



June 17, 2021

**Feedback of the Institute for Policy Integrity at
New York University School of Law on Buyer-Side Mitigation Reform Considerations**

The Institute for Policy Integrity at New York University School of Law¹ (Policy Integrity) appreciates the opportunity to provide feedback on potential buyer-side mitigation (BSM) reform. In response to the questions posed by NYISO in its June 3, 2021 presentation,² Policy Integrity provides the following three recommendations.

First, in response to Question 1, the underlying rationale for BSM rule reform should be to ensure market rules are based on economic principles. Reform will result in just and reasonable rates if capacity market rules recognize that (1) state-policy-driven payments are not exercises of buyer-side market power; and (2) generation-based externality payments are efficiency enhancing and correct market failures.

Second, in response to Questions 2 and 3, NYISO's reforms should ensure that all efficiency enhancing revenues, including state-policy-driven payments, may be accounted for in calculating unit Net CONE under the BSM tests. NYISO should not seek to craft broad, but inflexible, exemptions for state-sponsored resources from the rules. Receipt of state-policy-driven payments is not an indicator of ability to exert market power. At the same time, an individual resource, which happens to receive state-policy-driven payments, might still be able to exert market power if circumstances allow.

Third, in response to Question 4, NYISO should focus on improving its economic tests for buyer-side market power rather than importing legal standards from other contexts. NYISO should not follow PJM's lead and apply legal preemption standards prohibiting a bid-and-clear requirement as a trigger for economic mitigation. Instead, NYISO should allow all efficiency

¹ This document does not purport to present the views of New York University School of Law.

² Mike DeSocio, Buyer Side Mitigation Reform Considerations, Presentation at ICAPWG (June 3, 2021).

enhancing revenues to be accounted for (even if they are state-policy-driven payments) and, where necessary, use an economic test to determine whether there is buyer-side market power.

1. BSM Reforms Should Be Based on Sound Economic Principles

The basis for BSM rule reform must be to ensure that market rules are based on sound economic principles. This practice includes recognizing that current state policies are not exercises of buyer-side market power and that well-designed externality payments are efficiency enhancing. In so doing, NYISO's rules will protect market competition and ensure just and reasonable rates.

To begin, current state policies are not exercises of buyer-side market power. BSM reforms should focus on identifying true buyer-side market power through rigorous economic tests. Buyer-side market power enables buyers to purchase a good at a price below its marginal value as determined by the demand curve for the product.³ Buyer-side market power increases the surplus buyers get, while creating a deadweight loss to society, analogous to the effects of seller-side market power. The key point here is that exercising buyer-side market power leads to lower average private costs for the buyer. Market power exists when actors can affect prices for "their own benefit."⁴ By changing its behavior in the market, a buyer can affect the market price, and lower its average expenditure.⁵

Externality payments do not necessarily reduce capacity prices⁶ and thus do not reduce the capacity costs to the consumers. New York supports non-emitting resources not because the payments reduce the average private cost of capacity procurement, but because of the

³ ROBERT S. PINDYCK ET AL., MICROECONOMICS 364-68 (6th ed., 2005).

⁴ Mariano Ventosa et al., *Power System Economics*, in REGULATION OF THE POWER SECTOR 47, 101 (Ignacio J. Pérez-Arriaga ed., 2013).

⁵ FERC's notice inviting comments on its resource adequacy technical conference outlines the clearest example of this behavior. See Notice Inviting Post-Technical Conference Comments at 3-4 n.2, *Modernizing Electricity Market Design*, Docket No. AD21-10 (Apr. 5, 2021).

⁶ See generally Sylwia Bialek & Burcin Unel, *Efficiency in Wholesale Electricity Markets: On the Role of Externalities and Subsidies* (CESifo Working Paper No. 8673, 2020); see also Comments of the Institute for Policy Integrity at New York University School of Law at 7-9, *Modernizing Electricity Market Design*, Docket No. AD21-10 (Apr. 26, 2021) (explaining working paper findings).

externalities associated with air pollution and climate change.⁷ That is, New York does not exercise buyer-side market power to manipulate market prices to create an in-market benefit; it makes payments to avoid generation externalities given that NYISO's market fails to address them. Such revenues should, therefore, not be excluded from Net CONE calculations on the basis of market power.

Additionally, NYISO's rules should recognize that externality payments enhance the economic efficiency of NYISO's markets and improve social welfare. New York's policies are designed to internalize an uninternalized externality, greenhouse gas emissions and other pollutants, and bring the revenue that resources receive closer to what they would have gotten if external costs of pollution were taken into account.⁸ New York's programs, therefore, are not a source of market distortion, but rather part of an effort to correct the more fundamental distortion in wholesale electricity markets arising from failure to value the climate change externality of emissions from electricity generation.⁹ Market rules that undermine the corrective features of such payments by disallowing their inclusion in Net CONE calculations distort the economic efficiency of market outcomes, rendering the market unjust and unreasonable.¹⁰

Not only are externality payments efficiency enhancing, but they are unlikely to result in inefficient price suppression. While proponents of applying BSM rules to state-sponsored resources have relied on a theory of price suppression to justify mitigation of resources receiving externality payments, Policy Integrity's recent research finds that long-run capacity prices will tend to be unaffected by current generation-based state policy support for non-

⁷ See, e.g., N.Y. DEP'T OF PUB. SERVS., CLEAN ENERGY STANDARD WHITE PAPER COST STUDY 5-6 (2016) (finding that meeting New York's clean energy targets would provide net positive benefits of \$1.8 billion by 2023 from lowering carbon emissions).

⁸ Comments of the Institute for Policy Integrity at New York University School of Law at 9, *Calpine Corp. v. PJM Interconnection, L.L.C.*, Docket Nos. EL16-49 & EL18-178 (Oct. 2, 2018) [hereinafter PJM 206 Initial Comments].

⁹ Comments of the Institute for Policy Integrity at New York University School of Law, *Cricket Valley Energy Ctr. L.L.C. v. N.Y. Indep. Sys. Operator, Inc.*, Docket No. EL21-7 (Nov. 18, 2020).

¹⁰ See Comments of the Institute for Policy Integrity at New York University School of Law at 18-20, *Calpine Corp. v. PJM Interconnection, L.L.C.*, Docket No. ER18-1314 (May 7, 2018) [hereinafter PJM 205 Comments]; PJM 206 Initial Comments, *supra* note 8, at 7-12.

emitting resources.¹¹ While these payments could alter long-run capacity market prices when provided to the energy market resource that is the marginal resource during the peak demand time, when generation-based externality payments are paid to *infra*-marginal renewable resources, as is the case currently, they are unlikely to affect equilibrium capacity market prices.¹² In the short- to medium-term, generation-based externality payments may even increase capacity prices.¹³

2. NYISO Should Focus on Ensuring All Efficiency Enhancing Revenue Can Be Accounted for in BSM Tests, Rather than Creating Exemptions

Any BSM reform should ensure that all state-policy-driven payments that enhance the economic efficiency of market outcomes may be included in a resource's calculation of its unit Net CONE, and avoid broad exemptions for resources. Reforming the BSM rules to ensure all revenue is accounted for, rather than creating broad exemptions for resource types, best facilitates state goals while ensuring NYISO may monitor its markets for uneconomic and anti-competitive conduct.

As explained above, state payments by themselves do not indicate a resource is able to or actually exerting buyer-side market power. Receiving a REC or any other state payment does not indicate, one way or the other, whether a resource can exert market power in capacity markets. Thus, current state-policy-driven revenues should not be excluded from a resource's Net CONE calculation. Furthermore, if there is an inefficient rent seeking subsidy, NYISO's tariff should continue to allow it to address the effect of those payments. But, NYISO should intervene only where market actors are incentivized to act in a manner that would lead to economically inefficient prices.¹⁴ There are objective tests that could be used to distinguish between policies that result in economically efficient low prices and those that cause inefficient

¹¹ Bialek & Unel, *supra* note 6.

¹² *Id.* at 24.

¹³ *Id.*

¹⁴ Reply Comments of the Institute for Policy Integrity at New York University School of Law at 13-16, *Calpine Corp. v. PJM Interconnection, L.L.C.*, Docket Nos. EL16-49 & EL18-178 (Nov. 6, 2018).

price suppression.¹⁵ Until such policies are put in place, however, NYISO should ensure that revenues derived from state policies can be properly considered.

However, while receipt of state-policy-driven revenues does not indicate an ability to exert market power, that does not mean that an individual resource, which happens to receive state-policy-driven payments, cannot ever exert buyer-side market power. Even if it may not currently be the case, there may be market conditions, especially in the future when all resource types are expected to be CLCPA resources, that allow an individual resource to manipulate the market price. Such uneconomic conduct should not be ignored simply because the resource type is preferred under state policy.

NYISO, therefore, should not provide broad exemptions to state-sponsored resources, but instead opt to ensure that all efficiency enhancing revenue is properly accounted for. Broad exemptions might work well today, but, given CLCPA goals, exemptions will likely cover nearly all resources in the future. NYISO will then be left without a tool to address exercises of true buyer-side market power that are unrelated to the resources' receipt of benefits from state policies. To ensure that NYISO can protect its markets in the future without needing to undertake further stakeholder processes, it should not put in place rigid exemptions. Inflexible exemptions also may not protect new resources that are preferred under future state policies from buyer-side mitigation. A clear policy of allowing efficiency enhancing payments to be considered avoids that problem for resources today and technologies of the future.

3. NYISO Should Enhance Its Economic Test Rather than Import Legal Standards

Finally, NYISO should avoid falling into the trap that has muddled PJM's stakeholder process for reforming its minimum offer price rule. PJM's initial preferred option for identifying buyer-side market power by state policies sought to use a "good faith presumption." The RTO would assume that state policies that provide out-of-market revenues to resources are not exercises of buyer-side market power unless FERC found that a specific policy was "targeted" and "tethered" to the wholesale capacity market.¹⁶ In its most recent proposal, PJM updated

¹⁵ *Id.* at 19-25.

¹⁶ See PJM Interconnection, PJM's Initial Proposal: Minimum Offer Price Rule (Apr. 28, 2021).

the language to remove the good faith presumption text, but kept the concept. PJM, under that proposal, would subject a resource receiving revenues from a state policy to mitigation only if that revenue is “provided in exchange for the sale of a FERC-jurisdictional product conditioned on clearing.”¹⁷ PJM’s rules would then mitigate *only* state policies that it (and FERC) deems preempted. A clearance requirement, like that described in PJM’s proposal, was deemed unconstitutional in *Hughes v. Talen*.

While some PJM stakeholders have argued that using this preemption standard provides a bright line that stops FERC from overstepping its authority under the Federal Power Act, this standard would prevent the RTO from taking action to protect competitive markets and ensure just and reasonable rates in the face of a legally valid, but inefficient or rent-seeking state subsidies. In such situations, FERC must have authority to protect its competitive markets and mitigate the effect of rent seeking state policies when necessary.

Furthermore, using a legal standard from a separate context as a trigger for economic mitigation is inappropriate. Whether a state policy is preempted is a different question than whether that policy inefficiently distorts FERC-jurisdictional wholesale rates and thus can be mitigated. This conflation also could lead to further problems down the line. What happens when NYISO or FERC inevitably finds that a policy has a clearance requirement (potentially an implicit requirement) and thus prevents a resource from including revenues derived from that policy in its Net CONE calculation, and a federal court later disagrees? What would happen for resources improperly mitigated and prevented from succeeding in the auction? The authoritative venue for a determination of whether a state policy is preempted by the Federal Power Act lies with the federal courts, not an independent federal agency (or the public utility it oversees). By applying a standard that FERC does not have the final say over, PJM’s proposal would create uncertainty about the future.

If NYISO must mitigate a state policy for an economic reason, it should not use a preemption-based legal standard to create a broad exemption. It should do so using an economic test that assesses the efficiency of the revenues provided and the economic impact

¹⁷ See PJM Interconnection, CFIB Matrix for June 16, 2021 Meeting (2021).

on market outcomes. It should use a test that is grounded in rigorous economic analysis, not mere rhetoric around price suppression, buyer-side market power or preemption. Additionally, NYISO should be judicious in its application of such rules and act only where it has demonstrated with substantial evidence that the payment, when factored into a bid, harms the market. If the policy is inefficient and distorts market outcomes, NYISO should implement a narrowly tailored rule to prevent a resource from including the revenues in its calculation of Net CONE.

Policy Integrity welcomes the opportunity to provide feedback on the questions posed by NYISO on buyer-side mitigation reforms, and looks forward to further discussion throughout the stakeholder process.

Sincerely,

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