast-track. The Commission should reject both requests.

EPMI attempts to justify its request for a technical conference by claiming that in the absence of certain market enhancements, which it asserts must be implemented immediately, there will be no "wholesale market" in New York. This is demonstrably false. The centerpiece of EPMI's program is a call for the immediate implementation of "virtual bidding," which the Commission has already rejected in another proceeding.[32] Similarly, although the NYISO agrees that it is desirable to provide for "block trading" and create trading hubs, these projects are not necessary prerequisites for the existence of competition and are already being addressed by the NYISO staff and its committees --- albeit not as quickly as EPMI would prefer. EPMI's attack is also heavily dependent on its deeply flawed analysis of external transactions, which the NYISO addresses below in Section II.C.1.a. In addition, the NYISO has already made the implementation of more robust price sensitive load bidding mechanisms, which is a prerequisite to the implementation of virtual bidding, a top priority. There is thus no need for a technical conference.

Even more importantly, the NYISO objects to EPMI's proposal that the technical conference result in the elimination of basic features of the NYISO's market design, such as the use of TCCs and the replacement of the NYISO's current scheduling function with a reservation (*e.g.,* first-come-first-served or an auction.)" These are radical, unwarranted and ill-advised changes, not "easy, common sense solutions," as EPMI claims.[33] The NYISO respectfully submits that its market design is sound and, when fully and successfully implemented, will be far more efficient than the rules that EPMI would have the Commission impose. Indeed, EPMI's proposals would make the

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32 *See Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.,* 93 FERC ¶ 61,017, *slip op.* at 5-6 (2000) ("Morgan Stanley has not demonstrated that there is an overriding immediate need to design and implement a non-physical bidding structure . . . .").

33 EPMI at 3.

NYISO less like PJM and ISO-New England, contrary to EPMI's professed desire to increase coordination among the three Northeastern ISOs.[34]

Moreover, EPMI has failed to explain what would be gained by convening a technical conference. It states only that such a conference would provide a process "where the parties can discuss with each other and the Commission staff how best to provide real relief for New York's

[35] This function is already performed by the NYISO's governance process which works far more efficiently, and can review issues more thoroughly, than a technical conference. The Commission staff already has a wealth of information about the NYISO-administered markets as a result of the NYISO's filings in this proceeding and its own ongoing investigation of wholesale power markets.

The same criticism is equally applicable to the Member Systems' request that the NYISO prepare an entirely new market improvement "implementation plan" for review at a technical conference. Far from ensuring the most "effective and efficient utilization of the resources of the Commission, the NYISO and all market participants,"[36] the Member Systems proposal would require the NYISO to throw out the work it, and market participants, have already done to develop a consensus project list. Indeed, the Member Systems evidently envision having a lengthy debate over the basis for each of the NYISO's prioritization decisions, despite the fact that these discussions have

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[34] Of course, the three Northeastern ISOs and the Ontario Independent Market Operator are already working to harmonize their rules and procedures as part of the ISO Memorandum of Understanding process.

[35] EPMI at 4.

[36] Member Systems at 6.

already taken place.[37] They would compel the NYISO to waste time and resources preparing to present and defend a hastily prepared revised plan, and would force the Commission to enmesh itself in technical minutiae while micro-managing the NYISO's future activities. They would also impose excessive reporting requirements on NYISO staff that would distract it from the important substantive work that remains to be done.[38] In short, putting aside the objectionable nature of the Member Systems attempt to impose their own priorities by establishing a moratorium on efforts they consider unimportant, it should be abundantly clear that the technical conference procedures they have proposed are irrational and overly cumbersome.

Finally, as part of their attempt to justify a technical conference, the Member Systems incorrectly claim that the NYISO has "failed to institute any correc

"1) fixed block generation pricing; 2) reliance on western operating reserves when there is no congestion at Central-East; 3) development of a plan to permit customers to self-supply; and 4) curtailment of transactions with identical decremental bids on a pro rata basis." In order to clarify the record, the NYISO emphasizes that it in fact: (i) has asked for permission to adopt a hybrid fixed block generation pricing rule that will better meet the Commission's policy concerns, and will better protect LSEs (including the Member Systems) from artificially high costs, while simultaneously implementing the software changes required by the Commission's July 26th Order,[39] (ii) is moving as rapidly as feasible,

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37 Member Systems at 4 (asserting that the NYISO's "implementation plan" should describe the basis for the priority it assigns to each market improvement, "taking into account the relative impact that various market flaws are having on consumers and the market in general").

38 Member Systems at 5.

39 *New York Independent System Operator, Inc., et al.,* 92 FERC ¶ 61,073 (2000).

considering the technical challenges involved, to facilitate greater participation by western reserves suppliers and to create workable self-supply mechanisms;[40] and (iii) has worked with its software vendor, to make the changes necessary to implement *pro rata* curtailment for transactions with equal decremental bids and plans to introduce the required change by November 15.[41] Thus, while it may be that the NYISO has not been able to take corrective action as quickly as the Member Systems would like, it has acted as quickly as possible. Of course, having a technical conference will not make it possible for the NYISO to complete desired improvements any faster.

4. The Commission Should Not Hastily Impose Proposed Market Corrective Measures that Have Not Been Thoroughly Reviewed by the NYISO's Governance Institutions

Because there is no emergency in the NYISO-administered markets, there is no need for the Commission to adopt additional market corrective measures at this time. The NYISO is sensitive to consumers' concerns, and has previously demonstrated that it will take immediate action when exigent circumstances require it.[42] The NYISO is already working as quickly as possible to institute three important new consumer protection safeguards for implementation by the start of the 2001 Summer Capability Period, *i.e.,* (i) demand-side response mechanisms;[43] (ii) price sensitive load bids; and (iii) a

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40 See Section II.B.2 below.

41 In fairness to the Member Systems, the NYISO has not previously announced the November 15 implementation date.

42 The NYISO Board previously made exigent circumstances filings on March 27, 2000 (in Docket No. ER00-1969-000) and on June 30, 2000 in Docket No. ER00-3038-000. In addition, the NYISO has not hesitated to implement Extraordinary Corrective Actions when circumstances warranted.

43 The NYISO opposes 1st Rochdale Cooperative Group, Ltd. and Coordinated Housing Services, Inc.'s ("1st Rochdale") suggestion that the NYISO should implement demand-side response mechanisms more quickly. The NYISO is working as diligently as it can to ensure that these

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mechanisms are in place when they are truly needed, *i.e.*, in time for Summer 2001. The NYISO does not believe that it would necessarily be helpful to conduct a pilot program during the off-peak winter period.

44 *See* the NYISO Board's recent Section 206 filing in Docket No. ER01-181-000.

45 The City of New York falls prey to this temptation when it asks the Commission to take certain actions based on tabloid articles and its own belief that "deregulation is already perceived as a failure." City at 2 .

screens" on the NYISO-administered markets[46] and its request that the current bid-confidentiality period be shortened,[47] but is not prepared to conclude that ConEd's other proposals are without merit. However, there is no need for the Commission to rush to implement incomplete proposals that have not been fully evaluated by the NYISO or vetted by affected market participants. ConEd should be required to develop its proposals more fully and submit them through the appropriate NYISO Committee process so that they may be reviewed properly. Several parties have already made filings raising serious questions about ConEd proposals, and they should be afforded an opportunity to air their concerns through the governance process.[48] NYISO staff has its own questions about some of the proposals, and would like to address them with ConEd and other market participants. By allowing this review to take place, the Commission will ensure that flaws in ConEd's proposals are identified, ill-advised proposals are eliminated and worthy proposals are fleshed out prior to any required filings at the Commission.

In addition, the NYISO opposes the City's request[49] that the Commission impose "temporary" bid caps of $250, or lower, on all of the NYISO-administered markets, pending "the adoption and

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[46] The NYISO previously explained its opposition to price screens in Docket No. EL00-70-000, *et al.* *See* *New York Independent System Operator, Inc.'s Answer to Complaint of New York State Electric & Gas Corporation to Suspend Market Based Rates for Energy Markets and Request for Emergency Technical Conference, as Amended, and Answer to Strategic Power Management's Supplement to Complaint Requesting Fast-Track Processing and Motion to Consolidate*, at 56-59 (May 25, 2000, as corrected May 31, 2000) ("NYSEG Answer").

[47] *See* Section II.C.8 below.

[48] *See, e.g.,* *Motion for Leave to Respond and Response of Morgan Stanley Capital Group, Inc.,* at 5-8 (same); *Motion for Leave to Respond and Response of Keyspan-Ravenswood, Inc.* ("Keyspan II") at 4-6, 7, 8-9 (objecting to several of ConEd's substantive proposals).

[49] In its second, *i.e.,* October 23, filing in this proceeding, Westchester County expressed its support for the City's request.

proper implementation of appropriate mitigation measures such as those proposed by Con Edison."[50] The NYISO respects the City's concern for retail customers. Nevertheless, there is no need for such arbitrarily low caps, especially during the off-peak Winter Capability Period,[51] considering the various consumer protection mechanisms already adopted by the NYISO. The City has also failed to submit its price cap proposal to the NYISO's governance institutions for their review. Such price caps will not address the key factors that have led to price increases, *i.e.,* high fuel prices and the Indian Point 2 outage. Moreover, the City has not recognized the likelihood that such a low cap would harm the very customers it is meant to protect by impeding imports from neighboring control areas which have $1,000 caps, or no caps at all.[52] The City has failed to offer any evidence of specific market power abuses, or explained how specific market flaws are causing prices to be "unjust and unreasonable." It thus ignores

San Diego Gas and Electric Company order,[53] which established that the Commission will not approve such arbitrarily low caps in the absence of persuasive record evidence demonstrating their necessity.

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50 *Motion to Intervene Out of Time and Comments of the City of New York* (Docket Nos. ER00-3591-000 and ER00-3591-001) at 2, 7.

51 The Winter Capability Period begins on November 1 and lasts until April 30. The NYISO's July 1, 2000 Load and Capacity Data report predicts a peak load for the Winter of 2000-2001 of 24,250 MW and estimates that there will be a maximum of 36,735 MW of generation available.

52 To the best of the NYISO's knowledge, information and belief, all price caps were lifted in ISO-NE on October 31, 2000. Similarly, PJM will either retain its existing $1,000 cap or have no cap at all, depending on the Commission's resolution of Morgan Stanley Capital Group, Inc.'s October 6 complaint in Docket No. EL01-3-000.

53 *San Diego Gas and Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 92 FERC ¶ 61,172 (2000).

Finally, the NYISO strongly disagrees with ConEd's claims that it has not vigilantly exercised its market power monitoring and mitigation authority.[54] The Commission and all market participants can rest assured that the NYISO's market monitoring unit is fulfilling its responsibilities in an effective and professional manner. Although it often keeps a low public profile, the market monitoring unit has been very active. Its efforts have unquestionably helped to keep the NYISO-administered markets workably competitive during most periods, and to protect consumers when the markets have ceased to be workably competitive.

5. The Commission Should Not Impose Excessive Reporting Requirements or Unreasonable Implementation Deadlines on the NYISO

NYSEG[55] and ConEd,[56] ask the Commission to impose burdensome new reporting requirements and very short implementation deadlines on the NYISO. The Member Systems would also impose such burdens, albeit under the auspices of a formal technical conference. These proposals are inefficient and unhelpful and should be rejected.

The NYISO staff and its economic consultants have already had to submit numerous reports, including this filing, and are currently preparing still more. It would be absurdly inefficient to force the NYISO to spend its time writing reports on the effects of market flaws or the absence of certain market

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54 ConEd at 11-12.

55 NYSEG at 18, 25, 27.

56 ConEd at 10-11 (requesting a report on certain market flaws and on Bid Production Cost Guarantee payments). In response to ConEd's request for information, the NYISO notes that the "previously undetected market flaws" referenced in the Report (at 3) were addressed by the Extraordinary Corrective Actions that the NYISO issued on September 7 and October 6.

enhancements, instead of addressing underlying problems.[57] Moreover, many of the proposed new reporting requirements would serve no useful purpose. For example, NYSEG has requested that the NYISO be required to prepare a comprehensive report quantifying the various potential adverse effects associated with BME-related problems.[58] Although such information would doubtless be of inherent interest, a NYISO report on the subject would not effect the NYISO's market improvement efforts, since it has already made the identification and correction of BME-related problems a top priority. Therefore, the NYISO asks that it not be required to prepare such a report, or, at a minimum, not be required to prepare it unless the Commission first decides to grant NYSEG's request that all prices which may have been affected by BME-related problems be recalculated.[59]

The NYISO also objects to the arbitrarily abbreviated implementation deadlines that NYSEG, ConEd, the Member Systems and EPMI would impose on the NYISO. For example, ConEd demands that the NYISO "immediately correct the BME process."[60] The NYISO has already committed to do everything it can to make BME a better predictor of real-time prices as quickly as possible and has taken immediate action, *e.g.,* issuing "Extraordinary Corrective Actions ("ECAs"), to end gaming behavior that was distorting the relationship between BME and SCD prices. Nevertheless,

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57 The Commission should not interpret this statement as an assertion that NYISO staff is so heavily burdened that it will not be able to prepare whatever reports the Commission may direct it to submit. Rather, the NYISO is asking that it not be required to devote resources to preparing reports that could be better used to improve the NYISO-administered markets.

58 NYSEG at 18, 25.

59 NYSEG at 18.

60 ConEd at 32, 35. As in noted below in Section II.C.1.c, the NYISO disagrees with characterization of the effect that BME-related problems have had on imports into the New York Control Area.

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it is impossible for the NYISO to complete its work in this area "immediately." Similarly, NYSEG asks the Commission to direct the NYISO to implement certain corrective actions within 30-60 days, including a request that the NYISO implement transmission optimization procedures within this timeframe.[61] As is explained in the Report, and as further clarified below in Section II.B.2, such a timetable is not realistic.

The NYISO believes that nothing is accomplished by imposing arbitrary and unrealistic deadlines. As was discussed above, the NYISO believes that the Commission should permit the NYISO to set its own priorities and establish its own timetables. However, in the event that the Commission decides to override the NYISO's governance process and require that certain projects be completed on a special, expedited basis, the NYISO respectfully requests that the Commission limit itself to identifying those projects and permit the NYISO to propose an implementation timetable in the first instance.

B. The NYISO's Reserve Market Proposal Reflects a Reasonable Compromise Among Market Participants that Includes All of the Improvements That Can Feasibly Be Implemented at this Time

1. The Commission Should Uphold the NYISO's Reserves Market Proposals

Certain parties have objected to particular aspects of the NYISO's reserves market proposal. For example, Multiple Intervenors ask the Commission to delay the gradual elimination of the interim bid cap applicable to eastern suppliers of 10-Minute Non-Synchronized Reserves ("NSR") until there is absolute certainty that problems with the 10-Minute NSR portion of the reserves market will not

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61 NYSEG at 5, 7

recur.[62] Con Ed would require the NYISO to file a report assessing the performance of the 10-Minute NSR portion of the reserves market and await the Commission's approval before implementing each of the proposed increases to the current $2.52 (plus lost opportunity costs) bid cap.[63] NYSEG would require the NYISO to begin the staged implementation of a transmission-optimization system before beginning to lift the current cap.[64] By contrast Keyspan-Ravenswood, Inc. ("Keyspan") insists that the NYISO should be required to make a special filing in the event that it requests a further extension of the NSR bid cap and challenges the market power mitigation proposal that is part of the NYISO's plan.[65]

The NYISO asks that the Commission reject these requests. The NYISO's proposal incorporates the NYISO's assessment of how the 10-Minute NSR portion of its reserves market can best be re-opened, and reflects a compromise among market participants that has been approved by the NYISO's governance institutions.[66] As was noted in the Report, the reserves market proposal was developed through an open stakeholder process and endorsed by the market participant NYISO committees. The NYISO has already filed a status report confirming that the short-term improvements which are necessary prerequisites to the re-opening of the 10-Minute NSR portion of the market are in place. The NYISO will vigilantly monitor the market for unexpected problems and will take prompt action should any arise. By the same token, proposals that would restrict the NYISO's ability to take

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62 *Motion to Intervene and Comments of Multiple Intervenors* at 5-9 (September 27, 2000).

63 ConEd at 9-10.

64 NYSEG at 9-10.

65 *Motion of Keyspan-Ravenswood, Inc. to Intervene and Protest* ("Keyspan I"), Docket No. ER00-3591-000 and -001 at 3-6.

corrective action if the markets unexpectedly malfunction are clearly inappropriate. In short, the NYISO asks that the Commission accept its proposal to re-open gradually the 10-Minute NSR portion of its reserves market as it was approved by the Management Committee and filed with the Commission.

2. The Implementation of Longer-Term Reserve Market Improvements

RG&E and NYSEG complain that the NYISO has not done enough to accommodate self-supply by western LSEs or to permit western suppliers to supply reserves in the east. RG&E is especially strident on this point. The NYISO is sensitive to NYSEG's and RG&E's frustrations, but must disagree with their comments. As the Report explains, the NYISO is doing, and will continue to do, everything it can to establish workable self-supply mechanisms and to facilitate greater involvement by western suppliers.[67] It is simply specious for RG&E to claim that the NYISO is fabricating "excuses" for inaction when it is working diligently to address the complex technical challenges posed by its longer-term market improvements. Indeed, as the NYISO explained in the status report it recently filed in this proceeding, it is ready to implement a locational reserve pricing system which, RG&E's puzzling attacks notwithstanding, is a necessary prerequisite to the development of transmission optimization tools that RG&E supports. Most market participants have accepted that there is no short-term alternative to the longer-term improvements, and that the longer-term improvements will

[66] *See, e.g.,* Keyspan at 4, n. 5 (acknowledging that the reserves proposal reflects a compromise among market participants); *Motion by Long Island Power Authority and LIPA to Comments of Several Intervenors*, at 2 (October 12, 2000).

[67] *See* Report at 15-19.

take time to implement properly. The NYISO submits that RG&E and NYSEG must also acknowledge this reality.

In particular, the Report explained that the NYISO has reviewed the frequency and extent of constraints at the Central-East interface observed in real-time operations during June, 2000, which the NYISO believed to be reasonably representative of conditions throughout the year. This review indicated that Central-East was constrained approximately 80% of the time, which demonstrated that the feasibility of procuring additional 10-Minute Reserves across the Central-East transmission constraint could not be predicted in the day-ahead or hour-ahead market in advance of real-time.[68] NYSEG has challenged the NYISO's conclusion, claiming that the NYISO has used "selective" data and failed to consider that from January through late March, 2000, there was often considerable capacity available across Central-East in the day-ahead market.[69]

In order to dispel any doubts arising from NYSEG's allegation, the NYISO has conducted an expanded study of the frequency and extent of real-time constraints at Central-East from January through September, 2000, and found that Central-East was, on average, constrained during 70% of real-time intervals. The NYISO's study also reaffirmed that it was very difficult to anticipate the times of day when Central-East would not be constrained. It is therefore reasonable to conclude that it would be "impractical, in the short-term, to develop automated or manual procedures that would permit the

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68 Report at 8-9.

69 NYSEG at 6. *See also* RG&E at 7.

NYISO to rely on western supplies when there is no anticipated congestion at Central-East, because congestion is so frequent and intervals without congestion are difficult to anticipate."[70]

Furthermore, although NYSEG may be correct to note that there is sometimes day-ahead capacity available across Central-East, the NYISO does not believe that this should be a decisive factor. The NYISO is extremely reluctant to schedule reserves day-ahead that it knows probably will not be available in real-time, when room to deliver the reserves will actually be needed. Indeed, the NYISO believes that taking such an approach would irresponsibly threaten reliability and frequently force the NYISO to buy expensive eastern reserves, in the real-time market, unnecessarily raising LSEs' costs.

3. Locational Reserve Pricing

RG&E's complaints concerning the NYISO's locational reserve pricing proposal are totally unjustified. Contrary to RG&E's claims, locational reserve pricing is not unjust and unreasonable.[71] Rather, it is a necessary first step towards the fuller optimization of reserve location that RG&E professes to favor. RG&E likewise ignores the reality that locational reserve pricing brings consistency between reserve pricing and constraints on reserve scheduling.

As an initial matter, RG&E's suggestion that the NYISO is adopting locational reserve pricing as part of a deliberate effort to "to prohibit suppliers like RG&E from participating in the NYISO's

[72] is false. RG&E, like all other western suppliers, is permitted to bid all of

[70] Report at 9.

[71] RG&E at 12.

[72] RG&E at 7.

its resources into the reserves markets, and the NYISO will schedule RG&E's resources when they are economic. RG&E's real complaint appears to be that it thinks it should be paid the prevailing price for eastern operating reserves, despite the fact that it provides western operating reserves. The NYISO believes that this would be inappropriate as the two products are not of equivalent value.

Similarly, when RG&E inaccurately implies that the NYISO is deliberately preventing it from self-supplying operating reserves, it includes a complaint that the NYISO does not value the RG&E's western reserves as if they were eastern reserves.[73] RG&E seems not to realize that this is entirely appropriate in order to satisfy applicable reliability criteria. The NYISO wishes to clarify that any self-supply mechanism it develops will, consistent with the Commission's May 31 Order, require self-suppliers to comply with its locational reserve requirements.[74] Self-supply will not provide NYISO members with a free ride.

RG&E also argues that the NYISO should schedule western reserves to meet the eastern locational reserve requirement when Central East is not constrained on a day-ahead basis. RG&E fails to recognize the Report's conclusion that implementing such an improvement in locational reserve scheduling would require several major market and software changes. First, significant software changes would be required to modify the process by which resources are committed to meet reserve requirements in order to account for changing loadings on Central East. This would require the

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73 *See* RG&E at 8 ("Thus, since all of RG&E's generation is located west of the Central-East interface [the NYISO's proposal] would completely fail to permit RG&E to self-supply operating reserves from its generation.").

74 *See* 91 FERC ¶ 61,218 at 61,806 ("However, in devising a [self-supply] plan, the NYISO may require that the right of customers to self-supply comes with the obligation to self-supply generating capacity that meets all applicable technical requirements, including locational requirements.").

development of new software logic and algorithms; the NYISO is currently examining the magnitude of the required changes as part of its scoping studies concerning the optimization of energy and reserves.

Moreover, as the Report noted, optimizing the use of Central-East to permit western reserves to meet eastern requirements requires the prior introduction of locational reserve pricing. To further clarify the Report, one reason why locational reserve pricing is a prerequisite to the adoption of a transmission optimization system is the need to maintain revenue adequacy for Transmission Congestion Contract ("TCC") payments. If the NYISO were to optimize reserves and energy schedules across the Central-East interface, and reduce energy schedules to make room for western reserves to meet eastern reserve requirements, it would be inappropriate to pay additional western reserves the eastern reserve price. Rather, such suppliers should be paid a western reserve price that would be lower than the eastern reserve price by an amount equal to the cost of congestion at Central-East, *i.e.*, the value of the energy that is backed down at the margin to accommodate the transaction. The impact of the scheduling of western reserves would be a possible increase in TCC values, as relatively high cost eastern generation would be dispatched up to displace less expensive western generation, in order to create room on Central East.[75] Thus, locational reserve pricing must be in place if the NYISO is to collect the congestion costs incurred when western reserves are used to satisfy eastern requirements. Locational reserve pricing is therefore a necessary precondition to any potential improvement of the

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75 Absent locational reserve pricing, western reserves suppliers would be paid the eastern reserves price, and the NYISO would not collect any congestion rents in connection with the relevant capacity on Central-East, and thus would not collect the money owed to TCC holders. If, however, energy and reserves were fully locationally optimized in SCUC, western reserve prices, like western energy prices, would remain low when the system is constrained and the NYISO would be able to collect the proper congestion rents.

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NYISO's reserve scheduling algorithms. The NYISO is only now completing the work required to implement locational reserve pricing, in the event that it is approved by the Commission, and can now begin to turn its attention to completing its scoping studies of the far greater challenges posed by optimization.

The implementation of a full two settlement system for reserves may also be a precondition for the implementation of a transmission optimization system. Absent such a system, if the NYISO were to purchase reserves at one location in the day-ahead market, and at another location in real-time because of transmission constraints that are only binding in real-time, market participants would in effect pay for those reserves twice. Thus, if the NYISO were to schedule western reserves in the day-ahead market to meet eastern reserve requirements when Central-East is not binding, or when it is inexpensive to do so, the NYISO would have two options. It could either impose a dispatching restriction to reduce real-time flows across Central-East and maintain transfer capability for western reserves, no matter how expensive this becomes, or it could use the transfer capability to supply western energy in real-time and buy eastern reserves in real-time in order to replace the western reserves that were scheduled day-ahead. The first approach would require changes to SCD's security analysis and would raise the cost of meeting load in real-time, while the second approach would require implementation of a complete two settlement system for reserves to avoid double payments by the NYISO.

RG&E expresses two other concerns about locational reserve pricing. First, it claims that it is "illogical to separately calculate the payment for suppliers of operating reserves in the west, yet not reflect a separate price for purchases in the west."[76] RG&E fails to mention that the allocation of reserves costs among transmission owners is, given the current locational requirements, distinct from the scheduling and pricing of reserves. The NYISO does not have any reliability or market incentive concerns pertaining to the allocation of reserve costs, so long as that allocation is de-linked from the supply market and does not distort incentives. By contrast, cost allocation matters are of great concern to the transmission owners, and the NYISO has no incentive to choose sides among them. As the Report explained:

> For the time being, the NYISO does not propose to modify the way in which the total cost of reserves is allocated among transmission customers, *i.e.,* it does not intend to implement a locational system of payments by reserves customers. Such a change would require extensive negotiations among market participants before any software changes could be undertaken. However, the NYISO staff and the committees will study the feasibility and desirability of developing such a system and may make a future filing on this subject.[77]

Thus, at least for the time being, the NYISO is willing to implement whatever cost allocation methodology is agreed upon by the transmission owners or required by the Commission. RG&E's complaint concerning the allocation of reserves costs among transmission customers is thus better directed at its fellow transmission owners. Furthermore, if the Commission determines that changes to the allocation of reserves costs are necessary, the NYISO believes that it may order them without effecting its locational reserve pricing proposal.

RG&E's second concern is not clearly stated. RG&E argues that the tariff language should be "clarified to ensure that Western prices would be calculated to the extent that there is a constraint over

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76 RG&E at 10.

77 Report at 18.

Central East."[78] If RG&E means by this that the western reserve price should differ from the eastern reserve price only when the constraint on reserves located east of Central- East is binding, the NYISO's proposed tariff language already assures this outcome. If, however, RG&E means that the western reserve price should differ from the eastern reserve price only when the Central East constraint is binding on the energy dispatch (rather than constraints binding on reserve locations), its proposal is unworkable because it would entail pricing reserves in a manner inconsistent with the constraints governing reserves scheduling.

Finally, RG&E is incorrect to claim that the Management Committee did not approve the use of locational reserves clearing prices by a 94% affirmative vote.[79] The key concepts of the locational reserve pricing proposal were worked out by the NYISO's economic consultants, with input from market participants, prior to the issuance of the May 31 Order, and most of the relevant tariff language was developed months before the Management Committee's vote. A detailed technical paper describing the proposal was posted on the NYISO website and circulated to the members of the Management Committee. Moreover, the full extent of the proposal was understood by participants in the Reserves Working Group and, to the best of the NYISO's information and belief, was understood by those Management Committee members that voted in favor of locational reserve pricing, regardless of what RG&E may believe. Indeed, RG&E's claim is belied by the fact it is the only party in this proceeding to complain about locational reserve pricing.

4. Issues Raised by HQ Energy Services (U.S.), Inc.

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78 RG&E at 11.

79 RG&E at 9, n .21.

Finally, H.Q. Energy Services (U.S.) Inc. ("HQUS") asks that the Commission direct the NYISO to raise the priority of increasing the amount of 30-Minute Reserves that HQUS can supply to the New York Control Area. The NYISO shares HQUS's interest in facilitating the sale of external reserves into New York, but opposes HQUS's attempt to give this project a higher priority than the NYISO governance institutions have assigned it. The NYISO's Operating Committee, which is composed of and led by market participants, has agreed to authorize the NYISO to make the software and operating changes necessary to allow HQUS's participation, subject to HQUS clarifying certain reliability issues. Once the Operating Committee has given its approval, the NYISO will make the necessary software and operational changes, consistent with a timetable specified by the NYISO's governance process. The Commission should keep in mind that shortages of 30-Minute Reserves have not been a serious problem.

C. Additional Compliance Issues

1. Imports and Other External Transactions

a. EPMI's Arguments

EPMI claims that unspecified software flaws are reducing the level of inter-ISO transactions in the Northeast based on an analysis prepared by Mr. Scott Englander, which concludes that many economic transactions were not scheduled in hours during which transmission constraints are not present. EPMI, and Mr. Englander, are incorrect. The reality is that when external transactions are not transmission-constrained, market participants have the ability to ensure that inter-ISO transactions are scheduled in either the DAM or HAM, by submitting appropriate bids. When external transactions are transmission-constrained, it is the physical limitation associated with the constraint, rather than NYISO software or market rules, that is to blame.

Mr. Englander's analysis also has at least five readily apparent deficiencies.[80] Specifically:

(i) Mr. Englander's analysis is wrongly predicated on the assumption that market participants have perfect foresight. His analysis shows only that a hypothetical (and counterfactual) market participant with such foresight could have made a great deal of money. His analysis does not show that the unexploited price differences were predictable, or even if they were large enough to warrant arbitrage, since it includes any transaction that could have earned 1 cent in excess of the transmission charges. A similar study of trades on the New York Stock Exchange would identify thousands of profitable transactions that were not made, despite the stock market's efficiency, because traders lack perfect hindsight.

(ii) Economic transactions that are scheduled in BME will not actually flow in real-time if they fail in the inter-control area "check out" process due to inaccurate NERC tags, or because a market participant did not submit the transaction in both control areas involved in a transaction. The latter phenomenon has caused numerous curtailment problems in New York, as well as in both PJM and New England. The source of these problems is not BME, but the failure of some market participants to correctly submit transactions, together with what the NYISO believes to be deliberate efforts by others to create congestion artificially and game the markets by submitting sham transactions, *i.e.*, transactions that are submitted to only one of the two or more affected control areas. The NYISO has addressed this problem through discussions with PJM and ISO-New England and by implementing NYISO Extraordinary Corrective Action 20000907A ("ECA 9/7-A"),[81] which is intended to deter sham transactions while avoiding onerous restrictions on market participants.

(iii) Mr. Englander's analysis does not consider the Desired Net Interchange ("DNI") constraint which limits the magnitude of schedule changes from hour to hour. The ISO-New England, NYISO and PJM control areas all enforce DNI limits. Moreover, contrary to EPMI's assertions,[82] ramp constraints are evaluated in BME and transactions that violate the DNI or ramp constraints will not be scheduled.[83] These constraints have

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80 Because these flaws are so substantial, and because there is so much uncertainty as to how Mr. Englander has derived his conclusions, the NYISO has not replicated Mr. Englander's analysis. However, the NYISO is prepared to conduct a more detailed study if the Commission directs it to do so.

81 The NYISO is authorized to implement ECAs for limited periods of time. ECA 9/7-A was issued on September 7, 2000 and is posted on the market-monitoring section of the NYISO's website.

82 EPMI at 13.

83 One effect of the sham transactions noted in Item I is that if the sham transactions were relieving the DNI constraint in the BME, a market participant's failure to supply scheduled energy will cause

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been binding, and they are necessary at present to maintain reliable operations in the various control areas. As a result of this constraint, fewer transactions were scheduled, a factor that is ignored by Mr. Englander's analysis.

(iv) Mr. Englander's estimates of "unutilized economic transfer capability" and "potential economic transfer capability" are so unclear as to be without value absent additional supporting data and clarification. The NYISO cannot properly respond to Mr. Englander's allegations without more information about how he derived these figures.

(v) Aside from its other limitations, Mr. Englander's analysis is not structured to identify the origin of any scheduling or market rules problem that might exist. Even if it were redone in a manner that: (i) established that predictably profitable transactions were not being scheduled between New York and New England; (ii) excluded transmission or DNI constraints in BME, the New England schedule evaluation, or in real-time; and (iii) properly discounted hours affected by sham transactions, it would still not establish whether the root cause of the problem existed in the New York, New England or PJM scheduling processes or market rules.

b. NYSEG's Arguments

NYSEG's criticism of the NYISO's interim policy of treating external transactions as *de facto* must-run transactions in order to prevent erroneous curtailments is without merit. First, NYSEG argues that "[e]very time BME is substantially negative, all positive bids into the HAM, including bids of $0 or $10 per MWh are rejected. The rejected HAM transactions again force the NYISO up the bid stack in the RTM, resulting in higher than efficient locational- based marginal prices ("LBMPs") in the RTM that all loads in the RTM must pay."[84] NYSEG's reasoning is faulty because any time BME is negative,

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legitimate transactions scheduled in BME, including transactions on other interfaces, to be cut in the post-BME check-out process. These sham transactions have often had ripple effects on New York and, to an even greater extent, PJM. As was noted above, the NYISO has addressed these sham transactions through ECA 9/7-A. Furthermore, the NYISO has sought to minimize secondary effects by ensuring that once a sham transaction is identified, it is removed from the BME evaluation for the remainder of the day, or until the market participant responsible for a transaction corrects its deficiencies.

84 NYSEG at 16.

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causing day-ahead transactions to be cut, and positive bids to be rejected, it is because there is congestion on the system and the NYISO cannot accept all bids. By definition, day-ahead transactions are cut only when it is impossible to schedule the transaction due to physical transmission limitations, and LBMPs should reflect this transmission congestion on the system.

Moreover, NYSEG's criticism does not account for the substantial benefits that NYISO Extraordinary Corrective Action 20001006B ("ECA 10/6-B") is expected to bring.[85] ECA 10/6-B ensures that imbalance prices for external transactions reflect the impact of external (to New York) as well as internal constraints, and that the imbalance prices used to settle imbalances for external transactions are consistent with BME's bid evaluation. Thus, ECA 10/6-B helps to make real-time and hour-ahead advisory prices more consistent It also eliminates the use of gaming strategies that exploit the difference between the full set of transmission constraints evaluated by BME, and the subset of internal transmission constraints that were previously used to determine settlement prices at external proxy buses. Ultimately, once market participants are satisfied that ECA 10/6-B is working as intended, the NYISO anticipates that it will propose to amend its tariffs to reflect ECA 10/6-B's rules, and that they will completely supplant the use of the *de facto* must-run scheduling system.

The NYISO also takes issue with NYSEG's claim that the NYISO is too readily cutting imports when it should be attempting to use dispatchable resources to maintain system security.[86] NYSEG's comparison of the real-time transmission conditions facing the NYISO to historic conditions

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[85] The problem necessitating the issuance of ECA 10/6-B was noted in the Report at p. 60. ECA B was issued in its final form on October 6, 2000. The text of ECA 10/6-B is posted on the market-monitoring section of the NYISO's website.

is flawed because the volume and nature of energy flows on the system under NYISO operations are much changed from what they were in the past .[87] A significant problem, which did not exist prior to the commencement of NYISO operations, has been that the NYISO has frequently found it necessary to cut transactions in the check-out process, on account of transaction-entry errors and sham transactions submitted by certain market participants. As discussed above, this behavior has been addressed by ECA 9/7-A, which NYSEG criticizes by suggesting that the NYISO will unreasonably impose major fines on entities that make minor "clerical errors." NYSEG's criticism fails to account for the very serious consequences that arise when scheduled transactions do not flow because of deliberate or careless scheduling practices and other transactions are denied the use of transfer capability that should have been available. Despite NYSEG's concerns, the NYISO believes that the approach adopted by ECA 9/7-A has had, and will continue to have, substantial benefits.

c. ConEd's Arguments

Con-Ed complains that there have been periods during which potentially economic imports from New England have not flowed. Con-Ed offers little evidence to support this allegation, other than its observation that there were sixteen hours on June 26 when energy was flowing from New York to New England but prices were, counter-intuitively, higher in eastern New York than in New England. ConEd

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[86] NYSEG at 17.

[87] The dramatic increase in competition associated with the establishment of ISO-administered markets has created different operating conditions than prevailed in the past, especially inasmuch as increased use of the transmission system has tended to create more frequent and severe congestion. *See, e.g., ISO New England, Inc., et al.,* 91 FERC ¶ 61,227 at 61,829 at n.7 (2000) (recognizing that the Commission had substantially underestimated the extent to which transmission congestion would increase in New England once ISO-New England commenced operations and increased the amount of wholesale competition).

summarily concludes that this must be the result of market flaws, and that more imports should have been scheduled. The reality is, however, that the NYISO cannot accept import bids that are not submitted by New England suppliers. The NYISO has reviewed its records and determined that its Security Constrained Unit Commitment ("SCUC")[88] software accepted all import bids from New England for the hours in question in the day-ahead market on June 26 that were economic, *i.e.,* all of the unaccepted bids were higher than the day-ahead LBMPs. Similarly, the BME evaluations on June 26 accepted all supply offers from New England available at prices less than the applicable hour-ahead advisory prices. The NYISO cannot schedule resources that are not offered.

Con-Ed speculates that marketers and suppliers may not be scheduling transactions from New England to New York because the "risk of arbitrary curtailment is so great."[89] The NYISO's Report has already explained, however, that the NIYISO has successfully acted to reduce the likelihood that imports will be curtailed.[90] The NYISO agrees with ConEd's statement that BME should be improved and has made this effort a top priority. At the same time, the NYISO disagrees with ConEd's suggestion that "the NYISO should allow all market participants to schedule energy into the Day Ahead Market from external regions . . ." [91] because the NYISO already does this. Similarly, ConEd is incorrect to suggest that there are "artificial barriers" in the NYISO-administered markets that prevent New England suppliers from selling into the NYISO-administered markets.

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88 SCUC is a computerized algorithm that calculates prices in the NYISO-administered day-ahead markets.

89 ConEd at 33.

90 Report at 36-37 (explaining how the NYISO has given all external transactions *de facto* "must run" status as an interim corrective measure).

91 ConEd at 33.

2. The NYISO's Balancing Market Evaluation ("BME")

Various parties have called upon the NYISO to expedite its efforts to correct its BME-related problems. In order to clarify the record in this proceeding, the NYISO emphasizes that parties generally minimize, or entirely ignore, the substantial progress that the NYISO had made towards addressing the various factors that can lead to BME-related problems.[92] They also do not account for the NYISO's successful efforts since the Report was filed to solve certain problems that account for the bulk of the divergence between BME and SCD.

The NYISO has recently taken a number of actions to reduce "[c]hanges in the amount and mix of generation assumed during the execution of BME versus the amount actually available in real-time."[93] For example, by issuing ECA 9/7-A, the NYISO has implemented an interim measure that substantially eliminates the distortions that previously arose when imports and exports that BME expected to flow in real-time were cut in the inter-control area checkout process due to improper scheduling, thereby blocking the scheduling of legitimate transactions.[94] Permanent rule changes to address this problem are currently being developed by ISO staff in conjunction with the Scheduling and Pricing Working Group.

Similarly, the NYISO is close to implementing improvements that will enhance BME's ability to track the performance of intermittent generation, combined cycle turbines and certain PURPA units.[95] Software has been developed that will permit BME to use the actual output of such units, rather than

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[92] The NYISO's efforts are described in detail in the Report.

[93] Report at 42.

[94] *See* Report at 42-43, 44.

[95] *See* Report at 43-44.

their prior schedules, to predict and schedule them for coming hours. The NYISO is now testing the new software, and expects that it will be fully operational within two weeks.

In addition, the NYISO is continuing its efforts to give BME the ability to determine whether generators are running "out-of-merit" order. The NYISO still intends to solve this problem by developing a display and logging function through which schedules for all out-of-merit units will be maintained and made an input to BME, thereby ensuring that they are scheduled appropriately. The NYISO expects to propose an implementation schedule in the near future.

With respect to the reduction of differences in the security model used by BME and SCD, which can result in the two programs considering different sets of constraints,[96] the NYISO has worked with ConEd to ensure that all portions of its bulk power transmission system are secured by SCD in real-time. As was noted in the Report,[97] the current scheduling and operating distinction has caused divergences between BME's price forecasts and real-time prices and thus increased volatility. The NYISO engaged in discussions with ConEd that were intended to result in all of the bulk power elements of ConEd's transmission system being secured in real-time by the NYISO. The NYISO expects to take on this responsibility in December, when all current software-related obstacles impeding its assumption of control will be resolved.

Finally, the NYISO has taken an interim corrective action by issuing ECA 10/6-B which ensures that external proxy bus congestion costs are properly factored into real-time prices. This problem had previously contributed to the BME-SCD price divergence. The NYISO is developing

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96 *See* Report at 42.

97 Report at 45.

permanent rule changes to address this problem in conjunction with the Scheduling and Pricing Working Group.

3. Fixed Block Bidding

NYSEG claims that the NYISO's fixed block bidding policies can lead to artificial reductions in congestion which inappropriately result in higher statewide LBMPs. NYSEG theorizes that this occurs when the NYISO brings on a fixed block resource to meet load in a congested zone in an amount above its immediate need which thereby uneconomically relieves congestion into the zone. According to NYSEG, when this occurs, the NYISO wrongly allows the cost of serving load in the higher cost zone to set the LBMPs in both the high and low cost zones.[98] The NYISO has carefully reviewed NYSEG's concerns and determined that, in practice, bringing on fixed block generation generally will not cause transmission constraints to drop out of the constraint set for pricing purposes because fixed block resources are not treated as fixed when prices are calculated. Accordingly, even when the operation of a fixed block unit will "artificially" reduce congestion, LBMPs in every zone will continue to be calculated as if the congestion still existed. NYSEG's request that the NYISO take special corrective action therefore need not be granted because the problem should not occur.

As the NYISO explained in its August 25, 2000 filing in Docket No. ER00-3038-000 ("August 25th Filing"), in the past, the NYISO's SCD sometimes calculated inappropriately high prices, for reasons unrelated to congestion, when substantial amounts of fixed block generation were running. This problem has been reduced through operational changes, and, in August, the NYISO proposed a

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[98] NYSEG at 18-21.

modification to its software's price calculation logic that would ensure that the problem was eliminated.[99] The NYISO still believes that the "hybrid" fixed block generation pricing rule proposed in the August 25th Filing is the best solution for all market participants, including NYSEG, and will do the most to protect consumers from artificially high prices. By contrast, the fixed block pricing "workaround" proposed by NYSEG in this proceeding would have had little impact on the prices paid by NYSEG's retail load, and could have dramatically increased the uplift costs borne by NYSEG's customers. It would also leave NYSEG's customers exposed to potentially substantial gaming-induced uplift costs.[100]

Finally, the NYISO has considered ConEd's suggestion that certain steam-electric generators in New York City may use block-bidding as a screen to conceal economic withholding. The NYISO has not previously detected evidence that such withholding is taking place, but will instruct its market monitoring unit to watch carefully for signs that this kind of abusive behavior may be taking place.

4. Price Reservations and Corrections

NYSEG questions the NYISO's success in reducing the frequency of price corrections by arguing that the percentage of hours which are reserved for potential correction is still too high.[101] NYSEG, however, has overstated the chilling effect of these reservations. As the Report noted, the NYISO had to correct only 0.53% of real-time intervals in August.[102] Moreover, in September, the

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[99] As was noted above, the NYISO's development of its hybrid pricing proposal belies the Member Systems claim that the NYISO has failed to take any action in this area.

[100] *See* August 25th Filing, *Joint Affidavit of Dr. Scott M. Harvey and Andrew Hartshorn* at 42-48.

[101] NYSEG at 10-12. EPMI makes the same allegation, but does not attempt to develop it to the same extent as NYSEG. *See* EPMI at 2.

[102] Report at 32.

NYISO corrected only 0.42% of real-time prices and, as of October 25, it had only corrected 0.04% of real-time prices, excluding real-time prices at external proxy buses recalculated pursuant to ECA 10/6-B,[103] in October. Given that the frequency of price corrections has fallen to these levels, the NYISO believes that market participants will recognize that even when an hour is reserved for review, it is not very likely that any prices within that hour will have to be corrected. Moreover, market participants can be even more confident that if a particular hour is subject to correction, only one five-minute interval within it will have to be adjusted. Thus, the NYISO does not believe that its current price reservation and correction performance is creating excessive uncertainty in its markets.

The NYISO further emphasizes that because the NYISO must declare whether an hour will be subject to review within 24 hours, its practice has necessarily been to reserve all hours where prices may have been affected by market flaws, even if it appears unlikely that they actually were. Thus, the frequency of reservations will invariably be higher than the frequency of corrections. It is also only fair to mention that in the past few months the NYISO, responding to a request by NYSEG and the other Member Systems, has reserved many hours for review simply because there were high-price intervals within them. The Member Systems made this request because they wanted reassurance that any and all prices tainted by market flaws or software errors would be corrected. Now that the additional reservations have proven to be unnecessary, it is, at best, disingenuous for NYSEG to attack the NYISO on this issue.

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[103] Since the ECA was instituted on October 11, the NYISO has had to correct prices at the external proxy buses more frequently, especially at the PJM proxy bus. The ECA has not required the NYISO to correct prices at internal buses.

5. Exercise of Temporary Extraordinary Procedure Authority

In response to ConEd's and NYSEG's requests that the NYISO's Temporary Extraordinary Procedure ("TEP") and ECA authority be extended, the NYISO clarifies that it filed a request for another extension with the Commission on October 11 in Docket No. ER01-94-000.

In addition, NYSEG and the Member Systems both assert that the NYISO has invoked its TEP authority too infrequently to correct market flaws, and ask that the Commission direct the NYISO to use the TEPs more frequently. The NYISO wishes to reiterate its previously stated position that it is inappropriate for self-interested market participants, no matter how well-intentioned they believe themselves to be, to usurp the NYISO's independent discretion to determine when to invoke TEPs or ECAs.[104]

6. Virtual Bidding

Morgan Stanley Capital Group, Inc. ("Morgan Stanley") and EPMI both reiterate their previous calls for the immediate implementation of virtual bidding, *i.e.,* bidding by non-physical entities. The Commission should reject their requests and uphold its recent order in Docket No. EL00-90-000, which requires the NYISO to file a report on its development of a plan to implement virtual bidding by January 1, 2001.[105] The NYISO also wishes to clarify that it recognizes the possibility that the absence of virtual bidding could permit purchasers to exercise oligopolistic market power, but that it has

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104 *See* NYSEG Answer.

105 *See Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.,* 93 FERC ¶ 61,017, *slip op.* at 7 (2000).

detected no evidence that this potential evil is actually occurring. Moreover, if such behavior were to occur, the NYISO's market monitoring unit already has the tools it would need to mitigate it.

7. The Effect of Imports From Hydro Quebec on Voltage Levels In New York

HQUS has asked that the NYISO be required to submit a new study, by year's end, of other factors besides imports from Quebec that may have caused the voltage problems that necessitated the NYISO's reduction of its Hydro-Quebec import limit from 1800 MW to 1500 MW.[106] This is unnecessary. The NYISO has already presented a more detailed study to the Operating Committee which confirmed its original conclusion that increased imports from Hydro-Quebec led to serious voltage problems and justified its decision to reduce the limit to 1500 MW.[107] Moreover, the NYISO has established that the historical loading levels across the interface rarely exceeded 1500 MW, even when the official limit was much higher.

NYISO staff has been meeting with HQUS and other Hydro-Quebec entities to discuss this problem and find ways to increase the import limit as effectively and quickly as possible. Therefore, the NYISO asks that it not be required to prepare yet another report on this subject as HQUS requests.

8. Disclosure of Confidential Bid Information

The NYISO opposes ConEd's request that the period during which market participants' bid information is kept confidential be shortened from six months to one. The Commission has recently reaffirmed that the use of a six-month period is reasonable, and it should again uphold this policy

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106 HQUS at 5-6. *See also* Report at 51-52.

107 *Analysis of HQ-NY Transfers Above 1200 MW* (October 18, 2000), <http://www.nyiso.com/services/documents/groups/oper_comm/meeting_materials.html>.

here.[108] Market participant data submitted to the NYISO is currently subject to close scrutiny by the New York State Public Service Commission and the Office of the Attorney General of the State of New York before the six month confidentiality period expires. The Commission's staff has also had access to such data pursuant to its investigative powers. There is thus little need to allow full public access to confidential, commercially sensitive information by entities or individuals who may not respect the information's sensitivity or that may have competing economic interests.

9. Clarification Concerning the Blenheim-Gilboa Pumped Storage Facility

In its September 27th filing, Keyspan asked the NYISO to explain the basis for its statement that it "anticipates that Blenheim-Gilboa will bid approximately 250 MW of 10-minute reserves and supply as much as 500 MW."[109] The NYISO clarifies that its re-modeling of Blenheim-Gilboa is complete and accurately reflects the facility's operating capabilities. In fact, the Report's description of Blenheim-Gilboa's capabilities was developed with the assistance of NYPA, which owns and operates the facility. Blenheim-Gilboa is every bit as available today as it was under the administration of the New York Power Pool.

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108 *See NSTAR Services Company v. New England Power Pool*, 92 FERC ¶ 61,065, *slip op.* at 17 (2000). The Commission previously directed ISOs to adopt a six-month confidentiality period in *California Independent System Operator Corp.*, 90 FERC ¶ 61,316 (2000), *PJM Interconnection, L.L.C.*, 86 FERC ¶ 61,247 (1999) and *Central Hudson Gas & Electric Corp., et al.,* 86 FERC ¶ 61,062 (1999).

109 Keyspan I at 10-11, *citing* Report at 10-11.

10. Communications

NYSEG misinterprets certain language in the Report and suggests that the NYISO is no longer making communications improvements a high priority.[110] This is not the case. Although there have been major improvements in this area, the NYISO is still working to make things better.

To clarify the record further, the NYISO emphasizes that in the time since it submitted the Report, it has: (i) added new staff to its Market Services Department; (ii) established 24-hour telephone coverage for market participant questions on urgent issues; (iii) improved the timeliness and thoroughness of its communications with market participants concerning system changes; (iv) substantially reduced the backlog of unanswered market participant questions and increased the speed with which it answers new questions;[111] and (v) expanding the scope of its training programs to include specialized generator operator, transmission operator, accounting and billing and other specialty courses. Further improvements are being developed.

On a related issue, the NYISO believes that the Commission should reject EPMI's request that it be directed to immediately implement the information release policy adopted by the Business Issues Committee ("BIC") on September 22, 2000. At its November 2 meeting, the Management Committee deferred action on the BIC proposal until its December meeting. The Management Committee has also asked the NYISO to review the proposed change in policy to determine whether the release of such data might jeopardize the ability of any market participants to fairly compete in the NYISO markets. It

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110 NYSEG at 21-22. *See also* EPMI at 16-17. The NYISO has already instituted the "24 hour troubleshooting service" that EPMI asked the Commission to require the NYISO to institute.

would be premature for the Commission to compel the NYISO to adopt these disclosure requirements until the NYISO staff's review is complete and the Management Committee has taken final action.

11. Billing

NYSEG has urged the Commission to scrutinize further the NYISO's efforts to improve its billing procedures. In response, and to clarify the record in this proceeding further, the NYISO emphasizes that, as of October 29, it had completed all re-billing through May, 2000. Re-billing from June on is awaiting the completion of changes necessary to account for the payment of lost opportunity costs to suppliers of 10-Minute NSR. As of this writing, the NYISO has issued true-up bills through February 2000, and expects to meet the other billing objectives specified in the Report.[112] The NYISO's timetable for completing these efforts is set forth in detail in Attachment II to this filing.

D. Miscellaneous Issues

1. Retail Competition

1st Rochdale and the City both complain about the state of retail competition in New York City.[113] While the NYISO has sympathy for these concerns, neither the NYISO nor the Commission, are responsible for retail competition matters. 1st Rochdale and the City should identify their concerns to the PSC.

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111 For example, as of October 20, NYSEG had asked 172 questions of which 27 were outstanding. Most of the unanswered questions had to do with technical issues concerning ECA 10/6-B.

112 *See* Report at 49.

113 1st Rochdale at 5, City at 5.

2. NOx Management

ConEd asks that the NYISO be required to "include feasible NOx management procedures in its unit commitment and dispatch processes. . .," arguing its current inability to consider NOx rules creates gaming opportunities.[114] LIPA also asks that the NYISO be required to make incorporating NOx emission limitations into its protocols a priority.[115]

The NYISO recognizes that these requests are driven by valid concerns, but believes that ConEd and LIPA have not considered the difficulty of the changes they propose. The NYISO's market design incorporates an economic dispatch model that does not currently incorporate "environmental dispatching" considerations. Adding environmental dispatching features to the NYISO's software would be a major undertaking that would require some time to implement. Sweeping tariff changes would also be required to reflect the move away from the current economic dispatching based model. There is also cause for concern in putting the NYISO in the position of managing other entities' NOx limits, an area where it currently lacks special expertise, which could raise serious liability issues.

The Commission should defer action on this issue and allow the NYISO to continue to develop its own solution. The Generation Issues Focus Group of the NYISO's Business Issues Committee is already developing new "Energy Limited Resources" policies that would give generators greater bidding and operational flexibility in order to manage their own NOx and other environmental limitations. The current proposal would allow generators to prescribe the limitations that define the maximum run time

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114 ConEd at 8, 30-31.

115 LIPA at 9-10.

for the unit in the NYISO's daily analysis. This approach would be far less drastic than moving to environmental dispatching, and should address ConEd's and NYSEG's concerns.

3. The NYISO's Resources and Budget

EPMI alleges that the NYISO's resources and budget are inadequate to meet the challenges before it.[116] To clarify the record, the NYISO wishes to emphasize that its budget for 2001 already calls for substantial staffing increases, especially in the market monitoring area. The NYISO is developing a strategic plan to identify any other areas where additional resources may be required. Moreover, EPMI is wrong to imply that the NYISO has hesitated to out-source necessary software adjustments to outside vendors when it is cost-effective to do so. The NYISO has done everything it can to expedite needed software improvements.

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116 EPMI at 2, 17-18.

III. Conclusion

WHEREFORE, for the foregoing reasons, the New York Independent System Operator, Inc., respectfully asks that the Commission: (i) grant the NYISO's request for leave to submit an answer in this proceeding; (ii) reject the relief requested in various comments and protests; (iii) deny the requests that it hold a technical conference; (iv) authorize the NYISO to implement the reserves market proposal described in the Report; and (v) permit the NYISO to retain control of its efforts to correct market flaws and implement market improvements pursuant to the plan it has developed in conjunction with market participants.

Respectfully submitted,

NEW YORK INDEPENDENT
SYSTEM OPERATOR, INC.

By ____________________________
Counsel

Arnold H. Quint
Ted J. Murphy
Hunton & Williams
1900 K Street, N.W., Suite 1200
Washington, DC 20006-1109
Of Counsel

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cc: Ms. Patricia M. Alexander, Advisor to Chairman Hoecker, Suite 11-A,
Tel. (202) 208-0750
Mr. Michael D. Alexander, Advisor to Commissioner Breathitt, Suite 11C,
Tel. (202) 208-0377
Mr. Wilbur C. Earley, Advisor to Commissioner Massey, Suite 11-D,
Tel. (202) 208-0100
Mr. Joshua Z. Rokach, Advisor to Commissioner Hebert, Suite 11-E,
Tel. (202) 208-0748