UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.) Docket No. ER10-2220-000

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

Pursuant to Rules 212 and 213 of the Federal Energy Regulatory Commission's ("FERC" or "Commission") Rules of Practice and Procedure,[1] the New York Independent System Operator, Inc. ("NYISO") respectfully requests leave to submit the following response ("Response") to the comments and protests filed in this docket on September 3, 2010 by TransCanada Power Marketing Ltd. and TC Ravenswood LLC ("TransCanada"), the Electric Power Supply Association ("EPSA"), and the Independent Power Producers of New York, Inc. ("IPPNY") (collectively, the "Protests").[2] The Protests were submitted in response to the NYISO's *Request for Authority to Apply a Market Power Mitigation Measure to Rest-of-State Generators Committed or Dispatched for Reliability* that was submitted in the above-captioned Docket on August 13, 2010 ("Request").

I. Motion for Leave to Respond

The NYISO recognizes that the Commission generally discourages responses to protests. However, the NYISO respectfully requests leave to submit this Response. The Commission has allowed responses to protests when they help to clarify complex issues, provide additional information that will assist the Commission, correct inaccurate statements, or are otherwise

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[1] 18 C.F.R. §§ 385.212 and 385.213.

[2] *See Motion to Intervene and Protest of TC Ravenswood LLC and TransCanada Power Marketing Ltd.*, *Motion to Intervene and Protest of the Electric Power Supply Association*, and *Motion to Intervene and Protest of Independent Power Producers of New York, Inc*.

helpful in developing the record in a proceeding.[3] The NYISO's response meets this standard. The NYISO's response does not introduce new arguments, but instead is submitted for the limited purpose of clarifying certain factual matters and correcting inaccurate statements in the Protests, thereby assisting the Commission in its review and consideration of the issues presented in this proceeding. The NYISO therefore respectfully requests that the Commission exercise its discretion and accept this Response.

II. Documents Submitted with this Response

The documents being submitted are:

1. this Response;
2. Attachment A—the Affidavit of Dr. David B. Patton of the NYISO's Market Monitoring Unit ("Patton Affidavit");
3. Attachment B—the Affidavit of Shaun Johnson, the NYISO's Manager of Energy Market Products, attesting to the facts set forth in Section III.C. of this Response, included as Attachment B to this Response; and
4. Attachment C—the public version of the NYISO's October 13, 2009 *Motion for Leave to Respond and Response to Protests* in Docket No. ER09-1682-000, including all attachments thereto.

[3] *See, e.g., Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.*, 93 FERC ¶ 61,017 at 61,036 (2000) (accepting an answer that was "helpful in the development of the record ..... "); *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 at 61,797 (2000) (allowing "the NYISO's Answer of April 27, 2000, [because it was deemed] useful in addressing the issues arising in these proceedings ..... "); *Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138 at 61,381 (1999) (accepting prohibited pleadings because they helped to clarify the issues and because of the complex nature of the proceeding).

III. Response to Protests

A. Summary of Protests

The IPPNY and EPSA protests ask the Commission to direct the NYISO to develop additional methods of providing payment streams to Generators that are subject to the proposed mitigation measure and to submit those changes to the Commission in a compliance filing.[4] IPPNY and EPSA's requested changes include new Tariff revisions that would relax the mitigation thresholds that apply to frequently mitigated Generators, along with significant modifications to (or replacement of) the existing Open Access Transmission Tariff ("OATT") Attachment Y rules addressing the process used to determine a reliability need for a retiring Generator, and the process that will be used to determine the costs that a retiring generator is entitled to recover through a reliability-must-run ("RMR") agreement, or similar mechanism.

TransCanada requests that the Commission reject the NYISO's filing and require it to submit a filing that addresses uneconomic entry into the rest-of-state Capacity and Energy markets, in addition to addressing the concerns raised by IPPNY and EPSA. For the reasons set forth below, the Commission should reject the Protests and accept the NYISO's proposed Tariff revisions for filing without modification.

B. NYISO's Failure to Specifically Address a Particular Argument or Statement Does Not Indicate Agreement Therewith

The Protests contain numerous arguments, some of which are advanced in several different ways, and a range of factual assertions, with which the NYISO does not, or does not fully, agree. The NYISO has focused this Response on the issues of the most importance to the Commission's review of the NYISO's Request. Consistent with the Commission's directives to

[4] *See* EPSA protest at 16; IPPNY protest at 14. By requesting that the NYISO be instructed to submit IPPNY and EPSA's proposed changes in a compliance filing, IPPNY and EPSA seek to sidestep the NYISO's stakeholder governance process, as EPSA suggests on page 15 of its protest.

entities that seek permission to respond to protests, the NYISO has limited this Response to correcting the inaccurate statements, clarifying the complex issues, and providing the additional information that the NYISO believes will best assist the Commission to reach an appropriate decision in this proceeding. The NYISO's failure to respond to a particular nuance or version of an argument, or to a specific factual assertion, should not be interpreted as indicating the NYISO necessarily accepts the argument or agrees with the assertion.

In order to avoid the need to re-argue certain basic premises related to Generators' alleged "right" to recover fixed costs in the NYISO's markets, the NYISO has included as Attachment C to this Response, and incorporates by reference, its October 13, 2009 *Motion for Leave to Respond and Response to Protests* in Docket No. ER09-1682-000, including all of the attachments thereto.

C. The Proposed Mitigation Rule Is Not Expected to Significantly Impact Compensation to Reliability-Committed Generators Located Outside New York City

The Protests all contain broad assertions that New York Generators that are committed for reliability outside the New York City Constrained Area, as a class, will not be able to recover their going-forward fixed costs if the NYISO is permitted to implement its proposed mitigation measures. The Protests include no evidence to support the contention that applying tighter mitigation thresholds to reliability committed rest-of-state Generators will prevent this class of Generators from recovering their fixed costs in the markets that the NYISO administers. While the NYISO agrees that the proposed mitigation measure will prevent the exercise of market power by specific rest-of-state Generators when they are committed for reliability, the NYISO does not agree that the proposed mitigation measure is likely to have the sort of sweeping market impact to this entire category of Generators that the Protests suggest.

In order to test the broad-brush cost recovery arguments included in the Protests, the NYISO's Energy Market Products Department[5] first identified *all*[6] of the Generators located outside the New York City Constrained Area that have been committed via Supplemental Resource Evaluation ("SRE") or as a Day-Ahead Reliability Unit ("DARU") over the past 12 months. The NYISO then compared the identified Generators' total Day-Ahead and SRE scheduled hours[7] to the hours in which the Generators were committed via SRE or DARU. In total, 32 different rest-of-state Generators had at least some SRE or DARU committed hours over the past 12 months. Twenty of the 32 Generators were committed for reliability in less than 10 percent of their Day-Ahead and SRE scheduled hours over that time period. Only seven rest-of-state Generators were reliability committed in a third or more of their Day-Ahead and SRE scheduled hours. Two of the six Generators were reliability committed in more than 34 percent, but less than 50 percent, of their scheduled hours. The remaining five Generators were committed for reliability in more than 80 percent of their scheduled hours.

Twenty seven percent of all rest-of-state Generators that were the subject of DARU requests were economically committed by SCUC for their DARU-requested run hours. These economic commitments are not included as DARU commitments in the information provided above. Because these Generators were economically committed, their commitment would not be subject to the NYISO's proposed mitigation measure. In addition, 12.5 percent of rest-of-state Generators that were DARU-committed did not receive a Bid Production Cost guarantee. In

[5] Attachment B to this Response is the affidavit of Mr. Shaun Johnson, Manager of the NYISO's Energy Market Products Department, attesting to the accuracy of the figures contained in this section of the NYISO's Response.

[6] The study results include the three Generators that are already subject to a form of rest-of-state reliability mitigation. *See New York Independent System Operator, Inc.*, 131 FERC ¶ 61,169 (2010).

[7] "Total Day-Ahead and SRE scheduled hours" are all hours when a Generator was scheduled to produce Energy. Commitment to produce Energy at a Generator's minimum operating level are included.

these cases, LBMP revenues were more than sufficient to cover the Generators' Start-Up, Minimum Generation and Incremental Energy Bids.

In total, there are 264 Generators and more than 26,600 MW of Capacity located outside the New York City Constrained Area. The Protests are attacking a proposed mitigation rule that *might* significantly impact the revenues received by five to seven rest-of-state Generators *if* those Generators are offered in a manner that is not consistent with their marginal operating costs.

The NYISO's proposed mitigation measure will prevent the exercise of market power by reliability-committed Generators in rest-of-state. The NYISO does not agree that the proposed mitigation measure is likely to cause a significant number of rest-of-state Generators to propose to retire that would not do so otherwise.[8]

D. Response to Arguments Seeking Fixed Cost Recovery in Energy Offers

The IPPNY and TransCanada protests request that the Commission require the NYISO to change its Tariffs to permit Generators to increase their Bids above competitive levels (a) without requiring a determination that the Generator is needed for reliability, and (b) without requiring a determination that the Generator isn't able to recover its going-forward costs. Their proposal to permit reliability-committed Generators to exercise market power to increase their Start-Up, Minimum Generation and Incremental Energy Bids by up to $40/MWh above the Generator's marginal cost should be rejected.

In constructing an argument to support proposed Tariff modifications that would permit Suppliers to inflate their Generators' Start-Up, Minimum Generation and Incremental Energy Bids above the marginal cost of providing these services, the IPPNY and TransCanada protests incorporate a number of unsupported premises. First, they argue that because the NYISO or a

[8] Generator retirements are addressed in Section III.F. of this Response.

Transmission Owner commits a Generator for reliability for a few days each year, that Generator should be presumed to be an indispensable reliability resource at all times.[9] Second, the Protests argue that the commitment of a Generator outside of the NYISO's economic evaluation process to address a reliability need presents a unique, valid reason to pay the Generator more than its marginal operating costs.[10] Finally, the Protests argue that if a Generator is frequently reliability-committed, the Supplier offering the Generator should be permitted to exercise market power, and submit Bids that exceed the Bids that the marginal Supplier would be expected to submit in a competitive market.[11] Each of these contentions are addressed, in turn, below.

1. The NYISO Has Not Generically Determined that Any Generators are Needed for Reliability

In the 2004 - 2005 timeframe, Southwest Connecticut was severely transmission constrained. Until substantial transmission upgrades were completed, ISO New England could not permit the retirement of Generators located in the transmission-constrained areas of Connecticut. Permitting even one of the available resources to retire might have seriously compromised the reliability of electric service in Southwest Connecticut. ISO New England's determination that the continued availability/operation of several Generators was necessary for system reliability provided the underpinning for a series of Commission decisions authorizing cost recovery for these Generators to ensure that they were able to recover their going-forward costs.[12]

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[9] *See, e.g.*, IPPNY protest, Exhibit 1, para. 42.

[10] *See, e.g.*, IPPNY protest, Exhibit 1 at para. 18-20; TransCanada protest at p. 13.

[11] As explained above, there are only four rest-of-state Generators that satisfy the standard that IPPNY and TransCanada propose.

[12] *See, e.g., Milford Power Company, LLC*, 110 FERC ¶ 61,299 at P 25 (2005) ("This unexecuted agreement is the outcome of negotiations for reliability services between Milford and ISO-NE in which ISO NE has determined that these units are required for reliability. We find good cause to grant waiver in this instance.").

New York is not in the situation that ISO New England faced in Southwest Connecticut in 2004 and 2005. Since its inception in 1999, the NYISO has evaluated the potential reliability impacts of numerous Generator retirements. In each case, the NYISO determined that the Generator could retire without harm to the reliability of electric service in New York. While it is true that the New York Transmission Owners ("NYTOs") and/or the NYISO commit Generators "for reliability" as DARUs or via SRE, the Generators that are committed vary from day-to-day and are determined based on system conditions including transmission facility outages (planned or unplanned), and the need to support a Transmission Owner's local distribution system. It is not accurate, or even reasonable, to simply assume that a NYTO would need to execute a RMR agreement with any of the Generators that were committed for reliability over the past year if it proposed to retire.

The NYISO's Operations Department discussed the North American Electric Reliability Corporation ("NERC") criteria that require the NYISO to regularly commit a Generator located in Load Zone D, near the border with Canada, in a series of presentations to stakeholders.[13] In those discussions, the NYISO's Operations Department explained that, until a pair of 230 kV transmission lines that share a series of common towers are separated onto two different sets of towers, applicable reliability rules require the NYISO to commit a resource to address the potential impact of the recognized common tower contingency (the simultaneous loss of both

[13] *See, e.g.*, presentations to the Market Issues Working Group by Wes Yeomans, the NYISO's Director of Operations on September 14, 2009, October 5, 2009 and January 5, 2010 addressing the "North Country" reliability commitment. Links below:

http://www.nyiso.com/public/webdocs/committees/bic_miwg/meeting_materials/2009-09-14/North_Country_Reliability_Commitment.pdf

http://www.nyiso.com/public/webdocs/committees/bic_miwg/meeting_materials/2009-10-05/MIWG_October_5_2009_North_Country_Discussion.pdf

http://www.nyiso.com/public/webdocs/committees/bic_miwg/meeting_materials/2010-01-05/MIWG_Wind.pdf

230 kV transmission lines). However, if there are no resources available for commitment that are capable of mitigating the particular reliability concern (for example, if the Generator that is capable of alleviating the risk is out on maintenance, or if it were to elect to retire[14]), it does not mean that service to loads would be interrupted, or even compromised. Rather, the Operations Department would have to rely on operating procedures to manage the additional risk until the Generator returns to service, or until the underlying reliability concern is addressed (by reconfiguring the 230 kV transmission lines and eliminating the common tower contingency in this example).

2. Generators Are Compensated for their Availability in the Capacity Market

At several points the IPPNY and TransCanada protests argue that Generators committed for reliability via SRE or DARU to address a specific reliability concern are providing a "unique service" that is entitled to additional, or distinct compensation.[15] The NYISO does not agree with the artificial distinction proposed in the protests. The markets that the NYISO administers include a market for Unforced Capacity. Suppliers that elect to sell (via auction, or in a bilateral transaction) a Generator's Unforced Capacity in the New York markets are compensated for making their Generator's Capacity available for commitment. The amount of Unforced Capacity a Supplier is permitted to sell is directly tied to the historical availability of a Generator to be committed to produce Energy.

Unforced Capacity Suppliers in New York are expressly required by the NYISO's Tariffs to offer their Generator into the Day-Ahead Market so it is available for DARU commitment,

[14] The NYISO is not pre-judging whether the retirement of a particular resource would result in a reliability need that required the resource's continued operation in this filing. The NYISO will evaluate any formal notice of retirement it receives in its reliability planning process and determine if the Generator's impending retirement presents a reliability concern.

and are required to submit Bids in response to an SRE request.[16] Hence, responding to reliability related commitments is already a clear and express component of an Unforced Capacity Supplier's obligation in New York; it is part-and-parcel of the Unforced Capacity "product" that a Supplier sells.

The Protests present no valid basis for drawing a distinction between a Generator that is economically committed, and a Generator that is committed for reliability via a DARU or SRE. When a Supplier sells its Generator's Unforced Capacity in New York, the Supplier is compensated for making the Generator available to be committed—without regard to whether any resulting commitment is based on economics or is to address a reliability need.

3. The Proposed Compensation Scheme Could Result In Unjust and Unreasonable Compensation to Generators Committed for Reliability and Would Incent the Exercise of Market Power

Dr. Shanker's and TransCanada's proposal to provide additional compensation to Generators that are committed for reliability and mitigated in more than 60, 70 or 80 percent of their run hours over the past year may be well suited to PJM Interconnection, LLC's ("PJM's") markets. However, there are significant differences between the markets administered by PJM and the markets that the NYISO administers.[17]

The protests provide an incomplete explanation of how PJM's compensation rule would be applied in the NYISO's markets, and leave many details unresolved. The NYISO believes Dr. Shanker's proposal is to increase the "conduct threshold"[18] for Minimum Generation and

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[15] *See, e.g.*, IPPNY protest, Exhibit 1 at para. 18-20; TransCanada protest at p. 13.

[16] *See* Sections 5.12.1.6 and 5.12.1.10 of the NYISO's Market Administration and Control Area Services Tariff.

[17] For example, the foundation of PJM's mitigation of Energy offers is the "three pivotal supplier" test, while the NYISO uses conduct and impact mitigation.

[18] *See* Exhibit 1 to the IPPNY protest at para. 36 ("i.e., the conduct threshold").

Incremental Energy Bids[19] for rest-of-state Generators that were committed for reliability in more than 60% of their scheduled hours over the past 12 months by $20/MWh, by $30/MWh for rest-of-state Generators that were committed for reliability in more than 70% of their scheduled hours, and by $40/MWh for rest-of-state Generators that were committed for reliability in more than 80% of their scheduled hours.

Dr. Shanker does not propose any requirement that the Generators Bids were mitigated in order for the additional compensation to apply, only that the Generator was committed for reliability and was not scheduled to produce Incremental Energy beyond its reliability commitment.[20] It appears that the NYISO is expected to use the Generator's cost-based reference levels to perform the conduct test.[21] Start-Up Bids are not addressed in Dr. Shanker's proposed compensation measure.[22] Dr. Shanker's affidavit does not identify the changes to the NYISO's current processes for setting reference levels and applying mitigation that would be needed to implement his proposal, nor does he explain why each of the changes is appropriate. Dr. Shanker does not explain why his proposed $20/$30/$40/MWh thresholds are the right thresholds to use in the rest-of-state New York markets beyond his statement that the proposed thresholds would provide greater compensation to Generators that are frequently committed for reliability than the NYISO's proposed threshold.

[19] Increased Incremental Energy Bids would only apply to gas turbines, or in the rare instances where a DARU or SRE-committed Generator's output is increased for reliability via an out-of-merit call in the Real-Time Market. *See* Exhibit 1 to the IPPNY protest at para. 36 ("the percent of the time the unit is solely operated for reliability increases").

[20] *See* Exhibit 1 to the IPPNY protest at para. 36 ("the percent of the time the unit is solely operated for reliability increases").

[21] *See* Exhibit 1 to the IPPNY protest at para. 38 ("may include a $20 adder to their cost-based offer").

[22] No relevant threshold is proposed.

As Dr. Patton explains in paragraphs 24-30 of Attachment A to this Response, the proposed compensation rule is a poor fit for the NYISO's markets. The NYISO agrees with Dr. Patton and identifies several reasons why the proposal is a bad idea for New York below.

First, the compensation rule proposed in the IPPNY and TransCanada protests does not require a showing that a Generator is not already fully recovering its going-forward costs (no demonstration of insufficient revenues) in order to be eligible to receive additional compensation. Generators that are frequently reliability committed, but profitable, would gain an unwarranted boon if the NYISO were ordered to implement Dr. Shanker's proposal.

Second, the compensation "tiers" proposed by IPPNY and TransCanada provide an incentive for rest-of-state Suppliers to withhold their Generators from economic commitment in order to increase the percentage of commitments that are "reliability" commitments. For example, consider a rest-of-state Generator that is reliability committed in 50 percent of its run hours. The Supplier offering the unit will know that if it is able to prevent economic commitments in just 10% of the Generator's run hours, the Generator will be able to get an additional $10/MWh in all of its reliability commitment hours.

Generators that are frequently reliability committed will have little incentive to actively pursue economic commitments. Rather, they are likely to Bid in a manner that will ensure that the Generator does not lose its right to a $40/MWh margin. The result will be fewer economic commitments for Generators that pursue this strategy, but guaranteed enhanced revenues whenever the Generator is reliability committed.

The proposed measure would harm the New York markets in two ways. First, New York will pay a higher price to solve rest-of-state reliability constraints. Second, some Generators that presently offer economically will cease competing for economic commitments and will instead

let other, higher cost, resources serve load. Dr. Patton addresses the expected harm to the markets in paragraph 29 of Attachment A to this Response.

Finally, the proposed compensation measure does not take into account the frequency with which a Generator is committed. That is, while the proposed measure takes into account the percent of hours that a Generator is committed for reliability, the total number of hours that a Generator was scheduled over the prior twelve months does not factor into the permissible compensation. Depending on the frequency with which the Generator is committed, the compensation rule proposed by IPPNY and TransCanada may result in over-recovery, or under-recovery of a Generator's going-forward costs. While the protests propose additional rules to provide further compensation where the proposed compensation scheme still isn't sufficient to cover a Generator's going-forward fixed costs, Dr. Shanker does not propose to require the refund of any over-payments that might result from the compensation measure that he advocates.

As the Commission has recognized in ruling on a similar mitigation situation in New England, "the frequency with which a resource is dispatched out-of-merit is irrelevant when proposing mitigation rules that are designed to prevent the exercise of market power in all circumstances. If Bids are offered competitively, market participants will remain unaffected by the proposed mitigation framework."[23]

The Protests do not and cannot show that recovery of a fixed cost component as part of a market power mitigation measure should be permitted for energy markets in New York. Recovery of fixed costs as a component of a Generator's Minimum Generation, or Incremental Energy Bids is not consistent with the NYISO's market design and should be rejected.

[23] *ISO New England,* 129 FERC ¶ 61,008 at P 18 (2009).

E. The NYISO Should Not Be Required to Develop Tariff Provisions that Would Provide Cost-Based Compensation or a Pre-Determination of Reliability Need to Generators that Have Not Submitted a Retirement Notice

The Commission's Orders addressing reliability commitments in ISO-New England clearly and explicitly recognize the danger that permitting Generators to "toggle" between market- and cost-based compensation methods presents.[24] The ongoing economic downturn has, without doubt, decreased both electricity consumption and market revenues to Generators in New York. In these circumstances, it is no surprise that Suppliers that previously embraced the creation of the wholesale markets are now looking for ways to get their Generators compensated under cost-based rates. Consistent with its decision to reject "toggling" in the ISO-New England Orders, the Commission should reject requests to switch from market-based to cost-based rates, except where a Generator that is determined to be needed for reliability credibly indicates its intention to retire.

For similar reasons, the NYISO believes the Commission should reject IPPNY's proposal to require the NYISO to provide an assessment of reliability need to any Generator that asks for one. Providing a pre-determination of reliability need will only serve to encourage Generators that are needed for reliability to announce their "retirement" if the Supplier believes that the Generator will earn more under cost-based rates than it can earn in the NYISO's markets under current market conditions.

The NYISO is willing to consider and discuss stakeholder-proposed solutions that would prevent toggling between cost- and market-based rates, but that would not have the financial

[24] *See ISO New England Inc. and New England Power Pool*, 125 FERC ¶ 61,102 at PP 45-46 (2008) ("We agree with ISO-NE that it is not reasonable to allow a resource that will remain in the capacity market in future years to toggle between cost-based and market-based compensation since a resource that could receive market prices when they exceed its costs and cost-based prices in the other years would be virtually guaranteed to earn revenues above costs over time. Providing a resource with a cost-based

consequences to the Generator that the Protests allege. However, until a viable alternative is proposed and such discussions are complete, limiting recovery of fixed costs to Generators that submit a formal announcement of their intention to retire will prevent toggling and ensure that Generator compensation continues to be just and reasonable.

F. Generators Have An Adequate Opportunity to Recover their Going-Forward Costs in the NYISO's Markets

A primary purpose of the markets that the NYISO administers is to achieve the most cost-effective solution to serving New York load. One component of achieving a cost-effective solution is providing investors with adequate incentives to convince investors to develop new, efficient, projects in New York to supplement or replace older, less efficient resources.

As Dr. Patton explains in paragraphs 16 and 19-21 of Attachment A to this Response, Generators in New York have the opportunity to recover their going forward fixed costs (as that term is defined in footnote 2 of Dr. Patton's attached Affidavit) in the markets that the NYISO administers. In addition, all Generators that announce their intention to retire, but that are determined to be needed for reliability, have the opportunity to recover their going-forward fixed costs in accordance with the NYISO's OATT Attachment Y reliability planning process. The OATT Attachment Y rules are addressed in greater detail below.

Footnote 16 of the TransCanada protests states that "every State of The Markets reports issued by the NYISO Market Monitor since inception of the markets has pointed out that market returns to suppliers are insufficient to recover their costs (See Analysis Group report by Sue Tierny issued April, 2010 footnote #108)." It is not clear to the NYISO how TransCanada reached this conclusion. The relevant language, on page 62 of the NYISO 10-Year Review

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backstop would also blunt incentives for the resource to minimize its costs."); *Bridgeport Energy, LLC,* 118 FERC ¶ 61,243, at P 66 (2007); *Bridgeport Energy, LLC*, 113 FERC ¶ 61,311 (2005).

prepared by the Analysis Group, says "New York's markets do not routinely provide revenue support high enough to induce entry;[108] but in light of the state having installed capacity well above reserve requirements, this is consistent with conditions in the market." Footnote 108 includes statements from several of David Patton's annual State of the Market Reports, including the following quotes:

> 2005—"Based on market conditions in 2005, there are several locations where it might be profitable to build new capacity."
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> 2006—"This analysis also shows that market signals have tended to shift in favor of investment in baseload and intermediate resources that, while more costly to build, are lower cost to run and produce more electricity."
>
> 2007—"Over time, the markets provide efficient incentives to invest in a diverse array of generating resources, demand response resources, and transmission. Currently, market conditions appear most favorable for investment in combined-cycle generation, which have constituted most of the recent entry."
>
> 2008—"This comparison for 2008 shows that the Vernon/Greenwood load pocket within New York City is likely the only area of New York where an investment in a new combustion turbine might have been profitable…."

Footnote 21 of the EPSA protest targets the Market Monitoring Unit's 2008 and 2009 State of the Market Reports as evidence that the NYISO's markets provide insufficient revenues to incent new entry. Given the recession that was gripping the United States, it should come as no surprise to the Commission that Potomac Economics' State of the Market Report for 2009 states "The report shows that prices in 2009 would not support investment in new peaking

generation in most locations… Currently, market conditions appear more favorable for investment in combined cycle generation (which have constituted most of the recent entry) than in gas-fired peaking generation. However, net revenues in 2009 would not likely support investment in a combined cycle unit at a new site in any area of New York." In 2009, the average cost of a MWh of wholesale electric energy was $48.63, 49 percent below the previous year's cost. Reasons for the dramatic decline included reduced fuel costs, reduced load and mild weather. The fact that the NYISO's markets accurately reflected 2009 economic conditions in New York and the United States does not indicate a deficiency that needs to be remedied, nor does it show that New York Generators are being denied an adequate opportunity to recover their going forward fixed costs in the markets that the NYISO administers.

G. The NYISO's Attachment Y Reliability Planning Process Permits the Execution of Agreements With Generators that Formally Announce their Intention to Retire, that Are Determined to be Needed for Reliability, and that Require Recovery of Additional Legitimate Costs to Remain in Operation

Notwithstanding the various sources of revenue available to Generators in the NYISO's competitive energy, ancillary services and capacity markets, it is possible that a Generator that is needed for reliability might not receive adequate revenues to remain in operation. Even if this were the case - and the Protests have not shown that it is - it would be inappropriate to use inflated conduct thresholds as a means to permit a Generator to recover those costs for the reasons explained in Section III.D. of this Response, and in paragraphs 24-30 of Dr. Patton's attached Affidavit (Attachment A).

Dr. Patton has stated that in "cases where a supplier is providing necessary reliability services to the system that are not priced in the market, and is not recovering its fixed costs, the Commission has generally relied on contractual solutions that are customized and appropriate for

the specific resource in question."[25] In New York, this result can be achieved through Attachment Y to the NYISO's OATT if a reliability need arises that is not satisfied by the markets, and a particular Generator is determined to be needed to meet the need in either the short or long term.

There is no need to permit Generators to exercise market power in the energy, ancillary services, or Capacity markets in order to make necessary cost recovery payments to Generators that are genuinely needed for the reliability of the bulk power system and that are not able to recover their legitimate going-forward costs. The NYISO has Tariff provisions in place to maintain the economic viability of Generators that are determined to be needed for reliability, but that are not able to recover their going-forward fixed costs (as that term is defined in Dr. Patton's attached Affidavit) in the NYISO's markets.

If and when a Generator that is needed for reliability proposes to retire, Section 31.2.5.9 of Attachment Y to the NYISO's Open Access Transmission Tariff ("OATT") authorizes the NYISO Board, in consultation with the New York Department of Public Service ("DPS"), to identify "an imminent threat to the reliability of the New York power system,"[26] and in that event to require the appropriate Transmission Owner or Owners to propose an appropriate "Gap Solution" outside the normal reliability planning cycle.[27] Other entities, which could include the Supplier that owns the Generator that has announced its intention to retire, can also submit

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[25] *See* Paragraph 42 of Dr. Patton's September 4, 2009 Affidavit in Docket No. ER09-1682-000.

[26] The NYISO's planning responsibilities under Attachment Y to its OATT extend to the "New York State Bulk Power Transmission Facilities," as that term is defined in Sections 31.1.1.1 and on page 11 of Attachment Y.

[27] A "Gap Solution" is defined on page 10 of Attachment Y as: "A solution to a Reliability Need that is designed to be temporary and to strive to be compatible with permanent market-based proposals. A permanent regulated solution, if appropriate, may proceed in parallel with a Gap Solution." Section 31.2.5.9.1 of Attachment Y provides that Gap Solutions "may include generation, transmission or demand side resources."

proposed Gap Solutions. If the NYISO determines that operation of the retiring Generator is needed to prevent an imminent threat to the reliability of the New York State Bulk Power Transmission Facilities, the New York Department of Public Service chooses continued operation of the Generator as the appropriate method of meeting the need after considering available options, and if the Generator would cease operations because it is not able to recover its legitimate going-forward costs, then the predicate for the use of an Attachment Y Section 31.2.5.9 Gap Solution would be met. Section 31.4.4.3 of Attachment Y provides that the costs of a Gap Solutions that is not a transmission project, such as the funding of a contractual arrangement with a Generator. If the Generator is the preferred solution cost recovery will be available "in accordance with the provisions of the New York Public Service Law, New York Public Authorities Law, or other applicable state law."

Longer term non-transmission solutions to reliability needs can be proposed within the NYISO's Reliability Planning Process as regulated backstop solutions in accordance with Section 31.2.4.1.1 of Attachment Y.

With regard to claims that Attachment Y does not provide adequate assurance that Generators that are needed for reliability will have the opportunity to recover their going-forward costs, Section 31.4.4 of Attachment Y describes the costs that a regulated reliability project (regardless of whether it is a Gap Solution or a more permanent solution) is eligible to recover:

> 31.4.4 Cost Recovery for Regulated Projects
>
> Responsible Transmission Owners, Transmission Owners and Other Developers will be entitled to full recovery of all reasonably incurred costs, including a reasonable return on investment and any applicable incentives, related to the development, construction, operation and maintenance of regulated projects, including Gap Solutions, undertaken pursuant to Section 31.2.6.4 of this Attachment Y to meet a Reliability Need….

Section 31.4.4.3 of Attachment Y describes the means by which a Developer of a nontransmission regulated reliability solution can recover its costs:

> 31.4.4.3 Costs related to regulated non-transmission reliability projects will be recovered by Responsible Transmission Owners, Transmission Owners and Other Developers in accordance with the provisions of New York Public Service Law, New York Public Authorities Law, or other applicable state law. A Responsible Transmission Owner, a Transmission Owner, or Other Developer may propose and undertake a regulated non-transmission solution, provided that the appropriate state agency(ies) has established cost recovery procedures comparable to those provided in this tariff for regulated transmission solutions to ensure the full and prompt recovery of all reasonably-incurred costs related to such non-transmission solutions. Nothing in this section shall affect the Commission's jurisdiction over the same and transmission of electric energy subject to the jurisdiction of the Commission.

The provisions of Attachment Y quoted above contemplate that developers of a non-transmission regulated reliability project, including a Gap Solution, may receive "full recovery of all reasonably incurred costs" as determined under state law. Any jurisdictional rate that resulted from this process would be subject to review by the Commission.

Generators that propose to retire, but that are determined to be needed to provide reliable service to loads on facilities that are not New York State Bulk Power Transmission Facilities would need to seek any necessary cost recovery payments directly from the local Transmission Owner. The reliability commitment of such a Generator would be at the request of a local Transmission Owner.

Given the small number of Generators to which the Attachment Y Gap Solution process is likely to apply, the NYISO does not agree that the Protests have identified a significant need to streamline the existing Attachment Y process.[28] Attachment Y has been accepted for filing by

[28] On page 13 of its protest and in paragraphs 24, 25 and 31-35 of Dr. Shanker's Affidavit, IPPNY alleges that the Attachment Y process is "too narrowly drawn and cumbersome" and does not provide "a clear and transparent RMR-mechanism for generators to secure payment." The NYISO responds to IPPNY's arguments that additional compensation should be available to Generators that have not been specifically determined to be needed for reliability in Section III.D. of this Response. The NYISO responds to

the Commission, and revisions to that section of the OATT are outside the scope of the filing that is now before the Commission. The existing Attachment Y process is adequate to timely address any Generator retirement notices that the NYISO may be required to process.

H. Modeling a New Constraint that Can Only be Solved by One Supplier In Order to Permit Reliability-Committed Generators to Set LBMPs Could Expand the Effects of A Supplier's Exercise of Market Power

EPSA's protest argues that modeling the reliability concerns that require the commitment of a Generators will send an appropriate price signal to the market.[29] TransCanada raises similar concerns on pages 9-11 of its protest, and argues that any price that is set should include a "scarcity adder."[30] IPPNY's protest and Dr. Shanker's Affidavit (at Para. 7 and 19) raise similar concerns when discussing "invisible constraints."[31]

In some cases, it may be possible for the NYISO to develop methods of modeling reliability constraint that requires the commitment of a particular rest-of-state Generator. In other cases, modeling isn't possible (examples include voltage concerns, and constraints on local transmission facilities that aren't monitored by the NYISO) or wouldn't be practical for reasons that are explained in greater detail below. The appropriateness of the mitigation measure proposed in this filing does not turn on whether or not a particular constraint is, or is not modeled. A Generator that must be committed to address a reliability constraint will possess market power in either case.

IPPNY's argument that the NYISO should not require Generators to submit a notice of retirement in Section III.E. of this Response.

[29] EPSA Protest at 8-9.

[30] The NYISO addressed the interaction between reliability commitments and scarcity prices on pages 5 - 8 of its July 7, 2010 *Motion for Leave to Answer and Answer* in Docket No. ER09-1682-000. Rather than restating its response to "scarcity pricing" issues in this Response, the NYISO incorporates the relevant portion of its July 7, 2010 answer.

[31] Dr. Patton responds to Dr. Shanker's discussion of "invisible constraints" in Attachment A to this Response.

The vast majority of Generators that are committed for reliability via DARU or SRE are committed at their minimum generation level.[32] Generators committed at their minimum generation level do not set price in LMP/LBMP markets for their minimum generation MW.[33] Additional commitment of these Generators above the minimum generation level will ordinarily be the result of the NYISO's economic evaluation of the Incremental Energy Bids submitted for the Generator.[34] Such economically selected Incremental Energy Bids are eligible to set LBMP and are not subject to the NYISO's proposed reliability mitigation measure. Hence, even if the NYISO were to model rest-of-state reliability constraints in the manner EPSA suggests, the vast majority of reliability commitments would not set price.

As explained above, modeling the relevant reliability constraints will not cure the underlying market power problem that the NYISO's proposed mitigation measure addresses. Rather, modeling the constraint will shift the impact of exercising market power from guarantee payments to LBMPs.[35] Adding new constraints to the NYISO's market model that can only be solved by a single supplier will expand the potential market impact of that Supplier's ability to exercise market power.[36] Instead of limiting the impact to the guarantee payment made to a

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[32] Over the past year, the NYISO identified a total of 26 hours in which rest-of-state Gas Turbines ("GTs"), which do not submit Minimum Generation Bids, were committed via SRE or DARU for reliability outside the New York City Constrained area. As indicated, the commitment of GTs for reliability via DARU or SRE is a rare occurrence. The DARU and SRE processes are ordinarily used to commit Generators with two hour or more start-up times. GTs are relied on to provide operating reserves and are available for commitment within 10 or 30 minutes in the Real-Time Market, when needed.

[33] In LMP/LBMP markets, price is set based on the marginal cost of the *next* increment of a resource that would be dispatched. If a Generator's minimum generation MWs exceed the identified requirement, the resource will not set LMP/LBMP at the location, as the constraint has been relieved.

[34] Generators that are committed for reliability can have their reliability commitment increased in real-time via an Out-of-Merit instruction. Out-of-Merit calls for reliability committed rest-of-state Generators to operate above their minimum operating level in order to maintain reliability are rare.

[35] *See* paragraph 17 of Dr. Patton's Affidavit that is included in Attachment C to this Response.

[36] *Id*.

single Generator, the Supplier's non-competitive Bids could set an artificially high LBMP that could affect a far broader segment of the market.[37] In other words, permitting a Supplier that possesses market power to set price will not solve the underlying market power problem; it will only serve to expand the problem's scope.

I. Response to TransCanada's Uneconomic Entry and "When Competitive Markets Cease to Exist" Arguments

1. Uneconomic Entry

Throughout its pleading (and the supporting Affidavit) TransCanada argues that rest-of-state Capacity and Energy prices are being inappropriately reduced due to the entry of subsidized wind Generation. TransCanada also argues that the new wind generators are generally not capable of addressing the reliability concerns that the NYISO commits Generators via SRE or DARU to address. Finally, TransCanada argues that integrating significant additional wind capacity into the New York grid will cause the NYISO to commit fossil Generators for reliability more frequently.

The NYISO agrees that both federal and state policy makers have decided to provide incentives for the construction of wind generation. However, many new Generators receive subsidies of one type or another, and many existing Generators also benefit from subsidies (*e.g.*, PURPA facilities). The NYISO has, in general, assumed that its role is to do its best to reliably incorporate wind resources into its markets, and has made changes to its market design in order to do so.

With regard to the Capacity markets, at present 124 MW of wind Capacity are available to participate in the Capacity market for the Summer season, and up to 371 MW of wind

[37] The resulting LBMP should only be available to Generators that are capable of solving the reliability constraint.

Capacity are available to participate in the Capacity market for the Winter season. These values reflect market rules that allow 10% of nameplate in the Summer and 30% nameplate in the Winter, from a total nameplate of 1,241 MW. With regard to the Energy markets, by their very nature, intermittent resources with very low "fuel" costs generally Bid as price-takers when they are producing electricity.

The NYISO does not agree with TransCanada's contention that, in order to apply mitigation to the Start-Up, Minimum Generation and Incremental Energy Bids that the NYISO or a Transmission Owner commits for reliability outside the New York City Constrained Area, the NYISO must first address TransCanada's concerns regarding the alleged impact of wind Generators on the rest-of-state market. While it might be reasonable to assume that the recent influx of wind generators has had some effect on rest-of-state Capacity and Energy prices, TransCanada has not shown that it is inappropriate for the New York markets to reflect the participation of wind Generators. Nor has TransCanada shown that subsidies to wind Generators is part of a scheme to artificially suppress rest-of-state Capacity or Energy prices.

More to the point, TransCanada has not shown that its broad policy concerns regarding government subsidies to wind generators are closely tied to the market power concern that is the sole focus of the mitigation measure that the NYISO proposes in this filing. The Commission should reject TransCanada's tenuous effort to tie the NYISO's proposed mitigation measure to its broad policy concerns regarding the entry of subsidized "uneconomic" wind Generators in the rest-of-state New York market.

2. Existence of Competitive Markets

At several points in its protest TransCanada argues that the Commission needs to decide what appropriate compensation is "when competitive markets no longer exist" and a supplier

knows that it has market power.[38] The NYISO interprets TransCanada's phrase "when competitive markets no longer exist" to mean "when there is only one Supplier that can address a reliability need, and there is no competitive alternative."[39] Interpreted in this manner, the NYISO has proposed an answer to TransCanada's question. The NYISO's proposed answer is to apply the mitigation measure proposed in its filing, and to rely on the OATT Attachment Y procedures when a Generator that is determined to be needed for reliability is unable to recover its going forward fixed costs.

J. Response to IPPNY Arguments Proposing Revisions to the Tariff Language

Before responding to IPPNY's proposed changes to the Tariff language that the NYISO proposes, the NYISO must first correct IPPNY's statement on page nine of its protest that "the NYISO conceded as part of this process that it had not identified another generator to which these proposed rules would apply." This statement is not correct. There are rest-of-state Generators that are not subject to rest-of-state reliability mitigation measure that the Commission accepted in Docket No. ER09-1682-000 that submit Bids that exceed the 10% or $10/MWh thresholds proposed in this filing. Bids in excess of the proposed 10% or $10/MWh thresholds are being accepted and used by the NYISO for SRE and/or DARU commitments.

1. Request to Require the NYISO to Inform Generators of Reliability Commitments Before they Bid

On page 15 of its protest IPPNY asks that Generators be informed when they are needed for reliability in advance of submitting their Bids so that the Generator can be sure to Bid below the applicable threshold(s). The Commission appropriately rejected this argument in paragraphs

[38] TransCanada protest at 12 and 13.

[39] In addition, consistent with the discussion above, the compensation that should be paid to a reliability committed Generator at times "when a market does not exist" needs to take into account the revenues that the Generator receives from the competitive markets.

78 and 79 of its May 20, 2010 Order in Docket No. ER09-1682. Generators should Bid competitively at all times.

From a practical perspective, rest-of-state Generators that let their Day-Ahead Bids expire will receive a request to submit Bids in response to an SRE request from the Transmission Owner and will know their Bids may be used to commit the Generator for reliability. Because a DARU designation means that a Generator is guaranteed to be committed, if the NYISO or a Transmission Owner tells the Generator in advance that it is the subject of a DARU request, then the Generator will be subject to the mitigation. If the Generator is not informed in advance and the Generator is competitively committed, the proposed mitigation measure will not apply. In Section III.C. of this Response the NYISO explains that twenty-seven percent of all DARU requests prove unnecessary because the rest-of-state Generator that is the subject of the request is economically committed.

2. Request to Clarify that Generators that Bid Under the 10% or $10/MWh Threshold Will Not be Accused of Exercising Market Power

On page 15 of its protest IPPNY asks the Commission to require the NYISO to clarify that rest-of-state reliability committed Generators that Bid below the 10% or $10/MWh thresholds "will not otherwise later be subject to market power allegations under any other provisions of the NYISO's tariffs." While the NYISO believes this will likely be true in most cases, the NYISO is hesitant to support a request for blanket immunity. The NYISO believes that the facts and circumstances need to be considered in each instance.

3. Request to Exempt Some SRE-Committed Generators From Mitigation

On pages 15-16 of its protest IPPNY requests that in circumstances where there is more than one Supplier whose Generator that can address a reliability need, but where only one

Supplier's Generator submits a Bid in response to the NYISO's SRE request, the proposed mitigation measure should not apply. Dr. Patton responds to this contention in paragraphs 31-32 **of** the Affidavit that is included as Attachment A to this Response. The NYISO agrees with Dr. Patton that generators Bidding in response to an SRE request know they are needed for reliability, and thus may be in a position to exercise market power. In cases where the NYISO does not have at least two Suppliers' competing offers to evaluate, the mitigation should apply.

4. Request that DARU Generators that Know About a DARU Request be Exempt from Mitigation

On page 16 of its protest, IPPNY argues that a Generator that is the subject of a DARU request should not be subject to the proposed mitigation measure, even if it knows it is the subject of a DARU request, if there is another Supplier's Generator that is capable of meeting the reliability need. A Generator that is the subject of a DARU request is guaranteed to be committed in the Day-Ahead Market. For this reason, when a Generator knows it is the subject of a DARU request, it has market power.

5. Mitigation Should Only Apply When Physical Parameters are Changed

On pages 16 and 17 of its protest IPPNY argues that the mitigation measure that applies to "physical parameters" such as minimum run time, minimum down time, start-up time, max stops per day, etc. should only be subject to mitigation if the Generator changes its operating parameters. The NYISO agrees if IPPNY means changed from the reference level that the NYISO has in place for each operating parameter. The NYISO does not agree that if a Generator includes an unreasonable physical parameter in its Bid that causes the NYISO to unnecessarily extend the Generators reliability commitment for several additional hours, that the Generator should simply be able to rely on the fact that the physical parameter has been included in the

Generator's Bid for some time. The NYISO does not agree that any Tariff change is warranted to address IPPNY's concern.

IV. Conclusion

WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission (i) accept this response to the Protests, and (ii) accept for filing the revisions to the Market Mitigation Measures proposed by the NYISO without modification.

Respectfully submitted,

/s/ Alex M. Schnell
Robert E. Fernandez, General Counsel
Alex M. Schnell
New York Independent System Operator, Inc.

Dated: September 23, 2010

CERTIFICATE OF SERVICE

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

Dated at Rensselaer, New York this 23rd day of September, 2010.

/s/ Alex M. Schnell

Alex M. Schnell
New York Independent System Operator, Inc.
10 Krey Boulevard
Rensselaer, New York 12144
518-356-8707

Attachment A

Affidavit of Dr. David Patton

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.) Docket No. ER10-2220-000

Affidavit of David B. Patton, Ph.D.

I. Qualifications and Purpose

1. My name is David B. Patton. I am an economist and President of Potomac Economics. Our offices are located at 9990 Fairfax Boulevard, Fairfax, Virginia 22030. Potomac Economics is a firm specializing in expert economic analysis and monitoring of wholesale electricity markets. Potomac Economics currently serves as the Market Monitoring Unit ("MMU") for the New York Independent System Operator, Inc. ("NYISO"), as the External Market Monitor for the ISO New England Inc ("ISO-NE" or the "ISO"), and the Independent Market Monitoring Unit for the Midwest ISO ("MISO"). I am responsible for assessing the competitive performance of the markets administered by the ISOs, including assisting in the implementation of monitoring plans to identify and remedy market design flaws and abuses of market power. I also provide recommendations regarding market mitigation measures and other market rules.

2. I have worked as an energy economist for nineteen years, focusing primarily on the electric utility and natural gas industries. I have provided strategic advice, analysis, and expert testimony in the areas of electric power industry restructuring, pricing, mergers, and market power. I have also advised other existing and prospective RTOs on

transmission pricing, market design, and congestion management issues. With regard to competitive analysis, I have provided expert testimony and analysis regarding market power issues in a number of mergers and market-based pricing cases before the Federal Energy Regulatory Commission ("FERC"), state regulatory commissions, and the U.S. Department of Justice.

3. Prior to my experience as a consultant, I served as a Senior Economist in the Office of Economic Policy at the Federal Energy Regulatory Commission, advising the Commission on a variety of policy issues including transmission pricing, open-access and electric utility mergers.

4. Before joining the Commission, I worked as an economist for the U.S. Department of Energy. During this time, I helped develop and analyze policies related to investment in oil and gas exploration, electric utility demand side management, residential and commercial energy efficiency, and the deployment of new energy technologies. I hold a Ph.D. and M.A. in Economics from George Mason University and a B.A. in Economics with a minor in Mathematics from New Mexico State University.

5. The NYISO filed with the Commission a proposed market power mitigation measure to apply to generators outside of New York City that are committed or dispatched for local reliability on August 13, 2010. The proposed measure is substantially similar to a measure approved by the Commission in Docket No. ER09-1682-000 for three specific generators. As the MMU for the NYISO, we support this measure. The purpose of this affidavit is to answer protests that have been filed in response to the NYISO's filing.

II. Cost Recovery for Generators Needed for Reliability

6. Once of the key arguments against the proposed mitigation measures is that generators needed for reliability should be able to exercise market power in order to recover their going forward fixed costs.[1]

7. While I do *not* disagree with arguments by suppliers that resources needed for reliability should have an opportunity to recover their going-forward fixed costs, I strongly disagree that recovering such costs by exercising a prescribed amount of market power is a reasonable approach for the following reasons.

8. First, there is no one set of thresholds that would be appropriate for all suppliers. Any single threshold would cause some generators to under-recover their fixed costs and other suppliers to substantially over-recover.

9. Second, designing thresholds that require suppliers to raise their offer prices in order to recover fixed costs makes market power extremely difficult to distinguish from legitimate conduct. It necessarily requires subjective judgments to be made by the MMU or by the FERC regarding when an offer price increase by a supplier is acceptable and when it is an abuse of market power. In addition to the difficulty this would present to the MMU and the Commission, it would create uncertainty for suppliers regarding when their conduct may be deemed to be an exercise of market power.

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[1] This is essentially proposed by Dr. Shanker. See the First Tier of Dr. Shanker's proposal (paragraph 37).

10. Third, relying on suppliers to raise prices to recover fixed costs would create considerable risk for suppliers. Because of uncertainty regarding market conditions, suppliers may raise their offer prices and, in doing so, not be dispatched and forego opportunities to produce. In addition, when a supplier committed out-of-market for reliability does successfully raise prices and associated Bid Production Cost guarantee ("BPCG") payments, it may face unwarranted scrutiny after the fact when its offers are made public.

11. Hence, relying on market power rents that result from economic withholding to appropriately recover fixed costs is highly undesirable from a policy perspective. In cases where a supplier is providing necessary reliability services to the system and is not recovering its fixed costs, the Commission has generally relied on contractual solutions that are customized and appropriate for the specific resource in question. This is a reasonable approach, particularly in cases where the reliability need is local and cannot be satisfied through a competitive market process.NYISO pointed to the Attachment Y process as a means to ensure the recovery of going-forward fixed costs for resources that are determined to be needed for reliability. In their protests, IPPNY and Dr. Shanker argue that the Attachment Y process is inadequate for this purpose.

12. I recognize the importance of ensuring that generators that are determined to be needed for reliability and kept in service as a "gap" or as a more permanent solution to a reliability need have the opportunity to recover their going-forward fixed costs.[2] In cases where a

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[2] Going-forward costs include costs that could be avoided by taking a generator out-of-service for an extended period or by retiring a generator permanently. Going-forward costs may include maintenance costs incurred to keep the generator in service, labor costs necessary to keep the plant available, and/or expected profits from converting the facility to an alternative purpose that would be foregone by keeping the generator in service.

supplier is providing necessary reliability services to the system and is not recovering its going-forward fixed costs, the Commission has generally relied on contractual solutions that are customized and appropriate for the specific resource in question. I believe that a generator-specific contractual solution is clearly superior to allowing the supplier in question to exercise market power to recover its going-forward fixed costs. If the Attachment Y process is inadequate, which I do not address in this affidavit, then Attachment Y should be modified, supplemented, or replaced.

III. Delaying Imposition of the Proposed Mitigation Measures

13. IPPNY and Dr. Shanker argue that the proposed ROS mitigation measures should not be approved until provisions are added to the Tariff that clarify or enhance the opportunity for generators that are kept in service for reliability to recover their going-forward fixed costs.

14. It would be unreasonable to delay the implementation of the NYISO's proposed ROS mitigation measures. These measures will likely have an immediate effect on market outcomes. Currently, some generators are committed by an SRE or DARU instruction when they are pivotal. Some suppliers exceed the proposed conduct thresholds, but do not satisfy the impact criteria set forth in Section 23.3.2.3 of the NYISO's Market Power Mitigation Measures ("Mitigation Measures"). In these cases, the proposed mitigation measures will result in more reasonable energy prices and uplift costs. Hence, the

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Going-forward costs do not include sunk costs such as past expenditures or investments, and/or financing costs that could not be avoided by taking the generator out of service.

proposed mitigation measure fill a gap in the Mitigation Measures that will ultimately ensure that the market outcomes are competitive.

15. In my opinion, it is extremely unlikely that a Generator that does not exceed the thresholds proposed in the NYISO's filing would appropriately be the subject of a filing pursuant to Section 23.3.2.3 of the Mitigation Measures to apply additional or different mitigation. However, I would not categorically rule out such a filing. Rather, the facts and circumstances presented in each instance should be considered in reaching a decision.

16. Additionally, there is no indication in the record that the proposed reliability-must-run contract process will actually be needed by any generator if the NYISO's proposed mitigation measures are implemented. Given prevailing capacity prices and net revenues available from the energy and ancillary services markets, it would not be surprising if all of the generators that are needed periodically for reliability are more than covering their going-forward fixed costs.

17. Many of these fixed cost arguments were raised when comparable mitigation measures were implemented for three specific generating units in up-state New York.[3] Nonetheless, it has been one year since the mitigation measures were applied to these generators, and none of the three generators have filed a notice of its intention to retire.

18. For these reasons, it would be unreasonable to delay the implementation of the proposed mitigation measures until the proposed revisions to Attachment Y can be fully considered.

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[3] *New York Independent System Operator, Inc*., 131 FERC ¶ 61169 (2010).

IV. Rents Earned towards Fixed Costs of Generators Committed for Reliability

19. IPPNY and Dr. Shanker assert that generators that are frequently committed by a Supplemental Resource Evaluation ("SRE") or Day-Ahead Reliability Units ("DARU") instruction do not have an opportunity to earn infra-marginal revenues, implying that they cannot recoup their going-forward fixed costs. This assertion is generally not correct for generators in New York because such generators are able to earn significant revenues in excess of their marginal costs (*i.e.*, "net revenues") in several ways. First, the NYISO capacity market provides sufficient revenue to keep many units in service that run very infrequently. Indeed, some units outside New York City that are never committed for reliability and only rarely operate remain in service, relying almost exclusively on capacity revenues to cover going-forward costs

20. Second, when a generator is committed by an SRE instruction, it has the opportunity to earn real-time energy and ancillary services revenues. In this regard, even high-cost generators can receive substantial revenues above their marginal costs in peak periods when transitory shortages occur, resulting in prices that are much higher than the generators' marginal costs. In fact, high-cost generators that are committed for reliability are more likely than other high-cost generators to be online in real-time and earn revenue during such periods.

21. Third, when a generator is committed by a DARU instruction, it receives a BPCG payment for any costs required to operate to its day-ahead schedule. Such generators routinely earn profits in the real-time market for increasing or decreasing output relative to their day-ahead schedules for energy and ancillary services. Because these generators are

already on-line and available (no additional start-up cost), they have an enhanced opportunity to be scheduled to provide incremental Energy and earn inframarginal revenues than they would absent the DARU instruction.

22. Dr. Shanker's characterization of constraints that result in DARU and SRE commitments as "invisible" constraints that do not allow for infra-marginal rents creates an impression that they are different from other constraints in a manner that causes the NYISO's normal settlements to be inadequate. Although generators that are committed for reliability do not earn infra-marginal rents in some cases, they are not unique in this regard from other locational pricing markets that are all uniform price auctions. An important feature of the uniform price auction market design is that suppliers have an incentive to offer at marginal cost. This allows the market to commit and dispatch resources efficiently. One implication of this design is that the marginal generator usually receives little or no infra-marginal rents to contribute toward the recovery of its fixed costs. When constraints involve small areas where there are relatively few generators, each generator is more likely to be marginal, but such units are not prevented from earning additional energy and ancillary services revenues when prices rise above the marginal costs of the generator, particularly during shortage pricing events.

23. Therefore, whether a reliability constraint is "invisible" and not reflected in prices, or modeled and included in prices does not materially change the market power the supplier possesses or the appropriateness of the proposed mitigation.

V. Problems with the First Tier of Dr. Shanker's Proposal

24. IPPNY and Dr. Shanker argue that the mitigation measures should be revised to allow higher thresholds for generators based on "the frequency of out of merit calls" (i.e., like the PJM measures which allow thresholds of $20 to $40/MWh for frequently mitigated units).[4] This proposal is unreasonable for a number of reasons.

25. First, there is no competitive or economic theory that would justify increasing the mitigation thresholds as a generator is committed more frequently for reliability. PJM filed similar measures in 2004 to address revenue adequacy problems under circumstances that were very different from the current situation in New York. At the time, PJM did not have a shortage pricing mechanism or a capacity market that provided substantial revenues.[5] In contrast, the NYISO market currently has effective shortage pricing provisions and a robust capacity market. Hence, the economic signals provided by the energy, ancillary services, and capacity markets are generally sufficient to sustain generators that are necessary for reliability. Furthermore, if a contractual mechanism is in place for ensuring that generators that need to be kept in service for reliability have an opportunity to receive their going-forward fixed costs, there is no reason to also allow these generators to increase their offers above competitive levels.

26. Second, Dr. Shanker never explains why the revenues that would result from his proposal would be more appropriate than those that would result from the $10/10% threshold

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[4] See Shanker paragraph 38.

[5] See January 25, 2005 Order in EL03-236-003 for a discussion of the circumstances.

proposed by the NYISO, nor does he articulate a standard for evaluating the threshold. He simply asserts that his proposal would result in more revenue to the generator without justifying why this revenue would be efficient or appropriate.

27. Third, as I described earlier in this affidavit, allowing generators to raise their offers above competitive levels provides no guarantee that such generators receive appropriate compensation. Appropriate compensation would be sufficient to allow such generators to just cover their going-forward fixed costs. However, Dr. Shanker's proposal could result in revenue that is insufficient or excessive depending on how frequently a generator is committed. Hence, an RMR contract, when and if needed, is a better mechanism for ensuring such generators receive appropriate compensation.

28. Fourth, Dr. Shanker's proposal would result in inefficiencies to the extent that generators are committed and dispatched less frequently as a consequence of offering above the competitive level. The primary virtue of the uniform price auction is that it gives generators incentives to offer at marginal cost, which allows the ISO to commit and dispatch generators efficiently. However, allowing generators that are necessary for reliability to offer substantially above their marginal cost will cause them to run less frequently, and may actually result in fewer economic commitments and more reliability commitments.

29. For example, suppose a coal-fired generator is committed for 5,000 hours per year, 2,000 hours by DARU instructions and another 3,000 hours for economic reasons at an average profit of $10/MWh. Further suppose that if the generator was never economic, it would be committed for 3,000 hours per year through DARU. If Dr. Shanker's proposal was

implemented using the PJM thresholds, the generator would not initially be considered a frequently mitigated unit (because only 40 percent of its run hours resulted from a reliability commitment) and would be subject to the lowest ($10/MWh or 10 percent) mitigation threshold, allowing it to earn $10/MWh for the 3,000 economically committed hours and the greater of $10/MWh or 10 percent of its costs in the 2,000 reliability-committed hours. However, the generator's owner would quickly realize that it would be more profitable to raise the generator's offer to $39.99/MWh above its marginal cost in order to increase the share of its hours when it was mitigated, since this would allow the generator to earn $39.99/MWh for 3,000 hours per year. This change in the generator's offer would result in significant inefficiencies because the generator would run much less frequently when the generator would have been economic (the example posits that some of the reduction in economic commitments would be offset by an increase in reliability commitments) and would earn $39.99/MWh above its costs for its committed hours, without being required to compete for commitments or to show that the compensation it received was just and reasonable.

30. This example is not unrealistic since six generators were committed for reliability reasons between 20 percent and 50 percent of their total run hours from September 2009 to August 2010. The six generators, which comprise almost 800 MW of capacity, ran for almost 60 percent of all hours during the year. The majority of these run-hours occurred when the units were economically committed. Hence, the inefficiencies of Dr. Shanker's proposal illustrated in the example above are a real concern.

VI. Pivotal Supplier Test when Multiple Generators are Located in the Constrained Area

31. IPPNY argues that the provisions are unnecessary when the generator is one of several generators capable of satisfying the reliability need, but: (i) it is the only one that has submitted a valid offer (this would only apply to generators committed by SRE instructions), or (ii) it is committed by a TO's DARU instruction and it was notified of this by the TO in advance of the day-ahead market. IPPNY says that when the owner of such a generator does not know why it was committed by a SRE or DARU instruction, the uncertainty leads the owner to offer competitively.

32. I do not agree with this assertion. Even if the owner of a generator does not know the reason for a DARU or SRE instruction, a firm that frequently receives DARU and SRE instructions can determine that it likely has local market power. The firm will make a profit-maximizing decision under uncertainty that balances (a) the probability of higher revenues from raising its offers above the competitive levels against (b) potential losses from foregone sales if it is economic and does not have local market power. In most circumstances, such a firm would not offer competitively unless it estimated a very low probability of having local market power.

VII. Conclusion

33. In conclusion, the protests filed in response to the NYISO's market power mitigation proposals in this docket have not raised issues that would suggest the proposed measures are not just and reasonable. Because these measures will address legitimate local market

power concerns, we recommend that the Commission approve the measures filed by the NYISO.

34. This concludes my affidavit.

ATTESTATION

I am the witness identified in the foregoing Affidavit of David B. Patton, Ph.D. dated September 23, 2010 (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.

David B. Patton

September 23, 2010

Subscribed and sworn to before me

this 23th day of September, 2010

MATTHEW JAMES CARRIER
Notary Public
City/County of Fairfax
Commonwealth of Virginia
Notary registration number - 7233763
My commission expires - Nov. 30, 2013

Notary Public

My commission expires: Nov. 30 2013

Attachment B

Affidavit of Shaun Johnson

Manager of Energy Market Products for the
New York System Operator, Inc.

AFFIDAVIT OF SHAUN JOHNSON

State of New York §
§
County of Rensselaer §

I, Shaun Johnson, being duly sworn, depose and state as follows:

1. My name is Shaun Johnson I serve as the Manager of Energy Market Products for the New York Independent System Operator, Inc. ("NYISO").

2. The generator commitment information used in Section III.C. of the NYISO's September 23, 2010 *Motion for Leave to Respond and Response* was prepared by me, or by persons working under my supervision and subject to my direction.

3. The generator commitment information used in Section III.C. of the NYISO's September 23, 2010 *Motion for Leave to Respond and Response* is being issued by the NYISO following my review, and is true and accurate to the best of my knowledge, information and belief.

Shaun Johnson

Executed on September 23, 2010

Pamela J Mead
Pamela Mead
Notary Public for the State of New York

PAMELA J MEAD
Notary Public, State of NY
No. 01ME5062365
Qualified in Columbia Cty
Commission Expires 6/24, 2014

My Commission Expires on: 6/24/2014

Attachment C

NYISO's Motion for Leave to Respond and Response

Filed on October 13, 2009 in Docket No. ER09-1682-000

Public Version, Includes All Attachments

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.) Docket No. ER09-1682-000

MOTION FOR LEAVE TO RESPOND, AND RESPONSE, AND REQUEST FOR CONFIDENTIAL TREATMENT AND EXEMPTION FROM FREEDOM OF INFORMATION ACT DISCLOSURE OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

THERE IS NO PRIVILEGED OR CONFIDENTIAL INFORMATION IN THIS PLEADING. CONFIDENTIAL VERSIONS OF ATTACHMENTS B AND C HERETO ARE SUBMITTED IN A SEPARATE ENVELOPE THAT IS CLEARLY MARKED "CONTAINS PRIVILEGED INFORMATION—DO NOT RELEASE"

Pursuant to Rule 212 and 213 of the Federal Energy Regulatory Commission's ("FERC" or "Commission") Rules of Practice and Procedure,[1] the New York Independent System Operator, Inc. ("NYISO") respectfully requests leave to submit the following response ("Response") to the comments and protests filed in this docket on September 25, 2009 by TransCanada Power Marketing Ltd. and TC Ravenswood LLC ("TransCanada"), PSEG Energy Resources & Trade LLC and PSEG Power New York LLC (the "PSEG Companies"), Attachment E Supplier,[2] Electric Power Supply Association ("EPSA"), an unidentified generation owner ("Generation Owner"), AES Eastern Energy, L.P. ("AES"), and Independent Power Producers of New York, Inc. ("IPPNY") (collectively, the "Generator Protests"). The Generator Protests were submitted in response to the NYISO's *Filing Requesting Authority to Prospectively Apply New Mitigation Rules to Three Specifically Identified Generators, Requesting Limited Waivers of the NYISO's Tariff and of the Commission's Regulations, Seeking*

[1] 18 C.F.R. §§ 385.212 and 385.213.

[2] According to the NYISO's records, the Market Party filing as the "Attachment E Supplier" was, in fact, the subject of Privileged and Confidential Attachment C to the NYISO's September 4 Filing, not Attachment E. To avoid confusion, this Market Party and the generator it owns will be referred to as the "Attachment E Supplier" in this submission.

Expedited Commission Action, and Requesting Shortened Notice and Comment Periods that was submitted in the above-captioned Docket on September 4, 2009 ("September 4 Filing").

In Section II of this Response, the NYISO identifies certain Attachments hereto that contain privileged, confidential and commercially sensitive information specific to individual Market Participants[3] that the NYISO is required to safeguard under its Tariffs. The NYISO requests confidential treatment, and exemption from Freedom of Information Act ("FOIA") disclosure, for that information. The NYISO does not request privileged treatment, or an exemption from FOIA disclosure, for any of the information contained in the body of this Response.

I. Motion for Leave to Respond

Some of the Generator Protests in this docket were submitted as "comments," while others were called "protests."[4] The NYISO recognizes that the Commission generally discourages responses to protests but allows responses to comments.[5] The NYISO respectfully

[3] Unless otherwise specified, capitalized terms have the meanings specified in the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff") or in Attachment H thereto.

[4] *See* "Comments of TransCanada Power Marketing Ltd. and TC Ravenswood LLC under ER09-1682," Docket No. ER09-1682-000 (Sept. 25, 2009); "Motion to Intervene of the PSEG Companies under ER09-1682," Docket No. ER09-1682-000 (Sept. 25, 2009); "Attachment E Supplier submits Protest and Request for Confidential Treatment of the Attachment E Supplier et al under ER09-1682," Docket No. ER09-1682-000 (Sept. 25, 2009); "Comments of the Electric Power Supply Association under ER09-1682," Docket No. ER09-1682-000 (Sept. 25, 2009); "Generation Owner's Motion to Intervene and Protest in Docket No. ER09-1682," Docket No. ER09-1682-000 (Sept. 25, 2009); "Motion to Intervene and Comments of AES Eastern Energy, L.P. under ER09-1682," Docket No. ER09-1682-000 (Sept. 25, 2009); "Motion to Intervene and Comments of Independent Power Producers of New York, Inc. under ER09-1682," Docket No. ER09-1682-000 (Sept. 25, 2009).

[5] 18 C.F.R. § 385.213(a)(2) and (3).

requests leave to respond to the protests, including any of the comments that the Commission determines also constitute a protest. For the reasons explained below, the Generator Protests do not show that the NYISO's new mitigation rules are not correct in principle, or that the application of the measures to the three Generators specifically identified in the NYISO's September 4, 2009 Filing in this docket would be unjust or unreasonable. The Commission has previously allowed responsive pleadings when they correct inaccurate statements,[6] help to clarify complex issues, provide additional information that will assist the Commission, or are otherwise helpful in the development of the record in a proceeding.[7] This filing is limited to points that satisfy the Commission's stated objectives. Thus, the NYISO submits that good cause exists to permit this response, to the extent permission is required.

II. List of Documents Submitted with This Response and Request for Confidential Treatment and Exemption from Freedom of Information Act Disclosure

The documents being submitted are:

1. This Response;

2. Supplemental Affidavit of Dr. David B. Patton, the NYISO's independent Market Advisor ("Patton Supplemental Affidavit"), Attachment A to this Response;

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

[7] *See, e.g.*, *N.Y. Indep. Sys. Operator, Inc.*, 108 FERC ¶ 61,188 at P 7 (2004) (accepting NYISO answer to protests because it provided information that aided the Commission in better understanding the matters at issue in the proceeding); *Morgan Stanley Capital Group, Inc. v. N.Y. Indep. Sys. Operator, Inc.*, 93 FERC ¶ 61,017 at 61,013 (2000) (accepting an answer that was "helpful in the development of the record . . .").

3. Supplemental Affidavit of Mr. Joshua A. Boles, the Supervisor of Monitoring, Analysis and Reporting for the NYISO ("Boles Supplemental Affidavit"), Attachment B to this Response; and

4. Affidavit of Mr. Ricardo T. Gonzales, the NYISO's Vice President of Operations ("Gonzales Affidavit"), Attachment C to this Response.

Attachments B and C to this Response contain confidential, proprietary and commercially sensitive information. The confidential portions of the Attachments for which the NYISO requests privileged treatment and an exemption from FOIA disclosure each contain commercially sensitive information, including: (a) the identity of a specific Generators that the NYISO proposes to apply Rate Schedule M-1 to, (b) descriptions and analyses by the NYISO's MMP of the conduct of the specified Generator that gives rise to this filing, (c) a description of the evidence and arguments presented by the Market Parties in support of claims that their Bids did not violate Sections 1(b) and 3.2.3 of the MMM, (d) the bidding strategies of the subject Generators and the impact that the Bids submitted for each Generator had on the guarantee payments to that Generator, and (e) costs and operating data relating to the subject Generators.

Disclosure of this information could cause commercial harm to each entity to which it relates, and could harm the markets administered by the NYISO. For the reasons set forth in Section VIII of the NYISO's September 4 Filing and in accordance with Sections 388.107 and 388.112 of the Commission's Regulations,[8] Article 6 of the NYISO Market Administration and Control Services Tariff, and Sections 1.0(4) and 4.0 of the NYISO's Code of Conduct, the NYISO requests Privileged and Confidential treatment of the confidential versions of Attachments B and C to this Response. The NYISO also requests that the identified Attachments

[8] 18 C.F.R. §§ 388.107, 388.112 (2009).

be exempted from public disclosure under the Freedom of Information Act ("FOIA"), 5 U.S.C. § 552, for the reasons explained in Section VII of the NYISO's September 4 Filing.[9]

In accordance with the Commission's regulations, "public" versions of Attachments B and C hereto, from which all privileged and confidential material has been redacted, are submitted with this Response. The NYISO is separately submitting the versions of Attachments B and C that contain Privileged and Confidential Market Participant specific information, clearly labeled "CONTAINS PRIVILEGED INFORMATION—DO NOT RELEASE." In addition, the NYISO has provided to each of the Suppliers that is responsible for one or more of the generators that the NYISO proposes to apply Rate Schedule M-1 to versions of Attachments B and C that include the confidential information that is pertinent to their generator(s).

III. Response

A. NYISO's Failure to Specifically Address a Particular Argument or Statement Does Not Indicate Agreement Therewith

The Generator Protests contain numerous arguments, some of which are advanced in several different ways, and a range of factual assertions, with which the NYISO does not, or does not fully, agree. The NYISO has focused this Response on the issues of the most importance to the Commission's review of the September 4 Filing, and the time available for this filing does not permit the NYISO to address every subtle shading of an argument, or partial or complete misstatement, contained in the Generator Protests. In addition, the NYISO has made every effort to keep privileged and confidential market Participant-specific information out of this filing, so that the Commission can issue a decision in this Docket that does not require the disclosure of

[9] The information provided by the NYISO for which the NYISO claims an exemption from FOIA disclosure are designated "Contains Privileged Information - Do Not Release."

protected information. Consistent with the Commission's directives to entities that seek permission to respond to protests, the NYISO has limited this Response to correcting the inaccurate statements, clarifying the complex issues, and providing the additional information that the NYISO believes will best assist the Commission to reach an appropriate decision in this proceeding. The NYISO's failure to respond to a particular nuance or version of an argument, or to a specific factual assertion, should not be interpreted as indicating the NYISO necessarily accepts the argument or agrees with the assertion.

B. The Bids Submitted by Generation Owner and the Attachment E Supplier when their Generators were Committed for Reliability were not Consistent with Bids under Competitive Market Conditions

Generation Owner and Attachment E Supplier repeatedly assert that the bids they submitted when their Generators were called on for reliability were consistent with bids under competitive conditions because any increment over variable operating costs in those bids was simply intended to recover the relevant Generator's fixed costs.[10] These assertions fly in the face of the Commission's long standing recognition that competitive bids should reflect only the Generator's variable operating costs. From the inception of the NYISO, the Commission has recognized that its markets use "'a pricing methodology under which the price of Energy at each location into the NYS Transmission System is equivalent to the cost to supply the next increment of Load at that location (*i.e.*, the short run marginal cost).'"[11] It necessarily follows that

[10] *See, e.g.*, Privileged and Confidential Affidavit provided as Attachment C to the Protest submitted by Attachment E Supplier ("Attachment C Affidavit"), ¶ 40, Generation Owner at 25-26.

[11] *NRG Power Marketing, Inc. v. N.Y. Indep. Sys. Operator, Inc.*, 91 FERC ¶ 61,346 at p. 62,165 (2000) (quoting §1.17e of the NYISO's Open Access Transmission Tariff).

competitive bids should reflect each generator's marginal cost, so that the market-clearing price is set at the marginal cost of the marginal unit.

Similarly, in an order ruling on the proper mitigation of certain Generators that were erroneously committed but correctly subject to guarantee payment mitigation once committed, the Commission found that "no further compensation is necessary for these generators," because the mitigated generators "received their reference bids, which are intended to reflect the generators' actual cost of operation;" and since the mitigated Generators were paid at the level of their reference bids, they were "appropriately--and adequately--compensated pursuant to the terms and conditions of the NYISO Services Tariff."[12]

These holdings are consistent with the Commission's policies in other markets comparable to those in New York. In an order issued on October 2, 2009 in Docket No. ER09-1546-000, the Commission found that mitigated payments to Generators committed for reliability in New England should not include a fixed-costs component.[13] Dr. Patton states that the ISO-NE and NYISO proposals "address[] the same concerns," and "the proposals themselves are virtually identical."[14]

The exclusion of fixed costs recovery from market power mitigation was unequivocally endorsed by Dr. Patton in the affidavit he submitted in support of the NYISO's September 4 filing:

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[12] *N.Y. Indep. Sys. Operator, Inc.*, 115 FERC ¶ 61,021 at P 22 (2006). See also *N.Y. Indep. Sys. Operator, Inc.*, 103 FERC ¶ 61,291 at n.8 (2003) (finding that: "A reference price is a proxy for [the] marginal costs of a resource.").

[13] *ISO New England, Inc. and New England Power Pool*, 129 FERC ¶ 61,008 at P 4, 19 (2009); Patton Supplemental Affidavit, ¶ 27.

[14] Patton Supplemental Affidavit ¶ 24.

> As a preliminary matter, suppliers in a competitive market would not include fixed costs in their offers. When suppliers do not have market power (cannot influence prices or payments by raising their offers) in a market with a uniform clearing price, they will maximize their profits by submitting offers priced at their short-run marginal costs. Offers priced above this level can only reduce the number of hours that the unit will be dispatched and lower its profits. Hence, the offers identified by the NYISO in this filing are inconsistent with what would be expected in a competitive market because they are priced substantially above the suppliers' short-run marginal costs.[15]

In response to the arguments advanced in the Generator Protests, in his Supplemental Affidavit Dr. Patton further explains why Generators in a competitive market are expected to submit offers that reflect their marginal operating costs.[16] Dr. Patton points out that the Attachment C Affidavit to Attachment E Supplier's protest "does not distinguish clearly between competitive conditions and market power, or between short-run and long-run considerations."[17] Dr. Patton further explains that bidding at marginal cost is the profit-maximizing strategy in a competitive market, and thus is the expected bidding strategy because it is in a generator's selfinterest in the absence of market power.[18]

The Generator Protests do not and cannot show that recovery of a fixed cost component as part of a market power mitigation measure should be permitted for energy markets in New York. Recovery of fixed costs as a component of a Generator's Minimum Generation, Start-up or Incremental Energy Bids is not consistent with the NYISO's market.

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[15] Patton Initial Affidavit, ¶ 34.

[16] *Id.*, ¶¶ 5-9.

[17] *Id.*, ¶ 5.

[18] *Id.*, ¶¶ 7-9.

C. Generators are not Guaranteed Recovery of Fixed Costs in the NYISO Energy Markets; Even in Capacity Markets, Competitive Bids would be Based on GoingForward Costs, not Fixed Costs

Competitive bids in the New York energy markets are expected to be at the level of a Generator's variable operating costs. It follows that a Generator would have an opportunity, but not a guarantee, to recover its fixed costs in the energy markets, to the extent it operates as an inframarginal unit when the clearing price is above its marginal costs. A Generator would have an additional opportunity to recover its fixed costs by participating in the New York Capacity markets.[19] Even in Capacity markets, however, the measure of a competitive bid is a Generator's going-forward costs, not its fixed costs as suggested in the Generator Protests.[20] This is expressly recognized in the Services Tariff,which permits Generators in the portfolio of a pivotal Supplier in the New York City Capacity market to submit Capacity bids up to the level of the Generator's going-forward costs without exceeding the Capacity mitigation thresholds.[21]

None of the Generator Protests discusses going-forward costs or provides any analysis showing that the relevant Generators have not been able to recover their going-forward costs in

[19] *See, e.g., ISO New England,* 129 FERC ¶ 61,008 at P 19.

[20] Generation Owner at 7, 17-18, and supporting affidavit, ¶¶ 7-9.

[21] Services Tariff, Attachment H §§ 2.1 and 4.5(b) & (c); *see also N.Y. Indep. Sys. Operator, Inc.*, 124 FERC ¶ 61,301 (2008) (holding, with respect to the New York City Capacity market, that: "Because some generators have market power, their bids are mitigated to their going-forward costs as a way to approximate their competitive bids;" and also holding that "the relevant costs in the calculation of going-forward costs are those costs that can be avoided if a unit is mothballed."); *see also* Patton Initial Affidavit, ¶¶ 35-36. As specified in Attachment H, "going-forward costs" are the marginal costs of providing Capacity, that is, the net costs that a Generator would not incur if it went out of operation for a year or more (*i.e.,* were mothballed), or permanently retired. Going-forward costs may include maintenance costs incurred to keep the generator in service, labor costs necessary to keep the plant available, and expected profits from converting the facility to an alternative purpose that would be foregone by keeping the generator in service. Going-forward costs do not include sunk costs such as past expenditures and/or

the energy, ancillary services or Capacity markets. Thus, the Generator Protests provide no basis on which the Commission could conclude that any of the three Generators that the NYISO proposes to mitigate is not recovering the costs it should expect to recover in competitive energy and Capacity markets. As Dr. Patton states, "[n]one of the suppliers in question have presented data showing that the current energy, ancillary services, and capacity markets do not cover the going-forward costs of the resources in question."[22]

The Generator Protests do not make any effort to place their cost recovery issues in the context of the current economic climate. To the extent that some Generators are not achieving their hoped-for levels of profitability in the current difficult economic conditions, with low demand and low LBMPs, that is not a basis for changing the design of the New York markets or for rejecting the NYISO's proposed Rate Schedule M-1.

D. Permitting Generators to Exercise Market Power Is Not an Appropriate Method of Providing Generators that are Needed for Reliability an Opportunity to Recover Going-Forward Costs

In addition to the economic and policy considerations against recovery of fixed costs in market power mitigation measures discussed above, attempting to "fine tune" reference levels and mitigation thresholds to permit Generators that are needed for reliability to recover their going-forward costs would be an impractical and imprecise cost recovery method, because it would almost always result in either over-recovery or under-recovery. For example, suppose that a Generator required for reliability could demonstrate unrecovered going-forward costs and was anticipated to be needed for reliability, and thus pivotal, on 10 days each year. If a premium

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financing costs that could not be avoided by taking the generator out of service. *See* Patton Supplemental Affidavit. ¶ 15.

[22] Patton Supplemental Affidavit, ¶ 15.

(in $/MWh) for going-forward cost recovery were added to its reference level based on the assumption of 10 days of commitment as a pivotal supplier, the Generator would under-recover if it turned out to be pivotal on fewer than 10 days, and would over-recover if it were pivotal on more than 10 days. By contrast, as the Commission has recognized in ruling on a similar mitigation situation in New England, "the frequency with which a resource is dispatched out-of-merit is irrelevant when proposing mitigation rules that are designed to prevent the exercise of market power in all circumstances. If bids are offered competitively, market participants will remain unaffected by the proposed mitigation framework."[23]

E. The NYISO Tariff Provides a Remedy if There is an "Imminent Threat" to Reliability Because a Generator Intends to Cease Operations Absent Additional Legitimate Cost Recovery

As Dr. Patton acknowledged in his affidavit in support of the September 4 Filing, notwithstanding the various sources of revenue available to Generators in the competitive energy, ancillary services and capacity markets, "it is possible that a unit needed for reliability will not receive adequate revenues to remain in operation."[24] Even if this were the case -- and the Generator Protests have not shown that it is[25] -- Dr. Patton shows that it would be "highly undesirable" to use inflated market power mitigation reference levels as a means to recover those costs.[26] Instead, in "cases where a supplier is providing necessary reliability services to the system that are not priced in the market, and is not recovering its fixed costs, the Commission has generally relied on contractual solutions that are customized and appropriate for the specific

[23] *ISO New England,* 129 FERC ¶ 61,008 at P 18.

[24] Patton Initial Affidavit, ¶ 38.

[25] Patton Supplemental Affidavit, ¶ 15.

[26] Patton Initial Affidavit, ¶ 39-41.

resource in question."[27] In New York, this result can be achieved through Attachment Y to the NYISO's OATT.

Section 8.9 of Attachment Y authorizes the NYISO Board, in consultation with the New York Department of Public Service ("DPS"), to identify "an imminent threat to the reliability of the New York power system,"[28] and in that event to require the appropriate Transmission Owner or Owners to propose an appropriate "Gap Solution" outside the normal reliability planning cycle.[29] Other entities, which could include the Generators identified in the September 4 Filing, can also submit proposed Gap Solutions. If the operation of one of the subject generators is needed to prevent an imminent threat to the reliability of the New York State Bulk Power Transmission Facilities, and if such a Generator would cease operations because it is not able to recover its legitimate going-forward costs, then the predicate for the use of an Attachment Y Section 8.9 Gap Solution would be met. Section 13.6 of Attachment Y provides for the recovery of the costs of a Gap Solutions that are not transmission projects; such as the funding of a reliability must-run arrangement with a given Generator in appropriate circumstances. Hence, there is no need to permit Generators to exercise market power in the energy, ancillary services, or Capacity markets in order to make necessary cost recovery payments to Generators that are

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[27] *Id.*, ¶ 42.

[28] The NYISO's planning responsibilities under Attachment Y to its OATT extend to the "New York State Bulk Power Transmission Facilities," as that term is defined in Sections 1.1 and 2.0 of Attachment Y.

[29] A "Gap Solution" is defined in § 2.0 of Attachment Y as: "A solution to a Reliability Need that is designed to be temporary and to strive to be compatible with permanent marketbased proposals. A permanent regulated solution, if appropriate, may proceed in parallel with a Gap Solution." Section 8.9(a) of Attachment Y provides that Gap Solutions "may include generation, transmission or demand side resources."

genuinely needed for the reliability of the bulk power system and that are not able to recover their legitimate going-forward costs.[30]

None of the Generator Protests address the availability of Gap Solutions under Attachment Y. Consequently, the Generator Protests do not show that the NYISO must be directed to submit a compliance filing allowing for reliability must-run payments, or that not providing for the recovery of fixed costs makes the NYISO's proposal unreasonable.[31]

F. Modeling a New Constraint that Can Only be Solved by One Supplier Would Expand the Effects of that Supplier's Exercise of Market Power

IPPNY and several of the other Generator Protests argue that modeling the reliability concerns that required the commitment of the three Generators will address the Generators' cost recovery concerns by sending an appropriate price signal to the market. There are two problems with this suggestion. First, modeling the relevant constraints would not cure the market power problem, but only shift its effects from guarantee payments to energy prices.[32] Second, as the NYISO explained in the September 4 Filing and as Dr. Patton explains in his Supplemental Affidavit, adding new constraints to the NYISO's market model that can only be solved by a single supplier will expand the potential market impact of that Supplier's ability to exercise market power.[33] Instead of limiting the impact to the guarantee payment made to a single

[30] Generators whose continued operation is needed to provide reliable service to loads on facilities that are not New York State Bulk Power Transmission Facilities would need to seek any necessary cost recovery payments directly from the local Transmission Owner. The reliability commitment of such a generator would be at the request of the local Transmission Owner.

[31] *See, e.g.*, Attachment E Supplier at 31; Attachment C Affidavit, ¶¶ 35 and 36.

[32] Patton Supplemental Affidavit, ¶ 16; September 4 Filing at 8..

[33] *Id.*.

Generator, the Supplier's non-competitive bids would set an artificially high LBMP that could affect a far broader segment of the market. In other words, permitting a Supplier that possesses market power to set price will not solve the underlying market power problem; it will only serve to expand the problem's scope.

As Dr. Patton explains in his Supplemental Affidavit, in order to send appropriate price signals to the market, the modeling of a new reliability constraint that that can only be addressed via the commitment of a pivotal Suppliers generator(s) would need to be accompanied by appropriate mitigation measures.[34] The NYISO would support IPPNY's proposal if there are mechanisms in place to require a pivotal Supplier to submit competitive bids that reflected its Generators' marginal costs. The NYISO expects to discuss this proposal further in its stakeholder governance process.

G. The NYISO has Provided Appropriate Support for the Mitigation Thresholds Proposed in Rate Schedule M-1

The Generator Protests assert that the NYISO has not provided adequate cost support or an adequate economic rationale for the proposed "greater of 10% or $10/MWh" mitigation thresholds proposed in Rate Schedule M-1.[35] Contrary to the Generators' assertions, the thresholds are not intended as a vehicle to permit Generators to recover their fixed or going-forward costs. Any such use of the thresholds would be inappropriate for all the reasons explained above. Rather, as explained by Dr. Patton and Mr. Boles, the thresholds are appropriate to provide some flexibility in bidding to account for the potential uncertainties in determining reference prices, particularly changes in fuel prices, thereby avoiding over

[34] Patton Supplemental Affidavit, ¶ 16.

[35] *See, e.g.*, Attachment E Supplier at 25, 26.

mitigation of guarantee payments.[36] Dr. Patton also points out that the 10% threshold in Rate Schedule M-1 rests on the same basis as the 10% threshold recently approved by the Commission for use in comparable circumstances in New England.[37] The Generator Protests argue that the thresholds should be looser to permit additional fixed cost recovery, but do not show that the proposed thresholds are not at appropriate levels for the purposes for which they were intended.

Dr. Patton has explained that setting thresholds in Rate Schedule M-1 that are significantly lower than the default mitigation thresholds "is analogous to the situation in the New York City load pockets where much lower conduct and impact thresholds are applied to address local market power."[38] The Commission approved the New York City thresholds on the basis of analysis by Dr. Patton similar to that provided with the September 4 Filing.[39] In that proceeding, the Commission agreed with NYISO that the proposed "threshold reasonably balances the need for flexibility for generators bidding in constrained areas to reflect legitimate changes in marginal costs and the need to prevent undue exposure of the market to locational market power."[40] In doing so, the Commission noted the NYISO's explanation that the proposed threshold level "is between levels that are impractically low and thus likely to mitigate

[36] Patton Initial Affidavit, ¶¶ 15-20; Patton Supplemental Affidavit, ¶ 24 and 27; Boles Supplemental Affidavit, ¶¶ 4-6.

[37] Patton Supplemental Affidavit, ¶ 27.

[38] Patton Initial Affidavit, ¶ 15.

[39] *See N.Y. Indep. Sys. Operator, Inc.* 99 FERC ¶ 61,246 at p. 62,047-48 (2002).

[40] *Id.* at p. 62,048.

unjustifiably (mitigate instances of legitimate conduct) and levels that would permit sustained price increases resulting from the presence of locational market power."[41]

The Attachment E Supplier asserts that the Commission's rejection of a March 2007 filing by the NYISO of a form of mitigation for the In-City ICAP market supports its claim that the NYISO has not provided adequate "cost support" or "economic justification" for its proposed Rate Schedule M-1.[42] This assertion is completely misplaced. First, the NYISO itself acknowledged that the proposed reference price at issue in the In-City ICAP proceeding was not based on a cost analysis, but was instead a negotiated compromise.[43] Second, the September 4 Filing does not address how reference levels are determined. Rather, it proposes to re-set the threshold above a Generator's reference level at which mitigation will be applied.

A cost of service justification would be appropriate for determination of the reference levels on which mitigation is based. Reference levels are determined on a case-by-case basis under the NYISO's existing tariff provisions.[44] The setting of reference levels, however, is not at issue in this filing. The issue here is mitigation thresholds, which serve a different purpose. The NYISO has provided both an economic justification of,[45] and cost support for certain aspects of,[46] its proposed Rate Schedule M-1.

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[41] *Id*. at p. 62,047.

[42] Attachment E Supplier at 26, *citing N.Y. Indep. Sys. Operator, Inc.* 118 FERC ¶ 61,182 at PP 13-14, 17; *see also* Generation Owner at 11.

[43] *N.Y. Indep. Sys. Operator, Inc.*, 118 FERC ¶ 61,182 at P 15.

[44] Services Tariff, Attachment H § 3.1.4.

[45] *See, e.g.*, Dr. Patton's Initial and Supplemental Affidavits.

[46] *See, e.g.*, Boles Supplemental Affidavit, ¶¶ 4-6.

H. The NYISO's Calculation of Impact Pursuant to Section 3.2.3(2) of its Market Mitigation Measures was Performed Correctly

Attachment E Supplier and Generation Owner argue that the NYISO's method of determining whether the bids they submitted on behalf of their Generators exceeded the 100% guarantee payment impact mandatory filing threshold specified in Section 3.2.3(2) of the Market Mitigation Measures ("MMM") was not the appropriate method of performing this test because it can produce anomalous results in some circumstances.[47]

The NYISO used the same method it uses on a daily basis to test for real-time guarantee payment ("RTGP") impact under Section 3.2.1(2) of its MMM to determine if the bids submitted on behalf of the three Generators exceeded the "increase of 100 percent in guarantee payments" threshold set forth in Section 3.2.3(2) of the MMM.[48] The method that the NYISO used to calculate guarantee payment impact in this case is consistent with the calculation method it described on page 4 of its August 31, 2007 RTGP mitigation filing in Docket No. ER07-1334-000 ("August 31, 2007 Filing"):

> Under the MMM, competitive "reference levels" [footnote omitted] are established for each generator's Incremental Energy, Minimum Generation and Start-Up Bids. Bids that exceed the relevant reference level by the conduct thresholds specified in Section 3.1.2 of the MMM fail the conduct test and are eligible for guarantee payment mitigation if they would also result in a real-time BPCG payment to the generator that is 50% (in New York City) or 200% (in the rest of New York State) greater than the "reference" BPCG payment that would be available for the operating day if all conduct-falling Bids were replaced with reference levels (the "RTGP Impact Test"). [footnote omitted] Stated another way, the RTGP Impact Test compares (i) the BPCG payment that a generator would receive if its Bids that fail the conduct test were replaced with reference levels (the "Reference BPCG"), to (ii) the BPCG payment that the generator would receive if the generator were compensated based on the offers the NYISO

[47] *See, e.g.*, Attachment C to the Attachment E Supplier's Protest ¶¶ 20 through 31. The MMM are set forth in Attachment H to the Services Tariff.

[48] Boles Supplemental Affidavit, ¶ 12.

> used to run its Real-Time Market (the "Initial BPCG"). If the comparison of the Initial BPCG to the Reference BPCG indicates that the generator's offers increased its BPCG payment by more than 50% (in New York City) or by more than 200% (in the rest of New York State), then all of the generator's conduct-failing Bids are mitigated for the entire operating day and a revised BPCG payment (which can never he less than $0) is calculated based on the mitigated offers.

Before the NYISO submitted the August 31, 2007 Filing, the NYISO explained the method it intended to use to calculate guarantee payment impact to its stakeholders. Both the NYISO's presentation to the Business Issues Committee[49] and its presentation to the Management Committee[50] included slides illustrating how guarantee payment impact would be calculated.

The vast majority of the Generation sector entities that submitted protests in this Docket participated in the stakeholder process that resulted in Management Committee approval of the NYISO's August 31, 2007 Filing. The concerns that Attachment E Supplier and Generation Owner raise in this proceeding regarding the appropriate method of calculating guarantee payment impact were also raised in the stakeholder process that ultimately resulted in the August 31, 2007 Filing. Although the concerns were identified as a potential area for future improvement[51] in the stakeholder discussions, seventy-two percent of the NYISO's Management

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[49] The NYISO's April 20, 2007 presentation to its Business Issues Committee can be found on the NYISO's web site at the following location:

> http://www.nyiso.com/public/webdocs/committees/bic/meeting_materials/2007-04-20/BIC_agenda_05_Realtime_Guarantee_Payment_042007.pdf

[50] The NYISO's April 30, 2007 presentation to its Management Committee can be found on the NYISO's web site at the following location:

> http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2007-04-30/mc_agenda_06_presentation_re_gp_proposal.pdf

[51] Possible improvements that were discussed included not applying guarantee payment mitigation if a generator's guarantee payment would change by $500 or less as a result of the

Committee voted to move forward using the RTGP calculation method described above. In the end, seventy-two percent of the NYISO's stakeholders voted in favor of the NYISO's proposal at the Management Committee.[52] The Commission accepted the proposed Tariff revisions that accompanied the NYISO's filing in an order issued on October 30, 2007.[53]

In addition, as explained in the Supplemental Affidavit of Joshua A. Boles, the impact calculations that resulted in the NYISO's filing in this proceeding identified substantial daily guarantee payment impacts of thousands of dollars per Generator, per commitment day.[54] Hence, the theoretical concern that the NYISO could mathematically calculate an inappropriate guarantee payment impact when the LBMP is, to use the extreme example in the Protests, $49.99/MWh, the generator's (minimum generation) reference level is $50/MWh and the generator's (minimum generation) bid is $51/MWh,[55] while technically correct, is not relevant to the facts presented here. Had the scenario posited by Attachment E Supplier and Generator Owner occurred, the NYISO would have exercised its authority under Section 3.2.3 of the MMM

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mitigation. Prior to the initiation of this proceeding, the NYISO's stakeholders had not asked the NYISO to prioritize developing a solution to the guarantee payment impact test calculation concern identified by the Attachment E Supplier or Generation Owner. The NYISO presumes its generation sector stakeholders did not show sustained interest in addressing this calculation concern because, relatively speaking, it is a concern that is of relatively small financial importance to them.

[52] *See* NYISO August 31, 2007 filing in Docket No. ER07-1334-000, at 15.

[53] *N.Y. Indep. Sys. Operator, Inc.* 121 FERC ¶ 61,112 (2007).

[54] Boles Supplemental Affidavit, ¶¶ 13-16.

[55] Resulting in potential mitigation of $1.01/MWh.

to determine that the guarantee payments received were "due to legitimate competitive forces or incentives," which would have obviated the need for the NYISO's September 4 Filing.[56]

I. Attachment E Supplier's Proposed Alternative Method of Calculating Guarantee Payment Impact Under Section 3.2.3(2) of the Market Mitigation Measures is Either a Conduct Test or a Total Revenue Impact Test; It is Not a Guarantee Payment Impact Test

In its protest, Attachment E Supplier suggests that the guarantee payment impact test set forth in Section 3.2.3(2) of the MMM should not be calculated the same way as the RTGP impact test. Rather, Attachment E Supplier argues that for purposes of Section 3.2.3(2) of the MMM, guarantee payment impact should instead be calculated by comparing the accepted portions[57] of a Generator's bid to the corresponding reference levels to determine if the Generator's bid resulted in a guarantee payment impact. Hence, if a Generator with a $40/MWh (minimum generation) reference level has a $120/MWh (minimum generation) bid accepted, the resulting impact would be a 200% increase to the Generator's guarantee payment under the Attachment E Supplier's proposal.

As Dr. Patton and Mr. Boles explain in their Supplemental Affidavits,[58] the alternative method for determining when mitigation should be imposed proposed by Attachment E Supplier ignores the LBMP revenues that the Generator receives, so it would not accurately test the impact that a Market Party's bidding behavior had on the guarantee payment that its Generator

[56] *See* Boles Supplemental Affidavit, ¶ 17.

[57] Attachment E Supplier's filing did not thoroughly explain the details of its proposed MMM Section 3.2.3(2) impact calculation method. The NYISO assumes that the proposed test is intended to be performed after-the-fact and to compare a generator's accepted bids to the corresponding reference levels.

[58] Patton Supplemental Affidavit, ¶¶ 18 and 19; Boles Supplemental Affidavit, ¶ 12.

receives. Rather, Attachment E Supplier's proposed test compares a Generator's bids to its reference levels. The proposed test is a either a conduct test (as Mr. Boles suggests) or a total revenue impact test (as Dr. Patton suggests) In either case, it is ***not*** a guarantee payment impact test.[59] The relevant provisions of Section 3.2.3(2) of the MMM expressly state that the NYISO is to determine the extent to which a Market Party's bidding behavior increased its guarantee payment, not to perform a conduct test, [60] or to determine the extent to which a Market Party's total revenues were enhanced by its bidding behavior.[61]

J. The NYISO's MMM Section 3.2.3(2) Guarantee Payment Impact Test is not Deficient Simply Because Generators Assertedly May Not Know in Advance if their Bids will Result in a Determination of Impact

Attachment E Supplier and Generation Owner argue that the NYISO's method of calculating guarantee payment impact under Section 3.2.3(2) of its MMM is impermissible because at the time a Supplier submits its bid, the Supplier cannot know whether its bid will exceed the mandatory filing threshold and trigger the NYISO's submission of a proposed mitigation measure to the Commission pursuant to Section 205 of the Federal Power Act.[62] Generation Owner's pleading argues that Section 3.2.3(2) should be applied on the basis of a

[59] While the NYISO proposes to employ a new conduct test that is similar in nature to Attachment E Supplier's proposed "impact" test in its Rate Schedule M-1, the NYISO explained on pages 10 and 11 of its September 4 Filing and in paragraphs 25-30 of Dr. Patton's Initial Affidavit that proposed Rate Schedule M-1 is different from the NYISO's existing mitigation measures because it incorporates an assumption that when the three identified generators are committed for reliability and are pivotal, they will (unless mitigated) be able to recover the full amount of their bids. The September 4 Filing requests the Commission's permission to implement its proposed new mitigation measure.

[60] *See* Boles Supplemental Affidavit, ¶ 12.

[61] *See* Patton Supplemental Affidavit, ¶ 18 and 19.

[62] Attachment E Supplier at 15-17; Generation Owner at 14 and 16.

Supplier's bidding conduct, not the impact on its guarantee payments, and in effect suggests that a "right" to bidding certainty entitles Suppliers to exercise market power, so long as their offers do not exceed the default conduct or impact thresholds specified in the NYISO's mitigation measures.

The NYISO vigorously disagrees with both assertions. First, as pointed out above, the language of Section 3.2.3(2) explicitly requires the NYISO to perform a guarantee payment impact test. Second, Suppliers that bid a Generator into the NYISO's markets can know with certainty that they will not be mitigated by bidding the Generator's marginal cost. The very purpose of the MMM Section 1(b) and 3.2.3 monitoring requirements is to identify Generators that are able to exercise market power in a targeted manner that does not exceed the otherwise applicable mitigation thresholds set forth in the NYISO's MMM. The purpose of the mitigation thresholds is not to permit a Supplier to receive compensation in excess of the compensation it would receive if it bid competitively. Moreover, in its Order accepting the NYISO's proposed MMM in 2000, the Commission made clear that the NYISO "may make a section 205 filing any time it believes conduct in a particular circumstance warrants it, even when the thresholds are not met."[63] By definition, a mitigation measure that is designed to catch Market Parties that are attempting to "fly under the radar" by bidding just under an existing mitigation threshold cannot, and should not, be subject to any set or defined minimum criteria (other than the generator's reference level). Suppliers that want certainty should submit bids at competitive levels, and use the consultation process, as necessary, to ensure their Generators' reference levels are accurate.[64]

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[63] *N.Y. Indep. Sys. Operator, Inc.*, 90 FERC ¶ 61,317 at p. 62,053 (2000).

[64] In addition, in the NYISO's proposed Rate Schedule M-1 the three generators are provided the additional assurance of the 10% or $10 thresholds before mitigation will be applied.

K. The NYISO's Obligation to Inform Generators of the Reliability Need they are Being Committed to Address

Generation Owner and Attachment E Supplier argue that the NYISO is obligated to inform them of the reason(s) their generators are being committed for reliability. The NYISO agrees. However, they are not entitled to more information than the NYISO provides to the rest of the market.

As Ricardo T. Gonzales, the NYISO's Vice President of Operations, explains in his attached affidavit,[65] Section 4.0 of the NYISO's Code of Conduct (Att. F to the OATT) provides:

> The ISO shall disclose data that is not Confidential Information, and information required to be disclosed by FERC, by posting the information on the OASIS. If an ISO Employee improperly discloses TSI to any Market Participant, the ISO shall immediately post the information on the OASIS and notify the Commission.

The NYISO interprets this requirement, along with the requirement in Section 2.0 of its Code of Conduct that it administer the OATT and Services Tariff fairly and impartially, as requiring the NYISO not to give a particular market party preferential access to market data. This is one of the reasons that the NYISO publicly posts all reliability commitments on its web site at http://www.nyiso.com/public/market_data/reports/operational_announcements.jsp.

L. Other Suppliers' Resources Cannot Address the Reliability Concern that its Generator(s) Are Being Committed to Address

In paragraphs 4 through 8 of his attached Affidavit, Ricardo T. Gonzales, the NYISO's Vice President of Operations, responds to Attachment E Supplier's claims that its Generator(s) should not be subject to Rate Schedule M-1 because the Attachment E Supplier is not the only Supplier that can, or that has been designated to, solve the reliability need for which its

[65] Gonzales Affidavit, ¶ 3.

generator(s) were committed or dispatched. In his Affidavit Mr. Gonzales explains that there are circumstances under which Attachment E Supplier's Generator(s) are the only resource(s) that are able to address an identified reliability need.[66]

M. The NYISO's Requested Waivers are Appropriate

The Generation Owner asserts that the NYISO has not presented any evidence to suggest that the reliability problems that occurred during the hottest months of the year will occur again before next summer, and thus asserts that the requested waiver of the six month effective period for mitigation measures should not be granted.[67] The Generation Owner admits, however, that relevant reliability commitments occurred last winter, and provides no analysis establishing that the same cannot be expected this winter.[68] Mr. Boles confirms that reliability commitments of the relevant Generators during the winter months are likely.[69]

The Generator Owner also does not show that the NYISO's waiver request does not meet the criteria in the Commission's Guidance order.[70] First, Generation Owner's protest asserts that there is no adverse impact on the market because the conduct at issue does not meet the existing mitigation thresholds.[71] This assertion simply ignores the fact that the existing mitigation thresholds are not the only criteria in the MMM for identifying a significant adverse market

[66] *Id.,*¶ 8.

[67] Generation Owner at 32.

[68] *Id.* at 8.

[69] Boles Supplemental Affidavit, ¶ 11.

[70] *See. e.g.,* Generation Owner at 32 *et seq.*

[71] *Id.* at 33.

impact. The MMM include the market impact threshold specified in §§ 1 (b) and 3.2.3. Those are the thresholds that required the NYISO to submit its September 4 Filing.

Second, Generation Owner's protest asserts that the need for the NYISO to take action was not unanticipated because the conduct at issue is within the existing thresholds and Generation Owner has not changed its bidding behavior.[72] Again, the issue in this filing is not whether the existing thresholds for rest-of-state mitigation are met, but whether significant adverse market impacts are occurring that require a filing under Sections 1(b) and 3.2.3 of the MMM.

Finally, Generation Owner's protest claims that there is no evidence that prompt action is needed because its generator has been selected to operate under almost identical bids in the past without triggering mitigation.[73] Generation Owner's apparent belief that it is entitled to some sort of detrimental reliance on past bidding behavior is utterly without merit. The mitigation measure in Rate Schedule M-1 would only apply prospectively, and past bids will have no bearing on whether future bids should be mitigated. Once the schedule becomes effective, the three Generators will be on notice that they are subject to mitigation, and can formulate their bids accordingly. They can avoid mitigation by bidding competitively.

As the NYISO explained in its September 4 Filing, the NYISO hopes to be able to complete the stakeholder process to develop a new mitigation measure within six months. Automation of the new mitigation solution will, however, of necessity require longer than six months to complete. Limiting the NYISO's authority to apply Rate Schedule M-1 to the three

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[72] *Id.*.

[73] *Id.* at 34.

identified Generators to a six-month period will not provide the NYISO sufficient time to develop, code and test the additional software capability that will be necessary to implement the new mitigation measures it develops with its Market Participants. In the meantime, the requested mitigation measure will only require the relevant Generators to bid as if they were facing competitive market conditions. Accordingly, the NYISO respectfully submits that the requested waiver is appropriate.

N. The Stakeholder Process for Determining a Permanent Mitigation Measure

The Generation Owner contends that the stakeholder process for consideration of tariff changes to incorporate a mitigation measure for Generators that are committed for reliability outside New York City should be provided an economic analysis of the alternatives for addressing each reliability concern that requires a Generator to be committed. IPPNY contends that the NYISO should be required, in the stakeholder process, to develop comprehensive market rules to ensure that Generators are appropriately compensated when called upon to meet reliability needs.[74]

The NYISO is of course committed to providing appropriate economic analysis as necessary to support stakeholder consideration of issues that come before them. However, the NYISO's proposed tariff revision will not be directed at a specific reliability concern, but rather the general solution for the market power that can arise when Generators must be committed for reliability, including future reliability concerns that are not yet known. In the meantime, the analysis submitted with the September 4 Filing and this Response shows that mitigation of

[74] *Id.* at 30-31; IPPNY at 7.

Generation Owner's identified Generation is warranted. No further direction from the Commission on this is warranted.

The NYISO agrees with IPPNY that any new mitigation rules should provide appropriate compensation to Generators. The NYISO's view of "appropriate compensation" would differ from IPPNYs, however, if IPPNY proposes that market power mitigation measures should provide for the recovery of fixed costs. The NYISO has invited its stakeholder governance participants to present proposed compensation procedures for discussion in its Market Issues Working Group. However, as explained above, IPPNY has not shown that there is a need for additional procedures to supplement the Gap Solution process that is already available in Attachment Y to the NYISO's OATT.

O. The Rate Schedule M-1 Consultation Process

The Generator Protests contend that the existing time frames for real-time guarantee payment mitigation in Section 3.3.3.1 of the MMM should be adopted in Rate Schedule M-1.[75]

Upon consideration of these comments, the NYISO agrees that this proposed modification of Rate Schedule M-1 is appropriate, with the exception that the NYISO requires at least 10 business days to identify Bids that appear to violate the mitigation thresholds. The NYISO is otherwise willing to agree to use all of the other consultation deadlines set forth in Section 3.3.3.1 of the MMM, and to change its proposed Rate Schedule M-1 to reflect this requirement in a compliance filing.

The NYISO requires 10 business days to identify Bids that appear to violate the mitigation thresholds because Rate Schedule M-1 is being implemented manually by the NYISO

[75] IPPNY at 8-9; *see also* EPSA at 4.

staff. As a result, it is not possible for the NYISO to identify possible mitigation under Rate Schedule M-1, notify the affected Market Party, and reflect the proposed mitigation in the Market Party's settlement results as quickly as the partially automated Real-Time Guarantee Payment Mitigation procedure contemplated by Section 3.3.3.1. With this exception, the NYISO believes the use of the timelines in Section 3.3.3.1 would be appropriate.

IV. Conclusion

WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission accept this response to the intervenors' comments and protests and accept the new mitigation rules proposed by the NYISO in this docket for the three specifically identified Generators for filing, subject only to the modification agreed to by the NYISO in Section III(O) of this filing.

Respectfully submitted,

/s/ Alex M. Schnell
Robert E. Fernandez, General Counsel
Alex M. Schnell
New York Independent System Operator, Inc.

William F. Young
Hunton & Williams LLP
Counsel to the New York Independent System Operator, Inc.

Dated: October 13, 2009

CERTIFICATE OF SERVICE

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

Dated at Washington, D.C. this 13th day of October, 2009.

/s/ William F. Young
William F. Young
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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc. **Docket No.** ER09-1682-000

SUPPLEMENTAL AFFIDAVIT OF JOSHUA A. BOLES

I. Qualifications and Purpose

1. My name is Joshua A. Boles. I currently serve as the Supervisor of Monitoring, Analysis, and Reporting for the Market Monitoring Department ("MMP")[1] of the New York Independent System Operator, Inc. ("NYISO"). My responsibilities include supporting the Manager of Market Monitoring in administering the NYISO's Market Mitigation Measures ("MMM"), which are set forth in Attachment H to the NYISO's Market Administration and Control Area Services Tariff. I hold a M.A. in Applied Economics and a B.A. in Economics from the State University of New York at Buffalo. I am the same Joshua A. Boles who submitted an affidavit in support of the NYISO's September 4, 2009 filing in the above docket.

2. This affidavit is submitted in response to the protests received from the suppliers whose offering behavior was addressed and whose generators were

[1] The NYISO's May 15, 2009 compliance filing in Docket No. ER09-1142-000 proposes to modify the duties assigned to the NYISO's Market Monitoring and Performance Department, and to change the name of that department to the Market Mitigation and Analysis Department.

identified in attachments C, D, or E to the NYISO's September 4, 2009 filing in Docket No. ER09-1682-000.

3. In this testimony I: (1) provide analysis to support the "greater of 10% or $10/MW increase in guarantee payments" incremental energy and minimum generation mitigation thresholds proposed in Rate Schedule M-1; (2) explain why the guarantee payment impact test that the NYISO performed to determine if the Bids submitted on behalf of the three generators is the appropriate test to apply; and (3) explain why the NYISO is proposing to Apply Rate Schedule M-1 to the

II. Analysis Supporting the Proposed Rate Schedule M-1 "Greater of 10% or $10" Mitigation Thresholds

4. Protests submitted by the "Attachment E Supplier" and "Generation Owner" in Docket No. ER09-1682-000 argue that the NYISO failed to provide economic analysis or cost support for its proposed "greater of 10% or $10/MWh" incremental energy and minimum generation mitigation thresholds.

5. Dr. Patton's Initial and Supplemental Affidavits explain the basis for the thresholds in Rate Schedule M-1, and respond to the protesters' arguments that they should be permitted to incorporate fixed costs into their offers. Set

forth below is additional support, consistent with Dr. Patton's analysis, for the NYISO's proposed "greater of 10% or $10/MWh" threshold for the mitigation of Incremental Energy Bids[2] and Minimum Generation Bids. The discussion below refutes the unsubstantiated assertions of the Attachment E Supplier and the Generation Owner that the thresholds do not provide a just and reasonable bandwidth for the suppliers to recover their respective marginal operating costs, and shows that there is only a very limited chance that a supplier that bids competitively could be over mitigated.[3]

6. In calculating the likelihood of over-mitigation, the NYISO examined day-over-day changes in Transco Z6 NY spot natural gas costs for the time period May 11, 2007 through October 7, 2009. The NYISO found that the daily price changes reflected spot natural gas price increases in excess of 10% on less than one day in twenty. The observed spot gas price increases would have increased the reference levels of a generator with a heat rate of

of the market days studied. Such increases would have increased the reference levels of a generator with a heat rate of of the

[2] Capitalized terms that are not defined herein have the meaning ascribed to them in the NYISO's Market Administration and Control Area Services Tariff, or the meaning ascribed to them in the MMM.

[3] Over-mitigation due to inaccurate reference levels can be addressed via consultation with MMP in accordance with Rate Schedule M-1 if and when the greater of 10% or $10/MWh threshold proves inadequate to address variation in a generator's marginal operating costs. In the NYISO's Response to Protests that this Affidavit supports, the NYISO agrees with IPPNY's suggestion that the NYISO should (with one exception that is noted in the NYISO's Response) use the process and timelines for consultation that are set forth in Section 3.3.3.1 of the MMM.

market days studied. The observed spot gas price increases would have increased the reference levels of a generator with a heat rate of

of the market days studied. Such increases would have increased the reference levels of a generator with a heat rate of of the market days studied. These heat rates provide a reasonable approximation for purposes of analyzing the thresholds in Rate Schedule M-1. The results of this test of day-over-day changes in spot natural gas costs is consistent with the results of a similar test that was the basis for the Commission's acceptance of a similar conduct threshold provision in New England.[4]

III. NYISO Proposal to Mitigate Generation Owner's Generation

7. In an affidavit filed on behalf of the Generation Owner

[4] *ISO New England and New England Power Pool*, 129 FERC ¶ 61,008 at P 27 (2009) (stating that: "Filing Parties have justified the 10% threshold by explaining that this threshold was determined to reflect a reasonable bound of measurement error based on the Internal Market Monitor's analysis of inter-day fuel price creations.").

8. Generation Owner further argues that: (1) there were no adverse impacts to the market because Generation Owner's bidding behavior did not exceed the existing mitigation thresholds; (2) the conduct was not unanticipated because it was within the existing mitigation thresholds

; and (3) there is no evidence that expedited Commission action is needed because

As explained below I disagree with these arguments.

9.

10. The issue here is not whether the existing thresholds for mitigation outside the New York City Constrained Area were exceeded. Rather, the issue is whether (a) Generation Owner engaged in conduct that departed significantly from conduct that would be expected under competitive market conditions, and (b) that conduct had a significant impact on guarantee payments. As explained in my prior affidavit

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The entities that are responsible for paying the guarantee payment were adversely affected by this bidding behavior.

11. Consistent with my prior affidavit, it is not possible to predict whether and to what extent the Generation Owner's generation will be committed for reliability and have the opportunity to continue to exercise market power.

[5] Based on this information the NYISO still believes expedited Commission action is warranted to protect the entities that are responsible for paying for the guarantee payments in the event that these generators are needed for reliability in the near term.

IV Impact Test

12. The Attachment E Supplier and Generation Owner's protests question the validity of the impact test that was described in my previous affidavits. The impact test that was calculated is consistent with the FERC-accepted Real Time Guarantee Payment ("RTGP") Impact Test. I calculated the impact on guarantee payments by comparing the original Bid Production Cost Guarantee ("BPCG") payment based on the bids submitted by the generators with the BPCG payment based on the applicable references of the generators. This is the same methodology that has been consistently used by the NYISO to

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determine guarantee payment impact since the inception of the Market Mitigation Measures, and has been the subject of extensive stakeholder discussions and approval and prior Commission proceedings. A calculation based on a generator's bids rather than its guarantee payments would be a conduct test rather than an impact test. Section 3.2.3(2) of Attachment H explicitly requires an impact test.

13. The Attachment E Supplier and Generation Owner argue that the impact test that the NYISO performed produces unreasonable results as the LBMP approaches the generator's reference level, and posits that a generator could be adversely affected by an inappropriate determination of impact under these circumstances.

14. Although the concerns raised in the protest may identify a potential enhancement to the current guarantee payment impact test methodology, the argument is purely academic when one considers the facts that the NYISO has presented in this proceeding.

15. First, the evidence contained in my Initial Affidavits shows that the level of payments received in excess of marginal costs by these suppliers supports the NYISO's determination of impact. The Generation Owner received,

and the Attachment E Supplier received, in guarantee payments above the payments they would have received at the applicable reference level each time the generators were committed in 2009.

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16. The following information also refutes the unsubstantiated claims that as a result of the LBMP approaching the reference level the results of the impact test are unreasonable. During the time period the committed for reliability the average hourly real time zonal LBMP was The average hourly real time zonal LBMP was Based on these facts, the NYISO's impact calculation in this case is not subject to the concerns raised by the protesters.

17. Second, prior to making a determination that sections 1(b) and 3.2.3 of the MMM were violated and a filing was necessary, the NYISO is required to determine if the behavior was inconsistent with competitive market outcomes. A bid that was only a minimal amount above a generator's reference level would not be found to be inconsistent with competitive market outcomes. That was not the case here.

V. Conclusion

18. For the foregoing reasons, the Commission should reject the objections made by the protestors in this case and approve the mitigation rule changes proposed in this docket.

Further affiant sayeth not.

ATTESTATION

I am the witness identified in the foregoing Affidavit of Joshua A. Boles dated October 13, 2009 (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.

Joshua A. Boles
Supervisor of Monitoring, Analysis, and Reporting
New York Independent System Operator, Inc.

October 13, 2009

Subscribed and sworn to before me
This 13th day of October, 2009

Diane L. Egan
Notary Public for the State of New York

DIANE L. EGAN
Notary Public, State of New York
Qualified in Schenectady County
No. 4901500
Commission Expires March 21, 20 10

My commission expires: March 21, 2010

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc. Docket No. ER09-1682-000

AFFIDAVIT OF RICARDO T. GONZALES

I. Qualifications and Purpose

1. My name is Ricardo T. Gonzales. I am the Vice President of Operations for the New York Independent System Operator, Inc. ("NYISO"). My responsibilities include the reliable operation of the New York Control Area transmission system, in compliance with all applicable NERC, NPCC, and NYSRC reliability rules and standards, the operation of the ISO Day-Ahead and Real-Time wholesale Energy Markets and validating the Energy Markets' prices, and the operation of the NYISO Transmission Congestion Contract and Installed Capacity Markets, and other NYISO administered markets.

2. The purpose of this affidavit is to respond to a number of protests that challenge certain aspects of the reliability commitments of the identified generators.

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II. Response to Protests

3. In its protest the Attachment E Supplier complained that it was not informed of the nature or extent the reliability commitment need its generator was being committed to address. As detailed in its Code of Conduct, the NYISO is not permitted to disclose Confidential Information to a single market participant, in this case Transmission System Information (TSI), which has not yet been posted on the OASIS or in some other public forum. In order to provide transparency of the North Country reliability need,

4.

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5.

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7.

the Attachment E Supplier argues in its protest that the NYISO's proposed Rate Schedule M-1, by its terms, does not apply to its generator because there are other suppliers, including demand response, that can

fully address the reliability need that the generator is being committed to address. I do not agree.

8. There are no demand-side resources that are capable of solving the reliability requirement that the Attachment E Supplier's generator is being committed to address.

9. Further, affiant sayeth not.

ATTESTATION

I am the witness identified in the foregoing Affidavit of Ricardo T. Gonzales (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.

Ricardo T. Gonzales
Vice President, Operations
New York Independent System Operator, Inc.

October 13, 2009

Subscribed and sworn to before me

this 13th day of October, 2009

Notary Public

My commission expires: 9/29/2013

DIANE LEMNER
Notary Public, State of New York
Saratoga Co. #01LE5065930
Commission Expires Sept. 29, 2013

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc) Docket No. ER09-1682-000

Supplemental Affidavit of David B. Patton, Ph.D.

I. Purpose and Summary

1. My name is David B. Patton. I am an economist and President of Potomac Economics. Our offices are located at 9990 Fairfax Boulevard, Fairfax, Virginia 22030. Potomac Economics is a firm specializing in expert economic analysis and monitoring of wholesale electricity markets.

2. I filed an affidavit previously in this case explaining the need for and benefits of the proposed mitigation measure that would apply to specific units that have frequently been committed out-of-market ("OOM") to address reliability issues.[1] When a resource is committed out-of-market, it receives a payment equal to the

[1] My out-of-market (OOM) term broadly encompasses commitments like the NYISO's Day-Ahead Reliability Unit ("DARU") commitments and Supplemental Resource Evaluations ("SRE's") commitments. It also covers additional OOM dispatch of OOM committed generators.

difference between its offered cost and wholesale market LBMP. I will refer to this as a "BPCG payment."

3. When a large share of a generator's commitments is made for reliability, the supplier may have an incentive to offer above its marginal costs in order to increase its BPCG payments. The proposed mitigation rule is intended to reduce the incentive and ability for participants to exercise market power by raising their offers when they face no competition to resolve a local reliability issue.

4. The purpose of this affidavit is to respond to a variety of protests that challenge the basis for the mitigation measure or the conclusions that were drawn regarding the conduct of the identified generators.

II. Response to Protests

A. Generator Offers Expected Under Competitive Conditions

5. In an affidavit filed on behalf of Attachment E Supplier, their consultant argues that the NYISO did not show that the generators' offers departed from competitive expectations.[2] However, these arguments do not distinguish clearly between competitive conditions and market power, or between short-run and long-run considerations.

6. The objective of any rational business is to maximize its profits. When a supplier does not have market power, its offer will not substantially affect the market's

[2] *See* Attachment C to the "Attachment E Supplier's" protest at ¶¶ 33-40.

clearing prices or its payments. Hence, its offer will simply determine when its resource will be committed and dispatched. A profit-maximizing supplier will seek to be dispatched any time the market revenue exceeds its production costs.

7. Generation Owner argues that if a generator's costs are generally higher than the LBMP, the expected profit-maximizing strategy is to offer at its marginal cost plus the maximum mark-up allowed under the current mitigation measures. Generation Owner's argument is correct for a supplier with market power, but demonstrably incorrect under competitive conditions.

8. Assume a resource has marginal cost of $50 per MWh and average fixed costs of $20 per MWh. In a competitive single clearing price market, a profit-maximizing supplier will never offer its resource at $70 per MWh. By offering at $70 per MWh, it will receive the difference between the price and its marginal cost in all hours when the price is greater than $70 per MWh. However, if it were to offer at $50 per MWh, it would receive the same amount of profit in the hours when the price exceeds $70 per MWh *plus* the margin between the price and its marginal costs in hours when the price is between $50 and $70 per MWh. For example, if the price in an hour is $60, the supplier that offers at $70 per MWh will earn no profit while the supplier offering at $50 will earn $10 MWh. The latter strategy is clearly the profit-maximizing strategy for a supplier facing competition and is, therefore, the offers that one would expect under competitive conditions.

9. The consultant for Attachment E Supplier acknowledges this when the consultant indicates "I agree that in a purely competitive scenario, an entity has the incentive

to lower its bid to the degree possible so that it is chosen to run as an inframarginal generator. . .”[3] The consultant then argues that the situation is different here because the market is not competitive and there are not many other suppliers that can set the price above competitive offer of the resource in question. This argument does nothing to alter the competitive expectations of a supplier when it determines its offer price. The fact that the particular conditions that the proposed mitigation measure addresses are significantly different from normal competitive conditions is precisely why the mitigation measure is proposed.

B. Incorporating Fixed Costs into a Supplier's Offer

10. The consultant for Attachment E Supplier and I agree that a supplier that is needed for reliability should have an opportunity to recover its fixed costs of remaining in operation. However, Attachment E Supplier argues one reasonable means to accomplish this is to employ mitigation measures that allow generators to raise their offers as a means to recover fixed costs.[4] The consultant then attempts to support this approach by citing a 2002 Order from the Commission that established “Peaking Unit Safe Harbor” or “PUSH” thresholds, which allowed certain generators in chronically constrained areas to raise their offer prices.[5]

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3 Attachment C to the “Attachment E Supplier's” protest at ¶ 38.

4 *Id*.

5 *Id*. at 39; *New England Power Pool and ISO New England, Inc.*, 100 FERC ¶ 61,287 (2002),.

11. The PUSH thresholds case is not applicable here for a number of reasons. The Commission's objective in that case was to allow clearing prices to rise in the constrained areas to reflect local reliability needs in those areas that were not fully priced due to the lack of locational operating reserves markets and locational capacity markets. Allowing higher offers from the New York generators in this case will not increase energy prices and produce economic signals that reflect the reliability needs of their respective areas, they will simply result in higher guarantee payments made directly to the suppliers. Hence, it would not alter the economic signals that are received by other new and existing suppliers. Additionally, the New York ISO *does* currently have locational requirements in both its operating reserves and capacity markets. When ISO-New England implemented locational requirements in these markets, they discontinued the use of the PUSH thresholds. Furthermore, both the internal and external market monitors in New England found that the PUSH thresholds were not effective in achieving the Commission's objectives.[6]

12. In Section III below, I explain that ISO-New England recently filed a mitigation measure that is very similar to the measure proposed by the New York ISO to address the same competitive issue. The measure proposed by ISO-New England was conditionally approved by the Commission on October 2, 2009.

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[6] See *A Review of PUSH Implementation and Results*, ISO-NE, December 2003. See also *2004 Assessment of the Electricity Markets in New England,* Potomac Economics, June 2005.

13. Therefore, while I do *not* disagree with arguments by Generation Owner and Attachment E Supplier that resources needed for reliability should have an opportunity to recover their fixed costs, I strongly disagree that recovering such costs by exercising a prescribed amount of market power is a reasonable approach. My prior affidavit provided a number of reasons why such an approach is not reasonable.

14. Many of the protests argue that if such costs are not recovered through the market, some form of contractual backstop (*e.g.*, a reliability agreement) would be needed. I agree. The Attachment E Supplier's consultant asserts that the NYISO does not have Tariff provisions that would allow for such agreements. The NYISO disagrees, arguing that Attachment Y to its Open Access Transmission Tariff would facilitate such agreements. Regardless, relying on some form of process to establish reliability agreements is preferable to rejecting the proposed mitigation measure.

15. None of the suppliers in question have presented data showing that the current energy, ancillary services, and capacity market do not cover the going-forward fixed costs of the resources in question.[7] Given the net revenues available to

[7] Going-forward costs include costs that could be avoided by taking a generator out-of-service for an extended period or by retiring a generator permanently. Going-forward costs may include maintenance costs incurred to keep the generator in service, labor costs necessary to keep the plant available, and/or expected profits from converting the facility to an alternative purpose that would be foregone by keeping the generator in service. Going-forward costs do not include sunk costs such as past expenditures or investments, and/or financing costs that could not be avoided by taking the generator out of service.

relatively high-cost units from the energy and capacity markets, I believe it is not unlikely that the markets would cover these resources' fixed going-forward costs with no reliability agreement. At best, the arguments regarding fixed cost recovery are theoretical at this point.

C. Modeling the Reliability Constraint

16. A number of the protests argue that the best way to resolve the problem of fixed cost recovery is to model the constraints so that they can be reflected in the clearing prices.[8] Contrary to their assertion, modeling a reliability constraint that only one supplier can satisfy would not address the fixed cost issue. It would simply shift the market power rent from the guarantee payment to the energy payment. The market power mitigation measure would still be needed and would engender comparable fixed cost recovery concerns because the generator's Incremental Energy Bid would need to be mitigated to a competitive level that reflects the generator's marginal cost of producing energy.

17. Additionally, even if a transmission constraint is priced, the lumpiness of generation may still prevent the clearing price from reflecting the need for the generator. For example, if 30 MW of generation is needed to resolve a transmission constraint, and the only available generator has a minimum

[8] *See* IPPNY at 6, EPSA at 4, and AES at 5.

generation level of 45 MW, the generator will be dispatched at minimum and the LBMP will not reflect the cost of dispatching the generator.

D. Application of the Impact Test

18. A consultant for the Attachment E Supplier argues that the NYISO applied the impact test for guarantee payments incorrectly. The consultant argues extensively that changes in the underlying LBMP can significantly change the estimated impact of a participant's conduct on its guarantee payment. The consultant argues that a more reasonable approach would be to apply the conduct test to the participants total payments (i.e., not to subtract the LBMP revenue). That is, the consultant claims that Sec. 3.2.3(2) of Attachment H of the Services Tariff should be interpreted to require testing of "the revenues that the generator received as a result of its offer compared to the revenues it would have received at its reference price."[9] The Attachment E Supplier makes this same argument, apparently focusing on the difference between a generator's reference price and its offer rather than the revenues produced by each, but this produces the same result as proposed by the consultant.[10] Since the offer and reference price would be multiplied by the same number of MW of output to determine the gross revenue levels produced by each, the percentage increase is the same for the difference between the offer and reference price or the total revenues each would produce. Either approach amounts to only testing the impact of the generator's conduct on

[9] Attachment C to Attachment E Supplier protest, at ¶31.

[10] Attachment E Supplier at 15.

its total revenues, rather than the impact of its conduct on its guarantee payments. This type of impact test is only slightly different than a conduct test.[11]

19. While the consultant claims that the approach discussed in the preceding paragraph is a "reasonable interpretation" of the Tariff, the argument cannot be reconciled with the plain language of the Tariff, which clearly indicates that the impact is related to the change in the *guarantee payment*. It requires a relatively tortured interpretation of the Tariff to argue that performing the impact test based on the total revenue is consistent with the Tariff. Furthermore, since the impact on energy prices is separately tested, it is appropriate in this context to measure only the change in the guarantee payment to the participant. This impact measures the true change in the costs to New York's consumers and the payments to the generator. Section 3.2.3(2) by its terms specifies an impact test, not a conduct test.

20. The reason why the impact results vary as substantially as they do in the examples provided by the Attachment E Supplier in ¶¶ 26-31 of Attachment C to its protest is that it is measured in percentage terms only. Therefore, a small increase in a small number can result in a large percentage increase, which seems counterintuitive to Attachment E Supplier's consultant. In reality, this is a criticism of the impact threshold (i.e., that fact that only a percentage threshold is

[11] A conduct test is performed on the entire offer curve, while this test is performed up to the level actually committed and dispatched by the NYISO.

used in §3.2.3(c) rather than a combination of a percentage change and/or absolute dollar change). Attachment E Supplier's criticism does not apply to the conduct at issue in this case because the impact test was correctly performed, the guarantee payments were sizable and there was a significant difference between the LBMP and the generator's reference level, as shown in the Supplemental Affidavit of Joshua A. Boles.

III. Mitigating Similar Local Market Power Issues in New England

21. On August 5, 2009, ISO New England filed proposed changes to its market power mitigation measures to address the exercise of market power by a supplier with a resource that must be committed to satisfy a local reliability need of the system.[12] As described below, ISO New England's proposed measure is very similar to the measure proposed by the New York ISO, and it was conditionally approved on October 2 by the Commission.[13] Given the similarities in the proposals and the issues in the two cases, the same determination is warranted in this proceeding.

A. The ISO New England and NYISO Proposals

[12] *ISO New England Inc. and New England Power Pool*, ISO New England Inc. and New England Power Pool, Market Rule 1 Revisions Relating to Mitigation of Supply Offers for Resources Committed to Satisfy Reliability Needs, Docket No. ER09-1546-000 (Aug. 5, 2009).

[13] *ISO New England Inc. and New England Power Pool,* Order Conditionally Accepting Market Rule 1 Revisions, 129 FERC ¶ 61,008 (2009). (Hereinafter "ISO-NE Order").

22. The mitigation measure proposed by the New York ISO are similar to provisions approved by the Commission for use in ISO New England. Both measures address local market power issues associated with generators committed for local reliability. Hence, the proposals address the same issue in the two markets.

23. The NYISO proposal is arguably more necessary because the current conduct threshold applied to these New York generators is less stringent than the conduct threshold that had previously applied to the New England generators.[14] However, the scope of the NYISO current proposal, which would apply to just three generators until a more general tariff revision is filed and approved, is much narrower than the ISO-NE measure, which applies to all generators committed for reliability.

24. In addition to addressing the same concern, the proposals themselves are virtually identical. Both ISOs employ a conduct and impact mitigation framework. Both NYISO and ISO New England would apply a 10 percent conduct threshold standard to offer components related to the commitment of a generator (i.e., start-up cost and cost of operating at the minimum generation level). The most significant difference between the NYISO's proposed conduct threshold and the

[14] In the NYISO the conduct threshold that applies to generators located outside the New York City Constrained Area is currently an increase of (the lesser of) $100/MWh or 300 percent over a generator's reference level, while the conduct threshold previously applied to New England generators committed for local reliability was an increase of (the lesser of) $25/MWh or 50 percent over the generator's reference level.

ISO-NE's is that the NYISO proposal would use the *greater* of 10 percent or $10/MWh as the threshold for testing Minimum Generation and Incremental Energy Bids. The ISO New England proposal would use the lesser of 10 percent or $80/MW-day. Hence, the New York ISO proposal is less stringent than the ISO-NE measure.[15]

25. Finally, both New York and New England's proposals recognize that an impact test is not necessary because increases in offers submitted on behalf of generators committed out-of-market for local reliability that are eligible to receive a guarantee payment will directly impact the generator's compensation.

26. In conditionally approving the ISO-NE measure, the Commission noted that the ISO-NE "justified the 10 percent threshold by explaining that this threshold was determined to reflect a reasonable bound of measurement error based on the Internal Market Monitor's analysis of inter-day fuel price variations." The 10 percent threshold is also likely to be appropriate in New York where most fuel prices fluctuations are highly correlated with prices in New England and driven by similar factors.

27. Furthermore, in its Order on ISO New England's proposal the Commission rejected a contention that generators should be allowed to exercise market power

[15] The Commission conditionally approved the ISO New England proposal, but required a compliance filing to provide more justification for the $80/MW-day portion of the conduct threshold. See ISO-NE Order at p. 19.

in order to recover their fixed costs in an ISO with locational markets for energy, operating reserves, and capacity. The Commission indicated that "[concerns related to fixed cost recovery] are more appropriately addressed in another proceeding or in ISO-NE's stakeholder process."[16]

IV. Conclusion

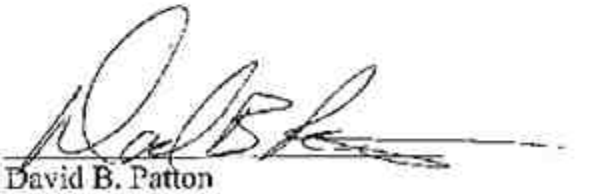
28. For the foregoing reasons, the Commission should reject the objections made by the protestors in these case and approve the mitigation rule changes proposed by the NYISO.

29. This concludes my affidavit.

[16] See ISO-NE Order at p. 25.

ATTESTATION

I am the witness identified in the foregoing Affidavit of David B. Patton, Ph.D. dated October 13, 2009 (the "Affidavit"). I have read the Affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.



David B. Patton

October 13, 2009

Subscribed and sworn to before me

this 13th day of October, 2009

Dorothy M. Shute

Notary Public

DOROTHY M. SHUTE
Notary Public, State of Indiana
My County of Residence: Hendricks
My Commission Expires May 8, 2017

My commission expires: _____

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