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David P. Boergers, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

New York Independent System Operator, Inc.: Market Monitoring Plan
Docket Nos. ER97-1523-010, OA97-470-009 and ER97-4234-007

Dear Mr. Boergers:

In its Order Accepting for Filing in Part and Rejecting in Part Market Monitoring and Mitigation Plan, Subject to Modifications ("MMP Order"), issued November 23, 1999 in the above dockets, the Commission accepted in part and rejected in part the market monitoring plan and mitigation measures filed by the New York Independent System Operator, Inc. ("NYISO"), and directed the NYISO to file a revised plan and mitigation measures modified as required by the MMP Order. The modifications that the MMP Order directed be made affect the provisions of the Market Mitigation Measures that were filed as Addendum A to the Market Monitoring Plan. Accordingly, in compliance with the MMP Order, the NYISO has made extensive changes to its proposed Market Mitigation Measures, and submits for filing a new Addendum A to the Market Monitoring Plan.

List of Documents Submitted

The NYISO submits an original and fourteen copies of the following:

1. This transmittal letter;
2. A complete version of the revised Market Mitigation Measures, Addendum A to the NYISO Market Monitoring Plan, for filing under seal to protect certain competitively sensitive information, as described in more detail below;

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3. A public version of the revised Market Mitigation Measures, from which the competitively sensitive information has been redacted; and
4. A Federal Register Notice (also enclosed is an electronic copy of the Notice in WordPerfect Format).

Proposed Effective Date and Request for Waivers

The NYISO became operational on November 18. Since that date, the NYISO has been operating its day-ahead and real-time markets on the basis of market-based bids. As noted below, the Commission's approval of market-based pricing in the New York markets was premised on there being in place a market monitoring plan with appropriate mitigation measures. Accordingly, the NYISO requests the Commission to permit this filing to become effective on December 23, 1999, or at the earliest practicable date.

The NYISO also requests a waiver of any other applicable Commission requirements that are not otherwise satisfied by this filing.

Names and Addresses of Persons to Whom this Filing has been Mailed

A copy of this filing is being served upon all persons on the Commission's official service lists in Docket Nos. ER97-1523-000, OA97-470-000 and ER97-4324-000 (not consolidated) and on the respective electric utility regulatory agencies in New York, New Jersey and Pennsylvania.

Compliance with the MMP Order

In the MMP Order, the Commission rejected the NYISO's initial mitigation proposals because "they give too much discretion to the ISO in price-setting and other similar regulatory functions without Commission review." MMP Order, Slip Op. at 8. The Commission went on to find that the "ISO has not described with enough specificity the types of conduct that would trigger the imposition of these measures." *Id.* In particular, the Commission determined that the

ISO has not established specific thresholds or bright line tests that would trigger the conclusions that market power has been exercised. The plan states that the ISO will choose one or more of the mitigation measures to the minimum extent necessary to mitigate price effects, but what constitutes this minimum is left to the discretion of the ISO.

Id.

The MMP Order states that acceptable revised mitigation measures could commit the ISO to make filings with the Commission under § 205 of the Federal Power Act, 16 U.S.C. § 824d (1999), on a case-by-case basis requesting authorization to impose specific mitigation measures when the ISO concludes that such measures are warranted. "Alternatively, as another permissible approach, the plan

might describe specific types of conduct that would trigger mitigation measures and the specific mitigation measures that would apply for each identified conduct.” Slip Op. at 9

The revised Market Mitigation Measures have been extensively modified to adopt both alternatives. With respect to the second alternative, the revisions set forth specific thresholds for identifying conduct warranting mitigation, and specific measures to be applied to such conduct. These revisions reflect the best initial judgment of the NYISO, in consultation with the New York Market Advisor, on a set of trigger points for mitigating abuses of market power, consistent with the principle, as articulated in the mitigation measures, that: “these Mitigation Measures are intended to minimize interference with open and competitive markets, and thus to permit, to the maximum extent practicable, price levels to be determined by competitive forces under the prevailing market conditions.” Market Mitigation Measures, § 1. The trigger points are intended to reflect clear instances of abuses of market power that should not be permitted to continue, even for relatively short periods. The New York electric markets administered by the NYISO have only just completed their first month of operation, however, and further modification of the thresholds and mitigation measures may be appropriate as the NYISO gains experience with possible market power problems in those markets. Since the thresholds are specified in an addendum to the Market Monitoring Plan, any changes to the thresholds would require a further filing with the Commission.

In addition, the revised Market Mitigation Measures provide that if the NYISO concludes that conduct has occurred that does not meet the specified thresholds but nonetheless constitutes a significant abuse of market power that warrants mitigation, the NYISO may make a filing with the Commission under § 205 requesting mitigation authorization. The Mitigation Measures establish thresholds at which a presumption would arise that such a filing is warranted, unless the NYISO concludes, based on information supplied by a Market Party or other facts and circumstances known to the NYISO, that the Market Party’s bidding or other conduct in excess of an applicable threshold constitutes a legitimate response to competitive market forces and not an effort to exploit market power. The thresholds for a presumption that a § 205 filing is warranted are below the levels that would trigger the imposition of mitigation measures by the NYISO, but high enough to identify conduct that may give rise to significant market power concerns. The NYISO would not be precluded from making a § 205 filing requesting mitigation authorization for conduct below the presumptive thresholds, if such action appears warranted in a particular set of circumstances. A § 205 filing in any of the foregoing situations would identify the specific conduct at issue and specify the justification for the specific mitigation measure proposed as a remedy for the conduct, in compliance with the first alternative for additional specificity set forth in the MMP Order. Slip Op. at 9. Thus, the attached filing in effect embraces both of the alternatives posed in the MMP Order.

Confidentiality of Numeric Thresholds

In tendering this compliance filing, the NYISO requests that the numeric percentage, MW and dollar thresholds in Sections 3.1.1 through 3.1.3 and in Section 3.2 be filed under seal (a public version with these numbers left blank is also being submitted for filing). The reason for this request is the NYISO’s concern that with knowledge of the numeric level of these thresholds, a Market Party could

raise its bids substantially but to levels just below the thresholds, secure in the knowledge that automatic mitigation would not be triggered. The Commission recognized this concern with approval in the MMP Order, which notes that the “New York ISO contends that disclosure of these standards would permit market participants to game the system, *i.e.*, engage in behavior that comes close but just avoids the threshold levels.” Slip Op. at 10-11. The MMP Order goes on to state that: “The Commission accepts the New York ISO’s proposal as consistent with NEPOOL.” Slip Op. at 11.

The danger of gaming is particularly acute in light of the NYISO’s proposal to set the thresholds at fairly high levels, in order to err on the side of not intervening in the relevant markets. Setting high thresholds increases the margin for gaming the mitigation measures by seeking to act just under the threshold levels.

At the same time, the ability of the Market Parties to participate meaningfully in the Commission’s review of the revised Market Mitigation Measures should not be impaired by keeping the numeric thresholds under seal. The NYISO proposes to withhold only the precise numeric levels of the thresholds; the public version of the mitigation measures is complete in every other respect. Thus, the Market Parties would be able to express their views to the Commission on how the level of numeric values should be determined, on the appropriate numeric values that should be used, on what values would be too high or too low, and indeed on whether some other approach should be used altogether.

NYISO Role in Market Mitigation

The Market Monitoring Plan and its accompanying Market Mitigation Measures were originally filed by the NYISO in response to ordering paragraph “N” of the Commission’s January 27, 1999 Order Conditionally Accepting Tariff and Market Rules, Approving Market Based Rates and Establishing Hearing and Settlement Judge Procedures (“NYISO Order”).¹ In the NYISO Order, the Commission identified an effective market monitoring plan as a condition of its approval of the use of market-based rates in the markets administered by the NYISO, noting that “[t]o the extent that the ISO’s monitoring observes significant exercise of market power, it will be able to take additional steps to mitigate the market power.” *Id.* at 61,236. Similarly, in the MMP Order the Commission stated that: “Our prior approval of market-based rates in the ISO markets was premised, in part, on having an effective market monitoring and mitigation plan in place.” MMP Order, Slip Op. at 8.

In filing these revised Market Mitigation Measures, the NYISO wishes to emphasize that it has no desire to limit the prices or other outcomes in the markets under its administration except—and only—as determined by the Commission to be necessary to permit the use of market-based pricing. Indeed, the NYISO remains concerned that the imposition of mitigation measures involves regulatory and adjudicative functions that belong in the hands of the Commission. Accordingly, in preparing these modified Market Mitigation Measures, the NYISO carefully considered limiting the revisions to the alternative posed in the MMP Order of making case-by-case filings under § 205 requesting prior

¹ *Central Hudson Gas & Electric Corp., et. al.*, 86 FERC ¶ 61,062 at 61,240 (1999).

authorization to impose mitigation measures. In principle, the NYISO would prefer this approach, and certainly has no desire to usurp the role or functions of the Commission.

The NYISO is concerned, however, that as a practical matter the delays inherent in seeking prior Commission approval under § 205, and the limits on the resources available to the Commission, could create significant opportunities for abuses of market power while such filings are pending before the Commission, particularly with respect to conduct that exceeds the relatively high thresholds established in the revised Market Mitigation Measures for action by the NYISO. Thus, the attached filing proposes specific thresholds and mitigation measures directed at short term abuses of market power, and in particular the market power that can arise if transmission constraints lead to isolated sub-markets within New York. The thresholds are set at sufficiently high levels that, absent a Market Party's being able to offer a legitimate explanation for its conduct, there should be little dispute that the conduct involves an abuse of market power. Moreover, the measures are largely prospective in application, and are intended simply to cause a Market Party to behave as it would under competitive market conditions, rather than to impose punitive fines or other penalties. Finally, the threshold levels are subject to review and approval or adjustment by the Commission as a result of the instant filing. The NYISO believes the revised Market Mitigation Measures represent an appropriate—and appropriately limited—initial program for compliance with the Commission's orders approving market-based pricing, unless the Commission concludes that regulatory policy, due process or other concerns outweigh the potential for short-term abuse of market power so that mitigation measures should only be imposed after review and approval by the Commission.

Summary of the Mitigation Measure Revisions

In making this compliance filing, the NYISO has retained the basic approach of its original filing. As originally filed, the Market Mitigation Measures focused on conduct that is significantly inconsistent with competitive conduct, and would have imposed mitigation measures only if such conduct would have a material impact on prices or other payments to sellers. The same two step approach governs the revised Market Mitigation Measures. The revised measures, however, set forth specific thresholds for identifying the conduct and market effects that would warrant mitigation, and remove a number of provisions that gave the NYISO discretion in the imposition of mitigation measures. Two sets of thresholds are specified: a higher level set that would trigger mitigation action by the NYISO, and a second, lower level set that would trigger a filing by the NYISO with the Commission requesting authorization to impose mitigation measures. A section-by-section summary of the major modifications made to the Market Mitigation Measures is set forth below.

Section 1: Purpose and Objectives.

The Purposes and Objectives Section continues to make clear that the Market Mitigation Measures are intended to address the effects of conduct that would “substantially distort” competition in any of the markets administered by the NYISO, and are intended to avoid unnecessary interference with competitive price signals. To that end, Section 1 states that “the Mitigation Measures are designed to apply only to specific conduct that exceeds well-defined thresholds” Section 1 also commits

the NYISO to notify the Commission of conduct below the thresholds that may nonetheless constitute an abuse of market power for which the Commission may deem the imposition of a mitigation measure appropriate. In accordance with the requirements of the MMP Order, Section 1 specifies that any such filing would identify the particular conduct the NYISO believes warrants mitigation, propose a specific mitigation measure for the conduct, and set forth the NYISO's justification for imposing that mitigation measure.

Section 2: Conduct Warranting Mitigation.

The revised measures continue to specify two essential conditions for the imposition of mitigation measures: (1) conduct by a Market Party that is significantly inconsistent with the conduct that would be expected under competitive market conditions; and (2) a material effect on market prices or other payments to sellers that is attributable to such conduct. Section 2 now explains that the NYISO shall consider “conduct to be inconsistent with competitive conduct if the conduct would not be in the economic interest of the Market Party in the absence of market power.”

As in the original filing, the mitigation measures identify three categories of conduct that meet the foregoing definition and that would warrant mitigation if the other specified conditions are met:

- (a) physical withholding of an Electric Facility;
- (b) economic withholding of an Electric Facility; and
- (c) uneconomic production from an Electric Facility.

In order to encompass a strategy that can be an effective means of physical withholding, the revised measures provide that operating a generating unit in real-time to produce an output level that is less than the level called for in the NYISO's dispatch instructions to that unit may be deemed an act of physical withholding. Revisions have also been made to recognize that the adverse effects of market power abuse can include causing an increase in production cost guarantee payments (*e.g.*, payments for start-up and no-load costs), as well an increase in market prices. Finally, Section 2 now provides that in addition to making a filing to amend the foregoing list of potentially abusive conduct as may be appropriate in light of experience with the administration of the New York markets, the NYISO may seek authorization from the Commission on a case-by-case basis to mitigate the effects of conduct that is not in one of the three specified categories but has nonetheless been determined to be an abuse of market power.

Section 3: Criteria for Imposing Mitigation Measures.

Revised Section 3 sets forth specific thresholds for identifying conduct in each of the three categories specified in Section 2 that may warrant mitigation:

- For physical withholding of a generating unit, the thresholds are set at the lower of a specified percentage of the unit's output or a specified number of MW. Percent and MW thresholds are also specified for the withholding of some portion of a bidding entity's total capability (*i.e.*, withholding portions of the output from several of an entity's units that together add up to the specified amounts). Physical withholding would also be deemed to occur if a unit's real-time output is below a specified percentage of the NYISO's dispatch level (basepoint) for that unit. For purposes of applying the above percentage or MW thresholds, capacity legitimately subject to a forced or maintenance outage would not be included. A transmission facility would be deemed physically withheld if it is not following NYISO operating instructions and its failure to do so would cause or contribute to transmission congestion.
- For economic withholding, thresholds are set at the lower of specified percent or dollar per MW increases over specified reference levels for a unit's bids for energy and minimum generation, its bids for real-time spinning reserves, or its bids for other reserves, with bids for start-up costs subject only to a percentage threshold (only a percentage threshold is specified because variations in start-up costs would likely make a dollar threshold impractical).
- For uneconomic production, the specified thresholds would be exceeded if energy is scheduled at an LBMP that is less than a specified percentage of the applicable reference level, and the dispatch of such energy would cause or contribute to transmission congestion. Alternatively, a threshold would also be exceeded if the real-time output from a generating unit exceeds a specified percentage of the NYISO's real-time dispatch instruction (*i.e.*, basepoint) for that unit, and such overproduction would cause or contribute to congestion.

In the Market Mitigation Measures as originally proposed, a hierarchy of reference prices was specified in Section 4 for purposes of determining default bids. In the revised measures, the reference price concept has been moved to Section 3, in order to provide specified baseline reference levels for the application of the percentage or dollar thresholds specified above. The reference level methodologies are set forth in the order in which they are to be used, with the sequence dictated by an effort to use the best available proxy for a competitive bid for the unit to which it is being applied. The highest ranking method for which there is sufficient data would be used.

If conduct has been identified on the basis of the foregoing thresholds as being a serious departure from the expected competitive conduct, mitigation would only be imposed if the conduct has a material impact on market prices or production cost guarantee payments. That is, there must be both non-competitive conduct, and a significant adverse effect on market conditions, before a mitigation measure may be imposed. A "material" impact would be determined to exist if the impact exceeds the lower of a specified percentage or dollar increase in day-ahead or real-time energy LBMPs or in any other price in a market administered by the NYISO, or exceeds a specified percentage increase in the

production cost guarantee payments to a Market Party (only a percentage threshold is specified because variations in guarantee payments would likely make a dollar threshold impractical).

The thresholds proposed by the NYISO are set at relatively high levels, in order to limit the NYISO's intervention in markets to short-term periods of substantial market power arising from transmission constraint or residual demand conditions. The NYISO expects that in either situation, the potential may exist for market power abuses to push prices to levels substantially in excess of those specified in the revised Market Mitigation Measures, and that appropriate mitigation measures will limit any resulting harm that could be inflicted on consumers. At the same time, even though high thresholds would mean that significant price increases would not automatically trigger mitigation, because the focus of the Market Mitigation Measures is on relatively short-term market power problems, even relatively large wholesale price increases should average out to relatively low increases in prices to consumers over the longer term.

Because the Market Mitigation Measures are aimed at short-term market power abuses, the thresholds should not be compared to the 5% price increase test used in the Commission's *Merger Policy Statement*, III FERC Stats. & Regs. ¶31,044 (1996), or the Department of Justice/Federal Trade Commission *Horizontal Merger Guidelines*, 4 Trade Reg. Rep. (CCH) ¶13,104 (1992). Longer term structural market power concerns meeting relatively low price effects criteria such as those in the *Merger Guidelines* are likely to warrant divestiture or other structural remedies that are beyond the scope of the NYISO's market administration or other operational responsibilities. In the operational context of the Market Mitigation Measures, the higher thresholds are appropriate to avoid undue interference in the market, although conduct below the thresholds may nonetheless be the subject of a filing by the NYISO with the Commission requesting authorization to impose a specific mitigation measure on a case-by-case basis, as discussed below.

In addition to specifying material price or guarantee payment effects that would be sufficient to warrant the imposition of mitigation measures, the compliance filing specifies lower thresholds that will create a presumption that a filing with the Commission requesting authorization to impose mitigation measures is warranted, unless the NYISO concludes, from information provided by a Market Party or otherwise available to the NYISO, that the increases are attributable to legitimate competitive market forces or incentives. The same procedures and analysis will be applied to conduct meeting these lower thresholds, except that the NYISO will make a filing with the Commission requesting authorization to impose mitigation measures rather than imposing mitigation immediately itself. As a result, Market Parties will not be able to presume that market power abuses will be immune from corrective action as long as they stay below the thresholds for NYISO action.

The revised Market Mitigation Measures bring forward (with some minor editorial changes) Section 3.3 from the original filing, which provides for consultation where practicable with the Market Party engaging in conduct that may warrant mitigation before mitigation measures are imposed. The purpose of this consultation is to determine whether the Market Party can offer an explanation of its conduct that shows that the conduct in fact reflected a competitive response to market conditions. For

example, a Market Party may be able to show that a significant increase in bids was a result of a concomitant increase in fuel costs experienced by the party of which the NYISO may not have been aware. There may be a variety of other pro-competitive explanations for conduct that violates the specified thresholds and thus appears at first blush to be problematic. If the NYISO concludes as a result of such consultations that no mitigation measures are appropriate, none will be imposed. While this affords a degree of discretion to the NYISO, the NYISO respectfully submits that this discretion is appropriate, and necessary to ensure that mitigation is not imposed when it is not warranted.

Section 4: Mitigation Measures.

The MMP Order criticized the original mitigation measures filing because it provided that “the ISO will choose one or more of the mitigation measures to the minimum extent necessary to mitigate price effects, but what constitutes this minimum is left to the discretion of the ISO.” Slip Op. at 8. Accordingly, the provision affording the NYISO this discretion has been eliminated, along with the related provisions listing various types of bid restrictions that might be selected by the NYISO as mitigation measures. Instead, a new introductory Section 4.1 has been added to make clear that the primary means for market mitigation shall be the prospective application of default bids. That is, the principal focus of the mitigation measures is on detecting bidding behavior that departs substantially from the bidding that would be expected under competitive market conditions and that has material market effects, and for a limited time substituting default bids that are intended to be as close a proxy as practicable for competitive bids from the unit at issue. An exception to this would involve a Market Party that physically withholds a unit by making false derating or forced outage claims, or by disobeying NYISO dispatch instructions. In such cases, there would be no bid for which a default bid could be substituted. Thus, in those cases the mitigation measure would be the imposition of a financial obligation to the NYISO in an amount determined as described below.

As stated in Section 4.2.1, a “default bid shall be designed to cause a Market Party to bid as if it faced workable competition” during periods when it does not and the unit seeks to exploit that situation by engaging in economic or physical withholding. Default bids shall be set using the methodology for the determination of reference levels described above. This is appropriate, since in both cases the goal is to determine the best available proxy for a unit’s expected actions under competitive conditions. As specified in the original mitigation filing, a unit subject to a default bid shall be paid the applicable LBMP or other market clearing price. Thus, default bids are not intended to be a form of penalty. Indeed, a unit may well be paid more than its default bid, unless it is the marginal unit at the default bid level.

The mitigation measure for physically withholding a generating unit or improperly overproducing from a unit is a specified financial obligation equal to the capacity withheld or the amount of output deviation (in MW), times a real-time LBMP for each hour the resource is withheld. This measure is simpler, less discretionary, and more market based than the corresponding provision in the original filing. For physical withholding, the formula would use the LBMP at the withheld unit’s location, since that is the location likely to feel the market effects of the conduct. This will be the case because if physical

withholding causes or exacerbates a transmission constraint that gives certain units market power, those units and the withheld unit would almost certainly be inside the constraint. On the other hand, the LBMP that would be used for cases of withholding of transmission facilities or of overproduction from a generating unit would be the highest LBMP at any location affected by the conduct. This is because those types of abusive conduct would be undertaken to cause transmission constraints and resulting price effects at locations other than the location of the misbehaving facility itself (indeed, overproduction may cause LBMPs to decrease at the overproducing unit's location).

Consistent with the MMP Order, the Load Bid Measures have been revised to specify that these measures will only be imposed if the NYISO has determined that doing so is necessary to address an operational problem, such as an inability to meet unscheduled load with available resources. The revised measures also obligate the NYISO to post on its web site an explanation of any such operational problem.

Some editorial changes have been made in the section on capacity markets. Finally, a new subsection has been added to Section 4 providing that, in accordance with the MMP Order: "Any mitigation measure imposed as specified above shall expire not later than six months after the occurrence of the conduct giving rise to the measure, or at such earlier time as may be specified by the NYISO."

Section 5: Other Mitigation Measures.

This Section has not been changed.

Section 6: Dispute Resolution.

This Section has not been changed. The MMP Order noted that the original mitigation measures proposal "includes no provision for an affected participant to appeal the ISO's decision to the Commission." Slip Op. at 8. This statement was made, however, in the context of the MMP Order's criticism of the discretion in the imposition of mitigation measures afforded the NYISO in its original filing. Accordingly, the NYISO understands that this concern is addressed by the specific thresholds for mitigation, and the concomitant limits on the NYISO's discretion, set forth in the revised Market Mitigation Measures. Those thresholds are, of course subject to review by the Commission in the proceedings on this filing.

In addition, the NYISO would note that the Market Mitigation Measures continue to specify that disputes about the imposition of mitigation measures are subject to the dispute resolution provisions of the New York Independent System Operator Agreement ("NYISO Agreement"). The dispute resolution provisions of the NYISO Agreement provide that: "All arbitration decisions that affect matters subject to the jurisdiction of the Commission shall be filed with the Commission." NYISO Agreement, Original Sheet 104. The NYISO Agreement goes on to provide that:

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Within one (1) year of the arbitration decision, a party may request that the Commission or any other federal, state, regulatory or judicial authority (in the State of New York) having jurisdiction over such matter vacate, modify or take such other action as may be appropriate with respect to any arbitration decision that is:

1. based upon an error of law;
2. contrary to the statutes, rules or regulations administered by such authority;
3. violative of the Federal Arbitration Act or Administrative Dispute Resolution Act;
4. based on conduct by an arbitrator that is violative of the Federal Arbitration Act or Administrative Dispute Resolution Act; or
5. involves a dispute in excess of \$500,000.

NYISO Agreement, Original Sheet 104.

Conclusion

The NYISO respectfully asks that the Commission issue an order: (1) approving the attached revised Market Mitigation Measures, or otherwise specifying the market power mitigation responsibilities and authority of the NYISO; and (2) filing under seal the numeric values for the mitigation thresholds to be implemented by the NYISO.

Respectfully submitted,

By: _____

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