

124 FERC ¶ 61,301
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

New York Independent System Operator, Inc.

Docket Nos. EL07-39-002
ER08-695-000
ER08-695-001

ORDER ON REHEARING AND FURTHER
ORDER ON COMPLIANCE TARIFF SHEETS

(Issued September 30, 2008)

1. In this order, the Commission grants, in part, and denies, in part, rehearing of its March 7, 2008 Order¹ conditionally approving the New York Independent System Operator, Inc.'s (NYISO's) proposals to strengthen market mitigation in the New York City (in-City) Installed Capacity (ICAP) market. The Commission also accepts NYISO's March 20, 2008 compliance filing, subject to conditions, effective March 27, 2008, and NYISO's May 6, 2008 compliance filing, subject to conditions, effective November 1, 2008.

I. Background

2. In 1998, Consolidated Edison of New York, Inc. (ConEd) divested most of its generators in three bundles – creating a high degree of market concentration for generation in New York City. To mitigate the market power of the owners of this divested generation, Con Ed proposed – and the Commission accepted – a \$105/kW-year offer and revenue cap on sales of ICAP from these units.² The three companies that

¹ *New York Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,211 (2008) (March 7, 2008 Order).

² *Consol. Edison Co. of N.Y., Inc.* 84 FERC ¶ 61,287 (1998) (1998 Divestiture Order).

purchased ConEd's units were KeySpan-Ravenswood, LLC (KeySpan), NRG,³ and Astoria Generating Company, L.P. (collectively, the Divested Generation Owners, or DGOs).

3. On March 6, 2007, the Commission issued an order rejecting proposed tariff revisions filed by NYISO that would have reduced the DGOs' mitigation reference price to \$82/kW-year.⁴ In the March 6, 2007 Order, the Commission instituted a proceeding pursuant to section 206 of the Federal Power Act (FPA)⁵ to investigate "the justness and reasonableness of the [in-City market], and whether and how market rules need to be revised to provide a level of compensation that will attract and retain needed infrastructure and thus promote long-term reliability while neither over-compensating nor under-compensating generators."⁶ The Commission directed that the hearing be held in abeyance to provide time for settlement judge procedures.

4. Following unsuccessful attempts at settlement, on May 4, 2007, the Independent Power Producers of New York, Inc. (IPPNY) filed a request to establish a paper hearing in the instant proceeding, augmented by a technical conference, if needed, to investigate the in-City market rules. On July 6, 2007, the Commission issued an order⁷ instituting a paper hearing in Docket No. EL07-39-000, and in response to a suggestion by NYISO, directed NYISO to submit a proposal for a revised in-City ICAP market within 90 days. The Commission also set the issue of whether any entity has engaged in manipulation of the in-City ICAP market for investigation by the Commission's Office of Enforcement.

5. On October 4, 2007, in compliance with the July 6, 2007 Order, NYISO filed a proposal for revised market rules (October 4, 2007 Proposal) for the in-City market, accompanied by supporting affidavits and exhibits. Specifically, NYISO proposed to retain the existing ICAP market structure, including the current set of ICAP auctions⁸ and

³ NRG consists of NRG Power Marketing Inc., Arthur Kill Power LLC, Astoria Gas Turbine Power LLC, Dunkirk Power LLC, Huntley Power LLC, and Oswego Harbor Power LLC.

⁴ *New York Indep. Sys. Operator, Inc.*, 118 FERC ¶ 61,182 (2007) (March 6, 2007 Order).

⁵ 16 U.S.C. § 824e (2006).

⁶ *Id.* P 17.

⁷ *New York Indep. Sys. Operator, Inc.*, 120 FERC ¶ 61,024 (2007) (July 6, 2007 Order).

⁸ NYISO operates six-month strip auctions, monthly auctions, and spot auctions.

the use of ICAP Demand Curves,⁹ while refining mitigation measures in order to prevent the exercise of market power by both capacity suppliers and net capacity buyers.

6. To mitigate the market power of sellers to economically withhold, bid caps equal to estimated going-forward costs would cap the offers of pivotal suppliers. Under NYISO's proposal, mitigation would only apply to in-City capacity that is owned or controlled by an entity that possesses market power at the time of each ICAP Spot Market Auction as measured by two pivotal supplier tests, one based on ownership of resources and the other based on control of resources. Supplier mitigation would not apply to market participants owning or controlling less than 500 MW of unforced capacity (UCAP).¹⁰ NYISO proposed to subject pivotal suppliers to a must-offer requirement and an offer cap equal to the higher of the price on the in-City market Demand Curve if all qualified UCAP clears the market or a market-clearing price that covers the net going-forward costs of the marginal unit. With the implementation of this new form of market mitigation, NYISO proposed to remove the existing revenue cap and the ban on sales of DGO capacity in bilateral contracts.

7. To mitigate the market power of sellers to physically withhold, various penalties would apply to specified actions deemed to constitute physical withholding. To mitigate the market power of net capacity buyers to depress market clearing prices with uneconomic entry, a bid floor of 75 percent of the net cost of new entry (CONE) would apply when market clearing prices are estimated to be below that level, absent the entry.

A. March 7, 2008 Order

8. On March 7, 2008, the Commission issued an order¹¹ conditionally approving NYISO's mitigation proposal and directing NYISO to file tariff sheets containing the revised market rules reflecting the approved mitigation measures within 60 days of issuance, or May 6, 2008.

9. The Commission found that NYISO's proposal would produce market clearing prices that cover suppliers' net going-forward costs and rejected arguments that the proposal would produce expected market clearing prices below net CONE. The

⁹ The Demand Curves attempt to replicate normal demand for capacity. There are three ICAP Demand Curves, all applied to spot auctions: one for the statewide market, one for New York City, and one for Long Island.

¹⁰ UCAP is the percentage of ICAP available after correction for the unit's forced outage rate.

¹¹ March 7, 2008 Order, 122 FERC ¶ 61,211 at Ordering Paragraphs (A) and (B).

Commission noted that the reference level is an offer cap, not a price cap, and thus, if the market clears at a higher price than the reference level, suppliers would receive that higher price. The Commission found the removal of the revenue cap to be an appropriate action in the context of NYISO's proposal because mitigated suppliers would not have the ability to affect market prices in the spot auction by submitting artificially high offers. The Commission also found that the removal of the revenue cap for mitigated suppliers rendered the prohibition on DGOs selling capacity via bilateral contracts unnecessary.

10. The Commission recognized the possibility of suppliers physically withholding their units by other means, such as retiring, mothballing, or derating, in order to influence the calculation of all available UCAP and the subsequent mitigation reference level, and thus affect market prices. However the Commission noted that retiring, mothballing, or derating units may also be an appropriate economic decision under particular circumstances. The Commission thus directed NYISO to address concerns with potential mechanisms for physical withholding, including premature retirement, mothballing, and derating in a compliance filing. The Commission also directed the NYISO's market monitor to monitor for physical withholding and promptly report any instances of withholding to the Commission's Office of Enforcement.

11. The Commission accepted that the application threshold of the pivotal supplier test should be 500 MW but it rejected NYISO's two-part test for pivotal suppliers and directed NYISO to file a pivotal supplier test based solely on control of resources. The Commission, citing Order No. 697, stated that "our guiding principle is that an entity controls the facilities when it controls the decision-making over sales of electric energy including discretion as to how and when power generated by the facilities will be sold."¹² The Commission also stated that NYISO may presume that an owner of a capacity resource retains control over that resource for the purposes of applying the pivotal supplier test until the owner is able to demonstrate that it has conveyed control of the capacity resource to a non-affiliated third-party.

12. NYISO defined going-forward costs as those costs a unit could avoid by being mothballed rather than staying in the market to provide capacity. The Commission accepted NYISO's definition with one exception. The Commission found that the costs of capital expenditures to re-power existing sites or develop new sites are inappropriate to include in the going-forward costs of an existing unit. The Commission deferred action

¹² March 7, 2008 Order, 122 FERC ¶ 61,211 at P 66 (quoting *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252, *clarified*, 121 FERC ¶ 61,260 (2007), *order on reh'g*, Order No. 697-A, 73 Fed. Reg. 25,832 (May 7, 2008), FERC Stats. & Regs. ¶ 31,268 (2008)).

on the appropriateness of including opportunity costs related to exports until NYISO's then-upcoming compliance filing related to physical withholding.

13. The March 7, 2008 Order also addressed the prevention of uneconomic entry. The Commission accepted NYISO's proposal for a buyer offer floor equal to 75 percent of net CONE but modified certain calculations for the period of mitigation. The Commission directed NYISO to reflect these changes to the calculation in its revised tariff sheets to be submitted in a compliance filing. The Commission accepted NYISO's proposed exemptions from uneconomic entry mitigation as modified to apply buyer mitigation only to net buyers. Further, the Commission stated that a review process to update the ICAP Demand Curve and the establishment of a Forward Capacity Market are beyond the scope of this proceeding.

14. Finally, the Commission noted that the July 6, 2007 Order referred allegations of market manipulation to the Commission's Office of Enforcement for investigation. The results of that separate investigation were placed in the record in this proceeding. That investigation found no manipulation, and the Commission stated that it would take no further action on the parties' allegations of market manipulation.

B. NYISO's Compliance Filings

15. On March 20, 2008, in partial compliance with the March 7, 2008 Order, NYISO filed proposed revisions to its Market Administration and Control Area Services Tariff (Services Tariff) in the instant Docket No. ER08-695-000 to implement mitigation of ICAP suppliers in the in-City market. NYISO requested Commission action before the start of its ICAP auctions on March 28, 2008. On March 26, 2008, in light of the request for expeditious action, and in advance of receiving comments on the filing, the Commission issued an order¹³ granting waivers and accepting NYISO's March 20, 2008 filing, suspending it for a nominal period and permitting it to become effective, as requested, on March 27, 2008, subject to refund and conditions, and subject to the issuance of further orders. The Commission deferred action on the merits of NYISO's filing until the issuance of those further orders.

16. On May 6, 2008, in partial compliance with the March 7, 2008 Order, NYISO filed additional revisions to its Services Tariff to address the market power of buyers.

¹³ *New York Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,282 (2008) (March 26, 2008 Order).

II. Requests for Clarification or Rehearing

17. On April 7, 2008, ConsumerPowerline, Inc. (ConsumerPowerline); ConEd, Orange and Rockland Utilities, Inc. (O&R), Long Island Power Authority, New York Power Authority (NYPA) and the City of New York (collectively, NY Parties); Astoria Generating Company, LLC and Energy Curtailment Specialists (Astoria); IPPNY; NYISO; and NRG filed requests for clarification or, in the alternative, rehearing. On April 7, 2008, KeySpan and the New York State Public Service Commission (NYPSC) each filed a request for rehearing. On April 21, 2008, ConEd and O&R filed an answer to the requests for rehearing filed by Astoria, NRG, KeySpan, and IPPNY. KeySpan filed an answer to the NYISO's and NY Parties' motions for clarification.

A. Procedural Matters

18. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2008), prohibits an answer to a request for rehearing. Accordingly, the answer of ConEd and O&R will be rejected. KeySpan states that its answer was directed to the NYISO and the NY Parties' requests for clarification, not to their requests for rehearing. However, NYISO and the NY Parties' requests for clarification are inseparable from their requests for rehearing. Thus, KeySpan's answer is an answer to a request for rehearing and is therefore also rejected under Rule 713(d).

B. Discussion

19. In the instant order, the Commission grants in part and denies in part the requests for clarification or rehearing of the March 7, 2008 Order and accepts, subject to conditions, the two compliance filings made on March 20 and May 6, 2008.

1. Issues Relating to Mitigation of Uneconomic Entry

20. NYISO proposed to mitigate uneconomic entry by applying an offer floor of 75 percent of net CONE to all uneconomic new entry into the capacity market. NYISO's proposal, as revised, provided that this floor would apply for the longer of three years of operation or for a period determined by the size of the new investment divided by the annual growth rate in capacity demand. In addition new capacity deemed uneconomic and subject to the floor would not be able to directly participate in bilateral transactions, or in strip or monthly auctions. Exemptions from buyer mitigation would be available if NYISO determined that a new entrant's costs were legitimately less than 75 percent of net CONE or if the post-entry market clearing price in the first year was higher than the offer floor or the average post-entry market clearing prices in the first three years after entry was higher than the new unit's entry costs.

21. In the March 7, 2008 Order, the Commission accepted NYISO's proposal for an offer floor equal to 75 percent of net Cone but the Commission modified the proposal so

that the floor would apply to net buyers only. The Commission stated that new capacity offered by net sellers of capacity would not profit from a strategy of uneconomic entry and thus directed NYISO to specify in its proposed tariff language that the mitigation of uneconomic entry applies only to net buyers bringing uneconomic capacity into the market.

22. The Commission also modified NYISO's proposal for calculating the period of mitigation by substituting a three year *average* of growth in capacity demand for NYISO's *annual* growth rate in capacity demand. The Commission directed NYISO to reflect these changes to the calculation in its revised tariff sheets to be submitted in a compliance filing. The Commission accepted NYISO's proposed exemptions of Special Case Resources (SCR) and of facilities that have recently become operational from net-buyer mitigation.

a. **Net Buyer Mitigation Rules Will Result in Unjust and Unreasonable Rates**

23. KeySpan asserts that the buyer mitigation rules will result in clearing prices below the Commission's standard for just and reasonable rates and in unduly discriminatory subsidization of uneconomic new entry by existing suppliers. KeySpan states that where the Commission has established a competitive market outcome standard for determining whether a capacity market design will produce just and reasonable rates, it must apply that standard or, at least, provide a reasoned explanation for accepting a market design that does not meet the prescribed standard. KeySpan further states that the Commission here has unambiguously set forth the standard of competitive market outcomes, which requires effective mitigation of uneconomic entry such that (1) over time, clearing prices average to net CONE; and (2) such clearing prices should be realized by both existing suppliers and all new entrants, without any discriminatory subsidization by existing suppliers of Load Serving Entity (LSE)-contracted new capacity. KeySpan contends that the buyer mitigation measures approved by the Commission do none of this, and consequently the resulting clearing prices will be unjust and unreasonable.

24. In particular, KeySpan asserts that the buy-side mitigation rules will not prevent uneconomic entry but instead will allow dominant capacity buyers in New York City to maintain uneconomic and anti-competitive surplus capacity conditions that will permanently suppress market clearing prices to levels substantially below net CONE.¹⁴

25. In addition KeySpan argues that these buy-side mitigation rules will result in undue discrimination against existing suppliers and would-be new suppliers desirous of

¹⁴ KeySpan cites testimony by its expert witness, Dr. Hieronymus presenting reasons why buyers would suppress prices to the extent permitted by the mitigation rules.

participating in the capacity market. KeySpan states that Commission policy clearly establishes that capacity market mechanisms are unduly discriminatory if all suppliers of a capacity product subject to identical obligations are not comparably compensated.¹⁵

26. KeySpan states that its alternative to the Commission-approved mitigation rules would be to require buyers to use competitive procurements for new capacity, which would assure that only economic capacity is built. Under KeySpan's proposal, capacity purchased in competitive procurements would not be subject to mitigation. The buyer mitigation rules would require all other capacity resources acquired by buyers, *i.e.*, those resources acquired outside of the competitive auction process, to be offered into the spot auction at no less than the lesser of (i) net CONE or (ii) verifiable, fully loaded capacity costs using amortization and other "adjustments" as are applied to determine net CONE in determining the Demand Curve that is reset in Docket No. ER08-283. This mitigation rule would apply to all resources, new and existing, including SCRs, under the control of buyers and their affiliates and agents and would extend for as long as the resources are used to satisfy the buyers capacity obligation. KeySpan asserts that the Commission erred in ignoring its proposed alternative without any discussion or analysis.

Commission Determination

27. The Commission does not agree that buyer mitigation rules will result in unjust and unreasonable rates. Rather, the proposed rules, as modified herein, assure that uneconomic new capacity will not be allowed to distort market supply curves and inefficiently depress market clearing prices below a competitive level. This is accomplished by setting a bid floor applied to new capacity for a stated period. Thus, we disagree with KeySpan's contention that dominant capacity buyers in New York City will be able to maintain uneconomic surplus. Under the proposed rules, such surplus must be offered at the price floor for at least a three-year period and if such capacity fails to clear the market, it will not suppress market clearing prices. KeySpan further requests that the Commission oversee New York's capacity procurement bidding practices to ensure that all parties will be treated in a non-discriminatory fashion. We see no need to do so. If buyers acquire capacity outside of the market and that capacity is uneconomic, then it will fail to clear the market and will not affect market clearing prices or satisfy an LSE's capacity requirement.

b. Limitation of New Entry Mitigation to Net Buyers

28. NYISO, IPPNY, Astoria, and NRG all request that the Commission grant rehearing and not limit market power mitigation measures to net-buyers only. Essentially

¹⁵ Citing *Indep. Energy Producers Ass'n v. California Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,069, at P 36 (2006).

these parties note that the limitation is impractical to implement and would achieve little positive result. They argue that the limitation would give parties an incentive to create companies solely for the purpose of subsidizing uneconomic entry, or that governmental bodies could subsidize uneconomic entry under a public policy rationale. NYISO, in particular, emphasizes that limiting uneconomic entry mitigation measures to net buyers could undermine enforcement because buyers may behave strategically to avoid categorization as net buyers. NYISO also points out that the process for identifying net buyers is unclear and that this could also result in evasion of the mitigation measures. NYISO notes that “net buyer” could be defined a number of different ways, for example, as a single entity or as an entity including all affiliates that serve load. Such a definition would not consider generation affiliates that could construct uneconomic generation and escape mitigation. NYISO also explains that contractual relationships could be undertaken to circumvent mitigation of uneconomic entry and that these would be extremely difficult to identify. For example, it asserts, a “contract for difference” might allow a buyer to subsidize uneconomic entry in a way that would not be apparent to NYISO. NYISO further emphasizes that if the Commission’s view that only “net buyers” have the incentive to engage in uneconomic entry is correct, the “net buyer” condition would be unnecessary since there would be no other sources of uneconomic entry. For these reasons, NYISO seeks rehearing.

Commission Determination

29. Upon further review, for the reasons set forth in the requests for rehearing, the Commission will grant rehearing on this issue. NYISO will not be required to modify its proposed market power mitigation rules for uneconomic entry so that they only apply to net buyers. We find that all uneconomic entry has the effect of depressing prices below the competitive level and that this is the key element that mitigation of uneconomic entry should address. Parties requesting rehearing have convinced us that defining net buyers raises significant complications and provides undesirable incentives for parties to evade mitigation measures. Accordingly, we grant rehearing on this issue and thus will reject NYISO’s compliance filing to the extent it reflects that the market floor only applies to net-buyers, and direct NYISO to file to reflect this ruling within 30 days of this order.¹⁶

c. Price Floor Applicable to New Entry

30. As noted above, NYISO proposed an offer floor of 75 percent of net CONE as a reasonable solution to forestall potential uneconomic entry by preventing such entry from depressing the market price significantly below the net CONE. In the March 7, 2008 Order, the Commission agreed with NYISO.

¹⁶ See *infra* P 84.

31. NRG and IPPNY argue that the Commission ignored Mr. Cavicchi's testimony in their protest, which, these parties state, demonstrated that only by setting the offer floor at 90 percent of CONE will the long-run price equal net CONE, and only at that level will the market attract sufficient investment and prevent LSEs from distorting the market by \$90 to \$100 million. Mr. Cavicchi raised concerns that combined elements of the mitigation will cause capacity prices to be too low. He argued that one element, the 75 percent net CONE price floor, should be increased to 90 percent of net CONE. NRG reiterates this argument in its rehearing request and states that the Commission must address uneconomic, bilaterally contracted generation creating an artificial surplus and effectively bidding in the market at zero, thus producing prices that remain below net CONE over the long-run.¹⁷ NRG argues that the offer floor set at 75 percent of net CONE will not eliminate the incentive for market distortion; only an offer floor of 90 percent of net Cone adequately addresses the distortion of efficient market outcome.

Commission Determination

32. The Commission continues to find that the proposed price floor of 75 percent of net CONE is appropriate. Contrary to the assertion of NRG and IPPNY, the Commission reviewed Mr. Cavicchi's testimony, along with all other testimony and evidence submitted in the proceeding, and based its decision to accept NYISO's proposal on that basis. Parties have raised no new arguments that cause us to reconsider this decision. As we noted originally, we have approved similar offer floors for other capacity markets¹⁸ and we find that 75 percent of net CONE should reasonably achieve our goal of deterring uneconomic entry especially since it will now apply to all new entry and not only new entry of net buyers. Furthermore, we emphasize that the value of the price floor will be reevaluated annually by NYISO.

d. Potential Adverse Consequences of Mitigation of Uneconomic Entry

33. NY Parties and the NYPSC request clarification or rehearing that the Commission did not intend for buyer mitigation measures, i.e., the floor price of 75 percent of net CONE, to potentially result in buyers purchasing the same capacity twice. These parties

¹⁷ NRG April 7, 2008 Request for Rehearing at 15-17. *See also* NRG's November 19, 2007 Protest at 40-89 (Mr. Cavicchi's Affidavit).

¹⁸*See* March 7, 2008 Order, 122 FERC ¶ 61,211 at P 107 (“[T]he Commission has approved the use of similar offer floors at or near seventy-five percent of net CONE for ISO-New England and PJM.” *citing* 115 FERC ¶ 61,340 at P 109-15 (2006); 117 FERC ¶ 61,331 at P 103-04 (2006)).

observe that capacity purchased or contracted for self-supply or to satisfy State-mandated requirements might not clear in a capacity auction. Consequently, consumers would be required to purchase their capacity requirements in the auction and, under NYISO's proposal, also pay for any of the capacity that did not clear in the auction because capacity that does not clear in the auction would not count toward an LSE's requirement. If the Commission does not grant the clarification, the NY Parties seek rehearing and request that the Commission allow the mitigated capacity to count against a buyer's installed capacity requirement even if the capacity does not clear in the market.

34. The NYPSC reiterates its concern that the mitigation rules interfere with the state's effort to meet resource adequacy standards, especially when those standards are focused on diversifying the resource mix. The NYPSC argues that despite recognizing that the NYPSC's authority to ensure resource adequacy includes determining what types of generation facilities should be built to achieve the IRM, the March 7, 2008 Order may frustrate that authority by establishing rules that prevent new facilities selected by NYPSC for reliability or other legitimate public policy purposes. The NYPSC is specifically concerned that the price floor included in the ICAP mitigation proposal could interfere with its "legitimate interest in ensuring that new resources, including self-supplied resources, which are deemed appropriate from a public policy perspective."¹⁹ The NYPSC argues that this is an impermissible exertion of Commission jurisdiction. It requests that the Commission direct the NYISO to establish provisions that would permit LSEs to self-supply uneconomic resources while at the same time not allowing such self-supply to depress ICAP prices. It points to provisions in PJM's and ISO-New England's capacity markets that allow certain new capacity constructed under a state mandate to be exempt from certain price floors that might otherwise apply to support its view.²⁰

Commission Determination

35. We addressed the NYPSC's jurisdictional argument in the March 7, 2008 Order, stating that

[a]lthough the Commission "will defer to state and local entities' decisions when possible on resource adequacy matters, . . . resource adequacy can have a significant effect on wholesale rates and service."²¹ In *Mississippi*

¹⁹ NYPSC April 7, 2008 Request for Rehearing at 2.

²⁰ *Citing Devon Power LLC*, 115 FERC ¶ 61,340 at P 109, *order on reh'g*, 117 FERC ¶ 61,133 (2006), *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, at P 103 (2006).

²¹ *PJM Interconnection, LLC*, 119 FERC ¶ 61,318, at P 40 (2007).

Industries v. FERC,²² the court stated, “[c]apacity costs are a large component of wholesale rates” and therefore the share of the capacity costs of the system carried by each affiliate will significantly affect the wholesale price it pays for energy.²³ While the allocation of capacity did not set sales prices, it directly affects costs and “consequently, wholesale rates”²⁴ and therefore “FERC’s jurisdiction under such circumstances is unquestionable.”²⁵

36. As we also stated in the March 7, 2008 Order,²⁶ uneconomic entry can produce unjust and unreasonable prices by artificially depressing capacity prices and NYISO’s proposal provides a reasonable means to deter that uneconomic entry, thus it falls under the Commission’s jurisdiction.

37. Although some concepts adopted in the PJM and ISO-New England forward capacity markets may translate to NYISO’s monthly ICAP market, not all do. In particular, in a multi-state Regional Transmission Organization (RTO) like PJM and ISO-New England, individual state support for new entry that happens to be uneconomic translates into subsidies for customers in other states—that is, the customers of one state pay for new capacity that is bid into a capacity market at a below-market price in order to guarantee it clears the market. This drives down the market-clearing price for all market participants including those in other states. An individual state is much less likely to do this in a multi-state RTO like PJM and ISO-New England than in a single state RTO like NYISO, given the localization of costs and dispersion of benefits in the case of a multi-state RTO.

38. Nevertheless, the Commission recognizes that the NYPSC may conclude that the procurement of new capacity, even at times when the market-clearing price indicates entry of new capacity is not needed, will further specific legitimate policy goals, such as renewable portfolio standards. We agree that it may be appropriate to exempt such new resources from the price floor proposed by NYISO, but the NYPSC has not provided

²² 808 F.2d 1525 (D.C. Cir. 1987), *vacated in part on other grounds*, 822 F.2d 1103 (D.C. Cir. 1987) (*Mississippi Industries*).

²³ *Id.* P 1541.

²⁴ *Id.*

²⁵ March 7, 2008 Order, 122 FERC ¶ 61,211 at P 109 (*citing Mississippi Industries*, 808 F.2d 1525, 1541 (D.C. Cir. 1987)).

²⁶ *Id.* P 110.

sufficient specificity to allow us to mandate an appropriately narrow exemption at this time. The NYPSC may make a filing under section 206 of the FPA to justify a mitigation exemption for entry of new capacity that is required by a state-mandated requirement that furthers a specific legitimate state objective. At that time, we will evaluate the merits of the proposed exemption, but at this time, the NYPSC has provided inadequate justification either for a general exemption or for a finding that the appropriate mechanism for supporting its goals is, in fact, an exemption from the price floor for new capacity.

e. **SCR Exemption from Mitigation**

39. NYISO proposed to exempt from the mitigation of uneconomic investment Special Case Resources (SCR) such as demand response resources.²⁷ The Commission agreed with NYISO and stated that demand response is a valuable tool for the maintenance of reliability, it fulfills this role in an environmentally benign way, and subjecting demand response to the offer floor could erect a barrier to entry into the markets. Moreover, the Commission concluded that there is no basis to establish an offer floor for demand response resources based on the cost of new generation entry because there is not necessarily any connection between net CONE by generation and net CONE by demand response resources. Finally, the Commission stated that it is unclear how NYISO would determine the cost of SCR entry or if that entry was uneconomical.²⁸

40. KeySpan asserts that exempting SCRs from mitigation will give demand resources the incentive and ability to suppress capacity prices and that this exemption should be removed. KeySpan is concerned that LSEs with market power could use uneconomic demand response to suppress market clearing prices similar to the way they can use uneconomic generation to suppress market clearing prices. KeySpan states that, in the aggregate, SCRs can have a very significant effect on prices. KeySpan argues that while it is true that the cost structure of SCRs differs significantly from the proxy unit used to develop net CONE, the same can be said for all other capacity resources that may be offered in the market. KeySpan asserts that in the final analysis, the burden to develop and approve mitigation measures that prevent anti-competitive price suppression falls upon NYISO and the Commission, respectively.

²⁷ SCRs are usually industrial or commercial companies that, in exchange for an advanced payment, agree to curtail power usage, usually by shutting down, when requested to do so by the NYISO.

²⁸ March 7, 2008 Order, 122 FERC ¶ 61,211 at P 120.

Commission Determination

41. Upon further review of this issue, we find that it is appropriate for NYISO's in-City market mitigation rules to apply to SCRs in the same manner as all other in-City market participants. In an order issued May 23, 2008²⁹ in Docket No. ER04-230-034, the Commission directed NYISO to revise Attachment H of the Services Tariff to clearly establish that Demand Side Resources, i.e., SCR, participating in the Operating Reserves and Regulation Services Markets are subject to of section 3.2.3 of Attachment H in the same manner as all other market parties.³⁰ That provision requires NYISO to seek the Commission's permission, via an FPA section 205 filing, to impose appropriate market power mitigation measures when conduct departs significantly from what would be expected under competitive market conditions. Consistent with our decision in that case, we will require SCRs to comply with NYISO's in-City mitigation rules as approved herein. Accordingly, we grant rehearing on this issue, and we direct NYISO to file revised tariff sheets to reflect this ruling within 30 days of this order.

f. Mitigation Exemptions for Existing Facilities

42. IPPNY, Astoria, NRG and KeySpan argue that the Commission erred in exempting two recently operational facilities³¹ from buyer market power mitigation (uneconomic entry deterrent) because both facilities constitute uneconomic entry and are depressing in-City capacity prices. These parties state that the exemption of these certain facilities unduly discriminates against the DGOs, which are subject to mitigation. Protestors claim the Commission's finding in this case was arbitrary and capricious. They state that there is no question that these facilities have produced surplus capacity in the market, driving capacity prices down the demand curve for all capacity sellers and distorting the efficient market outcome. KeySpan, for example, asks that the Commission adopt a transition mechanism to ensure that the in-City capacity rates are just and reasonable until the current surplus is absorbed by load growth. It recommends that the 1,000 megawatts of capacity added by ConEd and NYPA in 2006 be offered at a bid floor equal to the contract capacity payment stated in the power purchase agreement

²⁹ *New York Indep. Sys. Operator, Inc.* 123 FERC ¶ 61,203 (2008).

³⁰ On July 22, 2008, as corrected on July 31, 2008, NYISO filed tariff sheets to comply with the May 23, 2008 Order, which were accepted by letter order issued September 5, 2008. *New York Indep. Sys. Operator, Inc.*, Docket No. ER04-230-037 and ER04-230-038 (September 5, 2008) (unpublished letter order).

³¹ These facilities include the Astoria Energy, LLC 500 MW facility (which is subject to a bilateral contract with ConEd) and NYPA's new 500 MW facility.

for the ConEd unit. It claims that the resulting market clearing price would be lower than the net CONE but assures that these facilities would clear the market.

43. Demand response resource providers, such as ConsumerPowerline, share the view that exemption from mitigation of the capacity added by ConEd and NYPA in 2006 will improperly suppress market clearing capacity prices and discourage the participation of demand-side resources. Consequently, they express the concern that the proposed supply-side mitigation for new entry is inadequate and that continued price suppression by the large buyers will persist and discourage appropriate demand-side entry.

Commission Determination

44. As stated in the March 7, 2008 Order,³² buyer market power mitigation clearly applies to “new” uneconomic entrants, not existing capacity. To apply this new market rule to units that already exist in the market misses the point of this prospective rule, which is to affect future actions. Deterrence of the entry of existing units, by definition, is no longer possible.³³ Thus, whether or not these units were purposefully brought on-line to depress prices (a determination neither NYISO nor the Commission has made), they are already in the market, and should not be subjected to a price floor designed to mitigate future uneconomic entry. Similarly, we reject requests for transition mechanisms, such as that proposed by KeySpan, that are essentially requests to increase prices that would otherwise result by imposing modified bidding restrictions on the 1,000 megawatts of capacity added by ConEd and NYPA in 2006. Accordingly, we deny rehearing on this issue.

2. Issues Relating to Mitigation of Seller Market Power

45. NYISO proposed to apply mitigation to in-City capacity owned or controlled by any entity that possessed market power at the time of each ICAP Spot Market Auction, as measured by a two-part pivotal supplier test, one part based on ownership of resources and the other on control of resources. NYISO proposed to subject pivotal suppliers to a must-offer requirement and an offer cap equal to the higher of the price on the in-City market Demand Curve if all qualified UCAP clears the market or a market-clearing price that covers the net going-forward costs of the marginal unit. NYISO defined going-forward costs as those costs that would be avoided if the unit were mothballed. NYISO also proposed to eliminate the existing revenue caps on DGOs.

³² March 7, 2008 Order, 122 FERC ¶ 61,211 at P 118.

³³ In contrast, given the prospective nature of this rule, a future unit will be aware of the price floor before it chooses to enter the market.

46. The Commission accepted NYISO's proposal as modified and directed NYISO to file a pivotal supplier test based solely on control of resources. The Commission agreed with NYISO that going-forward costs are those costs a unit would avoid if it were shut down. That is, going-forward costs are those costs that the generator would not incur if it mothballed its unit and, thus, it would choose to mothball its unit if it could not recover at least this amount from the capacity market. The Commission accepted, with one revision, NYISO's definition of those costs. The Commission also agreed to eliminate revenue caps.

a. Going-Forward Costs

47. Parties argue that the Commission did not adequately show that a market clearing price based on recovery of going-forward costs by generators is a just and reasonable result. Other parties differ with the Commission on the calculation of going-forward costs.

48. NRG requests that the Commission clarify that going-forward costs include not only pollution control equipment but also other non-discretionary capital expenditures, i.e., any capital expenditures relating to compliance with federal or state law or regulation concerning the environment, safety, or reliability. KeySpan repeats a number of concerns about the calculation of going-forward costs that it made earlier and that the Commission previously rejected—that going-forward costs should reflect risk of a call option, and that a generator should be paid for all megawatts of its capacity if any megawatts clear in the market. Astoria asserts that capital costs, including debt service payments and dividend payments, should also be recoverable in order to maintain the financial integrity of the company and attract more investment.³⁴

Commission Determination

49. We continue to find that a market-clearing price based on competitive bids results in a just and reasonable rate. Because some generators have market power, their bids are mitigated to their going-forward costs as a way to approximate their competitive bids. As stated above, going-forward costs estimate how much it costs a generator to keep a unit available to deliver energy should it need to do so. In the absence of market power, market-clearing prices, at a minimum, should cover all accepted sellers' going-forward costs. However, the market-clearing price in the market is a uniform price, set by the

³⁴ *Citing Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*) (“[I]t is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.”).

marginal unit, and as such the market-clearing price allows all but the marginal unit to recover other fixed costs identified by parties in this proceeding. We agree with KeySpan and Astoria that such costs must be recovered in order to provide sufficient incentives for new entry, but their recovery will be achieved to the extent market-clearing prices exceed the generator's competitive offer, which may be mitigated to its going-forward costs if the seller is pivotal.

50. We grant NRG's request for rehearing to the extent we direct that all non-discretionary capital expenditures such as those necessary to comply with federal or state regulations for environmental, safety, or reliability reasons be included as going-forward costs. However, to be included as a going-forward cost, such a cost must not only be necessary to comply with federal or state regulations, but also must be necessary to make the unit available in the ICAP market. We continue to reject the other types of investment for inclusion in going-forward costs. These costs are not necessarily incurred in order to make a unit available in the spot ICAP market, and they should not be included in going-forward costs. We continue to hold to our earlier conclusion that the relevant costs in the calculation of going-forward costs are those costs that can be avoided if a unit is mothballed.³⁵ We direct NYISO to file revised tariff sheets to reflect the change in the definition of going-forward costs within 30 days of the issuance of this order.

b. Revenue Caps

51. In its October 4, 2007 filing, NYISO asserted that the revenue cap on DGOs was no longer needed as a measure against physical withholding since physical withholding was to be addressed by the spot market must-offer requirement for any capacity not sold bilaterally or in the strip or monthly auctions. The Commission agreed with NYISO that its proposal removes the ability of mitigated suppliers to affect the market clearing price. The Commission stated that "it is appropriate to allow all suppliers to be paid the market clearing price when the suppliers' market power has been adequately mitigated."³⁶

52. The NYPSC seeks rehearing of the Commission's determination to eliminate the revenue cap applicable to pivotal suppliers. The NYPSC states that this cap, set at \$105/kW-year, has functioned for several years as a significant deterrent to the exercise of market power by pivotal suppliers through physical withholding of ICAP and helped ensure ICAP prices remained just and reasonable. The NYPSC further states that with the elimination of the revenue cap, the only measures to ensure that prices remain at just

³⁵ March 7, 2008 Order, 122 FERC ¶ 61,211 at P 76, 81.

³⁶ *Id.* P 49 (citing *Southwest Power Pool, Inc.*, 114 FERC ¶ 61,289, at P 203 (2006)).

and reasonable levels will be newly structured bid caps imposed on pivotal suppliers and market forces. The NYPSC contends that these measures do not address existing conditions that render the relevant markets uncompetitive and the prices that may result due to physical withholding. Therefore, the NYPSC argues that the federal government, in such a situation, fails to meet its statutory mandate to ensure just and reasonable prices.³⁷

53. The NYPSC states that there is no record to demonstrate that the market for in-City ICAP is sufficiently competitive to preclude the exercise of market power via physical withholding, or that the market can be relied upon to keep prices at just and reasonable levels. Since the Commission's determination to remove revenue cap was based on what NYPSC considers the erroneous finding that pivotal suppliers cannot "affect the market price," NYPSC states that there is no basis for removing the revenue cap for pivotal suppliers. Accordingly, the NYPSC asserts that the Commission should reinstate the revenue caps for pivotal suppliers to ensure that prices are just and reasonable.

Commission Determination

54. As stated in the March 7, 2008 Order,³⁸ the Commission recognizes the possibility that suppliers may attempt to physically withhold capacity in an effort to affect market prices. We noted that NYISO had not proposed specific measures that could be used to distinguish when certain actions, such as de-rating or mothballing, might be legitimate economic decisions instead of attempts to withhold. The Commission required NYISO to address concerns with potential mechanisms for physical withholding—including premature retirement, mothballing, and de-rating—in its compliance filing. In addition, we directed NYISO's market monitor to monitor for physical withholding and promptly report any instances of withholding to the Commission's Office of Enforcement. As discussed in greater detail in section III of this order, NYISO's proposed market power mitigation proposals in its March 20, 2008 and May 6, 2008 filings are a just and reasonable response to our directive to develop a plan that addresses the potential for market power to be exercised by physical withholding. Therefore, while we understand the concerns of NYPSC regarding physical withholding, we find that NYISO has satisfactorily addressed these concerns, and thus we reject NYPSC's request for rehearing to reinstate the revenue cap for pivotal suppliers.

³⁷ *Citing Farmer Union Cent. Exchange, Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir. 1984).

³⁸ March 7, 2008 Order, 122 FERC ¶ 61,211 at P 50.

c. Reliability Must-Run Construct

55. Astoria argues that because NYISO has no reliability must-run payment construct, pivotal suppliers have no recourse under the Services Tariff if the market clearing price falls below the unit's going-forward costs but higher than NYISO's estimate of those costs. Astoria states that the pivotal supplier in this instance would be effectively held captive to the insufficient rate of recovery because any alternative action would result in massive penalties.

56. Astoria argues, therefore, that proposed section 4.5(f) of the Services Tariff should be revised to recognize that because the market clearing price is the result of a just and reasonable construct, a supplier's decision to retire or mothball a unit when the market clearing price is below the unit's going-forward costs is presumed to be economically rational. Astoria also requests that the Commission require NYISO to implement a reliability must-run payment construct for units needed for reliability. Astoria asserts that the Commission should determine the just and reasonable rate by which these units would be compensated.

Commission Determination

57. The Commission finds that Astoria's request to implement a reliability must-run construct falls outside the scope of this proceeding. Such a construct, in other markets, is used to compensate resources needed for reliability that seek to retire or when the Commission has made an explicit finding that the compensation in the capacity market is not just and reasonable. A mitigated supplier needed for reliability generally is not a retiring generator, and mitigation of market power is not a cause for retirement. If Astoria wants to pursue a backstop reliability must-run construct to compensate a generator that seeks to retire but is needed for reliability, it should do so through the NYISO stakeholder process.

58. Moreover, although we agree with Astoria that pivotal suppliers should not be held captive to insufficient rate recovery, we do not agree that lack of a reliability must-run contract or proposed section 4.5 (f) of the Services Tariff creates this risk for suppliers. The operation of NYISO's monthly in-City capacity auction does not require any unit to remain available if the market clearing price is less than a unit's going-forward costs. The process of establishing a market-clearing price for committed capacity does not result in a confiscatory rate; capacity resources are not required to remain available at a loss. There is no evidence that NYISO's proposal for mitigating market power in the in-City capacity market prohibits units that are not economic from retiring or mothballing, as appropriate. Accordingly, we deny rehearing on this issue.

3. Other Issues

a. Forward Capacity Market

59. NYISO did not propose a forward capacity auction, but stated that its proposed mitigation measures could easily be adapted to work with one, although a forward auction is not necessary to implement these mitigation measures. Several parties urged the Commission to implement a forward capacity design in the in-City market. Other parties argued that the stakeholder process should be allowed to continue to develop a forward capacity market, unfettered by timelines. The Commission determined that it would not order NYISO in this proceeding to put development of a forward capacity market on a priority track with any sort of specific timeline, but rather leave it to NYISO and its stakeholder to continue to consider the matter.

60. IPPNY requests that the Commission direct on rehearing that NYISO expeditiously develop a forward capacity market—informed by the market participant process—that augments the current demand curve structure with a compliance filing made within 180 days of the Commission’s order on rehearing. IPPNY states that a mandatory, non-discriminatory forward capacity market is required to foster the continued development of competitive markets in the state. By not establishing any deadline for the development of a forward capacity market in the March 7, 2008 Order, IPPNY contends that the Commission has failed to address long-term ICAP matters.

61. IPPNY argues that a forward capacity market will provide the predictable revenue streams necessary to attract new capacity and to meet reliability needs. IPPNY disagrees with the Commission’s characterization of a forward capacity market in the March 7, 2008 Order as a potential alternative method to address long-term capacity needs in New York City, and states that a forward capacity market is instead a necessary adjunct to the in-City market rules previously established in this proceeding.

Commission Determination

62. For the same reasons discussed in the March 7, 2008 Order,³⁹ the Commission will not require, or establish any sort of timeline for the development of a forward capacity market. As we found previously, NYISO’s proposed mitigation for the in-City ICAP market fully satisfies the objectives of this filing. We find unpersuasive IPPNY’s argument that a forward capacity market is necessary to satisfy the objectives of the instant filing. Matters related to the preferred attributes of a forward capacity market should be addressed in the on-going stakeholder process.

³⁹ *Id.* P 128-29.

b. Demand Curve Parameters

63. The ICAP Demand Curve, established for a three-year period, is based on the net CONE and the ICAP requirement. It sets a variable price cap for capacity depending on where the supply curve intersects the demand curve. NYISO proposed to retain the existing ICAP Demand Curve structure and asserted that the ICAP Demand Curves have been successful in producing more stable and predictable capacity auction prices, in providing proper market signals for new entry and existing capacity, in recognizing the reliability value of capacity in certain local areas and in reducing incentives for the exercise of market power. NYISO stated that it had recently filed the results of a comprehensive review process to update the ICAP Demand Curves and any issues related to the parameters of the in-City Demand Curve should be resolved in that docket.⁴⁰ The Commission agreed with NYISO.

64. KeySpan would like the Commission to reconsider the demand curve parameters. KeySpan reiterates its view that the Commission improperly ruled that demand curve parameters are beyond the scope of this proceeding, and that as a result, generators are exposed to risk that is neither accounted for in the demand curve nor in its bid. For example, capacity cleared in the auction will be providing a call option on energy and risking penalties, a risk factor that KeySpan notes is not accounted for by either the demand curve or by the calculation of going-forward costs. KeySpan further asserts that the failure to account for such risk is compounded by the inadequacy of the buy-side mitigation measures which still provide large buyers with the incentive and the ability to depress market clearing prices.

Commission Determination

65. The Commission denies rehearing. Although we agree that market clearing capacity prices should account for risk, we conclude that an appropriate risk premium has already been included in the Demand Curves as we previously noted in our March 7, 2008 Order.⁴¹ Reconsideration of Demand Curve parameters is beyond the scope of this filing.

⁴⁰ The Commission accepted NYISO's updated ICAP Demand Curves for the 2008/2009, 2009/2010, and 2010/2011 Capability Years in an order issued January 29, 2008. *New York Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,064 (2008), reh'g pending.

⁴¹ March 7, 2008 Order, 122 FERC ¶ 61,211 at P 83.

c. **Section 206 of the FPA**

66. NRG and KeySpan claim that the Commission failed to show that previous mitigation was producing rates that were not just and reasonable and that it did not establish that the new regime would produce just and reasonable rates. Specifically, KeySpan argues that the Commission erred by not making findings with respect to the clearing price impacts of the prior and newly-approved mitigation measures, and of the alternative proposals. NRG asserts that the Commission treated the NYISO proposal as if it were acting on a NYISO section 205 filing following approval through a stakeholder process, when, in fact, there was no stakeholder process here. NRG also argues that the Commission's decision departs from Commission precedent on forward capacity markets and the goal of increasing the use of demand response without explaining the basis for that departure. NRG further argues that it proposed a set of necessary modifications to NYISO's proposal and the Commission insufficiently explained its rejection of some of those modifications. Furthermore, after establishing a paper hearing, the Commission changed its stated goal and narrowed its focus to simply ascertaining whether the proposal improves what was already in place to mitigate market power.

Commission Determination

67. The Commission disagrees with NRG and KeySpan and finds that the instant proceeding is under section 205 of the FPA, and as such the Commission did not have a burden to find the existing market mitigation rules to be unjust and unreasonable. In its March 6, 2007 Order, the Commission instituted an investigation under section 206 of the FPA and also directed that a settlement judge be appointed. After settlement efforts failed, IPPNY requested paper hearing procedures. NYISO in response to IPPNY, submitted a filing on May 21, 2007, proposing, among other things, that the Commission "direct that, within 120 days of the Commission's order establishing paper hearing procedures, the New York ISO file a proposal for a revised in-City ICAP market."⁴² The Commission adopted this aspect of NYISO's proposal and directed NYISO in the July 6, 2007 Order to submit a proposal for a revised in-City ICAP market, stating that "we will adopt the New York ISO's proposed procedural schedule, with the exception that we will reduce to 90 days its proposed deadline for submitting its proposal to revise the in-City ICAP market."⁴³ Thus what began as an investigation under section 206 essentially changed to a voluntary section 205 filing by NYISO. The NYISO proposal, which was in narrative form, was the starting point for the Commission's determination in the March 7, 2008 Order. Consistent with the March 7, 2008 Order, NYISO then filed actual

⁴² NYISO May 21, 2007 Filing at 1.

⁴³ July 6, 2007 Order, 120 FERC ¶ 61,024 at P 1, 15.

tariff sheets on March 20, 2008 and May 6, 2008, under section 205 reflecting its proposal as modified to comply with the rulings of the Commission in its March 7, 2008 Order. Contrary to NRG and KeySpan's assertions, the Commission's obligation at that point was to review NYISO's proposal under section 205 to determine whether it was just and reasonable. The Commission reviewed that proposal, considered the arguments and evidence submitted in comments and protests, and determined that NYISO's proposal, with certain modifications, results in just and reasonable rates.

68. Alternatively, even if this proceeding is considered to be a section 206 proceeding, we find that the post divestiture market power mitigation measures applicable to all capacity sales from ConEd's divested units within the in-City market are unjust and unreasonable and that NYISO's proposal, with certain modifications, results in just and reasonable rates. Further, we find that the March 7, 2008 Order closes the investigation instituted in the March 6, 2007 Order.

69. In its December 12, 2006 filing⁴⁴ to modify market mitigation measures applicable to in-City generating units, NYISO stated that, with the entry of an additional 1,000 MW of capacity into the market in 2006, the in-City ICAP market had capacity in excess of the locational minimum requirement.⁴⁵ NYISO stated that, nevertheless, the clearing price remained at the cap of \$105/kW-year, the in-City ICAP market remained very concentrated, and each DGO remained a pivotal supplier. NYISO added that the market clearing price would be much lower if all capacity were offered as price takers. NYISO included in its filing an affidavit by Dr. David B. Patton, the Independent Market Advisor for NYISO, which stated:

The unsold capacity in question was not sold because the supplier offered the Capacity at a price that was higher than the Capacity Demand Curve price levels would have allowed the Capacity to clear. In particular, the DGO supplier offered the Capacity at the level of its offer cap, which exceeded \$12 per KW-month in the summer capability period. Had all capacity been sold, the price during the May 2006 auction would have cleared at less than \$6 per KW-month.⁴⁶

70. NYISO concluded that "under these circumstances, [we] deem[] it appropriate to submit the merits of additional mitigation embodied in a proposed Tariff amendment

⁴⁴ NYISO December 12, 2006 Filing, Docket No. ER07-360-000.

⁴⁵ *Id.* at 10.

⁴⁶ *Id.*, Attachment II at P 9.

developed through the NYISO governance process and approved by the Management Committee for consideration by the Commission.”⁴⁷

71. The Commission agrees with NYISO that additional mitigation is necessary. We believe that the mitigation measures approved in 1998, i.e., bid and revenue caps, must-offer requirements, and prohibitions on bilateral contracts and exporting, are no longer just and reasonable in light of the numerous market developments over the past decade.

72. Original bid caps that applied to DGO capacity were based on ConEd’s 1996 cost of service, not on what a unit would have offered if it operated in a competitive environment. However, in combination with the other mitigation measures approved at the time and the agreement with the NYPSC and ConEd that these measures would better ensure that the divestiture minimize the burden of stranded costs, we found the proposal to be just and reasonable. Since then, developments in New York’s electricity markets have altered the balance of interests existing in 1998.

73. In the intervening years, market concentration in New York City has remained very high and is unlikely to change in the near term. Initially, market power mitigation rules focused exclusively on seller market power and ignored the potential for LSEs to bid capacity they control in ways that distort market clearing prices. Second, NYISO has since adopted a capacity demand curve based on the cost of new entry, a mechanism updated to reflect changes in costs and technology every three years. Static bid and revenue caps that originally applied to the DGOs are inconsistent with the dynamic demand curve construct that effectively caps capacity prices in New York and is regularly adjusted for changes in costs and technology. Third, NYISO’s experience with the conduct and impact approach to market power mitigation in energy markets has provided a successful basis for developing a comparable approach to market power mitigation of capacity markets, one that is focused on supporting a competitive outcome and not on the stranded cost considerations of 1998.

74. Accordingly we find that the existing market mitigation rules are unjust and unreasonable, and that NYISO’s proposal, as modified in this order, is just and reasonable, and we deny rehearing on this issue.

III. NYISO’s Compliance Filings

A. Background

75. In the March 7, 2008 Order, the Commission conditionally approved NYISO’s mitigation proposal but directed NYISO to file tariff sheets within 60 days (1) addressing

⁴⁷ *Id.*

concerns with potential mechanisms for physical withholding, including premature retirement, mothballing, and derating; (2) addressing issues related to exports to neighboring markets; (3) specifying that mitigation of uneconomic entry applies only to net buyers bringing uneconomic capacity into the market; and (4) including all new uneconomic entry plus the portion of surplus capacity from previous investments that has not been absorbed by the market in calculating the length of mitigation.⁴⁸

76. NYISO made an initial compliance filing of tariff revisions for supplier mitigation on March 20, 2008. This filing, however, did not include buyer mitigation provisions to prevent uneconomic entry and included a continuation of the existing limitation on capacity exports from New York City pending further consideration by NYISO. On May 6, 2008 NYISO made a second filing containing the latter provisions to complete its compliance with the rulings of the March 7, 2008 Order.

1. March 20, 2008 Filing

77. On March 20, 2008, NYISO filed proposed revisions to its Services Tariff to implement mitigation of ICAP suppliers in the in-City market in partial compliance with the March 7, 2008 Order. NYISO states that its filing is limited to supplier mitigation measures because it is not necessary to implement buyer mitigation measures at this time. According to NYISO, since the March 7, 2008 Order did not apply buyer mitigation measures to existing generation, the buyer mitigation measures will not affect the in-City ICAP market until new in-City generation comes on line, which is not expected to occur this summer. NYISO addresses the net buyer mitigation portions of its proposal in the May 6, 2008 compliance filing.

78. In the March 20, 2008 filing, NYISO addresses physical withholding as it relates to mothballing, de-rating, and retirements. NYISO proposes to subject any proposal or decision by a market participant to retire, de-rate, or otherwise remove a resource from the in-City market to audit and review if the action will affect market clearing prices. NYISO proposes an audit and review process that will evaluate a proposal to determine if there is a legitimate economic justification for the action, or if it is an attempt to physically withhold capacity. NYISO proposes penalty provisions to be applied to suppliers that physically withhold.

79. In addition, NYISO addresses several issues relating to the determination of pivotal suppliers and when such suppliers have control over resources that may warrant

⁴⁸ As discussed *infra* P 15, the Commission accepted NYISO's March 20, 2008 filing to be effective on March 27, 2008, subject to refund and conditions, and subject to the issuance of further orders on the merits of the filing. The merits of the March 20, 2008 filing are the subject of the instant order.

mitigation. NYISO has revised the definition of “Control” for the purposes of the pivotal supplier test used in determining whether a capacity supplier will be subject to mitigation. The revised definition includes the retention of revenue or other financial benefits from Unforced Capacity, the offering rights to which have been conveyed to a third party.

2. May 6, 2008 Filing

80. In the May 6, 2008 filing, NYISO addresses buyer-side mitigation and physical withholding as it relates to exports and proposes a price test to evaluate whether an export constitutes physical withholding that would be subject to certain penalties. Among other things, NYISO also proposes to modify the definition of “going-forward costs” and proposes to redefine the term “Affiliated Entity” to include only entities that have connections to the NYISO capacity markets. Otherwise, it asserts, businesses such as banks and foreign companies could have been considered affiliates of in-City suppliers.

B. Notices of Filings and Procedural Matters

81. Notice of NYISO’s March 20, 2008 filing was published in the *Federal Register*, 73 Fed. Reg. 16,665 (2008), with interventions and protests due on or before April 10, 2008. Timely motions to intervene were filed by Dynegy Northeast Generation, Inc., and PSEG Power LLC and PSEG Energy Resources & Trade LLC. NYPSC filed a notice of intervention. KeySpan filed a motion to intervene out-of-time.

82. Notice of NYISO’s May 6, 2008 filing was published in the *Federal Register*, 73 Fed. Reg. 28,448 (2008), with interventions and protests due on or before May 27, 2008. Timely motions to intervene and comments were filed by Astoria, New York Transmission Owners (NY Transmission Owners), IPPNY, and NRG. NRG also filed supplemental comments. Reply comments were filed by KeySpan and NYISO.

83. Pursuant to Rule 214 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), the notice of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Pursuant to Rule 214(d) of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2008), the Commission will grant KeySpan’s late-filed motion to intervene given its interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay. Rule 213(a)(2) of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest or to an answer unless otherwise ordered by the decisional authority. We will accept KeySpan’s and NYISO’s reply comments because they have provided information that assisted us in our decision-making process.

C. March 20, 2008 Filing

1. Limitation of Uneconomic Entry Mitigation to Net Buyers

84. NYISO made a number of revisions to its tariff in response to the Commission's directive in the March 7, 2008 Order to limit the mitigation of uneconomic entry to net buyers. The Commission has granted rehearing on this issue⁴⁹ and thus, we reject those changes and direct NYISO to file revised tariff sheets that reinstate the original language.

2. Application of Mitigation to In-City Suppliers

a. NYISO's Proposal

85. In the March 20, 2008 filing, NYISO in Attachment H section 2.1 defines "mitigated UCAP" as "one or more megawatts of Unforced Capacity that are subject to Control by a Market Party that has been identified by the ISO as a Pivotal Supplier."

b. Protests

86. In the NY Transmission Owners' view, this definition of mitigated UCAP does not clearly limit the UCAP, to which these offer caps may be applied, to UCAP provided by resources in New York City. The NY Transmission Owners argue that the changes that NYISO has proposed should only apply to the mitigation of in-City ICAP suppliers and they request that the definition be modified to expressly state that the megawatts of UCAP are provided by resources within the New York City locality.

c. NYISO's Answer

87. NYISO states that the NY Transmission Owners ignore the fact that mitigation is limited to capacity subject to "Control," and "Control" is defined in terms of UCAP supplied "from an In-City Installed Capacity Supplier."⁵⁰

d. Commission Determination

88. The Commission disagrees with the NY Transmission Owners that the definition of "Mitigated UCAP" in the Services Tariff is not clearly limited to in-City suppliers and therefore could be construed to refer to suppliers in the rest of the New York Control Area. As NYISO points out in its Answer, mitigation is limited to capacity subject to

⁴⁹ *See supra* P 29.

⁵⁰ Services Tariff, Attachment H § 2.1 (definition of "Control"), Sixth Revised Sheet No. 467 (effective March 27, 2008).

“Control,” and “Control” is defined so as to eliminate UCAP from outside New York City. Thus, the NY Transmission Owners’ request to clarify NYISO’s tariff is unnecessary.

3. Definition of “Control” in Pivotal Supplier Test

a. NYISO’s Proposal

89. As part of its October 4, 2007 proposal, NYISO proposed to apply mitigation rules to “Pivotal Suppliers” defined by either ownership or control of ICAP resources. In the March 7, 2008 Order, the Commission rejected NYISO’s proposed two-part Pivotal Supplier test and required NYISO to file to revise its test to be based solely on “control” as explained in the order. Accordingly, the Commission rejected ownership of ICAP resources as a separate test of whether an entity is a “Pivotal Supplier” but clarified that ownership should be used to establish a rebuttable presumption of “control”. “Control” over ICAP, as clarified regarding ownership, was to be the determining factor. Citing Order No. 697,⁵¹ the Commission explained that “[o]ur guiding principle is that an entity controls the facilities when it controls the decision-making over sales of electric energy including discretion as to how and when power generated by the facilities will be sold.”⁵²

90. In the March 20, 2008 filing, NYISO proposes to define “Pivotal Supplier” in section 2.1 as follows:

For purposes of §4.5 of this Attachment H, “Pivotal Supplier” shall mean a Market Party that, together with any of its affiliates, Controls 500 MW or more of Unforced Capacity, and (b) Controls Unforced Capacity some portion of which is necessary to meet the New York City Locational Minimum Installed Capacity requirement in an ICAP Spot Market Auction.⁵³

⁵¹ *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252, *clarified*, 121 FERC ¶ 61,260 (2007), *order on reh’g*, Order No. 697-A, 73 Fed. Reg. 25,832 (May 7, 2008), FERC Stats. & Regs. ¶ 31,268 (2008).

⁵² March 7, 2008 Order, 122 FERC ¶ 61,211 at P 66, (quoting Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 176).

⁵³ See proposed Original Sheet No. 467.01, NYISO Electric Tariff, Original Volume No. 2, Attachment H.

91. NYISO states that it has complied with the Commission's directive to determine whether a supplier is pivotal on the basis of control over offers of capacity and that, in furtherance of that directive, it has revised the definition of "Control" in section 2.1 to read:

For purposes of §4.5 of this Attachment H, "Control" with respect to Unforced Capacity shall mean either (a) the ability to determine the quantity or price of offers to supply Unforced Capacity from an In-City Installed Capacity Supplier submitted into an ICAP Spot Market Auction, or (b) a right to revenue or other financial benefits from such Unforced Capacity.

92. NYISO explains that its proposed definition of "Control," in furtherance of the Commission directive, includes the retention of revenue or other financial benefits from UCAP, the offering rights to which have been conveyed to a third party. In support, NYISO states that a pivotal supplier "could readily use such a retention of rights to extend the benefits of withholding some or all of the Unforced Capacity for which it retains offering rights to the Unforced Capacity ostensibly conveyed to a third party."⁵⁴ As such, NYISO asserts that given the possible variations in contractual rights to capacity, it may be possible to attribute capacity to more than one market participant for purposes of a pivotal supplier determination.⁵⁵

93. NYISO also proposed a complex market rule in section 4.5(e) to define the rebuttable presumption of control due to ownership of ICAP. Of relevance to part (b) of the definition of "Control" in section 2.1, proposed section 4.5(e) provides that the presumption of control from ownership can be rebutted, *inter alia*, by conveying the ability to determine price or quantity of offers to supply ICAP if the conveyance is "without any right to revenues or other financial benefits from such Unforced Capacity that would enable the seller to benefit from an increase in the Market-Clearing Price in the New York City Locality."

⁵⁴ NYISO March 20, 2008 Filing at 6.

⁵⁵ In the May 6 filing, NYISO further refines its definition of affiliates used to determine pivotal suppliers that may exercise control over resources potentially subject to mitigation. NYISO proposes to redefine "Affiliated Entity" to include only entities that have connections to the NYISO capacity markets and thus exclude businesses such as banks and foreign companies that would have been considered affiliates of in-City suppliers.

b. Protests

94. In its protest, IPPNY⁵⁶ states that NYISO impermissibly has attempted to expand the definition of control in its March 20 Filing beyond that directed by the Commission to include a right to revenue or other financial benefits from such UCAP. IPPNY also claims that the definition's reference to "financial benefits" is unduly vague and could be interpreted to refer to a bank that holds a mortgage on a pivotal generating facility, for example. IPPNY also states that NYISO's definition also differs from the definition that NYISO itself supported in comments in response to the Notice of Proposed Rulemaking that led to Order No. 697, i.e., that the Commission's determination of control should be based on "(a) the levels of the bids from the plant, and (b) the level of output from the plant."⁵⁷ Accordingly, IPPNY asserts that the second part of NYISO's proposed definition of "Control" in the March 20 filing must be rejected.

95. Astoria states that NYISO's proposed definition of "control" incorporating the "right to revenues or other financial benefits" exceeds, without justification, the Commission's definition of "control" in Order No. 697 and may have the unintended effect of continuing the ban on bilateral contracting by pivotal suppliers. Astoria asserts that if a pivotal supplier controlling 1200 MW of ICAP enters into a bilateral contract in which it relinquishes control of over 700 MW of that capacity (so that it would be under the 500 MW mitigation threshold), but receives a "set" payment from the sale of the capacity, it would no longer have capacity market bidding control over the portion of its portfolio that it had sold. As such, it asserts, because its remaining, or unsold, portion of the resource is less than 500 MW, it should not be subject to the supplier-side mitigation measures. However, it claims that under NYISO's proposed definition, it would be subject to mitigation for the entire 1200 MW of capacity. It asserts that this effectively reinstates the proscription against bilateral contracts by capping the revenues the now-pivotal supplier could receive to the higher of the resources' going-forward costs or the default reference price. Accordingly, it asserts, financial interests should not be a determinative factor in the application of mitigation measures and the Commission should reject the second part of the proposed definition of "Control" in section 2.1.

c. NYISO Answer

96. In its Answer, NYISO states that IPPNY and Astoria do not acknowledge the potential for contracts or other financial arrangements to provide a ready means to evade a more limited "Control" standard. NYISO points out that KeySpan – an in-City supplier

⁵⁶ Astoria states that it agrees with IPPNY's arguments.

⁵⁷ IPPNY April 10, 2008 Protest at 5 (quoting Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 171).

– stated in a recent filing in a companion docket, with respect to mitigation measures for buyer market power in the in-City ICAP market:

The NYISO should be commended for identifying some of the ways in which the mitigation rules can be gamed to blunt their effectiveness. The NYISO has pointed out that buyers can bring uneconomic surplus capacity into the market without purchasing the capacity directly, as for example by entering into a “contract for differences” with a capacity supplier. NYISO Request for Clarification at 3-4. *There are likely numerous other “private contractual arrangements” that a buyer could enter into with a new capacity supplier or others to achieve the same result, and thus evade the buyer mitigation rules.*⁵⁸

97. NYISO states that nowhere do the suppliers recognize the potential for a similar range of contracts to be used to manipulate or evade the supplier mitigation measures. NYISO argues that such potential plainly exists, particularly given the minimum size test for being a pivotal supplier (i.e., below 500 megawatts). NYISO states that an otherwise pivotal supplier could enter into a contract that ostensibly transfers “control” over enough megawatts so that the supplier comes just below the threshold, but retains a right to revenues from those megawatts. NYISO states that the supplier could then evade mitigation, withhold all the retained megawatts, and realize the benefits of withholding from its rights in the other “transferred” megawatts.

98. NYISO also states that IPPNY and Astoria ignore the language in proposed section 4.5(e) providing that not just any financial interest will suffice to show “Control.” NYISO states that a supplier can show that it does not Control certain capacity if it can show that it has conveyed the ability to determine the price and quantity of offers for that capacity to an entity that is not an affiliate “without any right to revenues or other financial benefits from such Unforced Capacity that would enable the seller to benefit from an increase in the Market-Clearing Price in the New York City Locality.”⁵⁹ NYISO clarifies that if a supplier is a party to a contract that would not facilitate evading market power mitigation, then it will not be found to have retained “Control” over capacity subject to a bilateral contract. Furthermore, in its May 6 filing NYISO further clarifies

⁵⁸ NYISO April 25, 2008 answer at 10, (*citing New York Indep. Sys. Operator, Inc., Answer of KeySpan-Ravenswood, LLC to Motions for Clarification, Docket No. EL07-39-000, at 6 (April 11, 2008) (emphasis added by NYISO).*)

⁵⁹ *Quoting Services Tariff, Attachment H, Proposed § 4.5(e).*

that “Affiliated Entity” will apply only to those entities with connections to the NYISO capacity markets.

d. Commission Determination

99. We agree with protestors that NYISO’s proposed definition of “Control” contained in the March 20, 2008 filing, as revised in the May 6, 2008 filing, and its proposed rebuttable presumption rule in section 4.5(e) go beyond the directive of the March 7, 2008 Order as to defining “Control” for purposes of the pivotal supplier test. In the March 7, 2008 Order the Commission stated

[W]ith regard to the pivotal supplier test based on ownership or control, the Commission finds that it is appropriate for NYISO to determine pivotal suppliers based on control of capacity resources. As NYISO posits, and no protestors disagree, a supplier that accumulates control over enough capacity resources can have a significant impact on auction prices.⁶⁰

100. We cited Order No. 697 stating that “[o]ur guiding principle is that an entity controls the facilities when it controls the decision-making over sales of electric energy including discretion as to how and when power generated by the facilities will be sold.”⁶¹ We also noted that “the determination of control is appropriately based on a review of the totality of circumstances on a fact-specific basis.”⁶²

101. In broadening the definition of control to include the retention of revenue or other financial benefits from UCAP, NYISO goes beyond the scope of the Commission’s directive in the March 7, 2008 Order. As the Commission has stated in the past, compliance filings must be limited to the specific directives ordered by the Commission.⁶³ Therefore we accept proposed section 2.1(a) of Attachment H, but we reject proposed section 2.1(b) of Attachment H and the corresponding language in section 4.5(e) indicating that, in order to rebut a presumption of control, a person or entity must show that it is “without any right to revenues or other financial benefits from such Unforced Capacity that would enable the seller to benefit from an increase in the Market-Clearing Price in the New York City Locality.” We direct NYISO to file, within 30 days

⁶⁰ March 7, 2008 Order, 122 FERC ¶ 61,211, at P 66.

⁶¹ Order No. 697 at P 176.

⁶² *Id.*

⁶³ See *Niagara Mohawk Power Corp.*, 121 FERC ¶ 61,275, at P 38 (2007); *Reliant Energy Aurora LP*, 111 FERC ¶ 61,159, at 61,816 (2005).

of this order, revised tariff language in the definition of “Control” in section 2.1 and 4.5(e) of Attachment H to reflect the Commission directive.

4. NYISO’s Proposal Relating to Mothballing, De-Rating, and Retirement

a. NYISO’s Proposal

102. The March 7, 2008 Order required NYISO “to address concerns with other potential mechanisms for physical withholding, including premature retirement, mothballing, and de-rating.”⁶⁴ In response to this directive, NYISO’s March 20, 2008 filing proposes to establish a process and guidelines that it will use to evaluate whether decisions by a Market Participant to remove ICAP from the in-City market will be judged as an exercise of market power warranting mitigation.

103. The proposed tariff specifies that a decision by a Market Participant to remove capacity from the in-City Unforced Capacity market may be subject to audit and review by the ISO if such action would have a significant effect on market-clearing prices. A significant effect is defined as an increase in market-clearing prices in one or more ICAP Spot Market Auctions for the New York City Locality of five percent or more and at least \$.50/kilowatt-month.⁶⁵ If the ISO determines that the decision by the Market Participant constitutes physical withholding and the action has the specified price effect, mitigation will apply. NYISO proposes to impose a penalty for each violation in the amount of “up to 1.5 times the market clearing price in the ICAP Spot Market Auction for each month during which [ICAP] was withheld” times the total megawatts a supplier controls.⁶⁶

104. Because the critical measure for determining whether it is economically justified to remove capacity from the market is the unit’s going-forward costs, the tariff also specifies a process that Market Participants may use to identify, in advance, whether such removal would be judged as economic. The proposed tariff specifies that not later than 50 business days prior to the deadline for offers to sell Unforced Capacity in an ICAP auction, a Market Participant may request a consultation with the ISO to determine whether its going-forward costs justify taking its unit out of service. The ISO, with relevant cost support provided by the Market Participant, will determine the unit’s going-forward cost not later than seven days prior to the deadline for submitting offers to sell

⁶⁴ March 7, 2008 Order, 122 FERC ¶ 61,211 at P 51.

⁶⁵ Services Tariff, Attachment H, Proposed § 4.5 (f).

⁶⁶ *Id.*

Unforced Capacity in an ICAP auction.⁶⁷ If such capacity is not offered in the auction and causes or contributes to an increase in UCAP prices in the New York City Locality of five percent or more, and at least \$.50/kilowatt-month, mitigation as specified above will apply.

105. NYISO's tariff already allows for a dispute resolution process that may arise from the imposition of any tariff-authorized sanctions.⁶⁸ Thus, if a Market Participant does not agree with any conclusion reached by the ISO, payment of financial penalties may be withheld until the conclusion of any arbitration or dispute resolution process and any petition to the Commission for review.

b. Protests

106. IPPNY objects to NYISO's proposed ability both to summarily reject a unit's going-forward costs and to audit and review any supplier's decision to retire, mothball, or otherwise remove from service one or more of its generating units to determine if there is an economic justification for the decision or if the action constitutes physical withholding. IPPNY points out that a supplier could improperly be accused of physical withholding when its economic decision is based on a difference of opinion with the NYISO regarding the appropriate level of its going-forward costs.

107. IPPNY notes that under the proposed revisions, suppliers have no opportunity to be heard or offer their economic justification until after the penalties have begun to accrue, an unjust and unreasonable and legally infirm result under section 205(a). Astoria agrees, and argues that because NYISO has no reliability must-run payment construct, pivotal suppliers have no recourse under the Services Tariff if the market clearing price falls below the unit's going-forward costs but higher than NYISO's estimate of those costs. Astoria states that the pivotal supplier in this instance would effectively be held captive to the insufficient rate of recovery because any alternative action would result in massive penalties.

108. Astoria argues, therefore, that proposed section 4.5(f) of the Services Tariff should be revised to recognize that because the market clearing price is the result of a just and reasonable construct, a supplier's decision to retire or mothball when the market clearing price is below the unit's going-forward costs is presumed to be economically rational. Astoria also requests that the Commission require NYISO to implement a reliability must-run payment construct for units needed for reliability. Astoria asserts that the

⁶⁷ Services Tariff, Attachment H, Proposed § 4.5 (c).

⁶⁸ Services Tariff, Attachment H, § 4.3.5.

Commission should determine the just and reasonable rate by which these units would be compensated.

109. IPPNY argues that the problem is compounded because, at least as proposed by NYISO, the focus of its inquiry under section 4.5(f) of the Services Tariff will be on whether the supplier's action affects the market clearing price for capacity. IPPNY states that the retirement or mothballing of any capacity will have some effect on the market clearing price; thus, any decision by a pivotal supplier to retire or mothball one or more of its generating facilities will meet the standard for audit and review. Further, IPPNY argues that it is wholly unreasonable for suppliers to be forced to continue to operate their generating facilities at a loss and suffer substantial economic harm because NYISO disagrees with the suppliers' calculations of their going-forward costs. IPPNY states that it is equally unjust that, as drafted, these provisions would allow NYISO to assess penalties on proposals that have no direct and immediate impact on the capacity market and that, in and of themselves, cannot constitute withholding.

110. Astoria is also concerned that, as a pivotal supplier, the proposed tariff language could result in audit, review, and sanctions related to its considerations, decisions, and actions. Astoria argues that application of NYISO's proposed tariff amendments to proposals being considered by pivotal suppliers must be rejected. Astoria also disagrees with the physical withholding provision in proposed section 4.5(h) of the Services Tariff because of the provision's conflict with the requirements imposed by the New York Public Service Commission (NYPSC). Astoria points out that the NYPSC requires generators to provide 90 to 180 days advanced written notice of the retirement or mothballing of a unit, which allows the NYPSC to study the reliability impacts of the supplier's plan to retire or mothball and develop solutions to the needs identified. NRG⁶⁹ agrees, and states that if the Commission wants to preempt the NYPSC process already in place, it should do so with a proposal that has been fully vetted in the NYISO stakeholder process.

111. NRG notes the potential jurisdictional conflicts that could arise between the State of New York and the NYISO if the Commission does not reject the proposal. NRG explains that its own experience demonstrates that the State of New York may effectively direct a unit to retire for environmental reasons, while NYISO could tell the unit to continue operating or face severe penalties because (i) retirement may affect the NYISO capacity market; and (ii) the economics of the unit are such that there are legitimate economic reasons to continue operating.

⁶⁹ In its answer, KeySpan submits that it agrees with NRG's comments.

112. IPPNY, Astoria, and NRG argue that section 4.5(f) of the Services Tariff should be stricken in its entirety. NRG states that this section contains vague and uncertain standards by which NYISO would evaluate retirements. It states that due process requires clear tariff language on which market participants can base their actions, and that this section does not meet that standard.

113. NRG states that NYISO's focus on a "legitimate economic justification" raises practical issues as NRG (and other generators) attempt to retire aging units in New York City and replace those units with more efficient, cleaner burning generation. NRG notes that New York City is densely populated and highly developed with extremely limited opportunities for siting new generation, and that the best potential for adding new generation is the re-powering of older units on existing sites. NRG notes that to make room for the new units, the aging units must be retired and dismantled prior to the construction and commercial operation of the new units – even if those units would be deemed economic under the short-run horizon of going-forward costs as defined. NRG notes that NYISO would prevent retirement and dismantlement of the aging units because continued operation is economically justified. NRG argues that a temporary reduction in otherwise economic capacity should not be considered "an effort to withhold Installed Capacity physically in order to affect prices" particularly when (i) at the end of the process there would in most cases be more, not less, capacity available at these sites; and (ii) the units must be removed to make room for the new units. NRG states that, at the very least, the NYISO should permit such uneconomic retirements when there is a binding obligation to replace the units on a megawatt for megawatt basis.

114. IPPNY – in concert with Astoria – states that in order to ensure that suppliers receive a reasonable opportunity to be heard before any penalties are levied, and to ensure that suppliers have the ability to present their positions and arguments before an unbiased arbiter, the tariff provisions should incorporate a multi-step, expedited review process. IPPNY proposes that, concurrent with providing the requisite retirement notice to the NYPSC, a pivotal supplier should also provide its economic rationale to NYISO's MMU. If the MMU accepts that rationale, the inquiry ends; however, if the MMU disagrees with that rationale, it must provide its reasons in writing to the supplier. IPPNY further proposes that if the supplier then disputes the MMU's decision, it may submit the dispute to the NYISO's Dispute Resolution Administrator (DRA), as set forth in section 11 of NYISO's Services Tariff, for non-binding mediation or arbitration. IPPNY states that this process would permit a disinterested arbiter to evaluate the dispute over the level of going-forward costs and the economic rationale and render a decision before any penalties are imposed. IPPNY states that thereafter, a supplier that disagrees with the arbiter's decision would have the opportunity to invoke the Commission's assistance via alternative dispute resolution under Rule 604 (18 C.F.R. § 385.604) or arbitration under Rule 605 (18 C.F.R. § 385.605). Finally, IPPNY states that because any NYISO decision adverse to a generator may cause substantial economic damage to that

generator, NYISO should be obligated to make a filing under section 205 prior to restricting the generator's ability to retire or mothball its facility.

115. NRG notes that NYISO can interject itself into the retirement process at any time, even after the retirement has been properly noticed under the NYPSC procedures and is ready to be implemented. NRG explains that once NYISO intervenes, there is no timetable for completing its review and only vague standards to guide NYISO and the generator in the review. Finally, NRG points out that with NYISO's focus on the economic considerations, the unit could be required to operate indefinitely, until NYISO's economic requisites for retirement are met, while in PJM and ISO-New England, retirements are prevented only until system reliability issues are addressed.

116. NRG argues that if there is to be a process in NYISO separate and apart from the New York Public Service, then that process needs to be like the other ISOs in the region. NRG argues that the objective of the process should not be an isolated focus on "economics" but finding solutions that permit the retirement, such as transmission upgrades that alleviate any import restrictions or the entry by non-affiliates of the same amount of megawatts to be retired. Moreover, any such process should provide for the ability to obtain advanced clearance from the NYISO that the retirement can occur.

117. Finally, NRG protests the fact that NYISO would penalize suppliers for not offering mitigated capacity for any reason, including human or computer error. NRG argues that NYISO should be required to submit a default bid at the mitigated reference price on behalf of a supplier that fails to offer all of its capacity. NRG claims that this would be consistent with the treatment NYISO provides to load-serving entities.

118. The NY Transmission Owners state that in its filing, NYISO included provisions that could relax the offer cap that would apply to an ICAP Supplier that is considering retirement. The NY Transmission Owners state that the going-forward costs for such a resource would be permitted to include the costs that it would avoid as a result of retiring, and its ICAP offers would be permitted to be as high as its going-forward costs. The NY Transmission Owners point out, however, that the Services Tariff does not clearly state that the costs that would be avoided as a result of retiring should only be included in going-forward costs if a resource actually plans to retire if the ICAP revenues it receives are not sufficient to cover those costs, nor does it describe the actions that the NYISO would undertake if these expectations are not met—i.e., if a resource were to take advantage of this opportunity to relax its offer cap, but did not retire even though its offer was not accepted. The NY Transmission Owners state that, as a result, this could constitute a loophole in the NYISO's mitigation procedures that could facilitate economic withholding in the in-City ICAP market.

119. To clarify that these actions are contrary to the market rules, the NY Transmission Owners recommend that the NYISO's proposed section 4.5(c) of the Services Tariff be

modified by insertion of the following sentence: “The costs that an Installed Capacity Supplier would avoid as a result of retiring should only be included in its going-forward costs if that Installed Capacity Supplier actually plans to retire if the Installed Capacity revenues it receives are not sufficient to cover those costs.” In addition, while the NY Transmission Owners understand that the NYISO expects to refer such instances to the Commission’s Office of Enforcement, there is nothing in the NYISO’s proposed tariff language requiring it to do so, nor has the NYISO committed itself in writing to undertake such actions. Therefore, the NY Transmission Owners also request that the Commission direct the NYISO to refer to the Commission’s Office of Enforcement any instances in which: (1) a resource submits an offer that ordinarily would have exceeded its offer cap, but which did not exceed the offer cap because that cap was increased to include costs that resource would have avoided as a result of retiring; (2) its offer is not accepted; and (3) the resource does not retire.

c. NYISO’s Answer

120. NYISO states that the comments of Astoria, NRG, and IPPNY assume that NYISO will abuse its tariff authority to review and audit claims of going-forward costs associated with unit retirements in order to arbitrarily require units to stay in operation. NYISO states that it does not take lightly its responsibility to provide service in a nondiscriminatory manner and to administer its tariff provisions with impartiality towards all Market Participants.

121. NYISO notes that proposed section 4.5(f) of the Services Tariff states that an adverse determination in a retirement audit would require a finding that a retirement was “based on an effort to withhold Installed Capacity physically in order to affect prices;” more generally, section 2.4(a)(1) of the Services Tariff defines “physical withholding” as withdrawing a unit from a market “when it would be in the economic interest, absent market power, of the withholding entity to do so.”⁷⁰ NYISO states that NRG appears to have ignored the fact that NYISO may only assess a penalty for a retirement decision that meets these standards. NYISO states that there is no logic in NRG’s assumption that a decision to penalize a retirement based on state environmental requirements would meet the “effort to withhold” standard.

122. NYISO states that replacing an older, inefficient unit with a new, more efficient one would presumably be amply supported by the economics of the re-powered facility. NYISO points out that NRG advances no justification for its apparent assumption that the NYISO would act in bad faith when applying section 4.5(f). Moreover, NYISO states that NRG and the other suppliers ignore the fact that NYISO actions are subject to the

⁷⁰ Services Tariff, Attachment H, Proposed § 2.4(a)(1).

dispute resolution provisions of the tariff, and are always subject to review by complaint or other proceedings at the Commission.

123. NYISO states that protests that it would be instituting a review of unit retirements that would be duplicative of existing reviews are likewise unfounded. NYISO states that while the New York Public Service Commission does have a process for reviewing retirements, the purpose of that review is to study the reliability impacts of suppliers' retirement plans. NYISO states that the section 4.5(f) audit and review, by contrast, would focus on the "economic justification" for a retirement.

124. NYISO states that IPPNY's claim that the mere proposal by a supplier to retire or mothball a generating facility at a later date can constitute physical withholding is unfounded. NYISO points out that under proposed section 4.5(f) a penalty can only be imposed "for each month during which Installed Capacity was withheld."

125. NYISO states that contrary to the suppliers' suspicions, the ability to audit a "proposed" retirement was included to enable a supplier to have the benefit of NYISO's determination that the proposed retirement would not constitute physical withholding before the unit is retired. NYISO states that otherwise, suppliers that intended to retire a unit would have to actually take it out of service and face the risk that NYISO will conduct an after-the-fact review and, if appropriate, assess a charge for physical withholding. NYISO states that the provisions in the new tariff language for a market participant to request consultations on the level of its going-forward costs, or a review of retirement decisions in advance, address the professed concerns in the NRG comments that NYISO can interject itself into the process at any time. NYISO states that these provisions, which are similar to the provisions for the determination of energy reference levels, afford suppliers a substantial measure of control over the timing of the process for determining ICAP reference levels.

126. Regarding NRG's assertion that the instant filing contains a "new penalty provision" for failures to comply with the must-offer requirements for mitigated capacity, NYISO states that this charge is not new, as it has been applied in the past.⁷¹

127. NYISO further states that NRG protests assessment of a penalty not only on the capacity withheld but also on the other mitigated capacity in the pivotal supplier's portfolio of controlled capacity. NYISO points out that the purpose of withholding

⁷¹ NYISO April 25, 2008 answer at 11, (*citing Consolidated Edison Co. of N.Y., Inc., Request for Limited One-Time Waiver of Tariff Provision and Expedited Treatment of Consolidated Edison Company of New York, Inc., Docket No. ER08-45-000, at 4 (Oct. 10, 2007) (citing § 5.14.2 of the Services Tariff)*).

would be to benefit by a price increase on the capacity that was not withheld; accordingly, a withholding penalty cannot be limited to only the withheld capacity.

128. Regarding NRG and KeySpan's suggestion that NYISO implement a process that would automatically offer all capacity in a pivotal portfolio into the spot auction, NRG and KeySpan have not shown that a requirement that the NYISO automate the must-offer requirement, i.e., submit a default bid on behalf of a supplier that fails to offer all of its capacity, is warranted. Even if there is a potential for occasional bidding errors, NYISO states that the NRG undermines its own argument when it points out that in "the only known incident of a failure to bid capacity," the bidder was able to obtain a waiver of the penalty from the Commission.⁷²

129. Regarding the NY Transmission Owners' concerns about new tariff language governing going-forward costs, NYISO states that the new language in section 2.1 of the Services Tariff permits consideration of avoided costs for "either" (1) mothballing a unit or (2) retiring the unit, "as applicable." NYISO adds that section 4.5 (c) also requires a showing of "the cost that would be avoided if the Installed Capacity Supplier is taken out of service or retired, as applicable." NYISO states that it is less than clear what the NY Transmission Owners' proposed sentence would add, although it would do no harm if properly worded. NYISO proposed to revise the sentence to read: "The costs that an Installed Capacity Supplier would avoid as a result of retiring should only be included in its Going-forward costs if the owner or operator of that Installed Capacity Supplier actually plans to retire it if the Installed Capacity revenues it receives are not sufficient to cover those costs."

d. Commission Determination

130. We find that NYISO's market power mitigation proposal for pivotal sellers is a just and reasonable response to our earlier directive to develop a plan that recognizes the potential in capacity markets for market power to be exercised by physical withholding. The Commission will accept NYISO's proposed process for evaluating whether plans to retire, mothball, or de-rate generators constitute an exercise of market power and the corresponding proposed penalties as a reasonable mitigation measure to respond to such physical withholding. We agree with NYISO that the audit process would give suppliers the benefit of an up-front evaluation of decisions that could be interpreted as physical withholding and not subject them to an after-the-fact review. This, in our view, would serve to protect suppliers from mitigation based on a NYISO evaluation alone while

⁷² NRG April 15, 2008 Supplemental Protest at 5 (*citing Consolidated Edison Co. of N.Y., Inc.*, Docket No. ER08-45-000 (Nov. 7, 2007) (unpublished letter order granting tariff waiver)).

protecting customers from the potential market power of pivotal suppliers. We also agree with NYISO that any penalties levied should be applied to a supplier's entire capacity portfolio, not just to the amount withheld. Profitable physical withholding necessarily employs all a supplier's capacity portfolio, not just the amount of capacity withheld. As such, penalties must be applied to the capacity used in executing a withholding strategy, i.e., all of a supplier's capacity.

131. The Commission does not agree that revisions to NYISO's proposal are necessary to address concerns raised by the intervenors that the proposed process in various ways inappropriately substitutes NYISO's judgment for their own. For example, we agree with NYISO that there is little cause for owners to fear that the proposed audit would conclude that an old, inefficient unit should not be replaced with a more efficient re-powered facility, or that a retirement based on state environmental regulations should be penalized.

132. As IPPNY points out, however, economic assessments may differ. Nevertheless, generation owners that disagree with NYISO's initial review that a particular retirement, mothball, or de-rate decision constitutes economic withholding have a reasonable opportunity to resolve such differences through NYISO's dispute resolution process and ultimately through review by the Commission. We disagree with IPPNY's reading of the proposed Tariff language regarding whether the "mere proposal" to shut down a resource can constitute withholding and be subject to penalty. As NYISO points out in its Answer, penalties for physical withholding would not occur until a resource is actually taken out of service.

133. We find little merit in KeySpan's suggestion that NYISO implement a process that would automatically offer all of a supplier's capacity in the spot auction to avoid penalties for human or computer error. We agree with NYISO that given the historical low record of mistakes, an automated system is not warranted. In any event, mitigated suppliers that claim to have been penalized for human or computer error can request relief in the dispute resolution process or before the Commission.

134. The Commission agrees with NY Transmission Owners regarding its proposed revision to proposed section 4.5(c) of the Services Tariff. In its Answer, NYISO states that the NY Transmission Owners' proposed revision would do no harm if properly worded. The NY Transmission Owners' proposed revision, with NYISO's proposed edits, will clarify the market rules for all participants. Because the decision to retire a unit will invite scrutiny from the MMU and all affected market participants, it is especially important that a retirement-candidate resource understand the exact procedure it must follow in order to attempt to retire its capacity. NYISO is directed to include this revision in its compliance filing.

135. Regarding the NY Transmission Owners' request that the Commission direct NYISO to report any false retirement claims to the Office of Enforcement, NYISO notes

– and the Commission agrees – that the Commission’s as well as NYISO’s rules and policies already impose such an obligation.⁷³ NYISO states that it follows from the Tariff’s language that a claim of avoided costs premised on an intent to retire, when that was in fact not the case, would, absent compelling extenuation, be false or misleading. As such, we find it unnecessary to make any further revisions to the NYISO Services Tariff to recognize NYISO’s obligation to report false or misleading conduct to the Commission’s Office of Enforcement.

D. May 6, 2008 Filing

1. NYISO’s Proposal Relating to Exports

a. NYISO’s Proposal

136. In the March 7, 2008 Order the Commission deferred action on the appropriateness of including opportunity costs related to exports to neighboring markets—including PJM and ISO-New England – until NYISO fully addressed all issues relating to physical withholding and exporting.⁷⁴

137. In the May 6, 2008 filing, NYISO states that section 4.5(d) has been revised to recognize that capacity exports in response to legitimate price incentives further the overall economic efficiency of interconnected capacity markets and should be permitted,

⁷³ NYISO April 25, 2008 answer at 8 (citing 18 C.F.R. § 35.41(b) (providing that: “A Seller must provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, Commission-approved independent system operators, or jurisdictional transmission providers, to prevent such occurrences.”); *see also Market Monitoring Units in Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,267 (2005); NYISO Market Monitoring Plan § 11.3 (authorizing filings or other submissions to the Commission to address “a competition or efficiency problem”); *cf. Wholesale Competition in Regions with Organized Electric Markets*, Notice of Proposed Rulemaking, 73 Fed. Reg. 12,576 (March 7, 2008), FERC Stats. & Regs. ¶ 32,628 at P 191, 198 (2008) (identifying as an “existing function” of Market Monitoring Units “identifying and notifying the Commission staff of instances in which a market participant’s behavior may require investigation,” and proposing continuation of this function, including reporting to the Office of Enforcement “suspected rule or tariff violations, market manipulations, inappropriate dispatch, and suspected violations of Commission-approved rules and regulations.”)

⁷⁴ March 7, 2008 Order, 122 FERC ¶ 61,211 at P 78.

but that exports can also be a means for a pivotal supplier to physically withhold capacity from New York City. NYISO proposes to accommodate these divergent concerns, by revising section 4.5(d) of the Services Tariff that governs exports of the in-City capacity to permit exports, but to subject an exporting supplier to a penalty if an audit shows that the export fails a specified price test. NYISO states that the approach is similar to the mitigation of physical withholding in New York energy markets that has been in place for some time.

138. Currently section 4.5(d) requires that Mitigated UCAP be offered in each ICAP Spot Market Auction and not be exported to an external control area or sold to meet ICAP requirements outside the New York City Locality unless the New York City Locational Minimum UCAP requirement has been met. NYISO proposes to exempt from the requirement transactions that do not constitute physical withholding under the standards specified in section 4.5(d)(i) which states

(i) An export to an External Control Area or sale to meet an Installed Capacity requirement outside the New York City Locality of Mitigated UCAP (either of the foregoing being referred to as “External Sale UCAP”) may be subject to audit and review by the ISO to assess whether such action constituted physical withholding of UCAP from the New York City Locality. External Sale UCAP shall be deemed to have been physically withheld if the price, net of costs that would not have been incurred but for the export or sale of External Sale UCAP, in the shortest term organized capacity market for the area in which the Mitigated UCAP has been exported or sold that is most proximate in time to an ICAP Spot Market Auction for the New York City Locality in which the External Sale UCAP was not sold, when adjusted to a comparable basis is five percent or more below the price, net of any costs that would have been incurred because of the comparable internal sale, in such ICAP Spot Market Auction.⁷⁵

139. NYISO also proposes revisions to section 4.5(d)(ii) to provide that the failure to offer Mitigated UCAP or to meet the exemption triggers a penalty only if it causes or contributes to an increase in UCAP prices in the New York City Locality of five percent or more and such increase is at least \$.50/kilowatt-month.

140. The critical elements of the proposed mitigation are: (1) a determination of the relevant time period and market for comparison with the NYISO’s ICAP market; (2) the threshold by which price differences in the two markets would not be further evaluated for their impact on NYISO ICAP prices; (3) the degree to which the export may affect

⁷⁵ Services Tariff, Attachment H, Proposed § 4.5(d)(i).

NYISO ICAP prices before triggering the mitigation; and (4) the magnitude of the penalties imposed if NYISO's analysis concludes that the export was an exercise of market power.

141. NYISO's tariff defines the relevant market for comparison to be "the shortest term organized capacity market for the area in which the Mitigated UCAP has been exported or sold that is most proximate in time to an ICAP Spot Market auction for the New York City Locality in which the External Sale UCAP was not sold."⁷⁶ NYISO states that an entity could enter into a capacity sale in an external forward capacity market for a longer term than the periods covered by the NYISO's capacity auctions. According to NYISO, such a seller could and should buy out of such a forward position if the price in the shortest-term auction, such as a reconfiguration auction, in the external market is below the contemporaneous New York ICAP Spot Market Auction price. Thus, NYISO states, the price test focuses on the shortest-term organized capacity market in the external area that is most proximate in time to a New York spot market auction in which the Pivotal Supplier capacity was not offered. NYISO adds that appropriate adjustments to the external price may be necessary to account for differences in the requirements for selling capacity in the two markets, so that prices can be analyzed on a comparable basis. NYISO concludes that if a Pivotal Supplier has the ability but does not respond to the New York spot prices that are higher by the specified bandwidth than the comparable prices in the relevant external short-term auction, then a conclusion of physical withholding would be appropriate.

142. The relevant price threshold is set at five percent or more and the relevant price impact must be at least an increase of \$.50/kilowatt-month. The proposed penalty is

1.5 times the Market-Clearing Price for the New York City Locality in the ICAP Spot Market Auction in which the Unforced Capacity was not offered time the total of (1) the amount of Mitigated UCAP not offered or sold as specified above, and (2) all other megawatts of Unforced Capacity under common Control with such Mitigated UCAP.⁷⁷

143. NYISO also proposes language that would inform NYISO of any exports by market participants in the in-City market in order to properly monitor for the possible use of exports as a means of engaging in physical withholding. Under NYISO's proposal, market participants would be required to fill in specified information in NYISO's ICAP Automated Market System (AMS). NYISO states that in most instances, this information

⁷⁶ *Id.*

⁷⁷ Services Tariff, Attachment H, Proposed § 4.5(d)(ii).

is currently being provided in the AMS for capacity in the Rest of State that is being exported, but the proposed language clarifies that providing this information is mandatory for all capacity exports, including exports by market participants that are not otherwise participating in an ICAP Spot Market Auction.

144. Regarding the calculation and definition of going-forward costs, NYISO clarifies that “the definition appropriately provides for export opportunity costs as an alternative measure of [going-forward costs] to the avoided costs of mothballing or retiring a generator.”⁷⁸ NYISO states that any opportunity costs related to exports would not be additive to any costs that would be avoided by removing a unit from service. As noted above, NYISO would subject exports to the same scrutiny and penalties as other possible means of physical withholding, as detailed in proposed Attachment H, section 4.5 of the Services Tariff.

b. Protests

145. Various parties protest the four aspects of NYISO’s proposed treatment of exports as contained in its May 6, 2008 filing. Astoria and IPPNY argue that the proposed export test fails to adequately account for differences between NYISO’s and the adjoining regions’ capacity market rules and the timing of auctions in each region. Astoria and IPPNY, both citing consultant Mr. Younger, state that there are significant structural differences between NYISO’s monthly capacity markets and the forward capacity markets in neighboring regions that are not adequately accounted for in the proposed export test. They state that because of these differences, an in-City supplier may be evaluating whether to export capacity based on its forecast of market prices as much as approximately three years in the future, while in the NYISO proposal the determination of whether the in-City supplier has engaged in physical withholding will not be based on these forecasts, but, rather, it is based on the actual market clearing prices effective three years hence. Astoria argues that if the in-City supplier’s forecasts prove to be inaccurate, it is at risk of draconian penalties. Further, Astoria states that, according to Mr. Younger, NYISO’s proposal to buy out of positions to avoid incurring penalties is not, in practice, likely to be a viable alternative.

146. Astoria also argues that NYISO’s proposal to base the comparison on the neighboring regions’ auctions that most closely compare to the in-City monthly spot auctions exacerbates the flaws in the approach. Astoria states that in the neighboring regions, the shortest term auctions occur four months in advance of the commitment period, are for one-year terms, primarily address balancing issues, and are thinly traded; in New York, on the other hand, the Spot Market Auctions occur just before the

⁷⁸ NYISO March 20, 2008 Filing at 6.

commitment period, are only for one month terms, are a primary means of acquiring capacity, and are robust. Both Astoria and IPPNY conclude that, given these differences, the prices produced from these two types of auctions are not directly comparable and further, such a comparison does not take into account the value of the certainty obtained by in-City suppliers from locking in capacity prices as assured revenue streams on as much as a three-year forward basis for a year at a time.

147. The parties complain that the proposed five percent threshold and \$.50/kilowatt-month price effect are too stringent and will impede efficient exports. IPPNY and Astoria's consultant, Mr. Younger, states that the current NYISO UCAP Demand Curve for New York City has a value of \$14.35/kW-month at the minimum requirement and a slope of -0.89/kW-month for each 100 MW that the UCAP in the market exceeds the minimum requirement. Consequently, according to Mr. Younger, the \$.50/kW-month "impact" threshold that will be in effect for most of the points on the New York City Demand Curve requires only a 56 MW change in total New York City UCAP to exceed the threshold and incur penalties. Mr. Younger further states that even at the minimum capacity requirement for New York City, the five percent threshold translates to only \$0.72/kW-month or the equivalent of an 80 MW change in total New York City UCAP to exceed this threshold. Mr. Younger adds that, as evidenced by NYISO's own calculations earlier this year, it is unreasonable to expect that an in-City supplier, determining whether it is economic to export capacity, could forecast the total New York City capacity level to such a fine degree.

148. Mr. Younger cites as an example, on March 26, 2007 NYISO's preliminary estimate of the New York City Default Reference Price for May was a bid cap of \$6.37/kW-month,⁷⁹ while just one month later when NYISO provided the actual figure for May, it had dropped to \$5.36/kW-month. Mr. Younger contends that this change in price would have exceeded NYISO's proposed thresholds for its export test. According to Mr. Younger, most of the drop in the New York City Default Reference Price was the result of changes in the registered levels of SCRs for May. Astoria states that the decision of SCRs whether to participate in the New York City monthly market could cause the New York City capacity prices to change significantly, rendering a decision that seems reasonable and economically justified in one month to be considered uneconomic the next month, because every 100 MW of capacity currently moves the clearing price by \$0.89/kW-month.

⁷⁹ During the March 26, 2007 Installed Capacity Working Group meeting NYISO provided a preliminary estimate of the New York City Default Reference Price that is used when determining the UCAP bid cap for in-City suppliers.

149. Mr. Younger also states that NYISO will perform its export test on a monthly basis but under the PJM market rules, the in-City supplier will have an annual obligation. Thus, according to Mr. Younger, the in-City supplier could make a sale that passes the export test when the year is considered as a whole but would incur significant penalties for some months because of fluctuations in the New York City capacity resource levels that are likely to be unrelated to the in-City supplier's own decision.

150. The parties also complain that the penalties are exorbitant and not commensurate with the harm caused or with the benefit gained by withholding. Mr. Younger provides an example in which the New York City UCAP clearing price for the May Spot Market Auction was \$5.53k/W-month. He states that if an in-City supplier had sold 100MW into a neighboring market and NYISO determined that the sale was not consistent with competitive outcomes, NYISO would estimate that the New York City clearing price in the absence of the sale would have been \$4.64/kW-month. He states that, under the proposal, the penalty for the sale would be the seller's entire portfolio times the May Spot Market Auction clearing price, or, for an in-City supplier with a 500 MW UCAP portfolio, \$2.77 million per month. Mr. Younger adds that unless the in-City supplier was able to find a counterparty with which to enter into a bilateral transaction, the in-City supplier would be unable to reverse its capacity position in PJM by the time NYISO determined that a penalty was appropriate and penalties could accumulate for the rest of the summer and most likely for the winter as well.

151. Astoria acknowledges the need for rules to determine whether an in-City supplier's exports of capacity are consistent with competitive outcomes or constitute physical withholding, but the rules must take into account the significant differences between the regional capacity markets, account for natural market fluctuations and not create impediments to the maturation of inter-regional competitive markets. IPPNY and Astoria support three modifications to NYISO's proposed export test: (i) implement an *ex ante* consultation and determination process; (ii) expand the threshold levels to the greater of \$2/kW-month or 15 percent and apply the correct price comparison points; and (iii) revise the penalty structure. They propose that the penalty structure be based on 1.5 times the lesser of (i) the difference between the clearing prices in the NYC Spot Market Auction with and without the export; or (ii) the difference between the NYC Spot Market Auction clearing price and the neighboring region's adjusted clearing price. This difference would then be multiplied by the in-City supplier's residual New York City portfolio.

152. NRG makes a similar argument to Astoria regarding the differences among the markets and states that no market participant will be able to enter into a forward commitment under such conditions. Like Astoria and IPPNY, NRG also asks the Commission to direct NYISO to develop a process comparable to that for new entry for pre-determining whether exports should be subject to mitigation. It further requests that the penalty provisions be more closely tied to the harm caused and that NYISO review

imports from neighboring markets to make sure that they are not inappropriately depressing prices in New York.

153. KeySpan responds that because exports are not viable at present, the Commission should defer consideration of any mitigation proposal and direct NYISO to evaluate export-related rules in a stakeholder process.

c. NYISO's Answer

154. NYISO answers the protests to its export proposal by noting that the suppliers have misunderstood the proposal. NYISO states that, contrary to the suppliers' assertions, no part of NYISO's proposal for mitigation of capacity exports from New York City turns on comparing three-year forecasts of forward prices in an external market with spot market prices in New York City, and subjecting suppliers to "draconian penalties" by second-guessing three-year projections long after the fact. Rather, according to NYISO, mitigation turns on a supplier's conduct in the shortest term, organized external market that is closest in time to an in-City auction in which exported capacity was not offered, and correspondingly, a supplier would not be subject to mitigation because of a decision to sell capacity into a three-year forward external market. NYISO states that the language in proposed section 4.5(d)(i) of Attachment H clearly provides that the price test focuses on the shortest-term organized capacity market in the external area that is most proximate in time to a New York spot market auction in which the Pivotal Supplier has the ability but does not respond to New York spot prices that are higher by the specified bandwidth than the comparable prices in the relevant external short-term auction, then a conclusion of physical withholding would be appropriate. NYISO adds that if capacity is available in a short term external market at a price below the in-City spot auction price, there is no economic justification for a Pivotal Supplier not to take advantage of the lower-priced capacity to satisfy its external obligations, unless the Pivotal Supplier were seeking to use its market power to raise capacity prices in New York City.

155. NYISO also argues that a substantially higher threshold such as that proposed by Mr. Younger, i.e., the greater of \$2/kW-month or 15 percent, would allow each Pivotal Supplier to withhold as much as 220 megawatts from New York City with impunity.

156. NYISO also disagrees with Astoria and its witness Mr. Younger that the proposed penalties for withholding are excessive. NYISO states that it does not believe that it would be reasonable both to lower the penalty and significantly raise the price effects threshold to the levels advocated by Astoria and Mr. Younger; however, it may be reasonable to consider initially adopting a lower penalty level, with an option for NYISO to return to the Commission to seek a higher level if the deterrent is not sufficient.

157. NYISO argues that the suppliers' assertion that an *ex ante* consultation process is required for comparable treatment of buyers and sellers is based on the false premise that

mitigation of exports turns on a decision to sell into a three-year-forward market. To the contrary, according to NYISO, it turns on a decision not to buy in the shortest term external market closest in time to a New York City spot auction.

158. Finally, NYISO agrees with KeySpan that exports are not viable at this time and that this presents an opportunity for further stakeholder process, but it maintains that the protests do not show that its proposal should be changed.

d. Commission Determination

159. We agree that the RTO markets would benefit from the ability of capacity suppliers to be able to export their capacity to higher-priced neighboring markets. We also agree with NYISO that uneconomic exports (i.e., exports into markets with lower prices than the in-City capacity market price) are one means for pivotal suppliers to withhold from the in-City capacity market. And thus, we agree that it is important to establish a reasonable mechanism to deter uneconomic exports, while avoiding mechanisms that discourage efficient exports. We do not agree that NYISO's proposal for deterring uneconomic exports is reasonable.

160. NYISO proposes to compare the price in the external market "that is most proximate in time" to the New York City market auction. The capacity markets of NYISO's nearest neighbors, PJM and ISO-New England, require suppliers to commit their capacity for an entire year, while NYISO's market establishes only a 1-month commitment. Given that the market value for capacity generally varies over the year, it is not reasonable to compare the price for an annual product in PJM or ISO-New England with a monthly product in New York City.

161. An additional problem with the NYISO proposal stems from the fact that the final reconfiguration or incremental auctions nearest to the delivery year in PJM and ISO-New England are held months prior to the delivery year. This problem exists despite NYISO's clarification that it is not proposing to examine prices in the 3-year-forward auctions held by PJM and ISO-New England in its price comparison with New York City prices. For example, the final incremental auction in PJM is held four months prior to the beginning of the delivery year. The 12 monthly New York City capacity prices for the comparable PJM delivery year would not be known until several months after the conclusion of the final PJM incremental auction. Thus, an in-City supplier would not know at the time of the PJM incremental auction the price at which it could acceptably sell capacity into (or buy back capacity from) the final PJM incremental auction. Under the NYISO proposal, the in-City supplier would need to forecast New York City prices for the entire period corresponding to the PJM delivery year, the last month of which is 16 months after the conclusion of the final PJM incremental auction. And if the supplier's forecast is inaccurate by as little as 5 percent, NYISO proposes to conclude that the supplier is physically withholding. Forecasting is inherently fraught with uncertainty. NYISO has

not established that a 5 percent threshold is reasonable, given the variability of capacity prices over time. For example, as Astoria's expert, Mr. Younger, noted, NYISO's own estimate of the New York City Default Reference Price for May 2007 made in late March of 2007 turned out to be about \$1/kW-month (or about 15 percent) different from the actual Reference Price about a month later. We conclude that Mr. Younger's proposal to apply a higher threshold – the greater of \$2/kW-month and 15 percent – is reasonable. Accordingly, we direct NYISO to file, within 30 days of issuance of this order, a further compliance filing that revises its penalty threshold to indicate a threshold of the greater of \$2/kW-month and 15 percent.

162. In addition, as noted above, we conclude that it is not reasonable to compare the price for an annual product with the price of the New York monthly product. One way to make the comparison reasonable would be to compare (i) the net revenue that could have been received from the New York City market over the comparable period for which the supplier's capacity was committed in the export market with (ii) the net revenue that was actually received in the export market during that period. For example, if a supplier has sold its capacity for a 12-month term into the PJM capacity market, the net price per kW received in PJM's market could reasonably be compared with the net revenue per kW that the supplier would have received over the same 12 months in the in-City capacity market. Accordingly, we direct NYISO to file, in the compliance filing directed above, revisions to its tariff consistent with the discussion in this paragraph.

163. We agree with protestors that NYISO's proposed penalty for physical withholding is excessive, although we agree with NYISO that a sufficient deterrent to uneconomic exports is necessary to prevent the exercise of market power. Ordinarily, a reasonable and effective penalty would both remove the entirety of the financial benefit from withholding and apply a significant additional charge to deter future withholding, as Mr. Younger suggests. The profit from withholding can be measured based on the *difference* in the clearing prices of the New York City spot market auction with and without the export. But NYISO's proposed penalty appears to go far beyond this amount. It is based on a percentage above the *full* clearing price in the New York City spot market auction. Thus, NYISO's proposed penalty would be substantially higher than the entire capacity revenue that the supplier received from the New York City and external capacity markets. Such a penalty appears to be far more than is necessary to discourage withholding. In its Answer, NYISO suggests that it may be reasonable to consider initially adopting a lower penalty level with an option for NYISO to seek from the Commission a higher level if the deterrent is not sufficient. We think that NYISO's suggestion is the best course here. Accordingly, we direct NYISO in its compliance filing, to revise the penalty for physical withholding related to uneconomic exports so that it is 1.5 times the smaller of (i) the difference between the clearing prices in the New York City Spot Market Auction with and without the export and (ii) the difference between the New York City Spot Market Auction clearing price and the external region clearing price. However, in light of the importance of maintaining a sufficient deterrent to uneconomic exports, our direction is

without prejudice to a future filing by NYISO seeking a higher penalty in the event that the penalty accepted here is found to be an insufficient deterrent.

164. Finally, we agree with protesters that NYISO should institute an *ex ante* approval process for exports. Similar provisions are allowed for sellers who wish to retire as well as for new entrants who wish to enter the market with a guarantee of not being considered uneconomic. The process for exports should be treated comparably. Thus, we direct NYISO, in its compliance filing directed above, to develop a process, similar to the one above for retirement, that will allow a generator to submit a request to NYISO for a determination of whether its export is uneconomic, and therefore physical withholding.

165. For the reasons discussed above, we conclude that certain specifics of NYISO's proposal for identifying and penalizing physical withholding associated with uneconomic exports are not reasonable. Accordingly, we accept NYISO's proposal with the condition that NYISO file, within 30 days from the issuance of this order, a compliance filing as directed above.

The Commission orders:

(A) The requests for clarification or rehearing of the March 7, 2008 Order are hereby granted in part and denied in part, as discussed in the body of this order.

(B) NYISO's compliance filing of March 20, 2008 is hereby accepted, subject to condition, effective March 27, 2008, as discussed in the body of this order.

(C) NYISO's compliance filing of May 6, 2008 is hereby accepted, subject to condition, effective November 1, 2008, as discussed in the body of this order.

(D) NYISO is hereby directed to file tariff sheets containing revised market rules reflecting the above-accepted changes within 30 days of the issuance of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.