

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

**New York Independent System Operator, Inc.) Docket Nos. ER01-3001-021
ER01-3001-022
ER03-647-012
ER03-647-013**

**ANSWER OF THE NEW YORK TRANSMISSION OWNERS, OR IN THE
ALTERNATIVE, MOTION FOR LEAVE TO REPLY,
AND REQUEST FOR DEFERRED RULING**

Pursuant to Rules 212 and 213 of the Federal Energy Regulatory Commission’s (“FERC” or “Commission”) Rules of Practice and Procedure,¹ Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., Long Island Power Authority, New York Power Authority, New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation d/b/a National Grid, Orange and Rockland Utilities, Inc., and Rochester Gas and Electric Corporation (referred to herein as the “New York Transmission Owners”), individually and collectively file this Answer in opposition to the July 2009 Motion filed by the New York Independent System Operator, Inc. (“NYISO”)² seeking leave to respond to the New York Transmission Owners’ protest³ of the NYISO’s response⁴ to the deficiency letter⁵ issued by the Commission in this proceeding.

In light of the procedural history, the New York Transmission Owners and the NYISO recently conferred to attempt to narrow or otherwise resolve issues and concerns. Based on those

¹ 18 C.F.R. §§ 385.212 and 385.213.

² *N.Y. Indep. Sys. Operator, Inc.*, Motion for Leave to Respond, and Response, of the New York Independent System Operator, Inc., Docket Nos. ER01-3001-021 *et al.* (July 24, 2009) (“July 2009 Motion”).

³ *N.Y. Indep. Sys. Operator, Inc.*, Protest of the New York Transmission Owners, Docket Nos. ER01-3001-021 *et al.* (May 26, 2009) (“May 2009 Protest”).

⁴ *N.Y. Indep. Sys. Operator, Inc.*, Response of the New York Independent System Operator, Inc., Docket Nos. ER01-3001-021 *et al.* (May 4, 2009) (“May 2009 Report”).

⁵ Letter Order, *N.Y. Indep. Sys. Operator, Inc.*, Docket Nos. ER01-3001-021 *et al.* (Apr. 2, 2009) (“Deficiency Letter”).

discussions, the New York Transmission Owners believe that the record in this proceeding would best be served by the Commission deferring its ruling on the May 2009 Report for a period of 60 days following the date of this filing to allow the parties to continue their discussions. On or before the end of the 60-day period, the New York Transmission Owners and the NYISO will report back to the Commission. The NYISO has authorized the New York Transmission Owners to inform the Commission that the NYISO is in agreement with the description in this paragraph and supports this request.

With respect to the NYISO's July 2009 Motion, it should be denied, because the response the NYISO seeks to lodge does not clarify or enhance the record. Indeed, as more fully described below, the NYISO's response fails to directly address the central points made in the May 2009 Protest as to the NYISO's failure to comply with the Commission's directives. In the alternative, if the Commission grants the motion and accepts the NYISO's response to the May 2009 Protest, then the New York Transmission Owners request that the Commission accept this pleading in reply. In the absence of this reply, acceptance of the NYISO's response will result in an incomplete and misleading record.⁶

I. BACKGROUND

On January 15, 2008, the NYISO submitted a report,⁷ purportedly in compliance with an order issued by FERC on October 26, 2007, which directed the NYISO to "provide a complete analysis of withholding (including an analysis of bidding behavior) [of installed capacity] in the

⁶ See, e.g., *N.Y. Indep. Sys. Operator, Inc.*, 99 FERC ¶ 61,246, at 62,040 (2002) (accepting answers to protests that helped to clarify issues and did not disrupt the proceeding); *Morgan Stanley Capital Group, Inc. v. N.Y. Indep. Sys. Operator, Inc.*, 93 FERC ¶ 61,017, at 61,036 (2000) (accepting an answer that was "helpful in the development of the record"); *N.Y. Indep. Sys. Operator, Inc.*, 91 FERC ¶ 61,218, at 61,797 (2000) (allowing an answer deemed "useful in addressing the issues arising in these proceedings"); *Cent. Hudson Gas & Elec. Corp.*, 88 FERC ¶ 61,138, at 61,381 (1999) (accepting otherwise prohibited pleadings because they helped to clarify complex issues).

⁷ *N.Y. Indep. Sys. Operator, Inc.*, Compliance Filing, Docket Nos. ER01-3001-019 *et al.* (Jan. 15, 2008).

Rest of State [“ROS”] region (as well as in the other regions of New York State).”⁸ However, that report failed to include “an examination of how many (if any) of the offers [that were not accepted in the NYISO’s installed capacity spot market auction] significantly exceeded a reasonable estimate of their going forward costs,”⁹ as the Commission had required in its October 2007 Order. So on May 27, 2008, the Commission issued another order, again instructing the NYISO “to submit an analysis of ROS capacity offers that were not accepted by comparing the capacity offers submitted to a reasonable estimate of the resources’ going forward costs.”¹⁰

The NYISO submitted a filing on July 25, 2008,¹¹ purportedly in compliance with the May 2008 Order. The NYISO also submitted a filing on January 15, 2009,¹² which among other things, addressed withholding of Installed Capacity (“ICAP”) in the ROS region during calendar year 2008. On April 2, 2009, the Director of the Commission’s Division of Tariffs and Market Development – East issued a deficiency letter to the NYISO, indicating that both the July 2008 Report and the January 2009 Report were deficient, and containing specific directives regarding additional analyses that the NYISO was required to perform and additional information it was required to provide to support the conclusions the NYISO reached in those reports.¹³ On May 4, 2009, the NYISO submitted the May 2009 Report in response to the Deficiency Letter. In response, the New York Transmission Owners filed the May 2009 Protest, which demonstrated that the May 2009 Report failed to comply with the directives contained in the Deficiency Letter. On July 24, 2009, the NYISO filed the July 2009 Motion, which is the subject of this answer.

⁸ *N.Y. Indep. Sys. Operator, Inc.*, 121 FERC ¶ 61,090 at P 37 (footnote omitted) (“October 2007 Order”).

⁹ October 2007 Order at P 37, n.19.

¹⁰ *N.Y. Indep. Sys. Operator, Inc.*, 123 FERC ¶ 61,206, at P 42 (“May 2008 Order”).

¹¹ *N.Y. Indep. Sys. Operator, Inc.*, Compliance Filing, Docket Nos. ER01-3001-021 *et al.* (July 25, 2008) (“July 2008 Report”).

¹² *N.Y. Indep. Sys. Operator, Inc.*, Compliance Filing, Docket Nos. ER01-3001-022 *et al.* (Jan. 15, 2009) (“January 2009 Report”).

¹³ Deficiency Letter at 2, 3.

II. ANSWER

The July 2009 Motion does not address the NYISO's failure to comply with the directives contained in the Deficiency Letter.

A. First Directive: Revise Estimates of Going-Forward Costs

The Deficiency Letter contained two primary directives. Under the first of these directives, the NYISO was ordered to submit a revised analysis of estimated going-forward costs for ROS generators that offered ICAP in Spot Market Auctions conducted by the NYISO, but which did not sell ICAP in those auctions, and to provide a revised analysis of whether ROS ICAP was economically withheld in those auctions, based on those revised estimates of going-forward costs.¹⁴ The revised estimates of going-forward costs were to exclude “adjustments for costs associated with the risks of Day-Ahead Market bidding and for burning Powder River Basin coal”¹⁵ that had been included in the analysis performed in the July 2008 Report. In addition, “to account for the uncertainty in estimating the energy and ancillary services revenues that a generator owner (at the time it submits its bid into the capacity market) could expect to receive,”¹⁶ the NYISO was directed “to include [in its estimates of going-forward costs] a reasonable range of values for such expected energy and ancillary service revenues.”¹⁷

As the May 2009 Protest demonstrated, the estimates of going-forward costs included in the May 2009 Report failed to meet this directive for several reasons: (i) the calculations

¹⁴ *Id.* at 2.

¹⁵ *Id.* The New York Transmission Owners pointed out in their protest of the July 2008 Report that there was no plausible basis for including these adjustments in going-forward costs. *N.Y. Indep. Sys. Operator, Inc.*, Protest of the New York Transmission Owners, Docket Nos. ER01-3001-021 *et al.* at 7-10 (Aug. 15, 2008) (“August 2008 Protest”).

¹⁶ Deficiency Letter at 2.

¹⁷ *Id.*

appeared to include a number of data and arithmetic errors; (ii) the NYISO failed to provide the required range of values for energy and ancillary services revenues that a generator might reasonably expect to receive; and (iii) the NYISO's point estimate of the amount by which generators might increase their offers to reflect this uncertainty was inconsistent with the NYISO's projections for the net revenues that generators would expect to receive from the sale of energy and ancillary services. The NYISO's revised assessment of whether ROS ICAP was withheld and the implications of any withholding for ROS ICAP prices were also fatally flawed, since it was based on those flawed estimates of going-forward costs. Except for one minor data correction,¹⁸ the July 2009 Motion does not remedy any of these deficiencies.

1. The NYISO's Estimates of Going-Forward Costs Continue to Be Based on Unrealistic Calculations of the Net Revenues that Generators Would Earn on Sales of Energy and Ancillary Services.

In the May 2009 Protest, the New York Transmission Owners pointed out that in many cases, the NYISO's estimate of going-forward costs included net energy and ancillary service revenues that were frequently negative.¹⁹ This would suggest that generators would not even cover the variable costs incurred to produce energy or ancillary services, as this outcome could only occur if generators' bids were less than these variable costs.²⁰ However, there is no reason to expect that generators would submit such bids.

The July 2009 Motion does not provide any reason to believe that generators would bid in such a manner. Consequently, it provides no reason to justify the inclusion of a loss on sales of energy and ancillary services in the NYISO's calculation of going-forward costs. Rather, the

¹⁸ The NYISO corrected the maintenance adjustment that appeared in the table it used to illustrate its calculation of the going-forward costs of Class B generators in 2008. *See* July 2009 Motion at 3-4. With this correction, the arithmetic error noted in the May 2009 Protest (at 7) for this class is eliminated.

¹⁹ May 2009 Protest at 4-7.

²⁰ The NYISO makes Bid Production Cost Guarantee payments to generators that ensure that the revenues they receive are at least equal to the bids they submitted to provide the energy and ancillary services they are directed to provide. *See* Services Tariff, Att. C.

NYISO simply says, “a determination of net revenues calculated across the units in each of the relevant classes of units produces the results submitted in the May 2009 Report.”²¹ It is unclear why averaging these results over all of the generating units in a class should produce negative net revenues. Since the net revenue calculated for each generator in a given class should be positive, the average calculated for all units in that class should be positive.

The NYISO should be directed to provide an explanation of these calculations, containing sufficient detail so that the Commission and market participants can review it and assess whether the methodology is reasonable. If these calculations nevertheless yield a negative estimate of the net revenue from the sales of energy and ancillary services results for a given class in a given year, the NYISO’s calculation of going-forward costs for that class and year should be based on the assumption that net energy and ancillary services revenues will be zero, since that is the lowest plausible value.²²

2. The NYISO Has Still Not Addressed The Failure of Its Report to Provide A Range of Net Energy and Ancillary Services Revenues, as Directed.

The NYISO’s original estimates of going-forward costs, which were included in the July 2008 Report, were based on a single point estimate of net energy and ancillary services revenues. As the May 2009 Protest pointed out, the Deficiency Letter directed the NYISO “to include a reasonable range of values for such expected energy and ancillary service revenues”²³ in its analysis. This range was intended “to account for ... uncertainty in estimating [net] energy and

²¹ July 2009 Motion at 9.

²² The July 2009 Motion states, “[T]he Transmission Owners provide no support for their assertion that the negative numbers on Exhibit D should be converted to positive numbers with the same absolute value.” July 2009 Motion at 9. The New York Transmission Owners made no such assertion. While the New York Transmission Owners noted that a possible explanation for these implausible results was that the NYISO had accidentally used negative numbers where it meant to use positive ones (*see* May 2009 Protest at 6), the New York Transmission Owners simply requested that the Commission direct the NYISO to “[c]orrect the data and arithmetic errors in Exhibit D...” May 2009 Protest at 10.

²³ May 2009 Protest at 7, citing Deficiency Letter at 2.

ancillary services revenues.”²⁴ However, the May 2009 Report failed to provide such a range.

In the July 2009 Motion, the NYISO asserts, “The Transmission Owners’ assertion that Mr. Ungate’s analysis was not based on a range of estimates is not correct,”²⁵ but this wholly misses the point (as well as mischaracterizing the content of the May 2009 Protest). Whether Mr. Ungate’s analysis was *based* on a range of estimates is not relevant. As the Deficiency Letter clearly states, the NYISO was directed to “revise [its] analysis to include a reasonable range of values for such expected energy and ancillary service revenues.”²⁶ Nowhere does the July 2009 Motion address the fact that the May 2009 Report fails to provide such a range, and instead utilizes a single point estimate of energy and ancillary service revenues.

This is the point that the New York Transmission Owners made in the May 2009 Protest.²⁷ The NYISO should be directed to provide such a range, together with justification for that range.

3. The NYISO’s Estimate of the Risk Premium that Generators Would Require Due to Uncertainty in Net Energy and Ancillary Services Revenues Is Still Inconsistent with its Estimates of Those Revenues.

In the May 2009 Report, the NYISO included a risk premium in its estimate of going-forward costs to reflect uncertainty in net energy and ancillary services revenues. As the May 2009 Protest demonstrated, in many cases, the value used for this risk premium exceeded the value that had been used for net energy and ancillary services revenues in the first place.²⁸ The May 2009 Protest observed that there was no reason to believe that the risk premium included to account for uncertainty in net energy and ancillary services revenues should exceed the expected value of those revenues, since there is no reason to believe that net energy and ancillary services

²⁴ Deficiency Letter at 2.

²⁵ July 2009 Motion at 11.

²⁶ Deficiency Letter at 2.

²⁷ See May 2009 Protest at 10, Step 2.

²⁸ See May 2009 Protest, Appendix A, Table 2.

revenues would ever be negative.

The July 2009 Motion fails to address this point. Instead, it states, “If prices were lower than projected . . ., Mr. Ungate evaluated how much a generator seeking compensation for price uncertainty would have to raise its capacity offer to account for lower energy revenues.... [T]he data implies that energy prices can be much lower than expected, and thus the revenue uncertainty relatively high.”²⁹ If this revenue uncertainty is very high, generators might discount this revenue significantly. In the extreme, they might discount it altogether. But the July 2009 Motion provides no reason to believe that estimates of going-forward costs that take into account energy and ancillary services revenues would exceed estimates of going-forward costs that do not account for those revenues. Nevertheless, that is just what happens with the estimates of going-forward costs used in the May 2009 Report.

As previously noted, to comply with the Deficiency Letter, the NYISO must use a range of net energy and ancillary services revenues in its calculations of going-forward costs. The values used for net energy and ancillary services revenues at either end of that range should reflect a relatively large amount of discounting to account for uncertainty (indicating that these revenues are relatively uncertain) and a relatively small degree of discounting (indicating that these revenues are relatively certain). For example, one approach would be for the NYISO to prepare one set of estimates of going-forward costs under the assumption that net energy and ancillary services revenues were zero (which would indicate that uncertainty caused these revenues to be discounted in their entirety), while preparing another set of estimates of going-forward costs under the assumption that net energy and ancillary services revenues were equal to the projected level (which would indicate that no discounting to reflect uncertainty was

²⁹ July 2009 Motion at 12.

necessary).³⁰ .

The Deficiency Letter also requires the NYISO to “provide the results of [its] analysis, including the associated range of capacity prices....”³¹ To comply, the NYISO should indicate what ROS capacity prices would have been if ROS capacity, that was offered but not sold, had been offered at going-forward costs, both under the assumption that net energy and ancillary services revenues were at the low end of the range, and under the alternative assumption that net energy and ancillary services revenues were at the high end of the range.

B. Second Directive: Assess Whether Generators’ Tail-End Bids Were Consistent with Competitive Behavior

The Deficiency Letter also noted that the NYISO had stated that offered but unsold ROS ICAP generally would have been provided using the upper output levels, or “tail ends,” of generating units. Consequently, in its second directive, the Deficiency Letter ordered the NYISO to explain why unaccepted bids to provide ROS ICAP using the upper output levels of generating units were “consistent with competitive bidding behavior,”³² and to explain whether these bids “reflect the actual going-forward costs of the associated ‘tail-end’ portion of the capacity.”³³

As the May 2009 Protest indicated, the May 2009 Report failed to meet this directive because it never answered these questions. Moreover, the discussion that the NYISO did provide suggested that it did not fully comprehend the analysis that it would need to perform in order to answer the questions posed in the Deficiency Letter. Once again, the July 2009 Motion does not

³⁰ It might be reasonable to set the low end of the range of net energy and ancillary services revenues above zero, and to set the high end of that range below the projection that ignores any uncertainty, but the NYISO should be directed to include sufficient detail in its response so that the Commission and market participants can assess whether the degree of discounting reflected by each end of this range is reasonable. In no case should the low end of range of net energy and ancillary services be less than zero, nor should the high end of this range be greater than the level for these revenues that was projected before considering uncertainty.

³¹ Deficiency Letter at 2.

³² *Id.*

³³ *Id.*

remedy any of these deficiencies.

1. The NYISO Has Not Provided Any Assessment of Whether Bids for Offered But Unsold Tail-End Capacity is Consistent with Competitive Bidding Behavior.

In the May 2009 Protest, the New York Transmission Owners pointed out that the May 2009 Report never explained why bids for unforced capacity (“UCAP”) that would have been provided using the tail ends of generating units, but which were not accepted because the minimum prices specified in those bids were too high, were consistent with competitive bidding behavior. Nor did the May 2009 Report ever explain whether those bids reflected the actual going-forward costs of tail-end capacity.

In the July 2009 Motion, the NYISO responds, “The Transmission Owners’ Protest ... claims that the NYISO should be directed to perform a series of detailed generator-specific calculations.”³⁴ The NYISO goes on to claim, “[A]ny such calculations would be a new form of analysis going well beyond the class-based estimates of going-forward costs that the Commission directed the NYISO to provide.”³⁵ On the contrary, this is exactly what the Deficiency Letter directed the NYISO to provide. The Deficiency Letter instructed the NYISO to “explain why the generating units’ high end bids are consistent with competitive bidding behavior,”³⁶ and to “explain whether [these] bids reflect the actual going-forward costs of the associated ... capacity.”³⁷ The July 2009 Motion fails to explain how the NYISO can possibly perform these assessments without examining data for individual generating units that offered tail-end capacity, but did not sell that capacity. Consequently, the NYISO is clearly incorrect when it asserts that the May 2009 Protest asks it to perform additional “generator-specific

³⁴ July 2009 Motion at 13.

³⁵ *Id.*

³⁶ Deficiency Letter at 2.

³⁷ *Id.*

calculations.” It was already directed to perform these analyses in the Deficiency Letter.

2. The NYISO Continues to Mix Factors That Would Justify Higher Bids for Energy Produced Using the Tail Ends of Generating Units with Factors That Would Justify Higher Bids for Capacity Provided using the Tail Ends.

The May 2009 Report contained a discussion of the factors that, in the NYISO’s view, could cause going-forward costs for capacity provided by the tail end of a generator to be higher than going-forward costs of the rest of the generator. In the May 2009 Protest, the New York Transmission Owners pointed out that the going-forward costs for tail-end capacity could only be higher than going-forward costs for a generator’s remaining capacity if reducing the amount of ICAP that a generator can provide would yield significant reductions in going-forward costs, and that the NYISO’s discussion therefore implicitly assumed such savings could be realized. In the July 2009 Motion, the NYISO denied this, asserting, “[T]he discussion in the May 2009 Report is premised on a unit being *committed* at high levels of capacity and energy, and the consequent potential risks, in terms of outages and other adverse effects.”³⁸

This rationale has surfaced before, as the NYISO used it to justify the day-ahead market bidding adjustment that was included in the estimates of going-forward costs reported in the July 2008 Report. The New York Transmission Owners concur that if a generator operates at higher output levels, it may experience increased wear and tear, and its probability of incurring an outage may also increase. But, as the New York Transmission Owners stated while protesting the inclusion of this factor in those estimates of going-forward costs, while it might be appropriate to increase the *energy* bids for the tail end of a unit to reflect costs associated with these risks, there is no reason why these risks should cause increases in bids to provide *capacity*

³⁸ *Id.* (Emphasis in original; footnote omitted.)

using the tail end of a unit.³⁹

In the Deficiency Letter, the Commission directed the NYISO to remove this day-ahead market bidding adjustment from its estimates of going-forward costs. Similarly, the Commission should direct NYISO to include only the costs that are actually incurred as a result of providing capacity using the tail ends of generating units when it performs its analysis of the going-forward costs for tail-end capacity. Day-ahead market bidding adjustments should not be included in going-forward costs for tail-end capacity, for the same reasons why they are not included in going-forward costs for a unit as a whole. As the New York Transmission Owners demonstrated in detail in the May 2009 Protest, the same principles that apply to the determination of going-forward costs for an entire unit should also be applied to determine going-forward costs for the tail end of that unit. In particular, this means that if a generator owner cannot realize significant savings as a result of eliminating that generator's ability to produce energy using its tail end, then the going-forward costs for the tail end cannot be substantially above the going-forward costs for the rest of the generator.

IV. CONCLUSION

For the reasons stated above, the New York Transmission Owners respectfully request that the Commission reject the July 2009 Motion, or in the alternative, if it elects to accept the July 2009 Motion that the Commission accept these comments in reply, and defer ruling on the May 2009 Report for a period of 60 days to allow the parties to attempt to narrow or otherwise resolve these issues and report back to the Commission.

Respectfully submitted,

/s/ Elias G. Farrah by NJJ

³⁹ See August 2008 Protest at 8-9.

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Dated: August 10, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list in this proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Washington, D.C. this 10th day of August, 2009.

/s/ Claire M. Brennan

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