



October 14, 2005

The Honorable Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

**Compliance Filing of the New York Independent System Operator, Inc.
in Docket No. ER03-836-001**

Dear Ms. Salas:

Pursuant to the Commission's March 15, 2005 *Order Conditionally Accepting Compliance Filing And Granting Motion For Deferred Implementation Of A Self-Supply Option For Operating Reserves* ("March Order")¹ and its September 30, 2005 *Extension of Time* in this proceeding, the New York Independent System Operator, Inc. ("NYISO") respectfully submits this compliance filing.

I. List of Documents Submitted

The NYISO submits the following documents:

1. This filing letter which provides a revised schedule showing that work on the self-supply option has resumed and discusses a new in service date for reserve self-supply; and
2. Motion from the Management Committee October 11, 2005 meeting ("Attachment I").

¹ *New York Independent System Operator, Inc.*, 110 FERC ¶ 61,287 (2005).

II. Copies of Correspondence

Copies of correspondence concerning this filing should be served on:

Robert E. Fernandez, General Counsel and Secretary
Mollie Lampi, Assistant General Counsel
Elaine Robinson, Director of Regulatory Affairs
New York Independent System Operator, Inc.
290 Washington Avenue Extension
Albany, NY 12203
Tel: (518) 356-7661
Fax: (518) 356-4702
rfernandez@nyiso.com
mlampi@nyiso.com
erobinson@nyiso.com

III. Service List

Copies of this filing are being served on all parties designated on the official service list maintained by the Secretary of the Commission in this proceeding. The NYISO will electronically serve a copy of this filing on the official representative of each of its customers, on each participant in its stakeholder committees, on the New York Public Service Commission and on the electric utility regulatory agencies of New Jersey and Pennsylvania. The NYISO respectfully requests a waiver of the requirement of Rule 2010 so that it may use electronic service methods. The NYISO's use of such methods has been convenient for both the NYISO and for the recipients of the service, and to date it has engendered no complaints.

IV. Compliance Schedule for Further Work on Self Supply of Operating Reserves

The Commission directed the NYISO, in its March Order, to submit a filing containing either (i) a revised schedule showing that work on the self supply option has resumed with a new in service date for reserve self supply, or (ii) a plan to implement a self-supply option in the NYISO-administered markets, including an updated timetable for full implementation of a self-supply option for operating reserves, in compliance with the May 2003 and July 2004 Orders. In compliance with the March Order, the NYISO hereby provides a revised schedule showing that work towards a self supply option has resumed. Additional discussion is provided in Part V, below.

The Commission also directed the NYISO to report on stakeholder discussions concerning the possible development of a method for optimizing the transmission system for energy and reserves prior to establishing any new financial hedging mechanisms. This issue is also addressed in Part V below.

As the NYISO reported in its January, 2005 Motion in this proceeding,² development of an operating reserves self supply option requires an analysis of the price separation between locational reserves after the implementation of Real-Time System (“RTS”) software and markets. Price spreads for the period from May through August, 2005 were especially important since summer months historically have the highest loads.³

Reserves price data collected as of January 2005, *i.e.*, prior to the implementation of RTS, had indicated that the differences among Western, Eastern, New York City and Long Island reserves costs were insignificant. Preliminary analysis of post-RTS data has shown, however, that cost differences among these locational reserves, while not large, are higher than the NYISO had predicted. The NYISO needs to collect additional data and perform further analysis before it can draw any final conclusions. The NYISO expects that this analysis will be complete in the first quarter of 2006. Further work on self supply would follow, as is set out on the following schedule.

NYISO Market Participants, at their most recent Management Committee meeting unanimously agreed that further price spread investigation and analysis was necessary and asked that the NYISO provide further information in this regard in 2006.⁴ As is more fully described below, the NYISO is proposing a time frame for this effort that would give its Market Participants an opportunity to further evaluate, the type of enhanced self supply mechanism that would best serve the needs of the NYISO-administered markets, assuming that it is ultimately decided that new enhancements are needed.

Schedule Of Activity

| DATE | Activity |
|---------------------------------------|---|
| December, 2005 through March 31, 2006 | Discussions continue on the difference between Eastern and Western Reserves prices. |
| Fourth Quarter, 2006 | Market Participant final determination on a self supply design |
| Mid-year 2007 | Preliminary work on a design document is complete. |
| End 2007 – first quarter 2008 | Implementation |

² January 14, 2005 Motion To Temporarily Defer Additional Development Work Related To A “Non-Bid Based Self-Supply” Option For Operating Reserve (“January Motion”), p. 7

³ *Id.*

⁴ See Attachment I.

V. **There Is Consensus Support Among Market Participants for Favoring Financial Over Physical Self-Supply Options**

Market Participants have unanimously endorsed the NYISO's current thinking that any future self-supply enhancements in New York should be financial rather than physical in nature. Therefore, with the concurrence of the NYISO Management Committee, the NYISO is currently preparing a new tariff filing clarifying that a physical self-supply option will not be made available at this time. The Market Participants' conclusion is embodied in the Motion they unanimously approved at their October 11, 2005 Management Committee meeting:

The Management Committee is of the opinion that physical self supply is not a necessary option for the New York Market at this time. Designing a physical self supply option within the basic framework of the New York Market would be a complex and time consuming process. Although no option should be completely discarded as unwarranted, we believe that further exploration of physical self supply options at this time would be unproductive and unnecessary.⁵

As the NYISO discussed in its January, 2005 filing in this proceeding, it has become apparent to the NYISO and its Market Participants that implementation of even the simplest of physical self-supply solutions would be a major undertaking. Both design development and software coding costs would be significant and would substantially delay work on other market improvements. Simply stated, there is a consensus among Market Participants that a physical self-supply option would bring no benefits that would justify bearing these costs, at least at this time. Discussions also revealed a general perception among NYISO staff and Market Participants that the risk of a reserve market failure in the absence of a physical self-supply option was remote.

Moreover, a physical self-supply option would not be well-suited for the reserves procurement and cost recovery systems currently used by the NYISO. Operating reserves obligations in New York State, both spinning and non-synchronous ("NSR"), are based on the single largest contingency statewide rather than on the size of the load or the size of any regional contingency. Each Load Serving Entity's ("LSE's") NSR payment obligation is rolled into its payment obligation for all reserves procured on its behalf: (i) ten-minute total reserves, (ii) ten-minute spinning reserves, and (iii) thirty minute reserves. These costs are recovered from each LSE on a load ratio share. LSEs do not have an individually determined NSR obligation which could easily be procured independent of the reserves market.

In effect then an LSE's share of the reserve costs is applied to the purchases of up to three different reserve products in each of three locations. Therefore a physical self supply

⁵ See Attachment I.

option for NSR would either require major restructuring of the reserve market mechanism or require an LSE to self-supply NSR from as many as three different locations, which is almost certain to be impractical. In addition, physical self supply of NSR could remove resources from the NYISO's co-optimized procurement process for energy and reserves which would tend to increase the costs of statewide reserves rather than reduce them.

As noted in the schedule provided above, the NYISO continues to evaluate, with the Management Committee's concurrence, reserves price data and other market and system information for the purpose of making a recommendation in 2006 regarding the type of financial self supply mechanism that is necessary for the NYISO-administered markets. At the conclusion of this further analysis, Market Participants and the NYISO will evaluate the costs, and potential benefits, of pursuing new financial self-supply enhancements that would allow Market Participants to more fully cover their exposure to the price of NSR in the New York market.

A decision to pursue further financial hedging mechanisms would advance several of the Commission's stated goals. Enhanced financial hedging would provide the financial equivalent of physical self supply and would ensure that the customer using such a hedge would bear the costs of that decision.⁶ The NYISO and Market Participants should be given the time that they will need to carefully determine what form of self supply option would best serve the NYISO-administered markets.

In the course of exploring the development of a further financial hedge, the NYISO would also continue to examine the costs and benefits of an improved optimization of the transmission system for energy and reserves. This issue was discussed at a September 12, 2005 of the NYISO's Market Structures Working Group, where the NYISO agreed that any effort to develop locational settlements for reserves would include an examination of the feasibility of transmission optimization.

The NYISO expects that it would file new tariff revisions to implement enhanced financial self-supply mechanism no earlier than the third quarter of 2006. If the NYISO and Market Participants were to decide that no further enhancements were needed the NYISO would inform the Commission of this conclusion and seek further guidance in the same time frame.

⁶ March Order, pp. 3-4. The Commission earlier determined that only a financial hedge that completely covered the costs assigned to a customer by the NYISO to procure NSR on its behalf could be equivalent to NSR physical self supply. *New York Independent System Operator, Inc.*, Docket No. ER03-836-001, *Order on Rehearing*, (May 7, 2004) ("Rehearing Order"), p. 3.

Honorable Magalie R Salas
October 14, 2005
Page 6

V. **Conclusion**

WHEREFORE, for the foregoing reasons, the New York Independent System Operator, Inc. respectfully requests that the Commission accept this compliance filing.

Respectfully submitted,



Mollie Lampi
Assistant General Counsel
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, NY 12303
518-356-7530

Attachment

ATTACHMENT I

Management Committee - October 11, 2005
Meeting Motion - Agenda # 8

WHEREAS: The NYISO and its market participants have been discussing self supply of operating reserves since 2000. These discussions have, at various times, included discussions of possible designs for physical self supply options.

WHEREAS: The Management Committee is of the opinion that physical self supply is not a necessary option for the New York Market at this time. Designing a physical self supply option within the basic framework of the New York Market would be a complex and time consuming process. Although no option should be completely discarded as unwarranted, we believe that further exploration of physical self supply options at this time would be unproductive and unnecessary.

WHEREAS: The NYISO and its market participants are exploring the need to enhance or expand upon the two financial self supply options that are currently available under the NYISO's Market Administration and Control Area Services Tariff, Rate Schedule 4.

WHEREAS: The Management Committee concurs with the NYISO's current plan to continue to evaluate operating reserves price data and other market and system information for the purpose of making a recommendation to the market participants in 2006 on whether another financial self supply option(s) is necessary. Based on such recommendation and the results of the underlying analysis, the market participants will decide in 2006 whether they choose to proceed with the design of an enhanced self supply option.

WHEREAS: The Management Committee encourages the Commission to allow the New York market to continue its analysis of the need for another financial self supply option and allow it to end, for now, any further effort towards a design of a physical self supply option for operating reserves.

NOW, THEREFORE, IT IS MOVED THAT the Management Committee approves amendments to the current tariff to clarify that physical self supply is not available in the New York Market at this time and identifying the two financial options that are currently noted in the tariff as the only presently available self-supply options.

The Management Committee also requests that the NYISO continue to monitor the price differentials between east and west and further analyze the production costs savings as identified in the LECG Report presented to the 9/21/05 BIC and make a recommendation in 2006 on the need for a further financial hedge and/or locational reserve settlements.

The Management Committee also recommends that if a further financial hedge is determined by the NYISO and its stakeholders to be necessary, that the NYISO include in the development of that hedge an evaluation of the feasibility, costs and benefits of optimizing transmission capacity for eastern and western reserves. Any improvement in the reserve cost hedging mechanism that would contain a move to locational settlements would also have to address the potential need for transmission optimization at that time.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all parties listed on the official service list maintained by the Secretary of the Commission in Docket No. ER03-836-000 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 385.2010 (2005). The NYISO is electronically serving a copy of this filing on the official representative of each of its customers, on each participant in its stakeholder committees, on the New York Public Service Commission, and on the electric utility regulatory agencies of New Jersey and Pennsylvania.

Dated at Albany, NY this 14th day of October, 2005.



Mollie Lampi
Assistant General Counsel
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, NY 12303