

## NYISO BOARD OF DIRECTORS' DECISION

ON

### APPEAL OF THE MANAGEMENT COMMITTEE'S AUGUST 25, 2010 DECISION TO REVISE IN-CITY ICAP BUYER-SIDE MITIGATION

SEPTEMBER 24, 2010

#### INTRODUCTION

The Independent Power Producers of New York, Inc. ("IPPNY") and, jointly, Consolidated Edison Company of New York, Inc., Orange and Rockland Utilities, Inc., the Long Island Power Authority, the New York Power Authority, and Niagara Mohawk Power Corporation d/b/a National Grid (collectively, the "Indicated NYTOs") each timely filed appeals of the Management Committee ("MC") decision to recommend to the Board of Directors filing under Section 205 of the Federal Power Act ("FPA"), revisions to the New York Independent System Operator, Inc.'s ("NYISO's") Market Mitigation Measures.<sup>1</sup> The proposed amendments to the tariff would refine and enhance several previously approved mitigation rules that guard against the exercise of buyer-side market power in the In-City Capacity market.<sup>2</sup> Specifically, the proposed revisions would (a) adjust and clarify the manner in which the NYISO performs the test to determine whether a new Installed Capacity Supplier is exempt from an Offer Floor or, if not exempt, the level of the Offer Floor; and (b) modify the duration for which a new Capacity supplier is subject to an Offer Floor.

Four Motions in Support and/or Opposition to the appeals were submitted.<sup>3</sup> No party requested oral argument, with the exception of the Indicated NYTOs who subsequently withdrew their request. Consequently, the NYISO's Board of Directors ("Board") reviewed the appeals based on the written submissions.

For the reasons set forth below, the Board denies both appeals and directs the NYISO management to file the tariff provisions proposed by the MC with the Federal Energy Regulatory Commission ("FERC") pursuant to Section 205 of the FPA.

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<sup>1</sup> The NYISO's Market Mitigation Measures are set forth in Attachment H to the NYISO's Market Administration and Control Area Services Tariff.

<sup>2</sup> The potential for suppliers to exercise market power is dealt with through offer caps on Pivotal Suppliers as well as the slope of the demand curve.

<sup>3</sup> Specifically: (i) TC Ravenswood, LLC submitted a *Motion in Support of IPPNY Appeal and In Opposition of the Indicated TOs Appeal*; (ii) U.S. Power Generating Company submitted a *Motion in Support of IPPNY Appeal and In Opposition of the Indicated NYTOs Appeal*; (iii) the City of New York filed a *Motion in Support of the Appeal Filed by the Indicated New York Transmission Owners and in Opposition to the Appeal Filed by the Independent Power Producers of New York, Inc.*, and (iv) the New York State Consumer Protection Board filed a *Response* in support of the Indicated NYTOs.

## SUMMARY OF APPEALS

IPPNY appeals two elements of the MC's recommended tariff revisions. First, it objects to the proposed tariff changes that would eliminate the Offer Floor after a minimum of six Capability Periods when the equivalent of 100% of a mitigated unit's Capacity clears in the equivalent of one year (e.g., 50% clears in twenty-four months).<sup>4</sup> It also opposes the thirty Capability Period limit on a unit's Offer Floor. IPPNY argues that the 50% threshold in the Cleared UCAP formula lacks support<sup>5</sup> and is too permissive. IPPNY also expresses concern that the revised duration rules are "too lenient to effectively mitigate uneconomic entry" and claims that they will result in artificially suppressed prices. IPPNY asserts that the revisions will weaken the buyer-side mitigation rules and disrupt the balance between the existing supplier-side and buyer-side ICAP mitigation measures by allegedly relaxing the latter without making any conforming change to the former.

Second, IPPNY claims that the revisions appear to grant "a generator the ability to retest after it has made an investment decision" and thus to distort the exemption calculation process. IPPNY suggests that it is unclear whether this proposal is included in the approved tariff revisions and, more generally, complains that the tariff revisions were not fully vetted through the stakeholder process.

The Indicated NYTOs appeal the MC's rejection of an amendment to the proffered tariff revisions which would have eliminated the minimum six Capability Period duration during which a mitigated ICAP Supplier cannot offer below its Offer Floor. The Indicated NYTOs argue that the minimum six Capability Period duration of the Offer Floor should be eliminated. They argue that the Cleared UCAP formula is sufficient to deter uneconomic entry because once the new ICAP Supplier satisfies the Cleared UCAP formula, it has demonstrated it is economic, and therefore, should no longer be subject to the Offer Floor. Further, because the length of mitigation is based on a forecast of market prices, a unit could demonstrate that it is economic before the end of the six Capability Periods by satisfying the Cleared UCAP test.

## BOARD DECISION

In April 2010, the MMU issued its *2009 State of the Market Report*<sup>6</sup> which found, among other things, that previously approved supply side In-City ICAP mitigation measures

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<sup>4</sup> For convenience, this methodology for calculating the duration of an Offer Floor is referred to as the "Cleared UCAP" formula.

<sup>5</sup> IPPNY notes that Potomac Economics, the NYISO's independent Market Monitoring Unit ("MMU") has expressed some concern regarding the 50% threshold. As is noted below, the Board's decision to reject IPPNY's appeal is informed in substantial part by the MMU's support for the entire package of proposed tariff improvements.

<sup>6</sup> Potomac Economics, LLC, April 2010. 2009 State of the Market Report. Available at: [http://www.nyiso.com/public/webdocs/documents/market\\_advisor\\_reports/2009/2009\\_NYISO\\_SOM\\_Final\\_4-30-2010.pdf](http://www.nyiso.com/public/webdocs/documents/market_advisor_reports/2009/2009_NYISO_SOM_Final_4-30-2010.pdf).

appeared to be working well but that it was too early to evaluate whether the Offer Floor had been effective. The MMU noted that it had reviewed the “detailed thresholds and testing procedures used to implement the offer floor” and recommended that the NYISO review “the thresholds and procedures used to implement the offer floor, and identify those that may ... [c]ause uneconomic entry to be exempted from the floor; or erect an inefficient barrier to economic entry.”<sup>7</sup>

The proposed tariff amendments are a first response to the MMU’s recommendations. Although some features are opposed by some stakeholders, the package as a whole appears to be reasonably balanced and likely to bring important benefits including: (i) providing greater certainty and transparency to potential new entrants before they are required to make critical investment decisions, and (ii) avoiding unintended and unreasonable mitigation outcomes that could occur under the existing language.

The Board is particularly concerned that the current tariff requires the NYISO to determine whether a new entrant is “economic” on the basis of a *forecast* based on three prior year’s load growth taking into account the level of surplus capacity projected for the date of entry. However, subsequent *actual* market conditions may prove the forecast to be erroneous not only because of unanticipated changes in load growth; but because of unforecasted retirements of existing units for reasons unrelated to load levels. Indeed, we believe such retirements could occur suddenly. The proposed changes will allow the NYISO to recognize such deviations from forecasted market conditions and avoid the unintended adverse consequences of over-mitigating units that later turn out to be economic investments.

There is also a need to address questions regarding: (1) the retesting of a unit that was initially determined to be deliverable and later requests additional MW of Capacity Resource Interconnection Service (“CRIS”), and (2) the applicability of mitigation measures to facilities that repower or that increase their MW due to an uprate. The MC and the Business Issues Committee (“BIC”), respectively, have referred these two issues for further stakeholder consideration.

In the course of evaluating the appeals and the responses thereto, the Board discussed other possible enhancements in order to ensure that the In-City buyer-side mitigation measures are not over or under-mitigating facilities, and to ensure that the rules are narrowly tailored to prevent uneconomic entry while not having a negative effect on the development of economic generation. The Board’s specific concerns are outlined in Section C below, but in the final analysis the Board feels that the most effective way to mitigate market power is to put in place measures that encourage the entry of additional participants in the In-City Capacity market, both buyers and sellers. The Board is cognizant of the importance to developers and all stakeholders of predictable and stable market rules. The Board has carefully weighed the value of the improvements afforded by the MC’s proposed tariff revisions, along with whether it is better to delay these revisions and package them with further enhancements that NYISO management is directed to bring to the stakeholder process for consideration. On balance, the Board has determined that the proposed

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<sup>7</sup> *Id.* at p. 180.

revisions provide important refinements and that the value of the increased transparency and predictability should not be delayed.

IPPNY and the Indicated NYTOs have shown no compelling reason to delay filing the proposed tariff improvements and postpone the benefits that they would bring. The Board has consulted extensively with the MMU in making this decision. After careful consideration, the Board must, therefore, deny the IPPNY and Indicated NYTOs Appeals for the reasons set forth below.

#### **A. Denial of IPPNY's Appeal**

IPPNY's challenge to the 50% threshold in the Cleared UCAP formula for computing the Offer Floor duration overlooks the fact that 50% is a value that reflects compromises among stakeholders to achieve consensus. The Board believes that it is a reasonable result, and that it balances the dual objectives of preventing uneconomic entry and encouraging economic investments. Retaining the minimum duration of six Capability Periods was part of the overall package of stakeholder compromises underlying the proposed tariff revisions and is viewed by the MMU as an important substantive check to ensure that the measures provide an adequate deterrent. The 50% rule and the six Capability Period minimum together strike an acceptable balance.

IPPNY's appeal does not address the realistic prospect that the existing tariff provisions could, unintentionally, subject new ICAP Suppliers to Offer Floor mitigation for the life of the facility or longer notwithstanding market changes that economically justify a facility's operation. The Board believes that such lengthy mitigation periods would clearly go beyond the purpose of Offer Floor mitigation, which is to deter uneconomic new entry. Without revision, that current provision could inadvertently punish new entrants, inappropriately insulate incumbent suppliers from competition, and artificially inflate Capacity prices. The proposed thirty Capability Period maximum Offer Floor duration appears to be an adequate limit. It is difficult to imagine that an uneconomic new entrant would be willing to forego capacity revenues with the sole expectation of benefiting from its uneconomic entry thirty Capability Periods after it begins to sell Capacity. The Board is particularly mindful of the fact that FERC policy discourages over-mitigation.

IPPNY's appeal also states that it is not clear whether a retesting provision is included in the proposed tariff revisions. It argues that the exemption test must be applied before the investment decision is made. In fact, the proposed tariff revisions provide for the exemption determination to be made at the time of the Class Year study. Thus, the exemption test would coincide with the investment decision; *i.e.*, when the developer decides to accept or reject its allocation of System Deliverability Upgrade costs.

The proposed tariff revisions presented to the MC had included a test for a unit that was partially deliverable in its initial Class Year but rejected its System Deliverability Upgrade costs for the undeliverable MW, and subsequently requested Capacity rights for those additional MW in a later Class Year. The MC clearly voted that that portion of the proposal be removed. The motion approved by the MC states that the tariff change recommended to the Board be

“modified to specify that it does not address, and that the Stakeholder process should promptly review, the issue of the timing and manner to make an exemption or Offer Floor determination for a generator initially found to be deliverable for part of its MWs of requested CRIS rights when subsequently it requests CRIS rights for the remaining MWs....”

The Board is informed that NYISO staff explicitly stated at the MC that it also would identify in its transmittal letter to FERC that the issue was not intended to be addressed in the proposed amendments and the issue would be considered further in the stakeholder process.

Finally, we must address IPPNY’s allegation that “very little time was dedicated to review of the tariff language itself.” NYISO staff has indicated that different iterations of the tariff language were presented at ICAP Working Group meetings, including a line-by-line review. In addition, tariff revisions were presented to the BIC and the MC. The Board, therefore, finds no basis to sustain this aspect of IPPNY’s claim.

#### **B. Denial of Indicated NYTOs’ Appeal**

The Board rejects the Indicated NYTOs’ argument that the minimum six Capability Period duration of the Offer Floor should be eliminated, because the Cleared UCAP formula is sufficient to deter uneconomic entry. As explained above, the minimum mitigation period preserves the deterrent value of the Offer Floor. It also functions as a check against the possibility that the Cleared UCAP formula might allow certain ICAP Suppliers to escape mitigation prematurely. Moreover, the minimum period is well balanced with the proposed Cleared UCAP formula which will prevent over-mitigating new entry.

Reducing the period to fewer than six Capability Periods would dilute the deterrent to buyers that might enter into contracts with an otherwise uneconomic unit simply to depress Capacity prices. Moreover, mitigated new entrants would only be impacted by the Offer Floor if the ICAP Spot Market Auction clears below the floor.

#### **C. Board Objectives**

Based on its consideration of the proposed tariff revisions, the appeals, and the responses thereto, the Board has identified a series of In-City buyer-side mitigation design issues it would like NYISO management and stakeholders to consider in the governance process.

First, consistent with the motion approved by the BIC, we direct NYISO management to promptly work with stakeholders to assess whether existing facilities that are “repowered” or uprated should be subject to an exemption/Offer Floor determination, and if appropriate, develop revisions to Attachment H. Second, consistent with the motion approved by the MC, we direct NYISO management to promptly work with stakeholders to develop revisions to Attachment H to address the timing and manner for the NYISO to make an exemption or Offer Floor determination for a facility initially found to be partially deliverable (and therefore initially permitted to offer only that portion of its Capacity) that later requests authority to sell additional Capacity.

Third, the Board directs NYISO management to consider with stakeholders whether the objectives of the buyer-side mitigation measures would be met and better balanced if a percentage of the unit's net cost of new entry (other than 100%) was employed to test for exemption, and set the Offer Floor; and fourth, we ask NYISO management and stakeholders to consider whether facilities that are subject to an Offer Floor should be permitted to offer Capacity into the NYCA ICAP Spot Market Auction without an Offer Floor, and if so, to propose tariff revisions to accomplish this objective.

**D. Denial of Appeals and Direction to Submit Section 205 Filing**

For all of the foregoing reasons, the Board denies the IPPNY and Indicated NYTOs appeals and directs the NYISO management to file the tariff provisions proposed by the MC with FERC pursuant to Section 205 of the FPA.

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