10 Krey Boulevard ♦ Rensselaer, NY 12144

THIS FILING LETTER DOES NOT CONTAIN ANY PRIVILEGED OR CONFIDENTIAL INFORMATION. ATTACHMENTS C, D AND E TO THIS FILING LETTER CONTAIN PRIVILEGED AND CONFIDENTIAL INFORMATION. ATTACHMENTS C, D AND E TO THIS FILING ARE SUBMITTED IN A SEPARATE, CLEARLY MARKED ENVELOPE.

September 4, 2009

BY HAND DELIVERY

Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: New York Independent System Operator, Inc.'s Filing Requesting Authority to Prospectively Apply New Mitigation Rules to Three Specifically Identified Generators, Requesting Limited Waivers of the NYISO's Tariff and of the Commission's Regulations, Seeking Expedited Commission Action, and Requesting Shortened Notice and Comment Periods; Docket No. ER09-___-000.

Dear Secretary Bose:

Pursuant to Section 205 of the Federal Power Act ("FPA"),[1] the Federal Energy Regulatory Commission's ("Commission's") *Guidance Order on Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators* ("Guidance Order"),[2] and Sections 1(b) and 3.2.3 of the New York Independent System Operator, Inc.'s ("NYISO's") Market Mitigation Measures ("MMM"),[3] at the direction of its Board of Directors ("Board"), the NYISO hereby submits its *Filing Requesting Authority to Prospectively Apply New Mitigation Rules to Three Specifically Identified Generators, Requesting Limited Waivers of the NYISO's Tariff and of the Commission's Regulations, Seeking Expedited Commission Action, and Requesting Shortened Notice and Comment Periods* and respectfully requests that the Commission accept the proposed stand-alone Rate Schedule Market Mitigation No. 1 ("Rate Schedule M-1") that is included as Attachment A to this filing letter on an expedited basis so that

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[1] 16 U.S.C. § 824d (2007).

[2] *Guidance Order on Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,009 (2005).

[3] The NYISO's Market Mitigation Measures are set forth in Attachment H to its Market Services and Control Area Administration Tariff.

proposed Rate Schedule M-1 is permitted to become effective on September 8, 2009; one business day after the date of this filing.

Sections 1(b) and 3.2.3 of the NYISO's MMM require the NYISO to submit a Section 205 filing proposing to implement a new mitigation measure in response to conduct it identifies that constitutes an abuse of market power, but that does not trigger the conduct and impact mitigation thresholds set forth in the MMM, if the identified behavior increases an hourly market clearing price, or daily guarantee payments by 100% or more.[4] As explained in greater detail below, the NYISO's monitoring of offering behavior below the conduct and impact thresholds that is required by its MMM, along with the NYISO's ongoing efforts to identify causes of uplift in its markets, has identified three Market Parties[5] whose Generators are being committed for reliability (not based on the economics of their Bids), that have each received guarantee payments that exceed the "100% increase in guarantee payments" mandatory filing threshold specified in Section 3.2.3(2) of the MMM.

The NYISO describes the evidence it has collected in support of its determination that three specific Generators should be subject to a conduct-specific proposed mitigation measure in Section III of this filing, and provides Generator-specific details for the Commission's consideration in Privileged and Confidential Attachments C, D and E to this filing letter.[6]

Consistent with the requirements of Sections 1(b) of the MMM, which requires the NYISO to "identify the particular conduct that the ISO believes warrants mitigation" and to "propose a specific mitigation measure for that conduct," the NYISO has worked with its Independent Market Advisor to develop a proposed mitigation measure that is tailored to address the specific conduct it has identified. The NYISO's proposed mitigation measure is described in Section IV of this filing letter and is set forth in proposed Rate Schedule M-1, which is included as Attachment A to this filing. Attachment B to this filing is an Affidavit of Dr. David Patton, Independent Market Advisor[7] to the NYISO. Dr. Patton's Affidavit explains in detail the design of the NYISO's proposed mitigation measure and how it is carefully tailored to address the specific conduct that the NYISO identified. In his attached Affidavit, Dr. Patton also concurs with the NYISO's Market Monitoring Department's ("MMP's")[8] conclusion that the Bids that

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[4] *See* MMM §§ 3.2.3(1) and (2).

[5] Capitalized terms not otherwise defined herein have the meaning ascribed to them in Article 2 of the NYISO's Market Services Tariff, or in its MMM.

[6] The NYISO has also provided to each affected Market Party a complete copy of the Privileged and Confidential Attachment to this filing letter (Attachment C, D or E) that addresses its Generator.

[7] The NYISO's May 15, 2009 compliance filing in Docket No. ER09-1142-000 proposes to make Potomac Economics, the company that performs the duties of the NYISO's Independent Market Advisor, the NYISO's Market Monitoring Unit.

[8] The NYISO's May 15, 2009 compliance filing in Docket No. ER09-1142-000 proposes to modify the duties assigned to the NYISO's Market Monitoring and Performance Department, and to change the name of that department to the Market Mitigation and Analysis Department.

are the basis for the NYISO's proposed mitigation measure reflected an exercise of market power and departs significantly from the conduct that he would expect to see under competitive market conditions.

As explained in Section VI of this filing letter, the NYISO is both authorized and required by its MMM to submit this filing and, accordingly, that it does not require authorization through its stakeholder governance process. However, several aspects of this filing are specifically designed to address possible stakeholder concerns about the absence of a stakeholder process. First, the mitigation measure proposed in this filing will (absent further authorization by the Commission[9]) only apply to the three Generators for which Bids were submitted that exceeded the threshold set forth in Section 3.2.3(2) of the NYISO's Market Mitigation Measures. While the NYISO could have requested broader application of its proposed mitigation measures, the NYISO interprets Sections 1(b) and 3.2.3 of the MMM as permitting it to propose a mitigation measure that is narrowly targeted to specific Generators that have exceeded the thresholds set forth in Section 3.2.3 of the MMM. The NYISO's submission of proposed mitigation measures in these circumstances has already been authorized by the Commission. The potentially affected Generators will, of course, have an opportunity to intervene in the docket that is assigned to this filing and raise any issues they deem relevant. Second, at the upcoming September 14, 2009 Market Issues Working Group ("MIWG") meeting the NYISO staff will initiate discussions with its stakeholders to develop a general mitigation measure to apply to all rest-of-state Generators that are committed or dispatched for reliability. This broader measure should and will be subject to the full stakeholder process for revisions to the MMM. Once the stakeholder process is completed, the NYISO expects to submit a FPA Section 205 filing that will propose replacing the Rate Schedule M-1 that is proposed in this filing with the general mitigation measure that the NYISO designed jointly with its stakeholders.

As discussed in further detail in Section VIII below, Attachments C, D and E contain confidential, proprietary and commercially sensitive information. Disclosure of this information could cause commercial harm to each entity to which it relates, and could harm the markets administered by the NYISO. Accordingly, the NYISO requests confidential treatment for these three attachments.

The NYISO requests waiver of (1) the six month limit on the application of mitigation that is set forth in Section 4.7 of its MMM in Section V of this filing letter; (2) the obligation to submit redacted versions of Privileged and Confidential Attachments C, D and E hereto in Section VIII of this filing letter; (3) service requirements contained in Section 35.2(d) of the

[9] As explained in Section IV of this filing, below, the NYISO's proposed Rate Schedule M-1 will only apply to Generators to which the NYISO receives Commission authorization to apply the measure. In this filing, the NYISO requests permission to apply the new mitigation measure to offers submitted on behalf of the three Generators identified in Privileged and Confidential Attachments C, D and E to this filing letter. In order for Rate Schedule M-1 to apply to a different or additional Generator the NYISO would have to submit a separate filing to the Commission justifying the application of proposed Rate Schedule M-1 to that Generator.

Commission's Regulations in Section XI of this filing letter; and (4) other requirements contained in Part 35 of the Commission's regulations in Section XII of this filing letter.

The NYISO requests expedited consideration of this filing so that its proposed Rate Schedule M-1 is permitted to become effective on Tuesday, September 8, 2009, one business day after the date of this filing.[10] In accordance with Section 35.11 of the Commission's Regulations, the NYISO requests waiver of the 60-day prior notice period set forth in Section 205(d) of the Federal Power Act and Section 35.3 of the Commission's Regulations.[11] The NYISO also requests that the Commission shorten or waive the comment period in order to permit it to act on the NYISO's filing as expeditiously as possible. Unless it is instructed to do otherwise by the Commission, on the morning of September 8, 2009 the NYISO will begin taking all of the actions necessary for it to ensure that the provisions of proposed Rate Schedule M-1 are applied to the three Generators identified in Privileged and Confidential Attachments C, D and E to this filing whenever these Generators are committed for reliability. The NYISO's implementation plan is addressed in Section VII of this filing letter. Because Rate Schedule M-1 will only apply to individual Generator guarantee payments, should the Commission later determine it must reject the NYISO's proposed rate schedule, the NYISO will be able to retroactively "undo" any mitigation it has imposed.

I. Documents Submitted

1. This filing letter;

2. Proposed Rate Schedule M-1 (a proposed new stand-alone rate schedule, so there are no existing Tariff provisions to redline) ("Attachment A");

3. The Affidavit of Dr. David Patton, the NYISO's Independent Market Advisor, explaining the design of the NYISO's proposed mitigation measure and expressing the Independent Market Advisor's concurrence with the conclusions reached by MMP in Attachments C, D and E ("Attachment B");

4. An explanation of the reasons why MMP concluded that offers submitted for a New York Control Area ("NYCA") Generator exceeded the thresholds set forth in Sections 1(b) and 3.2.3 of the MMM, and that the Generator should be made

[10] In similar circumstances, the Commission has allowed proposed tariff revisions to be implemented shortly after they were filed, and before they were accepted by the Commission. *See, e.g., New York Independent System Operator, Inc.*, 124 FERC ¶ 61,174 at PP 20-21 (2008) (allowing the implementation of tariff revisions to prohibit market participants from scheduling transactions along certain circuitous routes one day after they were filed); *ISO New England, Inc.* 123 FERC ¶ 61,021 at PP 22-27 (2008) (allowing the implementation of tariff revisions to prevent gaming two days after they were filed, even though it appeared that it might not be possible to calculate refunds if the filing were rejected).

[11] 16 U.S.C. § 824d(d); 18 C.F.R. §§ 35.3, 35.11 (2008).

subject to the mitigation measure proposed in Rate Schedule M-1, including a supporting Affidavit of Joshua A. Boles ("Attachment C");

5. An explanation of the reasons why MMP concluded that offers submitted for a NYCA Generator exceeded the thresholds set forth in Sections 1(b) and 3.2.3 of the MMM, and that the Generator should be made subject to the mitigation measure proposed in Rate Schedule M-1, including a supporting Affidavit of Joshua A. Boles ("Attachment D"); and

6. An explanation of the reasons why MMP concluded that offers submitted for a NYCA Generator exceeded the thresholds set forth in Sections 1(b) and 3.2.3 of the MMM, and that the Generator should be made subject to the mitigation measure proposed in Rate Schedule M-1, including a supporting Affidavit of Joshua A. Boles ("Attachment E").

The NYISO requests Privileged and Confidential treatment of the contents of Attachments C, D and E in Section VIII of this filing letter.

II. Copies of Correspondence

Communications regarding this proceeding should be addressed to:

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III. Reasons and Basis for this Filing—Behavior Observed

The NYISO's MMP and its Independent Market Advisor have reviewed each Market Party's offering behavior and determined that when any of the three Generators that are identified in Attachments C, D and E to this filing are committed for reliability as Day-Ahead

Reliability Units ("DARU")[12] or via a Supplemental Resource Evaluation ("SRE")[13]: (a) that Market Parties' offering behavior typically departs from the conduct that would be expected under competitive market conditions (in particular, the Bids significantly exceed each facility's marginal operating cost); (b) the Market Party's offering behavior has increased the guarantee payments the Market Party has received for the relevant identified Generators by more than the 100% mandatory filing threshold specified in Section 3.2.3 of the MMM; and (c) that the Market Party's offering behavior and associated guarantee payment are not attributable to legitimate competitive market forces or incentives. In discussions with, and in documents provided to, the NYISO, the Market Parties have sought to explain or argue that (i) their offering behavior does not exceed the conduct and impact thresholds set forth in Sections 3.1.2 (conduct) or 3.2.1 (impact) of the MMM, so they were acting "within the rules,"[14] (ii) they should be permitted to recover legitimate fixed costs associated with the operation of their generators, and (iii) their guarantee payments would not exceed the thresholds set forth in the MMM if the NYISO reflected the cost of solving the constraints or system conditions the Generators are committed to solve in LBMPs (higher LBMP revenues would reduce the guarantee payments each Generator requires).

After carefully considering the position/arguments advanced by each of the Market Parties, the Independent Market Advisor and MMP rejected the Market Parties' claims for the following reasons:

First, the purpose of Sections 1(b) and 3.2.3 of the MMM is to require the NYISO to look for conduct that constitutes an abuse of market power, but that does not trigger the conduct and impact mitigation thresholds specified in Sections 3.1.2 and 3.2.1 of the MMM. By definition, behavior that the NYISO identifies will not exceed the MMM Section 3.1.2 and 3.2.1 mitigation thresholds (if the conduct exceeded these thresholds, the NYISO would mitigate the Bids). Rather, the purpose of Sections 1(b) and 3.2.3 of the MMM is to review offering behavior below the defined mitigation thresholds in order to identify vulnerabilities in the NYISO's mitigation scheme, and to propose targeted fixes to address the vulnerabilities that are identified.[15]

In addition, the identified Market Parties will be subject to the mitigation measure proposed in this filing only on a prospective basis. Past offering behavior that did not trigger a determination of conduct and impact under the market mitigation rules that were in place at the

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[12] *See* § 2.37a of the NYISO's Market Administration and Control Area Services Tariff.

[13] *See* § 2.176 of the NYISO's Market Administration and Control Area Services Tariff.

[14] The Market Parties have shown an intent to comply with the Market Mitigation Measures. One of the three Market Parties that the NYISO consulted with regarding its reference levels has, of its own volition, recently modified its offering behavior in a manner that is substantially consistent with the thresholds that the NYISO proposes to apply in Rate Schedule M-1.

[15] This issue is further discussed in Section VI below ("Authority for Filing").

time those Bids were submitted will not be mitigated under the NYISO's proposal.[16] Instead the NYISO proposes to apply a significantly tighter threshold to the Bids that the Market Parties submit on behalf of the three Generators identified in Privileged and Confidential Attachments C, D and E to this filing letter on a prospective basis only. The identified Generators will thus have an opportunity to be heard in the docket that is assigned to this filing before being subject to mitigation. The NYISO also proposes to work with its Market Participants through the stakeholder governance process to develop new mitigation measures that address the potential for any Generator that is committed for reliability reasons outside the New York City Constrained Area to exercise market power. Once the new measures are in effect, the NYISO plans to seek permission to withdraw its proposed Rate Schedule M-1.

Second, Section 3.2.3 of the Market Mitigation Measures requires the NYISO to look for conduct that departs significantly from competitive market conditions. The markets run by the NYISO generally determine Generator compensation based on the appropriate "market clearing price" or a Locational Based Marginal Price ("LBMP"). Under this widely-used market construct, the expected profit-maximizing strategy is to offer a Generator to the market at its marginal cost of production. The Generator that is marginal (that sets the market clearing price) will recover its marginal operating costs, while inframarginal Generators will recover their marginal operating costs, plus a contribution to their fixed costs and, possibly, a profit. The three Generators that are addressed in this filing Bid into the Day-Ahead Market, but were not selected to operate based on the economics of their Bids. Instead, they were committed by the NYISO (at the request of a Transmission Owner, or based on a reliability need identified by the NYISO) outside the economic selection process. Generators that are selected to operate for reliability are entitled to recover their "startup and minimum generation costs not recovered in the Dispatch Day"[17] via a guarantee payment. In addition, because they are operating, these Generators have the opportunity to receive additional real-time energy revenues based on the economics of their Incremental Energy Bids. There is nothing in the NYISO's Tariffs that guarantees Generators that are committed for reliability the opportunity to recover "fixed" costs as a component of their guarantee payment.

As Dr. David Patton, the NYISO's Independent Market Advisor, explains in his attached Affidavit, submitting Bids that incorporate a fixed cost component is not consistent with the conduct that would be expected under competitive market conditions. In a competitive market, Generators offering at their marginal costs would be expected to undercut Bids that include a fixed cost component. The generators offering at marginal cost would be selected to run, while a Generator that incorporated the recovery of fixed costs into its Bids would forego opportunities to be committed. The profit maximizing strategy in a competitive market is to offer a Generator to the market at its marginal cost of production. This marginal cost standard for competitive

[16] Although the NYISO proposes to apply its new mitigation rules prospectively in this filing, the language of Sections 1(b) and 3.2.3 of the MMM does not *require* that the NYISO's proposed mitigation measure apply prospectively.

[17] Market Administration and Control Area Services Tariff Section 4.1.7.

Bids has been recognized by the Commission as a governing principle of the NYISO's mitigation measures.[18]

Third, one of the affected Market Parties has suggested that the offers they submitted on behalf of one of the Generators identified in Attachments C, D and E to this filing letter should be allowed to set price in response to the reliability constraints that they are being committed for, resulting in additional LBMP compensation that would reduce the associated guarantee payments. While this proposal could, under certain circumstances, reduce the Generator's guarantee payment impact below the mandatory filing threshold specified in Section 3.2.3(2) of the MMM, it would do nothing to solve the market power problem that the NYISO proposes to address in this filing. Whether the exercise of market power results in additional revenues from LBMP compensation or additional guarantee payments, the result will be inconsistent with competitive behavior. In fact, enabling Generators that have exercised market power to set price in response to the specific reliability constraints that they are being committed for would result in the establishment of non-competitive LBMPs, and consequent costs for other ISO Market Participants. In short, regardless of whether it is feasible to model the relevant constraints, the market power concerns would remain. The three generators that the NYISO proposes to guarantee payment mitigate are eligible to set price for all modeled constraints in the same manner as any other NYCA Generator.

The Generator-specific information supporting the application of Rate Schedule M-1 to the identified Generators is set forth in Privileged and Confidential Attachments C, D and E to this filing. The Generator-specific information included in Attachments C, D and E hereto includes Bids, applicable reference levels, guarantee payment compensation on a daily basis, summaries of the MMP's discussions and correspondence with each of the affected Market Parties requesting an explanations of the causes of their bidding behavior (to determine if the Bids were "attributable to legitimate competitive market forces or incentives"), and an assessment of daily guarantee payments against the threshold specified in Section 3.2.3(2) of the MMM. Each of the three Privileged and Confidential attachments addresses a specific Generator.

For the foregoing reasons, and for the reasons explained in Attachments B, C, D and E hereto, the NYISO requests permission to apply its proposed Rate Schedule M-1 to offers submitted for the Generators identified in Attachments C, D and E to this filing.

[18] Attachment B, Patton Affidavit at ¶¶ 9, 33-42; *N. Y. Indep. Sys. Operator, Inc.*, 99 FERC ¶ 61,246 at p. 62,038 (recognizing that the default bids used by the NYISO to mitigate market power are "designed to cause a market participant to bid as if faced by a competitive market, for participants who exceed thresholds for withholding. Such bids are by design at a level that allows participants to recover marginal costs at a minimum.").

IV. Description of Proposed Mitigation Measure

The NYISO seeks authorization to apply the mitigation measure set forth in Attachment A, and designated "Rate Schedule Market Mitigation No. 1," to address the bidding practices, and resulting guarantee payments, described above. As discussed further below, the NYISO seeks this authorization to fulfill its market power mitigation obligations under Sections 1(b) and 3.2.3 of its MMM.

Consistent with the requirements of Sections 1(b) and 3.2.3 the MMM, under Section 1 of Rate Schedule M-1 the proposed mitigation measure will apply only to the Generators identified in the confidential attachments to this filing, or as otherwise explicitly requested by the NYISO and authorized by the Commission. As explained in Section III and Attachments C, D and E to this filing letter, each of these Generators is consistently the only alternative for resolving a particular reliability concern. When that is the case, each has the ability to submit an offer that causes its guarantee payment to exceed the applicable conduct and impact monitoring thresholds specified in Section 3.2.3 of the MMM. As discussed above, and in the attached Affidavit of the NYISO's Independent Market Advisor, Dr. David B. Patton, such offers and the resulting payments are not consistent with the results that would be expected under competitive market conditions.[19]

Sections 2 and 3 of Rate Schedule M-1 specify that the proposed mitigation measure will apply to one of the subject Generators only when it is the only alternative available to the NYISO to solve a particular reliability constraint. This will be the case when one of the three Generators is committed by a Transmission Owner as a DARU, when it is the only resource that is identified by a Transmission Owner as being adequate to address a reliability issue in a SRE request, or when there is only one Supplier that is able to address a reliability concern that the NYISO is responsible for securing. Under these circumstances, the Generator must be committed or dispatched for reliability rather than economic reasons, and mitigation is appropriate because the unit does not face the discipline of competing alternatives when making its offers.[20]

Consistent with the NYISO's conduct-and-impact approach to market power mitigation, Rate Schedule M-1 would be triggered by bidding conduct that exceeds the applicable Bid or Bid component reference level by specified amounts that have been determined to be significant by MMP and the Independent Market Advisor. Under the NYISO's conduct-and-impact mitigation, reference levels are determined using a series of methods that are designed to capture the marginal costs of providing the service that is being Bid. Reference levels thus serve as a proxy for the Bids a Generator would be expected to submit under competitive conditions.[21] In order

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[19] Attachment B, Patton Affidavit at ¶ 43.

[20] Attachment B, Patton Affidavit at ¶¶ 31-32.

[21] *See N.Y. Indep. Sys. Operator, Inc.*, 99 FERC ¶ 61,246 at pp. 62,038, 62,043 (noting with approval that "(r)eference levels are benchmarks against which NYISO can evaluate bids to see if market power

to allow for possible uncertainty in setting reference levels, including possible changes in costs since the reference level for a Bid or Bid component was last set, it is appropriate to provide a (narrow) bandwidth for bidding conduct before mitigation is triggered.[22] The thresholds over the applicable reference levels proposed in Rate Schedule M-1 were determined in consultation with the Independent Market Advisor, and are similar to the thresholds used in comparable situations in other markets.[23]

In its proposed Rate Schedule M-1, the NYISO proposes that mitigation would be triggered if a Bid or Bid component:

a. exceeded the Generator's Minimum Generation Bid reference level by the greater of 10% or $10/MWh, or
b. exceeded the Generator's Incremental Energy Bid reference level by the greater of 10% or $10/MWh, or
c. exceeded the Generator's Start-Up Bid reference level by 10%, or
d. exceeded the Generator's minimum run time reference level by more than one hour, or
e. exceeded the Generator's minimum generation MW reference level by more than 10%.

If an offer exceeds one of these thresholds, consistent with the NYISO approach to mitigation, a default bid at the reference level would be substituted for the submitted offer when determining the Generator's guarantee payment. As explained in Dr. Patton's affidavit, it is appropriate in the circumstances of Rate Schedule M-1 to apply default bid mitigation once the foregoing conduct thresholds have been exceeded because each of the specified Generators has a demonstrated ability to cause its guarantee payments to increase to non-competitive levels when the Generator is committed for reliability. Absent mitigation, payments would be determined by the Generator's own offers, which are not disciplined by competition. Imposing mitigation when the above conduct thresholds are exceeded will, effectively, recognize that conduct at or exceeding the threshold will always have a material impact.[24] This is similar to the methods used to determine when Generators committed for local reliability in New York City, which has

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exists," and that default bids, which are based on reference levels, are "designed to cause a market participant to bid as if faced by a competitive market . . .").

[22] Attachment B, Patton Affidavit at ¶¶ 15-24; *see N.Y. Indep. Sys. Operator, Inc.*, 99 FERC ¶ 61,246 at p. 62,047 (noting with approval that a bidding threshold over the applicable reference level is appropriate to "give some flexibility for generators bidding in constrained areas to reflect legitimate changes in marginal costs while limiting undue exposure of the market to locational market power.").

[23] Attachment B, Patton Affidavit at ¶ 15-24.

[24] Attachment B, Patton Affidavit at ¶ 25-30.

been designated a Constrained Area, should be mitigated.[25] In both situations, the demonstrated structural market power conditions justify mitigation to keep Generator payments within a relatively tight bandwidth around the applicable reference level to ensure that market results are consistent with competitive outcomes.

The NYISO requests a waiver of the requirement in Section 4.7 of the MMM that mitigation be imposed for no longer than six months. In the case of each of the three specified Generators, there is no apparent basis to conclude otherwise than that the constraints giving rise to the need for mitigation will continue to confer market power for considerably longer than six months. In the meantime, the development of a general mitigation measure will replace Rate Schedule M-1 before market developments, such as the construction of new Generation, could be expected to alleviate the constraints. In addition, the structural screen will ensure that mitigation will be imposed only when a specified Generator is in fact pivotal.[26]

Rate Schedule M-1 obligates the NYISO to inform an affected Supplier if it determines that the Supplier has submitted Bids that will result in the application of mitigation under the schedule. This will enable the Supplier to consult with the NYISO if the Supplier believes that mitigation in that instance is not justified. Each such Supplier will have already been afforded the consultation process specified in Section 3.2.3 of the MMM, however, and would not be subject to mitigation unless that consultation showed that it had submitted Bids that were not competitively justified. Thus, the only relevant issues for consultation during the limited period that Rate Schedule M-1 would apply to a particular Generator are, as specified in the proposed Rate Schedule, whether (a) a change in costs justifies the particular Bid or Bids that lead to the Supplier being notified of potential mitigation, or (b) the proposed specific instance of mitigation is affected by a calculation error.[27]

V. Request for Waiver of Section 4.7 of the MMM

Because proposed Rate Schedule M-1 is filed pursuant to the NYISO's authority to propose new mitigation measures in Sections 1(b) and 3.2.3 of the MMM (as explained in greater detail below), it is arguably subject to the six month limit on the duration of mitigation measures that is set forth in Section 4.7 of the MMM. However, the NYISO is not aware of any reason to expect that the conditions that create the need for reliability-based commitment of the three Generators identified in this filing will change in the foreseeable future; certainly not by the end of the 2010 summer peak season. While the temporal limitation set forth in Section 4.7 of the MMM reasonably constrains the NYISO's authority to impose mitigation measures that it is authorized to implement without Commission involvement, in this case the Commission must review and accept the NYISO's proposed mitigation measure in order for it to become effective.

[25] See MMM Section 5.2 (DARU Generators that Bid above their reference level are automatically mitigated in the New York City Constrained Area).

[26] Attachment B, Patton Affidavit at ¶ 31-32.

[27] See Attachment B, Patton Affidavit at ¶¶ 43-48.

Under the circumstances presented, it is neither necessary, nor appropriate to limit the NYISO's authority to apply proposed Rate Schedule M-1 to the three Generators identified in this filing to a six month duration. Instead, the NYISO requests that the Commission waive the six month limit contained in Section 4.7 of the NYISO's MMM, and instead permit the NYISO to apply Rate Schedule M-1 to Bids submitted for the three Generators that are identified in Attachments C, D and E to this filing until such time as the NYISO completes its stakeholder process and the Commission accepts amendments to the NYISO's MMM implementing rules addressing the mitigation of Generators that are committed for reliability outside the New York City Constrained Area. While the NYISO hopes it will be able to complete the proposed discussions with its stakeholders within six months, even if this ambitious goal is achieved, it will not be possible for the NYISO to automate the agreed upon rule set in its market software within such an abbreviated timeframe.

VI. Authority for Filing

This filing is required by the NYISO's mitigation obligations under Section 1(b) and 3.2.3 of the MMM. Section 1(b) of the MMM specifies that

> the ISO and its Market Monitoring Unit shall monitor the markets the ISO administers for conduct that the ISO or the Market Monitoring Unit determines constitutes an abuse of market power but that does not trigger the thresholds specified below for the imposition of mitigation measures by the ISO. If the ISO identifies or is made aware of any such conduct, and in particular conduct exceeding the thresholds for presumptive market effects specified in Section 3.2.3 below, it shall make a filing under Section 205 of the Federal Power Act, 16 U.S.C. § 824d (1999) ("§ 205") with the Commission requesting authorization to apply appropriate mitigation measures. Any such filing shall identify the particular conduct the ISO believes warrants mitigation, shall propose a specific mitigation measure for the conduct, shall incorporate or address the recommendation of its Market Monitoring Unit, and shall set forth the ISO's justification for imposing that mitigation measure. . . .

Section 3.2.3 of the MMM states:

> The ISO shall make a filing under § 205 with the Commission seeking authorization to apply an appropriate mitigation measure to conduct that departs significantly from the conduct that would be expected under competitive market conditions but does not rise to the thresholds specified in sections 3.1.1 through 3.1.3 above if that conduct has a significant effect on market prices or guarantee payments as specified below, unless the ISO determines, from

> information provided by the Market Party or Parties, including a Demand Side Resource participating in the Operating Reserves or Regulation Service Markets, that would be subject to mitigation or other information available to the ISO that the conduct and associated price or guarantee payments are attributable to legitimate competitive market forces or incentives. For purposes of this section, conduct shall be deemed to have an effect on market prices or guarantee payments that is significant if it exceeds one of the following thresholds:
>
> (1) an increase of 100 percent in the hourly day-ahead or real-time energy LBMP at any location, or of any other price in an ISO Administered Market; or
>
> (2) an increase of 100 percent in guarantee payments to a Market Party for a day.

In accepting the provisions that are now set forth in Section 3.2.3 of the MMM, the Commission stated:

> The revised [MMM] states that the exercise of market power may warrant mitigation even if defined [conduct and impact] thresholds are not triggered. Therefore, the ISO proposes lower thresholds that would automatically trigger a section 205 filing to impose mitigation. Behavior that increases the hourly day-hand or real-time price at any location or in guarantee payments to a market party for a day by a certain percentage is one example of a lower threshold that would warrant a section 205 filing to get authority for appropriate mitigation.[28]

Similarly, in approving the NYISO' 2002 Comprehensive Mitigation Measures filing, the Commission stated that: "NYISO will, for those behaviors which are not detected through the conduct and impact tests, make a Section 205 filing with the Commission to remedy conduct that departs significantly from conduct that would be expected from competitive conditions."[29]

Section 3.2.3 of the MMM specifies that the NYISO "shall" make a filing requesting appropriate mitigation authority when the conditions specified in that section are met. As explained above, the Generators in question have each exceeded the 100% guarantee payment increase threshold, and have not provided explanations to the NYISO that would justify the conduct giving rise to the resulting guarantee payments as being consistent with competitive conduct. The NYISO is thus required by Section 3.2.3 of its MMM to seek authorization to mitigate the particular conduct of the Generators specified in this filing. Accordingly, consistent

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[28] *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,317 at p. 62,053 (2000).

[29] *New York Independent System Operator, Inc.*, 99 FERC ¶ 61,246 at p. 62,038 (2002).

with the requirements of Section 3.2.3 of the MMM, this filing requests limited authority to apply specified mitigation measures to specific Generators in particular circumstances in which the units have realized an increase of 100% or more in guarantee payments that it is not consistent with competitive market conditions, even after taking into account the explanation for the increase provided by the Market Parties.

Consistent with its ongoing efforts to keep the Market Participants apprised of conditions affecting the structure and performance of the New York markets, to the extent permitted by its confidentiality obligations and the time required to make an affirmative determination of impact for each of the Generators, the NYISO has described, at an appropriate level of detail, the nature and expected scope of this filing to its Market Participants. In addition, as explained above, on September 14, 2009 the NYISO intends to commence discussions with its stakeholders about the need for more general authority to impose an appropriate mitigation measure on Generators that become pivotal suppliers when they are committed or dispatched for reliability. Any such authority would be set forth in a proposed revision to the MMM, and would be voted on by the NYISO's Management Committee and submitted to the Commission for its consideration in accordance with the usual stakeholder review and approval process. Since this filing is submitted to comply with an existing mitigation obligation specified in the MMM that have already been approved by the Commission, the usual procedural filing requirements are not applicable.

Consistent with the requirements of FPA Section 205(c), the authority requested in this filing is set forth in a special rate schedule, denominated Rate Schedule Market Mitigation No. 1, as set forth in Attachment A to this filing.[30] Consistent with Section 3.2.3 of the MMM, proposed Rate Schedule M-1 will apply only to specific Generators that the Commission has authorized the NYISO to apply it to, and will be replaced with a mitigation measure of more general applicability once changes to the MMM have been vetted with stakeholders and approved as described in the preceding paragraph. If the NYISO determines that Rate Schedule M-1 should be applied to other Generators, the NYISO will submit a further filing requesting such authorization and setting forth the facts and circumstances supporting that request.

VII. Implementation Plan

The NYISO will manually monitor and apply mitigation to Bids submitted for the three identified Generators that exceed the thresholds specified in Rate Schedule M-1. The NYISO will check for conduct failing Bids on the next business day after the reliability commitment of a Generator that is subject to Rate Schedule M-1. The mitigation will be manually performed and communicated to the Market Party via e-mail as soon as practical, but no later than 10 business days after the conduct failure. The Market Party may not see the mitigation on its initial daily invoice. However, whenever practical (except when the conduct occurs very close to the end of the month) the results of the mitigation will be included as part of the initial monthly invoice.

[30] Federal Power Act § 205(c), 16 U.S.C. § 824d(c).

After identifying a conduct failing Bid in accordance with Rate Schedule M-1, the NYISO's MMP will ordinarily manually update the NYISO's Market Information System ("MIS") software, replacing the conduct failing Bid with the appropriate reference level if the units bid fails conduct under Rate Schedule M-1 Section 4(a), 4(b) or 4(c). When it is possible to perform the replacement in this fashion, the NYISO's settlement system will automatically calculate the appropriate revised guarantee payment. However, in other circumstances, including when a Generator's Bids fail conduct under Sections 4(d) or 4(e) of Rate Schedule M-1, or on days when a large event reserve pickup occurs, then a manual replacement of the Bid or Bid component with the appropriate reference level will need to be performed as a line item adjustment on the appropriate Market Party's bill/invoice. In this circumstance, the payment will be manually calculated by the NYISO and will, necessarily, be an estimate.

Consistent with proposed Rate Schedule M-1, if a mitigated Market Party wishes to consult or review the mitigation of a certain Bid, it must initiate such consultation within five business days of receiving the notification that mitigation was applied in accordance with Rate Schedule M-1. The only permissible bases for changing a mitigation result are (1) a determination that the reference level that the NYISO used when performing the mitigation was incorrect, or (2) if the NYISO made a mathematical error in applying the mitigation or determining the resulting settlement impact. The NYISO will review all timely consultation requests and work with the Market Party and its Independent Market Advisor to reach a decision within 15 business days of receiving the consultation request.

Unless it is instructed to do otherwise by the Commission, commencing with Hour Beginning Zero on September 8, 2009, the NYISO will begin manually monitoring Bids submitted for the Generators identified in Attachments C, D and E to this filing to ensure their compliance with Rate Schedule M-1, and applying mitigation in accordance with that Rate Schedule.

VIII. Request for Confidential Treatment of Attachments C, D and E

In accordance with Sections 388.107 and 388.112 of the Commission's Regulations,[31] Article 6 of the NYISO Market Administration and Control Area Services Tariff, and Sections 1.0(4) and 4.0 of the NYISO's Code of Conduct, the NYISO requests Privileged and Confidential treatment of the contents of Attachments C, D and E to this filing letter. The NYISO also requests that the identified Attachments be exempted from public disclosure under the Freedom of Information Act ("FOIA"), 5 U.S.C. § 552.[32]

The Attachments for which the NYISO requests Privileged treatment and an exemption from FOIA disclosure each contain commercially sensitive information, including: (a) the

[31] 18 C.F.R. §§ 388.107, 388.112 (2009).

[32] The information provided by the NYISO for which the NYISO claims an exemption from FOIA disclosure are labeled "Contains Privileged Information - Do Not Release."

identity of a specific Generators that the NYISO proposes to apply Rate Schedule M-1 to, (b) descriptions and analyses by the NYISO's MMP of the conduct of the specified Generator that gives rise to this filing, (c) a description of the evidence and arguments presented by the Market Parties in support of claims that their Bids did not violate Sections 1(b) and 3.2.3 of the MMM, and (d) specifying the impact that the Bids submitted for each Generator had on the guarantee payments to that Generator. Commercially sensitive Generator-specific information included in each attachment includes a list of DARU and SRE commitment days, Generator-specific reference levels and the Bids submitted for the identified generators (all of which are less than six months old[33]), as well as the guarantee payments to each of the Generators.

Attachments C, D and E contain privileged and commercially sensitive information that is not made public by the NYISO and that could cause competitive harm to the affected Market Parties if publicly disclosed. In addition, as the Commission has previously suggested (***see*** footnote 33), the disclosure of this information could facilitate collusion in the NYISO markets. The described categories of commercially sensitive information are exempt from disclosure under 5 U.S.C. § 552(b)(4). For these reasons, the NYISO requests that the contents of Attachments C, D and E to this filing letter receive Privileged and Confidential treatment and be exempted from FOIA disclosure.

Because this filing letter recounts all of the information contained in Attachments C, D and E that is suitable for publication, the NYISO requests waiver of any obligation it may have under the Commission's regulations or the Secretary's rules to submit redacted copies of Attachments C, D and E.

Each Market Party that is financially responsible for the Generator to which a confidential Attachment relates has been served with a copy of that Attachment. Since each Attachment is specific to a particular Generator, and is not relied upon for mitigation action against any other Generator, the NYISO submits that further access to the confidential Attachments is neither necessary nor appropriate. The NYISO is providing courtesy copies of all

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[33] Section 6.3 of the Services Tariff provides:

> Pursuant to Commission requirements, the ISO shall make public Bid information from the Energy, Capacity and Ancillary Services markets (but not the names of the bidders making these Bids) six-months after the Bids are submitted. The ISO shall post the data in a way that permits third parties to track each individual bidder's bids over time. Prior to such disclosure, Bid information submitted to the ISO by Market Participants shall be considered Confidential Information.

In its Order 719 compliance filing the NYISO proposes to reduce this time frame from six months to three months. The NYISO's compliance filing has not yet been accepted, but the Bids that are relevant to this filing are all less than three months old.

See also, *Central Hudson Gas & Electric, et al*. 86 FERC 61,062 *mimeo* at pp. 44, 52, 59 (1999) (explaining that the basis for keeping bid data confidential for six months is to prevent collusive behavior).

three Privileged and Confidential Attachments to this filing to Larry Gasteiger and Daniel Nowak of the Commission Staff.

The Attachments for which confidential treatment is requested are identified and marked in accordance with the Commission's regulations and the rules published by the Secretary's Office.

IX. Requested Effective Date and Request for Expedited Commission Action

At an August 31, 2009 special meeting that was held to address the concerns raised in this filing, the NYISO's Board of Directors instructed the NYISO's management to submit this filing immediately, and to request permission to implement the NYISO's proposed Rate Schedule M-1 as quickly as feasible in order to prevent possible future harm to the markets that the NYISO administers. Consistent with its Board's instructions, the NYISO requests expedited consideration of this filing so that its proposed Rate Schedule M-1 is permitted to become effective on September 8, 2009, one business day after the date of this filing. In accordance with Section 35.11 of the Commission's Regulations, the NYISO requests waiver of the 60-day prior notice period set forth in Section 205(d) of the Federal Power Act and Section 35.3 of the Commission's Regulations.[34] The NYISO also requests that the Commission shorten or waive the comment period in order to permit it to act on the NYISO's filing as expeditiously as possible.

The Commission's Guidance Order sets forth specific criteria that ISOs and RTOs are expected to meet in a filing seeking expedited review of Tariff revisions (or, in this case, a proposed new stand-alone rate schedule) that is designed to remedy instances in which Market Participant activity in compliance with an ISO or RTO's Tariff rules produces an unjust or unreasonable result. In this case, the NYISO's MMP and its Independent Market Advisor have determined that offering behavior for three Generators that does not exceed the applicable MMM Section 3.1.2 and 3.2.1 conduct and guarantee payment impact thresholds, nevertheless reflects an exercise of market power that should not be permitted to continue.

In paragraph two of its Guidance Order the Commission sets forth three criteria that should be satisfied in order for a new rule addressing an identified Market Participant activity to qualify for expedited consideration by the Commission under that Order. First, the concern must materially adversely impact the market. Studies performed by the NYISO's MMP that are included as Attachments C, D and E to this filing letter indicate the market impact of the three Generators' exercise of market power at levels below the existing mitigation thresholds, to date. Weather and system conditions determine the need for reliability commitments. Because it is not possible to precisely predict the weather, or what system conditions will be on a going-forward basis, it is likewise not possible to predict how frequently the three Generators are likely to receive reliability commitments, or to predict the necessary level (in MW) of those

[34] 16 U.S.C. § 824d(d); 18 C.F.R. §§ 35.3, 35.11 (2009).

commitments. Therefore, it is not possible to specifically quantify the going-forward market impact of permitting the three Market Parties to continue their current offering behavior. Privileged and Confidential Attachments C, D and E indicate, however, that the potential for a going-forward material adverse impact to the markets that the NYISO administers is all but inevitable if the identified exercise of market power is permitted to continue unabated. At the same time, if the conditions specified in Rate Schedule M-1 are not met, then the ability to exercise market power would not likely be present, and no mitigation will occur.

Second, the Guidance Order requires a showing that prompt action is needed to prospectively revise the Tariffs to remove the ability to cause such material adverse impacts. In this case immediate action is needed because it is impossible to predict when one, two, or all three of the Generators that the NYISO has identified as exercising market power will need to be committed to address a reliability need. Although system load and other conditions cannot be predicted with absolute accuracy, the NYISO expects to see additional reliability commitments for one or more of the three Generators (1) during high summer loads, (2) during shoulder months, when other Generators are down for maintenance, and (3) during higher winter load conditions. The NYISO's proposed mitigation measure will permit the three Generators to continue to recover their marginal cost of responding to the NYISO's reliability commitments while more strictly restraining the ability to exercise market power when the Generators are committed for reliability.

Finally, the NYISO is required to show that the concern it has identified is susceptible to being remedied by a clear-cut revised or interim market rule. The narrowly tailored mitigation measure proposed in Rate Schedule M-1 will significantly reduce the ability of the three Market Parties to exercise market power when one of the Generators identified in the Attachments to this filing is committed for reliability by a Transmission Owner, or by the NYISO. Proposed Rate Schedule M-1 is only intended to be in place until the NYISO finishes working with its Market Participants to develop, and the Commission accepts, a new mitigation measure that will apply more broadly to Generators that are committed or dispatched for reliability outside New York City.

For the reasons explained above, and in accordance with Section 35.11 of the Commission's Regulations, the NYISO requests that the Commission waive the 60-day prior notice period set forth in Section 205(d) of the Federal Power Act and Section 35.3 of the Commission's Regulations[35] and permit its proposed Tariff revisions to become effective on September 8, 2009. The NYISO also requests that the Commission shorten or waive the comment period in order to permit it to act on the NYISO's filing as expeditiously as possible.

As explained in this filing letter, good cause exists for the Commission to grant the requested waivers and act on an expedited basis because waiting the full sixty days to make the proposed Tariff revisions effective could permit the Market Parties identified in Attachments C,

[35] 16 U.S.C. § 824d(d); 18 C.F.R. §§ 35.3, 35.11 (2009).

D and E to this filing to continue to exercise market power at times when their Generators are committed for reliability. In light of the continuing potential for warm summer weather to drive the need for additional reliability commitments, it is entirely appropriate for the Commission to take expedited action in this proceeding.

Unless it is instructed to do otherwise by the Commission, on September 8, 2009 the NYISO will begin taking all of the actions necessary for it to begin applying its proposed Rate Schedule M-1 to the Bids submitted for the Generators identified in Privileged and Confidential Attachments C, D and E to this filing letter. The NYISO's implementation plan is addressed above. Should the Commission determine it must reject the NYISO's proposed Tariff revisions after the NYISO has begun applying mitigation, the NYISO will be able to "undo" any mitigation it has applied because the mitigation will only affect guarantee payments to individual Generators; it will not change market clearing prices.

X. NYISO Stakeholder Process

As discussed above, consistent with its ongoing efforts to keep the Market Participants apprised of conditions affecting the structure and performance of the New York markets, to the extent permitted by its confidentiality obligations and the time required to make an affirmative determination of impact for each of the Generators, the NYISO has described at an appropriate level of detail the nature and expected scope of this filing to its Market Participants. In particular, at the August 26, 2009 Management Committee meeting, Mr. Stephen Whitley, the NYISO's Chief Executive Officer, notified the NYISO's Market Participants that the NYISO was considering submitting this filing.[36]

As explained in this filing letter, at the September 14, 2009 MIWG meeting the NYISO will commence a stakeholder process to develop a comprehensive set of mitigation measures that will be designed to address the ability of Generators that are committed or dispatched for system reliability to exercise market power at levels below the currently applicable conduct and impact thresholds. Following approval by its Management Committee and Board, the NYISO will submit the proposed mitigation measures to the Commission in a FPA Section 205 filing.

XI. Service

Consistent with Paragraph 2 of the Guidance Order, and longstanding NYISO practice, the NYISO will electronically send a link to the non-confidential version of this filing to the official representative of each of its Customers, to each participant on its stakeholder committees, to the New York Public Service Commission, and to the electric utility regulatory agencies of New Jersey and Pennsylvania. The NYISO will also provide to each affected Market

[36] Mr. Whitley's statement is available on the NYISO's web site at: http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2009-08-26/Statement_of_Stephen_G_Whitely.pdf

Party a complete copy of the Privileged and Confidential Attachment to this filing letter (Attachment C, D or E) that addresses its Generator.

The complete non-confidential version of the filing will be posted on the NYISO's website at www.nyiso.com. The NYISO will also make a paper copy available to any interested party that requests one. To the extent necessary, the NYISO requests waiver of the requirements of Section 35.2(d) of the Commission's Regulations to permit it to provide service in this manner.[37]

XII. Waiver of Cost of Service Filing Requirements

To the extent necessary, the NYISO respectfully requests that the Commission grant it waivers of the requirements of Section 35.12(b) of the Commission's regulations[38] addressing the filing of initial rate schedules and requiring the submission of certain cost-of-service information. The information required under Section 35.12(b) is not applicable to Rate Schedule M-1, because it is not a traditional cost-of-service rate schedule. The NYISO also requests waiver, to the extent necessary, of any other Part 35[39] requirements that the Commission may deem to be applicable, but which are not addressed in this filing.

XIII. Conclusion

The NYISO Board has exercised its independent judgment, and concluded that the submission of the attached Rate Schedule M-1 is both required under Sections 1(b) and 3.2.3 of the Market Mitigation Measures, and otherwise appropriate. Accordingly, for the reasons explained in this filing letter, the NYISO respectfully requests that the Commission (1) accept proposed Rate Schedule M-1 that is included in Attachment A hereto for filing on an expedited basis to become effective on September 8, 2009, (2) authorize the NYISO to apply the provisions of Rate Schedule M-1 to each of the Generators identified in Privileged and Confidential

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[37] 18 C.F.R. § 35.2(d) (2009).

[38] 18 C.F.R. § 35.12(b) (2009).

[39] 18 C.F.R. Part 35 (2009).

Attachments C, D and E to this filing, and (3) grant the waivers requested in this filing, including the requested waiver of Section 4.7 of the MMM that is discussed in Sections IV and V of this filing letter.

Respectfully submitted,

/s/ Alex M. Schnell

Robert E. Fernandez, General Counsel
Alex M. Schnell
New York Independent System Operator, Inc.

William F. Young
Hunton & Williams LLP
Counsel to the
New York Independent System Operator, Inc.

ATTACHMENT A

Rate Schedule Market Mitigation No. 1

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

RATE SCHEDULE MARKET MITIGATION NO. 1

Effective Date:
September 8, 2009

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

RATE SCHEDULE MARKET MITIGATION NO. 1

For purposes of this Rate Schedule, capitalized terms shall have the meaning ascribed to them in the New York Independent System Operator, Inc.'s ("ISO's") Market Administration and Control Area Services Tariff ("Services Tariff"), or the meaning ascribed to them in the Market Mitigation Measures that are appended as Attachment H to the Services Tariff.

If provisions 1 through 3 below are met, when calculating a daily Bid Production Cost guarantee for a New York Control Area Generator that is located outside the New York City Constrained Area, the ISO shall substitute a reference level (determined in accordance with Attachment H to the Services Tariff) for each Bid or component of a Bid for which the applicable threshold specified in provisions 4(a) through 4(e) below is exceeded:

1. The Commission has authorized the ISO to apply this Rate Schedule to Bids and Bid components submitted for the Generator; and
2. the Generator was committed to protect or maintain New York Control Area or local system reliability as a Day-Ahead Reliability Unit ("DARU") or via a Supplemental Resource Evaluation ("SRE"), or was committed as a DARU or via SRE and is also dispatched Out-of-Merit to protect or maintain New York Control Area or local system reliability; and

3. the Supplier that owns or offers the Generator is the only Supplier that can, or is the Supplier that has been designated to, solve the reliability need for which the Generator was committed or dispatched; and

4. the Bids or Bid components submitted for the Generator that were accepted to protect or maintain New York Control Area or local system reliability:

   a. exceeded the Generator’s Minimum Generation Bid reference level by the greater of 10% or $10/MWh, or

   b. exceeded the Generator’s Incremental Energy Bid reference level by the greater of 10% or $10/MWh, or

   c. exceeded the Generator’s Start-Up Bid reference level by 10%, or

   d. exceeded the Generator’s minimum run time reference level by more than one hour, or

   e. exceeded the Generator’s minimum generation MW reference level by more than 10%.

Overlap with Market Mitigation Measures. A Generator that is subject to this Rate Schedule shall remain subject to the provisions of the Market Mitigation Measures. This Rate Schedule shall not be applied to mitigate a Bid or Bid component that has already been mitigated in accordance with the Market Mitigation Measures.

Notice of Intent to Apply Rate Schedule Market Mitigation 1 to Bids Submitted for a Generator. The ISO shall send an electronic copy of its filing proposing to apply this Rate Schedule Market Mitigation No. 1 to Bids submitted for a particular Generator to the Market Party that is identified as being financially responsible for that Generator in the ISO's settlement systems.

Consultation Regarding Proposed Mitigation. The ISO shall electronically inform the Market Party that is identified as being financially responsible for a Generator in the ISO's settlement systems each time it determines that a Bid, or Bids, or Bid components submitted for the Generator may be subject to mitigation under this Rate Schedule. The ISO's notification shall identify the particular day(s) and Bid(s) or Bid component(s) that it is proposing to mitigate. The Market Party will have five business days following receipt of the notification from the ISO to request consultation regarding the proposed mitigation by contacting the NYISO's Customer Relations Department, opening a ticket, and requesting that the matter be immediately referred to the NYISO's Market Monitoring and Performance Department (or any successor Department thereto).

The permissible bases for challenging, or requesting a modification to mitigation applied in accordance with this Rate Schedule shall be that (a) the costs associated with operating the Generator exceeded the reference level that the ISO employed when determining the mitigation, or (b) the ISO made a mathematical error when determining that mitigation was appropriate or in calculating the settlement impact of a mitigation.

ATTACHMENT B

Affidavit of Dr. David Patton

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

AFFIDAVIT OF DAVID B. PATTON, PH.D.

I. Qualifications and Purpose

1. My name is David B. Patton. I am an economist and President of Potomac Economics. Our offices are located at 9990 Fairfax Boulevard, Fairfax, Virginia 22030. Potomac Economics is a firm specializing in expert economic analysis and monitoring of wholesale electricity markets.

2. I currently serve as the Independent Market Advisor for the New York Independent System Operator, Inc. ("NYISO"), as the Independent Market Monitor for the ISO New England Inc ("ISO-NE" or the "ISO"), and the Midwest ISO ("MISO"). In these roles, I am responsible for assessing the competitive performance of the markets administered by the ISOs, including assisting in the implementation of monitoring plans to identify and remedy market design flaws and abuses of market power. I also provide recommendations regarding market mitigation measures and other market rules. I have served in this capacity for NYISO since 1999.

3. I have worked as an energy economist for eighteen years, focusing primarily on the electric utility and natural gas industries. I have provided strategic advice, analysis, and expert testimony in the areas of electric power industry

restructuring, pricing, mergers, and market power. I have also advised other existing and prospective RTOs on transmission pricing, market design, and congestion management issues. With regard to competitive analysis, I have provided expert testimony and analysis regarding market power issues in a number of mergers and market-based pricing cases before the Federal Energy Regulatory Commission ("FERC"), state regulatory commissions, and the U.S. Department of Justice.

4. Prior to my experience as a consultant, I served as a Senior Economist in the Office of Economic Policy at the Federal Energy Regulatory Commission, advising the Commission on a variety of policy issues including transmission pricing, open-access and electric utility mergers.

5. Before joining the Commission, I worked as an economist for the U.S. Department of Energy. During this time, I helped develop and analyze policies related to investment in oil and gas exploration, electric utility demand side management, residential and commercial energy efficiency, and the deployment of new energy technologies. I hold a Ph.D. and M.A. in Economics from George Mason University and a B.A. in Economics with a minor in Mathematics from New Mexico State University.

6. When the wholesale market does not schedule sufficient resources to satisfy all of New York's reliability requirements, the ISO takes additional steps to ensure sufficient capacity is available such as committing resources out-of-market

("OOM").[1] When a resource is committed out-of-market, it receives a payment equal to the difference between its offered cost and wholesale market LBMP. I will refer to this as a "BPCG payment."

7. When a large share of a generator's commitments is made for reliability, the supplier may have an incentive to offer above its marginal costs in order to increase their BPCG payments. The mitigation rules are intended to address this conduct without intervening excessively in the market. However, when these reliability issues are well known by the supplier and result in chronic commitments, the current rules may allow material increases in BPCG payments that are not effectively mitigated. To reduce the incentive and ability for participants to engage in this conduct, the ISO proposes a new mitigation rule that would apply initially to three generators.

8. Section II of this affidavit outlines the proposed measure, and explains why the proposed thresholds and other elements of the measure are appropriate. Section III discusses issues related to fixed cost recovery for the suppliers that may be affected by the proposed mitigation measure. Section IV provides an overview of the ISO's consultative process and how that will limit the potential for over-mitigation. Section V contains my concluding remarks.

[1] My out-of-market (OOM) term broadly encompasses commitments like the NYISO's Day-Ahead Reliability Unit ("DARU") commitments and Supplemental Resource Evaluations ("SRE's") commitments. It also covers additional OOM dispatch of OOM committed generators.

II. The Proposed Mitigation Measure

A. Summary of Mitigation Measure

9. A generator committed OOM to meet a reliability requirement ultimately receives its offer price (rather than a market clearing price). This provides incentives for the generator to submit an offer exceeding its marginal cost. This incentive undermines a critical feature of the uniform price auction market design—that generators have an incentive to offer at marginal cost. Additionally, it is frequently the case that the reliability needs pertain to a very limited geographic area where the resources available to satisfy the reliability needs are owned by a very small number of suppliers, sometimes only one, making them pivotal. This raises competitive concerns in addition to the incentive issue described above.

10. As a safeguard against generators required for reliability from substantially raising their offers above marginal costs, all generators outside of New York City are subject to manual conduct and impact tests. Currently, in order for a generator's offer to break the conduct threshold it must be 300 percent or $100 greater than the generator's reference level. The current impact thresholds are a $100/MW increase in market clearing prices, or a 200 percent increase in guarantee payments.

11. For a generator to be subject to mitigation under the current framework it has to fail both the conduct and impact tests. For the past several years, generators committed for reliability have rarely failed these tests. At a lower threshold level, however, the NYISO has identified three generators which were committed for

reliability over the past several weeks which have received BPCG payments in excess of 100 percent of the amount they would have received had they submitted offers at their reference levels. Given the local market power that generators committed for reliability often have, the NYISO has proposed the following new mitigation measure to more effectively mitigate this market power. We concur that the proposed changes to the mitigation rules would improve market efficiency.

12. The proposed measure is intended to apply to three generators that have recently been committed for reliability (e.g., DARU, SRE). The generators are all located outside the New York City Constrained Area. The proposed mitigation measure will apply if:

- the unit is identified in the ISO's filing; and
- the unit was committed for reliability (rather than economics); and
- there is only one supplier that is able to solve the reliability need; and
- its submits offers that exceed its reference level by specified amounts.

13. Specifically, the new measure will mitigate the generator's offer if it:

a. exceeded the applicable incremental energy, or minimum generation reference level by the greater of 10 percent or $10, or

b. exceeded its startup reference level by 10 percent, or

c. increased its minimum run time offer parameter by more than one hour over the unit's reference level, or

d. increased its minimum generation MW offer parameter by more than 10 percent over the unit's minimum generation MW reference level.

14. The following subsections discuss the proposed conduct thresholds, the change proposed for the impact test, and the pivotal supplier screen.

B. The Proposed Conduct Thresholds

1. Incremental Energy and Minimum Generation Thresholds

15. The proposed thresholds of the greater of 10 percent or $10/MWh are substantially lower than the current upstate conduct thresholds. These lower thresholds are justified because local market power exists when the resources owned by a single supplier must be committed to resolve a reliability requirement. This is analogous to the situation in the New York City load pockets where much lower conduct and impact thresholds are applied to address local market power.

16. The 10 percent threshold cannot be compared to the 2 percent limit used in the New York City thresholds or the 5 percent threshold used in antitrust contexts. The latter thresholds correspond to overall price increases over all hours, while the proposed 10 percent threshold would apply only episodically when the resources in question are committed for reliability.

17. There is significant precedence for this modification to the current $100/300 percent threshold. A 10 percent threshold is used by PJM to trigger mitigation of local market power. In addition, the ISO-NE recently submitted a filing to the FERC to reduce the threshold for out-of-merit guarantee payments, to the lower of 10 percent or $80/MW-day for generators committed for local reliability.

18. Percentage thresholds are effective in accounting for changes in fuel prices. As fuel prices rise, both reference levels and the conduct threshold rise. For example, if fuel prices raise a unit's incremental energy reference level from $50 to $100/MWh, the conduct threshold will rise from $5/MWh to $10/MWh. This is appropriate because the uncertainties associated with the unit's true marginal costs generally increase with fuel prices. However, some of these uncertainties are not correlated with fuel costs.

19. To prevent over mitigation of offers caused by increases in marginal costs above reference levels which are not a function of fuel costs, it is appropriate to consider absolute increases above the reference level rather than only percentage increases. Hence, the proposed mitigation measure applies the greater of a ten percent or $10/MWh threshold to a unit's reference level in determining whether its offer warrants mitigation. This approach sets a floor on the conduct threshold for incremental energy and minimum generation of $10 per MWh. Under low fuel price conditions, the application of the $10/MW threshold is more appropriate than the ten percent threshold.

20. To illustrate this, let us assume that requiring a generator to produce in a certain off-peak hour might result in a five percent probability of a forced outage during a peak hour. If the expected LBMP during the peak hour is $100/MW this would result in a $5/MW increase in the marginal cost to reflect the expected loss to the generator for producing in the off-peak hour. If we assume that the generator's reference level is $40/MW and it offers $45/MW to reflect its expected loss, the $5/MW increase in its offer exceeds the 10 percent threshold and would result in

the unit being mitigated if not for the option of applying the additional $10/MW threshold. Since the proposed mitigation measure requires that the offer not exceed its reference level by the greater of $10/MW or 10 percent, its unit will not be mitigated. Hence, the option to apply the greater of the ten percent or ten dollar threshold above reference levels is an important safeguard against over-mitigation.

2. Conduct Thresholds for Minimum Runtime and Minimum Generation Levels

21. The proposed minimum run time and minimum generation MW thresholds are appropriate as they provide assurance that resource owners will not make their resources inflexible to increase their BPCG payments. The proposed threshold for the minimum run time offer parameter is one hour over the unit's reference level which is lower than the three hour threshold that could currently apply upstate. For example, a resource with an actual 4 hour minimum run time cannot offer a minimum run time in excess of 5 hours without failing the proposed test. For the minimum generation MW test, offers exceeding their reference levels by more than 10 percent level will also fail the test.

22. Offering inflexible physical parameters allows units being committed for reliability to increase their BPCG payments. For example, if we assume that a unit with marginal costs of $80 per MW, with an actual minimum run time of 4 hours was committed OOM to provide reliability when LBMPs were $40 per MW, it would receive BPCG payments of $160. If however the generator offered an inflated minimum run time of 8 hours it would receive BPCG payments of

$320 thereby doubling its BPCG payment. Raising minimum generation levels from reference levels would similarly magnify the BPCG payments being made to the generator thereby increasing market power profits and inefficiencies to the market. The minimum run time and minimum generation MW thresholds outlined in the proposed mitigation measure provide safeguards against generators inflating their physical parameter offers as a means to increase their BPCG payments.

23. Inflated physical offer parameters from generators being committed OOM to meet reliability needs in New York not only would increase BPCG revenues to the generators, but would guarantee even larger inefficiencies. Assume the current LBMP is $40 per MW and a generator with marginal costs of $80 per MW is committed out of market to provide reliability service. Further, assume the generator offers a slightly inflated price of $88 per MWh and an inflated run time of 8 hours as opposed to its reference level of 4 hours. This will cause the generator to displace a marginal unit for 4 hours longer than necessary resulting in a "deadweight loss." The increase in production costs is 4 hours * $40 per MWh ($80-$40/MWh) or $160. The gain to the OOM generator is 4 hours * $8 per MWh ($88-$80/MWh) or $32.

24. Hence, the inefficiency caused by this activity would likely be much larger than the additional revenue earned by the market participant, which warrants the relatively tight conduct threshold.

C. Proposed Changes in the Impact Test

25. The mitigation rules as outlined in Attachment H of the NYISO tariff (purpose and objective of impact test, Sections 1 and 2) are designed to prevent the exercise of market power while allowing market participants the flexibility to submit competitive offers when conditions are likely to be competitive. This flexibility is important because any measure of marginal costs will be subject to significant inaccuracies. These inaccuracies can result in "over-mitigation" if the mitigation measure compels a supplier to produce output at prices below the supplier's true marginal cost.

26. Hence, the conduct and impact tests are designed to balance the risk of over-mitigation against the risk of under-mitigation. In general, the impact test prevents the ISO from intervening in the market when offers above the conduct threshold do not have substantial market impact. While the impact test is very important for the energy market, it is less important when the mitigation is being applied to address BPCG impacts associated with reliability rather than energy price impacts.

27. The ISO proposes new criteria for the impact test for resources that are committed to address a local reliability need: that a generator is deemed to have impact if it needs to be committed for reliability and has failed the new conduct test. This section of my affidavit explains how the proposed impact criteria would help prevent generators that are committed OOM for reliability from extracting excess revenues through BPCG payments.

28. The impact test is intended to determine whether offers that exceed the conduct thresholds have a significant effect on LBMPs or BPCG payments. However, the current 200 percent impact threshold for BPCG payments[2] allows some generators to profit from raising their offers significantly above their marginal costs. For example, if the LBMP is $40/MWh, a generator offering into the market at its marginal cost of $80/MWh would receive a BPCG payment of $40/MWh in order to make up the difference between its offer and the LBMP. If the generator raises its offer above marginal cost, it receives a corresponding increase in its BPCG payment. Hence, the generator could raise its offer to $159/MWh, resulting in a BPCG payment of $119/MWh, without exceeding the 200 percent impact threshold.

29. When the reliability commitments are recurring and the resources of only one supplier are necessary to address the concern, the pivotal supplier may be able to determine when it is profitable to raise its offers above marginal cost. In these cases, an offer that fails the conduct test will generally have a significant effect on the supplier's BPCG payment, so there is no need to perform a separate impact test.

30. The proposed change by NYISO is consistent with this logic. Under the proposed approach, if a unit committed out of market (and therefore pivotal) fails the conduct test, the ISO will infer that sufficient impact will occur to warrant mitigation. We agree with this inference.

[2] The currently applicable impact threshold is a 200 percent increase in guarantee payments.

D. Pivotal Supplier Requirement

31. As discussed above, the proposed thresholds are much tighter than the current mitigation thresholds that are applied upstate. This raises an increased risk of over-mitigation and is, therefore, only warranted in cases where the local market power is acute. To ensure this, the NYISO has proposed a structural test to identify when a supplier likely has substantial local market power related to satisfying a local reliability requirement. This structural test is the determination that the supplier in question is "pivotal."

32. A supplier is pivotal if only its resources are capable of satisfying a reliability requirement. When a resource must be dispatched under an SRE or DARU commitment for reliability reasons, it is generally pivotal. When this occurs, the pivotal supplier faces no competitive pressure because its resource will be committed regardless of its offer. Hence, the tighter mitigation measure is warranted for these suppliers due to the relatively acute local market power they possess. The pivotal supplier test accomplishes this objective of focusing the proposed mitigation measure on only these suppliers.

III. Fixed Costs Recovery

33. Some have argued that mitigation thresholds should be large enough to allow generators to recover fixed costs. In most cases, the fixed costs include both the fixed going-forward costs that must be incurred to keep a resource in operation, and a return on past investment in the resource. I disagree with these arguments.

34. As a preliminary matter, suppliers in a competitive market would not include fixed costs in their offers. When suppliers do not have market power (cannot influence prices or payments by raising their offers) in a market with a uniform clearing price, they will maximize their profits by submitting offers priced at their short-run marginal costs. Offers priced above this level can only reduce the number of hours that the unit will be dispatched and lower its profits. Hence, the offers identified by the NYISO in this filing are inconsistent with what would be expected in a competitive market because they are priced substantially above the suppliers' short-run marginal costs.

35. With regard to recovery of fixed costs through the competitive market, it is important to recognize that some costs are sunk and other fixed costs are ongoing. For example, investment costs are sunk once they are made so decisions regarding investments are made based on the investor's expectation of the unit's future market revenues. A competitive market may provide a return on investment that is very attractive or unattractive depending on supply and demand conditions. However, it is inappropriate in a market power mitigation context to seek a return on investment that exceeds what would be provided by a competitive market.

36. Other fixed costs are not sunk, which we generally refer to as "going-forward costs." The markets should provide sufficient revenues to cover the fixed going forward costs for any resource needed to satisfy market requirements. These revenue sources include energy, capacity and reserve markets. With regard to the energy and ancillary services markets, even high-cost units can receive substantial

revenues above their marginal costs in peak periods when transitory shortages occur that result in prices much higher than the units' marginal costs.

37. Additionally, New York's wholesale market has a voltage support payment mechanism which compensates generators that are available for providing voltage support services.

38. However, even with these sources of revenues, it is possible that a unit needed for reliability will not receive adequate revenues to remain in operation. In general, this occurs when there is a reliability need that is not reflected in the market requirements. When this happens, the reliability service provided by the generator is not fully priced. Even in this case, relying on economic withholding to recover fixed costs (by using loose mitigation thresholds) is highly undesirable for at least three reasons.

39. First, there is no one set of thresholds that would be appropriate for all suppliers. Any single threshold would cause some generators to under-recover their fixed costs and other suppliers to substantially over-recover.

40. Second, designing thresholds that require suppliers to raise their offer prices in order to recover fixed costs makes market power extremely difficult to distinguish from legitimate conduct. It necessarily requires subjective judgments to be made by the market monitor or by the FERC regarding when an offer price increase by a supplier is acceptable and when it is an abuse of market power. In addition to the difficulty this would present to the market monitor and the Commission, it

would create uncertainty for suppliers regarding when their conduct may be deemed to be an exercise of market power.

41. Third, relying on suppliers to raise prices to recover fixed costs would create considerable risk for suppliers. Because of uncertainty regarding market conditions, suppliers may raise their offer prices and, in doing so, not be dispatched and forego opportunities to produce. In addition, when a supplier committed out-of-market for reliability does successfully raise prices and associated BPCG payments, it may face unwarranted scrutiny after the fact when its offers are made public.

42. Hence, relying on market power rents that result from economic withholding to appropriately recover fixed costs is highly undesirable from a policy perspective. In cases where a supplier is providing necessary reliability services to the system that are not priced in the market, and is not recovering its fixed costs, the Commission has generally relied on contractual solutions that are customized and appropriate for the specific resource in question. This is a reasonable approach if the reliability requirement cannot be priced in the market.

IV. The NYISO's Consultation Process

43. The NYISO has already consulted with the relevant Market Parties' regarding their past offering behavior. I participated in several of those discussions and reviewed the NYISO's findings. I concur with the NYISO's conclusion that the offers submitted for the three Generators identified in the Privileged and Confidential attachments to the NYISO's filing departed significantly from the

conduct that would be expected under competitive market conditions, and that the associated guarantee payments were not attributable to legitimate competitive market forces or incentives.

44. As discussed above, the proposed thresholds are much tighter than the current mitigation thresholds that are applied upstate, which increases the risk of over-mitigation. However, this risk is lessened by the NYISO's proposed process for consultation with generators regarding mitigation. This consultation process is described in the NYISO's proposed Rate Schedule Market Mitigation 1 ("Rate Schedule M-1").

45. In summary, the NYISO is required to contact and provide a market party an opportunity to consult before imposing mitigation. The manual nature of the mitigation that the NYISO proposes to apply allows time for this consultation process by providing market participants an opportunity to explain their offers. Under the consultation process, the ISO must first provide notification to the market participant regarding its mitigation action that identifies the particular day(s), hours(s) and Bid(s) that it is proposing to mitigate. The participant may then submit a consultation request within 5 business days after the ISO posts its results.

46. The scope of the proposed consultation includes whether the costs associated with operating the Generator exceeded the reference level that the ISO employed when determining the mitigation, or whether the ISO made a mathematical error when determining that mitigation was appropriate or in calculating the settlement

impact of a mitigation. Given the consultation process that has already occurred regarding the offers submitted for these Generators, I believe the proposed consultation process should be adequate to prevent over-mitigation.

47. In addition to this process, the market participant can also consult with the NYISO regarding its reference levels prior to submitting its offers. If it can show that its reference levels are lower than its legitimate marginal costs, the NYISO will adjust its reference levels so that the participant will not be exposed to inappropriate mitigation in the first place.

48. Given this thorough consultation process, the likelihood of inappropriate mitigation is very small. Nonetheless, if the participant disagrees with the outcome of the mitigation process, following the conclusion of consultation with the ISO regarding its offers it may contact me directly[3] and, if it still isn't satisfied, may file a complaint with the Commission. Taken together, these processes provide the participant ample opportunity to explain its offers. Therefore, the tighter thresholds proposed by the NYISO should not result in inappropriate mitigation.

V. Conclusion

49. The relatively high threshold levels that are currently applied in outside of New York City allow generators that are pivotal in relation to specific reliability

[3] When and if the NYISO's Order No. 719 compliance filing in Docket No. ER09-1142-000 is accepted, Potomac Economics' role will change from that of Independent Market Advisor to be the NYISO's Market Monitoring Unit. In either role, I am available to assist in the reference level consultation process as needed.

requirements raise their offers and their corresponding BPCG payments. In screening for conduct at lower conduct thresholds, the NYISO identified three generators in the ROS area in New York that have been receiving BPCG payments in excess of 100 percent of the payments they would have received had the offers been equal to their reference levels. Given the local market power that generators committed for reliability can have, the NYISO has proposed a new mitigation measure to more effectively mitigate this market power.

50. I concur with the findings of the NYISO regarding the three generators identified in their Section 205 filing and support the mitigation rule changes proposed by the ISO in the filing.

51. This concludes my affidavit.

ATTESTATION

I am the witness identified in the foregoing Affidavit of David B. Patton, Ph.D. dated September 3, 2009 (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.

David B. Patton

September 3, 2009

Subscribed and sworn to before me

this 3rd day of September, 2009

Notary Public

MATTHEW JAMES CARRIER
Notary Public
City/County of Fairfax
Commonwealth of Virginia
Notary registration number - 7233763
My commission expires - Nov. 30, 2013

My commission expires: Nov. 30, 2013

ATTACHMENT C

Market Monitoring and Performance Department Determination that the Thresholds Set Forth in Sections 1(b) and 3.2.3 of the NYISO's Market Mitigation Measures Have Been Exceeded

ATTACHMENT D

Market Monitoring and Performance Department Determination that the Thresholds Set Forth in Sections 1(b) and 3.2.3 of the NYISO's Market Mitigation Measures Have Been Exceeded

ATTACHMENT E

Market Monitoring and Performance Department Determination that the Thresholds Set Forth in Sections 1(b) and 3.2.3 of the NYISO's Market Mitigation Measures Have Been Exceeded