UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

H.Q. Energy Services (U.S.), Inc.	)	
v.	)	**Docket Nos. EL01-19-000,**
New York Independent System Operator, Inc., and	)	**EL01-19-001,**
	)	**EL02-16-000,**
PSEG Energy Resource & Trade LLC	)	**EL02-16-001**
v.	)	
New York Independent System Operator, Inc.	)	

MOTION OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.
FOR LEAVE TO SUBMIT A RESPONSE
AND RESPONSE TO ANSWERS AND PROTESTS

Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213, the New York Independent System Operator, Inc. ("NYISO"), by counsel, respectfully requests leave to submit a response, and submits this response, to the answers and protests (collectively, the "Answers") filed in response to NYISO's Motion to Reopen Record and for Disposition on Remand ("NYISO Motion").

REQUEST FOR LEAVE TO SUBMIT RESPONSE

The NYISO recognizes that the Commission generally discourages responses to answers. Here, however, the Answers present hypothetical bidding alternatives and make other arguments and assertions that are misleading, and do not address the Market Design Flaw [1] underlying the Energy Limited Resource Emergency Corrective

[1] "A 'Market Design Flaw' is defined as a market structure, market design or implementation flaw giving rise to situations in which market conditions or the

(continued...)

Action ("ELR ECA"). This Response will help to clarify complex issues, provide additional information that will assist the Commission, correct inaccurate statements, and otherwise help in the development of the record in this proceeding, and should thus be accepted by the Commission.[2] The NYISO's response does not introduce new arguments, but instead is submitted for the limited purpose of clarifying certain factual matters and correcting inaccurate or misleading statements in the Answers, thereby assisting the Commission in its review and consideration of the issues presented in this proceeding. The NYISO therefore respectfully requests that the Commission exercise its discretion and accept the NYISO's response.

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application of ISO Procedures would result in inefficient markets or prices that would not be produced in a workably competitive market." *H.Q. Energy Services (U.S.), Inc. v. New York Independent System Operator, Inc.*, Complaint of H.Q. Energy Services (U.S.), Inc., Docket No. EL01-19-000, at p. 11 (December 12, 2000) ("HQUS Complaint"). Unless otherwise specified, capitalized terms have the meaning specified in the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff").

[2] *See, e.g., Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.*, 93 FERC ¶ 61,017 at 61,036 (2000) (accepting an answer that was "helpful in the development of the record . . . ."); *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 at 61,797 (2000) ("Initial Order") (allowing "the NYISO's Answer of April 27, 2000, [because it was deemed] useful in addressing the issues arising in these proceedings . . . ."); *Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138 at 61,381 (1999) (accepting prohibited pleadings because they helped to clarify the issues and because of the complex nature of the proceeding).

RESPONSE

I. The Answers' Hypothetical and Speculative Bidding Strategies Ignore the Fundamental Problem Addressed by the ELR ECA

The problem addressed by the ELR ECA is the management of the limited energy output of an ELR unit. By definition, an ELR can use its capacity to generate only a limited amount of energy over a given period.[3] As shown in the NYISO Motion and the NYISO's earlier submissions in this proceeding, prior to the ELR ECA, sellers could only manage the limited energy of ELRs indirectly, by submitting artificially high bids that did not reflect a unit's costs, but were merely intended to prevent the unit from being dispatched.[4] As happened on May 8 and 9, 2000, this indirect means of managing ELR output could have the collateral effect of causing energy prices to rise to artificially high levels, if : (1) the ELR units were needed for energy in Real Time; and (2) an ELR bidder would have made energy available at lower prices if it had another means besides the level of its energy bids to manage its ELR.[5]

The ELR ECA corrected this Market Design Flaw by providing a means to manage the limited energy of an ELR directly, by providing for the specification of two operating limits, one for normal conditions and another for emergency conditions. As

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[3] *See* Savitt Affidavit ¶ 3 (stating that ELRs "can operate for only a limited number of hours within a given period because of water level, fuel, maintenance, environmental or other restrictions").

[4] NYISO's Motion at pp. 9-10.

[5] Rougeux Affidavit ¶ 9; Deasy Affidavit ¶ 8.

stated in the NYISO's July 28, 2000, memo to market participants explaining the ELR ECA:

> The approach being developed by the NYISO would permit ELRs to submit bids that designate two ranges for operation. First, an ELR unit could bid an initial range with an operating upper limit at which the unit would under any circumstances be dispatched so long as it is in economic merit order. Second, an ELR unit could bid an upper operating range, available for a limited duration, designed to be used only when triggered by certain system requirements.[6]

Likewise, the NYISO's filing to incorporate the ELR ECA into the Service Tariff states: "The NYISO proposes to allow [Capacity Limited Resources] and ELRs to submit bid curves specifying their operating limits under normal conditions, and the amount of additional capacity that they would be able to provide in emergencies."[7] With these additional bidding parameters, a bidder can specify how much energy is available from an ELR over the course of a given day, and the NYISO can schedule and dispatch the unit as needed within that overall limit.

The Answers speculate on various hypothetical bidding strategies other than the one used by NYPA on May 8 and 9, but these supposed possibilities either do not provide an alternative to offering a segment of capacity at a very high price in order to

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[6] *H.Q. Energy Services (U.S.), Inc. v. New York Independent System Operator, Inc.*, Answer of New York Independent System Operator, Inc. to Complaint of H.Q. Energy Services (U.S.), Inc., Docket No. EL01-19-000, at Attachment A, p. 5 (January 17, 2001) ("July 28 Memo").

[7] *New York Independent System Operator, Inc.*, Filing of Tariff Revisions to Permit Capacity Limited Resources and Energy Limited Resources to be Scheduled Above Their Normal Upper Operating Limits, Docket No. ER01-2459-000, at p. 5 (June 29, 2001).

ensure that it is not taken for energy, or simply ignore tariff or reliability requirements. Thus, the "solutions" offered by the Answers all entail flaws that are comparable to, if not worse than, the unintended consequences of the market rules encountered on May 8 and 9; they all suffer from the problem of trying to do indirectly what the ECA does directly.

One hypothetical alternative suggested by PSEG and Dr. Shanker is that B-G could have bid into the Real-Time market only the amount for which it was scheduled in the DAM.[8] This ignores the fact that the DAM schedule included 220 MW of reserves availability, and carried with it the tariff obligation to honor that commitment in Real Time.[9] The bid for any capacity segment offered for operating reserves would have had to be at a very high price, in order to avoid having it dispatched for energy. If, as was the case, additional capacity segments above the DAM schedule were needed for energy, prices would have jumped to the same artificially high levels that prompted the ECA.[10] Moreover, as the NYPA DAM bid curve indicates,[11] the entire capacity of B-G was in fact available, and as the NYPA affidavits indicate, NYPA did not desire to

[8] Answer of PSEG Energy Resources & Trade LLC to Motion of the New York Independent System Operator, Inc. to Reopen Record and for Disposition on Remand ("Answer of PSEG") at p. 12.

[9] Rougeux Affidavit ¶ 7.

[10] *See* Initial Order at 61,960-61 (finding that during the relevant period, the "NYISO's procurement of energy in the Day-Ahead Market was thus insufficient to meet the high demand, and NYISO was forced to call upon a significant amount of generation resources offered in the Real-Time Market to maintain reliability").

[11] Rougeux Affidavit, Exhibit A.

withdraw or derate the capacity above its DAM schedule, but only to manage the use of the limited amount of energy available from B-G's capacity, and would have been willing to offer energy at lower prices in an emergency but for the bidding rules. The arguments of PSEG and Dr. Shanker notwithstanding, before the ELR ECA, NYPA could only manage B-G's energy output limits with a tool—energy bids—that was at best a blunt instrument, as compared to the precise capacity management tool made available by the ELR ECA. The PSEG / Shanker hypothetical carries the same potential for unintended price increases that the ELR ECA fixed.

Keyspan suggests that B-G could have submitted additional reserves without bidding the entire unit for energy.[12] Keyspan does not explain, however, how capacity could be made available for spinning reserves, yet not be taken for energy, except by having a very high bid for the capacity intended for operating reserves. Thus, Keyspan's "solution" still poses the potential for energy to be taken at very high prices during periods of high demand, when NYPA was in fact willing to offer such energy at much lower prices, if it had some means other than energy bids to manage the limited B-G energy.

PSEG and Dr. Shanker claim that NYPA could have adjusted its bid every hour in an effort to ration the output of its unit while achieving its other objectives, or could

[12] Answer of Keyspan-Ravenswood LLC to Motion of the New York Independent System Operator, Inc. to Reopen Record and for Disposition on Remand ("Answer of Keyspan") at p. 12.

have submitted the exact same bids that the NYISO used to correct prices,[13] while Keyspan suggests that NYPA could have adjusted its offers in R-T to reflect actual supply and demand.[14] But Dr. Shanker acknowledges that "Mr. Rougeux wasn't omniscient, and didn't adjust prices exactly correctly to meet the needs of the NYISO, thus resulting in some of his intended 'reserved' energy being taken at high prices."[15] This confirms the "hit or miss" nature of the hypothetical bidding strategies proposed in the Answers, and their implicit and unnecessary risk that artificially high prices would result from trying to manage the limited energy of an ELR just with its energy bids. PSEG provides no basis for supposing that NYPA could have had any idea what the next lowest bid in the bid stack was, or would have had any proper basis for submitting the exact same bid as a competing unit. Keyspan provides no basis for supposing that NYPA could have had any idea of system supply and demand on an hour-to-hour basis so that it could have adjusted its bids accordingly. NYPA is not the system operator. The NYISO is the system operator—but neither could the NYISO tell how much ELR energy was available or for how long, until the ELR ECA was implemented. The ELR ECA gives the NYISO this information, and relieves an ELR bidder of having to make guesses about supply and demand levels, thus facilitating more efficient operations by both entities.

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[13] Answer of PSEG at pp. 11-12; Shanker Affidavit ¶ 14.

[14] Answer of Keyspan at pp. 11-12.

[15] Shanker Affidavit ¶ 18.

The claim that once B-G was on-line, it could have provided additional spinning reserves while providing energy at the same price as its second bid segment, or any other price, is based on an assertion that is true, but beside the point.[16] It ignores the fact that in order for B-G to provide capacity for "additional SR," the pre-ELR ECA rules forced B-G to submit a very high bid for that capacity to avoid its being called for energy. Thus, this hypothetical bidding strategy once again begs the question of the Market Design Flaw that underlies the ELR ECA.

Arguments that the NYISO and NYPA may have been unprepared for the May 8 and 9 scarcity, or that NYPA acted on imperfect information, and that those facts do not constitute a Market Design Flaw, again beg the central question.[17] The NYISO does not contend that lack of preparedness, or imperfect information, constituted a Market Design Flaw. The Market Design Flaw was the limitations on, and the adverse consequences resulting from, the use of energy bids to manage the limited output of an ELR. Instead of having to guess about supply or demand, or other conditions it did not know and did not have the means to know, the ELR ECA permitted a bidder of ELR generation to bid on the basis of what the bidder did know: the amount of available ELR energy. The ability to specify its energy limits gave an ELR bidder the ability to bid in ways that would accommodate unexpected conditions or imperfect supply and demand information, and put the energy limitations information (and correct energy

[16] Answer of Keyspan at pp. 12-13.

[17] *Id.* at pp. 8-10.

offer prices) in the hands of the entity with the ability to act on it: the NYISO, the system operator. The absence of this bidding option, and the resulting limitations on both the bidder and the system operator, was the Market Design Flaw.

II. Operating Reserves Bidding or Pricing is not the Market Design Flaw

The ELR ECA corrected energy prices, not operating reserves prices, and the NYISO is not now proposing a new or different ECA for operating reserves. Nothing in the ELR ECA would have changed the bidding or use of spinning reserves from B-G. To the contrary, operating reserves issues have arisen only because PSEG has suggested a strategy of not bidding in Real Time as a way of avoiding the problems that led to the ECA. NYISO did not have an opportunity to address PSEG's bid-withdrawal argument in the prior proceedings, because the Initial Order was issued before NYISO's answer to the PSEG complaint was due; and since the operating reserves issues were not in the record before the Commission, they could not have been raised by the NYISO on appeal. Because there was no prior opportunity for the NYISO to respond to assertions that NYPA could have refrained from bidding in Real Time, the NYISO's response cannot be deemed to have been waived.[18]

[18] The Commission's rejection in the Rehearing Order of PSEG's claim that the Commission erred in ruling on the PSEG complaint before answers were due, cited in Answer of PSEG at 9 n.25, plainly does not stand for the proposition that the NYISO has waived any arguments. As the Commission held in the Rehearing Order, "PSEG can not maintain that it did not have an adequate opportunity to make its case, " but that cannot be said of the NYISO. *New York Independent System Operator, Inc.*, 100 FERC ¶ 61,028 at P 14 (2002) ("Rehearing Order").

As shown in the NYISO Motion and in the discussion above, the hypothetical strategy of not bidding in Real Time would not have resolved NYPA's incompatible bidding objectives, and the NYISO's system reliability objectives, because it would have conflicted with the objective of providing operating reserves. Since operating reserves are critical to system reliability, not bidding in Real Time could have adversely affected reliability in the NYCA, and cannot be blithely assumed away. Correspondingly, Keyspan's arguments that the NYISO should be required to show that markets would have been inefficient or not workably competitive if operating reserves had not been available from NYPA turns the logic of bid-based markets upside down, and ignores the importance of reserves for reliability.[19] The B-G operating reserves were selected in economic merit order on May 8 and 9. Thus, Keyspan in effect advocates withholding resources that would otherwise be in merit order. This describes a bidding strategy that is fundamentally at odds with the objectives of competitive markets, and is founded on the conduct that is the reason for the NYISO's market power monitoring plan and mitigation measures. Indeed, Keyspan is articulating a compelling reason for concluding that there was a Market Design Flaw requiring the ELR ECA: without the ECA, NYPA would be relegated to withholding a resource that otherwise would be selected, while with the ECA, it could have provided that resource for operating reserves, while also providing energy at the lower prices at which it wished to sell.

[19] Answer of Keyspan at p. 7.

III. There is No Evidence that NYPA was Bidding Its Opportunity Costs

NYPA has submitted two affidavits confirming that its bids were set at levels that were not based on a determination of its opportunity costs, but only on an effort to select a number that would prevent B-G from operating during normal conditions.[20] In its Rehearing Order, the Commission found that: "the Commission notes that neither PSEG nor any other party provide any support for a particular level of such costs for NYPA on May 8 and 9."[21] This continues to be the case. The Answers likewise come forward with no basis for concluding that NYPA was not bidding on the basis described in its affidavits. There is no reason to question the credibility of NYPA's witnesses.[22]

Likewise, there is no basis for Dr. Shanker's assertion that NYPA's actions were consistent with those of an entity seeking to maximize revenues by making energy available at times of highest demand.[23] An entity seeking to maximize its revenues would have made a careful determination of expected opportunity costs, and submitted a bid carefully tailored to that determination—that is, as stated in PSEG's Answer, it

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[20] *See* Deasy Affidavit ¶ 4; Rougeux Affidavit ¶ 6.

[21] Rehearing Order at P 19.

[22] Mere speculation about opportunity costs or other bidding strategies is not a sufficient basis for requesting discovery. Answer of PSEG at p. 7; *See Transwestern Pipeline Co.*, 50 FERC ¶ 61,211 at 61,674 (1990) ("Where a party 'requesting an evidentiary hearing merely offers allegations or speculations without an adequate proffer, the Commission may properly disregard them.'") (citing *General Motors Corp. v. FERC*, 656 F.2d 791, 798 n.20 (D.C. Cir. 1981)).

[23] Shanker Affidavit ¶ 18.

would have carefully "balanced the costs and benefits of operating its facility in a particular hour against the costs and benefits of preserving its finite resources in order to operate at a later time."[24] Both Mr. Deasy and Mr. Rougeux have stated under oath that this was not the basis on which the B-G bids were submitted.[25]

Furthermore, as the Commission held in the Rehearing Order, "regardless of whether opportunity costs existed, NYISO's market was flawed in that NYPA could not under the NYISO bidding rules submit the complex bid it sought to make, and nothing required NYISO to let a flawed bid set the market price when it had TEP authority to correct the flaw."[26] This continues to be correct, for two reasons. First, the mere fact that opportunity costs may have existed does not mean that NYPA did, or was required to, include opportunity costs in its bids. The affidavits before the Commission flatly state that was not the case, and nothing in the Services Tariff requires the inclusion of opportunity costs in bids. Second, even if the Answers had shown that, by mere coincidence, the B-G bids that were accepted approximated B-G's opportunity costs (and there is no evidence that was the case), that would not change the fact that B-G was willing to supply energy at much lower prices, but was precluded from doing so by the bidding rules. Thus, the opportunity costs arguments in the Answers are

[24] Answer of PSEG at p. 13.

[25] Deasy Affidavit ¶ 5; Rougeux Affidavit ¶¶ 6-7.

[26] Rehearing Order at P 19.

fundamentally not responsive to the issue of whether there was a market design flaw on May 8 and 9.

Keyspan complains that "NYISO asserts that NYPA's bids were not based on its opportunity costs but never explains why, or why NYPA could not or should not have bid its opportunity costs."[27] NYISO does not just "assert" that NYPA's bids were not based on its opportunity costs; it has come forward with sworn evidence that the NYPA bids were not based on opportunity costs. Affidavits from the bidder are the appropriate evidence, because what costs were or were not included in NYPA's bids was up to NYPA. By contrast, the Answers: (i) have come forward with no evidence to the contrary whatsoever; (ii) ignore the fact that nothing in the tariff requires NYPA to include opportunity costs in its bids; and (iii) ignore the sworn evidence that NYPA was willing to sell at prices far below its bids, whatever its opportunity costs might have been.

IV. There is No Evidence of an Operating Reserves Violation on May 8 or 9

The mere fact that B-G was the marginal unit for energy does not imply that there was a violation of the NYISO's operating reserves requirements. As stated by Mr. Rougeux,[28] and as shown on Exhibit A to Mr. Rougeux's affidavit, B-G was scheduled to provide 220 MW of spinning reserves throughout both May 8 and 9, 2000. There is no

[27] Answer of Keyspan at p. 10.

[28] Rougeux Affidavit ¶ 7.

evidence that any of the B-G capacity scheduled for spinning reserves was converted to energy.

The Court found that the ECA reduced prices from $3,487 on May 8 and from "roughly $3,000" on May 9.[29] Correlation of these prices with the B-G bid curves[30] shows that the amount of energy taken from B-G did not even reach the first high-priced bid point on the B-G bid curve, and that only a few MW were needed at the high prices, since the bid curves are very steep between the $3,500 bid point and the preceding point. Thus, there was substantial additional energy available on B-G at offer prices—even at the pre-ECA bidding levels—substantially below the $10,000 price advocated by Dr. Shanker,[31] and B-G continued to provide all the operating reserves it was scheduled to provide. These facts contradict the speculative assertion that the NYISO had to convert operating reserves to energy in order to dispatch B-G. There is no basis for requiring further submissions on this point, as suggested by Dr. Shanker.

V. PSEG's Complaints about the Timing of the Remand Filing are Baseless

PSEG asserts that the NYISO Motion was somehow timed to take advantage of the other parties to this proceeding.[32] PSEG, however, never requested an extension of time to file its Answer. The NYISO would have consented to any reasonable request for

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[29] *PSEG Energy Resources & Trade LLC v. FERC*, 360 F.3d 200, 202 (2004).

[30] Rougeux Affidavit, Exhibit A.

[31] Shanker Affidavit ¶ 20.

[32] Answer of PSEG at p. 6.

additional time to respond, as it did earlier this summer in connection with responses to its Motion for Disposition on Remand in the Operating Reserves docket.[33] Not having asked either the NYISO or the Commission for such time, PSEG cannot now be heard to complain about filing its Answer in accordance with the schedule set forth in the Commission's rules.

VI. Conclusion

As the Court makes clear near the end of its opinion, the key question in determining whether there was a Market Design Flaw on remand is whether "NYPA would have made a different bid absent any flaw."[34] The record in this Docket shows that is plainly the case. NYPA's affidavits establish that it would have bid differently if it had had at its disposal a means to specify directly the amount of energy output available from its ELR, rather than having to manage that limit indirectly through energy bids. The ELR ECA gave NYPA that means. If NYPA had told the NYISO that its bids reflected a legitimate determination of B-G's opportunity costs, and had not said that it was willing and able to supply energy under the conditions on May 8 and 9 at prices much lower than those in its bid curve, this might well be a very different case. But those are not the facts. The reality is that the market rules, and hence a Market Design Flaw, prevented the NYISO-administered market from obtaining energy from a

[33] *New York Independent System Operator, Inc.*, Motion of the Long Island Power Authority and LIPA for a One Week Extension of Filing Date, Docket Nos. ER00-1969-000, *et al.*, at p. 3 (July 6, 2004).

[34] *PSEG*, 360 F.3d at 205.

willing seller at much lower prices than those experienced on May 8 and 9. The fact that the market was required to forego these lower prices and pay some ten times more than the price at which energy was in fact available was a Market Design Flaw. It was appropriate to remedy this Market Design Flaw with the ELR ECA, and nothing in the Answers contradicts this conclusion.

WHEREFORE, for the above stated reasons, the NYISO respectfully requests that the Commission reopen the record in this proceeding as described above and conclude that the NYISO properly exercised its TEP authority and properly corrected prices in accordance with the ELR ECA.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service lists compiled by the Secretary in these proceedings in accordance with the requirements of Rule 2010 of the Rules of Practice and Procedure, 18 C.F.R. § 385.2010.

Dated at Washington, DC this 22nd day of September, 2004.

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