



discretion not to invoke its Temporary Extraordinary Procedures (TEP) and also regarding whether NYISO violated its tariff and refunds should be granted. In this order, the Commission finds that refunds should not be granted for NYISO's actions permitting interdependent determination of prices for spinning and non-spinning operating reserves. We also find that NYISO did not violate its tariff by permitting the parties to model the treatment of the Blenheim-Gilboa plant so as to prevent the use of that plant's output for operating reserves.<sup>2</sup>

## **BACKGROUND**

### **A. NYISO's Reserve Requirements**

2. NYISO sets an overall reserve requirement for the region. Load Serving Entities (LSEs)<sup>3</sup> in NYISO have an obligation to meet that reserve requirement, through either self-supplying reserves, or through purchasing reserves from NYISO. Of the various types of reserve, ten minute spinning reserve (SR) is synchronized to the system and available almost immediately, while ten minute non-spinning reserve (NSR) can be synchronized within 10 minutes but is not immediately available to the system, and is thus a less valuable product. Under its Market Administration and Control Area Services Tariff (Services Tariff), NYISO maintains markets for ancillary services, including the different types of operating reserves, which enable suppliers to offer their generation into the reserves markets at the same time that they submit offers to provide energy.<sup>4</sup> NYISO accepts sufficient offers to procure the necessary amount of each type of reserves for the region as a whole, and the highest-priced bid that NYISO accepts for SR and for NSR sets the clearing price that will be paid to all suppliers of each service.

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<sup>2</sup> *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 (2000) (May 31 Order), *reh'g denied*, 97 FERC ¶ 61,155 (2001) (November 8 Order), *reh'g denied*, 99 FERC ¶ 61,125 (2002) (April 29 Order).

<sup>3</sup> An LSE is a transmission facility owner that has an obligation to provide electric service to load.

<sup>4</sup> *See Central Hudson Gas and Electric Corp.*, 86 FERC ¶ 61,062 at 61,226-27 (1999).

**B. NYISO's TEP Procedures**

3. Before beginning operation, NYISO filed the TEP as an amendment to its open access tariff.<sup>5</sup> The purpose of the TEP is to enable NYISO

to address unanticipated market design flaws and transitional abnormalities. Applicants state that these procedures are designed to address issues in the first ninety days of [Independent System Operator (ISO)] operations and will permit the ISO to propose, or in emergencies impose, extraordinary corrective measures.<sup>6</sup>

4. NYISO's TEP filing defined a market design flaw as "a market structure, market design or implementation flaw which would result in market outcomes that would not be produced in a workably competitive market."<sup>7</sup> The Commission further stated that "[e]xamples of market outcomes that are a result of a market design flaw are the following: (1) dispatch of higher-priced resources when lower-priced resources are available; (2) situations in which ISO procedures would create a shortage of supply in actual operations when sufficient supply would have otherwise been available; or (3) the derivation of prices that are significantly inconsistent with actual system operations."<sup>8</sup>

5. The tariff further states that

Possible indications of Market Design Flaws include the dispatch of higher priced resources in the market when resources with lower-priced bids are available and not selected to operate, and there is no valid reason for not operating the lower-priced resource; situations in which approved procedures would inadvertently create a shortage of

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<sup>5</sup> *New York Independent System Operator, Inc.*, 88 FERC ¶ 61,228 (1999) (First TEP Order).

<sup>6</sup> First TEP Order at 61,752.

<sup>7</sup> *Id.* at 61,752-53.

<sup>8</sup> *Id.* at 61,753 n.6.

supply in actual operations when sufficient supply would have otherwise been available; or the derivation of prices in the price model that are significantly inconsistent with the actual operation of the system.<sup>9]</sup>

6. The TEP provided that, in the event of a NYISO declaration of a market design flaw that would impair reliability or market prices, NYISO could take Extraordinary Corrective Actions (ECAs). ECAs could be imposed only on an interim basis, and included (1) requesting market participants to submit bids that provide greater operating flexibility, (2) recalculating clearing prices to the level that would have been reached absent the market design flaw, and (3) replacing clearing prices with an unspecified alternative, default procedure if NYISO was unable to determine the proper clearing price. If NYISO found that the Location-Based Marginal Price (LBMP) has reached a level substantially unrelated to the price that would be derived absent a market design flaw, the TEP allowed NYISO to recalculate the LBMP or clearing price as it should have been but for the market design flaw, "[i]f possible with reasonable certainty."<sup>10</sup>

7. The Commission approved the TEP on September 14, 1999, and has since that date periodically reauthorized the TEP.<sup>11</sup>

### C. NYISO Filing to Address Market Abnormalities

8. NYISO began operation on November 18, 1999. This proceeding arose shortly thereafter, as a result of events that occurred between January 29, 2000 and late March 2000, when prices in the bid-based market for NSR rose dramatically. The NSR capacity in New York is owned by five entities, with KeySpan-Ravenswood (KeySpan), the Long Island Power Authority (LIPA), and NRG Power Marketing (NRG) together accounting for 97 percent of that capacity.<sup>12</sup> Prices spiked from averages of \$1.04 per megawatt hour (MWH) in December 1999 to an average of \$65.57 in February 2000, with a high of \$302 that month. Also at that time, the quantity of NSR that suppliers offered into the market decreased. Prior to January 29, 2000, an average of

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<sup>9</sup> TEP, NYISO Services Tariff, Attachment E, at section A.

<sup>10</sup> TEP, NYISO Services Tariff, Attachment E, at section C.2.c(2).

<sup>11</sup> *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,320 (2000).

<sup>12</sup> NYISO Request for Suspension of Market-Based Pricing for 10-Minute Reserve, March 27, 2000, at 5 (NYISO March 27 filing).

more than 1,400 megawatts (MW) was offered into the NSR market. On January 29 the quantity of 10 minute NSR being offered dropped below 900 MW, and remained below the prior average levels for February and March.<sup>13</sup>

9. On March 27, 2000, NYISO made a filing with the Commission in which it proposed to address this situation in two ways. NYISO first sought to make prospective changes to the market, including revising its tariff to require cost based bidding and a bid cap on NSR. Second, NYISO asked the Commission to implement a settlement process to bring together buyers and sellers of NSR in NYISO to reach a resolution as to whether the pricing for SR and NSR had been at proper levels.

10. Also with regard to this period of anomalous prices for NSR, parties including several LSEs filed complaints with the Commission.<sup>14</sup> *Inter alia*, the LSEs sought retroactive relief for the February-March period. They requested that the Commission require NYISO to invoke its TEP to provide for retroactive relief for increases in prices for operating reserves, and also requested that the Commission find NYISO violated its Services Tariff. The LSEs argued that NYISO's market design was flawed because it excluded suppliers on the western side of an east-west constraint, and the output of the Blenheim-Gilboa pumped storage facility, from bidding into the reserves market. The LSEs asserted that that NYISO should have addressed these market flaws by correcting prices under its TEP authority.

#### **D. The Commission's Orders**

##### **1. The May 31 Order**

11. In the Commission's May 31, 2000 order, the Commission prospectively granted the bid cap for NSR that NYISO sought, effective as of the date after NYISO's filing, stating that NYISO had successfully shown that market-determined rates for NSR were no longer appropriate, because "capacity that was previously offered to the market is no longer being offered and that the decline in supply offers correlate[d] with a dramatic increase in bid prices."<sup>15</sup> The Commission found that the problems in the NSR market

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<sup>13</sup> *Id.* at 6-7.

<sup>14</sup> The LSEs include New York State Electric & Gas Corporation (NYSEG), Niagara Mohawk Power Corp. (Niagara Mohawk), and Rochester Gas & Electric Company (Rochester Gas & Electric), supported by Consolidated Edison Company of New York, Inc. (Con Ed) and Orange and Rockland Utilities.

<sup>15</sup> May 31 Order at 61,799.

were largely the result of high levels of concentration in the market,<sup>16</sup> but were also, in part, the product of certain aspects of NYISO's design and operating protocols. It stated that NYISO's practice of procuring all of the SR and NSR it needed from generators located on the east side of an east-west constraint, even during periods when that interface was not constrained, on the basis that this was the past practice of the New York Power Pool, contributed to the price anomalies, and directed NYISO to develop procedures to maximize access to western suppliers of reserves.<sup>17</sup>

12. The Commission further stated that one reason for the rise in prices for NSR was NYISO's practice of allowing the highest bid for NSR to set the market clearing price for SR under certain circumstances. NYISO has a total 10-minute reserve requirement of 1,200 MW, of which at least 600 MW must be met by SR. The remaining 600 MW requirement may be met by either SR or NSR. As NYISO states:

[U]nder normal conditions 10-minute NSR prices would be expected generally to be somewhat lower than 10-minute SR prices. . . . On the other hand, if the price for 10-minute NSR is bid up above the normal pricing levels for 10-minute NSR, the price for 10-minute NSR should set the clearing price for both types of reserves. This is because spinning reserves are superior quality reserves by comparison to non-spinning reserves, and thus spinning reserves should not be valued at anything less than the value of NSR.<sup>18</sup>

13. The Commission noted in the May 31 Order that that this practice contributed to the rise of prices for SR as well as NSR.<sup>19</sup> The Commission stated that this method of establishing the price of SR was reasonable, although it considered NYISO's tariff insufficiently detailed as to this procedure. We stated:

Section 4.21 of the ISO Services Tariff states that suppliers of each category of operating reserves shall be paid the applicable market clearing price. Elsewhere, in Rate Schedule 4, the ISO Services Tariff states that the spinning reserve price is equal to the highest

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<sup>16</sup> *Id.* at 61,798-99.

<sup>17</sup> *Id.* at 61, 799-800.

<sup>18</sup> NYISO March 27 filing at 4-5.

<sup>19</sup> May 31 Order at 61,800.

accepted bid. The New York ISO's practice of setting the price of 10 minute spinning reserves no lower than the price of 10 minute non-spinning reserves is necessary for the spinning reserve price to clear the market. We agree with the New York ISO that if these items were priced separately . . . generators would not want to be in the spinning market; they would bid into the non-spinning market in order to receive the higher price, resulting in less spinning reserve supply.<sup>20</sup>

14. Finally, the Commission noted that another cause of the price spike was that, as NYISO had modeled its software, the Blenheim-Gilboa pumped storage facility, a 1,000-MW facility, could not offer SR and NSR. The Commission pointed out that "[i]f this unit were included, it could lower the market concentration levels . . . and add another large competitor to the market."<sup>21</sup>

15. Ultimately, however, the Commission denied any form of retroactive price relief. The Commission also denied the request by NYISO to initiate a settlement process for the purpose of determining the correct charges to be billed for the past period of January 29 to March 28 because "such changes should be prospective. Customers cannot effectively revisit their economic decisions in these circumstances -- there is no way for buyers and sellers to retroactively alter their conduct."<sup>22</sup>

## **2. The November 8 Order**

16. In the Commission's November 8 Order, the Commission denied requests for rehearing of the May 31 Order.

17. On rehearing, the LSEs argued that NYISO violated its Services Tariff by improperly excluding the Blenheim-Gilboa pumped storage facility from competing to supply 10-minute reserves. The Commission noted in response that it had found, in the May 31 Order, that Blenheim-Gilboa was not available to supply operating reserves due to NYISO's software flaws. It then stated:

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<sup>20</sup> *Id.* at 61,806.

<sup>21</sup> *Id.* at 61,800.

<sup>22</sup> *Id.* at 61,804.

The remedy chosen by the Commission was of a prospective nature. NYISO was directed to add the Blenheim-Gilboa pumped storage facility to its software for spinning and non-spinning reserves as quickly as possible [as has now happened] . . . . The question here is what is the fairest and most efficient way to ensure that the participants in the New York market receive the benefits of a well functioning competitive market. The Commission believes that the procedures it has chosen and the determinations it has made are best suited to accomplish these ends within the bounds of the Federal Power Act.<sup>23</sup>

18. The LSEs also asserted that NYISO violated its tariff by allowing the price for NSR to control the price for SR. In its rehearing order the Commission stressed the reasonableness of NYISO's practice in this regard, stating:

Section 4.21 of the NYISO's Services Tariff states that suppliers of each category of operating reserves shall be paid the applicable market clearing price. NYISO's bidding provision ensures that the SR price will clear the market. If the SR price were lower than the NSR price, generators would not want to be in the SR market; they would bid into the NSR in order to receive the higher price, resulting in less SR supply. . . .<sup>24</sup>

The Commission disagreed with the LSEs' argument that it was unlikely that the same types of generation could supply both SR and NSR, stating:

[G]eneration capacity that meets the requirements to provide SR (i.e., it is currently synchronized to the grid and is capable of providing the specified amount of energy within ten minutes) necessarily meets the requirements to provide NSR (i.e., it can be started, synchronized to the grid, and provide the specified amount of energy within ten minutes). Indeed, it is because SR capacity can meet the requirements to provide NSR that the Commission allowed

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<sup>23</sup> November 8 Order at 61,681.

<sup>24</sup> *Id.* at 61,679.

the ISO to substitute SR capacity for NSR capacity offered at a higher bid. Therefore, it is important that the price of SR at least matches the price of NSR, so that SR is not diverted to the NSR market.<sup>25</sup>

19. The LSE Intervenors also argued that the Commission improperly denied retroactive relief, and that the filed rate doctrine requires retroactive relief in instances of tariff violations. They also argued that NYISO was obligated to recalculate the anomalous prices for the period in question under its TEP authority, and that the Commission's approval of price recalculations in *NRG Power Marketing v. NYISO*<sup>26</sup> requires retroactive recalculation of prices here. The Commission ruled on rehearing that NYISO's TEP authority was not designed to be used in circumstances such as these, and that *NRG v. NYISO* is distinguishable, since it involved limited, simple, and precise corrections to ensure that prices conformed to the filed rate.

20. The Commission further stated that, given its finding of concentration as well as other market flaws in the operation of the NYISO markets, it would be very difficult for NYISO, or any party, to recalculate the correct market-based rates, and we therefore denied the requests for retroactive billing adjustments.<sup>27</sup> The Commission stated:

The Commission will not require NYISO to exercise its TEP authority retroactively in this case. The NYISO's TEP authority was not designed to be used in circumstances such as these. *NRG v. NYISO* is clearly distinguishable, since it involved limited, simple, and precise corrections to ensure that prices conformed to the filed rate. . . .

The Commission agrees that when a market is not functioning properly, the choices that customers have may be unnecessarily restricted. However, as a general matter, the best check on market power, and the best way to ensure a full array of economic choices, is to have adequate infrastructure, sound market rules, proper incentives, and continuous and effective monitoring of market structure and behavior and prompt prospective correction of detected flaws.<sup>28</sup>

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<sup>25</sup> *Id.* at 61,679-80.

<sup>26</sup> 91 FERC ¶ 61,346 (2000) (*NRG*).

<sup>27</sup> November 8 Order at 61,680.

<sup>28</sup> *Id.* at 61,682, footnotes omitted.

21. Finally, the Commission stated that "in the absence of a tariff violation, we cannot order the retroactive calculation of prices under the FPA."<sup>29</sup>

### **3. The April 29 Order**

22. In its April 29 Order, the Commission reiterated its decision not to allow retroactive rate relief.

#### **E. The Court's Ruling**

23. On review, the court upheld the Commission's ruling that pursuant to section 205 of the Federal Power Act, it could only grant rate relief prospectively, and that it was prevented from granting retroactive relief under the filed rate doctrine. The court then remanded the following issues to the Commission.

#### **1. Use of NYISO's TEP Authority**

24. The LSEs had argued that the Commission should have required NYISO to use its TEP authority to correct two market flaws: NYISO's exclusion of the Blenheim-Gilboa facility from bidding into the NYISO reserves market, and NYISO's refusal to accept bids from western suppliers into the reserves market.

25. The court found that the Commission had not supported its ruling that TEP applies only in "circumstances of straightforward calculation errors," noting that, when the Commission initially approved the TEP, it stated that it would "accept the ISO's proposal to recalculate prices to the level [they] would have [] reached in the absence of a market design flaw or transitional abnormality" and that "the recalculated prices are intended to reflect the prices that would have resulted from the market design [] already approved."<sup>30</sup>

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<sup>29</sup> *Id.*

<sup>30</sup> *ConEd* at 971, *citing* First TEP Order at 61,754.

The court noted that, in a subsequent TEP order, the Commission limited the procedures to the correction of "technical implementation errors and operational anomalies,"<sup>31</sup> but that the Commission had not explained what it meant by "technical implementation errors" or how such errors differed from "market design flaws."<sup>32</sup>

26. The court further stated that the Commission's argument distinguishing *NRG* (a case in which the Commission upheld NYISO's exercise of its TEP authority) from the instant situation, since the price anomalies in *NRG* "arose from software problems and NYISO's disregard of low-cost bids, resulting in posted prices that exceeded what properly established market-clearing prices would have been," was incorrect, and that here similarly, the Commission had found that certain aspects of NYISO's design and operating protocols exacerbated market concentration and the opportunity for the exercise of market power. Thus, the court stated, "we cannot accept FERC's claim that these two flaws fall outside the scope of a TEP-based remedy."<sup>33</sup> The court further stated that, even if *NRG* had only applied to erroneous calculations, this would not "preclude the application of TEP to problems beyond technical miscalculation."<sup>34</sup> The court found that, since the Commission pointed to only one case as precedent for limiting the scope of TEP to technical miscalculations, and given the broad language of TEP and the orders approving it, the Commission had not engaged in reasoned decision-making, and it remanded the case to the Commission to further explain why TEP was inapplicable to this case.<sup>35</sup>

## 2. Whether NYISO's Actions Violated its Tariff

27. The court found that the Commission had failed to explain why NYISO's actions had not violated its tariff, in two ways.

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<sup>31</sup> *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,320 at 62,066 (2000) (Second TEP Order).

<sup>32</sup> *ConEd* at 971.

<sup>33</sup> *Id.* at 972.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

**a. Treatment of the Pricing of SR and NSR**

28. In circumstances when the highest offer to provide NSR was higher than the highest offer to provide SR, as happened in the period in issue here, NYISO permitted the highest offer to provide NSR to be the clearing price for both NSR and SR. The LSEs claimed that this practice violated NYISO's Services Tariff by setting the price of SR interdependently with the price of NSR, whereas the LSEs alleged that the tariff required independent determination of the prices of SR and NSR. The LSEs argued that this practice aggravated the effect of anomalously high prices in the NSE markets, as NYISO's practice enabled NSR prices to drive SR prices up as well.

29. The Commission found that "the NYISO's method of establishing SR prices is consistent with its tariff and is reasonable" and that "[i]f the SR price were lower than the NSR price, generators would not want to be in the SR market; they would bid into the NSR in order to receive the higher price, resulting in less SR supply."<sup>36</sup> This, in turn, might prevent NYISO from ensuring that fifty percent of available reserves consisted of SR, as required by NYISO's tariff. Thus, the Commission considered NYISO's actions to be reasonable. The court disagreed, stating:

FERC's explanation might well be reasonable, but we agree with the LSEs that NYISO violated the Tariff's plain language. Rate Schedule 4 of the Services Tariff sets forth the rule for pricing SR: "The Day-Ahead Availability price for Spinning Reserve for each hour shall be equal to the highest Day-Ahead Availability Bid made by a Supplier that has been scheduled Day-Ahead to provide Spinning Reserve in that hour" . . . . The Rate Schedule repeats the same instruction for pricing Day-Ahead Availability NSR, . . . and gives similar instructions for the Real-Time Availability prices for SR and NSR. . . Moreover, Section 4.21 of the Tariff states that payments for each megawatt "shall be determined separately for each of the three categories of Operating Reserves: spinning reserve, 10-minute non-[spinning] reserve and 30-minute reserve."<sup>37</sup>

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<sup>36</sup> November 8 Order at 61,679.

<sup>37</sup> *ConEd* at 973, citations omitted.

30. The court then stated:

We see nothing ambiguous about this language. It requires NYISO to price SR and NSR separately. If NYISO believed it needed to modify its practice to ensure adequate supplies of SR, it should have sought permission from FERC.<sup>38</sup>

31. Therefore, the court remanded the case for further proceedings so that the Commission could either provide refunds, or else explain why refunds would not be appropriate.

**b. Treatment of the Blenheim-Gilboa Plant**

32. The court also held that the Commission had not adequately explained why NYISO's failure to obtain operating reserves from Blenheim-Gilboa did not violate tariff provisions. The LSEs claimed that NYISO violated its Services Tariff by excluding the Blenheim-Gilboa facility from the NSR market, arguing that NYISO had no basis for this exclusion, because Blenheim-Gilboa is a pumped storage hydro plant that satisfies NYISO's criteria for supplying operating reserves. As the court noted, the Commission agreed that inclusion of Blenheim-Gilboa in the operating reserves market would significantly reduce market concentration, and sought to correct this error by requiring NYISO to model Blenheim-Gilboa into its software and to accept the facility's reserve bids. The court took issue, however, with the Commission's response to the LSEs' claim that the exclusion of Blenheim-Gilboa amounted to a tariff violation requiring a refund, as to which the Commission stated:

The question here is what is the fairest and most efficient way to ensure that the participants in the New York market receive the benefits of a well functioning competitive market. The Commission believes that the procedures it has chosen and the determinations it has made are best suited to accomplish these ends within the bounds of the Federal Power Act.<sup>39</sup>

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<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 974, *citing* First Rehearing Order at 61,681.

33. The court found that the Commission's ruling here failed to address the LSEs' claim that NYISO violated its tariff, and also did not address the question of refunds, and remanded to the Commission for further explanation, both as to whether NYISO violated its tariff in its treatment of Blenheim-Gilboa and as to whether refunds would be appropriate:

Given FERC's findings that the market analysis underlying approval of market-based rates anticipated the inclusion of Blenheim-Gilboa, that NYISO had no reason to exclude the facility, and that accepting bids from Blenheim-Gilboa would have dramatically lowered market concentration, we will remand to FERC to explain why NYISO did not violate the Services Tariff. If the Commission finds a tariff violation but decides against ordering a refund, then, again, it has an obligation to explain why it is departing from its "general policy of granting full refunds."<sup>40</sup>

**F. Post-Remand Filings**

34. On June 25, 2004, NYISO filed a motion to reopen the record in this proceeding for the limited purpose of submission of additional evidence to resolve the issues remanded to the Commission from the court. The Long Island Power Authority and its subsidiary, LIPA filed a motion to extend the filing date to respond to NYISO's motion.<sup>41</sup>

35. On July 16, 2004, LIPA, Keyspan, Orion Power, NRG, and the Transmission Owners,<sup>42</sup> filed answers to the NYISO motion. The Indeck Companies<sup>43</sup> filed a motion to intervene and answer the NYISO motion. On August 2, 2004, NYISO filed an answer to the answers of LIPA, Keyspan, NRG, Orion, Indeck Companies, and the Transmission Owners. On August 2, 2004 the Transmission Owners filed an answer to the answers of LIPA, Keyspan, NRG, Orion, and Indeck Companies.

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<sup>40</sup> *ConEd* at 974, citation omitted.

<sup>41</sup> The extension was granted with a new filing deadline of July 16, 2004.

<sup>42</sup> The Transmission Owners are Consolidated Edison Company of New York, Inc., Orange and Rockland Utilities, Inc., New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation, and Niagara Mohawk Power Corporation.

<sup>43</sup> The Indeck Companies include Indeck Energy Services, Inc., Indeck-Olean, L.P., Indeck Oswego, L.P. and Indeck-Yerkes, L.P.

36. On August 17, 2004 Keyspan and NRG filed motions in opposition to the answers of NYISO and the Transmission Owners. On August 2, 2004 Mirant filed a motion to intervene and comments and on August 18, 2004 NYISO filed an answer to the Mirant motion. On August 25, 2004, Mirant filed an answer to NYISO's answer.

37. In its motion to reopen the record, in consideration of the TEP and tariff violation issues remanded by the court, NYISO proposes a methodology for calculating refunds. NYISO agrees with the court that its TEP authority is broader than the scope adopted by the Commission in the orders under review, and states that a refund for the exclusion of Blenheim-Gilboa would be appropriate, since it believes that the problems arising from the exclusion of Blenheim-Gilboa could be characterized as resulting from a market design flaw.<sup>44</sup> NYISO suggests that any refund determination attributed to a tariff violation for the exclusion for Blenheim-Gilboa be determined according to the same approach it proposes for the TEP refund.<sup>45</sup> However, NYISO does not find the exclusion of reserves from western suppliers to be a market design flaw.<sup>46</sup> NYISO suggests that, if the Commission determines that it violated its tariff by excluding Blenheim-Gilboa, any refund determination attributed to that tariff violation be determined according to the same approach used in the TEP refund calculation, but states that a refund for the tariff violation would be duplicative.<sup>47</sup>

38. In response to NYISO's motion to reopen the record, LIPA states that NYISO's motion to reopen the record and establish refund obligations is premature since the Commission has not yet addressed the legal questions remanded by the court regarding the applicability of TEP, NYISO's violation of its tariff by not pricing SR and NSR separately, and NYISO's treatment of the Blenheim-Gilboa Facility. LIPA states that there are numerous reasons why TEP is not applicable, including the fact that NYISO never invoked the TEP. LIPA states that sellers into the reserves market should not bear a refund obligation for NYISO's violation of its own tariff. LIPA also states that the

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<sup>44</sup> NYISO motion to reopen at 7.

<sup>45</sup> *Id.* at 9.

<sup>46</sup> *Id.* at 12.

<sup>47</sup> *Id.* at 9.

refund methodologies proposed by NYISO are flawed and the Commission should reject them, and requests that the Commission establish procedures allowing parties to submit meaningful positions and evidence. Likewise, NRG states that the refund methodology is flawed and that the court has not determined that exclusion of Blenheim-Gilboa was a market design flaw.

39. In Keyspan's response to NYISO's motion to reopen the record, it states that the exclusion of western suppliers from NYISO's reserves market was not a market design flaw. Keyspan further states that the Blenheim-Gilboa facility was not in the reserves markets due to decisions by the parties who had contracted to purchase the facility's output and chose to self-schedule the facility for energy rather than permitting it to make offers into the reserves markets, and TEP cannot be used to correct such decisions. Keyspan maintains that the results were consistent with the tariff, market rules, and decisions of market participants. Keyspan also states that the exclusion of Blenheim-Gilboa was not a tariff violation and that the claim that the tariff required the facility to be used as reserves is untrue:

The tariff, by reference to New York reliability rules, merely specifies the types of facilities that may provide NSR if a market participant offers them and they meet NYISO reliability requirements as well as other procedural requirements (emphasis in original). Here, the parties to the [Blenheim-Gilboa] contracts evidently requested the facility be scheduled to supply energy, which did not permit use of the facility for NSR. Therefore, [Blenheim-Gilboa] was treated exactly as the market participants had requested, all in conformance with the NYISO's tariff (footnote omitted).<sup>48</sup>

40. Regarding arguments that NYISO violated its tariff, Keyspan states that NYISO's tariff calls for NYISO to dispatch its system to achieve the least cost overall mixture of resources (energy and ancillary services), and NYISO concluded that this least cost dispatch could best be accomplished by reserving the west-east transmission for energy rather than reserves. Keyspan also states that NYISO's policy of pricing SR at the higher of the market clearing prices for SR or NSR was a reasonable measure to ensure system reliability, and that the Commission should exercise its discretion to not order refunds.<sup>49</sup>

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<sup>48</sup> Keyspan answer to NYISO's motion to reopen at 26-27.

<sup>49</sup> See Keyspan answer to NYISO's motion to reopen at 22-23.

41. Orion argues that exclusion of Blenheim-Gilboa was neither a market design flaw nor a tariff violation. Orion states that it even if there are found to be tariff violations, the Commission should exercise its discretion and deny or limit refunds because of the inaccuracy of NYISO's assumptions and the consequences of such assumptions on the rest of the New York market. Keyspan, NRG, and Orion each argue that TEP procedures were not followed and the remedy sought is inconsistent with TEP.

42. While the Transmission Owners support establishing refunds, they disagree with NYISO's refund calculation. They also argue that failure to include western suppliers was a market design flaw. Indeck requests that all interested parties be allowed to intervene in this proceeding and fully participate.

43. In its answer, NYISO states that the Commission has already found that exclusion of Blenheim-Gilboa was a market design flaw and affirms its refund methodology.

### **PROCEDURAL MATTERS**

44. We will grant NYISO's motion to reopen the record. The Commission may reopen the record in its discretion where there is good cause.<sup>50</sup> We will allow NYISO's filing for the limited purpose of responding to PSEG's argument that there was no market design flaw.

45. With regard to Indeck's and Mirant's motions for late intervention, Indeck's predecessor in interest Indeck Energy Services previously intervened in Docket No. EL00-57, and Mirant alleges that its predecessors in interest previously intervened in this proceeding in timely fashion.<sup>51</sup> Thus, Indeck and Mirant already have party status, and their current motions for intervention are therefore moot.

46. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a protest or to an answer unless otherwise ordered by the decisional authority. We will accept the answers of NYISO, LIPA, Orion, Keyspan, NRG and the Transmission Owners because they have provided information that has assisted us in our decision-making process.

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<sup>50</sup> 18 C.F.R. § 385.716 (2004).

<sup>51</sup> Mirant states that the predecessors to Mirant Bowline, Mirant Lovett, and Mirant NY-Gen, LLC timely intervened in this proceeding. Likewise, Indeck Energy Services intervened in the original proceeding.

## **DISCUSSION**

47. The Commission finds that NYISO did not abuse its discretion by refraining from exercising its TEP authority to recalculate prices. We also find that refunds should not be granted for NYISO's actions permitting interdependent determination of the prices of spinning and non-spinning reserves. Additionally, we find that NYISO did not violate its tariff by permitting the modeling of the Blenheim-Gilboa plant so that the output of that plant could not be offered into the reserves markets.

### **A. NYISO Did Not Abuse Its Discretion By Refraining from Exercising Its TEP Authority to Recalculate Prices**

48. In its remand, the court stated that the Commission's explanation for not invoking TEP suffers from two defects. First, when the Commission initially approved this part of TEP, it did not impose the limitation that TEP only applies in circumstances of straightforward calculation errors. Rather, in the order approving TEP, the Commission stated "[W]e will accept the ISO's proposal to recalculate prices to the level they would reach in the absence of a market design flaw or transitional abnormality."<sup>52</sup> The court stated that the Commission had not defined how such errors differ from market design flaws, which was the language accepted in the TEP provisions. Second, the court disagrees with the Commission's use of *NRG* as precedent for limiting the scope of TEP to technical miscalculations, as it considers *NRG* to be highly similar to this case.<sup>53</sup> The court states the Commission's conclusion that TEP is inapplicable to the circumstances of this case does not meet its obligation for reasoned decision making and therefore remands to the Commission to explain why TEP does not apply in this case.

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<sup>52</sup> *New York Independent System Operator, Inc.*, 88 FERC ¶ 61,228 at 61,754 (1999) (TEP Order).

<sup>53</sup> In *NRG*, the Commission found that NYISO had the authority to invoke TEP to recalculate prices to correct distortions caused by flaws in NYISO's dispatching software.

49. Upon further review of this matter, we agree that we did not initially accept TEP under the condition that it would only apply to certain technical miscalculations.<sup>54</sup> We find, however, that under the circumstances here, we cannot find that NYISO so abused its discretion in deciding not to exercise its TEP authority that we will retroactively find that TEP is invoked.

50. TEP, as drafted at this time, could conceivably apply to the situation involved here in which Blenheim-Gilboa facility was not dispatched. TEP identified a market design flaw to include "the dispatch of higher priced resources in the market when resources with lower-priced bids are available and not selected to operate, and there is no valid reason for not operating the lower-priced resource."<sup>55</sup> TEP, however, was drafted to enable NYISO to exercise its judgment as to whether and when TEP should be applied. NYISO's tariff provision on TEP states, for instance,

If the ISO determines that a Market Design Flaw or Transitional Abnormality exists, the ISO *may* take Extraordinary Corrective Action to correct a Market Design Flaw or to address a Transitional Abnormality. . . . Extraordinary Corrective Actions are to be effective and applied on an interim basis only, and are to be imposed only during the time needed to address a Transitional Abnormality or to develop a long-term solution to a Market Design Flaw on a non-emergency basis.<sup>56</sup>

51. The language of TEP provides NYISO with discretion as to when, or whether, it may take ECAs. First, it gives NYISO authority to determine when a market design flaw or transitional abnormality has occurred.<sup>57</sup> For example, TEP can be invoked whenever "one or more LBMPs would reach levels *substantially unrelated* to prices that would be

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<sup>54</sup> In fact, in the March 29 Order, *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,320 (2000), we accepted an extension of TEP noting that NYISO could use TEP to recalculate prices in the event of a market design flaw or transitional abnormality.

<sup>55</sup> TEP, NYISO Services Tariff, Attachment E, at section A.

<sup>56</sup> NYISO's Services Tariff, Attachment E, section C, emphasis added.

<sup>57</sup> NYISO's Services Tariff, Attachment E, Introduction ("The ISO staff . . . shall monitor for possible market structure, market design or implementation flaws, as defined below, in the ISO Administered Markets. If such flaws are identified, the ISO may impose corrective measures").

derived absent an identified Market Design Flaw" (emphasis added). NYISO then determines whether a change is substantial enough to invoke TEP. As noted above, the TEP states that NYISO "may" take Extraordinary Corrective Actions, not that it is required to do so. NYISO also has discretion as to what measures to take: it may request market participants to submit bids that will provide greater operating flexibility for products as to which NYISO anticipates a shortage, recalculate LBMPs, or "institute such alternative procedures as it deems appropriate under the circumstances, until the ISO is able to implement workable LBMP or other markets."<sup>58</sup>

52. Further, TEP makes clear that ECAs taken under NYISO's TEP authority are permissible only until NYISO can change its regular procedures, stating that "[d]uring the time that an Extraordinary Correction Action is in effect, the ISO, Market Participants and other interested parties shall cooperate to develop a new or modified ISO Procedure or other remedial measure, if needed, before the termination of the Extraordinary Correction Action."<sup>59</sup> Thus, NYISO should exercise its TEP discretion primarily to prevent immediately imminent harm, and that it should change NYISO's regular procedures to address longer-term problems.

53. NYISO itself has recognized that it would be unreasonable to require that TEP be applied in every instance in which it submits a section 205 tariff filing to correct a market design flaw:

Changes and improvements in market design do not mean that previously the market did not operate as designed; that illogical conclusion would require any market improvement to carry with it a requirement of an ECA and price redeterminations for all prior implementations of the market. The TEP were clearly never intended to impose such an absurd result.<sup>60</sup>

TEP, as its name implies, is reserved only for "Extraordinary" Corrective Actions.<sup>61</sup>

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<sup>58</sup> NYISO's Services Tariff, Attachment E, section C.2.c.

<sup>59</sup> *Id.*, section D.3.

<sup>60</sup> Motion of NYISO to Reopen Record, June 25, 2004, at 12.

<sup>61</sup> In our March 29, 2000 Order granting NYISO's request to extend TEP, we recognized NYISO's commitment to not overzealously invoke TEP. We stated that NYISO "commits to only taking an ECA if the problem cannot be addressed through

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54. In this case, NYISO at the time did not determine that the failure to include the Western generators or the Blenheim-Gilboa facility were sufficient to invoke TEP. Given the wording of TEP, we give this determination considerable weight. Moreover, we need to be cognizant that TEP itself contains various notice and other protections for market participants that would be absent if we required NYISO to invoke TEP retroactively.

55. We, therefore, find that we should reverse NYISO's determination not to invoke TEP only if we can conclude that NYISO's decision constituted an abuse of the discretion that TEP granted it. Upon review of these provisions, and of the sequence of events in the first quarter of 2000, the Commission concludes that NYISO did not abuse its discretion by not seeking to recalculate prices pursuant to its TEP authority. When NYISO discovered the pricing anomalies in the operating reserves markets, it chose not to use its TEP because it did not view the problems found in the reserves markets as the result of market design flaws. Rather, NYISO attributed those problems to high concentration levels and related bidding behavior.<sup>62</sup> While NYISO recognized that the market design might be flawed, it found that correction of those design flaws would not address the problem, stating that "although certain flaws in NYISO's market design have become apparent, eliminating these flaws alone would not restore the 10-minute reserve markets to a workably competitive state, and cannot change the past performance of the operating reserves markets."<sup>63</sup>

56. Thus, we find that NYISO made a reasonable determination that the problems in its market were primarily due to market power, not market design flaws, and that invocation of TEP was not the best and most efficient procedure to remedy such flaws. The Commission cannot find that this decision was an abuse of the discretion allowed by the tariff.

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revised ISO operations that do not require changes in ISO procedures and if the corrective measures are required immediately and must take effect before the New York ISO can begin or complete consultation with market participants and jurisdictional agencies to develop appropriate rule changes." We also stated that NYISO "cites its performance as evidence that it will not abuse its authority to undertake ECA." *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,320 at 62,065-66 (2000).

<sup>62</sup> As noted above, three entities control 97 percent of NSR in New York.

<sup>63</sup> NYISO answer to RG&E complaint, April 20, 2000, at 4.

57. Moreover, we cannot find that the exclusion of the western suppliers from bidding into reserves, and the exclusion of the Blenheim-Gilboa unit from bidding into reserves are market design flaws or, if they are, that it was an abuse of discretion for NYISO not to invoke TEP to recalculate prices. The TEP states that "possible indications of Market Design Flaws include the dispatch of higher priced resources in the market when resources with lower-priced bids are available and not selected to operate, *and there is no valid reason for not operating the lower-priced resource.*"<sup>64</sup> This is not the case here.

58. With respect to the western generators, NYISO points out that, due to serious transmission constraints that apply approximately 80 percent of the time, these generators cannot be considered as reliable reserves for the Eastern portion of its system. Given these constraints, NYISO made a reasonable determination to use this limited transmission capability for supplying energy (a higher valued product), rather than reserves. We cannot conclude that this was an abuse of discretion or did not constitute a "valid reason for not operating the lower-priced resource" as a reserve. Moreover, given these physical constraints, even if NYISO had permitted the western generators to submit bids in the reserve market, those bids would only take place in the limited circumstances in which the transmission capacity allowed. There is no evidence before us as to whether a correction of the so-called market design flaw for those instances in which the western generators could have provided reserves would have affected prices in the circumstances of this case. Further, TEP provides that price recalculation can be used to correct a market design flaw only when the prices can be recalculated with "reasonable certainty."<sup>65</sup> There is no evidence as to how prices could be recalculated to include these generators with the "reasonable certainty" required by the TEP tariff.

59. That leaves only one additional source of potential reserves – the Blenheim-Gilboa facility. Again, NYISO's decision not to invoke TEP here is not an abuse of its discretion. In the first place, NYISO's failure to model this facility for NSR reserves was reasonable, since, as NYISO points out, it was only reflecting the owners' choice to use the plant's output for energy rather than for reserves.<sup>66</sup> Again, this is a "valid reason for

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<sup>64</sup> TEP, NYISO Services Tariff, Attachment E, at section A, emphasis added.

<sup>65</sup> "To the extent Extraordinary Corrective Action is necessary, the ISO shall . . . *[i]f possible with reasonable certainty*, recalculate [Location Based Marginal Prices] or other clearing prices as they should have been but for a Transitional Market Abnormality or Market Design Flaw," NYISO's Services Tariff, Attachment E, section C.2.c, emphasis added.

<sup>66</sup> *Id.* at 4.

not operating the lower-priced resource." While NYISO, since the events of February and March 2000, has provided that Blenheim-Gilboa should be eligible to provide NSR, that subsequent revision does not necessarily mean NYISO abused its discretion in deciding not to invoke TEP. As NYISO itself points out, to interpret TEP in such a way that it must be invoked every time NYISO files to change a market design would produce an "absurd" result.<sup>67</sup> The change in market design here was as much to alleviate the market power problem by adding a competitor than it was because its prior market design was inherently flawed.

60. Further, even if NYISO could have invoked TEP to immediately correct the exclusion of Blenheim-Gilboa, that does not mean that price recalculation would be appropriate. There is no evidence to suggest that the effect of including Blenheim-Gilboa in the market can be predicted with the required "reasonable certainty." Blenheim-Gilboa did not bid in the NSR market at the time, and there is no evidence as to what its bid would have been or what factors would have influenced its bid. There is no evidence that the inclusion of one additional bidder into the market would necessarily have had any significant effect on prices in that market or that such an effect can be determined with "reasonable certainty." At this early stage in NYISO's operation, the NSR market had not yet begun to function competitively and NYISO would have had no clear basis on which to recalculate, with reasonable certainty, what the prices for NSR would have been with the inclusion of Blenheim-Gilboa.

61. In its post-remand filing, NYISO did attempt to create proxy prices for Blenheim-Gilboa for the purposes of calculating refunds. But this filing uses future prices, not contemporaneous prices, to try to create a proxy for what the Blenheim-Gilboa price would have been. Such *ex post* calculations do not satisfy the TEP standard, which

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<sup>67</sup> Just as evidence of future repairs is not deemed evidence of negligence (Fed. R. Evid. 407), NYISO's proposed change in market design does not establish that its past market design was so flawed as to justify the imposition of TEP. As Baron Bramwell put it, the rule rejects the notion that "because the world gets wiser as it gets older, therefore it was foolish before." *Hart v. Lancashire & Yorkshire Ry. Co.*, 21 L.T.R. N.S. 261, 263 (1869).

required that the prices can be recalculated with reasonable certainty at the time the TEP is invoked.<sup>68</sup> In any event, numerous other parties raise significant objections to the ex post methodology NYISO used to create the proxy prices, so that such recalculations can hardly be considered reasonably certain. Thus, the Commission cannot find that recalculation of prices meet the TEP standards in the NYISO tariff.

**B. Interdependent Determination of the Prices of Spinning and Non-Spinning Reserves**

62. The issue raised with respect to the prices of spinning and non-spinning reserves is whether NYISO had correctly followed its tariff in setting the price of spinning reserves no lower than the price of non-spinning reserves. In its prior orders, the Commission had simply found this practice reasonable, without examining the NYISO tariff. The court reversed the Commission's determination, finding that "FERC's explanation might well be reasonable, but we agree with the LSEs that NYISO violated the Tariff's plain language." The court cited to particular provisions of the NYISO's tariff in finding that spinning and non-spinning reserves should be "determined separately":

Rate Schedule 4 of the Services Tariff sets forth the rule for pricing SR: "The Day-Ahead Availability price for Spinning Reserve for each hour shall be equal to the highest Day-Ahead Availability Bid made by a Supplier that has been scheduled Day-Ahead to provide Spinning Reserve in that hour" . . . . The Rate Schedule repeats the same instruction for pricing Day-Ahead Availability NSR, . . . and gives similar instructions for the Real-Time Availability prices for SR and NSR. . . Moreover, Section 4.21 of the Tariff states that

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<sup>68</sup> In its motion to reopen the record, NYISO asserts \$92 million would be due in refunds. But multiple parties have responded in disagreement with that figure. Orion Power states that it is not possible to re-create the 10 minute reserve markets with the accuracy necessary to establish just and reasonable rates, and NYISO's recalculation is over \$6 million higher than the alleged harm to LSEs described in NYISO's request. LIPA also disagrees with NYISO's calculation, stating that NYISO relies on faulty assumptions, does not include analysis such as whether NSR would have always been available at prices below SR, and also does not include the impact on other product markets if the Blenheim-Gilboa facility were removed from energy markets in order to provide operating reserves. LIPA also suggests that NYISO's methodology may undercompensate generators by failing to take into account lost opportunity costs in the energy market. NRG, the Transmission Owners and Keyspan also raise issues with NYISO's methodology.

payments for each megawatt "shall be determined separately for each of the three categories of Operating Reserves: spinning reserve, 10-minute non-[spinning] reserve and 30-minute reserve."<sup>69]</sup>

The court then stated that it saw "nothing ambiguous about this language," and that the tariff clearly required NYISO to price SR and NSR separately, which NYISO had not done.

63. The court, however, recognized that even if NYISO violated its tariff, the Commission could use its discretion to not order refunds. As courts have noted many times, "the breadth of agency discretion is . . . at [its] zenith when the action assailed relates primarily not to the issue of ascertaining whether conduct violates the statute, or regulations, but rather to the fashioning of . . . remedies."<sup>70</sup> Additionally, "the Commission ordinarily has remedial discretion, even in the face of an undoubted statutory violation, unless the statute itself mandates a particular remedy."<sup>71</sup>

64. While the Commission's general policy is to provide refunds for a violation of the filed rate doctrine, we have found that refunds are not appropriate in certain circumstances. In determining whether to order refunds, the Commission must balance equity considerations and determine what is just and reasonable, and also determine whether an alternate remedy is more appropriate. In *Towns of Concord*, the court stated that "customer refunds are a form of equitable relief, akin to restitution, and the general rule is that agencies should order restitution only when money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it."<sup>72</sup> In *Louisiana Public Service Commission*, the court stated that a

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<sup>69</sup> *ConEd* at 973, citations omitted.

<sup>70</sup> *Connecticut Valley Electric Co. v. FERC*, 208 F.3d 1037, 1043 (D.C. Cir. 2000) (*Connecticut Valley*), citing *Niagara Mohawk Serv. Corp. v. FPC*, 126 U.S. App. D.C. 376, 379 F.2d 153, 159 (D.C. Cir. 1967); *Louisiana Public Service Commission v. FERC*, 174 F.3d 218, 225 (D.C. Cir. 1999) (*Louisiana Public Service Commission*).

<sup>71</sup> *Connecticut Valley* at 1043, citing *Towns of Concord, Norwood, & Wellesley v. FERC*, 955 F.2d 67, 72-73, 76 n.8 (D.C. Cir. 1992) (*Towns of Concord*).

<sup>72</sup> *Towns of Concord* at 75.

refund is not appropriate if the end result of a tariff violation is not "unjust, unreasonable, or unduly discriminatory."<sup>73</sup> In *Koch Gateway Pipeline Co. v. FERC*,<sup>74</sup> the court affirmed the Commission's interpretation that Koch had violated an ambiguous tariff provision, but reversed the Commission's ordering of refunds for the violation. The court concluded that "Koch's actions, even if technically violative of its tariff, did not truly implicate the [filed rate] doctrine's concerns,"<sup>75</sup> because the refund order was improper because Koch had not gain a windfall from the violation, and because a refund order would have run counter to the Commission's policy established in Order No. 636.

65. Here, NYISO's policy did not provide an improper windfall, because it was the proper and appropriate pricing method that provided efficient prices for the least cost dispatch. NYISO uses a security-constrained, bid-based, least-cost dispatch that maximizes net benefits for all market participants. In those cases where a non-spinning reserve bid is higher than a spinning reserve bid, least-cost dispatch would require that the higher-valued, lower-bid spinning reserve be substituted for non-spinning reserves and set the market clearing price for both spinning and non-spinning reserves. Efficient pricing requires that suppliers receive the highest market value for their resources, independent of their bids.<sup>76</sup> This gives all sellers the proper incentive to offer their

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<sup>73</sup> *Louisiana Public Service Commission v. FERC*, 174 F.3d 218, 223 (D.C. Cir. 1999) (court upheld Commission's discretion not to order refunds for a tariff violation in a case in which "the Commission thought it inequitable to order a refund when the predicate tariff violation had conferred benefits on the system"); *See also Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249, 1253 (5th Cir. 1986) (Commission does not have authority to impose a penalty, but can provide a remedy that is designed to prevent unjust enrichment).

<sup>74</sup> 136 F.3d 810 (D.C. Cir. 1998).

<sup>75</sup> *Id.* at 817.

<sup>76</sup> For example, NYISO pays generators the market clearing price (rather than their as-bid price), because, under this model, the generator has the proper incentive to bid the lowest price that covers its marginal cost, knowing that if the market produces a higher price it will receive the market price. If generators were paid only the price they bid, they would then try to guess at the market clearing price or else they would never receive more than their bid. *See Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Service*, EL00-95-012, at 18 (March 2001) (need to take into account incentives in designing proper payment schemes). As staff explained, "these arguments [for as bid pricing] generally ignore the fact that the

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resources at the marginal cost of their highest valued use, in this case spinning reserves. Generators able to provide spinning reserves should bid their marginal cost for providing spinning reserves without having to guess whether they could receive a higher price by instead bidding non-spinning reserves. Consistent with efficient pricing, NYISO's payment actions assured suppliers of spinning reserves that they would receive the highest market value for their product if they offered their product competitively into the more valued reserve market. Paying a lower price for spinning reserves than for non-spinning reserves would not provide the highest market value to suppliers of spinning reserves and would be inconsistent with a competitive market result.

66. Pricing that ignores cost saving substitution among reserve products and incentives that result when suppliers are not paid the highest market value for their product do not serve consumer's short-run or long-run interests. If a generator (capable of producing spinning reserves) thinks that on a particular day non-spinning reserve prices may be higher than spinning reserves, it may submit a bid in the non-spinning, lower quality, reserve market, in order to receive a potentially higher price. Such bidding behavior could unnecessarily compromise the reliability of the system by artificially decreasing the availability of spinning reserves.

67. An example shows why this is the correct method for pricing reserves. Assume that NYISO needs 1,200 MW of overall reserve, 600 MW of which must be spinning reserves and the following are the bids received:

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incentives and optimal bidding strategies under the two approaches are entirely different. Clearly, if suppliers know that they are going to receive only what they bid, they will attempt to bid the market clearing price, a practice that introduces additional risks into the market." *See also* Blue Ribbon Panel Report, "Pricing in the California Power Exchange Electricity Market: Should California Switch from Uniform Pricing to Pay-as-Bid Pricing?," Alfred E. Kahn, *et al.*, <http://www.cramton.umd.edu/papers2000-2004/kahn-cramton-porter-tabors-blue-ribbon-panel-report-to-calpx.pdf>.

Generator	Spinning Reserve Bids		Non-Spinning Reserves	
	MW	\$/MW	MW	\$/MW
1	200	\$6		
2	200	\$6.50		
3	200	\$7.00		
4	200	\$7.50		
5	200		200	\$5.00
6	200		200	\$8.00
7	200		200	\$8.50

68. In this example, if the two reserve markets were calculated independently, the Spinning Reserve price would be \$7.00 and the Non-Spinning Reserve Price would be \$8.50. However, such a pricing method would be inefficient, since the \$7.50 spinning is less expensive than the \$8 and \$8.50 non-spinning reserve bids and should be dispatched in place of the \$8.50 unit. Moreover, if the two reserve markets were priced independently, spinning reserve bidders would now have the incentive to guess which reserve price would be higher, and could very well decide to submit bids in the non-spinning reserve market, leaving the NYISO short of higher quality spinning reserves.<sup>77</sup>

69. This approach to pricing provides, in the long run, the lowest costs to customers and the correct market incentives to generators to bid into the appropriate reserve market. Indeed, well prior to the events taking place here, the Commission in *Central Hudson* had directed NYISO to make sure that lower priced, higher quality reserves were used in

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<sup>77</sup> It must be recognized that least cost dispatch is a system that on an overall prospective basis provides for the lowest cost, most efficient dispatch. It does not mean that on a retroactive basis, it will always produce the lowest price if such prices are recomputed based on historic bids. Thus, while the overall cost to customers might, in some cases, appear lower if the NYISO recomputed prices on a retroactive basis by separating the spinning and non-spinning reserve markets, this would not be consistent with least cost dispatch, because, in the long term, it would create the improper incentive for generators to guess which market, spinning or non-spinning reserves, would produce the highest price, rather than submitting their marginal cost bid into the market they can serve.

place of higher priced, lower quality reserves to ensure that its pricing model would produce the most efficient allocation of prices.<sup>78</sup> In line with this decision, NYISO's tariff at section 4.9 requires the NYISO to:

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

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<sup>78</sup> *Central Hudson Gas & Electric Corp.*, 86 FERC ¶ 61,062 at 61,227 (1999) (*Central Hudson*):

[I]n light of the experience in California, we will require that the tariff be modified to permit the ISO to procure more of a "higher quality" category of reserves and procure correspondingly less of a "lower quality" category of reserves when to do so would lower total cost. This procurement method is also known as cascading. For example, the ISO could procure more 10-minute spinning reserves (a higher quality reserve) and less 30-minute non-spinning reserves (a lower quality reserve) in the same location without reducing reliability and it should be allowed to do so if this is the cheaper alternative.

*See also ISO New England, Inc.*, 89 FERC ¶ 61,209 at 61,641 (1999). The Commission made clear that ISOs should take affirmative steps to ensure that prices in reserve markets cascade in this fashion:

Currently, the operating reserves markets clear sequentially with no cascading. This is a market imperfection that prevents the ISO from purchasing operating reserves at the lowest reasonable cost [because the ISO cannot substitute lower cost, but higher quality reserves, for higher cost, but lower quality reserves, p 61,641 n. 13]. The ISO intends to develop new software to permit it to cascade bids. This software should eliminate or substantially reduce price inversions when there are no capacity deficiencies or emergencies.

70. The Commission therefore finds, in balancing the equities, that refunds should not be paid in this case for failing to adhere to the tariff provisions requiring that the reserves be priced independently. First, the tariff provisions regarding pricing are inconsistent, since section 4.9 requiring least cost dispatch is at odds with the requirement for independent pricing. The customers, therefore, had notice from the *Central Hudson* decision, as well as the NYISO's tariff, that the least cost pricing methodology could be employed, despite the language in other sections of the tariff suggesting that reserve prices should be determined independently. Second, the NYISO's method for pricing reserves is the correct approach to pricing that produces the most efficient, least cost method of procuring reserves, without creating perverse incentives for generators who are capable of providing spinning reserves to bid their output into the NSR market rather than the SR market. The payments to the generators were, therefore, the proper payment of the market clearing price under the NYISO least cost dispatch model, and would not constitute unjust enrichment for which refunds are appropriate. To paraphrase the court's conclusion in *Koch*, the NYISO's actions "even if technically violative of its tariff, did not truly implicate the [filed rate] doctrine's concerns, because no generator obtained a "windfall from the violation," and because a refund would have run counter to the Commission's goals of establishing an efficient market mechanism for generator dispatch.

**C. NYISO Did Not Violate Its Tariff By Permitting Parties to Contract for the Blenheim-Gilboa Plant's Output So As to Make that Plant Unavailable to Provide Reserves.**

71. The court directed the Commission to address the LSEs' argument that NYISO violated its tariff by not including the Blenheim-Gilboa facility in the NSR market. The court noted that Rate Schedule 4 of NYISO's tariff incorporates New York State Reliability Rules, which allow NSR to be composed of units generated by pumped storage hydro facilities. The LSEs argued that the Blenheim-Gilboa facility is a pumped storage hydro plant that satisfies the criteria for supplying operating reserves and thus, NYISO had no basis under its tariff for excluding the Blenheim-Gilboa facility. The court remanded to the Commission the issue of whether the exclusion of the Blenheim-Gilboa facility was a tariff violation.

72. The effective tariff as of September 1, 1999 stated that "[t]he ISO shall provide procedures to establish adequate operating reserves that comply with the Reliability Rules,"<sup>79</sup> including the rules, standards, procedures and protocols developed and

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<sup>79</sup> NYISO's Services Tariff Original Sheet No. 137.

promulgated by the New York State Reliability Council (NYSRC).<sup>80</sup> The NYSRC standards allowed for operating reserves to be comprised of pumped storage hydro facilities, such as the Blenheim-Gilboa facility. However, although the Blenheim-Gilboa facility was eligible to supply reserves, the tariff provides no language requiring the use of the Blenheim-Gilboa facility or penalties from excluding the facility in the market. Section 4.1.2 of the NYSRC's Reliability Rules provides that non-spinning reserve may be composed of "hydro, pumped storage hydro and quick start combustion generation."<sup>81</sup> This is not equivalent to stating that all hydro, pumped storage hydro and quick start combustion generation are required to bid into the NSR market.

73. Further, as Keyspan points out, NYISO's decisions regarding the software modeling of the Blenheim-Gilboa was not driven by any specific intent to prevent Blenheim-Gilboa from offering its output into the reserves market or to prevent Blenheim-Gilboa from providing reserves under the tariff. Rather, the joint owners of the Blenheim-Gilboa plant decided that they wish to self-schedule Blenheim-Gilboa for energy during the relevant period, rather than make the plant available for reserves, and entered into contractual agreements with NYISO to facilitate this goal. To reflect this agreement, NYISO modeled its software so as to treat the Blenheim-Gilboa plant as a single 1000-MW unit (rather than breaking it into its four constituent 250-MW units that could have been scheduled for reserves, as was previously the case during operation of the New York Power Pool). Thus, NYISO only sought to accommodate the wishes of the Blenheim-Gilboa owners, not to prevent Blenheim-Gilboa from availing itself of any rights under the tariff.

74. Since, at the time that NYISO accepted the original agreements with the Blenheim-Gilboa owners, NYISO tariff did not require that Blenheim-Gilboa or other pumped storage units be available for reserves, we find that NYISO did not violate its tariff in modeling its software so as to achieve the intent of the Blenheim-Gilboa owners.

75. As discussed above, the Commission has broad discretion as to remedial action. Assuming, again, that NYISO's exclusion of Blenheim-Gilboa from offering to supply reserves was a violation of its tariff, the Commission would exercise that discretion not to require refunds here. In February and March of 2000, only a few months after NYISO had commenced operation, the impact of the Blenheim-Gilboa output owners' decision to self-schedule the plant for energy only was not yet clear. Once it became apparent that

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<sup>80</sup> Services Tariff Original Page No. 35, section 2.158.

<sup>81</sup> Request for Rehearing of May 31 Order filed by Rochester Gas and Electric on June 30, 2000, at 6 n.2.

enabling Blenheim-Gilboa to provide offers to supply reserves would be helpful, NYISO took steps to achieve this goal prospectively.<sup>82</sup> Because, however, NYISO was seeking to honor the choices made by its market participants, and it was not at that time apparent that that choice would have a negative impact on the reserves market, the Commission would not require refunds based on this choice. Moreover, as discussed earlier, there would be no reasonable method of calculating refunds.

The Commission orders:

(A) We find that NYISO did not abuse its discretion in choosing not to exercise its TEP authority to recalculate prices for the period in issue here.

(B) We find that refunds should not be granted for NYISO's actions permitting the price for SR and NSR to be determined interdependently.

(C) We find that NYISO did not violate its tariff by excluding the output of the Blenheim-Gilboa plant from being offered into the SR market.

By the Commission. Commissioner Kelliher concurring with a separate statement attached.

( S E A L )

Magalie R. Salas,  
Secretary

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<sup>82</sup> *See id.* at 6 ("on March 24, 2000, [NYISO] entered into an operating agreement with the Blenheim-Gilboa contractors to allow for the scheduling of an additional 250 MW of spinning reserves").

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc., Docket No. ER00-1969-019

Niagara Mohawk Power Corporation Docket No. EL00-57-003

v.

New York Independent System Operator, Inc.,

Orion Power New York, GP, Inc. Docket No. EL00-60-003

v.

New York Independent System Operator, Inc.

New York State Electric & Gas Corporation Docket No. EL00-63-003

v.

New York Independent System Operator, Inc.

Rochester Gas & Electric Corporation Docket No. EL00-64-003

v.

New York Independent System Operator, Inc.

(Issued March 4, 2005)

Joseph T. KELLIHER, Commissioner *concurring*:

This order addresses, *inter alia*, the question remanded by the United States Court of Appeals for the District of Columbia Circuit of whether the New York Independent System Operator, Inc. (NYISO) properly exercised its discretion not to invoke its authority under its Temporary Extraordinary Procedures (TEP) to reset energy prices between January 29 and late March 2000. I agree with the Commission's determinations in this order. I write separately, however, to address what I believe is the more significant question underlying this order, namely whether the TEP itself constitutes an improper delegation to the NYISO of the Commission's authority under section 205 of the Federal

Power Act (FPA).<sup>1</sup>

The law on delegation of federal authority is relatively clear and was expressed well by the D.C. Circuit in *U.S. Telecom Ass'n v. FCC*.<sup>2</sup> Under *U.S. Telecom*, delegations of federal authority to “outside parties are assumed to be improper absent an affirmative showing of congressional authorization.”<sup>3</sup> This rule is entirely sensible. One reason for the prohibition of delegations of authority is that “when an agency delegates power to outside parties, lines of accountability may blur, undermining an important democratic check on government decision-making.”<sup>4</sup> Another reason is that “delegation to outside entities increases the risk that these parties will not share the agency’s ‘national vision and perspective’ and thus may pursue goals inconsistent with those of the agency and the underlying statutory scheme.”<sup>5</sup>

Under the TEP, the NYISO was authorized to retroactively change wholesale power rates in the event it determined that a market design flaw impaired market prices. If the NYISO makes such a determination, it has subjective discretion to reset rates to what it believes they would have been but for the market design flaw. But section 205 of the FPA vests exclusive authority with the Commission to set the rates and charges for wholesale electric sales of energy. In my view, because the TEP authorizes the NYISO to change rates, the TEP represents a delegation of the Commission’s authority under section 205 to set rates. Applying the law on delegation from *U.S. Telecom*, since there is no provision of the FPA that authorizes such a delegation, the Commission cannot lawfully vest its rate setting authority with the NYISO through the TEP.

Moreover, the TEP seems to delegate more authority to the NYISO than the Commission itself possesses. Under the FPA, the Commission can change rates retroactively in the event of a tariff violation as a means of enforcing the filed rate. However the TEP authorizes the NYISO to reset rates in circumstances in which the tariff has not been violated. The NYISO need only determine that there is a flaw in the design of the market in order to reset rates, and to do so retroactively. Even if the FPA authorized a

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<sup>1</sup> 16 U.S.C. § 824d (2000).

<sup>2</sup> 359 F.3d 554 (D.C. Cir. 2004)(*U.S. Telecom*).

<sup>3</sup> *Id.* at 565.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 565-66 (citations omitted).

delegation of the Commission's ratemaking authority, which it does not, the Commission could not delegate more authority than it possesses under the Act.<sup>6</sup>

I do not view the fact that the Commission can review decisions by the NYISO invoking its TEP as diminishing the extent of this delegation. The Commission's review seems largely to be limited to determining whether the NYISO abused its discretion in exercising its TEP authority. Since the discretion afforded the NYISO appears to be so great, the Commission's review is largely circumscribed.

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Joseph T. Kelliher

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<sup>6</sup> See *Commonwealth of Massachusetts v. United States*, 729 F.2d 886, 888 (1<sup>st</sup> Cir. 1984).