

Penalties and Public Disclosure
for the
Exercise of Market Power

Materials for the April 16
Business Issues Committee Meeting

Summary

The Consumer Protection Board proposes that, in lieu of Enhanced Price Correction Authority to address market power, the following proposals for Penalties and Public Disclosure be adopted. A version of these proposals was presented to the Business Issues Committee on April 3, 2001. This version has been amended to reflect comments received at that meeting and at the BIC Penalty and Public Disclosure Task Force meeting on April 10, 2001.

PENALTIES FOR THE EXERCISE OF
MARKET POWER

Proposal of NYS Consumer Protection Board

April 16, 2001 (Revision 1:37pm) A

Background

The market power mitigation authority held by the New York ISO (NYISO) currently is applicable only on a prospective basis. If the NYISO determines that a market participant is exercising market power, it can only take actions to prevent the future reoccurrence of that market power. The NYISO does not have the power to retroactively correct prices that were impacted by the exercise of market power, or to assess financial penalties on the offending market participant to take away the gains that it made from the exercise of market power.¹

Because of this gap in the ISO's mitigating authority, a market participant knows that it can exercise market power and receive the full financial benefit of doing so until its behavior is detected and mitigated. There appears to be little or no deterrent to a market participant that has market power and might consider using it. The goal of the penalty provisions described herein is to provide such a deterrent. Note: the goal of these measures is not to provide compensation to the buying side of the market for the inflated prices that were paid as a result of the exercise of market power. Furthermore, these measures do not involve any correction or changes to prices.

Applicability

Initially, these penalty provisions are designed to apply only to the NYISO energy markets. They cover the day-ahead market, and the real-time market. They do not cover the ancillary services markets. If experience demonstrates that it is important to design penalties for ancillary services markets, they can be added at a later time. Market power exercised through physical withholding or overproduction are currently mitigated through the imposition of a financial obligation (Section 4.3 of the NYISO's April 18, 2001 compliance filing on market mitigation measures). The portion of Section 4.3

¹ With regard to the exercise of market power via physical withholding or overproduction, the NYISO does have a mitigation measure that enables it to impose a financial obligation on the offending market party (Section 4.3 of the April 18, 2000 ISO compliance filing, Docket Nos. ER97-1523-020...et al.).

related to the physical withholding of generation would be eliminated and be replaced by the penalties described here.

Penalties

Penalties will gradually increase in severity, with a lesser penalty for the first time a market participant is mitigated by the ISO, and larger penalties for the second time. The penalty for the first offense is as follows:

$$\text{1st Penalty} = (\text{MWh transacted in NYISO market}) * [(\text{LBMP}) - (\text{reference price of generator})]$$

MWh transacted in NYISO market is the amount of megawatthours a generator sells into the NYISO either as a short-term physical bilateral (this would include all bilateral, contracts or other arrangements of less than two years) or as a sale at the NYISO-administered prices.

LBMP is the NYISO locational-based marginal price at each generator's location.

Reference prices as defined in the NYISO Automatic Mitigation Plan.

The above penalty applies to all of the megawatthours transacted by the generation owner and its affiliates, parents, or subsidiaries in the NYISO market, except bilateral contracts and other arrangements of two years duration or more. For example, if a generation owner and its affiliates control 1,200 MW of generation, 200 of which exerted market power via removing itself from the DAM through economic withholding, 500 of which transacted a physical short-term bilateral in the DAM, 200 was a long-term bilateral and 300 of was scheduled to sell to the DAM market at DAM prices, then that owner and its affiliates will be penalized for 800 MW in the DAM for that hour (500 short-term bilateral plus 300 sold at DAM prices). This 800 MW will be subject to the penalty. The penalty will vary by generation unit and by generator bus to the extent the LBMPs vary from location to location and the generation reference prices vary among the generation owners' generating units.

The penalty for a second offense by the same generation owner is as follows:

$$\text{2nd Penalty} = (\text{MWh transacted in NYISO market}) * \text{LBMP}$$

The second penalty is larger than the first penalty in that it equals the full LBMP associated with each megawatt-hour transacted in the NYISO market, as defined above, by the generators owned by the offending entity and its affiliates.

The third time a generation firm is mitigated by the ISO, the bids of all of its generators would be constrained to its reference bid curve for a six-month period. It will also be levied a penalty equal to the 2nd penalty amount. Any further market power violations that occur are subject to the same penalty.

Trigger for Penalties

The imposition of a penalty will be triggered by an action by the NYISO to mitigate the behavior of a market participant. The market participant will have the right to appeal the NYISO action and take it to the NYISO Alternative Dispute Resolution (ADR) process for arbitration. The penalty will not be implemented until the ADR process is complete. If the market participant is not satisfied with the outcome of the ADR process it can take the matter to FERC for final resolution. If the market participant does not appeal the NYISO action to mitigate, the penalty will be automatically imposed.

An exception is made for mitigation that occurs through the use of the ISO's Automatic Mitigation Process (AMP). This exception is made for two reasons: (1) the automatic prevention by the AMP of price impacts prevents a market party from benefiting from its attempt to exert market power and therefore lessens the need for a financial penalty; and (2) the weaker communication between the ISO and market parties that occurs with the AMP, compared to regular mitigation, makes it more likely that an erroneous penalty could occur.

Duration of Market Activities Encompassed by the Penalty

Once a penalty is triggered, it is applicable to all market activities by the offending market party that: (1) are deemed to be of the same type as the activity that was mitigated; and (2) occurred prior to the implementation of mitigation by the ISO, but not more than 14 days prior to the implementation of mitigation by the ISO.

DISCLOSURE OF ENTITIES THAT
HAVE EXERCISED MARKET POWER

Proposal of NYS Consumer Protection Board

April 16, 2001

Background

In order to protect the market from the exercise of market power, it is important to provide a deterrent to entities that have market power and may be considering its exercise. One component of a deterrent is created by publicly disclosing the identity of any entity that exercises market power, and is found by the ISO to have done so.

Procedure

1. The first time that an entity is mitigated by the ISO, the entity will not be named.
2. The second time that an entity is mitigated by the ISO, it will be named. The “second” time means a second time in which the ISO had to implement mitigation that was applied to the same entity as the initial mitigation, or to an affiliate, parent, etc. It does not matter if the second mitigation is in a different market. For example, if entity A exercises market power and is mitigated in the day-ahead ten-minute non-spin reserve market, then later entity A exerts market power and is mitigated in the real-time energy market, this constitutes a second violation for entity A. Entity A is named and is revealed to be the party involved in both the first and the second violation. If the entity committing the second violation is entity B, and entity B is an affiliate of entity A, then both entity A and entity B are named, as well as the holding company that governs entity A and entity B. For purposes of this item, the second occurrence must occur within 36 months of the first occurrence.
3. The entity is named again for the third and all subsequent occurrences of a violation that was mitigated by the ISO.
4. No confidential information, such as bid prices, quantities, etc., will be revealed as part of the process by which the entity is named.
5. The ISO will maintain a list of all violations on its website showing the dates and, where applicable, the names of the entities involved.

6. Mitigation that occurs through the use of the ISO's Automatic Mitigation Process

(AMP) does not constitute a violation for the purposes of this public disclosure mechanism.

7. Public disclosure will be delayed until an appealing party's appeal has completed the ISO's dispute resolution process and any subsequent appeal to the FERC.