140 FERC ¶ 61,140
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

New York Independent System Operator, Inc. Docket No. ER08-1281-011

ORDER ON REHEARING

(Issued August 22, 2012)

1. The New York Independent System Operator, Inc. (NYISO) seeks rehearing of an order issued in this proceeding on March 15, 2012.[1] For the reasons discussed below, we grant rehearing, in part, and deny rehearing, in part.

Background

A. The Lake Erie Loop Flow Proceeding

2. NYISO instituted this proceeding to address a certain subset of unscheduled flows around Lake Erie. These unscheduled flows were the result of specific transactions for which the contract path was not consistent with the actual physical flow of power from the transaction-specified source to the transaction-specified sink.[2] To address these market distortions, NYISO proposed certain short-term solutions, which the Commission

[1] *New York Independent System Operator, Inc.*, 138 FERC ¶ 61,195 (March 2012 Order).

[2] The transactions at issue were scheduled by a small number of market participants, beginning in 2008, for the purpose of exporting power from NYISO to the PJM Interconnection, L.L.C. (PJM) regional transmission organization (RTO), by way of a circuitous flow around Lake Erie, utilizing a scheduled path through both the Ontario Independent Electricity System Operator (IESO) and the Midwest Independent Transmission system Operator, Inc. (Midwest ISO).

accepted, subject to the requirement that NYISO work with its neighboring RTOs/ISOs to develop a comprehensive, long-term solution.[3]

3. In response, NYISO, in collaboration with PJM, the Midwest ISO and the IESO, proposed to develop and implement an Interface Pricing Initiative, among other proposals.[4] As described in the NYISO Report, the Interface Pricing Initiative contemplated the development and implementation of interface pricing revisions to address existing seams that create incentives which exacerbate loop flows. NYISO stated that, under its proposal, the ISOs and RTOs in, and around, the Lake Erie region would be required to use similar methods to price inter-regional transactions.

4. In an order issued July 15, 2010, the Commission found that these initiatives appeared to represent a workable framework for minimizing the occurrence of Lake Erie region loop flows, but identified unanswered questions that remained.[5] The parties' responses to these questions were addressed by the Commission in an order issued December 30, 2010.[6] In the December 2010 Order the Commission noted NYISO's acknowledgement that the method of pricing external transactions employed by NYISO created incentives for market participants to schedule circuitous transactions which can exacerbate Lake Erie loop flow.[7] With respect to the Interface Pricing Initiative, the December 2010 Order directed NYISO to implement its initiative by the second quarter of 2011.[8]

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[3] *See New York Independent System Operator, Inc.*, 124 FERC ¶ 61,174 (2008); *New York Independent System Operator, Inc.*, 125 FERC ¶ 61,184, at P 20 (2008). In a subsequent order, the Commission established a deadline for NYISO to develop and file an implementation plan addressing its proposed long-term solutions. *New York Independent System Operator, Inc.*, 128 FERC ¶ 61,049 (2009).

[4] *See* Report on Broader Regional Markets; Long-Term Solutions to Lake Erie Loop, Docket No. ER08-1281-004 (January 12, 2010) (NYISO Report).

[5] *New York Independent System Operator, Inc.*, 132 FERC ¶ 61,031 (2010).

[6] *See New York Independent System Operator, Inc.*, 133 FERC ¶ 61,276 (2010) (December 2010 Order).

[7] *Id.* P 27.

[8] *Id.* at Ordering Paragraph (C). On rehearing, at the request of NYISO, the Commission granted an extension of this deadline through the end of the fourth quarter 2011, for implementation by January 2012. *See New York Independent System Operator, Inc.*, 136 FERC ¶ 61,011 at P 15 (2011) (July 2011 Order).

B. Interface Pricing Initiative

5. In response to the Commission's compliance mandate, in the December 2010 Order, NYISO submitted an informational filling, on December 22, 2011, providing notice of its development and deployment of the software it claimed it would require to implement its Interface Pricing Initiative. NYISO stated that its software would permit NYISO to implement two alternative methods, or modes, of pricing and scheduling interface transactions. NYISO stated that the first of these two modes (the Conforming Mode) would be used when actual power flows through the NYISO control area are expected to closely conform to scheduled power flows.[9] NYISO stated that, alternatively, a second mode (the Non-Conforming Mode) would be used when NYISO expected significant unscheduled power flows.[10]

6. NYISO asserted that, under either of these two modes, the resulting prices would be consistent with the expected location of power delivery and the value of delivery at these locations. NYISO further asserted that, when operating under the Non-Conforming Mode, the resulting pricing would be expected to be similar to the results produced by the external interface pricing methods currently employed by PJM and the Midwest ISO. NYISO stated that, in determining which mode is appropriate, it would review historical data on unscheduled power flows and take into consideration significant changes in system topology.[11]

7. NYISO stated that it would make public the mode it intends to employ, in advance of a new quarter, and that its determinations would generally remain in effect on a

[9] NYISO stated that, in this instance, NYISO would commit, dispatch and price generation and interchange transactions, in its day-ahead security constrained unit commitment, in real-time commitment, and real-time dispatch, by computing each resource's incremental impacts on its system.

[10] NYISO stated that, in this instance, day-ahead security constrained unit commitment, real-time commitment, and real-time dispatch would be configured to represent the incremental power distribution around Lake Erie when computing each resource's incremental impacts on NYISO's system. NYISO added that all generator, load, and proxy bus generator bus shift factors and delivery (penalty) factors would be computed in a manner that reflects the expected deviation of scheduled flows from their contract path.

[11] NYISO noted, for example, that the introduction of phase angle regulators (PARs), an electrical device to help control power flows at the Michigan-Ontario interconnection, may result in a change in unscheduled power flows.

quarterly basis.[12] NYISO stated that this approach would be appropriate because more frequent transitions between its two pricing modes would produce inconsistent and unpredictable prices and schedules, to the detriment of the interconnected markets. NYISO added that, instead of resolving seams, overly-frequent, intra-quarterly changes could create a new seam between the relevant markets.

C. March 2012 Order

8. In the March 2012 Order, the Commission found that NYISO had failed to comply with the December 2010 Order.[13] In reaching this determination, the March 2012 Order first considered whether, as NYISO had asserted, the Commission's compliance mandate contemplated NYISO's implementation of two distinct modes of pricing and scheduling of the sort outlined by NYISO in its compliance notice, or whether, instead, the Commission's compliance mandate required NYISO to adopt a pricing initiative consistent with PJM's methodology.

9. The March 2012 Order found that the resolution of this issue turned on the Commission's finding, in the December 2010 Order, that there were differences between the interface pricing methods used in PJM and the NYISO, given that PJM used North American Electric Reliability Corporation (NERC) tag information regarding the source and sink of a transaction to determine the price the transaction receives or pays, while the NYISO and IESO base the price on the path over which the external transaction is scheduled into their respective control areas.[14]

10. The March 2012 Order stated that "[t]o the extent [the Commission's] compliance directive in the December 2010 Order was unclear, we clarify here that NYISO is required to submit a further compliance filing that includes an interface pricing methodology consistent with PJM's methodology, i.e., an interface pricing methodology that uses NERC tag information to determine actual source and sink for a transaction and calculates prices based on the actual energy flows at all times."[15]

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[12] NYISO noted, however, that were conditions to change dramatically and have the potential of affecting prices and schedules to an inappropriate degree, NYISO would reserve the right to change modes on an intra-quarterly basis. NYISO added that, were that to be required, NYISO would provide as much advance notice to its market participants neighboring balancing authorities as is practicable.

[13] March 2012 Order, 138 FERC ¶ 61,195 at P 18.

[14] *Id.* P 19 (citing December 2010 Order, 133 FERC ¶ 61,276 at PP 27 and 31).

[15] *Id.* P 21.

11. The March 2012 Order noted that PJM's methodology utilizes NERC tag information to determine the actual source and sink for a transaction and calculates prices based on the actual energy flows. The March 2012 Order then concluded that because at least certain elements of the methodology outlined by NYISO in its compliance notice (namely, the Conforming Mode, which relies on NYISO's *status quo* pricing and scheduling policy), are inconsistent with the PJM methodology, NYISO's filing is non-compliant with the December 2010 Order.

12. Accordingly, the March 2012 Order directed NYISO to submit an additional compliance filing, including tariff sheets and all necessary support, addressing NYISO's Interface Pricing Initiative. Specifically, the March 2012 Order directed NYISO to submit tariff provisions specifying a revised pricing methodology for all interface transactions, based on NERC tag information and actual energy flows, i.e., consistent with PJM's methodology, that it proposes to utilize to determine prices, including but not limited to tariff provisions identifying all relevant terms and their definitions and identifying all relevant buses to be included in its calculations. The March 2012 Order directed that, in its filing, NYISO should include full explanations and support for its proposals, including examples.

Request for Rehearing

13. NYISO asserts that the March 2012 Order erred by: (i) misinterpreting NYISO's compliance obligation, as established in the December 2010 Order; (ii) determining that NYISO's December 22, 2011 compliance filing failed to include the changes to the NYISO's market rules required by the December 2010 Order; and (iii) imposing new compliance obligations on NYISO that are unjust, unreasonable, unduly burdensome, impermissibly vague, and prohibitively expensive to implement.

14. NYISO asserts that the March 2012 Order failed to explain how or why the changes that NYISO made to its market design to implement interface pricing revisions fell short of NYISO's compliance obligation. For example, NYISO asserts that the Commission did not explain why its path validation method,[16] which relies on the use of NERC tag information to validate transactions, is insufficient to achieve consistency between scheduled power flows and expected power flows for pricing purposes. NYISO states that this methodology is sufficient to achieve consistency as between scheduled power flows and expected power flows for pricing purposes. NYISO states that while this methodology is not identical to PJM's source-and-sink pricing, it achieves a similar

[16] NYISO describes its "path validation method" as one that validates that the bidding and scheduling entity has represented the transaction to NYISO in the manner that is consistent with both the NERC tag information and how the power will actually flow. *See* NYISO's April 10, 2012 filing in Docket No. ER08-1281-010 at 5.

result and improves the consistency between the NYSIO and PJM interface prices. NYISO adds that there are fundamental differences between the PJM and NYISO market designs that make the NYISO's implementation appropriate for NYISO's markets.

15. NYISO further argues that a literal reading of the March 2012 Order's directive that prices be calculated based on the actual energy flows at all times is inconsistent with PJM's interface pricing methodology, would produce prices that are inconsistent with dispatch, and would be impractical to accommodate, even partially. NYISO adds that requiring NYISO to implement interface pricing rules based on the actual energy flows at all times would make NYISO's rules less, not more, consistent with PJM's, and is far more than is required to address the Lake Erie loop flow.[17]

16. NYISO states that PJM relies on expected energy flows and does not, in fact, use actual energy flows to set interface prices or to determine settlements for external transactions. NYISO asserts that, as such, the March 2012 Order erred in assuming that PJM uses actual energy flows to set prices and that an actual energy flow requirement would harmonize the NYISO's rules with those used by PJM. NYISO asserts that both PJM and NYISO use expected power flows to determine interface prices in their real-time markets and both PJM and NYISO run their day-ahead markets using models and estimates, not actual energy flows, to develop schedules and prices.

17. NYISO argues that the March 2012 Order erroneously departed from the Commission's prior orders in this proceeding to the extent the March 2012 Order rejected NYISO's interface pricing proposal and directed NYISO to adopt PJM's method. NYISO maintains that all of NYISO's previous filings in this proceeding included clear descriptions of how NYISO interface pricing proposal would be implemented, within the framework of the NYISO's existing Commission-approved market design. NYISO asserts that if the March 2012 Order is read to require that the NYISO must adopt PJM's actual interface pricing rules, such an interpretation would require NYISO to make significant changes to its existing operating tariffs and market design that would require years of effort and would be prohibitively expensive to implement.

18. NYISO states that, whereas PJM uses a physical reservation system, NYISO has employed an economic evaluation-based transmission reservation model since its inception in 1999. NYISO notes that while PJM uses express, physical transmission service to schedule external transactions, NYISO economically evaluates external transactions based on the financial offers market participants submit. NYISO asserts that,

[17] NYISO asserts that its interface pricing proposal, particularly the Non-Conforming scheduling mode, achieves the objective of the Commission's orders to implement similar interface pricing methods that would work within existing market designs.

as such, the NYISO could not adopt PJM's rules without fundamentally revising the operation of NYISO's market.

19. NYISO adds that the requirement that the new pricing method apply to "all interface transactions" involving NYISO is unnecessary, would produce inaccurate prices at many NYISO interfaces, and would disrupt existing and proposed interface scheduling and pricing mechanisms between NYISO and neighboring systems. Specifically NYISO asserts that the Commission did not explain why it would require NYISO to alter its existing market design for external transactions between NYISO and ISO New England, Inc.,[18] or for those scheduled over tightly controlled interfaces (such as NYISO's DC interconnection with Hydro Quebec and "Scheduled Lines" such as Cross-Sound Cable, Neptune, *et al*.) that are not significantly affected by the loop flow issues in this proceeding. NYISO asserts that its interface pricing proposal, particularly the Non-Conforming scheduling mode, will achieve all of the objectives of the Commission's prior orders and is just and reasonable.

Discussion

20. For the reasons discussed below, we grant in part and deny in part rehearing of the March 2012 Order. First, we reject NYISO's assertion that its December 22, 2011 compliance filing included the changes to the NYISO's market rules, as required by the December 2010 Order. Such a finding could not have been made by the Commission, in the March 2012 Order, in the absence of tariff sheets and supporting evidence, as the March 2012 Order made clear in finding "that NYISO's filing, a brief summary transmittal accompanied by an attached slide presentation, falls well short of [the Commission's compliance] standard[.]"[19]

21. However, based on NYISO's representations, in its rehearing request,[20] that PJM uses expected energy flows rather than actual energy flows to determine interface prices, we find it reasonable to use expected flows for pricing purposes. We therefore grant rehearing of the March 2012 Order's determination that, to comply with the December 2010 Order, NYISO was required to submit a revised pricing methodology based on actual energy flows, consistent with PJM's methodology. Instead, to comply with the December 2010 Order, we require NYISO to submit a detailed proposal along with

[18] The Commission has accepted NYISO's proposed revisions to the Coordinated Transaction Scheduling tariff. *See New York Independent System Operator, Inc.*, 139 FERC ¶ 61,048 (2012).

[19] March 2012 Order, 138 FERC ¶ 61,195 at P 24.

[20] *See, e.g.*, NYISO Rehearing Request at 11.

complete explanations of how its proposal will better align scheduled and real-time energy flows, including an explanation of how it uses NERC tag information to better predict energy flows and to enhance existing interface pricing practices.

22. We also clarify that the March 2012 Order does not require NYISO to abandon its economic evaluation of external transactions and redesign its market in order to adopt interface pricing rules that are the same as PJM's existing rules. We recognize that the benefits of any market design enhancement must be weighed against the cost of doing so and that some changes may be cost prohibitive. As NYISO states, differences between existing regional market designs may preclude NYISO from adopting the exact same methodology employed by another RTO/ISO. Accordingly, we clarify that in requiring that NYISO's proposal be consistent with PJM's interface pricing approach, we are requiring NYISO's methodology to compatible with PJM's – not necessarily identical to it. We also clarify that the interface pricing revisions at issue in this proceeding were not intended to apply to those interfaces for which unscheduled Lake Erie loop flows are not an issue.

23. NYISO states that it will propose compliance modifications to its Interface Pricing Proposal to alter certain elements of its proposed methodology, "namely, the Conforming Mode, which relies on NYISO's status quo pricing and scheduling policy to the extent they are inconsistent with the PJM methodology."[21] In advance of proposed tariff provisions implementing this approach, we will not prejudge this issue here.

<u>The Commission orders</u>:

Rehearing of the March 2012 Order is hereby granted, in part, and denied, in part, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[21] *Id.* at 36-37 (internal quotations, citing the March 2012 Order, 138 FERC ¶ 61,195 at P 23, removed).