

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

New York Independent System Operator, Inc. Docket No. EL03-26-004

ORDER MODIFYING AND ACCEPTING COMPLIANCE FILING

(Issued March 4, 2005)

1. In this order, we will modify and accept the compliance filing of the New York Independent System Operator, Inc. (NYISO), incorporating into its Market Administration and Control Area Services Tariff (Services Tariff) a formula for compensating electricity suppliers whose bids NYISO has mitigated erroneously. This order benefits customers by ensuring that market power mitigation measures are clearly defined to market participants.

Background

2. NYISO's automated mitigation procedure (AMP) for the day-ahead energy market incorrectly mitigated the highest-priced bid block that Dynegy Power Marketing, Inc. (Dynegy) tendered into the August 10, 2001 day-ahead market.¹ Dynegy therefore was entitled, under Commission policy, to receive its "full bid" as compensation.² The parties could not agree on the compensation that would comprise Dynegy's "full bid" and took the matter to arbitration. Because the Commission did not define the term "full bid," the arbitrator relied primarily on NYISO's statement, in its Technical Bulletin No. 67 then in effect, of how it would compensate suppliers whose bids were incorrectly mitigated. The arbitrator's decision³ found that the bulletin's text supported Dynegy position, that the

¹ The AMP compares a generator's bids to its Reference Level and mitigates those bids that are excessive. A Reference Level is a value determined by an historical average of the seller's bids accepted by NYISO or, if there is insufficient historical information available, then it is determined by NYISO after consultation with the seller. It is undisputed that NYISO staff failed to enter Dynegy's revised Reference Levels into the AMP software, causing the erroneous mitigation.

² See *New York Independent System Operator, Inc.*, 95 FERC ¶ 61,471 at 62,690 n.9 (2001), *petition for review denied per curiam sub nom. Dynegy Power Marketing, Inc. v. FERC*, 62 Fed. Appx. 1 (2003).

supplier has a right to expect that if its bid is accepted, it will be paid the incremental bid price for all the megawatts supplied. The arbitrator awarded damages accordingly to Dynegy. NYISO filed the arbitration award with the Commission and subsequently asked the Commission to vacate it.

3. NYISO disputed the arbitrator's interpretation of Technical Bulletin No. 67. NYISO and Dynegy agreed that the starting point was to subtract the price actually paid for the purchase of all megawatts on that particular day and the particular hour, *i.e.*, the location-based marginal price (LBMP), from the bids for Dynegy's offers of blocks of megawatts. Where they differed was over which blocks of Dynegy's bids were affected so as to have this difference multiplied by the number of megawatts in the particular block and count towards Dynegy's compensation. NYISO interpreted the text as meaning only the blocks of incorrectly mitigated megawatts, while Dynegy interpreted it as meaning all the blocks that it had supplied for the hour in question, including the blocks that had not been incorrectly mitigated.

4. On November 17, 2004, the Commission upheld the arbitrator's reading of the text in Technical Bulletin No. 67.⁴ Because of an error in the arbitrator's calculation, the Commission required NYISO to re-calculate the correct compensation amount according to the arbitrator's methodology. NYISO complied with the Commission's directive, made the correct calculation, and applied the sum to Dynegy's account.⁵

5. In the November 17 Order, the Commission held that, although typically it does not require technical bulletins to be filed, it would require this bulletin to be filed because of the extent to which the bulletin's provisions affect NYISO's rates and charges for transmission. The Commission explained that the filing of these provisions would give market participants an opportunity to comment on the appropriateness of NYISO's remedy for erroneous mitigation.⁶

6. On December 17, 2004, NYISO filed its proposed compensation methodology, the same methodology stated in the current version of Technical Bulletin No. 76, as proposed

³ See American Arbitration Association Case No. 13 198 00247 02, *Dynegy Power Marketing, Inc. and New York Independent System Operator, Inc.* (October 28, 2002) (Grigg, Arb.).

⁴ *New York Independent System Operator, Inc. v. Dynegy Power Marketing, Inc.*, 109 FERC ¶ 61,163 (2004) (November 17 Order). This order gives more detailed background to the parties' dispute and the Commission actions in resolving it. See November 17 Order at P 2-15.

⁵ See NYISO's December 2, 2004 filing in Docket No. EL03-26-003.

⁶ November 17 Order at P 47.

amendments to Attachment H of its Services Tariff, “NYISO Market Monitoring Plan,” (December 17 Filing). NYISO requested February 15, 2005 as the effective date for the tariff amendments.

Compensation Methodology Filing

7. NYISO’s December 17 Filing adds to Attachment H a new section 4.2.2(c) which reads:

If an Electric Facility is mitigated to a default bid other than a default bid determined as specified in § 3.2.4, the Electric facility shall receive an additional payment for each interval in which such mitigation occurs equal to the product of: (i) the number of megawatts per interval scheduled or dispatched to which the incorrect default bid was applied, and (ii) the difference between (a) the lesser of the applicable unmitigated bid and a default bid determined in accordance with § 3.1.4, and (b) the applicable LBMP or other relevant market price in each such interval.

8. In section 4.2.2(c), NYISO proposes to use the same method of calculating erroneous mitigation compensation as described in its (unfiled) revised Technical Bulletin No. 67. Should NYISO erroneously commit a supplier to provide power at a price below its bid, the supplier will receive additional compensation only for those megawatts for which it received a price that was less than the bid amount. In other words, the supplier will be compensated the difference between the LBMP that it received for its output and its bid for that output, which will apply only to the megawatts that it supplied at an LBMP below its bid amount. NYISO states that this is consistent with the long accepted basis for compensating units that are dispatched out of economic merit for reliability. Additionally, NYISO states that applying the full bid to the supplier’s entire output, including the output of the unmitigated bid blocks, would, in effect, compensate the supplier as if its unmitigated bid had set the market clearing price, which would not have been the case.⁷

9. NYISO included in the December 17 Filing an affidavit from its Independent Market Advisor, Dr. David Patton, giving his economic assessment of the proposed compensation methodology in the context of NYISO’s market design. Dr. Patton explains that, in clearing-price markets under competitive conditions, a seller’s profit-maximizing strategy is to bid its marginal cost, including risk and opportunity costs, at every point on its bid curve. Thus, the seller’s bid curve signals its willingness to run at

⁷ NYISO states that determining what would have been the LBMP had the erroneous mitigation not occurred could be established only by re-running the entire market, which is difficult, infeasible, and beyond the scope of the full bid remedy.

any output level on its bid curve at any price equal to or greater than the bid for that output level. Therefore, all scheduled megawatts that are not incorrectly mitigated receive compensation that at least equals, and often exceeds, the price that the seller has shown willingness to accept. Only the incorrectly mitigated megawatts are scheduled in a manner inconsistent with the seller's offer for those megawatts. Dr. Patton disputes the theory that sellers make bids at lower output levels based on their bids for upper output levels, stating that a rational bidder would not bid below its marginal costs on one segment of its bid curve and above its costs on another segment.

Notice and Responsive Filings

10. Notice of NYISO's December 17 Filing was published in the *Federal Register*, 69 Fed. Reg. 78,405 (December 30, 2004), with interventions, protests, and comments due on or before January 5, 2005. In response to a motion by Independent Power Producers of New York, Inc. (Power Producers), the due date was extended to January 14, 2005.

11. AES Eastern Energy, L.P. (AES), the Mirant Parties (Mirant),⁸ and Reliant Energy, Inc. (Reliant) filed motions to intervene. The New York Transmission Owners (Transmission Owners)⁹ filed a motion to intervene and comments. Power Producers, Dynegy, and Keyspan-Ravenswood, LLC (Keyspan) filed motions to intervene and protests.

12. Transmission Owners support the proposed filing; however, they raise concerns that the language in proposed section 4.2.2(c) is ambiguous and may lead to payments in unintended circumstances. Specifically, Transmission Owners state that the text calculating the difference between the supplier's bid, before the erroneous mitigation, and the LBMP, which is used to determine the damages due the supplier, is written ambiguously. According to Transmission Owners, damages are to be awarded only if the

⁸ The Mirant Parties consist of: Mirant Americas Energy Marketing, LP; Mirant New York, Inc.; Mirant Bowline, LLC; Mirant Lovett, LLC; and Mirant NY-Gen, LLC.

⁹ Transmission Owners consist of: Central Hudson Gas & Electric Corporation; Consolidated Edison Company of New York, Inc.; LIPA (formerly, the Long Island Power Authority); the New York Power Authority; New York State Electric & Gas Corporation; Rochester Gas and Electric Corporation; Orange and Rockland Utilities, Inc.; and Niagara Mohawk Power Corporation.

LBMP received by the supplier is less than its original bid.¹⁰ In addition, Transmission Owners note that a time interval should be added to NYISO's calculation. NYISO's proposed section 4.2.2(c) multiplies a quantity stated in terms of MW by a price stated in terms of \$/MWh to produce a result stated in terms of \$/hour. To ensure the proper compensation, Transmission Owners say that this result should be multiplied by a third factor, the length of the interval for which the improper default bid was applied. Transmission Owners state that NYISO does not object to correcting these flaws by adding language to proposed section 4.2.2(c) that clarifies the calculation and recognizes the length of the interval. Transmission Owners suggest the following replacement language:

If an Electric Facility is mitigated to a default bid other than a default bid determined as specified in § 3.2.4, the Electric Facility shall receive an additional payment for each interval in which such mitigation occurs equal to the product of: (i) the amount of Energy in that interval scheduled or dispatched to which the incorrect default bid was applied; (ii) the difference between (a) the lesser of the applicable unmitigated bid and a default bid determined in accordance with § 3.1.4, and (b) the applicable LBMP or other relevant market price in each such interval, if (a) is greater than (b), or zero otherwise; and (iii) the length of that interval.

13. Dynege, Power Producers, and Keyspan urge the Commission to reject NYISO's proposed tariff revisions. They contend that, should erroneous mitigation occur, the compensation should be the difference between the original bid before mitigation and the LBMP, multiplied by all the megawatts that NYISO committed the supplier to produce for the day and hour of the erroneous mitigation.

14. Dynege states that NYISO's proposal is discriminatory because it ignores the market clearing price concept on which the NYISO market is based and under which the market compensates a supplier at its bid for all the megawatts supplied. Dynege states that NYISO's proposal would compensate erroneously mitigated suppliers differently and in an unduly discriminatory manner from other suppliers. It states that in order for the erroneously mitigated suppliers to be held harmless and be made whole in cases of erroneous mitigation, NYISO should be required to re-run the market and re-settle the suppliers at the recalculated LBMP. Dynege supports its protest by reference to the arbitrator's rejection of NYISO's position, and to the Commission's statement, in the

¹⁰ Transmission Owners point out that, as proposed by NYISO, an erroneously mitigated supplier could receive an LBMP for the megawatts it supplied that exceeds its unmitigated bid and still be awarded compensation because December 17 Filing does not clearly define the calculation's minuend and the subtrahend. In this hypothetical situation, the supplier would not have been harmed, and therefore should not be entitled to compensation.

November 17 Order, that the order benefits customers by ensuring that market power measures are consistently applied to market participants.¹¹ Power Producers state that Dr. Patton's supporting rationale, while generally correct for bids based largely on incremental operating costs, fails when applied to the portion of a generator's bids that are largely driven by risk and opportunity costs, the very bids that are likely to be mitigated or improperly mitigated by the AMP. Moreover, Power Producers find the rationale to be inconsistent with the way NYISO incorporates risk and opportunity costs into supplier Reference Levels. Power Producers state that particularly during peak hours, when a supplier's bid is more likely to be subject to mitigation, a bid is not merely a function of variable costs. At the higher levels of output, a bid is also a function of the risk associated with forced outages and the commitments of bidding into the day-ahead market, *i.e.*, purchasing energy at the real time price, which exceeds the day-ahead market price. Power Producers state that this risk premium necessitates that the Reference Levels at the higher output levels be higher than as currently calculated by NYISO. Power Producers urge that, unless NYISO revises its Reference Level calculation methodology, the Commission should require, in instances where NYISO incorrectly mitigates a supplier's bid, payment of the supplier's full bid on the entire output of the unit in question.

15. The protestors also raise several issues relating to the updating of technical bulletins and to the AMP in general. They criticize the current process for revising technical bulletins and for participant comment on technical bulletin provisions as inadequate, and give as an example, that Technical Bulletin No. 67 was revised after this dispute without stakeholder input. They urge the Commission to direct NYISO to amend its tariff to require: (1) incorporation of technical bulletins in NYISO manuals within 60 days of the date that the technical bulletins are published; and (2) stakeholder approval through the committee process before revisions to manuals become effective.

16. Power Producers and Dynegy are critical of the AMP and urge the Commission to direct NYISO to file a report with the Commission that demonstrates why the AMP is still necessary for the day-ahead market. Power Producers state that incorrect mitigation of supplier bids has detrimental effects on other market participants, including the suppression of market clearing prices. They state further that market improvements have been made since the AMP became effective; therefore, it is no longer needed. As support, they refer to the Commission's statement that, as markets mature, the Commission expects that underlying structural problems causing market power will be resolved, and at that point behavioral mitigation rules can be removed.¹²

¹¹ Dynegy cites the November 17 Order at P 1.

¹² Power Producers cite *New England Power Pool and ISO New England, Inc.*, 101 FERC ¶ 61,344 at P 28 (2002).

Discussion

17. We will accept NYISO's December 17 Filing, as modified by the text suggested by Transmission Owners, to be effective February 16, 2005, the first day following 60 days from the date of filing.¹³ The modification should eliminate confusion that may arise when interpreting the new provision. We will direct NYISO to file a revised section 4.2.2(c) to Attachment H of its Services Tariff within 15 days from the date of this order.

18. Erroneous mitigation may force a supplier to provide more energy than if the erroneous mitigation had not occurred. The erroneous mitigation would harm the supplier to the extent that its additional costs for supplying this additional energy exceed the additional market revenues that it received. We find that NYISO's proposed compensation methodology, as modified, will properly compensate the supplier for this harm. This compensation, together with the payment previously received for the erroneously mitigated megawatts, would constitute the full bid to which the erroneously mitigated supplier is entitled.

19. We decline to apply the supplier's bid for the erroneously mitigated megawatts to all the blocks of megawatts supplied, as the protestors request. In cases of erroneous mitigation, only the last scheduled segment on the bid curve would be mitigated and receive a price that was less than the supplier's bid. Only this last scheduled segment on the bid curve represents the quantity of megawatts for which the supplier is harmed. The generating unit would be dispatched according to its bids at all levels below the mitigated block. The unit would receive not only its bid, but the LBMP, which was greater than its bid. Should the LBMP be at or above the supplier's bid for the megawatts that were erroneously mitigated, the supplier would have received the market price, and compensation for the erroneous mitigation would be unnecessary. Appropriately, the proposed tariff modifications do not further compensate these megawatts. We agree with this approach. The megawatts that were fully compensated according to the bid curve (the supplier received at least what it was willing to accept for those megawatts) do not merit further compensation.

20. We disagree with Dynegy that the November 17 Order's endorsement of consistent application of market power mitigation measures supports Dynegy's view of the appropriate compensation for erroneous mitigation. We disagree also with Dynegy's argument that NYISO's proposed compensation method is discriminatory because it treats an erroneously mitigated supplier differently from other suppliers. Dynegy's error is its assumption that the erroneously mitigated supplier's bid would have determined the LBMP, so that the supplier would have received its unmitigated bid for all the megawatts accepted by NYISO. In accordance with the supplier's bid curve, if the upper

¹³ See section 205(d) of the FPA, 16 U.S.C. § 825d(d) (2000).

segments—the erroneously mitigated portion—were not to have set the LBMP, then the supplier would have been satisfied with producing the accepted level of megawatts at the market price. Under Dynegy’s discrimination argument, compensating a supplier as if the mitigated megawatts had set the market price, would in effect create a separate LBMP for this supplier only that exceeds the actual LBMP and would amount to a windfall payment to the supplier at the expense of New York electricity customers.¹⁴ Moreover, such a remedy would be unfair to all the other suppliers who did not receive this *artificial* LBMP.

21. We decline to address, as beyond the scope of this proceeding, the protestors’ objection that NYISO’s Reference Levels do not reflect the additional risk associated with bidding generating units at high output. This issue affects all suppliers of energy, those whose bids are correctly mitigated as well as those whose bids are erroneously mitigated. This proceeding is limited to whether NYISO’s proposed methodology for compensating erroneously mitigated bids, as set forth in proposed section 4.2.2(c), is adequate under the FPA.¹⁵

22. We find that the protestors’ requests concerning revision and stakeholder approval of technical bulletins are not germane to this compliance filing proceeding. Therefore, we will deny them. How NYISO revises its technical bulletins and manuals is an internal stakeholder process that should be taken, in the first instance, to that forum. Nevertheless, we remind NYISO and the protestors, as was stated in the November 17 Order, that the Commission requires the filing of terms and conditions in technical bulletins and manuals that sufficiently affect the rates and charges for transmission so as to fall within the Commission’s “rule of reason” regarding filings under section 205(c) of the FPA, 16 U.S.C. § 824d(c) (2000).¹⁶

23. Power Producers’ request for NYISO to justify its continued use of the AMP in the day-ahead market and the protestors’ questioning of whether the AMP is necessary and should be continued are also beyond the scope of this proceeding. We note, in regard to Power Producers’ request, that the U.S. Court of Appeals for the District of Columbia

¹⁴ The arbitrator and the Commission acknowledged the windfall component to Dynegy’s compensation when calculated according to the text of contemporaneous Technical Bulletin No. 67, which applied the full bid to all megawatts produced. *See* November 17 Order at P 30 and P 44.

¹⁵ If the protestors are dissatisfied with the Reference Levels established by NYISO, and cannot resolve the matter within NYISO, they can file a complaint with this Commission under section 206 of the FPA, 16 U.S.C. § 824e (2000).

¹⁶ November 17 Order at P 47 & n.51.

Circuit has vacated and remanded to the Commission the orders adopting the AMP,¹⁷ and has directed the Commission to discuss whether the AMP is anti-competitive and deters new suppliers from entering the market.¹⁸ Power Producers, Dynegy, and Keyspan have intervened in those proceedings. Accordingly, we find that their concerns regarding the necessity of the AMP are more appropriately raised in the remand proceeding.

The Commission orders:

(A) NYISO's December 17, 2004 compliance filing of tariff revisions is hereby modified and accepted, as discussed in the body of this order, to become effective February 16, 2005.

(B) NYISO is hereby directed to make a compliance filing, as directed in the body of this order, within 15 days of the date of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

¹⁷ *New York Independent System Operator, Inc. and Consolidated Edison Co. of New York, Inc.*, 99 FERC ¶ 61,246, *order on reh'g*, 103 FERC ¶ 61,291 (2005).

¹⁸ *Edison Mission Energy, Inc. v. FERC*, No. 03-1228, slip op. (D.C. Cir. January 14, 2005). The appellants' petition for review objected to NYISO's use of automated mitigation procedures for bids outside the New York City power market. Thus, NYISO's use of automated mitigation procedures for bids into the New York City power market and of manual mitigation measures still requires provisions governing possible erroneous mitigation.