

UNITED STATES OF AMERICA 92 FERC ¶ 61,073
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James J. Hoecker, Chairman;
William L. Massey, Linda Breathitt,
and Curt Hébert, Jr.

New York Independent System Operator, Inc. Docket No. ER00-3038-000

New York State Electric & Gas Corporation
v. Docket Nos. EL00-70-000
New York Independent System Operator, Inc. and EL00-70-001

ORDER ON TARIFF FILING AND COMPLAINT

(Issued July 26, 2000)

As discussed in this order, we find that there are several market flaws which exist in the New York Independent System Operator's (NYISO's) energy markets that warrant a temporary bid cap of \$1,000 per MWh through the summer capability period. The bid cap is effective on the date of this order and will expire on October 28, 2000. We require NYISO to address the market flaw problems identified and file a report by September 1, 2000 providing the status and results of its corrections. We also rule on certain tariff provisions.

I. Filings

A. Docket No. ER00-3038-000 (NYISO's Bid Cap Proposal)

On June 30, 2000, in Docket No. ER00-3038-000, NYISO filed to impose a temporary bid cap of \$1,300 per MWh on its energy markets to become effective on July 6, 2000 for suppliers submitting day-ahead bids for the July 7, 2000 market, and would apply starting July 7, 2000 in the real-time market. It proposes that the bid cap will expire no later October 28, 2000.¹ The \$1,300 per MWh bid cap would also apply to Minimum

¹NYISO is making this unilateral filing pursuant to the NYISO Board's independent filing authority granted under Section 19.01 of the ISO Agreement. Section
(continued...)

Generation Bids, Decremental Bids, Price Cap Load Bids, Sink Price Cap Bids and Installed Capacity (ICAP) recall bids.²

The NYISO Board states it has rejected the June 5th proposal to adopt a \$1,000 MWh bid cap.³ It explains that it has chosen a \$1,300 per MWh bid cap because \$1,300 is approximately equal to the highest day-ahead Locational Based Marginal Price (LBMP) that the NYISO-administered markets have experienced since they commenced operations. Additionally, the Board states it was persuaded by suppliers' arguments that the June 5th proposal's suspension of the Bid Production Cost Guarantees (BPCG) could unintentionally produce perverse economic consequences and has not included that provision in this filing.

The NYISO Board explains that it is philosophically opposed to any form of price control. However, it believes that a temporary bid cap is an appropriate interim solution to a significant market problem, namely, the absence of price responsive demand. The Board states that the bid cap will provide a safeguard against any price spikes arising from a lack of price-responsive load while a permanent solution to introduce price

¹(...continued)

19.01 permits NYISO to make a Section 205 filing when the Board certifies that "exigent circumstances" exist, without first getting approval from both the NYISO Board and the Management Committee. When a unilateral filing is made, it must contain an expiration date that is no later than 120 days after it has been filed, which in this case would be October 28, 2000.

² A minimum generation bid denotes the minimum quantity and price that an entity will make power available to the market; a decremental bid is the price at which the bidder is willing to reduce its scheduled level of energy production or transmission service; a price cap load bid is the maximum price above which a dispatchable internal load shall not be served; a sink price cap bid is the maximum price above which an external load or energy export shall not be served; an ICAP (installed capacity) recall bid is the level at which an entity will recall exports in favor of the NY market.

³On June 5, 2000, the NYISO's Management Committee approved a proposal to establish a bid cap of \$1,000 per MWh in the energy and ancillary services markets. The Board of Directors delayed consideration of this bid cap proposal in order to permit market participants to avail themselves of NYISO's appeals process, asking to be heard on this issue of bid caps. On June 30, 2000, the Board of Directors, after hearing market participants positions on this issue of bid caps, rejected the Management Committee's proposal and adopted a \$1,300 per MWh bid cap on the energy markets.

responsive demand is prepared. The NYISO Board informs the Commission that it has directed NYISO Staff and counsel to work with interested market participants to: (i) formulate effective demand-side market mechanisms in time for the summer of 2001; (ii) draft all necessary tariff revisions and develop all necessary software enhancements associated with these demand-side market mechanisms; (iii) seek to obtain the requisite NYISO stakeholder committee approvals; and (iv) subject to Commission review and approval, implement effective demand-side market mechanisms, as a permanent solution to the load price-responsiveness problem, by June 1, 2001.

NYISO requests waiver of the 60-day notice period in order for the filing to become effective on July 6, 2000. NYISO also requests that the Commission issue an order on this filing on an expedited basis. On July 3, 2000, NYISO filed a revised tariff sheet to correct a pagination error.

B. Docket Nos. EL00-70-000 and EL00-70-001 (NYSEG's Complaint)

On April 24, 2000, New York State Electric & Gas Corporation (NYSEG) filed a Complaint under Section 206 of the Federal Power Act (FPA) against NYISO requesting a suspension of market-based pricing in NYISO's energy and ancillary service markets and the imposition of cost-based bidding, or in the alternative price caps on bids, among other things. NYSEG alleges that NYISO has a number of severe implementation problems as well as several market flaws that, if left unattended, could cause prices to skyrocket during heavy demand periods this summer. Specifically, NYSEG's complaint alleges that NYISO's implementation problems include pricing rules that are not in NYISO's tariff, software problems, and communications failures. NYSEG further identifies the following market flaws that exist in NYISO's markets:⁴

- (1) energy imports from outside the New York Control Area (NYCA) have been unworkable;
- (2) energy prices fluctuate substantially over short periods of time in an inexplicable manner;
- (3) there is a significant lack of convergence in day-ahead and real-time prices;
- (4) the administration of fixed block generation has resulted in inefficient allocation of generation resources and customer payment obligations that are not permitted by the tariff;
- (5) NYISO has failed to recognize resources in the market;

⁴A detailed description of each of these flaws appears in Appendix C of this order.

- (6) advisory bills and settlement information are frequently revised over long periods of time, distorting market signals;
- (7) lack of timely communication on transaction curtailments and restoration prevent rational economic response; and,
- (8) ancillary services prices are uncompetitive.

On May 10, 2000, NYSEG withdrew its proposal requesting cost-based bidding and, in its place, filed an amended complaint asking the Commission to adopt the recommendation of the Members of the Transmission Owners Committee of the Energy Association of New York State (Member Systems) who support a "price screening" procedure that would become effective June 1, 2000 and be administered by NYISO. In addition, NYSEG and the Member Systems recommend an extension of NYISO's Temporary Extraordinary Procedures (TEP) until October 31, 2000 and request that the "price screening" procedures be incorporated into the TEP.⁵

II. Notice of Filings, Interventions, Protest, and Comments

Notice of NYISO's filing to impose a temporary bid cap in Docket No. ER00-3038-000 was published in Federal Register, 65 Fed. Reg. 41,970 (2000), with protests, answers and motions to intervene required to be filed on or before July 10, 2000. Timely motions to intervene were filed by entities listed in Appendix B to this order.

Notice of NYSEG's complaint filings in this proceeding were published in the Federal Register, 65 Fed. Reg. 25,320 (2000), with protests, answers, and motions to intervene subsequently required to be filed on or before May 25, 2000. Timely motions to intervene were filed by entities listed in Appendix A to this order.

III. Discussion

A. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2000), the timely, unopposed motions to intervene of the entities listed in the appendices to this order serve to make them parties to this proceeding(s) in which they intervened. At this early stage of the proceeding, given the lack of undue

⁵The Commission is addressing in a separate order in Docket No. ER00-2624-000 NYISO's proposal to extend the TEP.

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) (2000), prohibits the filing of an answer to a protest unless otherwise permitted by the decisional authority. However, we find the answers filed by NYSEG on May 30, 2000, and June 9, 2000, to be helpful in the development of the record in this proceeding, and accordingly we accept them. In this regard, we deny the June 23, 2000 request by Indeck Companies (Indeck) to strike these answers. We also deny waiver of Rule 213 to permit the response filed by Indeck on June 23, 2000 in Docket No. EL00-70-000 and the answer filed by NYISO on June 23, 2000 in Docket Nos. EL00-70-000 . The response of Indeck and answer of NYISO present no new facts for us to consider. In this regard, we grant NYSEG's June 30, 2000 request that the Commission reject NYISO's June 23, 2000 answer. Finally, we deny waiver of Rule 213 to permit the answer filed by the Member Systems on July 19, 2000 in Docket No. ER00-3038-000. The answer presents no new facts for us to consider.

B. Alleged Market Flaws⁶

1. Lack of Demand Side Response

The NYISO Board estimates that there is only approximately 50 MW of dispatchable load in the New York Control Area. If appropriate demand-side market mechanisms were in place, NYISO asserts, high prices would drive demand down, which would drive prices down.

2. Inter-control Area Transactions - Energy Imports and Exports

NYSEG states that energy imports have been unworkable and offers that NYISO's curtailments of inter-control area transactions have been so substantial, unpredictable, and

⁶In addition to those market flaws described in this portion of the order, Appendix C of this order describes other alleged market flaws. Allegations concerning bid blocks are discussed in the Tariff Violations section of this order below. Some of the additional alleged market flaws set forth in Appendix C, such as those involving certain ancillary services (i.e., reserves markets) have been addressed by the Commission in prior orders. Others do not appear to require specific Commission action at this time. However, in the report the Commission is requiring in this order, NYISO should address all market flaws alleged in Appendix C, as explained below.

on such short notice that PJM warned that it might discontinue day-ahead transactions with NYISO. According to NYSEG, PJM stated that it could not continue to be subject to NYISO's unpredictable curtailments with as little as 10 minutes' notice. NYSEG contends that ISO New England recently posted a letter to its market participants warning that it would not be able to rely on inter-control area energy transactions with NYISO during pre-emergency and emergency periods because of NYISO's volatile and unpredictable operations and pricing.⁷

NYSEG also argues that it has been financially harmed on several occasions when its out-of-state energy purchases were curtailed in a manner inconsistent with its bids. NYSEG states that it has had its bilateral transactions curtailed and has been charged a price for replacement energy that was above NYSEG's decremental bid and in some cases higher than its bilateral agreement energy price. NYSEG postulates that these problems are due to faulty software used for the advisory pricing produced by the Balancing Market Evaluation (BME), which dispatch is based on but is not financially binding. The BME curtails bilateral transactions when BME price predictions are less than the decremental bids associated with the bilateral transactions. Similarly, suppliers' offers of cheap energy in the hour-ahead market are rejected if they are above the erroneous BME price.

NYISO acknowledges that its BME scheduling system has experienced problems which have created risk for those scheduling imports in the day-ahead market. However, NYISO states that these problems are being solved. NYISO states that, in response to PJM's letter concerning curtailment of pre-scheduled day-ahead inter-control area transactions, it has taken a number of steps to address these concerns. NYISO states that this recent improvement, as well as other improvements in communication on information regarding curtailments, will reduce both the number of curtailments and the confusion regarding them, which will facilitate additional imports into the NYCA.

3. Dispatch of Fixed Block Generation

NYSEG contends that, in the case of fixed block generation, multiple units of combustion turbines (CTs) have been dispatched as a single unit when it would only have been necessary to dispatch one unit in order to balance the system. Given that CTs are

⁷Also, concerning inter-control area exports, on June 12, 2000, in Docket No. EL00-82-000, a complaint was filed by Niagara Mohawk Energy Marketing, Inc., (NMEM) claiming that NYISO rejected NMEM's request for export transmission service for several hours even though its decremental bid should have prevented it from being curtailed for economic reasons.

generally more expensive to operate, this can lead to large price increases that could be avoided if only a single unit were dispatched.

NYISO explains that the fixed block bidding rules are applicable to only 10-minute and 30-minute combustion turbine units and that the largest units are currently bid into the market in 160 MW blocks (there are three of these 160 MW blocks). NYISO states that it has negotiated with the turbine owners and has been successful in establishing bidding in 40 MW blocks for two of the 160 MW blocks and expects to reach a similar agreement for the remaining 160 MW block in the near future. With the new 40 MW block bids for combustion turbines, NYISO states that it will not have to reduce the loading of other units by nearly as much to put these combustion turbine units on line and this will mitigate the economic consequences of dispatching fixed block units out of merit order. We note that NYISO uses its TEP to address the pricing problems caused by the dispatch of fixed block generation. NYSEG is requesting an extension of its TEP procedures in order to continue to correct for these pricing problems.

4. Recognition of Market Resources

NYSEG complains that NYISO has a rule which rejects all bids of generators that bid above their Dependable Maximum Net Capability (DMNC), even if submitted in good faith. NYSEG states that generators that have successfully tested higher with a new DMNC have been unsuccessful in getting NYISO to recognize the results. NYSEG states that the NYISO operating committee approved a modification to this rule and implementation should not be delayed.

NYISO answers that the rule which required the rejection of bids in excess of the DMNC has been eliminated. Moreover, NYISO states it has instituted changes to allow resources to bid energy and ancillary services in an amount equal to their proven maximum production capability for the current capability period, or either of the prior two capability periods, and to further allow hydroelectric plants to use historical production data, acceptable to NYISO, to establish their proven maximum production capability. NYISO states that these rule changes were approved by the Operating Committee on April 19 and the Business Issues Committee on April 20, and thus there is no basis for the suggestion made in NYSEG's April 24 complaint that NYISO delayed implementation.

5. Timely Communication of Information

NYSEG states that a lack of timely communications by NYISO on transaction curtailments and restoration prevent rational economic responses.

NYISO acknowledges that there have been communications problems, mostly attributable to the initial staffing plan, but states that a variety of measures have been adopted to facilitate the dissemination of information, such as the establishment of the Technical Information Exchange, releasing technical bulletins, meeting with market participants, sponsoring training programs, expanding the operating hours of its market relations group, and seeking to hire additional staff.

C. Comments

We note that no party disputes that the market flaws identified by NYSEG are not in need of correction. Similarly, all parties agree that NYISO has already addressed, or is taking measures to address, each of these concerns. However, parties disagree over whether there remains a need for the imposition of additional corrective measures in light of NYISO's corrections.

NYISO responds that it anticipates that all of the market flaws identified will be addressed, or have already been addressed, in time to avoid serious problems this summer and thus, no other measures are required for this reason. However, NYISO concedes that a temporary bid cap should be placed into effect due to the lack of price-responsive load in NYISO's markets.

Several commenters, including the generators and power marketers, argue that there is no need for other measures for the summer period because NYISO has made significant progress in correcting these problems and most problems were addressed on or before June 1, 2000. In addition, these parties argue that other measures are not required because start-up problems, such as those identified, are to be expected and are not of a significant magnitude to warrant Commission intervention. These parties contend that NYSEG has failed to meet its burden of proof under Section 206 to demonstrate that the market flaws identified justify the relief it seeks.

These parties also contend that NYISO has not justified its proposal to institute a bid cap solely due to the fact that the New York markets lack a formal demand-response mechanism. They argue that if the Commission accepts this argument, then caps would have to be instituted in several more markets since many markets have not yet developed these types of programs. They argue that NYISO was fully aware of this when it requested market-based rate authority; and, if this were so important, a load response mechanism should have been developed by NYISO for implementation during this summer period. In any event, they claim there are several demand-reduction tools already available to load-serving entities. Load-serving entities can (1) sign bilateral contracts, thus locking in prices and avoid any real-time price spikes caused by supply shortages; (2)

buy in the Day-Ahead market, where there typically is less volatility, and (3) engage in hedging transactions. The generators and power marketers argue that workable competition does exist without such formal demand-response mechanisms. The lack of a demand-side response does not even constitute an "exigent" circumstance to justify the unilateral filing since there is nothing unanticipated about the situation this summer. These parties also argue that the lack of a demand-side response to price could be a voluntary non-response by consumers that are properly hedged. Finally, these parties argue that a bid cap will not fix the problem of a lack of demand responsiveness to price. In fact, they argue, a bid cap will exacerbate the situation in that load will not seek alternatives if they can rely on a regulatory cap.

Other arguments advanced by opponents of having other measures in place in NYISO's markets over the summer period include the claim that NYISO already has the necessary authority to take corrective action if problems arise under its TEP authority, if extended, its market mitigation plan, or the submission of a new Section 205 filing. Opponents also argue that generators will be discouraged from participating in NYISO's markets if any restrictions are imposed on the markets. And finally they contend that NYSEG is proposing various restrictions on NYISO's markets because it is seeking to protect its shareholders, not its ratepayers, as NYSEG is prohibited from raising its retail rates for the next three years as a result of a 1998 rate settlement and because NYSEG is not properly hedged in that it never entered into a long-term energy buy-back agreement when it sold its fossil generating assets.

On the other hand, several parties in this proceeding, including NYSEG, the Member Systems, and the New York Commission, believe that other measures are required. They find that although NYISO is making progress in correcting the market flaws, there are no guarantees that the problems have been completely corrected and that the risk is too great to go through the summer period without protective measures in place.

NYSEG contends that although NYISO has recently implemented some corrective actions and is working on others, time is too short to test the efficacy of these actions before summer peak load conditions and problems still remain which justify the imposition of protective measures.

The New York Commission states that although it is working closely with NYISO to address all of these problems, it is best to implement a bid cap. The New York Commission believes that there may be undetected or uncorrected market problems that could cause significant price spikes this summer beyond the level that would prevail in a properly functioning competitive market. The New York Commission states that an

efficient competitive market would rely on interruptible load and price capped load bids to deal with unanticipated generation shortages during extreme peak conditions, but such software and procedures are not yet readily available in New York. The New York Commission maintains that extreme price spikes contribute little to efficient energy market operations while subjecting market participants to significant financial risk.

D. Proposed Bid Caps

Several parties, including NYSEG, the Member Systems, the New York Commission, as well as NYISO, propose bid caps to be in place over the summer capability period in light of these alleged problems.⁸

In comments filed May 25, 2000 in the complaint proceeding, the New York Commission urges the Commission to establish an "out of bounds" cap on energy and ancillary services bids of \$1,000 per MWh, similar to that approved for PJM. The New York Commission states that the bid cap would bring increased certainty to the marketplace and needed protection to consumers without unduly preventing profit making opportunities, interfering with the functioning of a competitive market, or significantly adding to the already heavy workload of NYISO staff.

On June 5, 2000, a more refined proposal of the \$1,000 per MWh bid cap suggested by the New York Commission was approved by the NYISO's Management Committee (June 5 Proposal). This proposal provided for a \$1,000 per MWh bid cap until October 31, 2000 on all bids into all NYISO-administered markets, except for the regulation market which would be subject to an \$1,100 per MWh bid cap. The June 5 Proposal also proposed to suspend the BPCG for a supplier who bids minimum generation levels, start-up costs, or minimum run times when LBMP at the supplier's bus averages \$200 per MWh or more per day. Total payments, including the BPCGs may not exceed \$24,000 per MW per day. This proposal was rejected by the NYISO Board on June 30, 2000 and NYISO was directed to file the following proposal for implementing a bid cap.

On June 30, 2000, NYISO filed tariff sheets requesting that the Commission approve a temporary bid cap of \$1,300 per MWh on its energy markets. NYISO proposes

⁸In the complaint proceeding in EL00-70, NYSEG and others at one point suggested the use of cost based bidding and the addition of price screens for mitigating prices. Since these parties now support the proposals for bid caps, we will not address these other proposed remedies.

that the bid cap take effect on July 6, 2000 for suppliers submitting day-ahead bids for the July 7, 2000 market, and would apply starting July 7, 2000 in the real-time market. The bid cap will expire no later October 28, 2000. Suppliers would be subject to the bid caps regardless of whether they are located inside or outside of the New York Control Area. The \$1,300 per MWh bid cap would also apply to Minimum Generation Bids, Decremental Bids, Price Cap Load Bids, Sink Price Cap Bids and ICAP recall bids. Bid caps would not apply to ancillary services bids or Start-Up bids. The bid caps would be waived when necessary to permit emergency external purchases by NYISO, but such emergency external purchases would not be permitted to set the market-clearing price.

1. Support for Bid Caps - \$1,000 versus \$1,300

The New York Commission, the Member Systems⁹, Public Service Electric and Gas Company (PSE&G), Multiple Intervenors (Multiple Intervenors) and Municipal Electric Utilities Association (MEUA) prefer the establishment of an "out of bounds" cap of \$1,000 per MWh bid cap over the \$1,300 per MWh bid cap proposed by NYISO. These parties contend that the \$1,000 per MWh bid cap: (1) would provide consistency among neighboring ISOs; (2) is well above the operating costs that have been in place in PJM and have not dissuaded generators from entering PJM markets; (3) is high enough that bidders would not use it as a price floor; (4) would only be used as a temporary measure; and would protect customers from extreme price spikes; (5) should not result in a disincentive to suppliers such that they become unwilling to sell energy and ancillary services into the New York market; (6) would not act as a deterrent to developers such that they become unwilling to build new generation facilities in New York.¹⁰

These parties also support the bid cap being applied to the energy and ancillary service markets, whereas NYISO's proposal is to only apply the bid cap to the energy markets.

The New York Commission, Multiple Intervenors and MEUA also object to the NYISO Board's rejection of the anti-gaming provisions included in the June 5 proposal, when approving the \$1,300 per MWh cap. The NYISO Board rejected the anti-gaming provisions due to the fact that they could unintentionally produce perverse economic consequences. These parties argue that regardless of the level of the cap, anti-gaming

⁹The Member Systems initially proposed price screens in their comments filed May 10, 2000 in NYSEG's complaint filed in Docket No. EL00-70-000.

¹⁰The New York State Consumer Protection Board states that in PJM, there is a queue for generation interconnection projects that exceeds 40,000 megawatts.

provisions are necessary. Without some limitations, suppliers will be able to circumvent, or "game," the bid cap on energy during a period when the market is tight and the ISO has no alternative but to take the power. The provisions that should be included consist of the two limitations included in the June 5 proposal and approved by the Management Committee. The first is a provision which would place a \$24,000 per MWh limit on payments to suppliers over a 24-hour period to prevent a supplier from bidding huge start-up costs, high minimum generation levels, or long minimum runtimes as a way of evading the bid cap. In addition, BPCGs should be suspended for suppliers that bid minimum runtimes, minimum generation levels or start up costs whenever the LBMP averages over \$200 for the entire 24 hours of a day.

The Member Systems do not object to the NYISO Board's rejection of the anti-gaming provision, but believe there is an increased need for monitoring activities given that the NYISO Board did not approve the anti-gaming provisions.

Multiple Intervenors and the County of Winchester argue that no reasonable explanation has been provided as to why \$1,300 per MWh is an appropriate bid cap. Thus, they argue that NYISO's justification offers only that it happens to represent the highest LBMP the markets have experienced to date. Multiple Intervenors argue this reasoning is flawed given that the lack of a demand-response mechanism clearly existed on the June 26, 2000, the day the \$1,300 per MWh price occurred. Thus, they claim that the \$1,300 per MWh is tainted by the same transitional problems that led NYISO to conclude that prices were not currently being set by a proper interplay of supply and demand.

The County of Westchester supports a bid cap at a level not to exceed \$500 per MWh, which is similar to the \$500 cap imposed in California, and questions why NYISO would require a cap in excess of the cap in California.

Niagara Mohawk Energy Marketing (NMEM) is opposed to NYISO's proposal which applies the bid cap to Sink Price Cap Bids used for exports.¹¹ NMEM claims that market flaws and the lack of a demand-side response in NYISO's markets do not support the bid cap limitation on Sink Price Cap Bids which are used only to evaluate transmission requests for export transactions and are not used for energy payments.

2. Opposition to Bid Caps

¹¹On June 12, 2000, in Docket No. EL00-82-000, NMEM filed a complaint concerning Sink Price Cap Bids and export curtailments.

Orion Power New York GP, Inc. (Orion) and PECO Energy Company (PECO) oppose bid caps, claiming that bid caps: (1) would discourage generators outside of New York from selling into New York because they either can obtain unfettered market-based prices elsewhere, or do not wish to take the risk of delivering to a market where prices are subject to after-the-fact adjustments; (2) may encourage in-state generators who are able to export energy, to do so; (3) would act as a disincentive to investment in generation; (4) may become price floors as generators tacitly agree to bid electricity into NYISO at prices just under the caps, and (5) would interfere with the reasonable expectations of those parties who committed to sell ICAP in NYISO markets and purchased Transmission Congestion Contracts (TCCs) at a time when there were no bid caps in NYISO-administered markets.

Indeck Companies (Indeck) is opposed to bid caps and questions NYISO's proposal to subject domestic suppliers to caps but to exempt suppliers of imports from these caps during emergency situations.

3. Commission Decision

Given that NYISO's energy market is currently undergoing significant revisions to correct for existing market flaws, and the fact that there is a lack of demand-responsiveness to price, we find that to ensure just and reasonable rates during the summer period, it is necessary to implement some form of bid cap. The Commission recognizes that NYISO has made progress in addressing the market flaw problems; however, we share the concerns of intervenors that we cannot be assured that the corrections implemented by NYISO have completely resolved all of the market flaw issues, or that the recent corrections will not have other unintended adverse consequences.

We are similarly concerned that the lack of demand-side responsiveness to price and the predictions of tight supplies in the New York Control Area (NYCA), will exacerbate the potential problems for NYISO this summer. NYISO's predictions for supplies in the NYCA indicate that overall supplies are tight.¹² The NYCA Installed Capacity (ICAP) supply sources total 36,748 MW while requirements are at 35,636 MW. New York City's locational requirement of 8,272 MW is not met and is approximately 300 MW short. Similarly, the 2000 Summer Assessment (at 36) published by the North American Electric Reliability Council states that based on historical demand data and generator forced outage performance when NYISO demand exceeds 29,025 (a peak

¹²NYISO Reliability Assessment for Summer 2000 posted on NYISO's web site on May 19, 2000.

demand of 30,200 MW is projected), the area will not be able to satisfy its operating reserve requirements without invoking emergency relief measures. The combination of short supplies during peak periods and a lack of demand-responsiveness to price presents a situation in which NYISO has no alternative but to take the power. If load cannot respond to dramatic increases in prices, then generators can submit very high bids that NYISO must accept when supply is tight during peak periods, and price spikes can be magnified.

The lack of demand-responsiveness to price is due, at least in part, to factors that prevent retail customers from seeing the real-time hourly price of energy, rather than because retail customers are inherently willing to buy electricity at any price. For example, many retail customers do not have meters that measure the customer's energy consumption by hour, and face retail rate designs that establish prices that are fixed over long periods.¹³ Thus, even if some customers would want to reduce their electricity consumption during hours when prices are high, they do not see high hourly prices and so do not reduce their consumption. The result is that during capacity-tight periods, prices in NYISO's energy markets could rise significantly above the actual value of electricity to consumers and above the level that they would willingly pay. We recognize that NYISO is working towards alleviating this problem by developing a load responsive program to be in place by June 2001. However, this program will not be in place during this summer capability period.¹⁴

The possible consequences of these problems during the summer months are too serious to be ignored. The fact remains that many of the fixes are short-term, problems continue with NYISO's software, supply predictions are tight for the summer period, there is a lack of demand-side responsiveness to price and longer term fixes will not be implemented for some time. As a result, we are not confident that energy prices will not dramatically increase in New York this summer as a result of these problems.

We note that in addition to all of the changes that NYISO has made, and is making, to correct the market problems identified in these proceedings, NYISO is also correcting many problems in its ancillary service markets as required by our May 31

¹³The Commission recognizes that customers' ability to respond to price signals may be limited by the current availability and installation of demand management technology.

¹⁴The Commission is contemporaneously with this order considering similar issues in Docket No. EL00-83-000, NSTAR Services Company.

Order.¹⁵ It is not clear now what the cumulative effects of all of the recent quick fixes and long-term improvements will be, and any adverse effects may be magnified during the summer period because of the tight supply situation. Only experience will determine whether the solutions implemented completely alleviate the problems cited by NYSEG. Therefore, we believe the markets should not be left uncapped during the peak periods of NYISO's first summer of operation while NYISO continues to work to resolve each of these issues.

Based on the record in this case, we believe that to ensure just and reasonable rates during the summer period, it is appropriate to impose a restriction on NYISO's energy markets. Therefore, we will approve the bid cap proposal of NYISO, subject to certain modifications. First, we will set the bid cap at \$1,000 per MWh. Second, we will allow the bid cap to take effect on the date of this order in NYISO's energy markets and end on October 28, 2000. We have analyzed the other proposed remedies, including the \$1,300 per MWh bid cap proposed by NYISO, and find that the bid cap of \$1,000 per MWh provides the most reasonable remedy to implement on a temporary basis while NYISO implements market changes. The imposition of the \$1,000 per MWh bid cap, which is the same cap that is currently in effect in PJM, promotes our goal of coordination between neighboring ISOs. The adoption of the PJM cap for NYISO's energy markets also furthers our goal of gaining inter-regional coordination as expressed by our efforts to advance the formation of Regional Transmission Organizations (RTOs).¹⁶

We note that while bid caps in theory could affect the ability to get supplies into the market during the summer peak period, there are at least two offsetting factors here. First, load serving entities (LSEs) in New York are required to acquire Installed Capacity (ICAP) sufficient to meet their peak loads plus a reserve margin. Generation capacity designated to meet the ICAP requirement is required to bid into the New York ISO's energy market each day and may not sell outside of New York to the extent that it is required to meet New York load. Second, the ISO will be permitted to pay prices above the cap for emergency energy imports, if they are needed to meet load (although the prices paid for such imports would not set the clearing price in New York). These two factors should ensure that sufficient supplies can be obtained to meet load in New York

¹⁵New York Independent System Operator, Inc., 91 FERC ¶ 61,218 (2000).

¹⁶Regional Transmission Organizations, Order No. 2000, III FERC Stats. and Regs. ¶ 31,089 (2000). Concurrently with this order, the Commission is considering proposals for bid caps applicable to ISO New England in Docket No. EL00-83-000, NSTAR Services Company.

during the summer peak period. Moreover, a \$1,000 per MWh bid cap has been in place in the PJM market since PJM's inception and does not appear to have discouraged generators from participating in the PJM market nor from adding capacity to the PJM market.¹⁷

Our third modification to NYISO's bid cap proposal is to exclude Sink Price Cap Bids from the bid cap. We agree with NMEM that the bid cap should not apply to Sink Price Cap Bids used for scheduling exports from NYISO, because the Sink Price Cap Bids are not used to determine prices that are paid by buyers and received by sellers. Instead, the Sink Price Cap Bid is used only to determine scheduling for exports. Because of problems with NYISO's software, market participants have been told to submit high sink cap bids to ensure that their exports are not erroneously cut. Imposing a \$1,000 bid cap would undermine this temporary fix. However, under its market rules, NYISO can recall capacity sold in the Installed Capacity (ICAP) market. Should this capacity be recalled, it will be subject to the cap.

We will not apply the bid cap to NYISO's ancillary service markets¹⁸ as proposed by the New York Commission, the Member Systems, PSE&G, Multiple Intervenors and MEUA. We have already imposed bid restrictions on NYISO's 10-minute non-spinning reserves market due to the market concentration in that market.¹⁹ Based on the record in this proceeding, the market flaws identified by NYSEG pertain primarily to the energy markets. No showing has been made that a bid cap is needed in the ancillary service markets which do not already have one.

We will not require NYISO to file tariff language to include the "anti-gaming" provisions requested by the New York Commission, Multiple Intervenors and MEUA. We note that we approved "anti-gaming" language in PJM Interconnection, L.L.C. (PJM) to resolve specific instances identified by PJM in which generators could circumvent the

¹⁷In its comments at 8, the New York State Consumer Protection Board states that in PJM's experience with a similar cap, a queue for generation interconnection projects exists and exceeds 40,000 MW.

¹⁸NYISO's ancillary service markets include 10-minute spinning reserves, 10-minute non-spinning reserves, 30-minute non-spinning reserves, and regulation.

¹⁹New York Independent System Operator, Inc., 91 FERC ¶ 61,218 (2000).

bid cap.²⁰ Here, we do not have specific instances of gaming to tailor specific tariff provisions to prevent such actions. Nor do we find that there is sufficient support in this record for the specific tariff provisions proposed by these parties. Instead, we will direct NYISO to monitor for instances where generators may be engaging in behavior that would allow them to circumvent the bid cap we have imposed. In such instances, NYISO should make a filing with the Commission to propose tariff language that would prevent such behavior.

We recognize that these issues are difficult to address as they bring into focus the interrelationships of these markets. Therefore, the Commission encourages the Northeastern ISOs to address, in a collaborative process, other refinements and improvements that could be made that would facilitate the growth of competitive regional energy markets.²¹

We expect that the imposition of the \$1,000 per MWh cap will not have a significant impact on what parties paid for Installed Capacity (ICAP) and Transmission Congestion Contracts (TCC). This cap has been in effect in PJM and prices only on occasion reached the cap. We also note that prices in NYISO markets have only recently approached this level.

We believe it is appropriate to waive the cap on imports into NYISO during emergency situations, as proposed by NYISO. To do otherwise may increase the risk that there will not be adequate supply to meet peak demand. We also find it appropriate, as NYISO proposed, that the emergency purchases will not set the market-clearing price.

We are only approving this cap on an interim basis and are directing NYISO to continue to take corrective actions over the summer period and to continue developing a demand-responsive mechanism. We do not intend for this to become a permanent measure. As discussed later under reporting requirements, we are establishing a process

²⁰PJM Interconnection, L.L.C., 92 FERC ¶ 61,013 (2000).

²¹In encouraging this collaborative process, we also draw NYISO's attention to a recent order where the Commission directed ISO New England to consult with NYISO and PJM on other issues regarding coordination of market design, specifically ISO New England's proposal for four-hour reserves and virtual bidding. See ISO New England, 91 FERC ¶ 61,311 (2000).

to ensure that corrective actions are taken so that there will be no need for a permanent cap.²²

We reject the arguments of certain generators against a bid cap.²³ While it may be that the problems are in the process of being fixed, we cannot be assured that this is the case at this time.

E. Tariff Violations

NYSEG states that although NYISO has recently implemented some corrective actions and is working on others, some of the corrective actions are unauthorized and inconsistent with NYISO tariffs or Commission orders. NYSEG claims that in the instances detailed below the actions are unauthorized by the tariff and have harmed participants. A more detailed summary of NYSEG's allegations concerning tariff violations, as well as NYISO's response, can be found in Appendix C of this order.

1. Bid Production Cost Guarantees (BPCG) For External Generators

NYSEG claims that NYISO, in an effort to mitigate the effects of the unpredictable curtailment of imports from PJM, started paying external suppliers a BPCG. NYSEG states that the extension of BPCG to external generators causes substantial uplift and is not authorized by NYISO tariffs.

NYISO maintains that paying the BPCG to external generators is consistent with its tariff and the reliability needs of a competitive market.

We agree with NYISO that applying the BPCG to external generators is appropriate and consistent with the Commission approved NYISO Services Tariff. First, contrary to NYSEG's assertion that paying the BPCG is outside of NYISO's authority under the tariff, nowhere in the tariff is it stated that the BPCG is limited to internal generators. Second, regardless of the generator location, whether internal or external to NYISO, if a generator is committed by NYISO in the day-ahead market, its should be

²²In an order issued contemporaneously in Investigation of Electric Bulk Power Markets, the Commission is also directing its staff to undertake a study of bulk power markets.

²³We note that some generators support the extension of NYISO's Temporary Extraordinary Procedures authority over the summer period.

guaranteed cost recovery. Moreover, as we have stated in previous orders, NYISO should treat internal and external generators identically, and allowing external generators to be eligible for the BPCG payment is consistent with the Commission's previous decisions regarding NYISO.

2. Bid Blocks Setting LBMP and Lost Opportunity Payments

NYSEG believes that NYISO has adopted a pricing rule not provided by the tariff, e.g., that the fixed block bid price is used to set the LBMP. NYSEG contends that when NYISO dispatches a fixed block bid in the real-time market that is in excess of its needs, it must also back down the last most economic resource that was dispatched. The backed down resource must therefore "buy back" its dispatched energy at the LBMP set by the fixed block bid, thus the resource can be forced to purchase replacement energy in the real-time market at a price that exceeds its own bid price. NYSEG maintains that this pricing procedure is a violation of the tariff and the LBMP pricing theory.

NYSEG also complains that generators that are dispatched down to make room for fixed block generators are being compensated using "Lost Opportunity Payments" (LOP) and that these LOP payments are not authorized for this purpose under NYISO services tariff. NYSEG maintains that use of LOP in this manner, with the costs passed on to customers through the Schedule 1 charge, without a tariff revision, is improper. NYSEG maintains that the compensation of the dispatched down generator through an LOP, instead of using supplemental payments under the BPCG for the block bidding generator, results in a higher LBMP, higher cost to consumers, and appears to not be authorized by the services tariff. NYSEG also argues that the current approach may encourage gaming, whereas with compensation through BPCG, gaming incentives would be removed.

NYISO states that NYSEG is incorrect to claim that it is acting in a manner inconsistent with the tariff or LBMP pricing theory by allowing fixed block generators to set the LBMP. NYISO maintains that allowing fixed block generators to set the LBMP sends a price signal which is consistent with overall supply and demand conditions.

NYISO also argues that, contrary to NYSEG's assertion, its practice of paying lost opportunity payments (LOP) to generators that are dispatched down to make room for fixed block generation is consistent with NYISO tariffs. NYISO acknowledges that at the time of NYISO commenced operations, there were some discrepancies between the treatment of these charges in the SCUC and the ISO tariffs, and their treatment in the billing and accounting systems. NYISO explains that the procedures have been modified to properly reflect the tariffs and software.

We note that NYISO's Services Tariff states that LBMP is:

A pricing methodology under which the price of Energy at each location in the NYS Transmission System is equivalent to the cost to supply the next increment of Load at that location (i.e. short-run marginal cost). The short-run marginal cost takes Generation Bid Prices and the physical aspects of the NYS Transmission System into account. The short-run marginal cost also considers the impact of Out-of-Merit Generation (as measured by its Bid Price) resulting from the Congestion and Marginal Losses occurring on the NYS Transmission System which are associated with supplying an increment of load.²⁴

The Commission agrees with NYISO that fixed block generation resources should be allowed to set the market price for energy so long as that resource reflects the marginal cost of supplying one more unit of energy. However, this is not the point that NYSEG disputes. What is in dispute is the marginal cost of supplying the next increment of load when fixed block resources are dispatched and other generation resources, with bid prices less than the fixed block resource, are backed down out of merit order to make room for the fixed block resource. On this matter, however, the ISO Tariff is clear. If it is the case that generation resources, with lower bid prices, are dispatched downward to accommodate more expensive fixed block resources, then the marginal cost of supplying the next increment of load is equal to the bid price of the least expensive unit that has been backed down.²⁵

If the price is set in this manner, there should be no need to pay generators that are backed down any opportunity costs, and the fixed block resource can have its costs covered through the BPCG that has already been approved by the Commission. Therefore, we direct NYISO to revise how it is setting the price of energy with respect the

²⁴NYISO Services Tariff at Original Page 22.

²⁵For example, suppose there is 270 MW of load to be served and two generators that can serve the load. The first generator has a maximum output of 250 MW with a bid price of \$20 for all 250 MW. The second generator is a fixed block resource of 60 MW, and a bid price of \$50 for all 60 MW. The actual physical dispatch that must take place, given the fixed nature of the second generator, is the first generator dispatched at 210 MW and the fixed block generator dispatched at 60 MW. The marginal cost of supplying the next increment of load (1 MW) is the bid price of the first generator (\$20), not the \$50 bid price of the fixed block resource.

dispatch of fixed block resources so that it is consistent with the Services Tariff as described above.

3. Curtailment of Transactions

According to NYSEG, NYISO implemented a quick fix in order to reduce the number of bilateral transactions that are curtailed as a result of the BME producing a negative price below the decremental bids. As a way around this problem, NYISO advised market participants to submit decremental bids of -\$9,999 to prevent the BME from curtailing the transaction. However, NYSEG states that the result of this quick fix was to create a situation where several bidders had equal decremental bids. NYISO's tariff requires a pro rata allocation for curtailment when decremental bids are equal. However, NYISO's software is currently incapable of curtailing on a pro rata basis. NYSEG contends that to get around this new problem, NYISO started randomly adding pennies to certain transactions. Under this method, certain transactions are curtailed completely as opposed to a pro rata curtailment among all transactions with equal decremental bids.

We agree with NYSEG that the ISO OATT calls for pro rata curtailments of transactions with identical decremental bids. The Commission reiterates its approval of this curtailment procedure in the event that decremental bids are equal. Therefore, we find that if NYISO is engaged in this practice it is in violation of its tariff. If NYISO is undertaking such a practice, it should terminate such practices immediately as it is in violation of the Commission approved ISO OATT. If NYISO wishes to change the way it curtails bilateral transactions with identical decremental bids, then it must file proposed tariff changes with the Commission for approval.

F. Refunds and Refund Effective Date

NYSEG requests that the Commission establish the earliest refund effective date possible applicable to energy and ancillary services markets, and require the refund of overcharges to the extent that prices were not established in accordance with applicable tariffs or otherwise subject to correction.

1. Comments

The Member Systems and the New York Commission also support the establishment of a refund effective date. NYISO states that it would support the establishment of a refund effective date provided it has the money to pay refunds.

Ravenswood and Orion object to the request for a refund effective date. Orion argues that retroactive changes are disruptive and should be rejected.

PECO states that it has no objections to the establishment of a refund date. However, it believes this action is unnecessary, since NYISO itself has authority to correct invoices under Section 7.2A of NYISO Market Administration and Control Area Services Tariff, which allows NYISO to bill based on estimates, with true-ups at a later date.

Indeck states that such a request cannot be lawfully granted. It argues that NYSEG has failed to institute complaint proceedings against the specific energy suppliers whose market-based rates are challenged in a Section 206 proceeding to refund amounts in excess of just and reasonable rates. The Southern Parties make similar arguments. They contend that such relief is not available under either NYISO's market power monitoring and mitigation procedures or NYISO's TEPs.

2. Commission Decision

The Commission denied the requests for refunds and for the establishment of a refund effective date, in our recent order concerning NYISO's reserves markets.²⁶ The Commission denies such requests in this proceeding as well. The use of such remedies here, as when the Commission considered remedies for NYISO's reserves markets, would create substantial uncertainty in the New York markets and would undermine confidence in them, even if applied only to future periods. In addition, as with NYISO's reserves markets, customers cannot effectively revisit their economic decisions in these circumstances, and parties cannot retroactively alter their conduct. Further, the computation of refunds would be complex and would encourage needless litigation. The Commission believes that the remedy it has chosen, the \$1,000 per MWh bid cap, is both effective and fair, and is the one most likely to further the development of the New York markets.

G. Reporting Requirements

1. Support for Reporting Requirements

²⁶ New York Independent System Operator, Inc., et al., 91 FERC ¶ 61,218 (2000).

NYSEG and Member Systems request that the NYISO Management Committee, in conjunction with the NYISO staff, develop a consensus plan to resolve current problems and to provide periodic status reports. The New York State Consumer Protection Board (NYSCPB), PECO and PSE&G support this proposal.

2. Opposition to Reporting Requirements

NYISO objects to the Member Systems' proposal to require NYISO to develop a new "consensus plan" to address current market problems. NYISO contends that it already has prepared a "Project Management List," with the assistance of the market participants, that defines the priorities of its efforts to enhance its markets. NYISO states it has also prepared the "Summer 2000 Preparations" list which outlines its immediate priorities as summer approaches. In addition, NYISO states it has already committed to make weekly reports to NYISO committees on the "Summer 2000 Preparations" list and monthly reports on its "Project Management List." Thus, NYISO claims there is no reason to revisit NYISO's existing plan of action at this time.

Moreover, NYISO states it does not believe there is any need for it to submit formal reports to the Commission detailing its progress because it is engaged in constant dialogue with the New York market participants, and NYISO committees, regarding its efforts to correct market problems.

3. Commission Decision

We are approving the \$1,000 per MWh bid cap until October 28, 2000. This is an interim solution, while NYISO is resolving these market design and software issues. Although, NYISO is reluctant to file additional reports with the Commission, the Commission must have a comprehensive filed statement of the status of its efforts to increase the ability of customers to respond to price, and of the changes NYISO has made to correct the identified market flaws, and a report on the effects of the changes to NYISO's markets. This will be necessary in order for the Commission to determine whether further actions are necessary to ensure that the market flaws are corrected. Therefore, we will require NYISO to file by September 1, a status report of any changes or revisions it has made to correct or address the market flaws identified as outlined in Appendix C of this order, and the status of its efforts to increase the ability of customers to respond to price. We also direct NYISO to provide in that report a full description of the effects these changes have had on its markets and whether additional changes are necessary. The filing of this report will provide an opportunity for parties to comment on NYISO's actions to date and proposed course of action.

September 1, 2000, the date on which NYISO is to file its report on the status and effects of its changes, is the same date on which we required NYISO to make a similar report in our May 31, 2000 order in Docket No. ER00-1969-000, et al. The report in this case and in the report in the Docket No. ER00-1969 proceeding should be filed together as a combined report. This will enable the Commission to have, at the end of the summer period, a comprehensive picture concerning all the significant changes NYISO has implemented and those that are still under review in all of NYISO's markets. In this combined report, the Commission should have the information necessary to determine whether NYISO's changes have solved the problems identified. If the problems are not resolved, the Commission will have time to review the data and take whatever action is appropriate.

H. Tariff Sheet Designations

The proposed designations in NYISO's supplemental filing on July 3, 2000 in Docket No. ER00-3038-000 do not comply with Order No. 614. These should have been designated as Substitute Original Sheets. Appendix D of this order shows corrected designations in accordance with the guidelines set forth in Order No. 614. NYISO is directed to follow these guidelines in future filings.

The Commission orders:

(A) NYSEG's complaint, as amended, is granted in part and denied in part, as discussed in the body of this order.

(B) The bid cap will take effect on the date of this order and terminate on October 28, 2000.

(C) The tariff sheets filed by NYISO on June 30, 2000 in Docket No. ER00-3038-000 are rejected. The tariff sheets filed by NYISO on July 3, 2000 in Docket No. ER00-3038-000 are accepted to become effective on the date of this order, subject to NYISO filing revised tariff sheets, within 15 days of the date of this order, to reflect the modifications discussed herein. The status of these sheets as accepted or rejected, and their appropriate designations are listed in Appendix D of this order.

(D) On September 1, 2000, NYISO is required to file a report that describes the status of its efforts to correct the market flaws here identified, as discussed in the body of this order.

By the Commission. Commissioner Hébert dissented with a separate

Docket No. EL00-70-000, et al.

-25-

statement attached.

(S E A L)

David P. Boergers,
Secretary.

Interventions in Docket Nos. EL00-70-000 and EL00-70-001

Advantage Energy, Inc.
Aquila Energy Marketing Corp.*
City of New York
Coral Power LLC
Constellation Power Source Inc.*
County of Westchester
Dynegy Power Marketing Inc.
Electric Power Supply Association*
EME Homer City Generation, L.P. and Edison Mission Marketing &
Trading, Inc.
Energetix, Inc.
Engage Energy US LP
Enron Power Marketing, Inc.*+
1st Rochdale Cooperative Group, Ltd and Coordinated Housing Services, Inc.
Hydro Quebec Energy Services, Inc.
Indeck Companies*
Independent Power Producers of New York, Inc.*
Keyspan-Ravenswood, Inc.*
Member Systems of the Transmission Owners Committee of the
Energy Association of New York State
Merchant Energy Group of the Americas, Inc.
Merrill Lynch Capital Services, Inc.*
Morgan Stanley Capital Group, Inc.
Multiple Intervenors*
Municipal Electric Utilities Association of New York State
National Energy Marketers Association
New York Consumer Protection Board
New York Power Authority
New York State Rural Electric Cooperative Association
Niagara Mohawk Energy Marketing, Inc.
NRG Power Marketing Inc.*
NYSEG Solutions and Empire Natural Gas
Orion Power New York GP Inc.*
PECO Energy Company*

PG&E National Group, PG&E Generating, and PG&E Energy Trading-
Power, L.P.*
PPL Electric Utilities Corporation
Public Service Commission of the State of New York
Public Service Electric and Gas Company
Select Energy Inc.
Sithe Power Marketing LP and AES NY LLC*
Southern Energy Bowline, L.L.C., Southern Energy Lovett, L.L.C., and
Southern Energy NY Gen, L.L.C.*
Strategic Power Management Inc.
Technical Conference of Owners Committee on Electric Rates
TransCanada Power Marketing Ltd
Williams Energy Marketing & Trading Co.*

*protest
+late filed

Appendix B

Interventions in Docket No. ER00-3038-000

AES NY, L.L.C.
American Electric Power Service Corporation*
Aquila Energy Marketing Corporation and Strategic Energy, L.L.C.*
County of Westchester*
Dynegy Power Marketing, Inc.*
Electric Power Supply Association*
Engage Energy US, L.P.
Enron Power Marketing, Inc.+
H.Q. Energy Resources*
Indeck Companies*
Independent Power Producers of New York, Inc. and PECO Energy Company*
Keyspan-Ravenswood, Inc.*
Morgan Stanley Capital Group Inc.*
Member Systems*
Merrill Lynch Capital Services, Inc.*
Multiple Intervenors*
Municipal Electric Utilities Association*
Niagara Mohawk Energy Marketing, Inc.*
PG&E National Energy Group, Selkirk Cogen Partners, L.P. and Athens Generating
Company, L.P.*
PPL EnergyPlus, LLC*
Public Service Commission of the State of New York*
Public Service Electric and Gas Company, PSEG Energy Resources & Trade LLC, and
PSEG Power New York Inc.*
Sith Power Marketing, L.P. and NRG Power Marketing, Inc.*
Southern Energy Bowline, L.L.C., Southern Energy Lovett, L.L.C. and Southern Energy
NY-Gen, L.L.C.
TransCanada Power Marketing Ltd*

*Protest or Comments

+Late Intervention

Appendix C

Market Flaws and Tariff Violations Alleged by NYSEG and PECO

NYSEG alleges that implementation problems, extra-tariff pricing rules, software problems, and communications failures have caused energy market prices to reach exorbitant levels at times and could cause energy prices to skyrocket during heavy demand periods this summer. NYSEG identifies the eight market flaws described below. PECO also identifies a market flaw and NYSEG alleges that NYISO has violated several provisions of its tariff.

A. Energy Imports

1. NYSEG's Allegation

NYSEG states that energy imports have been unworkable. NYSEG contends that NYISO has engaged in numerous unexplained inter-control area curtailments and because of this PJM threatened to discontinue day-ahead transactions with NYISO. NYSEG maintains that the curtailments are because NYISO software incorrectly predicts less expensive supplies, only to force purchases at much higher prices. NYSEG states that although NYISO has recently implemented some corrective actions and is working on others, time is too short to test the efficacy of these actions before summer peak load conditions and that some of the corrective actions are unauthorized and inconsistent with NYISO's tariffs or Commission orders (i.e., NYSEG cites NYISO's use of the BPCG for external generators as inappropriate).

NYSEG states that NYISO's curtailments of inter-control area transactions have been so substantial, unpredictable, and on such short notice that PJM warned that it might discontinue day-ahead transactions with NYISO rather than continue to be subject to NYISO's unpredictable schedule curtailments with as little as 10 minutes notice.

NYSEG states that it has been financially harmed on several occasions when its out-of-state energy purchases were curtailed in a manner inconsistent with its bids. NYSEG states that it has had its bilateral transactions curtailed and has been charged a price for replacement energy that was above NYSEG's decremental bid and in some cases higher than its bilateral agreement energy price. NYSEG contends that NYISO software is not operating according to the tariff provisions and postulates that the problem is a disconnect between the advisory pricing produced by the Balancing Market Evaluation (BME), which dispatch is based on but is not financially binding, and the actual pricing in the real-time market which is financially binding. NYSEG asserts that this behavior is discouraging external transactions and may affect system reliability.

NYSEG conducted a study, for the period December 31, 1999 to March 31, 2000, of the effective price differential between PJM and NYWest market clearing prices. NYSEG multiplied the PJM/NYWest price spread, including transmission charges, by the corresponding hourly available transmission capability and concluded that the lost import opportunity was \$29 million. NYSEG points out that imports from PJM could result in lower consumer prices in the NYCA.

NYSEG claims that because total market participants are reduced when energy imports are restricted or discouraged, any market power analysis which is based on the inclusion of such energy imports is no longer valid when the import transaction participation is reduced. NYSEG contends that numerous market power applications submitted in recent years include imports from one or more neighboring regions. NYSEG cites an instance where market power increases from 7% to 33% when imports are excluded from the analysis. NYSEG argues that reduced imports lead to less surplus energy which causes an increased opportunity for the remaining participants to exercise strategic bidding behavior during peak load conditions.

NYSEG claims that the extension of the BPCG to external suppliers appears to not have been an effective solution. NYSEG states that the extension of BPCG to external generators causes substantial uplift and is not authorized by NYISO's tariffs. NYSEG states that market participants can not avoid erroneous transaction cuts by submitting artificially high decremental bids because other market participants also bid in the same fashion and that interim NYISO solutions currently in development will not solve the underlying problems nor is there enough time to develop, implement, test, and demonstrate reliable and correct import transaction processing before the summer peak load.

2. NYISO's Response

NYISO acknowledges that its BME scheduling system has experienced problems which have created risk for those scheduling imports in the day-ahead market. However, NYISO states that these problems are close to being solved.

NYISO states that, in response to PJM's letter concerning curtailment of pre-scheduled day-ahead inter-control area transactions, it has taken a number of steps to address these concerns. Specifically, NYISO states that it has: (1) implemented on May 23, 2000, a methodology that provides day-ahead external transactions with economic priority over hour-ahead external transactions by giving them a defacto "must run" status, thus ensuring that they are the last transactions cut in the BME's hourly evaluations; (2) established an interim notification process for the summer to notify market participants of

the reasons why a particular transaction has been curtailed; (3) begun work on a fully automated notification process that will be operational by the fall; and (4) created a fifth control room position to provide real-time communication between NYISO and generators. NYISO submitted a letter from PJM in which PJM states that it is encouraged by the proposal that transactions scheduled in the day-ahead market will be considered must-run for hourly evaluations and that it believes that this will result in fewer curtailments. NYISO states that its recent improvements will reduce both the number of curtailments and the confusion regarding them, which will facilitate additional imports into the NYCA.

NYISO states that NYSEG's criticism of the pricing and scheduling of energy imports in the NYCA confuses two issues. One issue, which NYISO has previously explained, deals with the must-run treatment for day-ahead external transactions. However, NYISO explains that there is a pricing problem in the hour-ahead market that arises when transmission or scheduling constraints, such as the maximum limitation on hourly schedule changes, impede imports. When such constraints occur, there can be a limitation on imports in the hour-ahead market that is not reflected in real-time prices which produces a divergence between prices used to schedule imports in the BME and the real-time prices used for settlements. NYISO states that this is the underlying source of many of the problems involving external schedules.

NYISO states that it has proposed an interim change to scheduling procedures that will mitigate the effects of the BME/real-time divergence. NYISO has presented a long term fix, a revised methodology for calculating real time prices at external buses when imports are constrained, to market participants.

NYISO maintains that NYSEG's complaint incorrectly asserts that as a result of the pricing problems in the hour-ahead market, participants cannot count on external energy supplies. NYISO points out that transactions are only curtailed in the hour-ahead market when imports are constrained in the BME, which means that the imports are limited by the constraint, not by economic considerations, and thus curtailments only occur when constraints prevent additional energy imports.

NYISO disputes NYSEG's assertion that it improperly invoked the BPCG for external suppliers, rejects NYSEG's interpretation of the tariff limiting the BPCG to internal suppliers, and that this use leads to potential substantial uplift charges which are inconsistent with the tariff. NYISO maintains that paying the BPCG to external generators is consistent with the tariff, the reliability needs of a competitive market, and that NYISO has acted in a manner consistent with Section 4.9 of the tariff. NYISO

maintains that the criticism of its determination that external suppliers are properly eligible for BPCG is based on a misunderstanding of the SCUC program's logic.

NYISO states that NYSEG's analysis of the PJM lost import opportunity is flawed in that it apparently relied on a number of erroneous assumptions that lead to a greatly overstated profitability of imports during the period analyzed. NYISO submitted an analysis by Mr. Scott M. Harvey and Andrew Hartshorn which concludes that the data contained in the NYSEG complaint affidavits of Mr. Kinney and Kimiecik did not reflect the impact of the real-time market price corrections and that the corrected New York real-time prices have actually been slightly lower than the corresponding PJM prices over the period covered by Mr. Kinney and Kimiecik's comparisons.

NYISO disagrees that the mere existence of import price uncertainty during periods in which imports are constrained necessitates a re-evaluation of market power in the NYCA. NYISO states that the constraint that most often limits the level of imports in individual hours is the constraint on the hour-to-hour change in imports. NYISO argues that even if the BME fails to correctly predict the profitability of the imports, the market mechanism anticipates that market participants would schedule imports based on their own analysis of the expected price relationships. Further, NYISO argues that any exercise of market power will be checked by its market monitoring functions and its ability to implement market power mitigation measures.

NYISO believes that the import problems identified by NYSEG are well on the way to being solved and that interim corrections will be in place for this summer. Additionally, NYISO states that it is working to improve inter-control area transactions with its neighboring control areas through the ISO-MOU process.

B. Energy Price Fluctuation

1. NYSEG's Allegation

NYSEG claims that the scope and frequency of the volatility of energy prices and the BME are difficult to comprehend, and that it has yet to receive a rational explanation from NYISO. NYSEG states that numerous extraordinary price spikes have occurred since the start of NYISO operations and that this volatility can render energy price prediction and planning to be of little or no value. NYSEG fears that the volatility is the result of software or modeling problems.

2. NYISO's Response

NYISO answers that price volatility in the real-time market has been greatly exaggerated (the market accounts for only 2-4 percent of the market transactions) and is the result of market forces not a market design flaw. NYISO states that the specific price variation identified in NYSEG's complaint can be attributed either to rapidly changing, volatile market conditions, or to specific, isolated computer failures. NYISO conducted a price analysis which establishes that the BME is only slightly more volatile than the day-ahead market and is less volatile than the real-time market. NYISO states that almost the entire difference in volatility between the BME and real-time markets is attributable to a very small number of hours in which the BME prices were extremely low, and that because BME prices are not used for settlement no resources are expended identifying and correcting erroneously calculated BME prices. NYISO denies that it failed to timely explain price volatility. NYISO states that it has worked to identify software problems, and market flaws, has instituted a tracing project to keep market participants informed of changes and enhancements, and has already implemented communications improvements to ensure that market participants have ready-access to information when prices become volatile.

C. Price Convergence

1. NYSEG's Allegation

NYSEG states that NYISO market structure was based on the premise that the day-ahead and real-time markets would converge and that one of the purposes of the BME is to narrow the gap between forecast and real-time prices. NYSEG believes that the BME has failed to narrow the gap and has exacerbated the differential between the forecast and real-time prices. NYSEG conducted an analysis of the convergence of the day-ahead market prices and real-time market prices and concluded that the real-time market is consistently priced lower than the day-ahead market, and that the difference is significant (2.88/MWh). NYSEG maintains that the price difference should not be this large or consistently in favor of the real-time market, and therefore concludes that the markets are not acting in a rational or competitive manner.

2.. NYISO's Response

NYISO responds that the NYSEG's complaint of a lack of convergence in the day-ahead, hour-ahead, and real-time markets is based on a faulty premise that price convergence is a fundamental market design goal. NYISO states that price convergence is not an indicator of how well NYISO administered markets are performing. NYISO further states that the lack of price convergence between the day-ahead and real-time market is not a cause for concern since some price disparity is to be expected due to the

relative price risk differences between the two markets. With regard to the lack of convergence between the BME and the real-time market, NYISO explains that the nature of the two software programs is such that they do not address the same time frames and consequently have different resources available to them. BME prices are calculated using essentially the same software used in the day-ahead market and analyze a three hour period, whereas real-time prices are calculated using the Security Constrained Dispatch software and a five minute period. Further, the BME can meet demand using resources which can be started in 30 minutes, while the real-time software can only use resources which can start in five minutes.

NYISO maintains that the BME/real-time price divergences are not as great as NYSEG's complaint indicates and states that its own analysis indicates that there has been substantial convergence. NYISO explains that the BME was never intended to be a hedging tool, but was meant to enable suppliers already in the commitment process to respond to information that was not available at the time they made commitment decisions in the day-ahead market.

NYSEG's own data shows that the day-ahead and real-time markets are converging, albeit slowly.

D. Administration of Fixed Block Generation

1. NYSEG's Allegation

NYSEG argues that NYISO's use of fixed block bidding in the real-time market creates three problems. First, NYSEG believes that NYISO has adopted a pricing rule not provided by the tariff, e.g., that the fixed block bid price is used to set the LBMP. Therefore when NYISO dispatches a fixed block bid in the real-time market that is in excess of its needs, it must also back down the last most economic resource that was dispatched. The backed down resource must therefore "buy back" its dispatched energy at the LBMP set by the fixed block bid, thus the resource can be forced to purchase replacement energy in the real-time market at a price that exceeds its own bid price. NYSEG maintains that this pricing procedure is a violation of the tariff and the LBMP pricing theory. Second, NYSEG argues that strategic bidding by suppliers in the east of fixed blocks can harm customers in the west. For example, if NYISO calls upon a fixed block resource on the congested side of the interface, it may cause NYISO to reduce generation on the unconstrained side of the interface, thereby removing congestion which, because the higher priced fixed block generation now sets the LBMP in more than one zone, exacerbates the impact of the increased LBMP resulting from the fixed block generation bidding strategy. NYSEG believes that bidding strategies are being developed

and used for reasons other than legitimate plant operating parameters. Finally, NYSEG states that generators that are dispatched down to make room for fixed block generators are being compensated using "Lost Opportunity Payments" (LOP) and that these LOP payments are not authorized for this purpose under NYISO services tariff. NYSEG maintains that use of LOP in this manner, with the costs passed on to customers through the Schedule 1 charge, without a tariff revision is improper.

NYSEG maintains that the current NYISO method of letting the block bidding generator set the LBMP and compensating the dispatched down generator through an LOP, instead of using supplemental payments under the BPCG for the block bidding generator, results in a higher LBMP, higher cost to consumers, and appears to not be authorized by the services tariff. NYSEG also argues that the current approach may encourage gaming, whereas with compensation through BPCG, gaming incentives would be removed.

2. NYISO's Response

NYISO maintains that while there have been problems with the market design, it has acted in a manner consistent with the tariffs and market design that it inherited from the New York Power Pool, and further, that it has fixed many of the inherited problems and expects to address the remainder in the near future.

NYISO explains that the fixed block bidding rules are applicable to only 10-minute and 30-minute combustion turbine units and that the largest units are currently bid into the market in 160 MW blocks (there are three of these 160 MW blocks). NYISO states that it has negotiated with the turbine owners and has been successful in establishing bidding in 40 MW blocks for two of the 160 MW blocks and expects to reach a similar agreement for the remaining 160 MW block in the near future. With the new 40 MW block bids for combustion turbines, NYISO states that it will not have to reduce the loading of other units by nearly as much to put these combustion turbine units on line and this will mitigate the economic consequences of dispatching fixed block units out of merit order.

NYISO states that NYSEG is incorrect to claim that it is acting in a manner inconsistent with the tariff or LBMP pricing theory by allowing fixed block generators to set the LBMP. NYISO maintains that allowing fixed block generators to set the LBMP sends a price signal which is consistent with overall supply and demand conditions.

NYISO also argues that, contrary to NYSEG assertion, its practice of paying lost opportunity payments (LOP) to generators that are dispatched down to make room for

fixed block generation is consistent with NYISO tariffs. NYISO acknowledges that at the time of NYISO commenced operations, there were some discrepancies between the treatment of these charges in the SCUC and the ISO tariffs, and their treatment in the billing and accounting systems. NYISO explains that the procedures have been modified to properly reflect the tariffs and software.

NYISO points out that NYSEG provided no factual support for the assertion that suppliers in the eastern part of the NYCA were gaming their fixed block bids to the detriment of customers in the western part of the state and did not explain how such behavior is even theoretically possible. NYISO also asserts that its market monitoring unit has detected no evidence of gaming thus far.

E. Recognition of Market Resources

1. NYSEG's Allegation

NYSEG complains that the block bid problem, and other supply problems, are exacerbated by a policy which rejects all bids of generators that bid above their Dependable Maximum Net Capability (DMNC), even if submitted in good faith. NYSEG states that generators that have successfully tested higher with a new DMNC have been unsuccessful in getting NYISO to recognize the results. NYSEG also argues that generators can have capability above the DMNC (e. g., hydroelectric generators under high run off conditions, thermal plants with favorable temperature conditions, or repowered or new plants that are available before DMNC tests) and that this capability could be used to meet energy needs and add to the generation base. NYSEG states that NYISO operating committee approved a modification to this rule and implementation should not be delayed.

2. NYISO's Response

NYISO answers that the NYSEG complaint is an oversimplification and a mischaracterization of the actual situation. While NYISO acknowledges that the rule which required NYISO to reject bids from generators that bid above their DMNC reduced available generation resources, it points out that this requirement was part of the original market design and was not imposed by NYISO, and that this issue has been recently resolved by the elimination of the DMNC restriction.

Further, NYISO reiterates that the rule which required the rejection of bids in excess of the DMNC has been eliminated. In addition, from NYISO startup through May 1, 2000, NYISO did not restrict resources from selling energy or ancillary services in

amounts greater than their DMNC rating; instead, resources were allowed to make sales in an amount equal to the higher of their maximum capability for the current capability period, or for the previous like capability period. This policy allowed the utilization of additional capacity from hydroelectric plants under high run-off conditions, and from combustion turbines during favorable temperature conditions.

Moreover, NYISO states it has instituted changes to allow resources to bid energy and ancillary services in an amount equal to their proven maximum production capability for the current capability period, or either of the prior two capability periods, and to further allow hydroelectric plants to use historical production data, acceptable to NYISO, to establish their proven maximum production capability. NYISO states these rule changes were approved by the Operating Committee on April 19 and the Business Issues Committee on April 20, and thus there is no basis for the suggestion made in NYSEG's April 24 complaint that NYISO delayed implementation.

F. Revision of Advisory Bills and Settlement Information

1. NYSEG's Allegation

NYSEG complains that advisory bills and settlement information are frequently revised over long periods of time, distorting market signals. NYSEG argues that the current market based system is inefficient, does not provide reliable market signals because corrections can occur well after the fact, and causes participants to not have faith in the price signals which causes the market to function poorly and leaves little alternative for participants but to guess at the appropriate market response.

NYSEG complains that load adjustments based on actual meter readings by the IOUs are not available for any month since NYISO's inception in November 1999, and that NYISO has not requested meter data for 2000. Advisory bills have been issued which include adjustments for software program errors but actual load data adjustments have not been incorporated. NYSEG explains that NYISO uses an estimation of a LSE's daily load based on transmission line flows into and out of a zone and the percentage of a LSE's daily forecast of load relative to the total of LSE's forecasted load in a zone. NYSEG states that it remains subject to billing adjustments going back to November 1999.

2. NYISO's Response

NYISO answers that NYSEG confuses the identification and correction of erroneously calculated prices pursuant to its TEPs with its authority to revise bills pursuant to its Commission approved tariffs and that NYSEG's allegations are incorrect.

NYISO argues that the TEP price review/correction authority does not create excessive uncertainty because NYISO must post all reservations within a 24-hour period, make any correction within seven days of the reservation, has missed the reservation/correction deadline only twice, and as it has gained experience has had to use the correction authority less frequently. Additionally, NYISO states that it has rarely corrected ancillary services prices, almost never corrects day-ahead prices and does not correct BME prices. NYISO points out that NYSEG strongly supported the TEP in the past and endorsed their extension in the May 10th amendment.

In addressing billing problems, NYISO responds that the sometimes poor quality of the data from the transmission owners has undermined its ability to generate accurate load information, but in fairness NYISO believes that both it and the transmission owners have found the billing procedures to be much more demanding than anticipated, and is confident that the billing process will work smoothly in the future.

NYISO acknowledges that while the daily load estimation procedures that it inherited as part of NYISO's market design are vulnerable to "cascading" errors if any LSE submits an erroneous load forecast, it is working to find a solution to the problem.

Finally, NYISO denies the allegations contained in the affidavit of Mr. Kimiecik attached to NYSEG complaint. NYISO states that it has consistently followed established practice since the commencement of NYISO, and has honored its informal invoice posting commitment.

G. Communications

NYSEG states that a lack of timely communications by NYISO on transaction curtailments and restoration prevent rational economic responses. NYISO acknowledges that there have been communications problems, mostly attributable to the initial staffing plan, but states that a variety of measures have been adopted to facilitate the dissemination of information, such as the establishment of the Technical Information Exchange, releasing technical bulletins, meeting with market participants, sponsoring training programs, expanding the operating hours of its market relations group, and seeking to hire additional staff. NYISO believes it is fully capable of addressing any problems which might arise this summer through the use of its authority to make Section

205 filings to modify its tariffs in exigent circumstances and through its recently approved market power mitigation plan.

H. Ancillary Services Prices

1. NYSEG's Allegation

NYSEG reiterates various arguments and points that have been made in other ongoing proceedings concerning the apparent flaws in the reserves markets including rapidly and steeply escalating costs for ancillary service from December 1999 to February 2000, the modeling flaw concerning the Blenheim-Gilboa Pumped Storage Project, and that regulation prices are high and frequently exceed energy prices. NYSEG states that in response to its inquiries concerning the high cost of regulation service, NYISO responded that the prices were the result of a matching of supply and demand. NYSEG does not believe that regulation prices it cites (in excess of the LBMP by \$20 in 38% of the off peak hours or by \$50 in 11% of the off peak hours) indicate that the markets are functioning efficiently and competitively.

2. NYISO's Response

NYISO acknowledges that the 10-minute reserve prices are not the result of a competitive market, and goes on to explain that this issue was raised in EL00-63-000 and ER00-1969-000 where NYISO demonstrated that the increased prices were primarily attributable to the exercise of market power by reserve suppliers located in the eastern portion of the state, and proposed a narrowly-tailored remedy designed in the least disruptive manner possible.

Further, NYISO states that the modeling problems concerning the Blenheim-Gilboa Pumped Storage Project have already been rectified. NYISO reiterates the explanation given to NYSEG for the high price of regulation service, i.e., that regulation prices appear to have been produced by legitimate market forces (e.g., shortages due to planned maintenance outages, the expense of providing regulation service from units when they are at minimum load, and communications problems between generators and local transmission-owning utilities resulting in an increased risk of incurring regulation penalties). NYISO indicates that the average day-ahead regulation price fell from \$40.73 in March to \$33.62 in April. NYISO concludes that although the regulation market may have minor imperfections, it is workably competitive, and that no evidence suggests that the market has been subverted by market power or market flaws.

I. Hydro-Quebec Imports

PECO complains that imports from Hydro-Quebec (HQ) have been adversely impacted by NYISO. PECO explains that previously HQ was able to sell up to 1,800 MW into the NYCA. However, HQ imports are now limited to 1,200 MW because NYISO requires, for reliability purposes, that spinning reserves be maintained at the level of the largest internal generator (1,200 MW), and this reserve level must be able to cover the sudden loss of the control area's largest single contingency. Thus, HQ is now limited to imports of 1,200 MW even though its import capability exceeds 2,300 MW. PECO states that NYISO is unsure how to treat the HQ DC transmission line with respect to operating reserves. PECO acknowledges that NYISO is aware of the problem, is working to find a solution and is hopeful that the issue will be resolved soon.

Appendix D

The following tariff sheets filed by NYISO on June 30, 2000 in Docket No. ER00-3038-000 are rejected:

<u>As-Filed</u>	<u>Corrected</u>
Original Page 227	Original Sheet No. 227
Original Page 228	Original Sheet No. 228
Original Page 229	Original Sheet No. 229

The following tariff sheets filed by NYISO on July 3, 2000 in Docket No. ER00-3038-000 are accepted to become effective on the date of this order, subject to NYISO refiling these sheets consistent with this order:

<u>As-Filed</u>	<u>Corrected</u>
Original Page 227	Substitute Original Sheet No. 227
Original Page 228	Substitute Original Sheet No. 228
Original Page 229	Substitute Original Sheet No. 229

New York Independent System Operator, Inc.

Docket No. ER00-3038-000

New York State Electric & Gas Corporation

v.

New York Independent System Operator, Inc.

Docket Nos. EL00-70-000
and EL00-70-001

(Issued July 26, 2000)

HÉBERT, Commissioner *dissenting*:

Like a moth to a flame, FERC again falls under the spell of price caps. Like a flame that, in the end, consumes everything in its wake, price caps and their cousins, bid caps, will undermine competition, something we all want and the American people deserve. Unlike a moth, that acts under an irresistible impulse, we humans exercise judgment and should place long term goals ahead of expediency. I would reject the bid caps for New York. I see no need for them and I think they will cause particular harm in this market.

Not only does the order rely on faulty economics and false analogy to impose the caps, the majority imposes more stringent ones than the New York Independent System Operator, Inc. (ISO) itself requested. The caps also have the practical effect of protecting those utilities that sold their generating plants, gambled on the spot market to find supplies for their customers and lost. Today's order punishes those market participants that made proper arrangements. These entities now stand to lose money, not because they misjudged the market, but because of interference by a regulatory agency that arbitrarily changed the rules in midstream. The bid caps the majority imposes also will tighten the market for this and following summers. I dissent.

Can't Anyone Here Play This Game?

Beneath lofty sentiments often lurk grisly facts. For example, the eloquent tributes to baseball from the pens of great writers, such as the late A. Bartlett (Bart) Giamatti, can mask the reality of ineptitude. Casey Stengel, on watching his expansion Mets of 1962, with their collection of cast-offs and amateurs, exposed the dark side when he exclaimed in exasperation, "Can't anyone here play this game?"

Beneath the noble policy pronouncements of this order lies a more disturbing picture. The miscalculation of some Member Systems, including New York State Electric & Gas Corporation (NYSEG), and the slap-dash justification the ISO uses in arriving at the bid caps, underscore that the mind set of regulation in a context of not-for-profit status can bring strange results, indeed.

The free market has its share of incompetence, but the government does not rush in, as the majority does today, to apply a policy of protectionism in the guise of a "safety net." Today's decision to impose caps lower than those the ISO requested further exacerbates the anomalous consequences of the policy the majority embraces. It will dry up supplies necessary for meeting demand during hot weather. As one example, owners of mobile peaking units will move them out of the New York market. Others, as had occurred in California, will hesitate to make the investments necessary to expand supplies for the next and following summers.

a. NYSEG and Other Member Systems

One of the protests in a related docket puts its finger on the heart of this case. FERC rushes in to cover utilities' mistakes that created exposed positions in the market. Despite the recitation in today's order, we do not deal with "market design flaws" in the straightforward meaning of that term. A review of the record here and the compliance filing in Docket No. ER00-1969 (involving the reserve market) indicates that the ISO has repaired all but one software problem. Even though experts consider some of the repairs "patches," temporary measures for this summer suffice to negate the need for bid caps. The one remaining problem involves the inability to use 600 megawatts of the Intertie with Hydro Quebec. The 600 MW constitutes a drop in the ocean of the 24,000 MW capacity of the New York market.

NYSEG's complaint and later pleadings (such as the Answer to the New York ISO's Motion to Intervene in Docket No. EL00-70) place great emphasis on the threat of the New England ISO and the PJM ISO to curtail exports to New York. According to NYSEG, this shows the breakdown in the market in New York. That may have been true at one time, but no longer. At today's meeting, we approved an agreement between PJM and the New York ISO for exports between the two markets. *New York Independent System Operator, Inc.*, 92 FERC ¶ 61, (2000). The threat from New England has faded as well.

Indeed, the majority admits that the ISO has "made progress" in addressing problems with the "design flaws." Slip op. at 14. The majority expresses its "concern[s]" that it "cannot be assured that . . . these corrections may not have unintended consequences." *Id.* By placing the onus on opponents to prove a negative, the majority turns on its head the burden of proof and, despite its rhetoric, makes it hard to let go of regulation.

Even if the New York market still needs more structure in place to operate through the summer, the period for which the majority approves these "temporary" bid caps, I

consider today's order bad policy. As I wrote in my concurrence to the order on reserve markets, if the remaining flaws rise to the level of undermining a competitive market, we should then substitute a form of cost-based rates and institute a proceeding against the ISO. *New York Independent System Operator, Inc.*, 91 FERC ¶ 61, 218 at p. (2000) (Hébert, Commissioner concurring). That, at least, has the advantage of dealing with the problem at its source.

Rather, the Member Systems' requests for bid caps result from a desire to have FERC offer a bail out for bad business decisions. The utilities in New York are divesting their generation, but, as load serving entities, must still sell to consumers in their service territories. These divesting utilities could have signed contracts for the capacity they needed. Some in New York and in other markets have done that. (For example, the Sierra Pacific-Nevada Power-Portland General Electric merger, on which we voted today, has in it issues arising from buyback contracts, under which the Nevada utilities did just that.)

The Member Systems could have protected themselves in other ways. They could have purchased hedging instruments, for example. Instead, NYSEG, in particular, relied on the spot market. The price in the spot market rose above the level these utilities calculated. The obligation to serve customers under rate freezes remained, however. The state of the spot market left company shareholders in the lurch.

In short, "[s]everal . . . utilities, including NYSEG . . . agreed to a price freeze for retail customers but failed to enter into transition contracts or otherwise properly hedge their positions for this summer against higher electricity prices." Motion of Merrill Lynch Capital Services, Inc. for Leave to Intervene and Protest (Docket No. ER00-2464) at 2. NYSEG does not dispute the fact that, on divestiture, it failed to sign contracts and remained vulnerable in the spot market. As NYSEG states, "It is *nearly fully* hedged." Second Answer of NYSEG (Docket No. EL00-70) at 2 (Emphasis added).

I understand that, in these circumstances, asking for a bail out serves NYSEG's and other Member Systems' self interest. Granting the bail out, however, as the majority does today, ill serves the public interest.

b. The New York Parties

At least NYSEG and the Member Systems have a business reason, though an illegitimate one, for supporting the bid caps. The grid's governing authorities have none at all. The ISO initially opposed them, in favor of market screens. Then, the ISO filed for a higher level than the majority approves today. In approving the \$1000 bid cap, the majority rejects the consensus of the ISO. Ironically, the same majority argues that ISO's,

non-profit entities, offer benefits because of the very consensus the stakeholder process offers but my colleagues override here. The majority, instead, favors the views of the New York Public Service Commission.

Its pleading begins by admitting that the ISO "has addressed most of the implementation flaws that have been identified to date." Notice of Intervention, Comments and Request for Expedited Relief of the New York Public Service Commission (Docket No. EL00-70) at 1. Nevertheless, the state supports bid caps because "there still *may be undetected* or uncorrected problems." *Id.* (Emphasis added). By definition, in any market there always "may be undetected problems." Following that logic, regulation would endure in perpetuity.

The Notice of Intervention goes on to argue that, while the laws of supply and demand may raise prices, "there is also the *possibility* that prices may be extremely high this summer . . . for reasons not at all related to" competition. *Id.* (Emphasis added). I admire the candor in admitting that we should enact price controls to guard against, not proven behavior, but the possibility of manipulation, however remote. That tells me the wish for bid caps in this market flows from a fear of deregulation. We at FERC must stand up to timidity.

Finally, the New York Commission argues that bid caps bring certainty. Notice of Intervention at 3. So does price fixing, yet the gross inefficiency that creates outweighs any alleged benefits. Here, too, the so-called certainty comes at too high a price. Moreover, approving bid caps has the opposite effect.

As several parties, including the Member Systems in their Answer in Docket No. ER00-3038-000 call to our attention, we impose the bid caps after the market participants took positions on future prices, to the extent of spending considerable amounts of money in the hedging market to buy transmission congestion contracts. Those entities that assumed high prices will lose, not because of the operations of the market, but because of FERC's interference. I disagree with the Member Systems that entities should have anticipated that, that we would arbitrarily impose bid caps to distort the market. Nevertheless, all would agree that this order introduces uncertainty from this day forward.

In the end, the comments of the Chairman of the New York ISO best characterize the flimsy support for and arbitrary nature of today's action. In an interview, he said that, though "philosophically" he opposes bid caps, "the state energy auction needs a 'safety net' . . . because the . . . market still is 'a bit wobbly.'" Grid Operators Diverge Widely on Price Caps, *Wall Street Journal*, July 3, 2000 at 1. Economists say that all markets lack perfection. When asked how he came up with the particular amount, he answered that

"it's hard to know what price is fair but that it is important to pick a number and stick with it." *Id.*

We policy makers ought to do better than that. Competition means moving away from trying to find fair prices. It means moving toward letting buyers and sellers set efficient prices. The market, not regulators, determine the outcome. Regulators call the balls and strikes. "Can't anyone here play this game?"

Get Me Through The Summer

As I indicated earlier, the majority acknowledges that the ISO has, for all practical purposes, fixed the problems NYSEG identified. The order brushes that aside, because "may of the fixes are short-term." Slip op. at 15. Since the majority claims to apply "temporary" bid caps for this summer only, the ISO applied a sufficient remedy. Without evidence of need, we should reject the bid caps. Moreover, we should replace the attitude "get me through the summer" with a long-term outlook. As we acknowledge with great fanfare in the Order Directing Staff Investigation of the markets, that I discuss in my dissent in *NSTAR Servies Co. v. ISO New England, Inc.*, 92 FERC ¶ 61, (2000), bid caps represent bad long-term policy.

The majority gives two reasons for imposing the bid caps. The order proclaims a "concern[] about the lack of demand-side responsiveness" in the New York market. Slip op. at 14. The order also states that, PJM has used the same bid cap, without apparent ill effect. Slip op. at 16. I find the first bad economics and the second illogical.

Prices come down through increases in supply, as well as reductions in demand. Seeing an opportunity to make money, owners of mobile peaking units will direct their assets over road, rail and barge to serve the New York market. Entrepreneurs now in business will approach owners of buildings with backup generators to aggregate capacity for customers in need. The entrepreneurs need only make arrangements for moving the energy. Opportunities for profit will induce other steps. Bid caps squelch innovation, in the short and long term.

Moreover, the pressure of shareholders enduring losses spurs management to institute demand side measures. A week ago Monday, the lead story on page 1 of the *New York Times* described demand side measures that Wisconsin Electric Power Company instituted when spot prices rose. In a matter of weeks, the utility compiled a list of top uses from which it would request reductions. The article told of a lignite quarry that agreed, for a payment, to close for the day. Deprived of the crutch of bid caps, the Member Systems would follow that example. They could have for this summer.

The story also mentioned a "Kilowatcher's Club," like that in Maryland, under which, for a credit on the monthly bill, consumers agree to allow the power company to shut off their air conditioners for different periods of time on hot days. The article also mentioned that residential customers of Wisconsin Electric Company take advantage of time-of-day rates that make it profitable to run appliances on nights and weekends. Instead of advocating price controls, NYSEG and the State should have instituted that reform for this summer, even if on an emergency basis. On their own, the Member Systems can broadcast appeals for conservation and State and local government can dismiss non-emergency employees for the day.

If the majority needs further proof of demand side response to prices, it can find the evidence in the record here. The Electric Power Supply Association, the trade association of generators and marketers calls the argument about the lack of demand side response "misleading," given the possibility for hedging and bilateral arrangements with suppliers, as well as conservation. Motion for Leave to Intervene at 4-6. Individual marketers call to our attention that consumers in New York City and its suburbs (and customers of Central Hudson Gas & Electric Corporation) do see on their bills increases in the price of electricity. Motion to Intervene and Protest of Merrill Lynch Capital Services, Inc.(Docket No. ER00-3038-000) at 8-9.

I note, however, that the majority breezed by the presence of demand-side "responsiveness" in New England to impose \$1000 bid caps there. (See my dissent in *NSTAR Services, Company v. New England Power Pool, et al.*, 92 FERC ¶ 61, at p. (2000) (Hébert, Commissioner *dissenting*)). The real reason for the bid caps comes from the fact PJM has them and allegedly "they do[] not appear to have discouraged generators from participating in the PJM Market nor from adding capacity [there]." Slip op. at 16. Before making PJM the poster child for other markets, let us look at the record.

Nobody knows the impact of price controls in PJM. I agree that capacity will still enter a market with \$1000 bid caps. Will enough come in, however? Without knowing how much capacity PJM needs, we cannot extrapolate to New York. While the \$1000 – which, for all we know, resulted from the capability of now three-year old software to handle three digits at most -- may mean nothing in PJM, it does in New York. Indeed, the New York ISO pegged \$1,300 as the highest price the market ever reached under the new arrangement. For that reason, the ISO requested the higher figure. For the sake of consistency, I would eliminate the PJM cap, instead of transplanting it to a completely different environment in New York.

Moreover, like the magician's claim that his spells keep elephants from the endangering North America, the conclusion that PJM's caps caused no harm does not

flow from the premise. Until three weeks ago, generators that needed to recover more than the bid cap, for example peak units, could specify minimum run times to make up the difference. Referring to this economically rational course as "gaming," the majority, over my dissent, allowed PJM to amend its rules to eliminate that possibility. *PJM Interconnection, LLC*, 92 FERC ¶ 61, (2000). With that "safety net" for recovering high costs gone, generators may stay out of PJM in greater numbers.

In the same vein, I remain highly skeptical about the "offsetting factors" the majority relies on as lessening the consequences of the bid caps. Slip op. at 16. I consider relying on these factors akin to whistling past a graveyard. The ISO may have rules under which it must acquire adequate capacity and generators must offer it. If, however, the bid caps curtail investment in high-cost peaking units, a shortage will result, despite all the requirements in the world. If the ISO may pay more than the bid cap for power outside New York, today's decision leads to the perversely inefficient result. We condone penalizing nearby generators in favor of the more remote. Some congestion management policy we have enacted. The majority should look before leaping to adopt bid caps as benign.

Conclusion

Whether or not my colleagues call the bid caps in New York "temporary," the truth remains that the ugly facts underlying today's action belie our lofty sentiments. The "Talking Points" column in the June 2000 issue of our internal newsletter, *FERC Insider*, contained the following observations:

Yet, as we all know change is continuing in the industry and the Commission must "roll with the punches."

* * *

[T]he Commission and its staff will play a key role in shaping a dynamic market environment that will be a beacon of openness and free enterprise. This is a very lofty goal that will challenge us all to excel.

Eagerly I await the time when this Commission actually lives up to that charge. Under the circumstances prevailing in those markets, this order and its companion, imposing bid caps on New England, lean into the punch, shape an environment of price controls and stand as a beacon of corporate welfare for utilities that made bad business decisions. Bowing to a fear of competition, the Commission stifles the market with a heavy hand. The words of Casey Stengel, not the eloquence of Bart Giamatti, rule this day.

I respectfully dissent.

Curt L. Hébert, Jr.
Commissioner

