

requirements with regard to self-supply. In addition, we address the concerns of related complaints.

Background

In Central Hudson Gas & Electric Corporation, et al. (Central Hudson),¹ the Commission accepted the New York ISO Member Systems' proposal to sell operating reserve service under market-based rates, effective November 18, 1999. With its approval, the Commission explained that, if the ISO detects the exercise of market power in the operating reserves market, the ISO will have the obligation to report to the Commission and recommend appropriate steps to mitigate such behavior.

The New York ISO's proposal categorized available operating reserves resources as 10 minute spinning reserve,² 10 minute non-spinning reserve,³ and 30 minute reserve,⁴ and created corresponding, bid-based markets for these resources. Generating resources bid into these markets, and the ISO selects these bids in a least-cost manner. Market participants who choose to purchase operating reserve service from the ISO share in an allocation among all market participants of the cost necessary to procure enough reserves to meet reliability requirements. However, market participants may also choose to self-supply or purchase operating reserves from a third party.

The New York ISO's instant filing

In its submittal on March 27, 2000, the New York ISO claims that it has recently observed bidding patterns into the 10 minute non-spinning reserves markets east of its central east transmission constraint that indicate the exercise of market power. The New

¹86 FERC ¶ 61,062 (1999)

²Spinning reserves are defined in Schedule 5 of the New York ISO OATT as operating reserves “already synchronized to the New York Power System and [.. .] able to respond to instructions to change output level within 10 minutes.”

³ 10 minute non-spinning reserves are defined in Schedule 5 of the New York ISO OATT as operating reserves “provided by generation facilities that can be started, synchronized and loaded within 10 minutes.”

⁴ 30 minute reserves are defined in Schedule 5 of the New York OATT as operating reserves “provided by generation facilities and interruptible load resources that can respond to instructions to change output level within 30 minutes.”

York ISO concludes that these patterns demonstrate that this market is no longer workably competitive. The ISO notes that, prior to January 29, 2000, on average more than 1400 MW of 10 minute non-spinning reserves were being offered into the market east of the constraint. On January 29, the quantity being offered dropped below 900 MW, or less than 40 percent of the total of 2359 MW of 10 minute non-spinning reserves capability east of the constraint, and remained below the prior average levels for the remainder of the period. In addition to a decline in the quantity of bids, the offer prices for 10 minute non-spinning reserves rose substantially during the same time period. Prior to January 29, the New York ISO states that the 10 minute non-spinning reserves market cleared at between \$0 and \$2.52,⁵ with an average price, for example, of \$1.06 for December. In February, however, the average price for non-spinning reserves climbed to \$65.57, reaching a high of \$302 on February 13. The New York ISO states that the quantity of 10 minute non-spinning reserves being offered at less than \$30 dropped from a high of over 1200 MW prior to January 29 to a subsequent low of just over 300 MW. After January 29, the quantity offered at less than \$30 was frequently below 400 MW or less, went above 500 MW only after March 10, and even then went above 600 MW on only four days.

There are several key characteristics of the New York ISO's operating reserves markets that magnify the effects of these bidding activities. In particular, its operating reserves markets are affected by the above-mentioned transmission constraint in its central east sector, which limits the availability of generating resources in the western regions to reliably provide operating reserves for loads in the east.⁶ The New York ISO therefore attempts to ensure that the current state-wide reliability requirement for operating reserves of 1200 MW is met wholly with supplies located on the eastern side of the central east transmission constraint. Reliability rules mandate that the New York ISO must fulfill at least 50 percent of the requirement of 1200 MW with 10 minute spinning reserves, which are the highest quality of operating reserves available. The New York ISO may use 10 minute spinning or 10 minute non-spinning reserves to fulfill the other half of the requirement. In addition, the New York ISO notes that the market for 10 minute non-spinning reserves east of the constraint is highly concentrated, with three entities (KeySpan-Ravenswood, Inc. (KeySpan), The Long Island Power Authority and LIPA (LIPA), and NRG Power Marketing, Inc. (NRG)) controlling 97 percent of such capacity.

⁵The prices referenced throughout this order are consistently stated in \$/MW for one hour of service.

⁶The central east transmission constraint affects the flow of power from west to east and does not hinder the ability of eastern supplies to reach the west.

The New York ISO notes that problems in its 10 minute non-spinning reserve markets have affected its 10 minute spinning reserve markets as well. When the New York ISO chooses to substitute 10 minute spinning reserves for 10 minute non-spinning (to meet the remaining 50 percent of its reliability requirement), it sets the market clearing price for spinning reserves at the highest bid accepted in the 10 minute non-spinning reserves market. The New York ISO asserts that this method is necessary to reflect the superior quality of 10 minute spinning reserves and to not allow the price for spinning reserves to fall below that of 10 minute non-spinning reserves. Furthermore, the New York ISO argues that this method is consistent with the Commission's requirements.⁷ Therefore, the end result of the bidding activity in the 10 minute non-spinning reserves market was to drive up the prices for all 10 minute reserves. The New York ISO notes that the total cost to load serving entities purchasing 10 minute reserves through the New York ISO rose by approximately \$65 million from January 29 through March 10, 2000.

The New York ISO's proposed remedy

The New York ISO requests authority to suspend the use of market-based bids for operating reserves until those markets can be demonstrated to be workably competitive. The New York ISO also requests authority to re-bill for the costs of operating reserves during the period from March 1 through March 28, when the highest prices in reserves were experienced, based upon a weighted average of operating reserves prices from previous periods. In addition, the New York ISO requests the implementation of a settlement process, in accordance with the Commission's alternative dispute resolution (ADR) procedures, in order to address, among other things, whether the pricing of 10 minute reserves has been at proper levels since January 29. The New York ISO requests an effective date of March 28, 2000, one day after its filing for the proposed bid caps.

In lieu of market-based bids, the New York ISO proposes to impose a bid cap of \$2.52 for eastern 10 minute non-spinning reserves suppliers, and a cap equal to verifiable fuel costs (plus any applicable opportunity costs) for eastern suppliers of 10 minute spinning reserves. In addition, the New York ISO proposes to impose a mandatory bid requirement which requires that all available capacity held by eastern suppliers of spinning and 10 minute non-spinning reserves, and that is not subject to a *bona fide* outage or conflicting contractual obligation, be bid into the market.

⁷The New York ISO notes that the Commission, in Central Hudson, directed that the proposed New York ISO tariff be "modified to permit the ISO to procure more of a 'higher quality' category of reserves and procure correspondingly less of a 'lower quality' when to do so would lower total cost."

In support of its cap of \$2.52 on 10 minute non-spinning reserves, the New York ISO notes that this price is the highest market clearing price for 10 minute non-spinning reserves during the period from the start of the 10 minute non-spinning reserves market, on November 18, 1999, to the time when the anomalous bidding and pricing started to occur, on January 29, 2000. The New York ISO argues that, since the incremental costs of providing 10 minute non-spinning reserves should be quite low, and since \$2.52 was the highest market-clearing price observed during the period when the market appeared to be functioning normally, using it as an upward limit on bids ensures that sellers are adequately compensated. With respect to the cap of verifiable fuel costs on 10 minute spinning reserves, the New York ISO notes that this bid cap is consistent with the approach approved by the Commission in Consolidated Edison Company of New York, Inc., (Con Ed).⁸ In addition, to ensure that a 10 minute spinning reserve supplier is made whole, the New York ISO states that, under the New York ISO Market Administration and Control Area Services Tariff (ISO Services Tariff), a unit providing 10 minute spinning reserves will be paid its lost opportunity cost based on the cost of energy it could have otherwise sold in the real-time market. The New York ISO argues that its proposed bid cap on 10 minute spinning reserves is necessary in order to preclude unanticipated consequences due to the relationship in price performance between the two markets. The New York ISO proposes to keep these caps in place until the market can be demonstrated to be workably competitive again.

Related Complaints

We note that several complaints have been filed that raise issues substantively related to the New York ISO's filing.

Docket No. EL00-57-000

On March 24, 2000, Niagara Mohawk Power Corporation (NIMO) filed a complaint in Docket No. EL00-57-000, alleging that the New York ISO had refused to permit NIMO to self-supply operating reserves without having to participate in the New York ISO's market for operating reserves. NIMO requests that the Commission: (1) direct the New York ISO to allow NIMO to self-supply operating reserves; (2) initiate a formal complaint proceeding concerning the recent increases in the prices for operating reserves; (3) permit NIMO to conduct discovery into, and present findings of, the generators supplying operating reserves; and (4) establish the earliest possible refund effective date in the proceeding applicable to NIMO's payments to the New York ISO for operating reserves and to the New York ISO's payments to suppliers of operating reserves.

⁸84 FERC ¶ 61,287 (1998)

Docket No. EL00-60-000

On March 31, 2000, Orion Power New York GP, Inc. (Orion) filed a complaint requesting fast track processing and an emergency order requiring the New York ISO to cease and desist from implementing its market mitigation measures for 10 minute reserves. Orion filed its complaint under Section 206 of the Federal Power Act alleging that the New York ISO had implemented its proposal to suspend market-based bids for 10-minute operating reserves and to impose bid caps without Commission approval. Orion argues that emergency relief is warranted because, for the purposes of calculating appropriate refunds, there will be no way to step back in time to determine what the market rates would have been without the New York ISO's actions. Finally, Orion claims that the New York ISO's actions could cost market participants thousands of dollars in lost revenue by capping the bids. In particular, Orion notes that its affiliated power supplier in New York City, Astoria Generating Company, L.P., stands to lose thousands of dollars per day related to the 100 MW of operating reserves it would otherwise be able to provide at market-based rates.

Docket No. EL00-63-000

On March 31, 2000, New York State Electric & Gas Corporation (NYSEG) filed a complaint in Docket No. EL00-63-000, alleging that, in addition to highly concentrated markets, there are market design flaws that compound the recent problems in the operating reserves market. NYSEG argues that the New York ISO has the authority to correct for market design flaws in the operating reserves market under the Temporary Extraordinary Procedures for Correcting Market Design Flaws and Addressing Transitional Abnormalities (TEP) of its Open Access Transmission Tariff (OATT), which the Commission accepted in New York Independent System Operator, Inc., et al.⁹ NYSEG requests that the Commission: (1) compel the New York ISO immediately to place market participants on notice that extraordinary corrective action will be implemented in regard to operating reserves services, retroactive to New York ISO startup and to issue rebills to reverse all erroneously high charges; (2) consolidate its complaint with all other New York ISO proceedings; (3) promptly initiate a settlement process facilitated by its dispute resolution service to determine whether an expedited resolution may be achieved; (4) establish the earliest possible refund effective date in the proceeding and that this date be applicable to NYSEG's payments to the New York ISO for operating reserves and to the New York ISO's payments to suppliers of operating reserves; (5) permit NYSEG to conduct discovery of the New York ISO and any generators supplying operating reserves to the New York ISO and present any evidence to the Commission of any changes that must be made to the New York

⁹88 FERC ¶ 61,228 (1999).

ISO OATT, ISO Services Tariff and/or the New York ISO's procedures; (6) to the extent that it determines that these increases are due to a misinterpretation or misapplication of the New York ISO tariffs, or to any other abuse prohibited by the FPA or the Commission's rules and regulations, investigate the basis upon which market-based rate authority was previously granted; and (7) order the parties engaging in such conduct to immediately cease and desist and to provide full restitution to the New York ISO and/or to NYSEG all overcharges for operating reserves.

Docket No. EL00-64-000

On April 7, 2000, Rochester Gas & Electric Corporation (Rochester G&E) filed a complaint in Docket No. EL00-64-000. Rochester G&E requests that the Commission: (1) compel the New York ISO to place market participants on immediate notice that extraordinary corrective action will be implemented in regard to operating reserves services, retroactive to the New York ISO startup date, and to issue rebills to reverse all erroneously high charges; (2) consolidate its complaint with the NYSEG complaint, the NIMO complaint, and the New York ISO's filing; (3) compel the New York ISO to permit load-serving entities to self-supply operating reserves; (4) initiate an expedited formal complaint proceeding concerning the recent increases in the prices for operating reserves; and (5) to the extent that it determines that these increases are due to a misinterpretation or misapplication of the New York ISO tariffs or to any other abuse prohibited by the FPA or the Commission's rules and regulations, order the parties engaging in such conduct to immediately cease and desist and to provide full restitution to the New York ISO and/or to Rochester G&E for all overcharges for operating reserves; and (6) establish the earliest possible refund effective date in this proceeding and that this refund effective date be made applicable both to Rochester G&E's payments to the New York ISO for operating reserves and the New York ISO's payments to suppliers of such operating reserves under the New York ISO's tariff.

Notice of Filing, Interventions, Protest, and Comments

Notice of the New York ISO's filing in Docket No. ER00-1969-000 was published in the Federal Register, 65 Fed. Reg. 19371 (2000), with protests and motions to intervene subsequently required to be filed on or before April 10, 2000. Timely motions to intervene were filed by entities listed in Appendix A to this order.

Notice of the complaint filed by NIMO in Docket No. EL00-57-000 was published in the Federal Register, 65 Fed. Reg. 17493 (2000), with protests, motions to intervene, and answers subsequently required to be filed on or before April 10, 2000. Timely motions to intervene were filed by entities listed in Appendix B to this order.

Notice of the complaint filed by Orion in Docket No. EL00-60-000 was published, with protests, motions to intervene, and answers due on or before April 10, 2000. Timely motions to intervene were filed by entities listed in Appendix C to this order.

Notice of the complaint filed by NYSEG in Docket No. EL00-63-000 was published in the Federal Register, 65 Fed. Reg. 19,747 (2000), with protests, motions to intervene, and answers due on or before April 13, 2000. Timely motions to intervene were filed by entities listed in Appendix D to this order.

Notice of the complaint filed by Rochester G&E in Docket No. EL00-64-000 was published in the Federal Register, 65 Fed. Reg. 20152 (2000), with protests, motions to intervene, and answers due on or before April 20, 2000. Timely motions to intervene were filed by entities listed in Appendix E to this order.

Discussion

I. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (1999), the timely, unopposed motions to intervene of the entities listed in the appendices to this order serve to make them parties to the proceeding(s) in which they intervened. At this early stage of the proceeding, given the lack of undue prejudice or delay and given the parties' interests, we also find good cause to grant under Rule 214 the unopposed, untimely motions to intervene in these proceedings.

Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. 385.213(a)(2) (1999), prohibits the filing of an answer to a protest unless otherwise permitted by the decisional authority. However, we found the New York ISO's Answer of April 27, 2000, useful in addressing the issues arising in these proceedings.

Several parties have filed motions to consolidate the New York ISO's tariff filing proceeding in Docket No. ER00-1969-000 with one or more of the complaint proceedings listed in the caption of this order. There is a substantial overlap of issues between the tariff filing and each of the complaints listed. However, since the Commission is not establishing any adjudicatory proceedings at this time, the Commission will not now consolidate these proceedings.

II. Evidence of Concentrated Markets and Design Flaws in New York's Operating Reserves Market

Protests and Comments

Certain intervenors argue that the New York ISO has not provided sufficient evidence to conclude that market power in the 10 minute non-spinning reserves market has been exercised or that market concentration is a problem. For example, AES NY notes that the New York ISO has based its conclusions on only three months of data. KeySpan argues that the New York ISO has not shown a correlation between the decline in bids and the fluctuations in the bid prices. Orion contends that the New York ISO has no economic basis for assuming that pre-January 29 pricing is an indicator of what workably competitive pricing would be after January 29. Orion adds that, with 2359 MW of available capacity in 10 minute non-spinning reserves, which is four times the market demand, it would be extremely difficult for suppliers to execute an anti-competitive strategy. Orion notes that the New York ISO presents no evidence that market concentration is any different from the concentration that existed at the time when the current market structure was proposed, when the New York ISO's sponsors argued that the operating reserves market would be workably competitive.

In a similar vein, other intervenors argue that the New York ISO exaggerates its claims, noting that there were never actually shortages in the reserves market. LIPA claims that, at all times during the period when the market was alleged to be manipulated, more than enough 10 minute non-spinning reserve capacity was available to meet the 10 minute reserve requirement, which can be no more than 600 MW under reliability rules.¹⁰ LIPA claims that it bid in less than 500 MW during only 56 percent of the period in question, and when it did so, the New York ISO selected its capacity only 20 percent of the time.

LIPA also claims that KeySpan was actually instructed by the New York ISO's staff to manage KeySpan's reliability concerns relating to the excessive use of their generating units by strategically bidding the units. Accordingly, LIPA claims that Keyspan notified the New York ISO that it would be cutting back its bids into the market during times when there was no system emergency. LIPA also claims that KeySpan was never notified during the period from late January to mid-March that the New York ISO had found this bidding behavior to be problematic.

¹⁰ As stated earlier, of the 1200 MW requirement for operating reserves east of the central east constraint, reliability rules dictate that at least 600 MW procured to meet the requirement be 10 minute spinning reserves. Therefore, the New York ISO cannot procure more than 600 MW of 10 minute non-spinning reserves to meet this requirement

Several intervenors claim that the New York ISO's analysis of the markets is flawed and inconsistent with the original application for market-based rates. Indeck notes that the analysis excludes the Blenheim-Gilboa pumped storage facility and the generating assets of Southern Energy NY Gen, et al. (Southern Energy) and Orion. Orion and Indeck Energy claim that the analysis also excludes New York's eastern 10 minute spinning reserve resources as a substitute for 10 minute non-spinning reserves, recognizing that a generating unit that is already spinning can supply non-spinning reserves as well.

Various intervenors, and NYSEG and Rochester G&E in their complaints, argue that the problems experienced in the operating reserves markets are primarily the fault of the New York ISO or market design flaws. In support, they note: (1) that the New York ISO software does not recognize the Blenheim-Gilboa pumped storage facility as a source of operating reserves, despite the fact that the Blenheim-Gilboa facility has traditionally been recognized (in the New York Power Pool) as a source of up to 1,000 MW in operating reserves for the location east of the transmission constraint; and (2) that more economic bids from resources west of the constraint are rejected at times when there are no constraints in the day-ahead energy market and western suppliers could be relied upon to support eastern loads.

NRG notes that there are other possible reasons for the price fluctuations that the New York ISO has not considered. NRG argues that the rise in prices may be due to the risk suppliers face in providing reserves, and, as energy prices rose,¹¹ so did the reserves prices and the opportunity cost of not supplying energy. Orion argues that the price fluctuations in the market could be due to the fact that the operating reserves market is a secondary market, and that suppliers were just beginning to focus on this market.

NRG, Orion and Central Hudson contend that any bid caps imposed should be subject to a strict time limit. Central Hudson argues that the limit on the bid cap should be no later than June 30, 2000. Central Hudson believes this will give the New York ISO an incentive to resolve the problems expeditiously, minimize market disruptions, and maintain confidence that the Commission is committed to its market pricing goals.

IPPNY and Sithe also object to the New York ISO's proposal to impose mitigation measures on both the 10 minute non-spinning and spinning reserve markets, as the New York ISO has only made allegations that there are market power concerns in the 10 minute

¹¹NRG states that the New York ISO real-time and hour-ahead market prices rose during the week of January 8, 2000, from under \$20 to \$80, and during the week of January 15, 2000, from less than \$40 to well over \$200.

non-spinning reserve market. These parties contend that the New York ISO has made no showing that generators have market power in the 10 minute spinning reserve market.

The New York ISO's Answers

The New York ISO filed separate answers to all of the complaints. The ISO argues that, contrary to the intervenors' and complainants' assertions, the operating reserve markets' problems have much more to do with high concentration levels, and related bidding behavior, than software problems. The New York ISO admits that, although certain flaws in the market design have become apparent, eliminating these flaws alone would not restore the 10 minute reserves markets to a workably competitive state, and could not change the past performance of these markets. Moreover, the New York ISO states that it is currently in the process of correcting its software to allow inclusion of the Blenheim-Gilboa pumped storage facility as a resource for reserves.

The New York ISO also argues that the alleged market design flaw of failing to accept day-ahead economic bids from operating reserves that are located west of the constraint during periods when there are no constraints on the system is not a flaw, but properly reflects the system operations as they were designed by the transmission owners in their formation of the ISO.

The New York ISO further claims that Rochester G&E and NYSEG have not justified the investigations proposed in their complaints, noting that such investigations would require access to sensitive bidding data, which is strictly confidential for a six-month period after bids are accepted.

Discussion on Evidence Presented

We find that the New York ISO has presented sufficient evidence to call into question continued reliance on market-based pricing for non-spinning reserves. When we approved market-based rates for ancillary services within the NY ISO, we expressed concern about the high market shares identified in the Member Systems' market analysis. We noted:

While the market shares for some services are significant, these analyses also do not reflect the divestiture of generating units. Also, the fact that a number of different suppliers are capable of fully satisfying the ISO's needs is an important factor. In all cases, the total potential supply of a particular type of reserve is at least twice the estimated requirement, and sometimes much greater. Differences between supply and demand of this magnitude are likely to deter the exercise of market power, because no individual supplier is irreplaceable. Each supplier - -

even one with a 51 percent share of the supply - - can be completely displaced with capacity from other suppliers in light of the substantial differences between total supply and total demand. . . .¹²

We now find out that the conditions under which market-based rate authority for ancillary services was granted do not match the current operational realities of the New York ISO's reserve markets.¹³ As a result, markets are even more concentrated than indicated in the original analysis and the prime mitigating factor upon which we relied, the presence of multiple suppliers with the ability to fully satisfy the ISO's ancillary service requirements, does not exist.

In addition, while we make no finding here that any supplier engaged in the withholding of capacity, the NY ISO has shown that capacity that was previously offered to the market is no longer being offered and that the decline in supply offers correlates with a dramatic increase in bid prices. The NY ISO has shown that, as a result, the rates paid by transmission customers for non-spinning reserves rose by approximately \$65 million from January 29 through March 10, 2000. Taken together, we believe that the evidence presented by the NY ISO is sufficient to call into question our continued reliance on market-based rates for non-spinning reserves.

We also disagree that the alternative explanations proffered by intervenors are the genesis of the pricing abnormalities reported by the NY ISO. First, we disagree that the risk of incurring penalties due to non-performance explains the higher prices that have been observed. We agree that a unit on 10 minute non-spinning reserve faces a risk that it may not be able to perform if called upon to produce energy. However, this risk is small since

¹²86 FERC ¶ 61,062 (1999) at p. 61,237.

¹³Among the differences between the assumptions underlying the earlier analysis and actual operations are (1) the assumption that the NY ISO could acquire non-spinning reserves from any resource located in the New York Control Area is inconsistent with the actual practice of acquiring all non-spinning reserves from resources located east of the central east constraint, (2) the assumption that the Blenheim-Gilboa pumped storage facility could place bids to supply non-spinning reserves is inconsistent with the actual practice of excluding this supplier from the market, and (3) the assumption that all generating units are equally capable of providing each type of operating reserve is inconsistent with the fact that some generators are capable of providing only one or two of these services. The New York ISO reports that the Herfindahl-Hirshman Index (HHI) level for the 10 minute non-spinning reserve market is 4,031. The addition of the Blenheim-Gilboa pumped storage facility would lower the calculated HHI levels to 2,848.

the probability of being called to produce energy out of non-spinning reserves is small.¹⁴ Thus, the risk premium factored into the bid should be relatively small and not of such magnitude to explain the 60-fold increase in prices observed between December and February.¹⁵

The Commission further disagrees that higher fuel prices during the months in question and environmental considerations explain an increase in the price of 10 minute non-spinning reserves. By its very nature, the generating unit providing 10 minute non-spinning reserves is not running, and therefore is not incurring any costs, nor is it creating emissions. The unit will only incur the higher fuel costs and produce emissions if it is called upon to run, so the higher fuel prices should be incorporated into the unit's energy bid, not its non-spinning reserves bid.

Intervenors also complain that higher prices for 10 minute reserves are explained by the fact that the ISO has run these units far more than they have been in the past, thus the higher price is needed in order to cover extra maintenance costs. We disagree. Just like fuel costs, wear and tear on a generating unit only occurs if the unit is being started up and running, not when it is sitting idle on reserve. Thus, these factors should be reflected in an energy bid, not a bid to supply non-spinning reserves. As the NYISO states, in order to protect units from excessive operation, a better strategy would be to bid

those units high into the energy market and low into the 10 minute non-spinning reserves market so that these units would not get picked for energy, but picked for non-spinning reserves.¹⁶

However, the Commission agrees with intervenors that aspects of the NY ISO design and operating protocols have contributed to the problems observed in the non-spinning reserve markets. First, the New York ISO's practice is to procure all 1200 MW of

¹⁴New York ISO's Answer, April 27 at 12. The New York ISO claims to have only called upon LIPA's combustion turbines one half of one percent of the time to provide 10 minute non-spinning reserves.

¹⁵The average price in December was \$1.06 and in February it was \$65.57.

¹⁶NYISO's answer, April 27 at 11-12.

10 minute reserves east of the central east constraint. While the NY ISO indicates that this is consistent with the New York Power Pool's past practice and the operating protocols incorporated into the NY ISO design initially, it is not clear why the NY ISO should not be able to rely on western suppliers when there is no congestion present. Moreover, we do not understand why procedures cannot be developed to permit the ISO to procure ancillary services from western suppliers, even during constraints, if it would lead to overall lower costs of energy and ancillary services, as several commenters suggest.¹⁷ Expanding the supply markets for 10 minute reserves to include western suppliers (as was contemplated in the market analysis which was submitted in support of market based rates initially) would reduce market concentration and reduce the opportunity for the exercise of market power by ancillary service providers. Accordingly, we shall direct the NY ISO to develop procedures to maximize access to western suppliers of 10 minute reserves.

Second, the New York ISO has already admitted that it has not modeled into its software the possibility that the Blenheim-Gilboa pumped storage facility could provide 10 minute spinning or non-spinning reserves. If this unit were included, it could lower the market concentration levels from 4,031 to 2,848, and add another large competitor to the market. The New York ISO has in its answers committed to getting this pumped storage facility modeled in the software so that it can be bid into the market as 10 minute reserves. We direct the New York ISO to do so as quickly as possible.

Finally, as discussed more fully below, the current practices of the New York ISO severely limit the ability of customers, particularly those located west of the central east constraint, to self-supply operating reserves. Self-supply is an important option to mitigate the potential exercise of market power.

Consequently, as discussed later, we will approve, with certain modifications, the New York ISO's proposed bidding restrictions on 10 minute non-spinning reserves as an interim measure.

As noted above, we disagree with the New York ISO that the evidence presented demands mitigation measures on the 10 minute spinning reserve market. We note that the New York ISO has failed to provide any justification for a mitigation measure beyond its assertion "that it is necessary in order to preclude unanticipated consequences due to the relationship in price performance between the [spinning and non-spinning] markets." As the New York ISO has stated, the reason the prices for 10 minute spinning reserves rose was

¹⁷NYISO's answer, April 27 at 11-12.

the ISO's practice of setting the market clearing price for spinning reserves at the highest bid accepted in the constrained 10 minute non-spinning market. Accordingly, we expect that, based largely upon the New York ISO's own statements, a bid cap upon the 10 minute non-spinning reserves market would adequately mitigate both markets. As intervenors have noted, we have previously accepted mitigation measures on spinning reserves within New York City in Con Ed similar to the ones proposed here. Nevertheless, the New York ISO has not shown why these measures should be expanded to include all of New York state east of the central east transmission constraint. Moreover, the New York ISO has not shown why our earlier approval of market-based rates for spinning reserves for the rest of the New York market in Central Hudson should be suspended. Therefore, we reject the proposed bid cap on the 10 minute spinning reserves market without prejudice to the New York ISO re-filing its request with adequate support. We note that our rejection of the proposed 10 minute spinning reserve bid cap effectively moots intervenors' comments and protests regarding this bid cap, and we therefore decline to address them further at this time.

III. The New York ISO's proposed mitigation measures for 10 minute non-spinning reserves

As noted above, the New York ISO proposes to impose a cap of \$2.52 for eastern 10 minute non-spinning reserves suppliers, and a mandatory bid requirement which requires that all available capacity held by eastern suppliers of 10 minute non-spinning reserves, and that is not subject to a bona fide outage or conflicting contractual obligation, be bid into the market.

Protests and Comments

Several intervenors argue that the New York ISO's proposal is inconsistent with Commission precedent or similar proposals accepted by the Commission. Central Hudson, Orion, and LIPA refer to the Commission's ruling in AES Redondo Beach, LLC (AES Redondo Beach),¹⁸ where we noted that the correction of market design flaws, rather than purchase price caps, is a preferable solution to market problems. LIPA and KeySpan note that, although we accepted a purchase price cap on California's ancillary service market in that order, we noted that suppliers were not required to sell to the ISO. Orion notes that the proposed bid cap is not consistent with the purchase price cap authorized for the California ISO in AES Redondo Beach or for ISO New England (capped at the energy price).¹⁹

¹⁸87 FERC ¶ 61,208 (1999).

¹⁹New England Power Pool, et al, 89 FERC ¶ 61,209 (1999).

Certain intervenors compare the proposed measures with the market mitigation authorities granted the New York ISO in New York Independent System Operator, Inc., et al.²⁰ Multiple Intervenors claims that the proposed bid cap and bid requirement is consistent with the default bid provision of Section 4.1 of the market mitigation measures. Indeck Energy argues that the New York ISO is in violation of the market mitigation measures because it is attempting to impose mitigation measures on all market participants rather than on the three parties that control the highest market shares.

Several intervenors argue that the proposal is discriminatory. LIPA claims that imposing the proposed measures only on suppliers east of the central east constraint is discriminatory on its face. Alternatively, IPPNY and Sithe, among others, argue that the New York ISO should seek to impose its proposal on only the offending parties.

Numerous intervenors contend that the proposal will not impose a reasonable cap that would allow for the recovery of opportunity costs. NRG and LIPA argue that the \$2.52 cap is unreasonable because it is based on a period when participants were still learning about the market. Similarly, Southern Energy NY Gen argues that the \$2.52 cap does not allow for a contribution to capital costs. AES NY and NRG argue that the proposed cap will not permit suppliers to recover the opportunity costs of not being allowed to sell into the energy market. NRG also argues that the proposal will not compensate suppliers for the performance-based financial penalties²¹ they may be subject to in the operating reserves market. LIPA argues that the price for quick-start units primarily relied upon in the 10 minute non-spinning reserves market ought to tend toward long-run marginal cost in a time of high demand, and that the bid cap may preclude recovery of these costs. EPSA claims that the caps will deny suppliers the opportunity to cover their fixed costs during transitory periods when market prices exceed long-run average costs.

AES NY argues that, by compelling market participation at a fixed, capped price, the New York ISO may prevent the market from ever growing into a robust, self-correcting

¹⁹(...continued)

²⁰90 FERC ¶ 61,137 (2000).

²¹Under section 5 of the New York ISO Services Tariff, the New York ISO will charge the reserves supplier the real-time energy price and impose a regulation penalty for any shortfalls in its supply of energy when and if the supplier is called upon to provide reserves.

market that will not need the New York ISO's continued intervention. Furthermore, AES NY argues that the proposed mandatory bid requirement of all available capacity will create an inefficient over-supply in the operating reserves market, diverting resources that could be used in the day-ahead and real-time energy markets and consequently driving up energy prices.

A number of intervenors claim that the proposal will create reliability concerns. Central Hudson, for example, notes that its large fossil-fired units face strict NO_x and opacity limits and that its natural gas turbines operate under state-mandated run-time restrictions. With regard to the mandatory bid requirement, Central Hudson continues that if its gas turbines reach their maximum annual run-time limitations because of a lack of due regard by the New York ISO, they may not be available to serve their primary local reliability function following local area transmission outages.

PG&E Group requests clarification that the proposed bid requirement will not create an obligation to bid in the reserve markets on the part of units not physically or legally capable of providing such reserves from excess capacity above PURPA requirements.

Certain intervenors propose alternative measures or modifications to the New York ISO's proposal. NRG argues that, if the mandatory bid proposal is accepted, suppliers should be permitted to recover their true opportunity costs and the performance penalties for reserves should be eliminated. NRG argues that the bid cap should be the same bid cap used in the California ISO because, as in California, operating reserves are a firm service in New York.²² Central Hudson contends that the bid cap should be set at the highest of the cost-justified rates in New York on file with the Commission and in effect prior to the start of New York ISO operations. Load Serving Entities (LSE) Intervenors argues that the bid cap should be an average of the corresponding prices in PJM and in ISO New England. LSE Intervenors adds that any suppliers submitting bids for operating reserves should be required to do so subject to refund and audit, as well as to describe their methodologies for calculating their incremental costs.

Discussion on Bidding Restrictions

In light of our findings above, we will suspend market-based pricing in the non-spinning reserve market for a temporary period and resort to an alternative pricing model that ensures that non-spinning reserve suppliers are made whole for their costs. As discussed below, we believe that the bidding rules proposed by the NY ISO will serve this

²²AES Redondo Beach, LLC, 87 FERC ¶ 61,208

purpose, if modified in one critical respect. We agree with the intervenors that the revised pricing rules must ensure that suppliers of non-spinning reserves are made whole for their lost opportunity costs. Providers of non-spinning reserves would incur lost opportunity costs when their energy bids are below the applicable energy price and their units could have been selected for the energy market, but their units are instead selected to supply non-spinning reserves. For example, when suppliers with higher energy bids aren't technically capable of providing non-spinning reserves (e.g., due to ramping constraints), these higher priced suppliers may be scheduled to produce energy, causing the energy price to rise. Suppliers with energy bids below the energy price would then be selected to provide non-spinning reserves and, thus, incur lost opportunity costs by not being able to supply energy in the energy market. We note that the price paid by the ISO for spinning reserves includes payments for lost opportunity costs, calculated as the difference between the applicable locational-based marginal price and bidder's energy bid. Non-spinning reserve suppliers are entitled to similar compensation, and we direct the ISO to modify its proposal accordingly.

With this modification, we find it appropriate to limit bids in the non-spinning reserve markets to \$2.52, which reflects the highest market clearing price during the initial period of ISO operations, when the market appeared to have been operating competitively. We note that opportunity costs may vary depending on market conditions. In all periods, however, the availability payment of up to \$2.52 will reflect additional revenues above and beyond the opportunity cost payment which may be required to make the supplier whole for any revenues lost by foregoing a sale into the energy market. Finally, we clarify that any generators who believe they are unable to recover their costs under the revised bidding procedures may file a proposed cost-based bid limit under section 205 of the FPA.²³

We also disagree with intervenors that our action here is somehow inconsistent with our approval of higher purchase price caps for the California ISO. First, in California, non-spinning reserve suppliers are not compensated for their lost opportunity costs, and they had to factor those lost opportunities into their bid price. Here, non-spinning reserve suppliers will now be made whole for their lost opportunity costs through a separate payment. Second, in California, we were not faced with a situation where we were compelled to suspend market based rates as we do here because there are indications not only that the initial market power analysis was faulty, but also that there are market design

²³The NY ISO describes its proposal as adopting a cost-based cap not to exceed \$2.52. With the clarification that parties may propose a higher figure through a separate Section 205 filing, we find it reasonable to adopt the \$2.52 figure as a proxy for the upward limit on cost-based bids as a means of avoiding additional proceedings to determine a unit's actual costs.

flaws that have the effect of preventing suppliers from participating in the non-spinning reserve market and preventing consumers from self-supplying non-spinning reserves, thereby creating the potential for unexpected market concentrations.

With regard to the mandatory bid requirement, which as a result of our ruling will only apply to eastern suppliers of 10 minute non-spinning reserves, we agree with the commenters that certain situations may exist that would exempt units from the mandatory bid requirement. For example, if a unit has legal, environmental, physical or contractual requirements, those units should not be subject to the mandatory bid requirement. However, absent these circumstances, we believe that the mandatory bid requirement is necessary to protect against the physical withholding of capacity for the 10 minute non-spinning reserve market.

We find it reasonable that the bid cap on 10 minute non-spinning reserves only apply to suppliers east of the constraint, as that is where the evidence suggests there is a market problem. We also find it reasonable at this time to apply the cap to *all* suppliers east of the constraint unless further study suggests that the mitigation can be applied more narrowly.

In response to intervenors' comparisons between the proposed measures and the market mitigation authorities granted the New York ISO on March 29, 2000,²⁴ we note

that the New York ISO has not attempted to invoke its market mitigation measures to solve the problems in the operating reserves markets. Accordingly, we find this issue moot.

IV. Retroactive Billing Adjustments

As noted previously, the New York ISO requests that the Commission initiate an ADR settlement process through its Dispute Resolution Service (DRS) office in order for all parties participating in the 10 minute spinning reserve markets to come to a resolution of the appropriate amounts that should be billed and collected for the period from January 29 to March 28. The New York ISO proposes to conclude the settlement process in 90 days.

Additionally, the New York ISO requests authority to bill and collect for both 10 minute spinning reserves and non-spinning reserves for the period from March 1 to March 28, the proposed effective date of the bid limitations, based on approximations of the

²⁴The Commission accepted the New York ISO's proposed market mitigation measures in *New York Independent System Operator, Inc., et al.*, 89 FERC ¶ 61,196

prices, pending the outcome of the ADR settlement process. These calculations would be based on the weighted average 10 minute spinning reserve prices prevailing in the period prior to the dramatic increases in prices described above.

The comments regarding this issue are essentially divided into two groups: the LSE Intervenor's which support the proposal to rebill and argue that the New York ISO has the authority to rebill for this past period in its Market Mitigation Plan (MMP) and TEP; and the generators which claim that the New York ISO does not have authority under the TEP or MMP and that the rebilling is retroactive ratemaking and a violation of the filed rate doctrine. These comments are all summarized in more detail below.

Comments in Support of Retroactive Rebilling Adjustments

MEUA and Strategic Power support the New York ISO's proposal to rebill for the period. Strategic Power states that without such relief, it will be driven out of the market because of an inability to meet such extraordinary cash demands. Strategic Power requests that the Commission revisit the market mitigation authority granted the New York ISO and suspend the general policy against retroactive price corrections.

In their complaints, NYSEG and Rochester G&E argue that the price fluctuations are due to market design flaws, and that therefore the New York ISO should be allowed to rebill for this period under its TEP. Rochester G&E notes that, under the TEP, the New York ISO is permitted to take extraordinary corrective action to correct market design flaws, and that such action may require rebilling of prices experienced due to a market design flaw. Rochester G&E notes that a market design flaw is defined in the TEP as "a market structure, market design or implementation flaw giving rise to situations in which market conditions or the application of ISO Procedures would result in inefficient markets or prices that would not be produced in a workably competitive market." Central Hudson concurs with the NYSEG and Rochester G&E complaints that the New York ISO has the authority to correct for erroneous prices under its TEP.

Central Hudson argues that the New York ISO is required by the filed rate doctrine to correct the errors and pay refunds as appropriate if the New York ISO calculated market clearing prices for operating reserves in a manner inconsistent with its tariff.²⁵

²⁵Citing ISO New England, Inc., 90 FERC ¶ 61,141 (2000), where the Commission stated: "we remind the parties that, consistent with the filed rate doctrine, the ISO already has the authority, and is required, to correct all market prices that do not reflect operation of the NEPOOL market rules."

(continued...)

Finally, LSE Intervenors contend that errors of material fact underlying market-based rates for suppliers of operating reserves warrant retroactive imposition of cost-based rates.

Protests and Comments Opposed to Retroactive Rebilling Adjustments

IPPNY, Indeck, NRG, Sithe, AES New York and Orion request that the Commission deny the request by New York ISO to recalculate prices retroactively. They contend that the New York ISO's market power mitigation measures do not provide the New York ISO with the authority to recalculate prices retroactively. They claim that the New York ISO's attempt to retroactively set prices is in direct contravention of the Commission's intent in its March 29 Order²⁶ that conditionally accepted the New York ISO's revised market mitigation plan. In the March 29 Order the Commission required the New York ISO to file another revised plan that would clarify that mitigation for market power is prospective only. The Commission further stated that it did not intend for mitigation to entail any retroactive recalculation of market-clearing prices. The March 29 Order also required that before the New York ISO can impose a particular mitigation measure, it must first publicly disclose the specific thresholds that would trigger possible mitigation. These parties contend that the thresholds which appear to have been violated have not been disclosed by the New York ISO nor have specific parties been notified that thresholds were exceeded.

Several parties including, IPPNY, Indeck, Southern Energy and Orion request that the Commission reject any attempt by the New York ISO to assert that it has authority under the TEP to set prices retroactively.²⁷ These parties claim that the TEP do not provide the New York ISO with any authority to set prices retroactively. In a recent Commission order granting a 90-day extension of the New York ISO's TEPs, the Commission noted that the TEPs are not designed to address market power concerns, but are limited to "correct[ing] technical implementation errors and operational anomalies that do not allow the dispatch produced from the bidding algorithms."²⁸ IPPNY claims that the New York

²⁵(...continued)

²⁶New York Independent System Operator, Inc., et al, 90 FERC ¶ 61,317 (2000).

²⁷We note that the New York ISO did not invoke its TEP authority in its March 27, 2000 filing. However, certain parties to related complaints in this proceeding claim that the New York ISO has such authority under the TEP.

²⁸New York Independent System Operator, Inc., 90 FERC ¶ 61,320 (2000)

(continued...)

ISO's filing cites market power concerns solely as the basis for the request to reset prices retroactively. The New York ISO provides no evidence that "technical implementation errors" or "operational anomalies" have caused prices in the 10 minute reserves markets to increase.

Additionally, these parties contend that the New York ISO should not be permitted to reset prices because it has failed to follow the requirements for flagging and correcting prices under its own Emergency Corrective Action (ECA) rules. Under ECA No. 2, the New York ISO has the ability to identify a posted price that appears to have been incorrectly posted and to retroactively revise the price if a market design flaw or transitional abnormality exists. Under the ECA, the New York ISO must identify potential errors in posted prices no later than 5:00 p.m. on the following calendar day and correct them within a period of five calendar days from the date of identification. The parties argue that the New York ISO failed to act within the timelines of its own TEPs and should not now be allowed to circumvent those requirements to set the prices for operating reserves retroactively. NRG also agrees that the New York ISO has not followed the procedures under its TEP.

Orion and Central Hudson state that the New York ISO's proposal violates the Commission's filed rate doctrine which forbids it to charge rates for services that are not on file in the tariff. Additionally, parties contend that the proposal violates the Commission's prohibition against permitting retroactive rate changes. The parties argue that the Commission has found that rate design changes should be prospective because customers cannot revisit their economic decisions.²⁹ Orion, NRG and IPPNY argue that if the Commission were to allow the New York ISO to retroactively alter market prices, there is no way for buyers and sellers to alter their conduct. Hence, a recalculation of market prices would create unacceptable risks for market participants and is unreasonable.

Orion argues that none of the cases cited by the New York ISO (Washington Water Power Co.,³⁰ Iowa Southern Utilities Co.,³¹ and Transcontinental Gas Pipe Line Corp.³²)

²⁸(...continued)

²⁹Connecticut Light & Power Co., 15 FERC ¶ 61,056 (1981); Union Electric Co., 58 FERC ¶ 61,247 (1992).

³⁰83 FERC ¶ 61,282 (1998).

³¹58 FERC ¶ 61,317 (1992).

support New York ISO's request to alter rates retroactively. Orion claims that these decisions reinforce the filed rate doctrine, which holds that a utility cannot charge something other than its properly filed rate.

Discussion on Retroactive Rebilling Adjustment

The Commission will deny the request by the New York ISO to initiate an ADR settlement process for the purpose of determining the correct charges to be billed for the past period January 29 to March 28, the effective date of the proposed bid caps. We deny the request because such changes should be prospective. Customers cannot effectively revisit their economic decisions in these circumstances -- there is no way for buyers and sellers to retroactively alter their conduct. Moreover, our ADR procedures are voluntary, and Central Hudson and Orion have already expressed that they do not believe ADR will resolve the issue.

In addition, we recognize that several parties argue that under the market mitigation plan, any mitigation would be prospective only. Similarly, in support of their respective positions, several parties contend either the TEP does, or does not, permit the rebilling of charges for a past period. We note that the New York ISO has not invoked either its market mitigation plan, nor its TEP to remedy the market power problems it has identified. Alternatively, the New York ISO has chosen to file a Section 205 filing with the Commission to establish a bid cap as a temporary measure until such time as the market is workably competitive. In addressing the Section 205 filing, as noted above, we find that it is unreasonable to permit the recalculation of market clearing levels for a past period as proposed here. We recognize that the New York ISO is responsible for correcting prices that are calculated incorrectly and is permitted to make retroactive changes in order to correct mistakes in the computation or calculation of prices, within reason. Here, the New York ISO is not proposing to correct prices that were calculated incorrectly, but to adjust prices to correct market-based rates through negotiations among the interested parties. Given our finding of concentration as well as other market flaws in the operation of the New York ISO markets, it would be very difficult for the New York ISO, or any party, to simply recalculate the correct market-based rates. Therefore, we deny the request for retroactive adjustments prior to the effective date we have authorized for the bid caps.

V. Self-Supply within the New York ISO

³¹(...continued)

³²52 FERC ¶ 61,248 (1992).

In complaints filed by NIMO in Docket No. EL00-57-000 and Rochester G&E in Docket No. EL00-64-000, these parties contend that the New York ISO is violating its OATT and Commission policy by not permitting transmission customers to self supply operating reserves.

NIMO explains that the New York ISO rejected its request to designate its Albany Steam Station as a source of operating reserves on the ground that the facility had not been selected as a provider of operating reserves in the bid-based markets administered by the New York ISO. NIMO is concerned with the New York ISO's requirement that customers must bid into the New York ISO's markets in order to self-supply.

Similarly, Rochester G&E claims that the New York ISO has not permitted it to self-supply in contravention of the New York ISO's tariff and Order No. 888. Rochester G&E claims that it has attempted on many occasions to self-supply operating reserves and its bids were not accepted, even when the bid price was significantly below the market prices for operating reserves.

Protests and Comments Regarding Self-Supply Issue

Multiple Intervenors and Southern Energy filed comments on the issue of self-supply in the NIMO Complaint. Multiple Intervenors support NIMO's position and request that the Commission order the New York ISO to allow NIMO to self-supply operating reserves and require the New York ISO to compensate NIMO for past failures in not allowing NIMO to self-supply.

On the other hand, Southern Energy filed comments in the NIMO complaint stating that the self-supply issue relates to a tariff interpretation and that the Commission should allow the process embodied in the New York ISO committee structure to examine this issue. At a minimum, Southern Energy suggests that permitting large LSEs to meet their operating reserves requirements without having to bid their resources into the New York ISO reserve market may decrease the liquidity of that market, exacerbating any perceived problems in the interplay of supply and demand.

New York ISO's Answer to Complaints Regarding Self-Supply Issues

The New York ISO filed separate answers to the NIMO and Rochester G&E complaints. The New York ISO requests that the complaints be rejected, as NIMO and Rochester G&E are incorrect that the New York ISO's self-supply practices are inconsistent with its tariff and Order No. 888.

In response to the NIMO complaint, the New York ISO claims that if transmission

customers were allowed to self-supply outside of the ordinary workings of the ancillary markets, scheduling and billing problems would result causing operational difficulties. The New York ISO claims that NIMO is fully aware of the New York ISO's requirement that the right to self-supply must be exercised within the framework of the New York ISO's market process. The New York ISO also claims that even if it were not permitted to make its self-supply procedure part of its centralized market process, NIMO would not be permitted to self-supply simply by informing the New York ISO via e-mail. The New York ISO argues that Commission precedent clearly states that a transmission customer and transmission provider must reach agreement on the amount of ancillary services that will be self-supplied.

In response to the Rochester G&E complaint, the New York ISO argues that the difficulties Rochester G&E has encountered in self-supplying operating reserves are attributable to New York State reliability rules. The New York ISO notes that, although it is true that it has had to reject Rochester G&E's self-supply bids on a number of occasions, it has done so because Rochester G&E's resources were located west of the central east constraint. Rochester G&E's bids were rejected because of the state-wide reliability rules, which the New York ISO must obey.

The New York ISO contends that its procedures for self-supply are consistent with Order No. 888 which established that the right to self-supply operating reserves would only be allowed if the transmission customers satisfied applicable "regional criteria." The New York ISO's centralized, bid-based ancillary service markets and locational reserve requirements are "prevailing regional practices."

Similarly, the New York ISO argues that in an order regarding the California ISO, the Commission recommended that the parties consider whether the market process could be designed in a manner to permit self-supply through the market process rather than through separate self-supply arrangements.³³

Discussion on Self-Supply within the New York ISO

In Order No. 888, the Commission first established the right to self-supply operating reserves. The intent of requiring the right to self-supply was to ensure that the market participants have the option of using their own or third party resources instead of being tied to the ISO to meet all of their requirements.

³³AES Redondo Beach at 61,810 (1999).

We recognize that we have not completely ruled out the possibility in a recent California ISO order that an ISO could permit self-supply through its market process. In the California ISO order, we acknowledged an ISO might implement self-supply through the ISO's market process provided, "...the market would place a customer in the same financial position as supplying Ancillary Services on its own behalf..." However, we disagree with the New York ISO that our California ISO order supports its current implementation of self-supply through its market process. We are concerned that the New York ISO's current mechanism may not meet this standard, given the current problems experienced by the New York ISO. We recognize that there may be situations where parties, including NIMO, could obtain operating reserves at lower prices outside the New York ISO's market process. We find that the parties should be given the option of self-supplying without being required to bid into the New York ISO's markets.

We therefore direct the New York ISO to meet with its Members and devise a plan that will permit its customers to self-supply outside of the NYISO market. However, in devising a plan, the New York ISO may require that the right of customers to self-supply comes with the obligation to self-supply generation capacity that meets all applicable technical requirements, including locational requirements. For example, if the New York ISO determines that all 10 minute reserves must be located east of the central east constraint, then all self-supplied 10 minute reserves must be located in that region. However, we are concerned with the inability of parties located west of the constraint, such as Rochester G&E, to self-supply to the east. Therefore, as noted earlier in this order, we direct the ISO to consider ways of allowing generation in the west to self-supply if they acquire sufficient transmission capacity to deliver capacity and energy to the east.

We direct the New York ISO to address these concerns and file its plan and findings with the Commission as part of the September 1, 2000 filing required by this order. Any procedures, rules and guidelines a customer must comply with in order to self-supply must be included as part of the New York ISO's tariff and must be filed with the Commission. We note that detailed procedures for permitting self-supply as alluded to by the New York ISO are not on file in its tariff.

VI. Other Issues Raised in NYSEG's Complaint

NYSEG also argues that the New York ISO has deviated from its tariff when suppliers' bids for spinning reserves are lower than bids for non-spinning reserves. NYSEG complains that the New York ISO incorrectly uses the higher market clearing price of the 10 minute non-spinning reserves to establish the price for both 10 minute spinning reserves and non-spinning reserves. NYSEG also asserts that, under Schedule 1 of the New York ISO OATT, units satisfying local reliability requirements may not set the market-clearing price for operating reserves. Finally, NYSEG asserts that a market design flaw exists

because KeySpan units on Long Island are essentially used as must-run units unchecked by mitigation and allowed to establish a state-wide market clearing price.

In its April 13, 2000, answer to NYSEG's complaint, the New York ISO asserts that its software design is consistent with the New York ISO Services Tariff³⁴ and guarantees that the total bid cost for all reserves will be minimized.

Discussion

We conclude that the provisions of the New York ISO's tariff with regard to pricing of 10 minute spinning reserves lacks detail, but that the ISO's method for establishing spinning reserve prices is reasonable. Section 4.21 of the ISO Services Tariff states that suppliers of each category of operating reserves shall be paid the applicable market clearing price. Elsewhere, in Rate Schedule 4, the ISO Services Tariff states that the spinning reserve price is equal to the highest accepted bid. The New York ISO's practice of setting the price of 10 minute spinning reserves no lower than the price of 10 minute non-spinning reserves is necessary for the spinning reserves price to clear the market. We agree with the New York ISO that if these items were priced separately, as NYSEG requests, generators would not want to be in the spinning market; they would bid into the non-spinning market in order to receive the higher price, resulting in less spinning reserve supply. Under the New York ISO's method, those generators that are qualified to be 10 minute spinning reserves have the incentive to bid into that market while still remaining a substitution option for 10 minute non-spinning reserves. We agree with the New York ISO that its current method of establishing 10 minute spinning reserve prices creates incentives to supply spinning reserves, and that the method proposed by NYSEG would tend to discourage generators from supplying spinning reserves.

However, since the tariff lacks detail regarding the ISO's current procedures, we direct the ISO to revise Rate Schedule 4 to indicate exactly how the prices are set. The New York ISO should make this tariff revision when it files to remove the cap on 10 minute spinning reserves, as directed in this order.

With regard to NYSEG's argument about local reliability requirements setting the market price, the New York ISO argues that the relevant provision of its OATT (requiring that costs incurred to satisfy local reliability rules be paid only by customers serving loads in zones where the rule is applied)³⁵ applies only to local reliability rules and not to state-wide reliability rules, such as the one at issue here. Nonetheless, the New York ISO states,

³⁴The New York ISO cites Tariff Sheets 51-52 of the New York ISO Services Tariff.

³⁵Schedule 1 (Second Revised Sheet No. 144).

because of the locational effect of this requirement, the New York ISO is reviewing whether the cost recovery arrangement for state-wide reliability rules should be revised. The Commission accepts the New York ISO's response as a reasonable approach to this issue, and will require the New York ISO to report on this matter in the September 1, 2000 filing required by this order.

With regard to NYSEG's argument concerning must-run reliability, the Commission will require the New York ISO to address such issues in the compliance filing described below to be made on or before June 30, 2000.

VII. Request for Cease and Desist Order

Orion requests in its complaint that an emergency order be issued requiring the New York ISO to cease and desist from unilaterally altering the market rules. Orion argues that emergency relief is warranted because, for the purposes of calculating appropriate refunds, there will be no way to determine what the market prices would have been without the New York ISO's actions. Orion further argues that the New York ISO's action violates Section 205 of the Federal Power Act (FPA) as well as the filed rate doctrine because the ISO has made a tariff change without a 60 day notice and is charging rates other than those properly filed with the Commission.

Numerous intervenors filed comments in support of Orion's complaint and request that the Commission issue a cease and desist order. Several intervenors opposed Orion's complaint and support some or all of the New York ISO's actions. LIPA recommends that the Commission reject Orion's complaint, issue a cease and desist order, and institute an ADR process.

The New York ISO opposes Orion's complaint and reiterates that it was necessary to implement bid caps for 10 minute reserves to avoid the serious potential for substantial financial harm to market participants that would result from the lack of competitive performance in the market. The New York ISO states that its action to suspend the use of market-based bids in the markets for 10 minute reserves effective April 1, 2000, was consistent with Section 205 of the FPA. The ISO states that it requested an effective date of March 28, 2000, but in order to provide notification to market participants and to implement the necessary software changes, it decided to implement the tariff changes on April 1. The New York ISO states that it provided good cause in its filing for implementing the market mitigation measures before the 60-day notice period expired. New York ISO also references Section 35.11 of our rules which provides that, upon application and for good cause shown, the Commission may waive the 60-day notice period and allow a rate schedule, or part thereof, to become effective on a date prior to the date of filing or prior

to the date the rate schedule would become effective in accordance with the rules. The New York ISO states that although it did not act under the provisions of its market mitigation measures approved by the Commission, its filing of a 205 tariff change and subsequent imposition of the changes is nonetheless consistent with the intention of the Commission's order in New York Independent Operator, Inc.³⁶

Discussion

Because the issues raised by Orion are interrelated with those raised in the New York ISO filing, we decline to issue a separate emergency order on Orion's complaint and instead will deal with the issues simultaneously. We will grant the New York ISO's request for waiver of the 60-day notice requirement and approve the New York ISO's request for implementation of the market mitigation measures for 10 minute non-spinning reserves effective March 28, 2000, as requested. Good cause has been shown for granting the waiver. This case is similar to AES Redondo Beach, L.L.C. et al.,³⁷ in which the Commission accepted an emergency filing by the California ISO to immediately impose a bid cap on ancillary services. Accordingly, we will deny Orion's request for a cease and desist order on the New York ISO's implementation of market mitigation measures. However, the New York ISO's request to implement price caps for the 10 minute spinning reserves market is denied because of our finding that the ISO has failed to provide supporting evidence justifying the caps. The New York ISO must remove the price caps on the 10 minute spinning reserves market effective on the date of this order and submit revised tariff sheets removing these price caps within 15 days.

VIII. The New York ISO's Compliance With Its Own Procedural Requirements

Several intervenors, including Keyspan, PG&E Group, and Indeck, argue that, contrary to footnote 1 of the New York ISO's filing, the proposed tariff changes may not be made pursuant to section 19.01 of the New York ISO Agreement because the New York ISO Board has not: (1) obtained the concurrence of the the New York ISO Management Committee, (2) made the required certification as to the need for the filing, and (3) limited the effective period of the filing to 120 days. They argue that the New York ISO's filing should be rejected since the New York ISO has not made an argument that exigent circumstances exist nor has the New York ISO included an expiration date of 120 days upon its proposed amendments.

³⁶89 FERC ¶ 61,195 (1999).

³⁷84 FERC ¶ 61,046 (1998).

Section 19.01 reads, in part, as follows:

19.01 Modifications.

. . . [T]he ISO Board may submit to the Commission a proposed amendment to the ISO OATT, the ISO Services Tariff or the ISO Agreement under Section 205 of the FPA, without the concurrence of the Management Committee, under the following circumstances: the ISO Board certifies that (1) the proposed amendment is necessary to address exigent circumstances related to the reliability of the NYS Power System or to address exigent circumstances related to an ISO-administered market; and (2) the urgency of the situation justifies a deviation from the normal ISO governance procedures. Any proposed amendment submitted by the ISO shall contain an expiration date of no later than one hundred and twenty (120) days after it is filed with FERC and shall expire no later than one hundred twenty (120) days after it was filed with FERC, unless the Management Committee files with FERC a written concurrence with the proposed amendment within the one hundred and twenty (120) day period or FERC approves the proposed amendment under the just and reasonable standard under Section 206 of the FPA. . . .

The New York ISO Board believes that the exercise of market power to the detriment of other market participants qualifies as “exigent circumstances” under section 19.01 of the ISO Agreement. The New York ISO states that the New York ISO Board provided the certification required by that section on March 21, 2000 in a regularly scheduled session of the Board.³⁸ We agree that the New York ISO Board has the authority to make the filing in Docket No. ER00-1969-000.

IX. Reporting Requirement

The Commission is approving implementation of the bid cap for 10 minute non-spinning reserves through November 1, 2000. However, this is only temporary; the New York ISO is directed to develop a permanent solution to the problems in the reserves markets discussed in this order, and to file no later than June 30, 2000, a timetable for implementing the solution to become effective no later than November 1, 2000. On September 1, 2000, the New York ISO must file its solution. The Commission directs the

³⁸New York ISO's answer, April 27, 2000 at 27.

New York ISO to address in its filings: (1) procuring reserves located west of the central east constraint when the transmission system is not constrained; (2) setting aside transmission capacity for reserves located west of the central east constraint when it leads to lower overall costs; (3) adding the Blenheim-Gilboa pumped storage facility to its software for spinning and non-spinning reserves; (4) devising a plan to allow customers to self supply; and (5) a review of the costs incurred to meet local reliability rules being paid by customers in those local areas compared to all customers state-wide.³⁹ If the New York ISO is unable to comply with these directives, the Commission will then determine what additional measures may be appropriate, including a section 206 proceeding.

The Commission orders:

(A) The New York ISO's March 27, 2000, filing, as modified above, is hereby accepted for filing to become effective on March 28, 2000, as requested, subject to the conditions set forth below and any additional orders the Commission may issue in this proceeding.

(B) On or before June 30, 2000, the New York ISO must file a timetable, as discussed in the body of this order.

(C) On or before September 1, 2000, the New York ISO must make a tariff filing to become effective no later than November 1, 2000, as discussed in the body of this order.

(D) Within 15 days of the issuance of this order, the New York ISO must file revised tariff sheets describing how prices are set for 10 minute spinning reserves, and reflecting our acceptance of the cap only on 10 minute non-spinning operating reserves.

(E) The complaints in these proceedings are granted in part and denied in part, as discussed in the body of this order.

By the Commission. Commissioner Hébert concurred with a separate statement attached.

(S E A L)

David P. Boergers,
Secretary.

³⁹Of course, the New York ISO should consider any other measures that would help alleviate the market problems discussed in this order.

Interventions in Docket No. ER00-1969-000

AES NY, L.L.C.*
California Electricity Oversight Board
Central Hudson Gas & Electric Corporation*
Coral Power, L.L.C. and Merchant Energy Group of the Americas
Electric Power Supply Association*
EME Homer City Generation, L.P. and Edison Mission Marketing & Trading, Inc.+
Enron Power Marketing, Inc.+
1st Rochdale Cooperative Group, Inc.+
Indeck Energy Services Inc.*
Independent Power Producers of New York, Inc.*
KeySpan-Ravenswood, Inc.*
LSE Intervenors
Long Island Power Authority and LIPA*
Multiple Intervenors
Municipal Electric Utilities Association
New York State Electric & Gas Corporation
Niagara Mohawk Energy Marketing, Inc.
NRG Power Marketing, Inc.*
Orion Power New York GP, Inc.*
PG&E National Group, PG&E Generating, and PG&E Energy Trading-Power, L.P.*
Public Service Commission of the State of New York
Public Service Electric and Gas Company
Sithe Power Marketing, L.P.
Southern Energy NY Gen, L.L.C., Southern Energy Bowline, L.L.C. and
Southern Energy Lovett, L.L.C.*
Strategic Power Management, Inc.
TransCanada Power Marketing Ltd.

*protest

+late filed

Interventions in Docket No. EL00-57-000

AES NY, L.L.C.+
Central Hudson Gas & Electric Corporation
EME Homer City Generation, L.P. and Edison Mission Marketing & Trading, Inc.+
Indeck Energy Services Inc.+*
Independent Power Producers of New York, Inc.
Keyspan-Ravenswood, Inc.*
LSE Intervenors
Long Island Power Authority and LIPA*
Multiple Intervenors
Municipal Electric Utilities Association
New York State Electric & Gas Corporation
Niagara Mohawk Energy Marketing, Inc.
NRG Power Marketing, Inc.*
Orion Power New York GP, Inc.+
PG&E National Group, PG&E Generating, and PG&E Energy Trading-Power, L.P.
Public Service Commission of the State of New York
Sithe Power Marketing, L.P.
Southern Energy NY Gen, L.L.C., Southern Energy Bowline, L.L.C. and
Southern Energy Lovett, L.L.C.*

*protest

+late filed

Interventions in Docket No. EL00-60-000

Central Hudson Gas & Electric Corporation
Dynergy Power Marketing, Inc.
EME Homer City Generation, L.P. and Edison Mission Marketing & Trading, Inc.+
Indeck Energy Services Inc.
Keyspan-Ravenswood, Inc.
LSE Intervenors*
Long Island Power Authority and LIPA
Niagara Mohawk Energy Marketing, Inc.
NRG Power Marketing, Inc.
PG&E National Group, PG&E Generating, and PG&E Energy Trading-Power, L.P.
Public Service Commission of the State of New York
Sithe Power Marketing, L.P.
Southern Energy NY Gen, L.L.C., Southern Energy Bowline, L.L.C. and
Southern Energy Lovett, L.L.C.

*protest

+late filed

Interventions in Docket No. EL00-63-000

AES NY, L.L.C.
Central Hudson Gas & Electric Corporation
EME Homer City Generation, L.P. and Edison Mission Marketing & Trading, Inc.
Independent Power Producers of New York, Inc.
Keyspan-Ravenswood, Inc.*
LSE Intervenors
Long Island Power Authority and LIPA*
Multiple Intervenors
Niagara Mohawk Energy Marketing, Inc.
NRG Power Marketing, Inc.*
Orion Power New York GP, Inc.
PG&E National Group, PG&E Generating, and PG&E Energy Trading-Power, L.P.*
Public Service Commission of the State of New York
Sithe Power Marketing, L.P.
Southern Energy NY Gen, L.L.C., Southern Energy Bowline, L.L.C. and
Southern Energy Lovett, L.L.C.*

*protest

Interventions in Docket No. EL00-64-000

AES NY, L.L.C.*

Central Hudson Gas & Electric Corporation

EME Homer City Generation, L.P. and Edison Mission Marketing & Trading, Inc.

Energetix, Inc.

1st Rochdale Cooperative Group, Inc.

Independent Power Producers of New York, Inc.*

Keyspan-Ravenswood, Inc.*

LSE Intervenors

Long Island Power Authority and LIPA*

Niagara Mohawk Energy Marketing, Inc.

NRG Power Marketing, Inc.*

Orion Power New York GP, Inc.

PG&E National Energy Group, PG&E Generating and

PG&E Energy Trading-Power, L.P.*

Sithe Power Marketing, L.P.

Southern Energy NY Gen, L.L.C., Southern Energy Bowline, L.L.C. and

Southern Energy Lovett, L.L.C.*

*protest

Niagara Mohawk Power Corporation
v.
New York Independent System Operator

Docket No. EL00-57-000

Orion Power New York GP, Inc.
v.
New York Independent System Operator, Inc.

Docket No. EL00-60-000

New York State Electric & Gas Corporation
v.
New York Independent System Operator, Inc.

Docket No. EL00-63-000

Rochester Gas & Electric Corporation
v.
New York Independent System Operator, Inc.

Docket No. EL00-64-000

(Issued May 31, 2000)

HÉBERT, Commissioner *concurring*:

The Commission here takes an important step toward establishing a truly competitive electricity market. In several ways, FERC departs from past practices. Today's order does not pretend that the New York Independent System Operator (ISO) designed a competitive market for operating reserves. Today's order does not pretend that any utility, singly or in combination, *exercised* market power. (In fact, we explicitly refuse to make that finding. Slip op. at 12.) Today's order does not pretend that *owning* a large portion of the capacity in a market amounts to anti-competitive activity. Finally, today's order does not pretend to take the approach contained in the ISO's request. Unlike in the past, we decline to reconstruct a competitive market through price or bid caps until the allegedly anti-competitive behavior ceases.

Instead, we all agree that New York faces a systemic problem with the rules and procedures of the ISO. Slip op. at 13-14. We agree the problem needs a solution. We agree that the ISO must fix five features of its procurement policies, and that it must do so soon. We further agree that in the interim we will supplant the reserve market currently in disrepair with a form of cost-based regulation. Finally, we agree that, if the problem remains beyond November 1, we will take further, appropriate steps, including a possible proceeding against the ISO under section 206 of the Federal Power Act.

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On today's record, and, as we will soon see, the record in a related complaint, the

ISO failed in its responsibilities. I think we should reconsider our approval of the organization as the operator of the grid in New York. I prefer we institute a section 206 proceeding against the ISO directly, rather than wait for the further report due on June 30. Slip op. at 31. Therefore, I concur.

Not Ready for Prime Time

Elementary economics teaches that businesses in a free market, unlike regulators, set prices according to customer value (what the buyer finds it worth paying), not the sellers' cost recovery. Generators submitting bids that would earn profits show the market at work, not manipulation, or "gaming," to use the currently popular term. Economics recognizes that, in addition to the forces of supply and demand, buyer ineptitude can lead to high prices, though set at inefficient levels.

The Commission has learned these lessons. Here, we state, slip op. at 12, that we make no finding that any generator withheld capacity. Instead, we find that buyer error by the ISO created the conditions for the severe breakdown of the reserve market that the order recites. Slip op. at 13-14. In particular, we identify the following mistakes -- basic ones, in my opinion -- the ISO made in organizing the reserve market.

- The ISO restricted the market when it "insisted" on purchasing from the east, though the path from the west remained open (91 FERC at , slip op. at 14);
- The ISO failed to set aside transmission capacity to buy from the west to keep open the path (*id.*);
- The ISO further restricted the market, as the operator failed to include a large hydroelectric facility in its list of available sources, even though "[i]f this unit were included, it could significantly change the market concentration and add another large competitor to the market." (*id.*);
- The ISO restricted the market even further by adopting practices that "severely limit the ability of customers . . . to self-supply operating reserves," though "[s]elf-supply is an important option to mitigate the potential exercise of market power." (91 FERC at , Slip op. at 15); and, I would add,
- The ISO kept prices high by applying to the spinning (stand-by) reserve market the higher prices in the non-spinning (not immediately available) reserve market, on the excuse that bidders would otherwise flock to the non-spinning reserve market.

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- 91 FERC at , Slip op. at 27. Of course, this ignores the fact that more bids in non-spinning reserves would bring the price down.

Teaching the Fundamentals

I consider price controls a device that enables undisciplined behavior and avoidance of hard choices. I would give the ISO the cold turkey treatment, in one of two ways. I would reject the bid caps altogether and let the prices fluctuate. This would act as an inducement to the ISO to reform its practices. Each of the errors the ISO made it could repair in short order. In fact, I understand that just one measure, including the hydroelectric project in the calculation will relieve the "crisis" here. While the ISO's software created the difficulty, systems exist that work and the ISO can install them. Alternatively, the ISO could purchase from the west and allow utilities to supply their own reserves. These changes the ISO can order immediately. With bid caps in place, it has no incentive to spend the money or change its practices. Without bid caps, the ISO will find the necessary time and money to do so.

The other method to fix the problem, on a long-term basis, requires that, in drastic cases, we substitute traditional regulation for the short term. Today's order adopts that solution. We state, 91 FERC at , slip op. at 18-19, that we adopt a proxy for capacity costs, and allow generators to recover more, if they show us that they incurred higher expenses. Then, we adopt opportunity costs (lost sales) as a proxy for energy costs. With traditional regulation, in effect, we supplant the ISO, until November 1, when we order it to change the way the New York reserve market operates .

Conclusion

As I stated at the outset, I agree that New York faces a potentially difficult summer. The problem lies in the failure of the participants to construct a market. I would agree, therefore, to start from the beginning. I would institute a proceeding under section 206 of the Federal Power Act, to withdraw our approval of the New York ISO, either here, or in the related case we will soon consider. This will allow everyone to deal with the reality of the failure of the parties in New York. With the deadlines of Order No. 2000 looming, this will give an impetus to the industry there to construct from the ashes of the current system, a real competitive market within the framework of a regional transmission organization.

Today's order, though not as explicit as I would write it, begins that journey. Readers should take away from our action the message that we will enforce standards on existing ISO's to ensure the proper framework for competition. We will direct solutions
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to systemic problems, as we do today. Though we will not institute a proceeding under section 206 now, the Commission stands ready to take tough action, even against existing ISO's. Complacent ISO's will not obtain approval as RTO's under Order No. 2000. We may not even allow them to continue in operation, stumbling from season to season and

year to year, distinguished only by their talent for self-preservation.

I hope the ISO will act to make the next step unnecessary. Today's order, at least, shows our resolve. I concur.

Curt L. Hébert, Jr.
Commissioner