



# **Escalation Factor and Inflation Rate in Buyer-Side Mitigation Rules: Review and Proposals**

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# Agenda

- **Background**
  - *Recap and stakeholder input on previous presentations*
  - *Today's objective*
- **Proposal overview**
- **Next steps**
- **Review of draft tariff revisions posted in separate PDF**

# Recap of Presentations and Input during 10/7/2016, 1/27/17 and 3/8/2017 ICAPWG

- The NYISO proposed several alternatives to current BSM rules for how to apply escalation and inflation in order to solicit input from stakeholders. Input received included the following:
  - *Inflation adjustments should be applied consistently to all parts of the BSM tests*
  - *Historical data used in Demand Curve escalation factor calculation may not represent the long-term trend*
  - *Historic measures of inflation should not be used to forecast inflation - forecasted inflation is the better measure and should be used*

# Today's Objective

- **Proposal Overview**
  - *Discuss NYISO's proposal on how to apply inflation adjustments in BSM determinations*
  - *Discuss NYISO's revised proposal on how to make adjustments to non-exempt facilities' Offer Floors at the time of and after entry*
- **Tariff language**

# Current BSM Processes That Use the Escalation Factor and Inflation Rate

- **Examined Facility Unit Net CONE – MST Att. H 23.4.5.7.2 and 23.4.5.7.6**
  - *As part of the Part B test, current provisions specify that the NYISO is to use the most recent Demand Curve “inflation rate” to identify Unit Net CONE for a Mitigation Study Period (“MSP”)*
- **ICAP Spot Market Auction clearing price forecast – MST Att. H 23.4.5.7.2**
  - *As part of the ICAP forecast, current provisions specify the NYISO is to use the most recent Demand Curve “escalation factor” to project ICAP Spot Market Auction clearing prices for a MSP*

# NYISO's Proposal for Inflation in BSM Determinations

Use the most recently published ten year projections for inflation from the Survey of Professional Forecasters (or if no longer available, a similar suitable source) to identify:

- Examined Facility Unit Net CONE projected for a MSP, and
- The price on the ICAP Demand Curve projected for a MSP
  - *Provides consistency between BSM tests*
  - *Removes more volatile and harder to predict cost data (i.e., turbine, materials, labor) used in Demand Curve escalation factor*
  - *Provides a transparent and reasonable forecast for future inflation expectations*
  - *Requires tariff change*
- This is the same proposal made in response to stakeholder input at the 3/8/2017 ICAPWG
- The following slides provide an example were NYISO to be making BSM determinations in Q-1 2017



# Survey of Professional Forecasters Long-Run Projections for Inflation – Q1 2017\*

Median Short-Run and Long-Run Projections for Inflation (Annualized Percentage Points)								
	Headline CPI		Core CPI		Headline PCE		Core PCE	
	Previous	Current	Previous	Current	Previous	Current	Previous	Current
<i>Quarterly</i>								
2017:Q1	2.2	2.5	2.2	2.4	1.8	2.0	1.8	1.8
2017:Q2	2.2	2.3	2.2	2.2	1.9	2.0	1.8	1.9
2017:Q3	2.2	2.3	2.2	2.1	1.9	2.0	1.9	1.9
2017:Q4	2.2	2.5	2.2	2.2	2.0	2.1	1.9	1.9
2018:Q1	N.A.	2.4	N.A.	2.3	N.A.	2.1	N.A.	2.0
<i>Q4/Q4 Annual Averages</i>								
2017	2.2	2.4	2.2	2.2	1.9	2.0	1.9	1.9
2018	2.2	2.3	2.2	2.3	2.0	2.0	1.9	2.0
2019	N.A.	2.3	N.A.	2.2	N.A.	2.0	N.A.	2.0
<i>Long-Term Annual Averages</i>								
2016-2020	2.13	N.A.	N.A.	N.A.	1.90	N.A.	N.A.	N.A.
2017-2021	N.A.	2.30	N.A.	N.A.	N.A.	2.03	N.A.	N.A.
2016-2025	2.22	N.A.	N.A.	N.A.	2.00	N.A.	N.A.	N.A.
2017-2026	N.A.	2.30	N.A.	N.A.	N.A.	2.10	N.A.	N.A.

\* <https://www.phil.frb.org/research-and-data/real-time-center/survey-of-professional-forecasters/2017/survq117>

# Survey of Professional Forecasters Long-Run Projections for Inflation – Q1 2017 cont'd

- **Headline inflation includes all aspects within an economy that experiences inflation. Core inflation removes components that can exhibit large amounts of volatility from month to month**
- **Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) are the two common measures for inflation**
- **The NYISO would take the average of the expected long-term annual averages for Headline CPI and Headline PCE inflation over the next 10 years**
  - *For Example, if Headline CPI = 2.30% and Headline PCE = 2.10% then the NYISO would use the average = 2.20%*



# Current Provisions for Adjusting New Entrants' Offer Floors to Year of Entry Dollars

- Non-exempt facilities that enter into service prior to, or after, the first Capability Year of the MSP have their Offer Floors adjusted to their Capability Year of entry – *MST Att. H 23.4.5.7.3.7*
  - *The NYISO had not initially proposed a change to this provision, but is now doing so in response to stakeholder input*

# NYISO's Proposal for Adjusting New Entrants' Offer Floors to Year of Entry Dollars

- 1) If a unit enters into service prior to the first Capability Year of the MSP the NYISO will use the same long-run projection for inflation that has been proposed on slide 6\* to deflate the entrants' Offer Floor
  - *Provides consistency between BSM tests (i.e., same value used during BSM determinations)*
  - *Uses forecasted inflation to reasonably predict what future inflation would be*
  - *Tariff change required*

*\* Same Long-run projection for inflation from the Survey of Professional Forecasters (or if no longer available, a similar suitable source) that was used at the time of determination*

# **NYISO's Proposal for Adjusting New Entrants' Offer Floors to Year of Entry Dollars cont'd**

**2) If a unit enters into service after the first Capability Year of the MSP the NYISO will adjust its Offer Floor using the relevant published Demand Curve inflation rate(s) that would have been used to make annual adjustment(s) had the unit entered into service in the first Capability Year of the MSP**

- *Maintains assumed general inflation rate from effective Demand Curve escalation factor*
- *Provides consistency with the Demand Curve annual updates*

# Examples: Adjusting Offer Floors to Year of Entry Dollars

- Assume a Class Year 2017 generator is determined to have an Offer Floor in the first Capability Year of the MSP (i.e., year 2020) = \$10.00/kW-month
- Assume long-run forecast for inflation = 2.0%
- Assume most recent Demand Curve inflation rate = 1.5%
  - *Example 1: Assume the generator enters into service in 2019 (i.e., 1 year prior to first Capability Year of the MSP)*
    - NYISO deflates the Offer Floor from 2020 dollars to 2019 dollars using the long-run forecast for inflation of 2.0%
    - Offer Floor 2019 =  $\$10.00/(1+2.0\%)$
    - Offer Floor 2019 = \$9.80/kW-month
  - *Example 2: Assume the generator enters service in 2021 (i.e., 1 year after first Capability Year of the MSP)*
    - NYISO inflates the Offer Floor from 2020 dollars to 2021 dollars using the most recent Demand Curve inflation rate of 1.5%
    - Offer Floor 2021 =  $\$10.00*(1+1.5\%)$
    - Offer Floor 2021 = \$10.15/kW-month

# Current Provisions for Annually Adjusting Offer Floor Levels

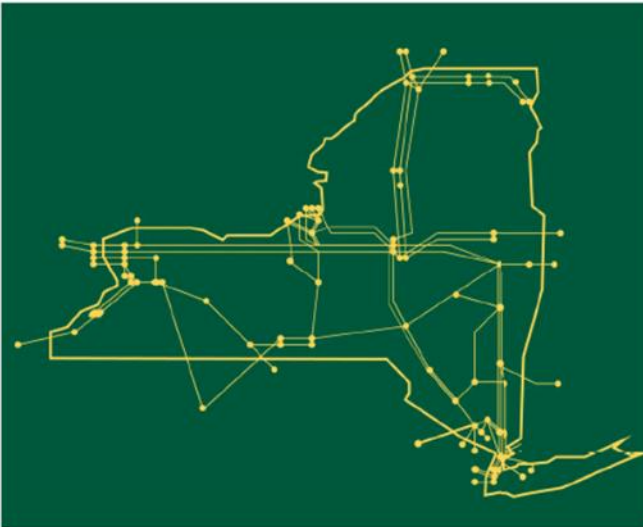
- Existing Offer Floors shall be adjusted annually using the most recent Demand Curve inflation rate – *MST Att. H 23.4.5.7*
- The NYISO is not proposing a change to this provision
  - *Maintains assumed general inflation rate from effective Demand Curve escalation factor*
  - *Provides consistency with the Demand Curve annual updates*
  - *No tariff change required*

# Next Steps

- The NYISO will consider input received during today's ICAPWG meeting
- Review draft tariff revisions posted separately
- Stakeholders may also provide additional comments in writing to [deckels@nyiso.com](mailto:deckels@nyiso.com) by April 18, 2017
- Depending on the input, the NYISO will either return to another ICAPWG or will present the proposal to the BIC



The New York Independent System Operator (NYISO) is a not-for-profit corporation responsible for operating the state's bulk electricity grid, administering New York's competitive wholesale electricity markets, conducting comprehensive long-term planning for the state's electric power system, and advancing the technological infrastructure of the electric system serving the Empire State.



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