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To: NYISO
From: Chris LaRoe
Date: 1/3/13
Re: IPPNY Comments on NYISO "Competitive Entry Exemption"

IPPNY is submitting these comments in response to the NYISO's solicitation of feedback on its initial presentation concerning its "Proposed ICAP Buyer Side Mitigation Competitive Entry Exemption" proposal, which the NYISO made on December 3, 2012.

IPPNY concurs with the basic concept that, if a purely merchant facility was to go forward, it may not per se have an incentive to artificially suppress capacity clearing prices.¹ However, the challenge in implementing such a pure merchant exemption policy lies in the inability to ensure that new entry is in fact solely relying on capacity auction revenues (importantly, with no direct or indirect subsidization) and the new entrant itself does not have -- nor does it have any affiliation with an entity that has -- buyer-side market power or other anti-competitive motives.

In fact, the NYISO itself has previously established to the FERC the difficulty that it would have in trying to gather and evaluate all potential contracts between parties or to understand intent. In its April 7, 2008 request for clarification/rehearing in the proceeding defining the NYISO's mitigation measures², the NYISO stated:

New "uneconomic" generation may be developed and brought on line by a developer with no apparent connection to a "net buyer." Nevertheless, that developer could have entered into a financial agreement, such as a "contract for differences," with another entity that would have the effect of providing an out-of-market subsidy and may enable the "uneconomic entry" by the developer. The NYISO would have no knowledge of such private contractual arrangements; all it would see is entry by an entity that is not itself a "net buyer."

¹ The incentives to artificially suppress market prices are not limited to the monopsony market power issues that have been litigated at FERC. A high cost competitor could use predatory pricing to improperly drive a lower cost competitor out of the market.

² Docket No. EL07-39

The NYISO does not have access to the full range of contractual arrangements that may be applicable to a new generator, would have no way of verifying that any set of contracts that might be provided to the NYISO constituted all of the relevant agreements, and may not be in a position to fully assess the significance of such documents even if they were furnished to the NYISO. Moreover, expanding the NYISO's access to contracts and agreements would not resolve the concern because contracts that provide a subsidy to the developer would not have to be specific to a particular unit. Financial contracts that are not explicitly linked to the new unit could, nonetheless, be fully effective in subsidizing uneconomic entry, as long as a sufficient subsidy flowed to the developer.

The NYISO's position in this regard rings as true today as it did four years ago when the NYISO submitted its pleading to the FERC. The NYISO is in no better position today to effectively police any such contractual arrangements or intent. No market changes have occurred in the intervening period that otherwise change the core issue with this proposal.

The impact of the offer floor (or, more specifically, the lack thereof) on capacity market clearing prices magnifies the need to apply the Buyer-Side Market Power Rules correctly. Failure to effectively police a "purely merchant" exemption would have significant adverse impacts on the market, potentially for years. At a minimum, the NYISO must mandate that all contracts be furnished to the NYISO and the MMU for review and certifications provided by company compliance officers after extensive due diligence. In addition, the NYISO must specify in detail how it will police indirect subsidies, including under joint efforts or public-private partnerships. Third, effective penalty provisions must be developed such that certifications are not merely form over substance.

In short, unless and until the NYISO provides convincing evidence that it is capable of policing this exemption properly, such a proposal should not go forward. To help ensure that this provision can be effectively policed, the NYISO may need to supplement its proposal to specify that entities that have load obligations or that have affiliates with load obligations are not eligible for this exemption.

Another critical flaw with the NYISO's proposal is that the NYISO evaluation of contracts between new entrants and a party that disqualifies the entrant from this exemption (NY distribution company, Municipal Utility, or any governmental entity including but not limited to Public Authorities) ceases upon the entrant's first selling energy into the market. While it is certainly appropriate for the NYISO to require re-certification at stages within the Class Year process and first entry into the market, there are ways in which a long-term agreement could be structured subsequent to the final certification that would still constitute market power. Indeed, during the December 3rd meeting, several market participants provided examples of how this rule could easily be gamed. It appeared during the meeting that the NYISO was moving away from this arbitrary cut-off in the certification requirements. The NYISO should amend its proposal to specify that monitoring through certification will also continue post commercial operation to ensure that any subsequent contracts are consistent with competitive market practices and are not long-term, all-costs contracts to be used for uneconomic entry and price suppression.

Additionally, notwithstanding the foregoing, should the NYISO nonetheless proceed forward to propose a “pure merchant” exemption, it must also correspondingly include a proposal to recalibrate the default offer floor to more effectively deter uneconomic entry in light of this proposed exemption. Presently, a unit that fails the mitigation exemption test must bid an offer floor of the lower of the unit’s net CONE or 75% of Mitigation Net CONE. There has never been sufficient justification for allowing an uneconomic unit to bid at a level that is 25% below the Net CONE value (much less the Mitigation Net CONE value) when its actual costs are higher.³ In any event, should the NYISO press forward with a “purely merchant” exemption proposal, a companion rule change also must go forward mandating that a unit that is determined to constitute uneconomic entry must be subject to the lower of its unit net CONE or 100% of Net CONE. Only then would a unit clear in the capacity auction when the market would support its actual unit net CONE, or when the market was short enough to support Net CONE. Otherwise, an offer floor lower than these two levels would allow uneconomic entry to suppress capacity prices artificially.

Finally, the NYISO noted that it was considering transitional mechanisms for projects that are in existing class years but have not yet provided any details. The NYISO’s timing for proceeding with this exemption and how it may align with existing class year processes is entirely unclear. However, in any event, IPPNY requests that the NYISO include in its next presentation for stakeholder review details of these proposed provisions and explain how markets will be impacted by them.

³ In fact, if a unit’s net CONE is higher than the 75% mitigated net CONE level yet the market is clearing at 75% of mitigated net CONE, that unit’s MW will nevertheless clear in the market even though it is still clearly uneconomic based on the unit’s own costs.