

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

New York Independent System Operator,)
Inc.)

Docket No. ER04-230-001

**REQUEST FOR REHEARING AND CLARIFICATION OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.**

Pursuant to Rules 212 and 713 of the Commission’s Rules of Practice and Procedures,¹ the New York Independent System Operator, Inc. (“NYISO”), by counsel, hereby submits this request for rehearing and clarification of certain aspects of the Commission’s February 11, 2004 order² on the NYISO’s Real Time Scheduling (“RTS”) Filing.

While the NYISO is very pleased by the Commission’s strong endorsement of RTS as a whole, two aspects of the RTS Order should be modified on rehearing. First, the Commission should accept the NYISO’s proposal to apply real-time automated mitigation procedures (“AMP”) outside of New York City to individual generators that have previously violated the conduct and impact mitigation screens. Second, the Commission should extend its November 1, 2004 deadline for the implementation of rules that would afford non-dispatchable generators greater flexibility in responding to price changes. In addition, the Commission should clarify its directive that the NYISO include demand side resources in RTS.

¹ 18 C.F.R. §§ 385.212 and 713 (2003).

² *New York Independent System Operator, Inc.*, 106 FERC ¶ 61,111 (2004) (“RTS Order”).

II. Specification of Errors

The NYISO respectfully specifies the following errors in the RTS Order.³

1. The Commission erred in prohibiting the application of the real-time AMP outside of New York City because of the alleged absence of “well-defined structural problems.”⁴
2. The Commission erred in establishing a deadline of November 1, 2004, for the NYISO to either reinstate price-chasing or implement one of two price-chasing alternatives.⁵

III. Request for Rehearing

A. **The RTS Order Erroneously Precludes the Effective Mitigation of Demonstrable Abuses of Market Power in the Rest-of-State Real-Time Market**

1. **The Erroneous Holding in the RTS Order**

The Commission’s February 11 Order found that

the NYISO has not justified the extension of the AMP into the Real-Time Market outside New York City. The Commission will approve only mitigation measures that address well-defined structural problems in the market. Although the NYISO does not initially intend to apply AMP outside of New York City, it implies that it will eventually. Therefore, we reject this proposal without prejudice to a filing that explains the underlying structural problem outside of New York City, that the NYISO feels justifies the use of AMP in the Real-Time Market outside of New York City.⁶

The NYISO requests rehearing because the real-time rest-of-state AMP will, by its terms, be applied only when the structure of a relevant market gives rise to significant market power

³ On March 5, 2004, the NYISO submitted a separate emergency request for rehearing of the RTS Order’s ruling barring the assignment of day-ahead reserve default availability bids to non-ICAP suppliers offering flexible capacity into the NYISO-administered markets. The specifications of error here are in addition to the error specified in that request for rehearing.

⁴ See RTS Order at P 30.

⁵ See *Id.* at P 40.

⁶ *Id.* at P 30 (citation omitted).

leading to substantial increases in rates. The NYISO's proposed extension of the AMP does not allow the NYISO to apply the AMP "eventually" on some as yet undefined basis, but only after a generator's breach of the conduct and impact tests for market power establishes that an abuse of market power has in fact occurred. The NYISO respectfully submits that the Commission's rejection of the rest-of-state real-time AMP reflects an unduly stringent standard for the use of automated mitigation procedures that is inconsistent with the Commission's prior holdings and with its obligation under the Federal Power Act to protect purchasers from rates that are unjust and unreasonable.

The RTS Order also appears to reflect a misunderstanding of the operation and market effects of NYISO's requested extension of the AMP, and the context of the previously-approved mitigation measures in which the rest-of-state AMP will function. Implementing the AMP in the real-time rest-of-state market will result in a more accurate and timely mitigation process, and may well result in fewer instances of mitigation than under the existing manual procedures.

Thus, the Commission should grant rehearing of the RTS Order, and for the reasons set forth below, should on rehearing permit the extension of the AMP to the real-time rest-of-state market.

2. Background

The Commission approved the NYISO's Market Mitigation Measures ("MMM") in March, 2000.⁷ From their inception, the MMM have implemented market power mitigation based on the use of conduct (assessment of bidding levels) and impact (assessment of effect of elevated bids on market prices) tests. In approving the MMM,⁸ the Commission stated that they

⁷ *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,317, *clarified* in, 91 FERC ¶ 61,154 (2000).

⁸ The Market Mitigation Measures are now set forth in Attachment H to the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff").

set[] specific thresholds for identifying economic and physical withholding and uneconomic production that would trigger possible mitigation. . . . The NYISO's ability to mitigate when specific thresholds are triggered will help to remedy market power quickly and deter participants from exercising market power, and it was a factor in approving market-based rates in the NYISO's markets.⁹

From the beginning, the MMM have provided for the state-wide mitigation of market power abuse in both the day-ahead and real-time markets through a so-called “manual” application of the conduct and impact tests.¹⁰ Under the manual mitigation procedures set forth in the MMM, the NYISO monitors bids and prices to determine if the conduct and impact tests have been exceeded. The “manual” process of course uses computerized methods to monitor and assess the huge mass of bidding data processed by the NYISO every day, in order to determine if any individual bidder has exceeded the applicable conduct test. A computerized analysis done after the bidding has closed is then used to determine whether, for units breaching the conduct test, a redetermination of prices with that seller’s bid reduced to its reference level (default bid) would exhibit a sufficient price change to trigger the impact test.

When a unit first exceeds the conduct and impact tests, however, mitigation does not occur. Rather, the NYISO initiates consultations to verify that breach of the tests stems from market power rather than competitive conditions. If the consultations confirm that bids were based on market power, the seller is put on a watch list. Going forward, the impact of its high bids on market prices having been demonstrated, the seller’s bids are replaced by default bids whenever its bids exceed the conduct test. Mitigation would continue to be applied to bids that

⁹ 90 FERC ¶ 61,317, at 62,054-55 (citation omitted).

¹⁰ In 2001, the manual procedures were augmented by the “automated mitigation procedures,” or AMP. *New York Independent System Operator, Inc.*, 95 FERC ¶ 61,471 (2001); *New York Independent System Operator, Inc.*, 97 FERC ¶ 61,176 (2001); *New York Independent System Operator, Inc.*, 97 FERC ¶ 61,242 (2001).

breach the applicable conduct threshold until the NYISO determines, on its own initiative or at the instigation of the seller, that the seller is no longer in a position to abuse market power.

3. The Rest-of-State AMP Will Make Mitigation More Timely and Accurate

As a practical matter, the only significant difference between the existing “manual” procedures described above and the requested extension of the AMP is that the AMP will provide a more timely and accurate application of the impact test. As with the rest-of-state manual procedures, under the requested rest-of-state extension of the AMP, an initial breach of the conduct and impact tests would also result in consultations with the seller,¹¹ without mitigation being imposed, as specified in § 3.2.2(d) of revised Attachment H:

The NYISO may implement automated mitigation procedures in RTC for a Generator that is not in a Constrained Area if a bid has been submitted for the Generator that (i) exceeds the applicable threshold for economic withholding specified in Section 3.1.2 and (ii) results in a market impact that exceeds the applicable threshold specified in Section 3.2.1 and (iii) the ISO, in consultation with the Market Advisor, determines that the bid is inconsistent with competitive conduct. Automated mitigation measures may be used for a Generator that is not in a Constrained Area for a period not longer than six months from the submission of such a bid.¹²

As with the manual process, if after consultations the NYISO determines that the seller’s conduct and impact is not competitive, the seller would be put on a watch list, and its bids evaluated under the applicable conduct test. The AMP software, however, will have the capability to re-evaluate the impact test in the same interval to which the bids crossing the conduct test apply, as part of the price determination process for each interval. Mitigation under

¹¹ As noted in the filing, the initial consultation requirement was included in recognition that at least to date, market power problems in the rest-of-state area have not been frequent. *See New York Independent System Operator, Inc.’s Revisions Reflecting the Implementation of Enhanced Real-Time Scheduling Software*, Docket No. ER04-230-000 (Nov. 26, 2003).

¹² *Id.*

the AMP is thus applied only if conduct and impact are breached in the same interval, rather than impact being determined “manually” on the basis of a prior interval. Thus, the impact test will be more accurate and timely under the AMP than under the more limited capabilities of the manual procedures now in place. The RTS Order arbitrarily precludes the NYISO from implementing this improvement in mitigation.

4. Consultation Ensures that Mitigation Will Only Occur When Market Power Has Arisen

The Commission has previously approved the permanent use of the AMP for the state-wide day-ahead market, and the day-ahead and real-time markets in New York City, in its order issued in response to the NYISO’s “Comprehensive Mitigation Measures” (“CMM”) filing in March, 2002. The Commission recognized in the CMM order that: “The MMM uses a two part conduct and impact test to limit mitigation to only those behaviors that result in significant market impact.”¹³ The Commission also recognized that: “Under the AMP, NYISO will continue the two part test, that of conduct and impact, to assess market power.”¹⁴ These findings are consistent with the Commission’s observation in its Standard Market Design Notice of Proposed Rulemaking that “[m]arket power is the ability to raise price above the competitive level,” and that this “can be accomplished if the generator can . . . cause physical power to be withheld through inflated bids (economic withholding).”¹⁵ These findings are also consistent with established principles on proof of market power in antitrust cases. As the Supreme Court has stated:

¹³ *New York Independent System Operator, Inc.*, 99 FERC ¶ 61,246 at 62,038 (2002) (“CMM Order”).

¹⁴ *Id.*

¹⁵ *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, Notice of Proposed Rulemaking, Docket No. RM01-12-000 (July 31, 2002) at P 393 (citation omitted) (“SMD NOPR”).

Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, “proof of actual detrimental effects, such as a reduction of output,” can obviate the need for an inquiry into market power, which is but a “surrogate for detrimental effects.” 7 P. Areeda, *Antitrust Law* P 1511, p. 429 (1986).¹⁶

Thus, “evidence of restricted output and supracompetitive prices, [] is direct proof of the injury to competition which a competitor with market power may inflict, and thus, of the actual exercise of market power.”¹⁷

It follows that in any consultations between the NYISO and a Market Participant under the real-time rest-of-state AMP, as under the manual mitigation procedures, the central issue will be whether the seller’s bids reflect an exercise of market power, or are instead consistent with legitimate competitive conduct (for example, reflecting a significant increase in fuel or other costs). This is made clear by § 3.3 of Attachment H, which states that: “If a Market Party’s explanation of the reasons for its bidding indicates to the satisfaction of the ISO, in consultation with the Market Advisor, that the questioned conduct is consistent with competitive behavior, no further action will be taken.” On the other hand, if the ISO, in consultation with the Market Advisor, determines that a seller’s bidding is not consistent with competitive behavior, that means that the bidding instead reflects the use of market power to significantly raise prices. The initial consultation threshold ensures that AMP mitigation is only applied when the structure of the market where the seller is located is enabling the seller to exercise market power. If so, the logic of the conduct and impact mitigation methods approved by the Commission, and the requirements of the Federal Power Act that rates be just and reasonable, dictate that mitigation

¹⁶ *FTC v. Indiana Fed’n of Dentists*, 476 U.S. 447, 460-61 (1986).

¹⁷ *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir.), *cert. denied*, 516 U.S. 987 (1995).

should be applied. Applying such mitigation using automated procedures in the rest-of-state real-time market only ensures that mitigation is done as accurately as possible and without unnecessary delays.

The Commission's prior approval of automated procedures for the real-time market in New York City suggests that the Commission may intend "structural problems" justifying the use of the AMP to be limited to situations analogous to the recurring transmission constraints that have led to the designation of New York City as a Constrained Area and thus subject to lower conduct and impact thresholds than apply in the rest of the state. If so, the RTS Order provides no justification for this distinction, and it cannot be reconciled with the Commission's prior orders approving New York's state-wide conduct-and-impact mitigation, and its state-wide day-ahead implementation through automated procedures. It also appears to ignore the safeguard provided by the initial consultation requirement, which ensures that mitigation is limited to market power situations. As shown above, the Commission has recognized conduct and impact as appropriate tests for exercises of market power.¹⁸ But market power by definition can only exist if some flaw in the structure of a relevant market has led to undue concentration among sellers--otherwise competition from other sellers would prevent bid and price increases from tripping the conduct and impact tests.

The RTS Order does not articulate any reason to distinguish the purportedly "structural" market power present in New York City from other market structures giving rise to market power sufficient to trip the conduct and impact tests, nor does the RTS Order articulate any reason why market power should be mitigated with automated procedures in the one instance and

¹⁸ See also, *id.*, 51 F.3d at 1434 (holding that while market power can be shown by "circumstantial evidence pertaining to the structure of the market," market power may also be shown by "direct evidence of the injurious exercise of market power.").

not in the other. While designation of New York City as a Constrained Area because of the frequency of congestion warrants lower conduct and impact thresholds, as the Commission recognized in the CMM Order,¹⁹ such designation does not mean that the rest-of-state area is suddenly immune from market power, or that conduct-and-impact mitigation at the normal threshold levels is not appropriate in the rest-of-state.

In short, the RTS Order does not articulate any reason why the AMP protects against rates that are unjust and unreasonable in New York City day-ahead and real-time markets and in the state-wide day-ahead market, yet a real-time rest-of-state AMP with a consultation process is not appropriate for the same reasons. In reality, no such distinctions can be articulated.

5. The AMP Has No Effect on Markets that Do not Exhibit Market Power, but Provides Important Protections if Market Power Does Arise

As discussed above, the foundation of the AMP in the conduct and impact tests, and the setting of those tests at the relatively high levels approved by the Commission, ensures that the AMP only applies mitigation in the presence of significant market power. An important corollary of this proposition is that when market power is not present, the MMM, whether applied via the AMP or manually, will have no adverse effect on the markets.²⁰ If the conduct and impact tests are not tripped, nothing happens. This is borne out by the fact that since the inception and state-wide application of the MMM some four years ago, no market participant has

¹⁹ 99 FERC ¶ 61,246 at 62,039-43.

²⁰ The Commission has previously recognized this. *See, e.g., Midwest Independent Transmission System Operator, Inc.*, 105 FERC ¶ 61,147 at P 34 (2003) (stating that conduct and impact market mitigation measures are not applied to generators lacking market power, and thus should not inappropriately over-mitigate, or suppress prices in scarcity conditions); *California Independent System Operator Corp.*, 100 FERC ¶ 61,060 at P 67 (2002) (recognizing that a MMM-like conduct-impact framework “can be effectively implemented as a market power mitigation tool without interfering with the efficient and reliable operation of the grid.”) *citing New York Independent System Operator, Inc., et al.*, 99 FERC ¶ 61,246 (2002), *New York Independent System Operator, Inc.*, 95 FERC ¶ 61,471 (2001).

demonstrated any adverse effect on competitive market conditions from the mere potential for mitigation under the conduct and impact tests, under either manual or automated procedures.

Approval of the rest-of-state AMP does not constitute approval of round-the-clock mitigation of the rest-of-state real-time market, but only mitigation when conditions that meet the conduct and impact tests arise.²¹ Authorization of the MMM as implemented by the AMP enables the NYISO to take quick action if market power does arise -- and to refrain from mitigation if analysis of the interval for which bids are submitted does not show the requisite impact. Moreover, if the rest-of-state AMP is triggered, in fulfillment of its MMM obligations the NYISO will continue to monitor the New York markets to see if competitive conditions have been reestablished, and is always open to requests for consultation with a market participant that wishes to make such a showing. In short, effective with its order approving the CMM, the Commission has appropriately used its authority to approve the use of the AMP in all of the New York markets except the rest-of-state real-time market. Neither the RTS Order, nor the logic of the Commission's order approving the use of conduct-and-impact mitigation and the AMP in all other New York markets, support denial of the NYISO's request for AMP capability in the rest-of-state real-time market. If problems do arise in the rest-of-state real-time market, then just as in the other markets an AMP should be in place to deal with such problems expeditiously and accurately, without the delay that would be required to amend the tariff or engage in other lengthy procedures.

²¹ SMD NOPR at P 397 (explaining that the AMP meets “the challenge [of] . . . an effective market power mitigation plan . . . that allows markets to function where they are competitive and, where they are not, uses market mechanisms to facilitate the transition to competitive markets.”)

B. The November 1 Deadline for Restoring “Price Chasing” or Instituting an Alternative Is Unreasonable

The RTS Order directed the NYISO to either restore off-dispatch generators’ ability to chase prices or “incorporate” one of two alternative options proffered by Sithe Energy Marketing and Indeck Energy Services (“Sithe”) no later than November 1, 2004. In its concurrently submitted compliance filing, the NYISO explains that the best of these options is allowing non-dispatchable generators to request that their schedules be set on a fifteen-minute basis and proposes to adopt it.²² The NYISO does not object to the Commission’s requirement to adopt this measure, as evidenced by its compliance filing, but there are several reasons why the November 1, 2004 implementation deadline should be extended.

First, although the Commission appears to believe that the NYISO should have a reasonable time after RTS implementation to institute a price-chasing alternative, the RTS Order’s mandate is inconsistent with this intent. The RTS Order recognizes that RTS is not expected to be ready until “September 2004, at the earliest”²³ but seemingly assumes that a November 1, 2004 deadline for installing a price-chasing alternative would fall after RTS implementation. This will not necessarily be true. Although the NYISO is striving to implement RTS as early in the Fall as possible, RTS might not take effect until November 1 in which case the RTS Order would require the NYISO to implement a RTS enhancement at the same time as the implementation of RTS itself.

Second, the Commission’s apparent assumption that two months, *i.e.*, the time between September 1 and November 1, 2004, is sufficient time to restore price-chasing, or implement an

²² See *Compliance Filing and Notice of Implementation of the New York Independent System Operator, Inc.*, at 3-5 (March 12, 2004).

²³ See RTS Order at P 10.

alternative to it, is mistaken. Developing the fifteen minute scheduling option will require extensive software coding and testing. All of the NYISO's available technical resources are currently committed to implementing core RTS features. In the immediate aftermath of RTS implementation, substantial resources will continue to be devoted to ensuring that RTS works as intended, to fixing any problems, and to introducing planned internal process enhancements that will increase RTS functionality. Consequently, it will not be possible to incorporate a price-chasing alternative within sixty days of the RTS effective date without significantly postponing RTS as a whole.

The NYISO's best estimate is that it will need one hundred fifty days after RTS implementation, and the completion of the immediate post-implementation work referenced above, to introduce a fifteen minute scheduling option properly. The NYISO staff and the RTS software vendor have determined that design, coding, and testing will take approximately five months. Given its current commitments to RTS and other projects, the vendor will not even be able to begin the work until after November 1. Once the vendor has completed its tasks the NYISO will need several additional weeks to test the new software and ensure that it is properly integrated.

Third, while the NYISO has begun to discuss the fifteen minute scheduling option with stakeholders it has not been thoroughly vetted by the New York stakeholders as a whole. There is great value in ensuring that all interested stakeholders have a chance to learn more about the fifteen minute scheduling option, and to comment on it, before it is filed. Stakeholder input substantially improved the RTS proposal and there is every reason to think that it will do the same for the fifteen minute scheduling option. Input is needed on the fundamental design issues identified in the NYISO's concurrently submitted compliance filing and to enable the NYISO to

learn more about the proposal's possible effects on specific stakeholders. Allowing the NYISO one hundred and fifty days after completing immediate post-implementation work to institute a fifteen minute scheduling option would ensure that it will have adequate time to complete discussions with its stakeholders before major software work begins.²⁴ Requiring that fifteen minute scheduling be in place by November 1 would not.

The NYISO therefore respectfully requests that the Commission modify the RTS order on rehearing and allow the NYISO one hundred and fifty days after RTS the completion of all RTS implementation efforts to "incorporate" the fifteen minute scheduling option into its markets. The NYISO would submit compliance tariff revisions reflecting the introduction of fifteen minute scheduling option at least sixty days before the option became available.

IV. Request for Clarification

The NYISO agrees with the RTS Order's guidance that it should continue to work with stakeholders to find ways to expand participation by demand side resources in the NYISO-administered markets.²⁵ It also appreciates the Commission's effort to clarify the extent to which treating demand side resources differently than generators would be appropriate. Nevertheless, because the ultimate goal that the Commission has set, *i.e.*, to "accommodate the special aspects of [demand side resources] without violating the fundamental design principles of the RTS," could be interpreted in various ways, further guidance from the Commission would be helpful.

For example, the RTS Order requires the NYISO to file tariff revisions "associated with the inclusion of [demand side resources] in RTS." It is unclear exactly what this means. "RTS"

²⁴ Because the NYISO is under an obligation to implement the fifteen minute scheduling option it will not be seeking stakeholder approval to make its compliance filing. The NYISO is simply suggesting that allowing time for stakeholder discussions will improve the fifteen minute scheduling option.

²⁵ As with the development of "price-chasing" rules, these discussions would properly focus on how, not whether, to achieve the objective established in the RTS Order.

is shorthand for the NYISO software enhancements that will upgrade its real-time market software and better align it with the day-ahead market software. It does not specifically refer to any particular market or product. To reduce confusion the Commission should articulate its expectations more clearly, or at least indicate that it will allow the NYISO, in consultation with its stakeholders, to determine what should be filed. If it chooses to offer further guidance, the Commission should not lose sight of the fact that a number of impediments to greater demand side participation are outside of the NYISO's control. Examples include: (i) reliability rules that prevent demand side resources from offering synchronized reserves or regulation service; and (ii) retail rate design issues.

Finally, the Commission should clarify that the RTS Order does not require the NYISO to adopt the "dual ancillary services bid process" previously proposed by the Multiple Intervenors.²⁶ The NYISO intends to discuss the proposal in good faith with interested stakeholders but is concerned that it might be unreasonably difficult or expensive to implement. It would be premature for the Commission to require the NYISO to implement this proposal without allowing for further discussion and review.

²⁶ See *Motion to Intervene and Comments of Multiple Intervenors* at 8-9.

V. Request for Relief

Wherefore, for the foregoing reasons, the NYISO respectfully requests that the Commission grant rehearing or clarification of the rulings discussed above.

Respectfully submitted,

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March 12, 2004

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (2003).

Dated at Washington, D.C., this 12th day of March, 2004.

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