UNITED STATES OF AMERICA 97 FERC ¶ 61,091
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

New York Independent System Operator, Inc. Docket No. ER01-3009-000 and ER01-3153-000

Morgan Stanley Capital Group, Inc.

v. Docket No. EL00-90-000

New York Independent System Operator, Inc.

ORDER ACCEPTING VIRTUAL BIDDING PROPOSAL AND MITIGATION MEASURES, AND DIRECTING COMPLIANCE FILING

(Issued October 25, 2001)

In this order, we accept for filing, subject to condition, tariff revisions submitted by New York Independent System Operator, Inc. (NYISO) to its Open Access Transmission Tariff (OATT) and Market Administration and Control Area Services Tariff (Services Tariff) to implement virtual bidding. These changes would allow market participants to bid non-physical (virtual) generation and load into the day-ahead market (DAM) and settle those bids in the real-time market (RTM). We also approve NYISO's proposed credit policy requirements based upon the condition that NYISO revise the formula for determination of the amount of the collateral to reflect a seven-day collaterization period. NYISO is also directed to file, within 30 days of the date of issuance of this order, revised tariff sheets to include all the proposed credit policy requirements, subject to modification directed herein. In addition, we direct NYISO to file a report describing its experience with virtual bidding within 30 days of the end of each of the first four capability periods, starting with the Winter 2001-2002 capability period. We also accept for filing revisions to NYISO's Market Mitigation Measures (MMM) to address gaming or market power strategies and other unexpected market conditions that may emerge as a result of the introduction of virtual bidding. We also grant waiver of the 60-day prior notice requirement to permit a November 1, 2001 effective date, as requested.

We believe that virtual bidding will increase liquidity of the NYISO-administered energy markets, thus reducing the spread between day-ahead prices and real-time prices, which will result in lower prices for consumers.

I. Background

By order acting on Morgan Stanley Capital Group, Inc.'s (Morgan Stanley) complaint (October 5 Order), the Commission directed NYISO to file a report on its development of a plan to allow bidding by non-physical entities, such as power marketers, into day-ahead and real-time power market.[1] In compliance with the October 5 Order, on February 2, 2001, in Docket No. EL00-90-000, NYISO filed a Report on Implementation of Virtual Bidding and Zonal Price-Capped Load Bidding (February Report) describing, among other things, its implementation efforts and its plan for introducing virtual bidding. NYISO outlined the steps necessary to develop and test virtual bidding procedures, and identified November 1, 2001 as the target implementation date.

On September 4, 2001, NYISO filed revisions to its OATT and Services Tariff to: (1) implement virtual bidding procedures and (2) make changes to its credit policies to accommodate virtual bidding and address the special creditworthiness concerns raised by virtual bidding. The proposed virtual bidding procedures will allow non-physical customers to submit bids for purely financial purchases or sales of energy, which do not entail physical generation or consumption of energy. A customer will be able to buy energy ("virtual load") in the DAM at day-ahead prices and sell it in the RTM at real-time prices or to sell energy ("virtual supply") in the DAM at day-ahead prices and buy energy to cover that sale in the RTM at real-time prices. NYISO states that virtual bidding will increase the liquidity of its markets and could increase the convergence of day-ahead and real-time prices.

In addition, NYISO proposes to revise its credit policies to address the financial risks associated with virtual transactions. The proposed credit policies require that virtual transactions be fully collaterized; that is, virtual bidding participants must maintain a cash deposit or an irrevocable letter of credit to support virtual market transactions.[2] NYISO will suspend services to a customer for failure to maintain creditworthiness.

Also, NYISO reserves the authority to temporarily suspend virtual bidding when: (1) there is a system malfunction that makes it impossible to determine, with reasonable accuracy, customers' financial exposure; (2) a market aberration associated with virtual transactions substantially impairs the functioning of markets; (3) virtual transactions substantially impair reliability of the transmission system.

[1] Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc., 93 FERC ¶ 61,017 (2000).

[2] Physical market participants are required to meet a minimum long-term debt credit rating to participate in the physical market. Virtual bidders would be required to post cash or a letter of credit equal to the maximum day-ahead/real-time price differential per MWh times the MWhs they wish to trade times 14 days in order to participate in the virtual market.

NYISO commits to inform the Commission about the virtual bidding suspension as quickly as possible, as well as to indicate the reasons for the suspension, steps to be taken to restore virtual bidding, and the timetable for re-institution of virtual bidding. NYISO also informs the Commission that the virtual transaction credit policies are an interim measure, while NYISO reviews all of its current credit policies, and that it may propose further modifications to its virtual transactions credit policy after it gains more experience with the market.

Furthermore, NYISO proposes to amend its cost recovery mechanism so that costs incurred from bad debts resulting from virtual transactions will be shared by all customers, not just by Load Serving Entities (LSEs), as provided under the current system. NYISO explains that this change is proposed because virtual bidding benefits directly all customers that are eligible to submit virtual bids and because virtual bidding presents a greater risk of loss than physical transactions.

NYISO also proposes a new allocation mechanism with respect to Bid Production Cost Guarantee (BPCG) payments.[3] NYISO explains that virtual bidding may increase the amount of generation scheduled to secure forecast load and thus increase the amount of BPCG required to be paid. It proposes to allocate additional BPCG costs to customers that are short in the RTM. Customers who arrange to sell energy through virtual transactions will, by definition, be short in the RTM and will bear the majority of the costs. Loads that underbid in the DAM will also bear some of these costs. Costs associated with BPCG paid to generators as a result of over-forecasting of real-time load by the NYISO will be allocated to LSEs under the existing formula.

On September 28, 2001, NYISO filed revisions to Attachment H to its Services Tariff to add market monitoring and mitigation measures specifically applicable to virtual bidding. The proposed revisions will allow NYISO to limit participation in the virtual market upon finding that there is a persistent hourly deviation in DAM and RTM prices. NYISO proposes to evaluate the price deviation on the basis of a rolling four week average hourly price for each zone, to determine whether there is a significant deviation between the DAM and RTM prices that cannot be corrected by the markets themselves.

NYISO requests waiver of the 60-day prior notice requirement to permit a November 1, 2001 effective date. NYISO argues that good cause exists for such waiver because virtual bidding is a substantial improvement in the NYISO-administered markets.

II. Notice, Interventions, Protests, and Comments

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[3] BPCG payments are designed to ensure that generators committed to secure forecast load in the DAM recover their minimum generation and start-up costs.

Notice of NYISO's filing in Docket No. ER01-3009-000 was published in the Federal Register, 66 Fed. Reg. 48,246 (2001), with protests, answers, and motions to intervene required to be filed on or before September 25, 2001. Notice of NYISO's filing in Docket No. ER01-3153-000 was published in the Federal Register, 66 Fed. Reg. 51,653 (2001), with protests, answers, and motions to intervene required to be filed on or before October 11, 2001. Timely motions to intervene were filed by entities listed in the Appendix to this order. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2001), the filing of a timely motion to intervene that has not been opposed makes the movant a party to the proceeding. Given the lack of undue prejudice and the parties' interests, we also find good cause to grant under Rule 214 Exelon Generation Company, LLC and Sithe Power Marketing, LP's unopposed, untimely motion to intervene in this proceeding. Member Systems also filed an answer to comments and protests in this proceeding. Pursuant to Rule 213(a) of the Commission's Rules of Practice and Procedure,[4] which prohibits an answer to an answer, Member Systems' answer is not permitted.

All intervenors generally support NYISO's proposal to implement virtual bidding. They believe that virtual bidding will increase liquidity, enhance competition, reduce price volatility and protect against LSEs under-scheduling their load in an attempt to manipulate the market.

Keyspan-Ravenswood, Inc. (Keyspan), Enron Power Marketing, Inc. (EPMI), Aquila Energy Marketing Corp. (Aquila), and PPL Energyplus, LLC and Constellation Power Source, Inc. (Joint Movants) see the proposed credit policy as a significant restriction on participation in the virtual market. In particular, Joint Movants argue that the collaterization requirement is inappropriate and excessive. They state that while physical market participants need only meet a minimum long-term unsecured debt rating, virtual market participants must provide collateral in the form of cash or an irrevocable letter of credit. Joint Movants further explain that the amount of bidding allowed is capped by the collateral provided through a formula, which provides that the collateral must equal the number of megawatt hours times the exposure period (14 days) times the 97th percentile delta of DAM/RTM prices for a given period. According to their example, in order to bid 1600 MWh daily, a virtual market participant is required to provide $3,852,800 (1600 MWH times 14 times $172) in collateral. Joint Movants believe that it is unlikely that virtual market participants will build losses at the rate the collateral requirement is designed to address. Instead, Joint Movants propose a seven-day collaterization period. Aquila, Exelon Generation Company, LLC, and Sithe Power Marketing, LP support Joint Movants' protest. Furthermore, Joint Movants argue that the description of the credit policies in tariff sheets submitted by NYISO is not adequate.

[4] 18 C.F.R. § 385.213(a)(2) (2001).

Aquila proposes to replace the NYISO-proposed credit policy with the same credit policy used for physical bidding. Aquila and Joint Movants believe that NYISO has failed to justify the proposed credit policy requirements. Aquila states that PJM has operated a virtual market without special credit policies for virtual bidders. Joint Movants request that the Commission direct NYISO to either make credit policies consistent between the two markets or provide justification for any disparity. EPMI also argues that the Commission should monitor performance of the NYISO-administered virtual market to determine if the rigorous credit policy is a barrier to participation in that market.

Furthermore, Aquila and Joint Movants argue that NYISO's authority to suspend virtual bidding is overbroad and that the proposed suspension criteria are vague. Aquila states that it has a number of reservations regarding NYISO's authority to suspend transaction in the virtual market. Lastly, EPMI requests that the Commission maintain oversight of NYISO's authority to suspend trading so that it does not interfere with the market.

The Mirant Companies request that the Commission direct NYISO to incorporate into its tariff objective thresholds or criteria that will trigger the proposed mitigation measures. Mirant Companies argue that the lack of standards for triggering mitigation will create uncertainty and hamper participation in the market. Mirant Companies request that the Commission order revised measures to be in effect no later than April 30, 2002.

III. Discussion

Given the overall support for NYISO's virtual bidding proposal and its importance for further development of the New York energy market, we accept the proposal for filing, subject to conditions. We direct NYISO to make, within 30 days of the date of issuance of this order, a compliance filing, as more fully discussed below.

Many intervenors protest the NYISO-proposed credit policies. The Commission's standard for creditworthiness is reflected in the Commission-approved credit policy for participants in the NYISO-administered physical market, which in turn is consistent with general commercial principles. We agree with intervenors that an excessive collaterization requirement may serve as a barrier to entry into the virtual market. We are persuaded by Joint Movants' and Aquila's argument that seven days, not fourteen days, of collateralization will allow sufficient time[5] for NYISO to monitor participants' market positions, and to suspend participants' services in time to avoid losses. We therefore direct

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[5] Seven days allows NYISO three days to gather data and assess a participants financial position, a day to notify the participant that it is deficient, a day for payment, and two days to act if payment is not made.

NYISO to change the formula for determination of the amount of the collateral to reflect a seven-day collaterization period.

On the other hand, we understand the risks inherent in a new virtual market and the need to proceed with caution until there is sufficient experience with virtual transactions on which to base our judgment. We also note that as the virtual process brings about convergence of the day-ahead and real-time prices, the amount of collateral required will decrease. For these reasons, we approve, subject to the condition discussed above, NYISO's proposed credit policy requirements as an interim measure until operation of the virtual market produces sufficient information to judge the appropriateness of these policies. We, however, find that the description of the credit policies in the tariff sheets submitted by NYISO is not adequate. NYISO is therefore directed to file, within 30 days of the date of this order, revised tariff sheets incorporating the entire credit policy, modified as directed above.

We are also concerned that the differing credit policies for the physical and virtual markets will present one more market inconsistency issue for the Northeastern ISOs to resolve in the formation of the Northeast RTO.[6] We therefore direct NYISO to file, within 30 days of the end of each of the first four capability periods in which virtual bidding is permitted, a report detailing its experience with the virtual market. The report must include, but not be limited to, market interventions, suspensions, mitigation, experience with bad debts and adequacy of and/or need for the differing credit requirements. NYISO should also propose changes to market design promoting formation of a single RTO in the Northeast.

Intervenors also challenge NYISO's authority to unilaterally suspend the virtual market. We, however, believe that the potential for unanticipated design flaws or gaming attempts makes these safeguards necessary. Suspension is limited to conditions specifically related to the virtual transaction market. We also believe that NYISO's commitment to promptly notify the Commission of the suspension of virtual bidding will restrain NYISO from unnecessary interference in the virtual market.

We also accept for filing revisions to NYISO's MMM to address gaming or market power strategies and other unexpected market conditions that may emerge as a result of the introduction of virtual bidding. We find that initially the potential for market implementation flaws warrants a broader level of NYISO's control over the virtual market. In response to Mirant Companies' request to order certain revisions to the proposed market mitigation measures, we will review the reports that NYISO is required to file on its experience with virtual bidding and, if necessary, will order revision of the market mitigation measures.

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[6] PJM applies a single credit policy to all market participants, including virtual bidders.

Also, given the overall support for the November 1, 2001 effective date, we grant waiver of the 60-day notice requirement, as requested.[7]

IV. NYISO's February Report on Virtual Bidding

Notice of NYISO's filing in Docket No. EL00-90-000 was published in the Federal Register, 66 Fed. Reg. 11,016 (2001), with protests, answers, and motions to intervene required to be filed on or before March 5, 2001. Timely motions to intervene were filed by the following entities: Aquila and Constellation Power Source, Inc., EPMI, and Member Systems. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2001), the filing of a timely motion to intervene that has not been opposed makes the movant a party to the proceeding.

Also, Morgan Stanley filed a motion challenging NYISO's proposed timetable for completing implementation of virtual bidding. The following entities filed answers to Morgan Stanley's motion: Ravenswood, New York Pubic Service Commission, NYISO, and PPL EnergyPlus, LLC. Morgan Stanley filed a response to NYISO's answer to its motion.

All parties, except Member Systems and New York Pubic Service Commission, protested NYISO's report, arguing mainly that virtual bidding on NYISO's system should be implemented sooner than November 1, 2001.

NYISO's February Report is hereby accepted for filing in part related to implementation of virtual bidding. We will not address comments and protests filed in Docket No. EL00-90-000 because the issues they raise are moot. We also deny Morgan Stanley's motion as moot. In addition, pursuant to Rule 213(a) of the Commission's Rules of Practice and Procedure,[8] which prohibits an answer to an answer, Morgan Stanley's response to NYISO's answer to its motion is not permitted.

The Commission orders:

(A) NYISO's revised sheets submitted in Docket No. ER01-3009-000 are hereby accepted for filing, subject to modification, effective November 1, 2001, as requested.

(B) NYISO is hereby directed to file, within 30 days of the date of issuance of this order, revised tariff sheets incorporating all the credit policy requirements, subject to the modifications directed by this order.

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[7] Central Hudson Gas & Electric Corporation, 60 FERC ¶ 61,106, reh'g denied, 61 FERC ¶ 61,089 (1992).

[8] 18 C.F.R. § 385.213(a)(2) (2001).

(C) NYISO is hereby directed to modify the formula determining the amount of the collateral to reflect a seven-day collaterization period, as discussed in the body of this order.

(D) NYISO is hereby directed to file, within 30 days of the end of each of the first four capability periods starting with the Winter 2001-2002 capability period, a report describing its experience with virtual bidding, as discussed in the body of this order.

(E) NYISO's revised sheets submitted in Docket No. ER01-3153-000 are hereby accepted for filing, effective November 1, 2001, as requested.

(F) The waiver of the 60-day prior notice requirement is hereby granted.

(G) NYISO's report on virtual bidding is hereby accepted for filing.

(H) Morgan Stanley's Motion for Immediate Commission Action Regarding Virtual Bidding Implementation Schedule is hereby denied as moot.

By the Commission.

(S E A L)

David P. Boergers,
Secretary.

Appendix

New York Independent System Operator
Docket No. ER01-3009-000

Aquila Energy Marketing Corp.*
Dynegy Power Marketing, Inc.
El Paso Merchant Energy, L.P.
Enron Power Marketing, Inc.*
Exelon Generation Company, LLC, and Sithe Power Marketing, LP*
Keyspan-Ravenswood, Inc.*
Member Systems*
Mirant Americas Energy Marketing, LP, Mirant New York, Inc., Mirant Bowline, LLC, Mirant Lovett, LLC, and Mirant NY-GEN, LLC
Niagara Mohawk Energy Marketing, Inc.
NRG Power Marketing Inc., Arthur Kill Power LLC, Astoria Gas Turbine Power LLC, Dunkirk Power LLC, Hutley Power LLC, and Oswego Harbor, LLC
PPL Energyplus, LLC and Constellation Power Source, Inc.*

Docket No. ER01-3153-000

Dynegy Power Marketing, Inc.
Keyspan-Ravenswood, Inc.
Mirant Companies*
NRG Power Marketing Inc., Arthur Kill Power LLC, Astoria Gas Turbine Power LLC, Dunkirk Power LLC, Hutley Power LLC, and Oswego Harbor, LLC
PPL EnergyPlus, LLC

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* parties filing protests or comments