UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	)	Docket Nos. ER08-695-001 EL07-39-000

MOTION FOR LEAVE TO RESPOND, AND RESPONSE, OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure,[1] the New York Independent System Operator, Inc. ("NYISO") respectfully moves to respond to certain points in the comments, protests and interventions filed on May 27, 2008 ("May 27 Filings") in the above dockets.[2] The May 27 Filings were made in response to the NYISO's second filing ("2nd Compliance Filing"), dated May 6, 2008, in compliance with the Commission's March 7, 2008 order conditionally approving the NYISO's proposed market power mitigation measures for the Installed Capacity market in New York City.[3, 4]

I. Motion for Leave to Respond

The NYISO recognizes that the Commission normally discourages responses to pleadings such as protests. The Commission has previously allowed answers, however, when they correct

---

1 18 C.F.R. §§ 385.212 and 385.213.

2 Substantive comments and protests were filed by Astoria Generating Company, L.P. ("Astoria Comments"), Independent Power Producers of New York, Inc. ("IPPNY Comments"), NRG Companies ("NRG Comments"), KeySpan-Ravenswood, LLC ("Ravenswood Comments"), the New York Transmission Owners ("TO Comments") and the New York Public Service Commission ("NY PSC Comments"). The NYISO does not oppose intervention by these or any other entities filing to intervene in this docket.

3 *New York Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,211 (2008) ("March 7 Order").

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

inaccurate statements,[5] help to clarify complex issues, provide additional information that will assist the Commission, or are otherwise helpful in the development of the record in a proceeding.[6]

The May 27 Filings make several points about the 2nd Compliance Filing that apparently misapprehend the filing, or otherwise misconstrue or mischaracterize the proposed mitigation measures, or are not analytically sound. The purpose of this response is to identify and briefly address the points in the May 27 Filings that suffer the above defects, and which should not provide a basis for changing the tariff language in the 2nd Compliance Filing. Thus, NYISO submits that good cause exists to permit this response.

II. Response

A. Net Buyer Limitation on Offer Floors for Uneconomic Entry

In the 2nd Compliance Filing, the NYISO reiterated its concerns with the limitation in the March 7 Order on the application of an Offer Floor to uneconomic entry by a Net Buyer. Nothing in the May 27 Filings alleviates this concern. Indeed, the May 27 Filings representing supplier interests all support the NYISO's contentions that a Net Buyer limitation on the mitigation of uneconomic entry is unnecessary and would be unworkable.

The NY PSC Comments contend that eliminating the Net Buyer limitation could be a significant barrier to certain forms of new entry, such as by demonstration projects or baseload

---

[5] *S. Minnesota Mun. Power Agency v. N. States Power Co.*, 57 FERC ¶ 61,136, at 61,494 (1991).

[6] *See, e.g., New York Indep. Sys. Operator, Inc.*, 108 FERC ¶ 61,188 at P 7 (2004) (accepting NYISO answer to protests because it provided information that aided the Commission in better understanding the matters at issue in the proceeding); *Morgan Stanley Capital Group, Inc. v. New York Indep. Sys. Operator, Inc.*, 93 FERC ¶ 61,017 at 61,036 (2000) (accepting an answer that was "helpful in the development of the record . . .").

units with long development times.[7] The NY PSC, however, ignores the reverse side of the coin: exempting such units from the Offer Floor could instead be a significant barrier to entry by market-based units, which rely on the price signals given by the NYC capacity market. If demonstration or baseload units are offered at below market levels, the result is likely to be distortion of capacity market price signals and a resulting barrier to entry by merchant generation.

While the NY PSC asserts, without providing any supporting facts, that an Offer Floor could be a barrier to entry by a baseload unit with a lengthy lead time, by its nature such a unit would likely have low operating costs and operate over a relatively high number of hours, and thus have a high net revenue offset to its cost of new entry ("CONE").[8] A baseload unit is thus unlikely to be deemed uneconomic relative to the Net CONE test, which is based on a peaking unit. By contrast to baseload units, peaking units have relatively high operating costs and relatively low operating rates.[9] As Mr. Meehan stated in his affidavit in support of the NYISO's October 4, 2007 filing of proposed mitigation methodologies in response to the Commission's July 6, 2007 Order Establishing Paper Hearing and Referring Certain Matters for Investigation in Docket No. EL07-39-000:[10] "By providing sufficient net revenue for a peaking unit, the ICAP Demand Curve also provides a sufficient, in fact more than sufficient incentive for more capital intensive baseload investment, when such investment is economic and for economic existing

---

7 NY PSC Comments at 4.

8 *Id*. at 4-5.

9 *See New York Indep. Sys. Operator, Inc.*, 113 FERC ¶ 61,271 (2005) at P 12 (holding that: "A peaking unit is defined as the unit with technology that results in the lowest fixed costs and highest variable costs among all other units' technology that are economically viable. Peaking units, by nature, operate the fewest hours out of a given year in comparison with all other units.").

10 *New York Indep. Sys. Operator, Inc.*, 120 FERC ¶ 61,024 (2007).

capacity to continue to operate."[11] If a baseload unit were potentially subject to an Offer Floor, that floor can be based on its Unit Net CONE, and the Unit Net CONE of a baseload unit would be relatively low and unlikely to prevent it from clearing in the ICAP market. The assertions in the NY PSC's comments about a "demonstration unit" are equally lacking in specificity and support.

In the 2nd Compliance Filing, the NYISO pointed out that a Net Buyer limitation would require the NYISO to gather a significant amount of new information from Market Participants, and "would require the NYISO to develop a new expertise in assessing complex project development agreements."[12] The NY PSC contends that applying a Net Buyer limitation would be no more difficult than analyzing unit-specific costs in order to determine a Unit Net CONE.[13] These two inquiries are not comparable. Unit-specific reference price determinations involve cost and accounting issues similar to those analyzed in the Demand Curve reset process and in energy or ancillary services reference price determinations. Analyzing an entity's status as a "Net Buyer" would involve gathering, understanding and interpreting a range of sophisticated project development, power offtake, financing and other documents and agreements, and a range of legal and financial issues, with which the NYISO does not otherwise have or need to have any familiarity. Administering a Net Buyer limitation would thus involve a significant burden and

---

11 *New York Indep. Sys. Operator, Inc.*, Compliance Filing of the New York Independent System Operator, Inc., Regarding the New York City ICAP Market Structure, Docket No. EL09-39-000 (Oct. 4, 2007) ("October 4 Filing"), Affidavit of Eugene T. Meehan ¶ 17. Mr. Meehan and the consulting firm NERA were retained by the NYISO to provide expert advice in the most recent update of the ICAP Demand Curves. Mr. Meehan and NERA, assisted by the firm of Sargent & Lundy, analyzed the cost of new entry by a peaking unit as a determining value for setting the ICAP Demand Curves. They also provided an assessment of the net revenues that a new unit could expect to earn from sales of energy and ancillary services as an offset to its costs of new entry.

12 2nd Compliance Filing at 6.

13 NY PSC Comments at 5.

expense. That effort might be justified if there were a strong case for including such a limit on the potential application of an Offer Floor to uneconomic entry, but the NY PSC contends that only Net Buyers would have the ability and incentive to introduce uneconomic entry. If that is the case, then the burden and expense of applying a Net Buyer limitation is not warranted, since only Net Buyers will fail the economic entry tests in any event.

The 2nd Compliance Filing includes proposed language to implement a Net Buyer limitation, pending rehearing of the March 7 Order and without prejudice to the NYISO's request for rehearing on the Net Buyer limitation. The Ravenswood Comments propose a number of changes to the Net Buyer provisions in the tariff language submitted with the 2nd Compliance Filing.[14] If anything, the Ravenswood proposals serve to illustrate the difficult distinctions inherent in applying a Net Buyer limitation. As stated in the 2nd Compliance Filing, the NYISO respectfully submits that the preferable course would be to eliminate the Net Buyer limitation altogether, and Ravenswood apparently agrees.[15]

The NRG Comments assert that the NYISO should make a filing to authorize its Market Monitoring and Performance Unit ("MMU") to identify subsidies that are distorting efficient market outcomes and to address such subsidies to ensure that no market distortion occurs. The NYISO's MMU is and will remain vigilant in detecting any conduct that threatens to distort the NYISO's markets, and the NYISO respectfully submits that the 2nd Compliance Filing is the filing advocated by NRG. Any relevant subsidies would become manifest in the capacity bidding of a subsidized unit, while the application of the Offer Floor proposed in the 2nd

---

[14] Ravenswood Comments at 3-4, 7-10.

[15] Ravenswood Comments at 7 (stating that "Ravenswood shares the NYISO's concerns regarding limiting mitigation to net buyers . . .").

Compliance Filing would prevent any subsidy from distorting prices in the NYC capacity market.

B. The *Ex Ante* Test for Offer Floor Exemption

In compliance with the March 7 Order, the 2nd Compliance Filing includes tariff language under which new entry would be exempt from an Offer Floor if, with the inclusion of the new entrant, either (a) spot auction prices for the first year after entry are projected to be higher than the Offer Floor based on Net CONE, or (b) the average spot auction prices for the first three years after entry are projected to be higher than the anticipated Unit Net CONE.[16] The proposed procedures for obtaining an *ex ante* exemption are synchronized with the existing generator interconnection procedures, so that a project developer can determine whether its project will be exempt in connection with the normal schedule for committing to go forward with a new unit.

Under the NYISO's proposal, a project developer can request an *ex ante* exemption determination upon entering into an Interconnection Facilities Study Agreement ("IFSA"). NRG contends that it is not clear that entering into an IFSA would entail a binding commitment to complete a project, and thus the date of entering such an agreement may not be an appropriate threshold for requesting a determination that a unit is economic.[17] The 2nd Compliance Filing does not, however, contend that entering into an IFSA constitutes a binding commitment to complete a project. Rather, the execution of an IFSA is an appropriate starting point for putting the NYISO on notice that a developer wishes to seek an Offer Floor exemption for a project, so that the NYISO can schedule and carry out the necessary study and analysis. The resolution of that study and analysis would be timed to coincide with the Initial Decision Period for the

16 March 7 Order at P 98; 2nd Compliance Filing, Services Tariff Attachment H § 4.5(g)(ii).

17 NRG Comments at 6.

project, which is the point at which a developer would need to make a significant commitment to carry through with a project.[18] As a result, the procedures in the 2nd Compliance Filing are carefully tailored to mesh with the existing generator interconnection procedures in the tariff, and to coincide with the point in those procedures at which a project developer would need to have the information relevant to determining whether to proceed with the project. NRG's contention that entering into an IFSA does not entail a binding commitment to complete a project is true but not germane, and the NYISO respectfully submits that NRG has not shown that any alternative procedure would better conform to the generator interconnection process, or otherwise be preferable.

NRG also asserts that the NYISO has not explained how the grandfathering exemption for units already in existence at the time of the March 7 Order, and thus not subject to being deterred from entry by an Offer Floor, would be implemented for a generator that has entered into an IFSA but is not an existing unit.[19] As explained above, however, execution of an IFSA is only a threshold for requesting an *ex ante* exemption and not a condition for being grandfathered, whereas the grandfathering exemption requires that a unit was "an existing facility on or before March 7, 2008."[20] Thus, if a facility has entered into an IFSA but is not an existing facility, then it is not automatically exempt because it is not an existing facility.

NRG also contends that there may be uncertainty about the application of the term "existing facility." NRG cites in support an example of a site for which there was an interconnection agreement and network upgrades, but no installed capacity facilities in place.[21]

---

18 2nd Compliance Filing, Services Tariff Attachment H § 4.5(g)(ii).

19 NRG Comments at 5-6.

20 2nd Compliance Filing, Services Tariff Attachment H § 4.5(g)(vii).

21 NRG Comments at 6-7.

As just discussed, if an Installed Capacity Supplier has entered into an IFSA then it is eligible to seek an exemption, but if it was not in existence on March 7, 2008, then it is not automatically exempt. Ultimately, given the limited and well-known set of ICAP suppliers in New York City, the NYISO does not believe there will be any serious controversy over the application of new Section 4.5(g)(vii).

Ravenswood asserts that the standards and procedures for application of the *ex ante* exemption should be the subject of further discussion with and input from the stakeholders, and that any exemption determination should be subject to challenge at the NYISO and before the Commission.[22] All decisions of the NYISO are subject to review by the Commission, however, and Ravenswood has not demonstrated that any special procedures are warranted for *ex ante* exemption determinations. Moreover, Ravenswood does not recognize that an exemption based on Unit Net CONE will involve highly sensitive, unit-specific cost information, and that the NYISO and the Commission would be obligated to respect a developer's request for stringent confidentiality protections for such information, particularly from competing ICAP suppliers.

The NYISO does not object to stakeholder discussion of the mechanics of implementing the *ex ante* exemption, potentially including issues identified by Ravenswood to the extent they are deemed relevant by the stakeholders, as long as such discussion is in the context of proposals that are consistent with the requirements of the March 7 Order. Any such discussion of implementation details would by its nature likely not involve matters that would rise to the level of tariff language, but in any event revisions to the tariff language proposed in the 2nd Compliance Filing should await the outcome and recommendations, if any, of any such

[22] Ravenswood Comments at 13-14.

stakeholder discussions. In the meantime, Ravenswood has not shown that any changes in the 2nd Compliance Filing tariff language are warranted.

C. Unit Net CONE Determinations

As discussed above, an Installed Capacity Supplier can obtain an *ex ante* determination that it is exempt from an Offer Floor if the average spot auction prices for the first three years after entry are projected to be higher than the anticipated Unit Net CONE. It can also seek a Offer Floor based on its Unit Net CONE if that is lower than the Offer Floor determined by 75% of Net CONE.[23]

Astoria contends that the same costs should be used when calculating a specific facility's Unit Net CONE as are used to calculate the Net CONE, citing Mr. Younger's affidavit.[24] Astoria's comment ignores the fact that the NYISO's proposal includes a unit-specific CONE determination precisely because a unit's CONE may differ from the *pro forma* CONE determined in the Demand Curve reset process. This is borne out by Mr. Younger's affidavit. Mr. Younger states that if a new entrant has a contract with a load serving entity, the NYISO should use the capacity price in the contract, with certain adjustments.[25] Such contract prices, however, would not play any role in the *pro forma* Net CONE determination. Mr. Younger's affidavit thus undercuts the premise of Astoria's comment. In reality, the NYISO will need to make a unit-by-unit, fact specific determination of Unit Net CONEs, just as currently is the case under the tariff for unit-specific cost-based reference levels for energy or ancillary services bids. This is simply not the same kind of determination as the *pro forma* determination of Net CONE in the Demand Curve reset process.

---

23 2nd Compliance Filing, Services Tariff Attachment H § 2.1.

24 Astoria Comments at 6.

25 Younger Affidavit ¶ 42.

Ravenswood points out that Unit Net CONE for a given unit will only be known when it is ready to commence commercial operations, and asserts that the NYISO should specify when an application for a reduced offer floor based on Unit Net CONE will be entertained.[26] But this comment essentially answers itself. As noted above, Unit Net CONE will necessarily be a unit-by-unit, fact specific determination. Consequently, it would be appropriate to entertain an application for an Offer Floor based on Unit Net CONE when the facts necessary to determine the Unit Net CONE can be determined, and this will be evident to both the NYISO and the applicant. Artificial *a priori* deadlines should not be imposed on legitimate, fact-based efforts to seek a lower Offer Floor based on Unit Net CONE.

Ravenswood requests a "transparent" review process for determining an Offer Floor based on Unit Net CONE, but again ignores the high commercial sensitivity of unit-specific cost information.[27]

D. Net CONE

In conformity to the March 27 Order, under the 2nd Compliance Filing the default Offer Floor is set at 75% of Net CONE (or at the Unit Net CONE, if lower), and a new entrant would be exempt from an Offer Floor if, with the inclusion of the new entrant, spot auction prices for the first year after entry are projected to be higher than the Offer Floor based on Net CONE.[28] The TO Comments argue that the Offer Floor based on Net CONE should be determined by taking 75% of the price on the New York City Demand Curve corresponding to 104% of the ICAP Requirement, not 100% of the requirement, which would result in a lower value for the Offer Floor. The TOs argue that the Demand Curve was set on the assumption that, because of

---

26 Ravenswood Comments at 16.

27 *Id*. at 13-14.

28 2nd Compliance Filing, Services Tariff Attachment H §§ 2.1 and 4.5(g)(ii).

the processes to ensure that capacity levels do not go below the minimum requirement, capacity in NYC will tend to fluctuate around a level at 104% of the requirement, not 100%. Thus, they claim that the Demand Curve is intended to produce sufficient net revenues to induce entry at 104% of the ICAP requirement.

The TOs mischaracterize the construction of the Demand Curves. In the 2nd Compliance Filing, "Net CONE" is defined as

> 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.[29]

In his affidavit in support of the October 4 Filing, Mr. Meehan explained that, in order to be revenue adequate, the levelized cost of a new unit had to be adjusted to reflect the systemic bias towards capacity levels not going below the minimum requirement:

> The objective of the ICAP Demand Curve is to induce new entry and to provide the new entrant with the expectation of sufficient revenue over time to cover its costs. As explained above, given the bias toward excess capacity, the new peaking unit could not be expected to receive the revenue implied by the net CONE figure over time. Hence, the ICAP Demand Curve would not incent sufficient new entry without an adjustment to the net CONE. This was explicitly accounted for in developing a levelized cost in the reset process. The economic methodology used to determine the levelization factor solved for an amortization period that would produce a levelized cost that would enable the new peaking unit to earn its cost of capital over an assumed 30 year physical life, recognizing that it would receive, on average, less than the net CONE.[30]

Accordingly, the Demand Curves reset "solved for an amortization period for New York City of 15.5 years."[31] Mr. Meehan testified that "levelizing investment costs over 15.5 years to determine the net CONE, considering that over time the price would clear below the net CONE,

---

29 2nd Compliance Filing, Services Tariff Attachment H § 2.1 (emphasis supplied).

30 October 4 Filing, Meehan Affidavit ¶ 26.

31 *Id.* ¶ 27.

would enable the peaking unit to earn its cost of capital over a 30 year life."[32] Accordingly, the 104% assumption referred to by the TOs and Mr. Caldwalader resulted in an adjustment to the levelized net CONE, rather than moving the net CONE cost recovery level down the Demand Curve to a price at 104% of the minimum requirement. As Mr. Meehan's affidavit in support of the NYISO's October 4, 2007 filing states: "The ICAP Demand Curve is intended to attract sufficient new generation from peaking units to maintain supply adequacy. To achieve this result, the net CONE established in the study, which is the estimated net cost for a new peaking unit, is used at 100% of the minimum requirement."[33] In sum, while the 104% average capacity level assumption resulted in an adjustment of the levelized net CONE number, it did not change the setting of the resulting net CONE at 100% of the minimum capacity requirement

The TOs' argument necessarily implies that at the minimum capacity requirement level, the Demand Curves produce revenues substantially in excess of the requirements of a new peaking unit. There is no support for this mischaracterization of the Demand Curves reset process. Furthermore, the TOs are trying to raise an issue that was decided in the March 7 Order. In addition to the statements from Mr. Meehan's affidavit cited above, in its reply to the comments on its filing giving rise to the March 7 Order, the NYISO stated that in the context of the proposed offer floor, "net CONE refers to the reference level at 100% of the minimum capacity requirement that is determined in setting the NYC demand curve."[34] The March 7 Order in turn states that: "The Commission accepts NYISO's proposal to set a net buyer offer floor equal to seventy-five percent of net CONE as a reasonable solution to forestall potential

---

32 *Id*.

33 *Id*. ¶17.

34 *New York Indep. Sys. Operator, Inc*., Docket No. EL07-39-000, Reply Comments of the New York Independent System Operator, Inc., at n.44 (Dec. 12, 2007).

uneconomic entry."[35] TOs' Net CONE arguments have no support in the records of the Demand Curve reset proceedings or of the proceedings on the In-City ICAP mitigation measures, including the March 7 Order.

E. Exports

The comments by the intervenors representing supplier interests do not seem to understand the NYISO's export mitigation proposal.

Contrary to the suppliers' assertions, no part of the NYISO's proposal for mitigation of capacity exports from New York City turns on comparing three year forecasts of forward prices in an external market with spot market prices in New York City, and subjecting suppliers to "draconian penalties" by second-guessing three-year price projections long after the fact.[36] Rather, mitigation turns on a supplier's conduct in the shortest term, organized external market that is closest in time to an In-City spot auction in which exported capacity was not offered. Correspondingly, as can be seen from a careful reading of the 2nd Compliance Filing, a supplier would not be subject to mitigation because of a decision to sell capacity into a three year forward external market.[37] Section 4.5(d)(i) of the proposed revisions to Attachment H of the Services Tariff states:

> External Sale UCAP shall be deemed to have been physically withheld if the price, net of costs that would not have been incurred but for the export or sale of External Sale UCAP, in the shortest term organized capacity market for the area in which the Mitigated UCAP has been exported or sold that is most proximate in time to an ICAP Spot Market Auction for the New York City Locality in which the External Sale UCAP was not sold, when adjusted to a comparable basis is five

---

35 March 7 Order at P 107.

36 Astoria Comments at 7, IPPNY Comments at 6, NRG Comments at 8.

37 *See* 2nd Compliance Filing at 12 (stating that: "Under the proposed tariff language, an entity could enter into a capacity sale in an external forward capacity market for a longer term than the periods covered by the NYISO's capacity auctions.").

> percent or more below the price, net of any costs that would have been incurred because of the comparable internal sale, in such ICAP Spot Market Auction.

This language clearly provides that, as stated in the 2nd Compliance Filing, "the price test focuses on the shortest-term organized capacity market in the external area that is most proximate in time to a New York spot market auction in which the Pivotal Supplier capacity was not offered."[38] This means that: "If a Pivotal Supplier has the ability but does not respond to New York spot prices that are higher by the specified bandwidth than the comparable prices in the relevant external short-term auction, then a conclusion of physical withholding would be appropriate."[39] No part of this test requires comparing three year forward external prices with short term internal prices.

Any price comparisons in the NYISO's proposal are essentially in the reverse direction from what the suppliers seem to suppose. The NYISO's proposal would require suppliers to compare prices in the shortest-term external market with anticipated prices in the most proximate New York City spot auction, particularly if the shortest term external market is for a longer period than a month. For example, assume the shortest term organized external market is for three months. Faced with the opportunity to purchase capacity in that market to fulfill its capacity obligation in the external market, a Pivotal Supplier would need to seek to buy in that market at any price below the anticipated New York City spot auction prices for the same period, with the benefit of a 5% bandwidth to provide a reasonable margin for error.

Properly understood, the NYISO's proposal would require a Pivotal Supplier to buy capacity in the external market to satisfy its external obligation if such capacity is available at a lower price than in New York City, and then make short-term sales of its New York City

---

38 2nd Compliance Filing at 12.

39 *Id.*

capacity in the New York City spot auction. If capacity is available in a short term external market at a price below the New York City spot auction price, there is no economic justification for a Pivotal Supplier not to take advantage of the lower-priced capacity to satisfy its external obligations, unless the Pivotal Supplier were seeking to use its market power to raise capacity prices in New York City. Moreover, this would be true whether or not the external market is "robust" or "thinly traded."[40] The only relevant fact is whether capacity is in fact available at a price below the short-term New York City price. It would be a Pivotal Supplier's failure to take advantage of the opportunity in the external market that would warrant mitigation, if the failure has the requisite price effects in New York City, not the supplier's initial decision to sell into an external forward market. Not surprisingly, the suppliers advance no economic justification for not buying capacity to satisfy an external position at a lower price in order to sell in New York City at a higher price.

The NYISO proposal would not put suppliers or external buyers in an "untenable" position, or compromise reliability in any market, external or internal, nor would a supplier have to choose between incurring significant penalties in the NYISO market or terminating a capacity market commitment in a neighboring market and incurring penalties in that market. [41] Contrary to NRG's suggestion, the NYISO mitigation proposal is not predicated on "terminating" an external position, but on satisfying the external capacity obligation with purchases on the short-term external market, thus freeing capacity for short term sales in New York City. [42] Again, this is no more than economically rational behavior—except for a Pivotal Supplier seeking to exploit its market power.

---

40 Astoria Comments at 8, Younger Affidavit ¶ 23.

41 NRG Comments at 8, 9-10.

42 *Id*. at 9.

The thresholds in the NYISO's proposal have not been shown to be unreasonably low. Astoria and its witness Mr. Younger, seconded by IPPNY, urge substantially higher thresholds (the greater of $2/kW-month or 15%) than those proposed by the NYISO (five percent or more, provided such increase is at least $.50/kilowatt-month).[43] All three, however, start from the premise, shown above to be false, that the NYISO's proposal requires forecasting prices three years ahead. Moreover, a 15% price increase threshold would allow each Pivotal Supplier to withhold as much as 220 megawatts with impunity from New York City. The suppliers' comments do not show that it would be fair or equitable to allow Pivotal Suppliers such a substantial free pass to engage in physical withholding.

The contentions of Astoria and its witness Mr. Younger that the proposed penalties for physical withholding through uneconomic exports are "exorbitant" are also based on a false premise.[44] Mr. Younger's analysis proceeds from a hypothetical that posits that

> unless the In City Supplier was able to find a counterparty with which to enter into a bilateral transaction -- again, at likely a very significant premium -- the In City Supplier would be unable to reverse its capacity position in PJM by the time the NYISO determined that a penalty was appropriate. Thus, penalties could continue to accumulate for the remainder of the summer and most likely for the winter as well.[45]

Contrary to Mr. Younger's contention, the NYISO's proposal is not predicated on forcing an exporter from New York City to find a "counterparty" to a "bilateral transaction" in order to "reverse its capacity position in PJM." Rather, as discussed above the NYISO's proposal is premised on economically rational bids to purchase in a short-term external capacity auction. If those bids are accepted when the external price is below the New York City price, or if they are

---

43 Astoria Comments at 12, IPPNY Comments at 7, Younger Affidavit ¶ 38.

44 Astoria Comments at 10.

45 Younger Affidavit ¶ 33.

not accepted because the external short-term price is above the spot auction price in New York City, then no withholding penalty would be assessed. Contrary to the assertions of Astoria and Mr. Younger that the proposed penalties are "exorbitant," as stated in the NYISO's 2nd Compliance Filing: "As with other physical withholding penalties in the MMM, since physical withholding can have a large impact on capacity customers, a relatively large penalty is appropriate to deter such withholding from occurring in the first place, while the bandwidths place reasonable bounds on application of [a] penalty."[46]

Astoria and Mr. Younger argue that to be proportional to the harm caused by a supplier's actions, the penalty should based on the price difference caused by the supplier:

> Thus, Astoria Generating proposes that the penalty structure be based on 1.5 times the lesser of: (i) the difference between the clearing prices in the NYC Spot Market Auction with and without the export; or (ii) the difference between the NYC Spot Market Auction clearing price and the neighboring region's adjusted clearing price. This difference would then be multiplied by the In City Supplier's residual NYC portfolio.[47]

In considering whether this is a reasonable alternative penalty structure, the Commission should evaluate whether this lower penalty level provides a sufficient deterrent to physical withholding, and is proportional to the likely effects on buyers of physical withholding. The Commission should also consider the relationship between the penalty and the price effects threshold discussed above. The NYISO does not believe it would be reasonable both to lower the penalty and significantly raise the price effects threshold to the levels advocated by Astoria and Mr. Younger. It may be reasonable, however, to consider initially adopting a lower penalty level, with an option for the NYISO to return to the Commission to seek a higher level if a

---

46 2nd Compliance Filing at 12.

47 Astoria Comments at 13 (emphasis removed); Younger Affidavit ¶ 39.

penalty based on price differences as advocated by Astoria and Mr. Younger proves not to provide a sufficient deterrent.

The suppliers' assertion that an *ex ante* consultation process is required for comparable treatment of buyers and sellers is likewise based on a false premise. The suppliers assert that both new entrants and exporters are faced with comparable long-term financial commitments, and thus both need a long-term *ex ante* exemption procedure in order to be treated on a comparable basis.[48] The NYISO would agree that a relatively long term forward-looking *ex ante* exemption for new entry is necessary because a decision to commit to a new generator would necessarily be made several years in advance of the commercial operation of the plant.[49] As discussed above, however, mitigation of exports does not turn on a decision to sell into a three year forward market, but on a decision not to buy in the shortest term external market closest in time to a New York City spot auction. The two situations are very different.

While the supplier protests are otherwise significantly flawed, the NYISO would agree with Ravenswood that "exports of capacity from New York City to neighboring ISOs are not viable at present."[50] The NYISO would also agree that this presents an opportunity for further stakeholder discussions of the implementation details of the proposed mitigation, including, for example, appropriate methodologies for comparing prices in short term external markets and New York City spot auction prices. In the meantime, however, the protests have not shown that any changes in the tariff language submitted with the NYISO's 2nd Compliance Filing are warranted.

---

48 Ravenswood Comments at 18, IPPNY Comments at 7, NRG Comments at 10.

49 *See* October 4 Filing at 29-30.

50 Ravenswood Comments at 17.

F. Opportunity Costs in Reference Prices

The definition of Going-Forward Costs in the tariff language submitted with the 2nd Compliance Filing specifies that such costs can be determined by "the opportunity costs of foregone sales outside of the New York City Locality, net of costs that would have been incurred as a result of the foregone sale if it had taken place."[51] NRG asserts that the Commission should clarify that a reference price based on opportunity cost allows bidding based on the clearing price in a neighboring market, minus costs, without the generator having a firm commitment to export.[52]

The thrust of NRG's comment is not clear. If NRG is concerned that opportunity costs would not be included in Going-Forward Costs unless a commitment to export has actually been made, that concern is unfounded. Going-Forward Costs are only used to determine reference levels for capacity offers made in a New York City spot auction. That necessarily implies that the relevant capacity would be sold in New York City, not externally. At the same time, however, there has to be a real opportunity to export that would be foregone to make such a sale in New York City. As Ravenswood points out, "exports of capacity from New York City to neighboring ISOs are not viable at present."[53] This being the case, if NRG means that Going-Forward Costs should currently be based on external prices even though exports "are not viable at present," its comment is not well founded, because there can be no opportunity cost unless there is an opportunity.

---

51 2nd Compliance Filing, Services Tariff, Attachment H § 2.1.

52 NRG Comments at 11.

53 Ravenswood Comments at 17.

G. Market-Distorting Imports

NRG asserts that a supplier in a higher value market, such as PJM, may have an incentive to export its capacity to a lower value market, such as New York, if the importer into New York could significantly raise the price of its remaining capacity in PJM. NRG asserts that the NYISO should therefore closely monitor and report to the Commission on "imports of capacity that appear to be uneconomic and thus an attempt to manipulate market prices in New York."[54]

The NYISO's MMU is always alert for efforts to distort New York markets, but its ability and authority to monitor for market power abuse affecting external markets is limited. NRG contends that a supplier in a higher value market, such as PJM, may have an incentive to export its capacity to a lower value market, such as New York, if the import into New York would significantly raise the price of its remaining capacity in PJM.[55] The conduct NRG describes would be an effort to exercise market power in the PJM market, not the New York City market. NRG does not specify how the NYISO would determine whether an entity PJM was attempting to artificially increase prices in PJM, nor does NRG adequately credit PJM's monitoring of the capacity market it administers.

The alternative concern, which could constitute an abuse of market power in the New York City market, is uneconomic entry, but that is the concern addressed by the 2nd Compliance Filing. More generally, capacity imports at present are only feasible in the Rest of State area. Rest of State market issues are beyond the scope of this compliance filing, which is limited to market power mitigation in the New York City capacity market.

---

54 NRG Comments at 12 -14.

55 *Id*. at 12.

H. Penalties Imposed As a Result of Inadvertent Errors

NRG continues to express concern with the possible imposition of penalties as a result of inadvertent or otherwise assertedly unintentional withholding by a Pivotal Supplier.[56]

The NYISO's proposed threshold of a 5% or greater price effect before penalties would be imposed specifically addresses these concerns. NRG has not explained how a Pivotal Supplier, by definition a large and presumably sophisticated entity, could inadvertently withhold over 56 MW, or how, in a constrained market, such withholding would not have significant price effects that would warrant the imposition of mitigation measures.

NRG also continues to advocate an automatic default bid at $0 price for any must-offer capacity not offered by a Pivotal Supplier.[57] If NRG believes that there is widespread support for its $0 default bid proposal, it is of course free to pursue the implementation of such a proposal in the stakeholder process. NRG's concerns may be significantly ameliorated, however, by the fact that, in response to the concerns voiced by NRG, in June the NYISO is planning to deploy modifications to the ICAP automated software that will enable a supplier to view its current market position based on offers submitted during the auction offer period. In contrast to the current limitation on viewing MWs offered, the June modification will permit Pivotal Suppliers to see that all capacity potentially subject to mitigation has been offered.

III. Conclusion

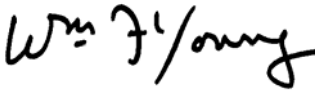
WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission accept its response to the May 27 Filings, and that the points set forth above be considered in the Commission's evaluation of the NYISO's 2nd Compliance Filing.

---

56 *Id*. at 13-14.

57 *Id*. at 14.

Respectfully submitted,



William F. Young
Hunton & Williams LLP
1900 K Street, NW
Washington, DC 20006-1109
(202) 955-1500

Dated: June 11, 2008

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 this proceeding in accordance with the requirements of Rule 2010 of the Rules of Practice and Procedure, 18 C.F.R. § 385.2010.

Dated at Washington, DC this 11th day of June, 2008.

/s/ William F. Young
William F. Young
Hunton & Williams LLP
1900 K Street, NW
Washington, DC 20006-1109