

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

Establishing Reference Prices for)
Mitigation in Markets Operated by) Docket No. PL05-6-000
Regional Transmission Organizations)
and Independent System Operators)

**COMMENTS OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.**

Pursuant to the *Notice Inviting Comments on the Establishment and Use of Reference Prices* (“Notice”) issued on April 1, 2005 in the above-captioned proceeding, the New York Independent System Operator, Inc. (“NYISO”), an Independent System Operator (“ISO”) that employs the conduct and impact approach to mitigation, hereby submits the following responses to the questions posed in the Commission’s Notice.

I. INTRODUCTION

The NYISO appreciates this opportunity to explain an integral part of its market design—reference levels that are substituted for actual offers when a supplier fails a two-pronged conduct and impact test. The NYISO recognizes that the Commission has a duty to assess, on an on-going basis, the appropriateness of market mechanisms affecting ISO and RTO markets. The NYISO urges, however, that the Commission proceed cautiously when considering whether to modify or abandon long-standing market features like reference price-based mitigation.

The conduct and impact tests, reference prices and the Automated Mitigation Procedures (“AMP”) present a first line of defense against exercises of market power. These tools, which have been in place for several years, serve important diagnostic,

remedial, and deterrent purposes. Importantly, they are also well understood and have been generally accepted by New York's load and supply stakeholders, as well as the New York Public Service Commission. As explained below, NYISO does not believe that the Commission erred in accepting these measures for filing several years ago, or by so doing impermissibly delegated some portion of its ratemaking authority to the NYISO. The NYISO does not believe that there is any legal imperative that requires the Commission to reverse course at this juncture. And while modifications may seem attractive, the Commission must carefully weigh the potential benefits that might be achieved against the harm that may result from disrupting what many New York participants consider to be well-settled market rules.

II. COMMENTS

Question 1. In practice: (a) when are reference prices used; (b) by whom are they developed; (c) what can be their effect, if any, on the wholesale market-clearing price and wholesale rates for electric energy; and (d) how often do they affect market-clearing prices?

Responses to Question 1:

a) Reference prices, or reference levels, are used by the NYISO to implement its market power mitigation measures as authorize by Attachment H to its Market Administration and Control Areas Services Tariff ("Services Tariff"). They are used for the manual implementation of mitigation, as well as the Day-Ahead and Real-Time AMP. Reference levels are substituted for generator bids that fail both the conduct and impact tests. The conduct test assesses whether a supplier has raised its bids by amounts indicative of market power, in accordance with thresholds specified in the NYISO's Services Tariff. The impact test determines whether a bid that breaches the conduct test would cause a significant increase in either market-clearing prices (Locational-Based

Marginal Price or “LBMP”) or guarantee (“Bid Production Cost Guarantee” or “BPCG”) payments, also in accordance with thresholds specified in the Services Tariff.

b) Reference levels are developed by the NYISO Market Monitoring and Performance Department (“MMP”) staff in accordance with Section 3.1.4 of Attachment H to the Services Tariff. Attachment H to the Services Tariff sets forth the NYISO’s “Market Mitigation Measures” or “MMM.”

In the vast majority of cases, reference prices are programmatically/automatically determined on the basis of a unit’s competitive bids in accordance with the requirements of Section 3.1.4(a)(1) of the MMM, using either the mean or median (as appropriate) of each generator’s accepted, unmitigated bids over the past 90 days. Bid-based reference levels are thus based on a unit’s own bidding history under competitive conditions. The accuracy of the resulting bid-based reference prices is monitored daily by MMP staff. Bid based reference prices are the preferred reference prices. They are used whenever the necessary data is available, in accordance with section 3.1.4(a) of the MMM.

If necessary because of a lack of bid data, reference levels are determined based on the marginal cost formula and factors set forth in Section 3.1.4(3) or 3.1.4(b) of the MMM, using information provided by the owner or operator of the generator during a semi-annual reference price update process. The information MMP receives from the owner or operator of the generator is validated by MMP staff from generator-supplied data that is certified by a Professional Engineer or by an audit of the plant by MMP staff. Cost-based reference prices are determined in consultation with the NYISO’s independent market advisor.

Very occasionally, a market participant will request an *ad hoc* adjustment to an

established reference level determined through bid histories or the marginal cost formula. This can occur close to the bidding day, and may involve assertions about fuel cost risks, opportunity costs, or other factors that may involve some measure of engineering or economic judgment to assess, as discussed further below. Otherwise, the reference level setting process is quite straightforward and mechanical, if not automatic. Issues arising in requests for adjustments in reference levels have been resolved through informal discussions with the market participant, generally on the basis of documentation supplied by the market participant.

All reference prices (cost or bid-based) are automatically updated daily for fuel prices by comparing day-ahead fuel (natural gas, oil) prices to a baseline fuel price, using publicly-available fuel price indices, and adjusting reference prices based on the delta between the two values.

c) Reference prices can affect wholesale market-clearing prices in intervals when mitigation is imposed because a generator has failed both the conduct and impact tests in the MMM mitigation framework. Requiring a supplier to bid at its reference level does not, however, mean that the reference level necessarily “sets” the market clearing price. Whether or not mitigation occurs, the market clearing price continues to be set at the point where supply intersects demand (*i.e.*, the price is set by the offer of the marginal supplier). A mitigated unit will only set that price if the market determines that it is the marginal unit. The imposition of mitigation can indirectly affect the market clearing price when a mitigated generator does not set the market clearing price by causing a unit to be committed that would otherwise not be committed, by causing energy that was offered at prices higher than the clearing price to be fully dispatched at mitigated offer

levels well below the clearing price, or by causing the market to clear at the offer of a previously committed unit that was lower in the offer stack than the pre-mitigated bid of a mitigated unit. But those effects reflect the results of market forces as applied with the mitigated unit bidding at competitive levels.

d) Since 2001, day-ahead energy mitigation has only occurred on four days in the area of New York other than New York City (“NYC”). Within NYC, of the units that were committed, on average, 21% of committed unit-hours in 2004 were mitigated in the Day-Ahead market and 20% of committed unit-hours were mitigated in the Real-Time market. From January through March of 2005, 14% of committed unit-hours were mitigated in the Day-Ahead market and 7% were mitigated in the Real-Time market. Because mitigation affects both generator commitment and dispatch, there is likely to be at least some effect on market clearing prices in the hours identified.

Question 2. In what ways do reference prices in the wholesale market function like bid caps, and in what ways are they like formula rates?

Response to Question 2:

When a Market Participant attempts to exercise significant market power, conduct and impact mitigation caps the Market Participant’s offer at the appropriate reference level. During those hours the reference level operates as a bid cap. It does not, however, inherently cap the market price or prevent the supplier from receiving the market price for its energy.

Reference levels are set based on formulas and methods that have been reviewed and accepted by the Commission. Most reference levels are based on past accepted offers during competitive periods, while some reference levels are determined based on a resource’s marginal production costs under a formula stated in the MMM. In both cases,

the reference price could be considered analogous to a formula rate because it is calculated under a pre-approved formula. Reference prices differ from true formula rates, however, because they do not generally determine, and their purpose is not to determine, the price that a supplier will be paid or a consumer will be charged, except that: (i) when a mitigated unit happens to make the marginal supply offer in the day-ahead or real-time market it will set the clearing price; and (ii) when a mitigated unit with a reference price that is higher than the LBMP must be run for reliability or other reasons, it is compensated at the level of its reference price (but does not set market-clearing prices) if its original bids exceed the conduct test.

Question 3. Under what circumstances do RTOs, ISOs, their market monitors, or their consultants use discretion in setting reference prices? What is the nature of the discretion used? Is their discretion within the parameters prescribed in the RTO or ISO's Commission-approved, filed tariff? Is discretion necessary in determining reference prices? If so, under what circumstances is discretion necessary? Can reference prices be developed without discretion on the part of the RTO, ISO or market monitor?

Response to Question 3:

Please see the NYISO's response to Question 3a, below.

Question 3a. If RTOs, ISOs, their market monitors, or their consultants exercise discretion within the parameters prescribed in the RTO or ISO's Commission-approved, filed tariff, is such discretion an impermissible delegation of the Commission's authority or is it a permissible implementation of a Commission-approved tariff? With respect to possible impermissible delegations of authority, does it make a difference if it is the RTO, ISO or an internal market monitor that exercises discretion within the parameters of a Commission-approved, filed tariff, or if it is an external market monitor or other consultant that exercises such discretion?

Response to Questions 3 and 3a:

**Existing Procedures for Setting Reference Levels
Do Not Allow for Impermissible Discretion and Are Constitutional**

The authority to set reference levels is not derived from a delegation of the Commission's ratemaking authority. Instead, when the NYISO and its independent market advisor set reference levels, they are implementing a tariff-based and Commission-accepted market power mitigation system that ensures that market-based rates in New York are the product of competitive bids. Neither the NYISO nor its independent market advisor exercise impermissible discretion in setting reference levels since their actions are governed by the Commission-approved MMM and are ultimately subject to Commission review. The NYISO's existing procedures are therefore constitutional, consistent with the decision in *United States Telecom Association v. FCC* ("*U.S. Telecom*")¹ and lawful under the Federal Power Act.

A. The NYISO's Procedures for Setting Reference Levels Limit the Discretion of Private Parties and Are Therefore not Based on an Impermissible Delegation of Commission Authority

In a recent rehearing order on market implementation issues in the Midwest Independent Transmission System Operator ("MISO") region, the Commission

¹ 359 F.3d 554 (D.C. Cir. 2004).

reaffirmed its earlier decision that the MISO's procedures for setting reference levels were not based on an impermissible delegation of Commission authority. The Commission concluded that the MISO tariff provided a "reasonably specific description of the reference level-setting process," that "the process of setting reference levels will take place within specific, Commission-approved parameters," and, thus, that the mitigation regime was not based on an impermissible delegation.² Similar reasoning, authorizing actions by private entities that were consistent with applicable regulations, has been approved by the courts.³

The Commission's conclusions in the MISO Order are equally applicable to the NYISO's reference level-setting procedures which were the model for MISO's and, as Attachment A to the Notice observes,⁴ allow for even more specific standards than the tariff provisions that were addressed in the MISO Order. The NYISO's MMM expressly require that, where possible, reference levels be calculated using programmatic or automatic means in the first instance. Section 3.1.4(a) of the MMM provides that reference levels first be calculated using the average of a generator's bids during similar periods over the last ninety days. As explained in response to Question 1b, above, this mechanism essentially removes the NYISO and its independent market advisor from the process of establishing reference levels, which are instead derived directly from each generator's competitive bidding history. Section 3.1.4 of the MMM includes similarly

² *Midwest Independent Transmission System Operator, Inc., et al.*, 111 FERC ¶ 61,053 at P 25 (2005) (the "MISO Order").

³ *See, e.g., Perot v. Federal Election Commission*, 97 F.3d 553 (D.C. Cir. 1996) (holding that no delegation problem arose when private organization's actions were consistent with agency regulations). *National Association of Psychiatric Treatment Centers for Children v. Mendez*, 857 F.Supp. 85 (D.D.C. 1994) (finding that agency did not impermissibly delegate authority where private entity acted consistent with agency regulations).

⁴ *See* April 1 Notice, Attachment A at n.5.

mechanical rules with respect to the calculation of reference levels for newly constructed units, for generator start-up costs, and for 10-minute non-synchronized operating reserves, all of which use non-discretionary, market-derived methods to set reference levels in the first instance.

When the preferred, mechanical methods of setting reference levels cannot be implemented for a particular generator because there is insufficient data available to apply automatic calculation alternatives, the NYISO's MMM provide a formula and instructions that constrain the alternative method of setting cost-based reference levels through consultation with individual suppliers. As Attachment A to the Notice explicitly recognizes, when the NYISO sets reference levels through consultation with a particular market participant it is directed to adopt a level that reflects marginal costs, as defined by a tariff formula (set forth in Section 3.1.4(a)(3) of the MMM).

Finally, aggrieved market participants have the ultimate right to appeal reference level decisions to the Commission, which guarantees that the Commission retains final decision-making authority. The NYISO appeals procedures appear to be substantially stronger than those considered in *U.S. Telecom*. According to the Court, in *U.S. Telecom* the only appellate route that aggrieved parties had was to file a petition for a declaratory order with the FCC.⁵ In the NYISO's case, the tariff contains specific appeals procedures, which includes alternate dispute resolution procedures and ultimate Commission authority to review the results of the dispute resolution process. Moreover, all arbitration decisions that affect matters subject to the jurisdiction of the Commission

⁵ See *U.S. Telecom*, 359 F.3d at 564.

must be filed with the Commission.⁶ These procedures have proven effective, and there is no reason to believe they would not be effective in the unlikely event that disputes would arise over the setting of reference levels.⁷ Federal courts have found that there is no impermissible delegation of agency authority when an agency has final review authority over actions taken by a private party.⁸

The Commission should therefore reaffirm the conclusion it reached in the MISO Order that no impermissible delegation of authority occurs when RTOs/ISOs or their market monitors set reference levels using procedures, such as the NYISO's, that adequately circumscribe the setting of reference levels and if ISOs/RTOs determinations are, ultimately, subject to Commission review.

B. Authorizing RTOs/ISOs to Set Reference Levels Is Not a Delegation of the Commission's Ratemaking Authority

Existing reference level procedures are not founded on an impermissible delegation of the Commission's ratemaking authority because implementing conduct and impact mitigation, including establishing reference levels, is not a ratemaking function.

In New York, and in other regions with conduct and impact mitigation regimes, the Commission has allowed market-based pricing so that jurisdictional rates are determined by the interplay of competitive market forces. Conduct and impact mitigation is the mechanism, described in detail in Commission-approved tariffs, that ensures that

⁶ Services Tariff § 11.3.

⁷ See, e.g., *New York Independent System Operator, Inc. v. Dynegy Power Marketing, Inc.*, 105 FERC ¶ 61,249 (2003).

⁸ See, e.g., *Riverbend Farms, Inc. v. Madigan*, 958 F.2d 1479, 1488 (D.C. Cir. 1992) (finding that an Executive Branch official could follow the recommendations of private entity so long as he was not merely "rubber-stamping" those recommendations); *The Ocean Conservancy v. Evans*, 260 F. Supp.2d 1162, 1183 (M.D. Fla. 2003) (holding that agency retained sufficient final decision-making authority over the recommendations of a private panel when the agency reviewed the panel's findings and based its final decision on that review).

market-based prices in these regions continue to be just and reasonable. The reference level setting process is an integral part of the conduct and impact regime. Federal appellate courts have held that in order for market-based rates to be just and reasonable, a competitive market must exist, or buyers and sellers in that market must not have the ability to exercise market power.⁹ Thus, the Federal appellate courts have long held that safeguards ensuring that market-based rates continue to be just and reasonable are required by the Federal Power Act.¹⁰

When RTOs/ISOs and market monitors implement Commission-approved mitigation measures they are not engaged in ratemaking and have not been authorized to exercise the Commission's exclusive ratemaking authority. Setting a reference level for a particular generator does not involve a determination of a just and reasonable market price. Rather, the objective for the market monitors is to follow the rules that the Commission has accepted in the NYISO tariff to determine reference levels. The

⁹ See, e.g., *State of California ex rel. Lockyer v FERC*, 383 F.3d 1006, 1012 (9th Cir. 2004) (“[A]pproval of [market-based] tariffs was conditioned on the existence of a competitive market. Thus, market-based applications were approved only if FERC made a finding that the seller and its affiliates did not have, or adequately had mitigated, market power.”) (internal quotations omitted); *Louisiana Energy and Power Authority v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998) (“[T]he Commission approves applications to sell electric energy at market-based rates only if the seller and its affiliates do not have, or adequately have mitigated, market power in the generation and transmission of such energy, and cannot erect other barriers to entry by potential competitors.”).

¹⁰ See, e.g., *California ex rel. Lockyer*, 383 F.3d 1006 at 1014 (discussing Commission approval of market-based rate authority, and finding that “a market-based tariff cannot be structured so as to virtually deregulate an industry and remove it from statutorily required oversight.”); *Cajun Electric Power Cooperative, Inc. v. FERC*, 28 F.3d 173, 176 (D.C. Cir. 1994) (stating that under competitive conditions, the Commission may use market-based rates to “assure a just and reasonable result”) (quoting *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1990)); see also *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir. 1984) (“FERC failed to show that the rates resulting from its newly articulated ratemaking principles would necessarily satisfy the ‘just and reasonable’ standard. FERC set rate ceilings which, if reached in practice, would admittedly be egregiously extortionate and then failed to demonstrate that market forces could be relied upon to keep prices at reasonable levels throughout the oil pipeline industry.”).

Commission-accepted tariff rules for determining reference levels are designed to accurately approximate each generator's marginal costs. Mitigated bids that result from the application of the Commission-accepted tariff rules will become part of the "bid stack" along with all other mitigated and unmitigated bids. Again, the NYISO's function is accomplished via its implementation of Commission-approved tariff rules, not, as some have alleged, through the exercise of delegated ratemaking authority. Prices continue to be set by the market under Commission-approved market rules, with Commission-accepted protections in place to discourage market manipulation or the exercise of market power. In *U.S. Telecom*, by contrast, the FCC made a wholesale delegation of its authority to determine whether certain statutory requirements were met—authority specifically entrusted by Congress to the FCC.¹¹ The Commission here has not made any such delegation of its ratemaking authority under the Federal Power Act to ISOs/RTOs and market monitors.

The United States Court of Appeals for the District of Columbia Circuit has held that no delegation of the exclusive authority of an administrative agency occurs when a private party is merely implementing agency regulations and the private party's implementation of the regulations is subject to the agency's ultimate review.¹² Moreover, as *U.S. Telecom* recognized, there is not necessarily a delegation every time a non-federal actor plays some role in the agency's decision-making process or is involved in the

¹¹ See *U.S. Telecom*, 359 F.3d at 567 (finding that the FCC "has delegated to another actor almost the entire determination of whether a specific statutory requirement -- impairment -- has been satisfied.").

¹² See, e.g., *Perot v. Federal Election Commission*, 97 F.3d 553 (D.C. Cir. 1996) (finding that permitting a private organization to determine "objective criteria" for presidential debates was not a delegation of authority from the Federal Election Commission).

implementation of agency rules.¹³ The Commission has itself held that no delegation of ratemaking authority is involved when an ISO implements a system of penalties established in a Commission-approved tariff,¹⁴ or establishes a purchase price cap.¹⁵ The role played by an RTO/ISO or market monitor in establishing reference prices is just another example of a private party's permissible implementation of rules established by an administrative agency that are ultimately subject to the agency's review.

The mere fact that a generator-specific reference level can set a market-clearing price at a particular location for a particular interval does not turn the setting of reference levels into an impermissible exercise of the Commission's ratemaking authority by an RTO/ISO. In most intervals the existence of reference levels will have no impact on clearing prices, because those prices will be set by the free interaction of unmitigated offers to sell and bids to purchase; reference prices will only come into play if a unit bids breach the conduct and impact tests. Even when individual sellers are mitigated to their reference level, clearing prices may be affected as described in the NYISO's response to Question 1c, above, but the reference level will set the market-clearing price only if the market determines that the mitigated unit is marginal.

If bids that are mitigated to reference levels set market clearing prices, they will do so because the Commission-accepted tariffs and market rules dictate that result in

¹³ See *U.S. Telecom*, 359 F.3d at 567. See also *Perot*, 97 F.3d at 560 (dismissing argument that agency delegated authority just because private party had some discretion, and stating that "virtually any regulation of a private party could be described as a 'delegation' of authority, since the party must normally exercise some discretion in interpreting what actions it must take to comply.").

¹⁴ See *California Independent System Operator, Inc.*, 107 FERC ¶ 61,118 at P 16 (2004) ("The authority to administer such penalty charges stems from the Commission-approved ISO Tariff, not from a delegation of authority.")

¹⁵ See *California Independent System Operator, Inc.*, 86 FERC ¶ 61,059 (1999); *AES Redondo Beach, et al.*, 85 FERC ¶ 61,123 (1998).

order to guarantee that market-based prices continue to be just and reasonable. Reference levels will ordinarily be mechanically determined based on rules that are clearly specified in Commission-accepted tariffs, or alternatively through the application of the Commission's rules for determining cost-based reference prices. There is no delegation problem in either instance because the cost-based determinations are developed in accordance with Commission-accepted tariff rules that are subject to Commission review in the event of a dispute.

C. The Fact that Independent Market Monitors May Not Be Treated As Commission Employees Does Not Give Rise to a Delegation Issue

Some concern has been expressed about the fact that the United States Court of Appeals for the District of Columbia Circuit recently held that the Commission may not deem independent market monitors to be Commission employees for purposes of its *ex parte* communications rules.¹⁶ The Court's opinion has no bearing on the setting of reference levels. The NYISO did not base its conduct and impact mitigation proposal, or the methods by which it has been authorized to determine reference prices, on the theory that its market monitoring staff, or its independent market advisor, were *de facto* members of Commission staff. Nor was the Commission's approval of the relevant tariff provisions premised, in any way, on such a theory. The NYISO's reference level procedures are constitutional because they require the market monitors to follow Commission-accepted tariff rules and do not involve any delegation of the Commission's ratemaking authority.

D. If the Commission Determines That There Is a Delegation Issue the Problem Can Be Remedied Without Abandoning the Use of Reference Levels

¹⁶ See *Electric Power Supply Association v. FERC*, 391 F.3d 1255 (D.C. Cir. 2004) ("EPISA").

Assuming, *arguendo*, that the Commission were to conclude that existing reference price procedures involve some impermissible delegation of Commission's authority, that conclusion should be limited to the occasional *ad hoc* reference level adjustments discussed above and in section 3(b) below. The Commission could remedy any such problem by requiring that reference price adjustments be subject to the Commission review and acceptance of such adjustments in appropriate circumstances. Although the NYISO does not think that Commission review is constitutionally necessary, its adoption could serve to eliminate any question that the mitigation rules allow private parties to exercise unreasonable discretion or to impermissibly engage in "ratemaking."

Requiring Commission review of reference level adjustments would make mitigation a more cumbersome process and would consume additional resources both at the Commission and within the affected RTOs/ISOs. Given the time constraints on the submission of bids and the determination of day-ahead and real-time market results, the implementation of additional review would have to be done with sufficient expedition and resources to ensure that conduct and impact mitigation remains workable. Discretion is only rarely used to adjust reference levels in New York today. If the Commission were to adopt expedited procedures for reviewing such reference level adjustments, perhaps by adopting streamlined review procedures and delegating responsibility for implementing the streamlined review process to its OMOI staff, the NYISO believes that a workable process could be achieved.

Question 3b. How often do RTOs, ISOs and their market monitors consult with individual market participants to determine the appropriate reference prices(s) for that market participant's unit(s)? How is the

consultation process carried out? Is this consultation process appropriate?

Response to Question 3b:

The NYISO uses a twice-yearly reference price updating process to determine cost-based reference prices. The updates coincide with the summer and winter environmental (SO_x and NO_x) regulation periods. This approach allows for proper inclusion of emissions costs, which vary by season, in determining cost-based reference prices. The approach also allows for updating fuel mix and heat rate information, and for the incorporation of seasonal capacity changes, based on the physical and auditable characteristics of the unit.

Market participants are the source of most of the information the NYISO utilizes to calculate cost-based reference levels. The semi-annual submission of revised information for each generating unit presents the initial opportunity to review this data with the NYISO's MMP staff. MMP staff will often speak with owners to verify and clarify some of the submissions during this update period. Information is processed by the MMP in consultation with the independent market advisor before being finalized as a reference level and shared with the owner. When disagreements arise, they typically involve mistakes in submissions—such errors are usually caught early on, but may require additional consultation with the market participant before they are resolved. In no case has this process led to formal dispute resolution proceedings. In general, the process has proved essentially mechanical and straightforward, as dictated by the marginal-cost formula and standards in the Services Tariff, and by MMP procedures requiring appropriate and verifiable documentation of costs.

The NYISO may also consult with a market participant who requests an *ad hoc*

adjustment (other than standard fuel adjustments) to an established reference level. This happens rarely, but can occur close to the bidding day and may involve assertions about fuel cost risks, opportunity costs, or other factors that may require some measure of engineering or economic judgment to assess. This kind of adjustment occurred only four times in 2004, in one instance because of a tube leak, and in the other instances because of a unit's need to avoid dispatch to comply with environmental requirements.¹⁷

Adjustments were made in seven other instances, but because of routine cost, data entry or software corrections that amounted to straight-forward error corrections. All of the foregoing instances were readily resolved with the affected market participant.

All requests for adjustments must be accompanied by verifiable documentation and are subject to physical audit by MMP staff to determine their veracity. Adjustments are made if they are consistent with the marginal cost formula and standards articulated in the Services Tariff.

Question 3c. How do RTOs, ISOs and their market monitors resolve disagreements with market participants about methods used to determine their individual reference prices, or about the data used to calculate their reference prices?

Response to Question 3c:

If the NYISO MMP concludes that a generator's data submission or proposed adjustment is inappropriate or overstated, MMP will request additional documentation and/or calculations from the generator. In general, appropriately documented, and in some cases certified, requests are granted subject to physical audit as appropriate. In addition the independent market advisor may be consulted to assist in resolving disputes.

¹⁷ In the case of the tube leak and one of the environmental adjustments, a subsequent change was also made to restore the original reference levels when the special situation ended.

If a dispute is not resolved in this manner, a market participant can invoke the NYISO's dispute resolution procedures, including arbitration and, if necessary, review by the Commission. Formal resolution of disputes about the proper numbers for a unit's reference levels have not occurred in the almost five-year history of conduct and impact mitigation to date.

Question 4. Is there a reason why reference prices, once set, would need to be adjusted quickly?

Response to Question 4:

Yes, primarily due to changes in the in-day fuel market. The timing of the fuel price postings and market bid closing can occasionally require quick reference recalculations. New York has a relatively large quantity of dual fuel units that can switch fuels quickly and thereby change their fuel costs, and there can be restrictions on gas delivery and use during peak winter periods. In addition compliance with NO_x limits may require additional bidding flexibility on relatively short notice, as may other environmental restrictions, such as noise. Finally, extraordinary plant conditions, such as gas line outage, failure of fuel delivery, or other factors may require immediate action. The NYISO MMP has established an e-mail database called AMP Notify which enables market participants to request emergency reference price adjustments. The need for such adjustments, however, is very infrequent. As discussed above, adjustments were required in only 11 instances in 2004, of which only four required anything other than mechanical error correction; those four involved operational or environmental issues that were readily resolved.

Question 5. How often are reference prices set based on the market monitor or RTO/ISO's estimate of a unit's generating costs, compared to other methods of calculating reference prices?

Response to Question 5:

Very rarely, if ever. Reference prices are generally set based on resources' past accepted offers, or by the application of a marginal cost formula. In constrained areas where competition is limited, a substantial share of the higher cost units, such as gas turbines, may have reference prices set based on the units' costs. Cost-based reference levels, however, are generally calculated based on information that is provided by the owner of the unit and validated by the NYISO. They are not calculated based on the NYISO's own estimate of the units' costs, except where the owner of the unit has not submitted valid cost information for the resource.

Question 6. To the extent that the RTO, ISO or market monitor may affect the market-clearing price at one or more locations and time intervals by determining reference prices, is there a better system that can be employed to mitigate bids?

Response to Question 6:

The NYISO is not aware of a better mitigation method than the conduct and impact framework it employs. Any mitigation framework is going to affect market clearing prices to some extent—that is its purpose. The conduct and impact tests are the most practical means to ensure that mitigation is only imposed when prices would be artificially inflated through economic withholding, and do not limit legitimate increases in prices during periods of shortage. Mitigation provisions that have been employed in other markets and the cost-based measures that had previously been employed in New York City result in much more active, and much less narrowly-tailored, intervention in the market than the conduct and impact framework. Most of the alternatives to conduct and impact-based mitigation will not preserve high prices during periods of shortage as

reliably as the conduct and impact framework.

The NYISO's multi-tiered approach to setting reference levels results in reference levels that require very little discretion to be employed by the market monitor or RTO/ISO, for reasons that are addressed in detail in response to Questions 1b, 3a and 4, above.

Question 6a. Should some method other than reference prices within a conduct and impact approach to mitigation be used? If so, what method? Would this alternative method involve discretion on the part of the market monitor, ISO or RTO?

Response to Question 6a:

Please see the NYISO's answer to Question 6. Based on more than five years of experience with the conduct and impact framework, we believe it is the most workable and effective approach to mitigation. Benefits include:

- **Prospective application**—the prices and dispatch patterns that prevail after the mitigation are efficient. Sanctions and other retroactive measures can only punish the entity with market power, but cannot prevent or repair the substantial harm to the market that occurs when an entity exercises market power.
- **Less Disruptive**—conduct and impact mitigation minimizes intervention in the market by requiring that the prerequisites to an exercise of market power exist prior to the imposition of mitigation.
- **Efficient**—permits timely, generator-specific adjustments that avoid inefficient over- or under-mitigation
- It is more **straightforward to administer** than most of the alternatives.

Question 6b. Reference prices could be developed by the market monitor, but submitted to the Commission for its approval. Should reference prices be set in that manner?

Response to Question 6b:

As discussed above, the NYISO tariff appropriately circumscribes the setting of reference levels. The hypothetical posed by the Commission would be most appropriate

in those cases that may require some measure of engineering or economic judgment. In New York, this is always or virtually always the case only when the NYISO is making a *ad hoc* reference level adjustment at the request of a market participant. To be useful, the Commission's review would have to be timely, so that unjustified mitigation can be avoided, and appropriate bids submitted, in the next market iteration. Therefore, an expedited process would need to be established at the Commission to review such adjustments (e.g., same day response in most cases).

III. COMMUNICATIONS

Please address all correspondence regarding this rulemaking to the following persons:

Robert E. Fernandez,
General Counsel and Secretary
Elaine D. Robinson,
Director of Regulatory Affairs
Alex M. Schnell
New York Independent System Operator, Inc.
290 Washington Avenue Extension
Albany, New York 12203
Phone: 518-356-8707
Fax: 518-356-8825
E-mail: rfernandez@nyiso.com
erobinson@nyiso.com
aschnell@nyiso.com

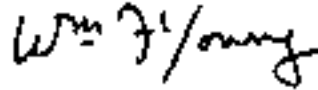
William F. Young
Ted J. Murphy
Michael E. Haddad
Hunton & Williams
1900 K St., N.W.
Washington, D.C. 20006-1109
Phone: 202-955-1500
Fax: 202-778-2201
E-mail: wyoung@hunton.com
tmurphy@hunton.com
mhaddad@hunton.com

IV. CONCLUSION

WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission consider these comments and act or elect not to take action in accordance with the NYISO's responses to the above questions.

Respectfully submitted,
NEW YORK INDEPENDENT
SYSTEM OPERATOR, INC.

By:



Counsel

William F. Young
Ted J. Murphy
Michael E. Haddad
Hunton & Williams LLP
1900 K Street, NW
Washington, DC 20006-1109
(202) 955-1500
Counsel to New York Independent System Operator, Inc.

May 2, 2005

Submission Contents

Comments.doc..... 1-22