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October 11, 2000

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BYHAND

The Honorable David P. Boergers, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

New York Independent System Operator, Inc.
Extension of Temporary Extraordinary Procedures

Dear Mr. Boergers:

The New York Independent System Operator, Inc. (“NYISO”), by counsel, hereby files to extend until April 30, 2001 Temporary Extraordinary Procedures for Correcting Market Design Flaws and Addressing Transitional Abnormalities (“Temporary Extraordinary Procedures”). The Temporary Extraordinary Procedures the NYISO seeks to extend without modification are those that were filed with the Commission on May 26, 2000 and that were accepted by the Commission in its July 25, 2000 “Order on Tariff Filing” in *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,051 (2000) (“July 25 Order”).

The NYISO has made considerable progress towards eliminating the market design and software flaws that led to a number of problems in its first months of operations. Corrective actions undertaken by the NYISO have generally worked well and, in most cases, have not had unexpected adverse consequences. The NYISO has also successfully passed through the peak demand summer months without encountering major market or reliability problems, although the NYISO recognizes that it has benefited greatly from unusually temperate summer weather.¹ In addition, as NYISO staff has gained experience, and grown in size, its ability to address known problems effectively and to anticipate new ones has increased greatly. On the whole, the performance of the NYISO-administered markets has improved substantially in recent months. For example, the frequency of price corrections continues to drop, the NYISO’s software has

¹ On the other hand, the NYISO-administered markets were also under unusual pressure on account of the unavailability of a major nuclear generating unit.

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been modified to rationalize its treatment of export transactions, and the number and size of multi-unit bidding blocks has been greatly reduced.

However, the NYISO also understands that its efforts to improve its markets are by no means complete, and that participants in the NYISO-administered markets are still adversely affected by market flaws. The NYISO is working hard to correct all remaining market flaws as quickly as possible. As described more fully in a Combined Compliance Filing and Report filed with the Commission on September 8, 2000 in Docket No. ER00-3591-000 (“September 8 Filing”), the NYISO will continue to implement additional corrections and enhancements during the upcoming months. Even though all such modifications will be thoroughly tested prior to implementation, they may have unintended consequences or create unanticipated gaming opportunities. The NYISO will, therefore, continue to require Temporary Extraordinary Procedures authority at least until April 30, 2001, which is the end of the Winter Capability Period.

Documents Submitted

Pursuant to Section 205 of the Federal Power Act and 18 C.F.R. § 35.13 (1999), the NYISO is filing six copies of:

1. This filing letter;
2. Temporary Extraordinary Procedures for Correcting Design Flaws and Addressing Transitional Abnormalities (Attachment A-1 hereto is to serve as Attachment Q to the ISO Open Access Transmission Tariff (“ISO OATT”) and Attachment A-2 hereto is to serve as Attachment E to the New York Independent System Operator Market Administration and Control Area Services Tariff (“ISO Services Tariff”);² and
3. A draft *Federal Register* Notice (Attachment B).

² The sheets submitted by the NYISO are labeled “Second Revised” in order to conform with the tariffs posted on the NYISO website. The sheets posted on the website are labeled “Original” and were set to expire on May 16, 2000. The sheets submitted on May 26, 2000 to extend the Temporary Extraordinary Procedures authority through October 30, 2000 should have been labeled “First Revised,” but were not appropriately designated. Therefore, the NYISO is submitting “Second Revised” sheets, and is not submitting a red-lined comparison because the only change from the sheets submitted on May 26, 2000 is to change the expiration date.

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Copies of Correspondence

Copies of correspondence concerning this filing should be served on:

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Washington, DC 20006

Parties on Whom Copies Have Been Served

Copies of this filing have been served on the parties to *New York Independent System Operator, Inc.*, Docket No. ER00-2624-000, on those parties who have executed service agreements under the ISO OATT or the ISO Services Tariff and on the electric utility regulatory agencies in New York, New Jersey and Pennsylvania.

Background

The Commission first granted the NYISO's request for Temporary Extraordinary Procedures authority for a 90-day period starting with the commencement of NYISO operations, *i.e.* from November 18, 1999 to February 16, 2000. *New York Independent System Operator, Inc., et al.*, 88 FERC ¶ 61,228 (1999). Subsequently the Commission extended the NYISO's Temporary Extraordinary Procedure authority through October 31, 2000. *See New York Independent System Operator, Inc., et al.*, 90 FERC ¶ 61,320 (2000); 91 FERC ¶ 61,051 (2000).

As was noted in the September 8 Filing, the NYISO has identified a number of software problems, market flaws and other anomalies since its markets commenced operations. Many of these problems have already been successfully remedied and the NYISO is working diligently to address the remainder, *e.g.*, by rectifying flaws in its Balancing Market Evaluation ("BME") software and developing effective demand-side response mechanisms. The NYISO also plans to implement a number of important market enhancements, *e.g.*, virtual bidding.

Because the NYISO's market design is the most sophisticated of all the Commission-approved ISO's, the work required to correct problems and institute improvements may be very time-consuming and technically challenging. Great care must, and will, be taken to ensure that the NYISO's corrections and enhancements do not have unintended adverse consequences or

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create unexpected gaming opportunities.³ The NYISO has carefully trained its staff, and hired highly qualified expert consultants, in an effort to avoid implementation problems. Nevertheless, the NYISO cannot guarantee that all of its corrections and adjustments will be problem-free.

This is especially true because the changes must be implemented within the framework of an already operational market system. Based on the NYISO's experience thus far, it is likely that fact patterns will arise that newly introduced market rules and software were not specifically designed to address, especially as Market Participants become more imaginative in adapting their bidding strategies to the changing market environment. Ultimately, the NYISO anticipates that it will identify and eliminate all unexpected problems associated with new corrections and enhancements. In the interim, however, the NYISO believes that it must have the tools to deal quickly with such problems..

Against this background, and with the additional support provided below, the NYISO seeks authority to extend the Temporary Extraordinary Procedures through April 30, 2001. The Temporary Extraordinary Procedures filed herein are identical to those filed May 26, 2000, except with respect to the proposed termination date.

The NYISO has invoked its authority pursuant to the Temporary Extraordinary Procedures only as necessary, and primarily to provide corrected prices that are consistent with the market design submitted to, and approved by, the Commission. The changes the NYISO continues to make in its software are designed to make that software fully consistent with the approved market design. The Temporary Extraordinary Procedures, and the Extraordinary Corrective Actions pursuant to those Procedures, are necessary in instances where the market is not operating as its proponents and the Commission intended. Toward that end, the NYISO does not use its Temporary Extraordinary Procedure authority to cap or "administer" prices, but also does not hesitate to correct prices that are inaccurate in the sense that their calculation is not consistent with the ISO OATT, ISO Services Tariff or market rules.. Where further analysis results in the need for a tariff change, such a proposal will be filed with the Commission prior to implementation.

The sophistication of the NYISO market design, by fully coordinating both day-ahead and real time energy markets with ancillary services markets, is both a strength and an administrative challenge. The NYISO will meet the challenge, but needs limited flexibility to continue to

³ The Commission has recognized that the NYISO must guard against disruptions to market fixes already in place, or the creation of new problems, and must "adopt a balanced, considered approach to needed corrections and changes to [its] software." *Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.*, 93 FERC ¶ 63,017, slip op. at 6-7 (2000).

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correct unanticipated problems that have prevented the full realization of the Commission-approved design and that may emerge as new market enhancements are introduced.

Identification and Correction of Incorrectly Determined Prices

The NYISO has invoked the Temporary Extraordinary Procedures most frequently to identify and correct posted prices that are initially posted incorrectly. The NYISO must have the authority, whether explicit or implicit,⁴ first to verify that posted prices are correct and then to correct any incorrectly posted price.

This issue has arisen only once in the day-ahead market in the months since the NYISO commenced operations. In the real-time market, in June 2000, the NYISO corrected prices in 3.92% of all (five minute) real-time intervals. In July, the NYISO had to correct prices in only 1.87% of real-time intervals and in August price corrections were required in 0.53% of real-time intervals. In September, the NYISO only corrected prices in 0.42% of real-time intervals. As was discussed in the September 8 filing, the NYISO expects that its performance will continue to improve in the future.

A clear understanding of what the NYISO means by price correction is important. The ISO Services Tariff establishes the details of an LBMP market. Behind the details provided in the ISO Services Tariff are sophisticated software programs that actually generate the LBMP prices. With the assistance of its expert consultants, the NYISO has developed an independent screening tool that analyzes and flags prices that do not appear to be consistent with the LBMP regime approved by the Commission. On the basis of this screening process, the NYISO posts notification that it is reviewing the price for a given hour even if only a single interval within that hour may be suspect. The NYISO then undertakes a more thorough review of the posted price to determine whether the price is, indeed, correct. If it is incorrect, a revised price is then posted.

The NYISO does not use its price review process to “cap” prices. Indeed, price corrections have frequently involved raising prices. While price spikes certainly are visible and

⁴ The Commission has held that the correction of an incorrectly posted price, one of the actions taken by the NYISO pursuant to the Temporary Extraordinary Procedures, is permitted without the Temporary Extraordinary Procedures as a result of the filed rate doctrine. *NRG Power Marketing, Inc. v. New York Independent System Operations, Inc.*, 91 FERC ¶ 61,346 (2000). Indeed, the filed rate doctrine, which establishes no time limits on price corrections, arguably affords the NYISO even greater flexibility. Regardless, the NYISO believes that by adhering to the time limits established by the Temporary Extraordinary Procedures whenever possible it benefits the markets by promoting price certainty. *See also ISO New England, Inc.*, 90 FERC ¶ 61,141 (2000).

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attract attention, the verification process focuses on the concordance of the software solution with the design of market models: the identification of marginal units used to establish the LBMP, the correctness of the dispatch schedule, and the relation of the bids to the LBMP in the determination of the commitment of generators. While some price spikes have been found to be anomalous, others have been found to be correct. Negative price spikes receive the same scrutiny as do positive spikes. Indeed, all prices are scrutinized with the same objective – that they be correct and provide appropriate signals to market participants.

The NYISO recognizes that its ability and capability using best efforts to correct incorrectly determined prices leaves some prices uncertain for a limited period of time. The NYISO continues to believe, however, that the value of correct prices, for the reasons described above, far outweighs the cost, if any, from a limited delay in posting the corrected price.

Other Software and Market Flaws

The NYISO has eliminated many of the problems that have required it to resort to its Temporary Extraordinary Procedure authority in the past. For example, the NYISO introduced software changes on July 25 to correct a problem that caused its Security Constrained Dispatch (“SCD”) to assign incorrect upper operating limits to steam units, thereby producing pricing errors. As described in the September 8 Filing, the NYISO has implemented software enhancements to prevent pricing errors caused by bids submitted by large multi-unit bidding blocks, as well as to reduce the running of large amounts of uneconomic energy associated with “block loading.” Such problems have been the most frequent causes of price miscalculations. The software modifications will reduce the number of price miscalculations, and thus the number of price corrections. However, as with the introduction of almost any new software, new problems may arise that could require the use of Temporary Extraordinary Procedure authority.

However, the NYISO still faces a number of major challenges. For example, the NYISO is currently developing effective demand response mechanisms, expanding the availability of price-sensitive load bids, developing mechanisms for virtual bidding and planning interim and permanent BME modifications in order to stabilize and improve its markets. The NYISO is planning various other changes, and it is possible that the Commission may require it to make others. Software complications and unexpected gaming opportunities associated with these corrections and enhancements may also necessitate NYISO action pursuant to its Temporary Extraordinary Procedures authority.

Moreover, as was stated in the September 8 Filing, the NYISO is modifying its Security Constrained Unit Commitment (“SCUC”) in several respects. These changes in the handling of marginal losses and external load add more variables to the system, possibly increasing the risk

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of introducing further anomalous behavior requiring prompt corrective action. Concurrent improvements to SCD software involve similar considerations.

The NYISO is engaged in numerous software modification projects pursuant to Commission directives, Market Participants' suggestions, and good utility practice. As these changes are continually made, the NYISO needs to retain its flexibility, through Temporary Extraordinary Procedure authority, to correct any unintended consequences of new software.

Requisite Approvals

This refile of the Temporary Extraordinary Procedures was approved by the Board of Directors of the NYISO and by the Management Committee with 91.04% in favor⁵ at its meeting on October 3, 2000,⁶ pursuant to the provisions of Section 19.01 of the ISO Agreement.

Effective Date and Request for Waiver

The NYISO requests an effective date of November 1, 2000, the day following the expiration of the currently approved Temporary Extraordinary Procedures. Waiver of the Commission's notice requirements is appropriate for a number of reasons. The NYISO Staff has carefully analyzed the extent to which the existing Temporary Extraordinary Procedures should be broadened or narrowed. As indicated above, the scope has remained unchanged. Nevertheless, experience has demonstrated the need for continuing limited authority to deal with unanticipated and unanticipatable events. Moreover, the Management Committee meeting, at which this issue was most recently discussed, did not occur until October 3, 2000.

⁵ 58% is required for approval.

⁶ Section 7.11(f) of the Independent System Operator Agreement ("ISO Agreement") provides that any action taken by the Management at a Management Committee meeting does not become effective until thirty (30) days after the Management Committee has acted. The ISO Agreement also contains provisions relating to appeals and stays.

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Federal Register Notice

A form of Federal Register Notice is provided as Attachment B hereto. A diskette of the notice is also provided.

Respectfully submitted,

Arnold H. Quint
Ted J. Murphy
Edwin G. Kichline
Counsel for
New York Independent System
Operator, Inc.

Enclosures

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.) Docket No. ER00-_____

NOTICE OF FILING

Take notice that on October 11, 2000, the New York Independent System Operator, Inc. (“NYISO”) requested an extension of Temporary Extraordinary Procedures for Correcting Market Design Flaws and Addressing Transitional Abnormalities. The NYISO requests an effective date of November 1, 2000 and waiver of the Commission’s notice requirements.

A copy of this filing was served upon all persons on the Commission’s official service list in Docket No. ER00-2624-000, on those parties who have executed service agreements under the NYISO Open Access Transmission Tariff or under the New York Independent System Operator Market Administration and Control Area Services Tariff and on the electric utility regulatory agencies in New York, New Jersey and Pennsylvania.

Any person desiring to be heard or to protest this filing should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, NE, Washington, DC 20426, in accordance with Rules 211 and 214 of the Commission’s Rules of Practice and Procedure (18 C.F.R. §§ 385.211 and 385.214). All such motions or protests should be filed on or before _____. Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a motion to intervene. Copies of this application are on file with the Commission and are available for public inspection.

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