

MEMORANDUM

DATE: June 7, 2005
TO: ICAP Working Group Members Involved in ICAP Import Rights Discussions
FROM: Mike Cadwalader
RE: Summary of Installed Capacity Import Right Allocation Proposal

This memo will describe a proposal to allocate ICAP import rights using a procedure that is similar in many respects to the current allocation procedure, but which is intended to eliminate many of the administrative problems associated with that procedure, while also adding some flexibility. It is not based on an auction of these rights.

PROCEDURE FOR REQUESTING RIGHTS

The beginning of the current ICAP import right allocation procedure would remain unchanged. The ISO would allocate ICAP import rights twice per year, using essentially the same schedule as it currently uses. It would declare a date on which all of the ICAP import rights for a given capability period would become available, and beginning on that date, market participants could submit requests to the ISO for ICAP import rights for that capability period. (It would be possible to modify this element of the proposal if desired to permit allocation of longer-term ICAP import rights.) Each entity could submit one or more requests. Each request would indicate the following:

- The maximum amount of ICAP import rights it wishes to secure in association with that request.
- The external control area from which it would like to be able to import ICAP in association with those ICAP import rights.
- The month or months for which it wishes to secure ICAP import rights.
- Documentation that the entity making the request owns or has sufficient capacity under contract in the control area for which it is requesting rights to utilize the requested rights fully.¹

The procedures described in the next section for allocating these rights when they are oversubscribed will eliminate the advantages inherent in the current system for being

¹ Each MW of capacity can only be used to support a single request.

first in line, which should eliminate the rush that currently occurs on the date when the ISO makes ICAP import rights available.

Entities requesting rights would not initially undertake any obligation to use those rights to offer ICAP into the New York ICAP market, which again is consistent with current procedures. However, at any time at which requests for ICAP import rights from a given external control area exceed the limit on the number of rights that the ISO can allocate to import capacity from that control area² (after taking grandfathered ICAP import rights into account), the ISO will notify market participants. During the two business days following such an announcement:

- Market participants who had previously requested ICAP import rights from that control area may withdraw their requests.
- Market participants may submit additional requests for ICAP import rights from that control area (as well as other control areas).
- Market participants requesting ICAP import rights from other control areas may inform the ISO that they would like to take on the obligation to import capacity using those rights, as described below.

At the conclusion of this two-day window, all market participants with outstanding requests for ICAP import rights for the control area(s) for which the two-day window was declared will take on the obligation to supply ICAP to New York using resources located in that control area and using those ICAP import rights, either through bilateral agreements, or through a \$0 offer in a New York ICAP auction, unless it is necessary for the ISO to deny some of those requests. If it is necessary to deny some requests (using the procedures described in the next section), then all market participants with outstanding requests for ICAP import rights for the control area(s) for which the two-day window was declared whose requests were granted will take on the obligation described above. All market participants with outstanding requests for ICAP import rights from other control areas who asked to take on the obligation to import capacity using their rights will be similarly obligated.

Similarly, at any time at which the total number of requests for ICAP import rights from all external control areas exceed the limit on the number of rights that the ISO can allocate to import capacity from all external control areas (after taking grandfathered ICAP import rights into account), the ISO will notify market participants that all requests for ICAP import rights will become obligations within two business days unless those

² This proposal does not envision any changes to the procedure for determining those limits, although eventually we may want to reassess this process.

requests are withdrawn before that time.³ The ISO would continue to accept additional requests for ICAP import rights within that two-day window. Entities that choose not to withdraw their requests will take on the obligation to supply ICAP to New York using those rights (either through bilateral agreements, or through a \$0 offer in a New York ICAP auction for the relevant months), unless requests to import ICAP continue to exceed the available supply, in which case the ISO will deny some of those requests, using procedures described further below. If it is necessary to deny some requests, then all market participants with outstanding requests for ICAP import rights whose requests were granted will take on the obligation described above.

ALLOCATING RIGHTS WHEN REQUESTS EXCEED THE AVAILABLE SUPPLY

It may be necessary for the ISO to deny requests for ICAP import rights because awarding all requests would cause the number of ICAP import rights awarded from one or more individual external control areas to exceed the limit on the amount of ICAP that can be imported from that control area or areas, because awarding all requests would cause the total number of ICAP import rights awarded to exceed the limit on the amount of ICAP that can be imported from all external control areas combined, or both. The procedure for determining the number of ICAP import rights awarded to each entity making a request in these situations would consist of two stages.

The first stage would resolve oversubscription of rights to import capacity from individual external control areas. Each request for a given quantity of ICAP import rights from a control area for which requests for ICAP import rights exceeds the limit on the number of ICAP import rights that can be allocated from that control area would be scaled down. The scaled-down quantity would be determined by multiplying the number of MW of rights from that control area contained in the original request for a given month by the ratio of (1) the number of MW of rights that can be awarded for that external control area, after taking grandfathered rights and other previously entered into obligations into account, to (2) the number of MW of rights from that external control area that have been requested for that month. Requests to import ICAP from control areas for which requests for ICAP import rights are less than or equal to the limit on the number of ICAP import rights that can be allocated from that control area would **not** be scaled down in this stage.

³ In determining whether the sum of all requests to import capacity exceeds the supply of ICAP import rights available, requests to import capacity from any single external control area would only be considered to the extent that they can be honored given the limit on imports of ICAP from that external control area. Therefore, requests for 5000 MW of ICAP import rights from PJM would not, by themselves, cause the sum of all requests to import capacity to exceed the amount available, even though only 2755 MW of ICAP can currently be imported into the NYCA, because the limit on imports on PJM is much less than 2755 MW, so most of those requests will be denied. Instead, only 1300 MW of requests from PJM would be considered in this determination, since no more than 1300 MW of ICAP import rights from PJM can currently be awarded.

In the second stage, it may be necessary to reduce awards further to conform to limits on the aggregate amount of capacity that can be awarded. If so, this would be accomplished by multiplying the number of MW of rights from each control area for each month, as scaled down in the first stage, by the ratio of (1) the total number of MW of rights that can be awarded, after taking grandfathered rights and other previously entered into obligations into account, to (2) the number of MW of rights that have been requested for that month, as scaled down in the first stage. However, if the total number of ICAP import rights that have been requested, after having been scaled down in the first stage of this process, is less than the total number of MW of ICAP import rights that can be allocated, then there is no need to reduce any awards further in this stage.

This procedure is illustrated in the following example.

Example 1

Suppose that, on the first day that ICAP import rights become available for a given month, the ISO has received requests for the following number of MW of ICAP import rights for that month:

- 300 MW of rights to import ICAP from PJM.
- 1000 MW of rights to import ICAP from New England.
- 764 MW of rights to import ICAP from Quebec.

Also assume that the current ICAP limits remain in place,⁴ and that all grandfathered rights listed in Att. B of the ICAP Manual also remain in place (and that all options to elect to utilize grandfathered rights listed therein are exercised).⁵

In that case, total requests for ICAP import rights would exceed the total number of rights available. The 300 MW of rights requested from PJM exceed the $1300 - 1080 = 220$ MW of rights to import ICAP from PJM that can be awarded after taking grandfathered rights into account, and the 1000 MW of rights requested from New England exceed the $950 - 50 = 900$ MW of rights to import ICAP from New England can be awarded after taking grandfathered rights into account. Nevertheless, even taking into account that only 220 MW and 900 MW of ICAP import rights can be awarded to

⁴ These limits are: a 2755 MW limit on all imports of ICAP, a 1300 MW limit on imports of ICAP from PJM, a 950 MW limit on imports of ICAP from New England, a 55 MW limit on imports of ICAP from Ontario, and a 1200 MW limit on imports of ICAP from Quebec.

⁵ These include: 1080 MW of rights to import ICAP from PJM, 50 MW of rights to import ICAP from New England, and 55 MW of rights to imports ICAP from Ontario, for a total of 1185 MW of grandfathered ICAP import rights.

entities requesting them from PJM and New England, respectively, the total number of MW of requests for ICAP import rights that could be awarded is $220 + 900 + 764 = 1884$ MW, which exceeds the $2755 - 1185 = 1570$ MW of rights that are available in total, after grandfathered rights are taken into account.

Accordingly, the ISO would announce that all requests for ICAP import rights would become binding obligations to import ICAP if not withdrawn within two business days of the announcement. Assume that no requests are withdrawn, and that a request for another 30 MW of ICAP import rights from PJM is submitted before the end of that two-day period.

In that case, in Stage 1, there are a total of $300 + 30 = 330$ MW of requests for ICAP import rights from PJM, but only 220 MW of rights available. Each request for ICAP import rights from PJM for this month would be scaled down by one third, so that each scaled request is for a quantity equal to two thirds of the amount originally requested. (Note that all requests for ICAP import rights are treated equally, regardless of when they were submitted, so long as they were submitted before the end of the two-day window.) Additionally, there are a total of 1000 MW of requests for ICAP import rights from New England, but only 900 MW of rights available. Each request for ICAP import rights from New England for this month would be scaled down by one tenth, so that each scaled request is for a quantity equal to nine tenths of the amount originally requested.

In Stage 2, requests for 1884 MW of ICAP import rights remain, after scaling down requests to import ICAP from PJM and New England as illustrated above. Only five-sixths of these requests can be accommodated, since $(5/6) \times 1884 = 1570$, and 1570 MW are available in total. Therefore:

- Entities requesting rights to import ICAP from PJM receive $(5/6) \times 220 = 183 \frac{1}{3}$ MW of such rights. Each entity making such a request would receive rights equal to $(183 \frac{1}{3}) / 330 = 55.55\%$ of its request.
- Entities requesting rights to import ICAP from New England receive $(5/6) \times 900 = 750$ MW of such rights. Each entity making such a request would receive rights equal to $750 / 1000 = 75\%$ of its request.
- Entities requesting rights to import ICAP from Quebec receive $(5/6) \times 764 = 636 \frac{2}{3}$ MW of such rights. Each entity making such a request would receive rights equal to $(636 \frac{2}{3}) / 764 = 83.33\%$ of its request.

TIMING ISSUES

This procedure entails some timing issues which must be explained further, because different limits on the number of ICAP import rights that can be awarded by the ISO may become binding at different points in time.

The general principle is that once the ISO has announced that ICAP import rights will be binding obligations to import capacity into New York, and ICAP import rights have been awarded subject to that condition, then all such ICAP import right awards shall be considered fixed, and all other awards shall be made subject to those awards. However, if ICAP import rights have not been awarded, then the ISO may consider other, newly developing constraints when determining awards.

Three variations on the example used in the preceding section should make this principle more clear.

Example 2

In Example 1, we assumed that the ISO received enough requests for ICAP import rights on the first day they were available to exceed the total available supply. Suppose instead that, on that first day, the ISO only received requests for 300 MW of rights to import capacity from PJM, exceeding the 220 MW of such rights that were assumed available. In that case, the ISO would simply have announced that requests for rights to import ICAP from PJM will become obligations to import capacity if not withdrawn within two business days, instead of announcing that all requests for ICAP import rights would become obligations at that time if not withdrawn. Suppose that, within the two business days following that announcement, the ISO only received the request for an additional 30 MW of ICAP import rights from PJM, bringing the total to 330 MW, and that no requests were withdrawn. In that case, the ISO would apply the reduction procedure described above. Only the first stage would be necessary, and the number of MW of ICAP import rights from PJM awarded to each entity making a request would be $220 / 330 = 2/3$ of the amount it had requested.

At that point, those entities have entered into an obligation, but so has the ISO, as it has obligated itself to permit those entities to import capacity from PJM. If, a week after the awards of ICAP import rights from PJM have been announced, the ISO receives requests for rights to import 1000 MW of ICAP from New England and 764 MW of ICAP from Quebec, as in Example 1, the awards of rights to import ICAP from PJM would remain fixed and could not be reduced. In Stage 1, each request for ICAP import rights from New England would continue to be reduced by one tenth; but in Stage 2, more requests to import ICAP from New England and Quebec would need to be denied, because awards of rights to import ICAP from PJM are locked in. As a result:

- Entities requesting rights to import ICAP from PJM receive 220 MW of such rights. Each entity making such a request would receive rights equal to $220 / 330 = 66.67\%$ of its request.
- Entities requesting rights to import ICAP from New England receive $(0.8113) \times 900 = 730.2$ MW of such rights. Each entity making such a request would receive rights equal to $730.2 / 1000 = 73.02\%$ of its request.

- Entities requesting rights to import ICAP from Quebec receive $(0.8113) \times 764 = 619.8$ MW of such rights. Each entity making such a request would receive rights equal to $619.8 / 764 = 81.13\%$ of its request.

Example 3

In Example 2, we assumed that the ISO received additional requests for ICAP import rights from New England and Quebec the week after the determination of ICAP import rights from PJM was finalized. Suppose instead that those requests had been made the day after the ISO made its announcement that demand for ICAP import rights from PJM exceeded the supply of those rights—in other words, within the two-day window following that announcement. In that case, the ISO would make an announcement that day that demand for ICAP import rights from the other external control areas also exceeded the supply of those rights, which would require the entities requesting those rights to determine whether they wished to withdraw those requests or not. In this case, the ISO would not first determine the awardees of ICAP import rights from PJM and then determine the awardees of ICAP import rights from other control areas, as in Example 2. Instead, it would determine all awardees simultaneously, as in Example 1, since the oversubscription of ICAP import rights from other control areas became apparent *before* the final allocation of ICAP import rights from PJM.

Example 4

Finally, modify Example 2 by assuming that, the day after the ISO made its announcement that demand for ICAP import rights from PJM exceeded the supply of those rights, the ISO received a request for 764 MW of ICAP import rights from Quebec, as in Example 1—but that it did not receive any requests for ICAP import rights from New England within that two-day window. Also assume that the entity or entities requesting ICAP import rights from Quebec informed the ISO, during that two-day window, that they wished to obligate themselves to import capacity into New York. In that case, their rights would not be disturbed, as they would have been locked in at the same time as PJM ICAP import rights were locked in, because the sum of the 764 MW request from Quebec and the 220 MW the ISO could allocate to entities requesting rights to import ICAP from PJM is less than the 1570 MW of ICAP import rights the ISO could allocate after taking grandfathered rights into account.

Then, if entities were to request 1000 MW of ICAP import rights from New England, as in the preceding examples—but only *after* both 220 MW of rights have been allocated to import ICAP from PJM and 764 MW of rights have been allocated to import ICAP from Quebec, then it would be necessary to impose further reductions on the amount of rights defined to import ICAP from New England, because the previously allocated rights would be locked in. Therefore, in this scenario:

- Entities requesting rights to import ICAP from PJM receive 220 MW of such rights. Each entity making such a request would receive rights equal to $220 / 330 = 66.67\%$ of its request.
- Entities requesting rights to import ICAP from Quebec receive 764 MW of such rights. Each entity making such a request would receive rights equal to 100% of its request.
- Entities requesting rights to import ICAP from New England receive $1570 - 220 - 764 = 586$ MW of such rights. Each entity making such a request would receive rights equal to $586 / 1000 = 58.6\%$ of its request.

This illustrates why some entities might choose to obligate themselves to import ICAP before the ISO requires them to do so; failure to elect this option may cause them to receive smaller awards of rights later, once requests for ICAP import rights from other control areas have been locked in.

TRANSFERABILITY

Finally, a market participant with an ICAP import right would be permitted to transfer its ICAP import right to another market participant, which would then assume the responsibility to import ICAP using that right. Such transfers would need to be approved by the ISO, which would verify that the entity assuming the responsibility had resources available to it that would permit it to fulfill that obligation.

Additionally, in the event that a market participant with a right to import ICAP from one control area wishes to use it to import capacity from another control areas, or to transfer than right to another market participant who would use it to import capacity from another control area, the ISO will verify that the resulting change in the location where capacity is provided would not cause any violation of the limit on the amount of ICAP that can be provided from individual external control areas before approving such a change.

ADVANTAGES OF THIS PROPOSAL

Relative to other proposals for the allocation of these rights through non-auction mechanisms, this proposal has the following advantages:

- It permits continuation of the current procedures for allocating ICAP import rights, which do not require market participants to lock themselves into obligations to import capacity until such time as demand for ICAP import rights exceeds supply.
- It reduces the potential for gaming through the two-stage procedure for determining awards, which will scale down any large requests for capacity to reflect total import capability from each control area.

- It permits entities who want to lock in their rights early because they know they want to import ICAP to do so whenever ICAP import rights from any control area become oversubscribed, instead of making them wait to lock in rights for their control area until their control area is oversubscribed (which may also subject them to having part of their request denied).
- It permits rights originally defined to permit capacity to be imported from one control area to be re-defined to permit the import of capacity from another control area, thereby permitting additional flexibility in response to changing regional markets and improving efficiency.