

99 FERC ¶ 61, 252
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

KeySpan-Ravenswood, Inc.

v.

Docket No. EL02-59-000

New York Independent System Operator, Inc.

ORDER DENYING COMPLAINT

(Issued May 31, 2002)

On February 15, 2002, KeySpan-Ravenswood, Inc. (Ravenswood) filed a complaint against the New York Independent System Operator, Inc. (NYISO) requesting that the Commission direct NYISO to make two limited modifications to the current localized in-City mitigation measures applicable to the installed capacity (ICAP) market. Specifically, Ravenswood requests: (1) to convert the current in-City ICAP price cap applicable to sales by divested generation owners (DGOs) into a bid cap of equal value, and (2) to eliminate the existing ban on bilateral sales of in-City ICAP by DGOs to in-City load-serving entities (LSEs).

In this order, we deny Ravenswood's complaint. We find that given the existing market conditions in New York City, the changes proposed by Ravenswood will not benefit customers.

I. Background

The localized in-City mitigation measures were developed to address the potential for in-City generation owners to exercise generation dominance in New York City. The ability of these participants to exercise market power stemmed from existing transmission constraints, as well as from the fact that in-City loads were frequently met by in-City generation supplied by three or four entities. The localized mitigation measures were initially formulated in a settlement of a restructuring proceeding, in which the the Public Service Commission of the State of New York (New York Commission) approved, subject to certain conditions, Consolidated Edison Company of New York, Inc.'s (ConEd)

plan to divest approximately 6,600 MW of its fossil-fueled generating capacity by year-end 2002. The localized mitigation measures were subsequently accepted by the Commission in an order issued on September 22, 1998 (1998 Order).¹

Among other things, the localized in-City mitigation measures impose certain restrictions on in-City DGOs with respect to ICAP transactions. First, the DGOs may not sell ICAP under bilateral contracts and must bid all ICAP resources into the auctions conducted by NYISO. For failure to participate in the NYISO-administered ICAP auctions, a DGO will be required to pay to ConEd, as provider of last resort, an amount equal to the product of the Capacity Deficiency Charge² for such capability period times the rated capacity of the relevant units at the time of the ConEd divestiture.

Additionally, DGOs are subject to a price cap with respect to ICAP. The price cap was initially based on a Capacity Reference Price of \$105 per kW/year. This amount was subsequently translated into \$112.95 per kW/year to accommodate NYISO's conversion to an unforced capacity (UCAP) methodology.³ If the market clearing price for in-City ICAP exceeds the Capacity Reference Price, the price paid to DGOs is limited by the price cap, while all other ICAP suppliers receive the market clearing price.

II. Complaint

In its complaint, Ravenswood requests limited modification of the mitigation measures for the ICAP market in New York City. Ravenswood also states that it submits this complaint in anticipation of NYISO's filing of its comprehensive mitigation plan.⁴ Ravenswood argues that the proposed modifications will not affect existing protections against the exercise of market power; however, they will provide ICAP buyers and sellers with greater transaction flexibility. According to Ravenswood, modifications to the ICAP markets: (1) will reduce market volatility; (2) enable DGOs to hedge against price fluctuations in the auction-only market; (3) provide DGOs with the same price incentives other generators are given; and (4) improve price signals by correcting the "muting of price signals to LSEs." It further asserts that the in-City mitigation measures were adopted prior to the establishment of the NYISO and that, as transitional measures, they were intended to be modified or removed with the entry of new participants. Ravenswood argues that new entry into New York City markets has actually taken place and that plans for additional entry are "well advanced." As evidence, Ravenswood points to: (1) 600 MW of in-City capacity that has recently come on line; (2) additional generation in progress; (3) NYISO's expectations of a 2002 in-City capacity surplus; and (4) increasing levels of available capacity and improved price responsiveness resulting from recently instituted demand response programs.⁵

Specifically, Ravenswood proposes to convert the price cap on in-City sales to a bid cap of equal value. Ravenswood argues that the original price cap accepted by the

Commission in the 1998 Order was intended to keep DGOs from exercising market power and that the bid cap will be equally effective as the price cap in preventing economic withholding of capacity. It further maintains that this alteration would allow the DGOs to collect the market clearing price, including periods when that price exceeds the Capacity Reference Price. Furthermore, Ravenswood characterizes the existing price cap as an ex post approach to preventing economic withholding; which is to say, the price cap seeks to correct the results of a market discrepancy rather than the cause of the problem. In contrast, the bid cap, according to Ravenswood, is an ex ante measure that serves as a preventative tool.

Ravenswood also argues that the existing price cap inhibits the recovery of fixed costs in the ICAP market during the summer period when ICAP prices are generally higher. It further maintains that if DGOs were allowed to receive the ICAP market clearing price, they would be better able to recover fixed costs. Consequently, Ravenswood concludes that DGOs would have the same incentives, as other ICAP suppliers, to invest in plant repairs and maintenance, which, in turn, will result in reduced outages, increased available capacity, and decreased price volatility. Ravenswood also argues that conversion from the price cap to a bid cap will decrease other costs and risks to market participants. It explains that the price cap increases risks with regard to financial transactions aimed at providing certainty and therefore increase the costs of hedging transactions. Ravenswood also asserts that initially a properly functioning market may yield higher prices (resulting from the need to increase supply or reduce demand) but, in the long run, these price signals will provide incentives to increase the availability of DGO units, which will lower ICAP prices.

Additionally, Ravenswood proposes to allow DGOs to enter into bilateral ICAP transactions subject to the following three limitations. First, ICAP not sold bilaterally must be sold in the NYISO-administered ICAP auction. Second, a purchaser must be an in-City LSE. Third, buyers of ICAP through bilateral contracts with DGOs that choose to resell ICAP in NYISO's auction would be subject to the bid cap. Under Ravenswood's proposal, DGOs will still pay the capacity deficiency charge if they fail to make ICAP available to the in-City market through the NYISO auction and will continue to submit maintenance schedules to NYISO for approval two years in advance of planned outages. NYISO will also retain the right to reschedule forced outages in the event of expected reserves shortages. Ravenswood asserts that allowing DGOs to enter into bilateral transactions with in-City LSEs will result in greater market participation, increase market competitiveness and price certainty, lower risks, and decrease volatility for all market participants.

On April 23, 2002, Ravenswood filed a motion to consolidate the instant complaint with the ongoing proceeding in Docket No. ER01-3155-002, et al. involving NYISO's proposed comprehensive market mitigation plan.⁶ Ravenswood argues that the Commission cannot conduct a comprehensive review of mitigation in New York without

taking into account the capacity markets.

III. Responsive Pleadings

In its answer, NYISO argues that Ravenswood's proposal should be rejected for the following reasons. First, NYISO asserts that because the Ravenswood-proposed changes would require modification of NYISO's Market Administration and Control Area Services Tariff and because the impact of these changes could affect multiple aspects of the NYISO's operations, the proposal should have been first submitted to the stakeholder committee process. NYISO states that NYISO and other market participants have established AMP/ICM Task Force to address the proposal made by Ravenswood. According to NYISO, at the time the instant complaint was filed, the Task Force discussions of the proposed changes had yet not been completed. NYISO concludes that the Commission should not allow an impatient market participant to circumvent the stakeholder process, but instead should direct Ravenswood to submit its proposal to the rigors of stakeholder and NYISO review to ensure that any resulting modification represent informed decisions about market rules and structures. NYISO believes that the proposed changes and their potential impacts should be thoroughly studied prior to implementation. It adds that there is no emergency that would warrant urgent modification of the currently effective mitigation measures. Furthermore, NYISO argues that the proposed changes will retroactively change the conditions of the ConEd divestiture transactions and may alter the economic position of DGOs and LSEs in New York City electricity markets.

In response, Ravenswood states that the complaint was filed only after it was clear that NYISO did not intend to consider ICAP market changes as part of its comprehensive mitigation plan.

1. Comments Opposing Complaint

ConEd and New York City (NYC) challenge Ravenswood's assertion that the ICAP market is more competitive today than at the time the in-City mitigation measures were adopted as unsupported by facts. The New York Commission agrees with NYC and also opposes a "weakening" of protections against exercising market power. ConEd and the New York Commission argue that the in-City ICAP market is still extremely tight, and each DGO would possess substantial market power but for the existing mitigation measures. The New York Commission also asserts that each of the DGOs is in a position to exploit market power in the ICAP market until there is an excess of ICAP, greater than that controlled by Ravenswood, Orion and NRG.

Additionally, ConEd argues that Ravenswood has failed to make a prima facie showing that the existing capacity mitigation measures are "unjust" and "unreasonable." NYC states that Ravenswood has failed to demonstrate how the proposed measures will

provide protection from the exercise of market power and how they would transmit more appropriate price signals to market participants. Similarly, the New York Commission argues that replacing the price cap with a bid cap would not provide protection from the exercise of market power. Moreover, while the bid cap may prevent economic withholding, it would not have an effect on physical withholding, which, the New York Commission argues, is just as effective in raising prices. The New York Commission also challenges the underlying assumption in Ravenswood's complaint that the ICAP revenues DGOs presently capture are inadequate to cover fixed costs as factually baseless.

ConEd further argues that given the UCAP methodology used in the New York City ICAP market, removal of the price cap would give DGOs an economic incentive to decrease the availability of their units and create a capacity shortage, which would drive up prices. NYC also expresses the concern that Ravenswood's proposal could result in significant price increases this summer. ConEd also asserts that in light of tight market conditions revealed by NYISO's recent ICAP study each unit will be pivotal in New York City this summer. Thus, it concludes, it would be entirely possible for a DGO that also owns unmitigated generation to bid the highest permissible price, thereby pulling the mitigated generation - now restrained by the price cap - up to the same level. ConEd also adds that because the price cap applies only to DGOs, and has no application to new entrants, its existence does not affect the new entry process.

In response, Ravenswood argues that any attempt to physically withhold capacity by artificially increasing forced outage rates would not be profitable, since it would have to force out 600 MW of capacity, 24 hours a days, seven days a week for 2002, in the hope of garnering above the market profits the following year. It further states that such withholding will be easily detectable and subject to possible sanctions from NYISO. In addition, it argues that the execution of bilateral contracts would reduce the likelihood that the physical withholding strategy would be successful because there would be less reliance on the auction markets and thus less revenues from a withholding strategy.

In addition, ConEd asserts that lifting of the restrictions on bilateral sales of capacity by DGOs would result in more gaming opportunities and, consequently, in increased costs to LSEs and customers. The New York Commission states that the ban on bilateral contracts was originally instituted in order to prevent DGOs from circumventing the price cap and that its removal would encourage improper behavior on the part of both buyers and sellers.⁷ Also, ConEd disputes Ravenswood's argument that bilateral transactions will be monitored by NYISO. ConEd asserts that NYISO does not monitor bilateral contracts; it merely reviews resales via auction, which, ConEd argues, Ravenswood purports to eliminate. In addition, ConEd argues that if bilateral contracts are permitted, market monitors would be required to audit and track all bilateral sales involving ICAP, which would increase administrative costs and intruding on non-regulatory entities, while the bilateral contracts would not improve reliability.

In response, Ravenswood counters that NYISO's auditing and tracking practice should not change if the bilateral ICAP option is extended to DGOs. NYISO already has to take measures to ensure that all other market participants in NYISO-administered markets satisfy the UCAP requirements, whether by auction, self-supply, or a bilateral contract.

Furthermore, Strategic Energy, L.L.C. (Strategic) argues that Ravenswood's requests should be rejected, as the alteration of the ICAP market "will only waste time." In Strategic's opinion, ICAP is a "value-less" product, the demand and market for which would not exist but for regulatory requirements. In its current form, ICAP is little more than a stranded cost payment, which generation owners insist on receiving because they are unable to capture adequate revenues in the markets. Strategic asserts that this payment will only increase as a result of Ravenswood's proposal and will prevent consumers from benefitting from competition. Also, Strategic urges the Commission to address the value of firm energy bilateral contracts, the price cap, reserves and ICAP as part of a comprehensive review of electric markets and capacity adequacy in the Standard Market Design proceedings.

2. Comments Supporting Complaint

The NRG Companies (NRG) and Reliant Resources, Inc. ("Reliant") support Ravenswood's complaint. NRG argues that Ravenswood's requests should be granted because in light of a forecasted increase in in-City capacity, the incentive to participants to exercise market power is greatly diminished. NRG and Reliant also support Ravenswood's request for elimination of the ban on DGOs selling in-City ICAP bilaterally to in-City LSEs, they argue that these sales will allow for greater market liquidity and increased competitiveness, as well as for greater LSE flexibility, without affecting the supply of in-City ICAP.

In addition, Reliant argues that, despite a Commission directive to undertake a complete review of its market mitigation measures, NYISO has not reviewed the ICAP market mitigation measures and instead chose to examine the market monitoring function and mitigation in the energy and ancillary services markets. Reliant asserts that a comprehensive mitigation plan for summer 2002 cannot be considered complete without addressing the ICAP market issues as well.

IV. Procedural Matters

Notice of Ravenswood's complaint was published in the Federal Register, 67 Fed. Reg. 8,949 (2002), with comments, protests, or interventions due on or before March 7, 2002. Timely motions to intervene were filed by entities listed in the Appendix to this order. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2001), the filing of a timely motion to intervene that has not been opposed makes the movant a party to the proceeding.

Ravenswood filed an answer to NYISO's answer to the complaint and other responsive pleading. ConEd also filed a response to Ravenswood's answer. We will permit these answers only to the extent they will assist the Commission's understanding of the issues raised.⁸

V. Discussion

1. Bilateral Transactions

While we recognize the value of bilateral contracts in competitive markets, we do not believe that allowing bilateral sales in the in-City ICAP market would be appropriate at this time. The ban on in-City bilateral sales by DGOs was originally implemented to prevent DGOs from circumventing the price cap – a measure that was itself instituted in order to protect the in-City market from an uncompetitive number of generation suppliers. In suggesting requirements for allowing ICAP bilateral sales, Ravenswood also seems to recognize the need to shield New York customers from exercise of market power. We agree with ConEd and the New York Commission that allowing bilateral transactions probably will not improve reliability, but may increase the costs and further complicate the market monitoring process. Ravenswood has not adequately addressed the concern that allowing such transactions will result in more gaming and opportunities to circumvent the ICAP price cap. Given the current state of the in-City ICAP market, the Commission does not believe that removing the ban on DGO bilateral sales will provide a net benefit to NYISO's customers.

Because NYISO is to assume full responsibility for the New York City transmission grid, which will be transferred from ConEd, as proposed in the comprehensive market mitigation plan in Docket No. ER01-3155-002, the Commission finds it premature to order significant changes to the in-City ICAP market design.⁹ Given that NYISO states that it "has not taken a position on the merits of Ravenswood's proposal,"¹⁰ the Commission encourages NYISO to examine, in consultation with its stakeholders, the feasibility and market impact of allowing in-City ICAP bilateral transactions.

2. Competitive Markets

At this time, there is not adequate competition in the in-City ICAP market and thus a shift from the price cap to a bid cap is unwarranted. The Commission agrees with ConEd and the New York Commission that the in-City ICAP market is still extremely tight, that each DGO would be able to exert substantial market power in the absence of the existing mitigation measures, and that each of the DGOs is in a position to exploit market power in the ICAP market until there is an excess of ICAP, greater than that controlled by Ravenswood, Orion and NRG. The Commission also believes, as argued

by ConEd, that in these circumstances under Ravenswood's proposal it may be possible for a DGO that also owns unmitigated generation to bid the highest permissible price and thereby pull the mitigated generation up to the same level.

In the affidavit submitted as part of its complaint, Ravenswood concedes that the market has been slow in responding to supply shortages and further states that of the announced merchant projects, several are likely to fail or encounter delays.¹¹ While it is true that there will be added capacity in the future, Ravenswood understandably offers no time-line for such an eventuality. Ravenswood only suggests that the prospect of new entry has become "more credible" since November 1999, implying that this possibility, in and of itself, is enough to discipline market prices.¹² The Commission finds that this possibility of new entry neither provides convincing evidence of a competitive market, nor does it sufficiently deter the exercise of market power. Moreover, there is considerable uncertainty regarding the amount and timing of new entry, which indicates that the in-City ICAP market remains prone to tight supply.

3. Price Cap, Bid Cap

In the 1998 Order, the Commission found that ConEd's proposed price cap, as a market power mitigation measure, was reasonable in addressing the dominance of in-City generation by three DGOs. The price cap was instituted prior to the ConEd divestiture for the express purpose of allowing new owners to properly value the assets. The Commission agrees with the New York Commission that Ravenswood has not shown that the ICAP revenues DGOs presently capture are inadequate to cover fixed costs. In addition, Ravenswood argues that its proposal to replace the price cap with a bid cap will provide market participants with more options in the ICAP market, but it fails to demonstrate that there has been a significant increase in generation since the implementation of the price cap, which would eliminate the need for the price cap. Ravenswood also does not effectively support its claim that the increased revenues to the DGOs resulting from its proposal will significantly increase in-City generation, either in the immediate future or the foreseeable future. Absent compelling evidence of increased competitiveness in the ICAP market, the Commission will not order a shift from the price cap to a bid cap.

For the above stated reasons, we will deny Ravenswood's complaint. Further, in view of our rejection of Ravenswood's proposal, there is no basis for consolidation of the instant complaint with the proceeding in Docket No. ER01-3155-002, et al., and we will deny the motion to consolidate the dockets.

The Commission orders:

The complaint filed by KeySpan-Ravenswood is hereby denied, as discussed in the body of this order.

By the Commission

(S E A L)

Linwood A. Watson, Jr.,
Deputy Secretary.

Appendix

KeySpan-Ravenswood, Inc. v.
New York Independent System Operator, Inc.
Docket No. EL02-59-000

City of New York*

Consolidated Edison Company of New York, Inc.*

Dynegy Power Marketing, Inc.

Mirant Americas Energy Marketing, LP, Mirant New York, Inc., Mirant Bowline, LLC,
Mirant Lovett, LLC, Mirant NY-GEN, LLC

New York Energy Buyers Forum

New York State Public Service Commission*

NRG Companies*

Reliant Resources, Inc.*

Strategic Energy L.L.C.*

*comment and/or protest

¹ Consolidated Edison Company of New York, Inc., 84 FERC ¶61,287 (1998).

² See NYISO's Market Administration and Control Area Services Tariff, Section 5.14.1(a), Tariff Sheet No. 155.

³ See New York Independent System Operator, Inc., 96 FERC ¶ 61,251 (2001), reh'g denied, 98 FERC ¶ 61,180 (2002).

⁴ On March 20, 2002, in Docket No. ER01-3155-002, et al., NYISO filed its comprehensive market mitigation plan. In that filing, NYISO proposed no ICAP mitigation measure revisions applicable to DGOs.

⁵ New York Independent System Operator, Inc., 95 FERC ¶ 61,223 (2001) (accepting for filing an Incentivized Day-Ahead Economic Load Curtailment Program); New York Independent System Operator, Inc., 95 FERC ¶ 61,136 (2001) (accepting for filing an Emergency Demand Response Program).

⁶ The order addressing NYISO's proposed comprehensive market mitigation plan is being issued concurrently with this order.

⁷ See the New York Commission's Notice of Intervention and Protest, Docket No. EL02-59-000, at 10-11 .

⁸ See, e.g., Atlantic City Electric Co., 90 FERC ¶ 61,268 at 61,898 (2000) and New York Independent System Operator, Inc., 91 FERC ¶ 61,128 (2000).

⁹ Consolidated Edison Company of New York, Inc., 97 FERC ¶ 61,241 at 62,092 (2001).

¹⁰ NYISO Answer at 6.

¹¹ See Affidavit of Aleksandr Rudkevich/Narashima D. Rao, ¶ 30.

¹² Id. ¶ 31.