

September 4, 2001

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FILE NO: 55430.000042

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, NE, Room 1A
Washington, D.C. 20426

New York Independent System Operator, Inc.'s Filing of
Tariff Revisions to Implement Virtual Bidding

Dear Mr. Boergers,

Pursuant to Section 205 of the Federal Power Act, the New York Independent System Operator, Inc. ("NYISO"), by counsel, hereby submits revisions to its Open Access Transmission Tariff ("OATT") and Market Administration and Control Area Services Tariff ("Services Tariff") to address implementation of bidding procedures that would allow Market Participants¹ to bid non-physical (i.e. "virtual") generation and load into the Day-Ahead Market and settle those bids in the Real-Time Market. Specifically, the NYISO proposes to: (i) make changes to its market design to implement virtual bidding procedures and (ii) make changes to its credit policies to accommodate virtual bidding and address the special creditworthiness concerns it creates.

I. Documents Submitted

1. This letter;
2. Clean revised sheets from the OATT incorporating new tariff provisions proposed by the NYISO ("Attachment I");

¹ Capitalized terms not otherwise defined herein having the meaning ascribed to them in Article 2 of the Services Tariff.

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3. Redlined revised sheets from the OATT depicting the new tariff provisions proposed by the NYISO (“Attachment II”);
4. Clean revised sheets from the Services Tariff incorporating new tariff provisions proposed by the NYISO (“Attachment III”);
5. Redlined revised sheets from the Services Tariff depicting the new tariff provisions proposed by the NYISO (“Attachment IV”); and
6. A form of Federal Register Notice (“Attachment V”).

II. Copies of Correspondence

Communications regarding this proceeding should be addressed to:

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III. Background

On October 5, 2000, the Commission issued an order directing the NYISO to file a report on its development of a plan to implement bidding of non-physical, *i.e.*, financial-only, supply and demand (“Virtual Transactions”).² In compliance, on February 2, 2001, the NYISO filed its Report on the Implementation of Virtual Bidding and Zonal Price-Capped

² *Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.*, 93 FERC ¶ 61,107 (2000).

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Bidding (“February 2 Report”) that described the NYISO’s efforts to implement virtual load bidding.³ In the February 2 Report, the NYISO outlined the steps necessary to develop and test virtual bidding procedures, and identified November 1, 2001, as the target implementation date.

Since the February 2 Report, the NYISO has worked diligently to develop and test mechanisms, including the necessary software modifications, for extending the opportunity to bid non-physical supply and demand to all Customers in the wholesale markets, including marketers and others who do not own physical assets for production or consumption of energy. The NYISO has also worked jointly with Market Participants to devise bidding and settlement procedures and credit policies applicable to virtual bidding. On August 2, 2001, the NYISO Management Committee approved a motion to implement virtual bidding, as presented by NYISO staff, by a vote of 92.77% and directed the NYISO to develop compatible credit policies to address virtual bidding. On August 21, 2001, the NYISO Board of Directors approved a motion directing the NYISO to implement virtual bidding.

The NYISO is designing the software changes necessary to implement virtual bidding within the New York Control Area⁴ and will begin final testing of these systems in October. As described in greater detail below, the NYISO asks the Commission to accept its proposed addition of virtual bidding to the NYISO-administered markets. This feature will expand the opportunity to participate in the NYISO-administered markets to include bids not associated with physical generation or load. This expanded bidding opportunity will increase the liquidity of the NYISO-administered Energy markets and thereby has the potential to increase the convergence of Day-Ahead and Real-Time prices.

³ *New York Independent System Operator, Inc.’s Report on the Implementation of Virtual Bidding and Zonal Price-Capped Load Bidding* in Docket No. EL00-90-000. (February 2, 2001).

⁴ It has been possible to engage in a form of virtual bidding at the NYCA’s four external proxy buses since the inception of the NYISO-administered markets. The existing market rules will continue to apply to bids submitted for transactions at the proxy buses. The changes proposed here will make it possible to enter virtual bids at any of eleven internal zonal load buses designated specifically for virtual bidding. Customers that wish to submit virtual bids will be required to identify the zone in which they intend to submit transactions.

IV. Summary of Virtual Bidding Procedures

The proposed virtual bidding procedures will open the NYISO-administered energy markets to non-physical customers by allowing for the submission of bids for purely financial purchases or sales of energy, rather than (or in addition to) purchases or sales associated with the physical input or withdrawal of energy. As proposed, the NYISO's virtual bidding procedures would allow a qualified customer to buy energy ("virtual load") in the Day-Ahead Market at Day-Ahead prices and sell it in the Real-Time Market at Real-Time prices or to sell energy ("virtual supply") in the Day-Ahead Market at Day-Ahead prices and buy energy to cover that sale in the Real-Time Market at Real-Time prices. Virtual bidding transactions ("Virtual Transactions") are financial transactions only and do not entail the physical generation or consumption of electricity.

A. Credit Policies Regarding Virtual Transactions

Working closely with Market Participants, the NYISO has determined that its existing credit policies are not adequate to address the potential financial risks associated with Virtual Transactions. Accordingly the NYISO has developed interim credit policies applicable to virtual bidding.⁵ Among the policies are the requirement that Virtual Transactions be fully collateralized, and that all customers maintain an irrevocable letter of credit or a cash deposit to support Virtual Transactions. Additionally, the NYISO would have authority to suspend services to a customer for failing to demonstrate creditworthiness in addition to its existing authority to terminate service to a customer for this reason.

B. Suspension of Virtual Transactions

Because virtual bidding will introduce a host of new financial complexities, and potential financial volatility, into the NYISO-administered markets, the NYISO believes that it must have the authority to temporarily suspend virtual trading in the event that: (i) the financial exposure of customers cannot be determined with reasonable accuracy due to a system malfunction; (ii) a market aberration associated with Virtual Transactions substantially impairs the functioning of the NYISO-administered markets; or (iii) Virtual Transactions substantially

⁵ The NYISO is currently reviewing all of its credit policies, and the interim credit policies applicable to Virtual Transactions will be reviewed as part of that initiative. The NYISO may propose further modifications to its permanent credit policies regarding Virtual Transactions after it gains more experience with this new market feature.

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impair the reliability of the New York State Transmission System. Temporary suspension authority under these limited conditions is a necessary safeguard since, while the NYISO has a high degree of confidence in the implementation of virtual bidding, the effects of this new market feature are not yet fully known and it is possible that unanticipated design flaws or gaming attempts could have serious adverse consequences. If the NYISO were to invoke its suspension authority it would report to the Commission as quickly as possible to indicate the reasons for the suspension, what must be done to restore virtual bidding, and the time that restoration of virtual bidding is likely to require.

C. Allocation of Losses Attributable to Virtual Transactions

Currently, costs incurred as a result of bad debts are recovered through Rate Schedule 1 and are paid entirely by Load Serving Entities. The NYISO proposes to amend this cost recovery mechanism so that costs incurred from bad debts resulting from Virtual Transactions will be shared by all customers, as explained in the formula in the proposed revisions to the Schedule 1 of the Services Tariff attached to this letter. This change is proposed in recognition of the fact that Virtual Bidding directly benefits all customers who are eligible to submit Virtual Transactions, and that Virtual Transactions may present a risk of loss that is greater than physical transactions. In addition, this change is consistent with the changes that the NYISO soon plans to propose regarding its overall credit policies applicable to all NYISO-administered transactions.

D. Allocation of Uplift Charges

Generators committed to secure forecast load in the Day-Ahead Market are given Bid Production Cost Guarantees (“BPCG”) to ensure their LBMP revenue recovers their minimum generation and start-up costs.⁶ BPCGs are currently recovered from Load Serving Entities on a Load-weighted share. Virtual bidding may increase the amount of generation scheduled to secure forecast Load and, therefore, may increase the amount of BPCG required to be paid. Rather than allocate this increase to Load, the NYISO and its Market Participants have developed an allocation mechanism, described in Attachment T to Rate Schedule 1 of the OATT, which would allocate BPCG to Customers, other than Suppliers, that are short in Real-Time Market. Customers that arrange to sell Energy through Virtual Transactions, by definition, will be short in the Real-Time Market and will accordingly bear the majority of

⁶ Units on dispatch also are guaranteed their bid costs.

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these costs. Loads that underbid in the Day-Ahead Market will also, appropriately, bear some of these costs. Costs related to BPCG that are paid to generators as a result of over-forecasting of Real-Time Load by the NYISO will be allocated to Load Serving Entities under the existing formula.

E. Market Monitoring and Mitigation

The NYISO has determined that certain modifications to its market monitoring and mitigation tools should be in place before the virtual bidding is implemented. The NYISO is currently resolving the details of these modifications with its stakeholder committees and will soon make a filing proposing necessary revisions to its market monitoring and mitigation plan. In that filing, the NYISO will ask for expedited consideration so that the market monitoring and mitigation changes may become effective at the same time as the virtual bidding provisions proposed herein.

V. Description of Proposed Changes

A. Virtual Bidding Mechanisms

The NYISO has made various revisions to the OATT and the Services Tariff to enable Market Participants to bid non-physical (i.e. “virtual”) generation and load into the Day-Ahead Market and settle those bids in the Real-Time Market. These changes are included in the clean and redlined versions of the OATT and the Services Tariff as identified in Attachments I, II, III, and IV of this letter.

B. Temporary Suspension of Virtual Transaction

As identified in Attachment IV, Section 5.2 of the Services Tariff is added to give the NYISO the authority to temporarily suspend Virtual Transactions under certain limited circumstances.

C. Credit Policies Regarding Virtual Transactions

As identified in Attachment IV, Section 8.4 of the Services Tariff creates special credit requirements applicable to Virtual Transactions.

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D. Loss Sharing Related to Virtual Transactions

As identified in Attachment IV, Rate Schedule 1 and Attachment I of the Services Tariff specify the mechanisms through which the NYISO will recover costs the NYISO incurs as a result of bad debt attributable to Virtual Transactions. These costs shall be recovered from Customers according to a formula contained in Attachment I of the Services Tariff.

VI. Proposed Effective Date

The NYISO respectfully requests that the tariff revisions proposed in this filing become effective on November 1, 2001. The NYISO submits that good cause exists for a waiver of the Commission's usual sixty-day notice period⁷ because virtual bidding represents a substantial improvement in the NYISO-administered markets, and the proposed changes have the broad support of Market Participants. Furthermore, the Commission has placed a high priority on the implementation of virtual bidding in the New York markets, and November 1 was the original target implementation date indicated in the February 2 Report.

VII. Federal Register Notice

A form of Federal Register Notice is provided as Attachment V hereto.

VIII. Service List

Copies of this filing are being served on all signatories of the OATT and Services Tariff and all parties in Docket No. EL00-90-000.

⁷ 18 C.F.R. § 35.11 (2000)

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IX. Conclusion

WHEREFORE, for the foregoing reasons, the New York Independent System Operator, respectfully requests that the Commission accept the proposed tariff changes identified in this filing.

Respectfully submitted,

NEW YORK INDEPENDENT
SYSTEM OPERATOR, INC.

By _____
Counsel

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Of Counsel

cc: All signatories to the OATT and Services Tariff
All parties in Docket No. EL00-90-00

ATTACHMENT I

ATTACHMENT II

ATTACHMENT III

ATTACHMENT IV

ATTACHMENT V

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

New York Independent System Operator, Inc.)

Docket No. EL00-90-000

NOTICE OF FILING

Take notice that on September 4, 2001, the New York Independent System Operator, Inc. ("NYISO"), acting pursuant to Section 205 of the Federal Power Act with concurrence of the NYISO's independent Board of Directors ("NYISO Board") and the Management Committee, filed proposed revisions to the NYISO's Open Access Transmission Tariff ("OATT") and Market Administration and Control Area Services Tariff ("Services Tariff"). The proposed filing would implement virtual bidding procedures. The NYISO has requested that the Commission make the filing effective on October 30, 2001.

A copy of this filing was served upon all parties in Docket No. EL00-90-000.

Any person desiring to be heard to protest this filing should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, NE, Washington, DC 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. §§ 385.211 and 385.214). All such motions or protests should be filed on or before _____. Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a motion to intervene. Copies of this application are on file with the Commission and are available for public inspection.

David P. Boergers
Secretary

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person on the official service list compiled by the Secretary in Docket No. EL00-90-000, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 2010 (1999).

Dated at Washington, D.C. this 4th day of September 2001.

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