

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Offer Caps in Markets Operated by)	
Regional Transmission Organizations and)	Docket No. RM16-5-000
Independent System Operators)	
)	

COMMENTS OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

In accordance with the *Notice of Proposed Rulemaking* issued by the Federal Energy Regulatory Commission (“Commission”) on January 21, 2016 in the above-referenced proceeding (the “NOPR”), the New York Independent System Operator, Inc. (“NYISO”) hereby submits its comments in response to the NOPR.¹ The NYISO continues to support the Commission’s goal of using the best cost information available for the purposes of calculating Locational Marginal Prices (“LMPs”).

I. COMMUNICATIONS AND CORRESPONDENCE

All communications and correspondence concerning these Comments should be served as follows:

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¹ NOPR at P 73.

II. COMMENTS

A. The NYISO Supports Capping Incremental Energy Offers at the Higher of \$1,000/MWh or a Resource's Cost-Based Incremental Energy Offer

The NYISO generally supports the Commission's proposal to revise its regulations to require that each regional transmission organization ("RTO") and independent system operator ("ISO") cap each resource's incremental energy offer² to the higher of \$1,000/MWh or that resource's verified cost-based incremental energy offer. The Commission's proposal would allow verified cost-based incremental energy offers above \$1,000/MWh to be included in the calculation of LMPs. The NYISO believes this approach is prudent to address future price volatility and market seams concerns. Subsections 1 and 2, below, describe the incremental cost review process that the NYISO uses to develop and revise Generator reference levels.³ The NYISO's review is a multistep process that initially relies on the Market Party's submission of anticipated costs, subject to review prior to calculating LMP, followed by after-the-fact review of supporting documentation and penalties for unwarranted or inaccurate costs. The NYISO believes this process achieves the goals of the Commission as outlined in the NOPR.

The NYISO, similar to the ISO/RTO Council ("IRC"),⁴ respectfully requests that the Commission clarify the requirement to verify costs before an offer can be used to calculate LMP.

1. The NYISO's Existing Incremental Cost Review Process

The NOPR proposes that the "costs underlying a resource's cost-based incremental energy offer above \$1,000/MWh must be verified before that offer can be used for purposes of

² In New York, the existing \$1,000 offer cap applies to Incremental Energy and Minimum Generation Bids. *See* Services Tariff Section 21.5.1. The NYISO expects that a revised offer cap, based on the higher of \$1,000/MWh or that resource's verified cost-based incremental energy offer subject to a hard cap, would also apply to Incremental Energy and Minimum Generation Bids, which the NYISO reviews against reference levels.

³ Capitalized terms not otherwise defined herein shall have the meaning specified in Section 1 of the NYISO Open Access Transmission Tariff ("OATT") and Section 2 of the NYISO Market Administration and Control Area Services Tariff ("Services Tariff").

⁴ The NYISO is a signatory to and supports the comments the IRC submitted in this proceeding.

calculating Locational Marginal Prices.”⁵ The NYISO’s existing incremental cost review process used to develop and revise Generator reference levels could be used to satisfy this verification requirement.

The NYISO’s general approach to imposing market power mitigation is to first compare a Market Party’s offers for a Generator to a set of “reference levels” for that Generator. Dollar-denominated reference levels, such as start-up, minimum generation and incremental energy reference levels, are generally intended to reflect a Generator’s marginal cost of providing a service.⁶ Several of the rules addressing the development of reference levels expressly require the NYISO to adjust reference levels to reflect changes in the price of the fuel that a Generator must consume.⁷ Even where the NYISO is not expressly required by its Services Tariff to fuel index a particular type of reference level, it incorporates fuel costs where appropriate to more accurately reflect Generators’ marginal costs. Fuel prices can change for a variety of reasons, including price volatility due to demand, a Generator’s capability to burn more than one fuel type, different fuel blends, or fuel from multiple sources with distinct prices. Therefore, the NYISO permits Market Parties to submit updated fuel type and fuel price information with Day-Ahead Market offers and Real-Time Market offers to accurately reflect the fuel type the Generator will burn and the associated costs incurred if it is committed.⁸ This information allows the NYISO to fuel-index Generator reference levels to accurately reflect changes in fuel

⁵ NOPR at P 56.

⁶ *See, e.g.*, Services Tariff Sections 23.3.1.4.1.1(iii), 23.3.1.4.1.2(iv), 23.3.1.4.1.3, 23.4.2.1.

⁷ *See, e.g.*, Services Tariff Sections 23.3.1.4.1.1, 23.3.1.4.1.2, 23.3.1.4.4.1.

⁸ Services Tariff Section 23.3.1.4.6.8 (“For purposes of this Section 23.3.1.4.6, “timely” notice or submission to the Real-Time Market shall mean the submission of fuel type and/or fuel price information using the methods specified in Section 23.3.1.4.6.4 of these Mitigation Measures prior to market close for the relevant Real-Time Market hour. For purposes of this Section 23.3.1.4.6, “timely” notice or submission to the Day-Ahead Market shall mean the submission of fuel type and/or fuel price information using the methods specified in Section 23.3.1.4.6.4 of these Mitigation Measures at least 15 minutes prior to the close of the Day-Ahead Market (*i.e.*, by 4:45 a.m.)).”; *See also* Services Tariff Sections 4.2.1.1 and 23.3.1.4.6.4; *see generally* Services Tariff Section 23.3.1.4.6.

prices. Each Market Party remains responsible for maintaining accurate cost information with the NYISO, including timely reflecting cost decreases.⁹ Market Parties are expected to submit updated cost data for all material changes to reference levels.¹⁰

The NYISO utilizes automated screening processes and manual review to evaluate the fuel type and fuel price information that Market Parties submit with their Energy offers. Market Parties are able to update the fuel price used to fuel-index their Generator's reference level at the time Energy offers are submitted. Fuel price updates are screened automatically by NYISO software and will be allowed if the update is within the pre-defined screening threshold.¹¹ The NYISO publicly posts the thresholds used to screen changes in fuel type or fuel price in advance.¹² At times when fuel prices are extremely volatile (for example, when natural gas prices are spiking or when gas is not available in the winter months due to heating demand), the NYISO posts correspondingly broader screening thresholds to permit Market Parties to react to price changes in the fuel markets. At times when fuel prices are relatively stable, the NYISO posts more stringent thresholds. Supporting documentation must be available for the NYISO's review *after the fact* when a Market Party updates its fuel type or fuel price information within the pre-defined thresholds. The screening thresholds also identify which fuel type and fuel price change requests need to be manually reviewed by NYISO staff before they are permitted to take effect and potentially be used to calculate LMP or generator guarantee payments.

In the event a Market Party needs to request a fuel type or fuel price change that exceeds the pre-defined thresholds, the Market Party may submit updated fuel type and/or fuel price

⁹ Services Tariff Section 23.3.1.4.6.2.

¹⁰ See Services Tariff Section 23.3.1.4.1.3.

¹¹ Services Tariff Section 23.3.1.4.3.3 permits the NYISO to implement a fuel type screening process that requires the NYISO to approve a Generator's change to a new fuel type.

¹² See *Fuel Entry Thresholds* at http://www.nyiso.com/public/markets_operations/services/market_monitoring/index.jsp.

information through the NYISO's Reference Level Software ("RLS"). Upon being noticed of a RLS submittal, the NYISO will initiate manual review in consultation with its external Market Monitoring Unit ("MMU"). NYISO staff and the MMU are alerted simultaneously when a new RLS submittal is received. The NYISO has a defined process to review extremely time-sensitive or "urgent" RLS submittals, such as requests related to fuel price or fuel availability that are close in time to the end of the Energy offer submission window.¹³ For "urgent" submittals, the NYISO will promptly contact the MMU to review the request and, following the discussion with the MMU, promptly contact the Market Party (conducting a conference call, if necessary). The discussions will identify the nature of the submittal and the basis for an immediate update. The NYISO will also communicate any concerns with the submittal and identify additional documentation required for approval. Any additional details discussed verbally will be documented in an e-mail from the NYISO and confirmed by the Market Party. If necessary, the Market Party will have the opportunity to provide additional information by adding an attachment to its original RLS submittal.

When a Market Party requests a temporary change in fuel type or fuel price because the commodity fuel cost exceeds the fuel cost used to develop a Generator's Reference Level, the NYISO may request evidence of the increased fuel cost. Supporting documentation must be provided by the Market Party enough in advance of the close of the bidding window to allow the NYISO to review and process the submittal.¹⁴ Based on the data documented in the RLS and/or e-mail exchange, the NYISO and its MMU will approve or deny the urgent request within 16 hours of submission. The NYISO will provide the basis for any denial in its comments in the

¹³ See NYISO Reference Level Manual Section 2.2, http://www.nyiso.com/public/webdocs/markets_operations/documents/Manuals_and_Guides/Manuals/Operations/rl_mnl.pdf.

¹⁴ See Services Tariff Section 23.3.1.4.6.8.

RLS (viewable by the Market Party). The NYISO will notify the Market Party immediately upon approval of the submission. Changes in reference levels will be implemented prospectively. Changes in fuel type and/or fuel price that are approved by the NYISO before the close of the bid window can be reflected in Energy offers that are eligible to set the LMP.

When the NYISO is not able to review and approve changes in fuel type and/or fuel price that are submitted prior to the close of the bid window, the fuel costs will be eligible for cost recovery as long as they accurately reflect the cost of the fuel that a Generator consumes. However, fuel costs that are not submitted sufficiently in advance to permit NYISO review are not used to calculate the LMP.

2. The NYISO's Penalty Structure for Market Parties that Submit Inaccurate Fuel Type or Fuel Price Information

Fuel type and fuel price information that is used to determine a Generator's reference levels can directly impact market clearing prices or a particular Generator's guarantee payment compensation. Once fuel costs are incorporated into a Generator's reference levels, applying mitigation *will not* prevent a Generator that submits inaccurate fuel price or fuel type information from receiving a financial benefit. For this reason, the NYISO applies a penalty when (1) a Market Party submits inaccurate fuel type and/or fuel price information for one or more Generators, and (2) the inaccurate information is used by the NYISO to develop reference levels for the Generators, and (3) the resulting inaccurately developed reference levels permit the Market Party to Bid the Generator(s) in a manner that increases the guarantee payments to one or more of the Market Party's Generators, or the market clearing prices at the Market Party's Generator locations, or the Market Party's Day-Ahead Transmission Congestion Contract ("TCC") revenues, above the payment that the Market Party would have received had it submitted accurate fuel type/price information. In order for a penalty to apply, the guarantee

payment or market clearing price must increase by more than the NYISO's conduct and impact thresholds for at least one of the Market Party's Generators.¹⁵ The penalty is calculated based on the difference between the compensation the Market Party received as a result of the inaccurate fuel type and/or fuel price information it submitted and the compensation the Market Party would have received if it had submitted accurate information. The Market Monitoring Unit also has the opportunity to review and comment on the NYISO's proposed penalty before it is applied.

B. The NYISO Supports a Hard Cap on Cost-Based Incremental Energy Offers, Inter-Regional Interchange Transactions, and Virtual Transactions

A hard cap should also be included in the final rule for cost-based incremental energy offers, inter-regional interchange transactions and virtual transactions.¹⁶ The NYISO's market design schedules internal supply resources, inter-regional interchange transactions, financial hedging transactions (or virtual transactions), and price responsive demand simultaneously using offer costs. This market design allows all customers to compete to the maximum extent possible in the NYISO energy markets. A hard cap remains appropriate for inter-regional interchange offers and virtual transaction offers because such offers are generally based on price expectations as opposed to verifiable costs. Often times, inter-regional interchange offers depend on an entity's expectation of price differences between two regional markets and virtual transaction offers depend on an entity's expectation of price differences between the Day-Ahead Market and the Real-Time Market. A consistent hard cap for all offers will allow all entities to continue competing to the maximum extent practicable.

¹⁵ See generally Services Tariff Section 23.4.3.3.3.

¹⁶ In New York, the existing \$1,000 offer cap applies to Day-Ahead and real-time Decremental Bids, Price Cap Load Bids, Sink Price Cap Bids and real-time CTS Interface Bids. See Services Tariff Section 21.5.1. The NYISO expects that a revised hard cap would apply to the same categories of Bids in addition to the Incremental Energy and Minimum Generation Bids discussed above.

The NYISO urges the Commission to hold a technical conference to lead an evaluation and discussion of an appropriate hard cap. Maintaining a hard cap will continue to serve several important functions; including protecting the marketplace against the inadvertent submission of offers above the cap, creating bounds for offers with costs that are difficult to verify, and preventing potential attempts to exercise market power that are not otherwise addressed by existing mitigation rules. Given the high correlation between wholesale LMPs and natural gas prices, adjustments to the hard cap should be carefully evaluated to ensure that consumers will realize economic benefits in both the electric and gas markets while maintaining a safe and reliable electric system. An appropriate hard cap should allow resources to reflect actual fuel costs during peak fuel demand conditions.

The NYISO does not have access to the fuel price data necessary to determine an appropriate hard cap. The NYISO can only evaluate whether the offer cap prevents Generators from submitting offers that reflect marginal costs by comparing the offer cap to the marginal cost data and energy market offers that Generators submit to the NYISO. In order to properly evaluate a hard cap, the elasticity of the fuel markets, including natural gas, and the relative fuel prices at various demand levels must be analyzed. The NYISO does not have access to the full fuel price supply curve across the various natural gas pipelines and Local Distribution Companies, which would be necessary to conduct such an evaluation. The Commission, the ISOs and RTOs, the states and the fuel suppliers (*e.g.*, natural gas pipelines, Local Distribution Companies, etc.) should work together to analyze the fuel prices that electric Generators face as a component of the short-run marginal costs of producing electric power. The offer cap should not prevent Generators from offering their short-run marginal costs and should not prevent LMP from reflecting the marginal cost of production.

The NYISO has not seen evidence of natural gas prices or other fuel prices that prevented Generators from submitting offers reflecting their marginal costs due to the current \$1,000 per MWh offer cap that applies to Incremental Energy and Minimum Generation Bids in New York. During the winter of 2013-2014, natural gas prices rose to unprecedented high levels in New York and elsewhere.¹⁷ Despite previously unseen gas prices, no supply resource in New York submitted invoices to the NYISO showing it incurred costs in excess of \$1,000 per MWh or sought recovery of actual costs in excess of the \$1,000 per MWh offer cap.¹⁸ The NYISO also did not identify any natural gas or other fuel prices that resulted in incremental costs that exceeded the offer cap during the sustained cold weather conditions of winter 2014-2015.

Although the NYISO has not seen, or does not have access to, evidence warranting changes to the offer cap in New York, the NYISO has consistently supported the coordinated inter-regional implementation of comparable offer caps in order to limit potential seams issues between neighboring regions.¹⁹ The NYISO also understands and appreciates the need to revisit the topic of offer caps based on concerns raised by other market areas. Offer caps must be addressed at an inter-regional level in order for all interested parties to evaluate the potential for

¹⁷ In response to the high natural gas prices and its concern that such prices could potentially reach levels that would prevent certain supply resources from recouping their actual costs under the current \$1,000 per MWh offer cap, the NYISO requested a temporary waiver to allow it to consider Incremental Energy and Minimum Generation Bids in excess of \$1,000 per MWh and compensate Generators that were able to demonstrate that they actually incurred variable costs in excess of \$1,000 per MWh. The NYISO requested that such temporary waiver apply from January 22, 2014 through February 28, 2014. Docket No. ER14-1138-000, *New York Independent System Operator, Inc.*, Petition for Temporary Tariff Waivers, Request for Shortened Comment Period, and Request for Expedited Commission Action by January 31, 2014 (January 22, 2014). In granting the NYISO's temporary waiver request, the Commission directed the NYISO to submit an informational filing by March 28, 2014 to, among other matters, provide the total amount of energy that qualified to receive compensation for costs in excess of \$1,000 per MWh during period in which the temporary waiver was in effect. *New York Independent System Operator, Inc.*, 146 FERC ¶ 61,061 at P 24 (2014).

¹⁸ Docket No. ER14-1138-000, *New York Independent System Operator, Inc.*, Bid Restriction Waiver Informational Filing (March 28, 2014).

¹⁹ See Docket No. AD14-14, *Price Formation in Energy and Ancillary Services Markets Operated by Regional Transmission Organizations and Independent System Operators*, Post-Technical Workshop Comments of the New York Independent System Operator, Inc. at 3-5 (March 6, 2015).

seams issues and other impacts that could arise from having different offer caps apply in markets that access an overlapping fuel supply and set of electric generating resources. Consistent offer caps among the regions are critical to equalize the fuel buying power of electric Generators in the various market areas.

Electric markets in the Mid-Atlantic and Northeast compete for a common supply of natural gas. Generators located in regions that are subject to lower offer caps could be denied access to fuel due to restricted buying power compared to Generators in areas with higher offer caps. Enacting materially different offer caps in these regions could result in operator actions to avoid electric system reliability impacts during periods of cold weather and high natural gas prices. Inter-regional or national coordination to appropriately modify offer caps is essential to ensure that Generators in all electric markets enjoy equivalent access to fuel.

III. CONCLUSION

WHEREFORE, for the foregoing reasons, the NYISO respectfully requests that the Commission: (1) hold a technical conference to determine an appropriate hard cap; and (2) consider these comments, including the description of the NYISO's cost review process, and provide the requested clarification when developing a final rule in this proceeding.

Dated: April 4, 2016

Respectfully submitted,

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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 Rules of Practice and Procedure, 18 C.F.R. §385.2010.

Dated at Rensselaer, NY this 4th day of April 2016.

/s/ Joy A. Zimmerlin

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