

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

New York Independent System Operator)	Docket No. ER00-1969-019
)	
Niagara Mohawk Power Corporation)	Docket No. EL00-57-003
v.)	
New York Independent System Operator)	
)	
Orion Power New York GP, Inc.)	Docket No. EL00-60-003
v.)	
New York Independent System Operator)	
)	
New York State Electric & Gas Corporation)	Docket No. EL00-63-003
v.)	
New York Independent System Operator)	
)	
Rochester Gas and Electric Corporation)	Docket No. EL00-64-003
v.)	
New York Independent System Operator)	

**REQUEST FOR REHEARING OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.**

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure¹ and Section 313(a) of the Federal Power Act,² the New York Independent System Operator, Inc. ("NYISO") respectfully requests rehearing of the Commission's decision in the Order on Remand in the above dockets ("March 4 Order")³ not to order refunds in connection with the interdependent determination of the prices of spinning operating reserves ("SR") and non-spinning operating reserves ("NSR"). The Commission's decision not to order refunds ignores the market manipulation that dramatically increased NSR prices in the refund period. Accordingly, the

¹ 18 C.F.R. §§ 385.713.

² 16 U.S.C. § 8251(a).

³ *New York Independent System Operator, Inc.*, 110 FERC ¶ 61,244 (2005).

Commission's decision on refunds was not consistent with its obligation to ensure that prices in jurisdictional markets are just and reasonable.

I. BACKGROUND

This case arises from the substantial and unjustified increases in prices for NSR that resulted from the high levels of supplier concentration and the withholding of bids experienced in the NYISO-administered operating reserves markets during the period from January 29 to March 27, 2000 ("Relevant Period").⁴ The Commission's initial order recognized the unprecedented manipulation of NSR prices to extraordinarily high and non-competitive levels, and authorized the prospective imposition of caps on NSR bids as a result.⁵ The denial of refunds in the March 4 Order, however, loses sight of the unprecedented conditions that prevailed during the Relevant Period, and erroneously characterizes NSR prices during this period as "efficient." Contrary to the Commission's conclusion, a refund should be required, in order to minimize, to the extent possible, the impact of manipulated NSR prices on New York ratepayers.

In *Consolidated Edison Co. v. FERC*,⁶ the Court remanded the Commission's decisions in these dockets for, among other things, a determination of whether refunds should be required as a result of the Court's determination that the NYISO's interdependent determination of prices for NSR and SR during the Relevant Period violated the then-effective provisions of the

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

⁵ *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 (2000) ("May 31 Order").

⁶ 347 F.3d 964 (D.C. Cir. 2003) ("ConEd Decision").

NYISO's tariff.⁷ As stated in the March 4 Order, interdependent pricing of NSR and SR meant that: "In circumstances when the highest offer to provide NSR was higher than the highest offer to provide SR, as happened in the period in issue here, NYISO permitted the highest offer to provide NSR to be the clearing price for both NSR and SR."⁸ Thus, during the Relevant Period, prices for all operating reserves were determined by the marginal bid for NSR. In the March 4 Order, the Commission found that refunds should not be required, notwithstanding that "the Commission's general policy is to provide refunds for a violation of the filed rate doctrine"⁹

The Commission's refund decision in the March 4 Order ignores the distortions in NSR prices during the Relevant Period. Indeed, the Commission effectively rewards the manipulation of NSR prices by allowing NSR prices to set the market clearing prices for all operating reserves, when under the Court's controlling interpretation of the tariff, the Commission has a clear opportunity to prevent this outcome. As a result, the Commission's denial of refunds for the interdependent pricing of NSR and SR ignores its obligation, and its opportunity, to ensure that, as much as practicable, operating reserves prices in the Relevant Period were just and reasonable.

II. REQUEST FOR REHEARING

A. The Commission Must Meaningfully Respond to the Evidence Presented

Both the Supreme Court and the D.C. Circuit have held that the Commission must give reasoned consideration to the evidence presented, including specifying the evidence on which it

⁷ *Id.* at 966-67.

⁸ March 4 Order P 28.

⁹ *Id.* P 64.

relies and explaining how that evidence supports the Commission's conclusion.¹⁰ This also means that, in order to avoid being arbitrary and capricious, the Commission must "respond meaningfully to the evidence,' [and] 'answer[] objections that on their face appear legitimate'"¹¹ Moreover, the March 4 Order recognizes that the Commission would have discretion to order refunds in this case.¹² Here, the Commission did not meaningfully respond to its own findings that the prices of non-spinning reserves were distorted by market power.¹³

B. The Commission's Decision not to Require Refunds Ignores the Manipulation of Non-Spinning Reserves Prices to Inefficient, Non-Competitive Levels

The Commission declined to order refunds for the interdependent pricing of SR and NSR on the theory that interdependent pricing produced "efficient prices." The Commission reasoned that the "NYISO's [interdependent pricing] policy did not provide an improper windfall, because it was the proper and appropriate pricing method that provided *efficient prices* for the least cost dispatch."¹⁴ The Commission went on to state:

NYISO uses a security-constrained, bid-based, least-cost dispatch that maximizes net benefits for all market participants. In those cases where a non-spinning reserve bid is higher than a spinning reserve bid, least-cost dispatch would require

¹⁰ See, e.g., *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (stating that an agency "must examine the relevant data and articulate a satisfactory explanation for its action Normally, an agency rule would be arbitrary and capricious if the agency . . . entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before it"); *Tarpon Transmission Co. v. FERC*, 860 F.2d 439, 445 (D.C. Cir. 1988).

¹¹ *KeySpan-Ravenswood, LLC v. FERC*, 348 F.3d 1053, 1056 (D.C. Cir. 2003) (quoting *Tesoro Ala. Petroleum Co. v. FERC*, 234 F.3d 1286, 1294) (D.C. Cir. 2000)).

¹² March 4 Order P 63.

¹³ See *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964, 969 (D.C. Cir. 2005) ("[T]he Commission's contradiction of its prior rulings . . . is the epitome of agency capriciousness.") (citing *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 57).

¹⁴ March 4 Order P 65 (emphasis supplied).

that the higher-valued, lower-bid spinning reserve be substituted for non-spinning reserves and set the market clearing price for both spinning and non-spinning reserves. *Efficient pricing* requires that suppliers receive the highest market value for their resources, independent of their bids. This gives all sellers the proper incentive to offer their resources at the marginal cost of their highest valued use, in this case spinning reserves. Generators able to provide spinning reserves should bid their marginal cost for providing spinning reserves without having to guess whether they could receive a higher price by instead bidding non-spinning reserves.¹⁵

Based on these findings, the Commission concluded that:

Consistent with *efficient pricing*, NYISO's payment actions assured suppliers of spinning reserves that they would receive the highest market value for their product *if they offered their product competitively* into the more valued reserve market. Paying a lower price for spinning reserves than for non-spinning reserves would not provide the highest market value to suppliers of spinning reserves and would be inconsistent with a *competitive market result*.¹⁶

The problem with the Commission's reasoning is that NSR prices plainly were not "efficient" or "competitive" during the Relevant Period. To the contrary, as recognized in the March 4 Order, the "NYISO had successfully shown that market-determined rates for NSR were no longer appropriate, because 'capacity that was previously offered to the market is no longer being offered and that the decline in supply offers correlate[d] with a dramatic increase in bid prices.'"¹⁷ The March 4 Order further recognized that the "Commission found that the problems in the NSR market were largely the result of high levels of concentration in the market"¹⁸ As a result "prices in the bid-based market for NSR rose dramatically," and "spiked from averages of \$1.04 per megawatt hour (MWH) in December 1999 to an average of \$65.57 in

¹⁵ *Id.* (emphasis supplied).

¹⁶ *Id.* (emphasis supplied).

¹⁷ March 4 Order P 11 (quoting *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 at 61,799 (2000) ("May 31 Order"), *reh'g denied*, 97 FERC ¶ 61,155 (2001), *reh'g denied*, 99 FERC ¶ 61,125 (2002)).

¹⁸ March 4 Order P 11.

February 2000, with a high of \$302 that month. Also at that time, the quantity of NSR that suppliers offered into the market decreased.”¹⁹ The Commission authorized the imposition of a NSR bid cap from the end of March 2000 forward, but the “dramatically” high price spikes during the Relevant Period were left unchanged.

Thus, the Commission’s own findings about conditions in the operating reserves market during the Relevant Period conclusively establish that pricing operating reserves at the level of NSR prices during the Relevant Period would not be “efficient,” nor consistent with a “competitive market result.” To the contrary, setting operating reserves prices at NSR price levels during the Relevant Period would only ensure that operating reserves prices were inefficient and not competitive.

The March 4 Order correctly describes the virtues of interdependent reserves pricing, “if [suppliers] offered their product competitively into the more valued reserve market.”²⁰ Thus, subsequent to the Relevant Period, when NSR prices were subject to a bid cap as a result of the high concentration levels among NSR suppliers, interdependent reserves pricing had, and continues to have, all of the benefits ascribed to it in the March 4 Order. During the Relevant Period, however, the critical condition precedent of competitive market conditions for efficient interdependent operating reserves pricing was, by the Commission’s own findings, simply not present. Moreover, granting refunds will not create “perverse incentives,” as suggested in the March 4 Order,²¹ since the refunds would relate only to a discrete historic period, and the NYISO’s tariff was revised after the Relevant Period to incorporate explicitly interdependent

¹⁹ *Id.* P 8.

²⁰ *Id.* P 65.

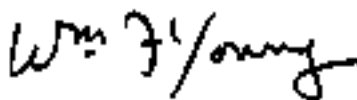
²¹ *Id.* P 70 and n.77.

pricing of NSR and SR.²² There is no basis on which to conclude that a refund determination for a long-past historic period would have any incentive effect on current bidding behavior. Since NSR prices during the Relevant Period were not at efficient, competitive levels, but were instead at artificially high levels as a result of undue concentration in the NSR market, the Commission should use its discretion to order refunds for the interdependent pricing of NSR and SR during the Relevant Period.

III. CONCLUSION

For the reasons set forth above, the NYISO respectfully requests the Commission to grant rehearing of its decision in the March 4 Order denying refunds for the interdependent pricing of NSR and SR during the Relevant Period. On rehearing, the Commission should exercise its discretion to order refunds in order to fulfill its statutory obligation to ensure that wholesale prices are just and reasonable.

Respectfully submitted,



Counsel for
New York Independent System Operator, Inc.

²² See *New York Independent System Operator, Inc.*, Docket No. ER00-1969-001 (June 15, 2000), at Attachment I (Services Tariff, Rate Schedule 4 at Original Sheet No. 137A (effective May 31, 2000)).

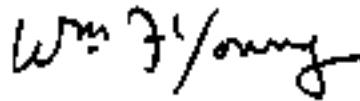
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April 4, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 385.2010.

Dated at Washington, D.C. this 4th day of April 2005.



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