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December 9, 2002

FILE NO: 55430.000046

Magalie Roman Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: <u>New York Independent System Operator, Inc., Docket Nos. ER00-3591-008, ER00-1969-009, ER00-3591-010 and ER00-1969-012</u>

Dear Ms. Salas:

Enclosed for filing is the report of the New York Independent System Operator, Inc. ("NYISO"), on certain Bid Production Cost Guarantee ("BPCG") costs and payments, in accordance with the Commission's Order on Compliance Filings in the above dockets, 100 FERC ¶ 61,213 (August 27, 2002).

Respectfully submitted,

Wm F. Young

William F. Young

Enclosure

cc: Daniel L. Larcamp, Director Office of Markets, Tariffs and Rates, Room 8A-01, Tel. (202) 502-6700
Alice M. Fernandez, Director Office of Markets, Tariffs and Rates -- East Division, Room 71-31, Tel. (202) 502-8284
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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.)	Docket No. ER00-3591-008, ER00-1969-009, ER00-3591-010 and ER00-1969-012

REPORT ON BID PRODUCTION COST GUARANTEE COSTS AND PAYMENTS

The New York Independent System Operator, Inc. ("NYISO") hereby provides the report specified in the Commission's Order on Compliance Filings ("BPCG Order") in the above dockets, 100 FERC ¶ 61,213 (August 27, 2002). The BPCG Order directs that:

> NYISO should report back to this Commission in 90 days from the date of issuance of this order to state its state-wide BPCG costs during this summer period, the BPCG payments made to Long Island generators, and whether it has allocated costs to Long Island, and if so, when and what costs. NYISO should also provide data and workpapers concerning the timing and amount of the BPCG costs incurred to meet Long Island requirements.

For its response, the NYISO states as follows. The information set forth below was furnished by the Market Monitoring Unit of the NYISO, incorporating data prepared by LECG, LLC ("LECG"), a consulting firm retained by the NYISO, and by the Operations Department of the NYISO.

1. State-wide BPCG costs during the Summer 2002 Capability Period.

Total state-wide day-ahead BPCG costs incurred during the Summer 2002 Capability Period were: $18.4 million.

2. BPCG Payments made to Long Island generators in Summer 2002.

The total day-ahead BPCG payments made to generators committed on Long Island that were scheduled to provide operating reserves during the Summer 2002 Capability Period were: $2.6 million.

3. Allocation of BPCG costs to Long Island.

As a result of the BPCG Order, Rate Schedule 4 ("Payments for Supplying Operating Reserves"), Section 4.0, to the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff") provides that:

> On any day that Long Island reserve constraints are binding, the NYISO shall allocate to Long Island customers the net incremental bid production cost guarantee charges for Long Island units that have been committed for either Energy or Operating Reserves, if it is determined that a Long Island Reserve constraint caused those units to be committed, and the commitment of those units resulted in an increase in bid production cost guarantee payments by an amount equal to or greater than the threshold for market power mitigation of guarantee payments specified in Section 3.2.1(2) of Attachment H to this Services Tariff.

The reason for allocating any BPCG costs to Long Island is to prevent any increment of operating reserves BPCG payments that is attributable to market power from being included in charges to state-wide loads. The BPCG Order states: "The purpose of the LRP [locational reserves pricing] proposal is to ensure that reserve suppliers, especially those in Long Island, would not be able to exercise market power to set reserves prices state-wide during constrained periods. Therefore the proposal reasonably links the allocation of BPCG to Long Island-only customers when such costs exceed the market mitigation threshold." 100 FERC ¶ 61,213 at ¶ 15. The LRP proposal limits Long Island reserves prices to the level of the clearing prices for reserves in Eastern New York, but does not address the potential for market power to be exercised through BPCG payments. Allocating any excess BPCG payments back to Long Island would be an effective mitigation device because, as stated in the NYISO's July 30, 2001, filing that resulted in the BPCG Order: "The BPCG payment allocation portion of the foregoing methodology is appropriate because the load-serving entity on Long Island (the Long Island Power Authority) controls virtually all of the generation on Long Island." The July 30 filing also noted, however, that: "Unless the test [for allocation of BPCG costs] is satisfied, BPCG payments to Long Island units will be recovered in the same manner as all other BPCG payments, that is, from statewide load."

In order to determine whether any allocation to Long Island units is necessary, the NYISO asked its consultants at LECG to perform an analysis under the market power mitigation thresholds of Attachment H of the Services Tariff of BPCG payments to units on Long Island supplying operating reserves during the period from September 30, 2001 (the effective date of the BPCG Order) to November 15, 2002. A memorandum prepared by LECG describing the results of that analysis is attached as Attachment A. As shown in Attachment A, LECG applied the "conduct" and "impact" tests of the NYISO Market Mitigation Measures ("MMM"), Attachment H to the NYISO Services Tariff, to determine whether any Long Island units may have abused market power. The MMM specify that mitigation of a unit's BPCG payment is appropriate if there is an increase in a unit's minimum generation bid of $100/MW or 300% or an increase in a unit's start-up bid of 200% (the "conduct" test), and as a result BPCG payments increase by 200% or more (the "impact" test).[1] As stated in § 4.1. of the LECG memo, the data show that during the relevant period BPCG payments to units on Long Island committed and providing operating reserves did not trigger the thresholds for market power mitigation.

Consequently, during the relevant period, BPCG costs for units on Long Island supplying operating reserves have not been allocated to Long Island loads. This result is consistent with the fact that even though a constraint resulting in a locational requirement for operating reserves on Long Island may be binding, reserves provided by units on Long Island nonetheless contribute to meeting the state-wide operating reserves requirement. The state-

[1] MMM §§ 3.1.2(a)(1) & (4) and 3.2.1(2).

wide operating reserves requirement is set by the largest state-wide contingency resulting from the loss of a single generator or interconnection facility, and that determination is not affected by the possibility of constraints onto Long Island.[2] While transmission constraints and their related operating criteria may give rise to locational reserve requirements for Eastern New York and Long Island, operating reserves from Long Island units are included in, rather than being taken in addition to, the Eastern New York and state-wide requirement. This is because even though transmission constraints may limit imports to Long Island, power associated with the activation of reserves can still flow off Long Island, enabling the Long Island units to be used to meet the state-wide requirement.

Accordingly, the ordinary costs of units on Long Island providing operating reserves are and should be included in state-wide uplift. A special allocation back to Long Island would only be appropriate if a Long Island unit sought to take advantage of the locational requirement by raising its minimum generation or start-up bids in order to impose a significant increase in BPCG payments that would be attributable to market power. As shown in the LECG analysis, however, application of the MMM tests for market power abuse establishes that, under the standards approved by the Commission, Long Island units have not been exerting market power through their minimum generation or startup bids during periods when Long Island locational reserves constraints were binding. At the same time, the locational reserves pricing (LRP) provisions limiting Long Island reserve clearing prices to the prices in Eastern New York ensure that Long Island reserves providers are also not able to exert market power through reserve clearing prices.

[2] The largest state-wide contingency is generally deemed to be the loss of the intertie to Hydro Quebec, resulting in an operating reserves requirement of 1200 MW.

Not allocating BPCG costs to Long Island for the period since September 30, 2001, is the correct economic result based on the MMM, and is endorsed by the NYISO Market Advisor, Dr. David B. Patton. As presently worded, however, § 4.0 of Rate Schedule 4 of the Services Tariff would require an allocation of BPCG costs to Long Island if (i) a Long Island reserve constraint caused a unit to be committed, and (ii) only the applicable MMM impact test, but not the conduct test, is met. With the benefit of the experience of administering operating reserves in the period since September 30, 2001, the NYISO has identified two significant problems with the present tariff wording. First, as shown above there has not been an abuse of the normal mitigation thresholds of the MMM that would indicate that more stringent standards should be applied to operating reserves on Long Island. Second, determining whether a reserve constraint caused a Long Island unit to be committed for operating reserves could only be done by re-running the Security Constrained Unit Commitment ("SCUC") program that determines the results of the Day-Ahead Market, including the commitment for operating reserves. Re-running SCUC for the historic period going back to September 30, 2001 would be enormously burdensome, and as discussed further below would not be justified by the facts.[3]

As part of its analysis, LECG was asked to apply only the impact test to the units committed on Long Island that were scheduled to provide operating reserves during the relevant period (September 30, 2001 to November 15, 2002). The LECG memo shows, at

[3] As indicated in the NYISO' supplemental data submission to the Staff in these dockets dated July 17, 2002, for the period from September 30, 2001 to June 10, 2002, it would be necessary to re-run the SCUC for at least 129 days.

§ 4.4, that less $2.4 million of BPCG payments exceeded this test.[4] Of that amount, only some portion would be attributable to units committed because of a Long Island reserves constraint, with the remainder attributable to units that would have been committed anyway, whether or not a Long Island reserve constraint were binding. The only way to determine what portion of the $2.4 million in BPCG payments is attributable to units that were committed expressly because of a Long Island reserve requirement would be to re-run the SCUC for well over a hundred days, in each case removing the Long Island requirement and assessing the results. This would entail a huge effort and expense that the NYISO believes would not be justified, both because the amount of BPCG costs involved is relatively small, and because application of the full two-part test for market power abuse of the MMM shows that, based on the standards approved by the Commission, there has not been an abuse of market power through BPCG payments by units on Long Island providing operating reserves.

Upon completion and submission of this report, the NYISO intends to initiate the procedures for a filing to conform the tariff language to the market power analysis described above, and to remove the requirement to determine whether a Long Island reserves constraint specifically caused a unit to be committed. In addition, the NYISO will continue to monitor the BPCG costs associated with operating reserves acquired from units on Long Island, and will take, or seek authority from the Commission for, whatever actions may become appropriate. In this connection, LECG was asked to run two additional cases in its BPCG analysis: one applying the conduct and impact mitigation thresholds at half the normal level,

[4] The comparable figure for the Summer 2002 Capability Period would be $1.3 million.

and one applying the conduct and impact thresholds at one-quarter of the normal level. The LECG analysis shows that at one-half the normal MMM thresholds, mitigation of BPCG payments to Long Island units providing operating reserves would not be warranted, and that even at one-quarter the normal thresholds, only a virtually *de minimis* amount of mitigation would be warranted. If continued monitoring shows that lower than normal market power mitigation thresholds would be warranted for guarantee payments for Long Island units providing operating reserves, the NYISO will take appropriate action.

4. Data and workpapers.

Data and workpapers on the allocation of BPCG costs to Long Island are provided in the form of a memorandum and attachments from LECG, describing the analysis of BPCG payments to units on Long Island that it performed at the request of the NYISO. *See* Attachment A hereto.

Respectfully submitted,

NEW YORK INDEPENDENT
SYSTEM OPERATOR, INC.

By__________________________
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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 list compiled by the Secretary in the above-captioned proceedings in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 385.2010 (2001).

Dated at Washington, D.C. this 9th day of December, 2002.

Wm F Young

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