UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION
104 FERC ¶ 61,002

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

New York Independent Transmission System Operator, Inc. — Docket No. ER03-836-000

ORDER CONDITIONALLY ACCEPTING PROPOSED TARIFF REVISIONS

(Issued July 1, 2003)

1. This order addresses proposed tariff revisions, submitted on May 9, 2003, by the New York Independent Transmission System Operator, Inc. (NYISO), to the NYISO's Market Administration and Control Services Tariff (Services Tariff). The proposed revisions would modify the current market mitigation measures for 10-minute non-synchronized (i.e., non-spinning) reserves (NSR). As discussed below, we will conditionally accept for filing the proposed revisions, to become effective July 8, 2003, as requested.

2. This order benefits customers by ensuring greater efficiency in the NYISO operating reserves markets.

Background

3. By order issued May 31, 2000 (NYISO I),[1] the Commission approved the general imposition of a bid cap of $2.52/MW on NSR offers in New York, along with a mandatory offer requirement for units east of the Central East constraint. By order issued November 8, 2000 (NYISO II),[2] the Commission extended the bid cap until such time as the NYISO could show that "the competitive state of the non-spinning reserve market has reached a level of improvement that would warrant a lifting of, or increase in, the existing

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[1] New York Independent Transmission System Operator, Inc., 91 FERC ¶ 61,218 (2000).

[2] New York Independent Transmission System Operator, Inc., 93 FERC ¶ 61,142 at 61,437 (2000).

$2.52/MW bid cap." In a third order issued on July 23, 2002 (Central Hudson),[3] the Commission stated that it is appropriate for matters relating to the 10-minute NSR market to be analyzed by the NYISO's Independent Market Advisor, Dr. David Patton, and vetted through the stakeholders, and that the Commission will consider the merits of any filings resulting from that process.

The Filing

4. The NYISO states that the proposed revisions would achieve the following. First, by deleting the relevant language from Schedule 4, Sections 3.1 and 3.2, the proposed revisions would remove the current $2.52/MW bid cap on NSR. Second, by adding a new Section 3.1.4(d) to the NYISO's Market Mitigation Measures (Mitigation Measures) (Attachment H of the Services Tariff), the proposed revisions would limit the reference levels used for assessing bids to either the lower of the amount determined in accordance with that section, or $2.52/MW. Third, by adding a new Section 5.4 to the Mitigation Measures, the proposed revisions would, for the first 12 months after July 8, 2003 (the NYISO's requested effective date for the proposed revisions), authorize the NYISO, in concurrence with the Independent Market Advisor, to flag NSR prices that it determines reflect a "significant abuse of market power"[4] that may warrant possible reimposition of a bid cap or some other mitigation measure (flagged prices). If the NYISO determines, in concurrence with the Independent Market Advisor, that a filing seeking imposition of a bid cap or some other mitigation measure is appropriate, Section 5.4 further provides that the NYISO will request authorization from the Commission to redetermine the flagged prices in accordance with such bid cap or other mitigation measure as may be approved by the Commission. Fourth, the NYISO states that the proposed revisions commit the Independent Market Advisor to undertake an assessment of the performance of the NSR market during the year after the cap has been limited. The NYISO further points out that, under the proposed revisions, the current mandatory NSR offer requirement, as set forth in Section 5.12.1(ix) of the Services Tariff, would continue.

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[3]Central Hudson Gas & Electric Corp., 100 FERC ¶ 61,107 (2002).

[4]NYISO OATT, Attachment H, Second Revised Sheet No. 477B.

5. In support of the filing, the NYISO contends that, pursuant to Central Hudson, the proposed revisions result from the Independent Market Advisor's analysis of the 10-minute NSR market and appropriate stakeholder review. In addition, pursuant to NYISO II, the NYISO and the Independent Market Advisor maintain that there have been several significant improvements in competitive conditions since the bid cap was imposed in March 2000, which warrant lifting the bid cap. These stated improvements include: (1) modeling of the Blenheim-Gilboa pumped storage plant in the NYISO's market software that now allows it to offer larger quantities of NSR; (2) the NYISO market mitigation measures that have been approved by the Commission and allow the NYISO to prospectively mitigate economic withholding by restating the offer of a withheld resource to a default bid based on the applicable reference level; (3) a reserve sharing agreement with New England that has allowed the NYISO to reduce its typical purchases from 1200 MW to 1000 MW; and (4) the quantity of NSR available now greatly exceeds the quantity required, and NSR prices have generally cleared in the range of $1.10/MW to $1.80/MW.[5]

6. With regard to stakeholder approvals, the NYISO states that, although the Business Issues Committee rejected the NYISO's proposal for lifting the NSR bid cap, the Management Committee reversed the Business Issues Committee's action and approved a filing lifting the NSR bid cap, subject to inclusion of a new Section 5.4, as described above. In addition, the NYISO maintains that, in April 2003, its Board of Directors approved a filing to lift the NSR bid cap.

7. As indicated above, the NYISO requests an effective date for the proposed revisions of July 8, 2003.

Notice of the Filing

[5]These stated improvements are set forth in the Independent Market Advisor's affidavit (at page 5) attached to the NYISO's filing and highlighted in the NYISO's transmittal letter (at pages 3-4).

8. Notice of the filing was published in the Federal Register,[6] with comments, protests, and interventions due on or before May 30, 2003. Timely motions to intervene were filed by Reliant Resources, Inc.; AES Eastern Energy, L.P.; and NRG Companies. Niagara Mohawk Power Company, Inc. (Niagara Mohawk) filed a timely motion to intervene and protest. The New York State Public Service Commission (New York Commission) filed a notice of intervention and limited protest. The New York Transmission Owners (NYTOs) filed a Timely motion to intervene and limited protest.[7] Timely motions to intervene and supportive comments were filed by the Long Island Power Authority and LIPA; Keyspan-Ravenswood, LLC; New York Power Authority; and Independent Power Producers of New York, Inc.[8]

9. Niagara Mohawk argues that the NYISO's proposed revisions should be rejected outright. First, Niagara Mohawk contends that the Independent Market Advisor's own analysis (set forth by affidavit attached to the NYISO's filing) shows that the market is still highly concentrated and should remain subject to regulation in the form of the current bid cap. Second, Niagara Mohawk states that the demand for NSR is inelastic and mitigated only by the NYISO's ability to substitute more valuable synchronized reserve resources for overpriced NSR. Third, Niagara Mohawk contends that prices of synchronized reserves in any hour must be set by the highest NSR bid accepted by the NYISO if that bid is higher than the highest bid for synchronized reserves accepted in that hour. As a result, according to Niagara Mohawk, any pricing distortions caused by the exercise of market power in the NYISO's NSR market will automatically spill over into its market for synchronized reserves.

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[6] 68 Fed. Reg. 27,998 (2003).

[7] Unless otherwise indicated, Niagara Mohawk, the New York Commission, and NYTOs shall be collectively referred to as "protestors."

[8] Parties that filed supportive comments will be referred to collectively as "commenters."

10. Moreover, Niagara Mohawk argues that the NYISO has failed to modify its tariff in accordance with prior Commission directives that would substantially improve the functioning of the markets for NSR, which would, in turn, justify lifting the bid cap. These modifications include allowing western New York suppliers to provide 10-minute NSRs and permitting parties to self-supply NSR without being required to bid into the NYISO's markets.[9]

11. Other protestors generally support the NYISO's proposed tariff revisions as a step toward improving the efficiency of the NYISO's markets, but they take issue with certain aspects of the filing. The New York Commission argues that proposed Section 5.4 is too limited, provides too much discretion, and is inconsistent with the Mitigation Measures. For example, the New York Commission states that while proposed Section 5.4 would allow reimposition of a bid cap or other measure where the NYISO determines there has been a "significant abuse of market power," the Mitigation Measures require the NYISO to make a filing with the Commission seeking authorization to apply appropriate mitigation to conduct that is deemed to have an effect on market prices that is significant, i.e., an increase of greater than 100 percent of Locational-Based Marginal Pricing (LBMP) at any location or any other NYISO price. The New York Commission contends that the proposed Section 5.4 should govern only the standard for flagging prices and that the Commission should clarify that Section 5.4 does not supersede any provision of the Mitigation Measures. The New York Commission further argues that the Commission should recognize the NYISO's prior commitments to conduct studies after three and six months of lifting the bid cap, not merely 12 months after doing so.

12. The NYTOs request Commission clarification that the NYISO's proposed revisions provide adequate notice to all suppliers of 10-minute synchronized reserves and NSR to allow the retroactive redetermination of flagged prices, i.e., those that have been determined by the NYISO and the Independent Market Advisor to reflect a significant abuse of market power. The NYTOs further state that the Commission should require the NYISO to revise its filing to make clear that "significant abuse of market power" means any abuse of market power. In addition, the NYTOs seek Commission clarification that the Commission intends to authorize the redetermination of flagged prices where the NYISO and its Independent Market Advisor have identified prices that reflect an abuse of market power.

13. The commenters also support the NYISO's filing as a step toward improving the efficiency of the NYISO's markets. They state that lifting the bid cap will improve market efficiency by permitting suppliers to bid their actual marginal costs, allowing the NYISO to differentiate between low- and high-cost resources and allowing the market to reflect these costs. They further state that, with the price cap, all higher cost units are artificially pressed against the

[9] See NYISO I, 91 FERC at 61,799-800, 61,806.

$2.52/MW price ceiling, while lifting the price cap will allow those superior reserve suppliers to be selected ahead of higher cost units, which will translate into more accurate price signals to the NSR market. The commenters also reiterate the NYISO's position that the NSR bid cap is no longer necessary because modifications and refinements in the market have significantly improved competitive conditions in the NSR market.

Procedural Matters

14. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[10] each timely, unopposed motion to intervene serves to make the filing entity a party to this proceeding, and the New York Commission's notice of intervention serves to make it a party to this proceeding.

Discussion

15. For the reasons set forth below, we will conditionally accept for filing the NYISO's proposed tariff revisions. These revisions will modify mitigation of the NSR market from the current approach, which consists of a $2.52 cap on all NSR bids, to one that utilizes the Mitigation Measures instead. As an initial matter, we find that the competitive state of the NSR market has reached a level of improvement that warrants modifying the NSR mitigation. The NYISO has made a number of improvements that mitigate market power among NSR suppliers. These include: (1) modifying its market rules so that the Blenheim-Gilboa plant, which is operated by the New York Power Authority, can now supply up to 600 MW of NSR; (2) providing lost opportunity costs to NSR suppliers so that they are not penalized for being selected to provide NSR instead of energy; (3) implementing locational reserves pricing so that operating reserves prices in the constrained Long Island area do not set the state-wide price; and (4) entering into a reserves sharing agreement with ISO-NE that allows it to meet up to 200 MW of the 1200 MW reserves requirement with resources from New England.

[10] 18 C.F.R. § 385.214 (2002).

16. The Commission also finds that sufficient measures exist under the proposed revisions to ensure that the NYISO's operating reserves market remains competitive. For example, under the NYISO's proposal to modify the NSR mitigation, NSR suppliers will continue to remain subject to the mandatory bid requirement, which we believe will help decrease the potential for physical withholding. A second key aspect of the proposal is that it expressly incorporates NSR bids, with a reference price of no higher than $2.52/MW,[11] into the NYISO's Mitigation Measures framework, which we believe will help mitigate the potential for economic withholding.[12] Addressing the NSR market through the Mitigation Measures also meets our standing concern that there be one set of Mitigation Measures in the NYISO markets, rather than potentially duplicative ones.[13]

17. Having stated the foregoing, however, the Commission is concerned about the lack of a self-supply option in the proposed revisions. We have consistently emphasized that customers must be allowed to self-supply their own operating reserves.[14] We believe that providing customers with the option to self-supply their own operating reserves decreases the likelihood that they will be held captive to the NSR suppliers' market power. Indeed, we previously directed the NYISO to devise a plan that would permit its customers to

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[11]The Commission accepted $2.52/MW as a reasonable figure for the bid cap because it was the highest market clearing price during the initial period of NYISO operations, when the market appeared to have been operating competitively. See NYISO I, 91 FERC at 61,802.

[12]Under the proposed revisions, the threshold for identifying economic withholding under the conduct test (which is part of the Mitigation Measures), using NSR bids, would be a 300 percent increase, or an increase of $100 per MW, whichever is lower, with respect to the reference level, which, in turn, is the lower of: (1) $2.52; or (2) the lower of the mean or the median of an NSR unit's accepted bids or bid components in competitive periods over the previous 90 days for similar hours or load levels, adjusted for changes in fuel prices.

[13]See Consolidated Edison Company of New York, Inc., 96 FERC ¶ 61,095 at 61,384 (2001), reh'g denied, Consolidated Edison Company of New York, Inc., 97 FERC ¶ 61,050 (2001); New York Independent System Operator, Inc., et al., 99 FERC ¶ 61,246 at 62,037 (2002).

[14]See NYISO I, 91 FERC at 61,799-800, 61,806; NYISO II, 93 FERC at 61,437-38.

self-supply their own operating reserves,[15] and we find that the NYISO must comply with our prior directive in that regard. However, we recognize that the NYISO will need to modify its software to allow self-supply, and that the NYISO is currently in the process of undertaking a complete redevelopment of its Real-Time software, with a deployment date of early 2004. Thus, we will not require the NYISO to immediately implement self-supply, but will require the NYISO to submit, within 60 days of the date of this order, a timetable setting forth a schedule for full implementation of its option for allowing customers to self-supply their own operating reserves.

18. We agree with the New York Commission that the NYISO should study and report on the competitiveness of the 10-minute NSR market earlier than 12 months after modifying its NSR mitigation. Such reports will assist the NYISO, market participants and the Commission in evaluating the 10-minute NSR's performance and provide a greater degree of certainty that market abuse is not going undetected. Accordingly, we will direct the NYISO to study and report on the competitiveness of the 10-minute NSR market at three, six, and 12 months after modifying the NSR mitigation.

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[15] NYISO I, 91 FERC at 61,799-800, 61,806.

19. In taking this action, we reject the NYTOs' requests for clarification that the flagged prices provision of proposed Section 5.4 provides adequate notice to reserves suppliers to allow retroactive redetermination of flagged prices, and that the Commission intends to authorize retroactive redetermination of flagged prices. We previously limited the NYISO's ability to recalculate prices under its Temporary Extraordinary Procedures, so that the NYISO can retroactively correct only those prices that violate its filed rate, as set forth in its tariffs.[16] The prospect that prices could be recalculated based on unspecified criteria would add unnecessary uncertainty to the NSR market.[17] We find that the NYISO's proposed revisions provide adequate protection against the exercise of market power in the NSR market. If in the future, as it monitors the markets, the Independent Market Advisor concludes that these protections are no longer adequate, the NYISO may file to change them prospectively.

20. We further reject the NYTOs' request for clarification that, under the proposed revisions, any abuse of market power will be deemed "significant." Abuses of market power will be identified under the criteria of the Mitigation Measures, i.e., the Mitigation Measures' conduct- and impact-thresholds. Under the Mitigation Measures, the NYISO must also monitor for conduct that does not rise to the level of these thresholds but which nonetheless constitutes market power abuse. To that end, we clarify, as the New York Commission requests, that "significant abuse of market power" as used in Section 5.4 shall govern only the standard for flagging prices and does not supersede any provision of the Mitigation Measures, although similar language may be used.

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[16] See New York Independent System Operator, 97 FERC ¶ 61,095 at 61,497-98 (2001).

[17] Previously, we rejected another proposal to permit the NYISO to impose mitigation when the ISO has not described with enough specificity the types of conduct that would trigger the mitigation. See New York Independent System Operator, Inc., 89 FERC ¶ 61,196 (1999), reh'g denied, New York Independent System Operator, Inc., 90 FERC ¶ 61,317 (2000).

21. Finally, we reject Niagara Mohawk's arguments regarding the concentrated nature of the market and the inelasticity of demand for 10-minute reserves in the NYISO region. Niagara Mohawk attempts to show that the market is non-competitive, a contention with which we disagree, as discussed above.

The Commission orders:

(A) The NYISO's proposal is hereby conditionally accepted for filing, to become effective July 8, 2003, subject to ordering paragraph (B) below, as discussed in the body of this order.

(B) The NYISO is hereby directed to submit, within 60 days of the date of this order, a timetable setting forth a schedule for full implementation of its option for allowing customers to self-supply their own operating reserves, as discussed in the body of this order.

(C) The NYISO is hereby directed to submit reports on the competitiveness of the NSR market at three months, six months, and 12 months after the modification of the NSR mitigation, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.