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July 25, 2008

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**Via Electronic Filing** **PUBLIC VERSION**

Kimberly D. Bose, Secretary
Nathaniel J. Davis, Sr., Deputy Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

**Re: New York Independent System Operator, Inc.,**
**Compliance Filing and Request for Confidential Treatment,**
**Docket Nos. ER01-3001-019 and ER03-647-011**

Dear Ms. Bose and Mr. Davis:

The New York Independent System Operator, Inc. ("NYISO") files the attached Compliance Filing in accordance with the Commission's May 27, 2008 order in the above-captioned proceeding. The NYISO's Compliance Filing contains confidential trade secret and commercial information relating to the identity of and installed capacity bids and awards of certain Installed Capacity ("ICAP") suppliers in Attachment II. This information is not otherwise disclosed by the NYISO, and disclosure of such information could adversely affect competition in the ICAP markets administered by the NYISO. Accordingly, the NYISO requests privileged treatment for the confidential portions of Attachment II. 18 C.F.R §§ 388.107(d); and 388.112.

The filing is marked as required by the Commission. The information for which confidential treatment is being sought has been masked in the public version. The masked information pertains to the identity of the entities making capacity offers, and the quantities of capacity offered, since that would reveal the identities. We have e-filed Attachment II (file named PRIVL_Att_II.xls) in addition to the public version of the Compliance Filing, pursuant to the

Commission's Notice of Release of eFiling v7.0 issued on February 28, 2008 in Docket RM07-16-000.

The person to be contacted regarding this filing is:

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Counsel for the NYISO

Sincerely yours,

Wm F. Young

William F. Young

Enclosures

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

| | | |
|---|---|---|
| New York Independent System Operator, Inc. | ) | Docket Nos. ER01-3001-019<br>ER03-647-011 |

**COMPLIANCE FILING OF**
**THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.**

In compliance with the Commission's May 27, 2008 order in the above-captioned proceeding,[1] the New York Independent System Operator, Inc. ("NYISO") respectfully submits the information requested by the Commission.

## I. Communications and Correspondence

Communications regarding this filing should be directed to:


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## II. Documents Included in this Filing

1. This compliance filing;

2. Attachment I: Affidavit of Christopher D. Ungate ("Ungate Affidavit"), with exhibits comprising spreadsheets showing (i) estimated going-forward costs for

[1] *N.Y. Indep. Sys. Operator, Inc.*, Order Accepting in Part Compliance Reports, 123 FERC ¶ 61,206 (2008) ("Compliance Reports Order").

rest-of-state ICAP suppliers for the generator classes that include the generators with capacity offered but not sold, including the average capacity factor, average in-service date and average summer/winter capacity for the units in the class (Exhibit B), (ii) a list of the units included in each class, together with the data obtained from the 2006 Gold Book for each unit (Exhibit C), and (iii) estimates of certain additional costs relating to capacity that was offered but not sold (Exhibit D);[2]

3. Attachment II: Spreadsheet showing the offers from ROS ICAP suppliers for MW offered but not sold, along with the quantities of capacity sold and not sold (filed in both a public version and a version containing confidential, commercially sensitive offer and unit identification information for which confidential treatment is requested in the cover letter submitted with this filing); and

4. Attachment III: Affidavit of Joshua Boles ("Boles Affidavit").

## III. Background

The Compliance Reports Order accepted in part the NYISO's 2007 annual report on the operation of its ICAP Demand Curves ("Annual Report"), filed on January 15, 2008, but directed the NYISO to submit certain additional information relating to possible withholding of ICAP by suppliers in the area of New York outside of New York City and Long Island, the so-called rest-of-state ("ROS") area. Specifically, the Compliance Reports Order directed the NYISO "to

[2] Unless otherwise specified, capitalized terms have the meanings specified in the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff").

submit an analysis of ROS capacity offers that were not accepted by comparing the capacity offers submitted to a reasonable estimate of the resources' going forward costs."[3]

While directing that this filing be made, the Compliance Reports Order also found that:

> NYISO did analyze the upper bound of any possible effects on prices from possible economic withholding of ROS capacity. As required, NYISO was able to show that the average monthly quantity of unsold ROS capacity has been quite small and there was virtually no unsold capacity during the Summer 2007 and Winter 2007-2008 Capability Periods. NYISO complied with the requirement in the October 26, 2007 Order to present the estimated amount of unsold capacity and its likely effects on capacity prices by stating that 2 MW were unsold in Summer 2006 and that if all offered capacity was sold, then the spot auction prices would have been lower by ostensibly the same in Summer 2007 as Summer 2006, which was $0.40/kW-month.[4]

While the quantification of the megawatts offered but unsold in the above quote is correct, the NYISO respectfully submits that the numbers are applied to the wrong years. In its Annual Report, the NYISO stated that

> on average, 240 MW and 2 MW were unsold in Summer 2006 and Summer 2007, respectively. Given the slopes of the NYCA ICAP Demand Curves for these two Capability Periods, if all offered capacity was sold, then the spot auction prices would have been [] lower by, approximately, $0.40/kW-month in Summer 2006 and ostensibly unchanged in Summer 2007.[5]

Nonetheless, the point remains that any withholding was minimal in terms of the overall market effect. Since there were virtually no megawatts offered but unsold in the summer of 2007, the analysis below focuses on 2006.

The Compliance Reports Order also found that:

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[3] Compliance Reports Order, at P 42.

[4] Compliance Reports Order, at P 43.

[5] *N.Y. Indep. Sys. Operator, Inc.*, Compliance Filing, Dkt. Nos. ER01-3001-019 and ER03-647-011 (Jan. 15, 2008) ("Annual Report"), Demand Curves section at 21, and Table 1 at 18; *see also* Compliance Reports Order, at P 19.

> NYISO's conclusion that no significant physical or economic withholding occurred in the ROS zone may be accurate. The Commission has previously stated that withholding is less likely to occur when: (1) the amount of unsold capacity in the ROS does not exceed a few percent of available supplies; (2) capacity purchased has consistently exceeded the minimum requirements; and (3) prices have been below the costs of entry. NYISO has shown this is the case still and there is no apparent market power among ROS suppliers. Without market power, a supplier will be unlikely to be able to successfully exercise and profit from a withholding strategy. Nevertheless, NYISO has failed to provide a complete analysis of ROS bidding behavior to ensure that no withholding has occurred, and is thus required to submit an analysis within 60 days of the issuance of this order, as discussed above.[6]

## IV. Estimation of ROS ICAP Supplier Going-Forward Costs by Generator Class

A generator's "going-forward" costs are the costs that could be avoided if a unit is mothballed rather than being maintained as an active market participant in order to provide Capacity. The term "mothballed" refers to a unit being taken out of service for at least one year but kept in a condition such that it could return to service at a reasonable cost if warranted by market conditions.[7] Examples of such avoidable costs from not supplying Capacity include: labor for routine operations and maintenance; routine materials and contract services, administrative and general costs, and insurance.[8] Except in special circumstances, additional costs, such as certain ordinary property taxes, or site leasing or other land ownership costs, would generally only be avoidable, if at all, if a unit is permanently retired, rather than being mothballed.

On October 4, 2007 in Docket No. EL07-39-000, the NYISO filed proposed market power mitigation measures for ICAP suppliers in New York City. That filing included an analysis of estimated going-forward costs for NYC ICAP suppliers prepared by Mr. Christopher

[6] Compliance Reports Order, at P 44.

[7] Ungate Affidavit, Attach. I, Ex. A, ¶ 8.

[8] Ungate Affidavit, Attach. I, Ex. A,¶ 9.

D. Ungate, a Senior Consultant for Sergeant & Lundy LLC. The NYISO's NYC ICAP supplier mitigation measures were accepted by the Commission in an order issued on March 7, 2008.[9] In order to comply with the Compliance Reports Order, the NYISO retained Mr. Ungate to prepare an analysis of going-forward costs for ROS ICAP suppliers using the same methodology as he used for NYC suppliers.

As in his previous analysis, Mr. Ungate determined the various classes of units, considering generation technology and primary fuel type, providing ICAP in the ROS, based on the data published by the NYISO in the 2006 "Gold Book."[10] While there are a number of different classes of generators providing ICAP from locations in the ROS, the generators with MW offered but not sold fall into classes denominated by Mr. Ungate as Classes B, F and H. Accordingly, the cost analysis in Mr. Ungate's spreadsheet is limited to these three classes of units. Details on the characteristics of these three classes are set forth in Mr. Ungate's affidavit.[11]

As discussed in Mr. Ungate's affidavit, a generator's avoidable costs tend to be periodic over the course of a year, and would not all have to be recovered in any one month. Thus, as previously, Mr. Ungate assessed avoidable costs over a one-year period, and assumed that recovery of a portion of those costs in each month (seasonally adjusted as appropriate) is sufficient for a given unit to remain a capacity supplier for that month. The results of his analysis of going-forward costs by generator class are submitted herewith in a spreadsheet attached as Exhibit B to Attachment I. Also included in Attachment I is a spreadsheet labeled

[9] *N.Y. Indep. Sys. Operator, Inc.* 122 FERC ¶ 61,211 (2008).

[10] NYISO, *2006 Load & Capacity Data Report*, *available at* http://www.nyiso.com/public/webdocs/services/planning/planning_data_reference_documents/2006/_goldbook_public.pdf.

[11] Ungate Affidavit, Attach. I, Ex. A, ¶¶ 13-14.

Exhibit C showing the data obtained from the 2006 Gold Book for the units in each class. Additional details on his analysis are set forth in Mr. Ungate's affidavit, including an explanation of the sources for the data he used to estimate the relevant costs.

## V. Other Going-Forward Costs for ROS ICAP Units Offered but Not Sold

Under the NYISO's proposal for ICAP supplier offer caps in New York City, the default offer cap is set at a level determined by the intersection of the supply and Demand Curves that is generally considered to be higher than the *pro forma* estimated going-forward costs of the ICAP suppliers, but with provision for a supplier to consult with the NYISO to justify a higher offer cap based on a unit's demonstrated going-forward costs.[12] Consistent with this proposal, the NYISO consulted with the ROS suppliers of ICAP from generators providing ICAP that was offered but not sold in 2006, to determine whether they would claim any additional costs relating to their capacity offers. These suppliers identified several other cost factors that assertedly affected the level of their ICAP offers from units with capacity that was offered but not sold during the period covered by the Annual Report.[13] These include the following:

- *Costs associated with the risks inherent in the DAM bidding obligation*. If a unit is selected in an ICAP auction, it will have an obligation to offer the capacity for which it receives an ICAP payment into the NYISO's Day-Ahead Market ("DAM").[14] A unit that does not meet its DAM schedule will have to replace the MW it is short by buying them from the real-time market at the prevailing real-time price.[15] A unit's

[12] Services Tariff, Attachment H §4.5(b).

[13] *See* Boles Affidavit, Attach. III, ¶ 4.

[14] Services Tariff §5.12.1(vi).

[15] Services Tariff §4.5(C)(1).

forced outage history will also determine the amount of Unforced Capacity that it is entitled to sell in the ICAP auctions. The risks associated with these obligations can be higher than otherwise if a unit is operating at the upper end of its output capacity, where stresses on a generator, and the potential for failure, are the greatest. In 2006, the ROS ICAP MW that were offered but not sold were generally at the upper output levels of the relevant units. This can be seen from Attachment III, which shows that, particularly in the summer of 2006, units with offered but unsold MW also were awarded substantial volumes of ICAP sales in the relevant auction. The ICAP suppliers asserted a need for a risk premium in ICAP bids for the upper end of a unit's output as a means of managing the risks of having the obligations incumbent on a DAM schedule.

- *Costs associated with changes in property tax treatment.* The NYISO understands that in some ROS locations, a unit that is taken out of service would be subject to a substantially lower real property tax rate than it would as an operational facility. The difference between operational and mothballed tax rates would qualify as a going-forward cost for purposes of this analysis, to the extent tax costs could be avoided by taking a unit out of service.

- *Costs associated with Powder River Basin coal in order*. Several coal-fired units have found that it necessary to convert from eastern to Powder River Basin ("PRB") coal in order to meet environmental and other requirements in order to stay operational. As discussed by Mr. Ungate in his affidavit, a unit with coal handling facilities that were sized and configured to burn Eastern coal could be expected to have some excess coal handling capacity so that maintenance can be performed on portions of the facilities while the remaining portions feed coal at a sufficient rate to maintain maximum boiler output. PRB coal, however, has a significantly lower heat content than typical Eastern coal. As a result, all of the coal handling output may be needed to maintain boiler output, forcing the unit to derate its output in order to do maintenance on its coal handling facilities.[16] The ICAP suppliers asserted a need for an increment in their capacity bids to reflect this risk.

- *Costs associated with certain maintenance contracts*. One relevant ROS ICAP supplier stated to the NYISO that it has a relatively expensive maintenance contract for some of the relevant units, and that payments under the contract would be substantially reduced or eliminated for a unit that goes out of service.

- *Costs associated with the uncertainty of energy and ancillary services revenues.* The portion of the unit's total costs that must be recovered through ICAP payments is reduced by the net energy and ancillary services revenues earned by the unit.[17] Accordingly, uncertainty in projecting energy and ancillary services revenues for a particular unit under particular market conditions was assertedly a factor in determining the net costs that a supplier may need to seek to recover in ICAP payments. Assuming such costs would be a legitimate factor in capacity as opposed

[16] Ungate Affidavit, Attach. I, Ex. A, ¶ 20.

[17] *See, e.g.,* Services Tariff, Attachment H §2.1 ("For purposes of §4.5 of this Attachment H, 'Net CONE' shall mean the localized levelized embedded costs of a peaking unit in the New York City Locality, net of the likely projected annual Energy and Ancillary Services revenues of such unit, as determined in connection with establishing the Demand Curve for the New York City Locality pursuant to §5.14.1(b) of the Services Tariff, or as escalated as specified in §4.5(g) of Attachment H.").

to energy bids, the NYISO did not consider them in its analysis, however, since it had no basis to quantify them.

As a refinement to Mr. Ungate's initial class-based estimates of going-forward costs, Mr. Ungate and the NYISO sought to estimate the additional costs that could potentially be attributable to the additional factors identified above, to the extent these costs could be quantified based on the data available to the NYISO. Based on the available information, the Mr. Ungate and the NYISO did the following estimations:

- *Property taxes*. The NYISO understands that the relevant units (units with capacity offered but not sold) in classes F and H would benefit from a reduction of 98% in the otherwise applicable property taxes if a unit were mothballed.
- *Powder River Basin coalderates.* Mr. Ungate calculated a value for the risks of derates based on an estimate derate level of 1% of total capacity on an annual basis, and replacement costs estimated at the gross revenue rate for the plant. To account for the potential for some of these costs to be recovered in energy bids, Mr. Ungate allowed for a risk premium based on 50% of these costs. [18]
- *DAM obligation risks*. The risks associated with DAM obligations are a function of unit outages. Consistent with the preceding paragraph, Mr. Ungate calculated an estimated value for the risks of outages based on the 2006 EFORd outage rate times the total capacity on an annual basis, and replacement costs at the gross revenue rate

[18] Ungate Affidavit, Attach. I, Ex. A, ¶ 20.

for the plant.[19] To account for the potential for some of these costs to be recovered in energy bids, Mr. Ungate allowed for a risk premium based on 50% of these costs.[20]

- *Maintenance contract costs.* The NYISO understands from the applicable ICAP supplier that approximately 95% of the maintenance contract costs would be avoided if the relevant unit did not operate, because most of the costs under the contract are proportional to hours of operation.[21]

In addition, estimated going-forward costs shown in Exhibit B to Mr. Ungate's affidavit are stated on an annual cost per kW basis, and thus need to be seasonally adjusted to account for lower unit capacities during summer months resulting from higher ambient temperatures. The estimated going-forward costs were seasonally adjusted by the factor used to seasonally adjust the NYCA Demand Curve during the relevant periods. For purposes of comparison to capacity market clearing prices, they also need to be translated from ICAP to UCAP. Finally, actual net revenues from energy and ancillary services were netted from the costs shown on Exhibit B to determine net going-forward costs.

To the extent they were not included in Mr. Ungate's estimated *pro forma* going-forward costs by generator class shown on Exhibit B, the factors described above are shown on Exhibit D as estimated additions to Mr. Ungate's class-based numbers. The use of these additional costs is based on the representations made in the informal consultations with the relevant ICAP

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[19] "EFORd" stands for "Equivalent Demand Forced Outage Rate," defined as: "The portion of time a unit is in demand, but is unavailable due to forced outages." Services Tariff §2.49c.

[20] Ungate Affidavit, Attach. I, Ex. A, ¶ 18.

[21] *Id*. ¶ 21.

suppliers. The numbers shown on Exhibit D represent the NYISO's effort, in consultation with Mr. Ungate, to estimate the potential effect of these factors on going-forward costs, based on publicly available data and Mr. Ungate's judgment and experience. As estimates, these numbers do not reflect an audit or other verification of the actual costs or bidding strategies of the relevant units, or any determination of whether the asserted costs fully qualify as "going-forward costs" under the definition specified above. The estimates do not reflect a determination that the asserted costs were or should have been recovered in the capacity markets rather than the energy and ancillary services markets.

Subject to these caveats, the numbers shown on Exhibit D to Mr. Ungate's affidavit are consistent with the conclusion that regulatory intervention to mitigate ROS capacity offers is not warranted. The adjusted costs on Exhibit D are above the average market clearing prices in the summer of 2006 and the winter of 2006-2007 respectively, and at most approximately equal to if not significantly above the highest clearing price in any one month. This is completely different from the situation in New York City which has lead to the imposition of market power mitigation measures on ICAP suppliers. There, the market had been clearing substantially above the level of the estimated going-forward costs of suppliers ostensibly engaging in economic withholding. Moreover, it is noteworthy that two of the units with capacity that was offered but not sold in 2006, and the only units with unsold capacity over the entire output of the unit, in fact were retired in 2007.

## VI. Economic and Policy Considerations in Assessing ROS ICAP Units Offered but not Sold

A definitive determination that all bids for units offered but not sold are equal to or less than the unit-specific going-forward costs would require unit-by-unit audit and verification, including further analysis of whether the costs asserted by the relevant suppliers are in fact going-forward costs or instead operating costs that a rational bidder would reflect in its energy bids. In addition to administrative burdens, this process would inevitably involve some measure of judgment, and hence some measure of second-guessing business decisions made by the ICAP suppliers at the time. ROS ICAP suppliers have no obligation to offer ICAP. Rather, they have to assess and respond to the incentives and risks provided by market prices and conditions as they perceive them.

Here, however, there is no evidence of a structural ability of ROS ICAP suppliers to exercise significant power over ICAP prices, and thus no economic predicate for undertaking the burden and expense of determining unit-specific going-forward costs and the concomitant regulatory intrusion into ICAP markets. Rather, the Commission has concurred in the NYISO's findings that the extrinsic market evidence shows that the NYCA ICAP market is not susceptible to significant market power abuse by ROS ICAP suppliers. As the Commission found in the Compliance Reports Order, the NYISO's Annual Report on the effectiveness of the ICAP Demand Curves showed that: "(1) the amount of unsold capacity in the ROS does not exceed a few percent of available supplies; (2) capacity purchased has consistently exceeded the minimum requirements; and (3) prices have been below the costs of entry."[22] The Commission also concurred in the NYISO's assessment that "there is no apparent market power among ROS suppliers."[23] The Commission's concurrence in the NYISO's findings is consistent with the

[22] Compliance Reports Order, at P 44.

[23] *Id*.

Commission's determination in 2005 that the market outside New York City is "workably competitive."[24]

Those findings are consistent with the Commission's approval of the analysis underlying the Demand Curves in effect during the period covered by the Annual Report, and with the economic reality that market power occurs in a continuum that only warrants regulatory intervention at relatively significant levels. In approving the Demand Curves in effect during the period covered by the Annual Report, the Commission effectively recognized that some minimal level of economic withholding could be feasible under the ROS Demand Curves. In particular, this could occur at relatively high levels of supply that pushed prices down to relatively low levels on the Demand Curves, as would have been the case in the 2006 Summer Capability Period and especially the case in the 2006/2007 Winter Capability Period. At those relatively high levels of demand, a supplier that otherwise would not be may become pivotal, but only because of the imposition of the demand resulting from the Demand Curve, and by definition only at very low pricing levels. The Levitan Report, which was the principal support for the Demand Curves approved by the Commission for use in 2006 and up to this past June, states:

> In Figure 46, we show the maximum revenue a 2,000 MW supplier could generate with and without withholding practices at various levels of ICAP surplus in the NYCA market. The left-hand axis indicates the supplier's revenue (*i.e*. portfolio quantity not withheld multiplied by the ICAP clearing price). The right-hand axis indicates the portion of the supplier's portfolio withheld. As shown, there is minimal incentive to withhold in the NYCA market, and only then, at very high levels of surplus (when ICAP prices diminish to near-zero).

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[24] *N.Y. Indep. Sys. Operator, Inc.*, 112 FERC ¶ 61,284 (2005), at P 13 ("the use of AMP in a workably competitive market, such as the market outside New York City, may cause harm by curtailing price increases attributable to genuine scarcity."). *See also N.Y. Indep. Sys. Operator, Inc.*, 111 FERC ¶ 61,399 (2005), at P 7.

More generally, the Commission has discouraged regulatory intervention to mitigate asserted market power abuse in the absence of structural or other market problems sufficient to conclude that there is a significant likelihood that the costs of such regulatory intervention will be more than offset by its market benefits. For example, in a 2001 order approving the NYISO's Automated Mitigation Procedure (AMP), the Commission cautioned that: "In general, we believe automatic market power mitigation may be most appropriate where it is tied to structural market power problems . . . ."[25] More recently, the Commission reiterated its policy when, in 2006, it rejected the request of the Midwest Independent Transmission System Operator, Inc. ("MISO") to extend the MISO's Broad Constrained Area mitigation measures for an additional year, explaining that:

> While undermitigation may result in some exercise of market power that is not mitigated, over-mitigation means more frequent intervention in the market, and some competitive market results will be mitigated. Mitigation is counterproductive to the extent it penalizes suppliers trying to resolve constraints, and when their higher offers reflect higher costs, not manipulation. Over-mitigation also can inadvertently lead to decreased confidence in the market and cause reliability problems to the extent that it keeps capacity out of the market over the long term.[26]

The NYISO of course intends to continue to monitor closely conditions in all of its ICAP markets, and would seek authority as appropriate to impose mitigation measures against any significant exercise of market power should they occur. Under the conditions in the market for ICAP from ROS suppliers during the period covered by the Annual Report, however, the NYISO respectfully submits that the burden and expense of definitively determining and verifying the

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[25] *N.Y. Indep. Sys. Operator, Inc.*, 95 FERC ¶ 61,471, at 62,690 (2001) (footnote omitted).

[26] *Midwest Indep. Transmission Sys. Operator, Inc.*, 115 FERC ¶ 61,158, at P 12 (2006) (footnote omitted); *see also Midwest Indep. Transmission Sys. Operator, Inc.*, 105 FERC ¶ 61,147, at P 35 (2003).

full going-forward costs of ROS ICAP suppliers, and regulatory intervention in the bidding freedom of ROS ICAP suppliers, is not justified by the market's structure or performance and would be inconsistent with the Commission's policy and precedent.

## VII. Conclusion

WHEREFORE, the NYISO requests that this filing be accepted as completing the NYISO's analysis of possible ROS withholding, as specified in the Compliance Reports Order.

Respectfully submitted,

NEW YORK INDEPENDENT
SYSTEM OPERATOR, INC.

By Wm F. Young
Counsel

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Dated: July 25, 2008

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, DC, this 25th day of July, 2008

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Wm. F. Young

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